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The Personality Traits of Successful Investors During the U.S. Stock Market's "Lost Decade" of 2000-2010.

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While much has been written about the economic toll of the 2008-2009 financial crisis, few studies have examined the psychological traits of those who thrived in the financial markets of the past decade. Over the past five years data on investment performance, risk management, and behavior were gathered in conjunction with an online personality test on the website www.marketpsych.com. In this paper we are reporting the results of 2,600 individuals who took the "Investing Personality Test" from 2005-2010. The Investing Personality Test includes 60 items from the IPIP-NEO, an open-source personality test based on the "Big Five" factor model. After completing the 60 items, investors who took the test disclosed financial statistics including their prior five year investment returns, largest loss in the prior five years, and made decisions in a series of hypothetical investment scenarios. The authors are publishing these results as a contribution to financial and investment educational programs. Our wish is that the results of this research may help more investors thrive in the coming decades.

INTRODUCTION

MarketPsych's free online Investor Personality Test has been taken by investors around the world, in various states of enthusiasm, sobriety, or panic since 2005. This report is a summary of those investors' results. You may take the test here before reading about the conclusions from prior test-takers. *If you intend to take the test, for your own benefit please do so before reading on, otherwise your score may not be accurate.*

As you noticed, the test is thought-provoking, and we expect the experience was worth your time and effort (if not, please send Dr. Peterson an email with specifics). You can skip ahead to Section 3 to see the results if you are in a rush. Background information follows.

We start this paper with a short primer on personality in Section 1 below. Next we explain which individual personality traits and "items" (questions) are correlated with investing performance in Section 2, and which with largest historical loss (risk management) in Section 3. Then we took a look at which traits correlated with the most common investing

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misbehaviors in section 3 below. There are some surprising correlations between personality traits and susceptibility to investing mistakes.

SECTION 1: PERSONALITY TRAITS

In 1936, two American psychologists, Gordon Allport and H. S. Odbert, hypothesized: "Those individual differences that are most salient and socially relevant in people's lives will eventually become encoded into their language; the more important such a difference, the more likely is it to become expressed as a single word."

In the 1970s, Lewis Goldberg, a professor of psychology at the University of Oregon, compiled a list of 1,250 phrases describing personality characteristics. He and his students went door to door, asking 750 homeowners in Eugene and Springfield, Oregon, to rate how well each of the 1,250 phrases described them. The phrases were statements such as "Like parties," "Follow rules," or "Fear the worst." Subjects rated how well that phrase described them on a 1 - to - 5 scale. They then circled an answer: "Strongly disagree," "Disagree," "Neither agree nor disagree," "Agree," or "Strongly agree."

Responses from 300 of the original 1,250 phrases statistically grouped into five different clusters. For example, people who agreed with "Like parties" also tended to agree with the statement "Radiate joy," implying that social and optimistic people have a common personality trait (subsequently called "extraversion"). The five clusters were named the "Big Five" personality traits:

1. Emotional stability
2. Extraversion
3. Openness
4. Agreeableness
5. Conscientiousness

Many of the following trait descriptions and item examples are adapted from Professor John Johnson's free online NEO personality inventory, available at http://ipip.ori.org/, which grew out of his work with Goldberg. See Table 3.1 for a description of the "Big Five " personality traits.

Table 3.1 The "Big Five" Personality Traits

Personality Trait	High Scores	Low Scores
Emotional stability	Emotionally stable. Relaxed and mellow.	Emotionally sensitive, scattered, indecisive, pessimistic, nervous.
Extraversion	Gregarious, optimistic, and social. Derives energy from others.	Introverted. Often enjoys and derives inspiration from solitude.
Openness	Open to experimenting with new ideas and experiences.	Traditional and conventional. Prefers continuity over change.
Agreeableness	Values cooperation and getting along with others, generous and altruistic.	Self-interested. Often mildly suspicious of others' intentions.
Conscientiousness	Self-disciplined, delays gratification, organized, follows rules, punctual. Uptight.	Impulsive and disorganized. Difficulty following set methods or rules. Spontaneous and relaxed.

Figure 1: The Big Five Personality Dimensions, from Inside the Investor's Brain (Wiley, 2007).

Statistically, test - takers' responses distribute in a normal curve, with 40 percent of people scoring in the "average" range. Each test - taker scores on a range from "very low" to "very high" on each trait. One who scores low on the extraversion scale is called an introvert, and one who scores high is called an extravert. "High" and "low" scores are more than one standard deviation from the average. Each personality trait has a primary pole and an opposite pole. Thus, a low scorer on extraversion is, by definition, high on introversion.

Taken together, all five personality traits comprise one's personality style. Some people have multiple strong personality traits, and it is generally the strongest scores, whether on one or five of the traits, that are what we think of as our unique personalities. People who score highly on both conscientiousness and emotional sensitivity are commonly seen as "perfectionists."

In the following sections we flesh out the profile of a successful investor in terms of the three most important investing metrics – past performance, risk management, and vulnerability to common mistakes.

SECTION 2: METHODS

In order to clean our data – to sift out useful from noisy respondents - we cleaned the data by excluding investors from developing countries, investors aged <25 or >80, and those with odd response patterns (long series of the same answer). Those filters eliminated approximately 40% of the test-takers' results primarily due to the developing world exclusion. These data are worth an article in their own right. For our final sample, 2,600 investors remained for the five-year period 2005-2010.

To ensure time stability in our sample, we tested whether the mean values of the personality traits were affected by major external events - such as the collapse of Lehman Brothers - over the duration of our sample. Fortunately the traits' average values remained stable over the five years of our study.

