Radhika Gupta
CEO, Edelweiss Asset Management Limited

"Nudge, nudge, wink, wink. Know what I mean?"

Dear Investors and Advisors,

At the end of the financial year, when we review our investments, particularly in years like one that just passed – volatile, uncertain, confusing – we often reflect on all the mistakes we as investors made. Not grabbing opportunities, stopping our SIPs too early, not investing enough maybe? Why does this happen, is it because we don't know what is good for us, despite being told time and again in talks, media, literature, and our own experiences? Or is it because we are human – and like humans, we have biases, in investments and otherwise, and make mistakes, despite knowing what is good for us?

While there are many books written on behavioural biases, it's always important to have solutions – what can we do about them? Two renowned American authors, Richard Thaler and Cass Sunstein wrote precisely about solutions in the form of nudges, in a book called Nudge. What is a nudge? It is a small push, a change in a way to frame a problem, a slight feature change that makes you do things that are good for you, that you may not have done otherwise. Let's take a simple example of a nudge in real life, eating healthy food, something many mothers struggle with their kids over. Imagine you have two kinds of food – healthy fruits and unhealthy chocolates. If you place both together on the same dining table, chances are the chocolates will be eaten first. If however, the chocolates are on a high shelf in a kitchen cupboard and hard to find, and the fruits in the centre of the table in full view, don't you think the consumption of fruits relative to chocolates will go up?

Nudges work very effectively for us as mutual fund investors and advisors too, so let's take a deepdive into how six simple nudges can be effective catalysts in mutual fund investing.

INCENTIVES: Humans respond to incentives because we are motivated by rewards! In a simple experiment in the US, when you changed the display on the thermostat which regulates heating from just showing temperature to also showing the cost of heating, you saw less people just increasing the temperature. Similarly in mutual funds, advisors can incentives investors and investors can reward family members who show good investment behaviour – saving more, investing when markets are weak. I saw an advisor actually celebrate investors who invested the most the day markets fell 6% a few years ago at an awards ceremony in Kerala, and it was a truly powerful statement!

MAPPING: Investing concepts can be abstract and needed to be mapped to your reality. Very few of us understand the difference between 3 and 5 megapixels on a digital camera, but we know what it means when one camera can take a 4x6 photo clearly versus another that can take a 10x12 photo clearly. Similarly in investments, the difference between a 10,000 rupee SIP vs a 20,000 rupee SIP is abstract when but when you translate the first into being able to buy 1 BHK in 10 years vs. being able to buy a 2BHK in the second case, the comparison is a lot more meaningful. Translate money into real objectives.

DEFAULT: We love the default option – the easiest one, whether it is the dish that the chef recommends when we are confused at a restaurant or installing the "Default" or "Recommended" option in a software package. Defaults are the most basic human tendency, and use them to your advantage by making good options – Perpetual SIPs in MFs, nominees in bank accounts – the default.

FEEDBACK: One of the reasons photography took off as a hobby in a big way after the digital camera was that it gave the individual instant feedback on his work, unlike the old school cameras. Investing often feels like the analogue camera – you don't get feedback on the outcome. As advisors give investors feedback on what investing at the bottom of the cycle versus investing at the top of the cycle means for their goals, and as investors ask your advisors for this feedback. That will make the impact of your actions a lot more real.

STOPPING ERRORS: Human beings make predictable errors, but since they are predictable, measures can be put in place to correct them. Many of us drivers forget to wear a seatbelt, only to be warned by the car beep that we better wear it. Similarly advisors and investors can discuss the common errors they make – for instance, not having enough in the bank account when the SIP trigger hits, or redeeming while paying exit loads – and put in place mechanisms to correct them.

STRUCTURING COMPLEXITY: Imagine if you were asked to find a house in all of Mumbai or Delhi or any other city? It's a daunting problem. It has to be broken down into a budget, size, and locality, with constraints, boundaries and structures. Investing – with all the categories of funds, market events and news, often appears like that. As investors and advisors, it is important to structure the complex problem of investing – a few goals solved by a few core categories of funds.

When used in a transparent and simple manner, nudges can be a powerful way to make us better investors and a peaceful one at that. This financial year, as we promise to improve our investment habits, use the power of that little nudge and wink to help you.

Happy investing!