Anger as a market force

Trading decisions made in fury permit investors to harness ‘the outrage cycle’

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Warren Buffett famously advised investors to be greedy when others are fearful, but new research suggests it may be equally profitable to be calm when others are angry.

That’s according to MarketPsych chief executive Dr Richard Peterson, a behavioural finance expert and psychiatrist specialising in the psychology of financial decisions. Everyone knows anger can distort judgment, temporarily blinding u to negative consequences. That prompted Peterson to wonder: might irate investors project their anger on to socially scorned companies? Might this drive selling pressure and subsequent underpricing, allowing less temperamental investors to scoop up bargain stocks?

To investigate, sentiment analysis researchers at MarketPsych screened for the top 100 stocks by media buzz in the US, ranking them by their sentiment over the past year.

The 20 stocks attracting the highest average media anger – think firms like Volkswagen in the wake of its emissions scandal in 2015, or Facebook following its recent data scandal – were bought and held for a year, with the process repeated each month with one-twelfth of the portfolio.

Spectacular results

The results were spectacular. Since 1999, the S&P 500 has more than doubled. However, a $1,000 investment in the “angry” portfolio in 1999 would be worth some $23,000 today – more than 10 times greater than index returns.

Nor was this return achieved by taking on excessive risk. The volatility of the anger strategy was only slightly higher than that of the S&P 500. Furthermore, this appears to be a global phenomenon. Looking at countries outside the US, MarketPsych found buying companies subject to public anger was a winning approach in all but one country, Brazil (“I’ll let cultural psychologists figure that one out,” says Peterson).

For Peterson, the data is unequivocal: “When a company runs afoul of the social consensus – BP due to the Gulf of Mexico oil spill, Facebook due to privacy concerns, VW due to falsifying pollution tests – investors have an opportunity.”

Now, some caveats are necessary. Real-life results couldn’t possibly be as exciting as the backtested ones, which do not allow for transaction costs. The findings would need to be independently verified by academics.

Furthermore, it’s worth remembering investors are sometimes angry for very good reasons, as Anglo Irish Bank investors will tell you.

Still, the results are striking. Contrarian strategies have long been utilised by savvy investors, and this one seems especially promising given huge outperformance was achieved without even accounting for share prices or company fundamentals.

“Irate investors are less willing to invest in a socially-scorned company, they feel more certain that their decision to avoid them is sound, and they hold on to these risk-averse feelings even after the company has taken action to remedy the situation,” says Peterson. The findings, he adds, confirm the Buddha’s point that we are not punished for our anger, but by our anger.

Psychological research

Anger’s unique ability to cloud decision-making is confirmed by much psychological research. *Portrait of the Angry Decision Maker*, a paper co-authored by Harvard psychologist Dr Jennifer Lerner, notes anger has been shown to make people “indiscriminately punitive”, “indiscriminately optimistic about their own chances of success”, “careless in their thought”, and “eager to act”.

The angry person approaches a situation “with the tendency to feel confident, in control, and thinking the worse of others”, writes Lerner. This confidence is misplaced: experiments that primed people to become angry by reminding them of the September 11th attacks not only changed people’s risk perception about terrorism, it changed their perceptions about completely routine events (for example, getting the flu).

Consequently, anger spills over: your anger towards your boss or your family or whoever might be guiding how you feel about Mark Zuckerberg and Facebook’s share price.

Psychological research indicates anger triggered by events like the Facebook data scandal and the BP oil spill is not always altruistic and motivated by a deep sense of justice. Experimental studies show moral outrage can be self-serving, a “cleansing fire” that alleviates guilt and upholds a sense of moral superiority, according to a paper published in the *Motivation and Emotion* journal last year.

Quite simply, anger and outrage can be exhilarating, making people feel better about themselves. Expressions of outrage can yield social affirmation – retweets and follows on social media, for example, where anger has been shown to be the most contagious of the emotions. All of this means anger can be hard to resist.

Risk-taking

And yet, it should be resisted. Contrarian investors like Buffett have long stressed how emotions guide financial decision-making, but their focus has tended to be be on the role played by fear and greed.

However, the impact of anger on financial decision-making can be especially dramatic, says Jennifer Lerner. Whereas fearful people are risk-averse, people are more willing to take risks when angry. She points to the desire to punish bankers and others deemed responsible for the global financial crisis in 2008, even if this meant taking a personal financial hit.

That’s echoed by MarketPsych’s Dr Frank Murtha, who describes anger as one of the “seven deadly sins” of investing. Whereas fear inhibits action and paralyses, “anger leads to action – usually impulsive, aggressive, highly regrettable action”, says Murtha.

“The worst decisions you have ever made, the ones you most wish you could take back were likely committed in anger. The same holds true for investments”, he says, cautioning that it “takes less than a second” to hit the sell button.

Murtha also cautions against the “revenge trade”, relating how he lost a lot of money on a “hot” stock during the late 1990s technology bubble, fallen communications giant JDS Uniphase. Feeling the stock “owed” him, he “decided to go in and take something back from it to even the score” – a bad idea that ended in tears.

Revenge trading

Most investors will immediately recognise that revenge trading is a bad idea, but don’t always appreciate how angry they get when others challenge their opinion.

“People don’t like having their preconceived notions jolted,” writes *Wall Street Journal* columnist Jason Zweig. America’ most-respected financial columnist, Zweig’s reward for warning investors against dotcom stocks in the late 1990s was to get hundreds of hate emails weekly. When he urged investors to hold on to stocks at the peak of the global financial crisis he was “called a shill for Wall Street and helplessly naive”. Warning against gold-heavy portfolios at the peak of the gold mania in 2011, angry readers “called me ‘weak minded’, ‘ignorant’, ‘pathetic’ and a member of ‘the big bank lobby’”. He has also, he adds, “been called an ignoramus, an idiot and dozens of epithets unprintable in a family newspaper” as well as being “told, almost every week, that I lack even the most basic understanding of how the financial markets work”.

None of this is wise, of course. Anger leads to silly decisions, and savvy investors may be able to profit by taking advantage of others’ anger. Anger’s ability to distort share prices is unlikely to vanish, says Richard Peterson. The “power of the outrage cycle to capture attention in the age of Facebook” means there’s likely “little risk of the anger price pattern we’ve identified disappearing in the near future”.

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