SECTION 3: INVESTOR PROFITABILITY (five year historical returns)

What are the most profitable traits of investors in our study? Openness and emotional stability are correlated with the highest profitability of all the personality traits. Additionally, open investors report the lowest lifetime losses (have the best risk management).

INVESTING TECHNIQUE

In terms of specific behaviors, the best long-term investors report both letting their winners run and cutting their losers short. Importantly, these behaviors are not endorsed by profitable short-term traders. This disparity may imply that long-term investors can tolerate downside volatility without panicking or changing course. They stick with investment hypotheses as long as fundamental evidence (not necessarily price) supports it.

EMOTIONAL QUALITIES

Good investing is a sober pursuit, and good investors are not excitement-seekers. They generally disagree with the statements "love excitement," "seek adventure," and "love action." Yet they are not pessimistic people, generally agreeing with the statement, "Love life." They don't significantly experience negative emotions, and they deny experiencing regret about past setbacks. They are emotionally resilient.

SOCIAL QUALITIES

Great investors don't need to be involved in social groups, however they tend to get along well with others and generally believe that others have good intentions. They like others but avoid following the crowd.

DISCIPLINE

Good investors are able to multitask under pressure and manage their emotional urges. They disagree with the assertion "like to act on a whim." They tend to follow a philosophy or plan in their investing, with which they remain consistent. At the same time they remain open to new ideas, and they are comfortable with change. They disagree with the statement “prefer traditional ways."

SECTION 4: INVESTING BLOW-UPS (DOWNSIDE RISK)

Investors who manage risk well tend to have the following traits.

TECHNIQUE

Good risk managers have exit plans in place before entering their investment positions. They avoid crowded trades. They will not "chase" stocks higher, and they deny holding their losing positions longer than anticipated (they cut losers short). Interestingly, while profit-taking (cutting winners short) does not contribute to long term profitability, it does help prevent large downside losses. Cutting winners short reduces both overall risk and returns.

DISCIPLINE

Good risk managers react quickly and are comfortable with change. Investors who procrastinate, as well as those who agree that they tend to act impulsively ("on a whim" or "binges"), report larger maximum losses in the markets.

EMOTIONAL TRAITS

Investors who do not notice their emotional reactions are MORE VULNERABLE to large losses. Apparently they are unable to use emotional discomfort as a warning or intuitive "feel" to recognize a potential opportunity. At the same time, good risk managers don't dwell on past losses.

Good risk managers remain "relaxed most of the time" and are humble (not overconfident). Further, they deny feeling excited about investing - rather they endorse more intellectual satisfaction.

FLEXIBILITY

Investors who agree that they “dislike changes” also report higher losses. Creatures of habit (those agreeing they are "attached to traditional ways") tend to lose money because of their inflexibility during market regime changes.

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Several social factors also impair risk management. Trend-following investors who "trust what others say," "enjoy being involved in a group," and who "wait for others to lead the way" report larger peak losses.

SECTION 5: INVESTING MISBEHAVIORS
While profitability and risk management are essential to good investing, there are also several unique “biases” in decision making that most investors experience. In our analysis of the personality traits correlated with these common investing mistakes, the strongest correlations were the following:

1. Extraverts like taking risk, and they are more likely than others to endorse both chasing after “hot stocks” and *buying* on price dips.
2. Agreeable investors tend to chase trends, *selling* on dips and buying when a stock is rising. The same trait that leads them to value social harmony with their peers may account for their tendency toward trend-following or “herding” - its equivalent in the markets.
3. Emotional investors (these vulnerable to negative emotions) tend to sell their winners when they are up and buy more when investments are down. Emotion-driven "cutting winners short" - seeking pride - is a costly behavior, and it may explain their lower overall returns. Buying losers that are down - dollar-cost averaging - also leads to lower overall returns, likely because extraverts are succumbing to the "confirmation bias" (declining to acknowledge recent bad news).
4. While conscientious, open, and extraverted investors rate themselves as having more skill than others (high confidence in their abilities), only open and emotionally stable investors report numerically higher returns. Thus, extraverted and conscientious investors appear to be overconfident about their skills.

SUMMARY
In summary, openness to new experiences (mental flexibility) and emotional stability appear to be the most correlated “success traits” for investors.

Please remember that the above findings are not deterministic. It is *not* true that everyone should have these traits if they want to be successful. These are simply correlations. In fact, some traits of successful *short-term traders* are opposite to those that underlie successful *long-term investors*. The proper reading of these results is to consider how to identify and build upon your own strengths while creating mechanisms to insulate yourself against acknowledged weaknesses.

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Weaknesses in our study include the self-report nature of the data and the fact that it is based on historical returns. While the above traits are correlated with reported performance, risk management, and biases through both a bull and a bear market, there is no indication that these traits *cause* success (i.e., we found correlations, we didn't study causation). Ideally we could have administered personality tests to a million traders and investors in 1995 and watched their behavior and returns going forward (a prospective study that could have addressed causation). But we didn't do such a study, and not for lack of trying (rest assured your trading data is well-protected by brokerages). While we believe the correlations noted above are statistically significant, we preferred a reader-friendly narrative format for this white paper rather than publishing tables of data. Please get in touch with us if you would like to review the source data. Despite the above weaknesses, as far as we know ours is the most comprehensive study on the relationship between personality and investing to date.

Because our expertise is training and coaching investors, we have many resources and assistance available at our website www.marketpsych.com. We wrote our book "MarketPsych" (named a "Top Financial Book of 2010" by *Kiplinger's*) to help you improve your investing (and your life).

Please contact Richard L. Peterson MD with questions or comments about this study at rpeterson@marketpsych.com (beware strict spam filter) or +1.310.573.8523.