KEY FEATURES OF A HEURISTIC MODEL FOR GENERATING THE INVESTMENT DECISION

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Abstract

The heuristic model for generating the investment decision includes the key investment determinants and their relationship, as well as the behavioural aspects related to the investment decisions and sketches the potential profile of the future professional investor. It is assessed that the (activated) learning and the heuristic simplifications can boost and multiply the investment decisions.

Keywords: Heuristic model, investment determinant, (activated) learning, investment decision, simplification.

JEL classification: G11, G41

Introduction

Building on the simplest meaning of the heuristic approach, namely the process leading to the discovery of new knowledge, a practical foray shall be conducted so as to identify the investment determinants defining the model, a synthetic presentation of the area of interests and concern of the potential investors shall be attempted, while the professional potential profile of the future professional investor shall be outlined – by emphasizing the professional requirements of the market in the current development phase. The wide variety of aspects to be considered in the formulation of both behavioural and practical investment decisions is highlighted, focusing on simplicity and simplification in the process of generating investment decisions, especially under the conditions of limited time and knowledge.

It is believed that the heuristic approaches may lead to the better understanding of the investments processes, since simplification has an essential part in generating and multiplying the investment decisions.

About the elements of the model/the investment determinants

I estimate that the key investment determinants supporting the investment decision are the following:

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- requirements related to knowledge, by highlighting the limited nature of the time factor and the limited/unlimited nature of the knowledge factor, in close connection with the time factor and the intrinsic characteristics of the investor;
- financial resources/money, with a clear indication of their limited nature;
- requirements related to learning – also quite limited, but as well difficult and high time-consuming; the continuity/perseverance is a requirement associated with quality learning;
- investment alternatives – are marked by uncertainty, present reveal many unknowns, require specialization in order to provide a proper understanding; education in itself might represent an investment alternative, but practical requirements guide us towards investments in the capital market, real estate sector, savings/investments in the bank sector or towards different alternative placements;
- investment decision-making, namely the effective decision represents a critical investment determinant; without it we can say that the investment decision is a theoretical element and not an itself investment decision that necessarily implies the investment decision-making and not only thinking, substantiating and theorizing it; the fact that in almost all situations decisions are taken under uncertain conditions increases the degree of difficulty of the investment endeavour;
- the investment gain is the termination point of the whole investment process and closes, in my understanding, the investment process; the difficulty of reaching it is given by its uncertain and limited nature.

Learning as an investment determinant takes a special place in shaping the model that might lead to the generation of new investment decisions. It can be perceived as latent learning (associated with the lack of investment decision-making) or activated learning (associated with investment decision-making). The pragmatic aspect points out a series of potential concerns that could be referred to what we call activated learning, providing special attention to their order:

- investment return/loss
- experience gained
- identifying any (potential) deficiencies in education/any (potential) investment deficiencies
- requirements to continue education
- more efficient time management
- more efficient money management
- risk management
- identifying new opportunities to act, to invest
- increase the efficiency of future actions/investments
- achieve the investment gain.

Please notice that by simply following the steps associated with the activated learning process there is a chance to switch from the investment gain/loss (first step) to the investment gain (target step). An attempt to graphically represent what the essential differences between activated learning and latent learning feature (in the idea of the positive effects of investment decisions) is shown in Fig. no. 1; based on the above it can be concluded that it is important to learn actively and to make investment decisions.

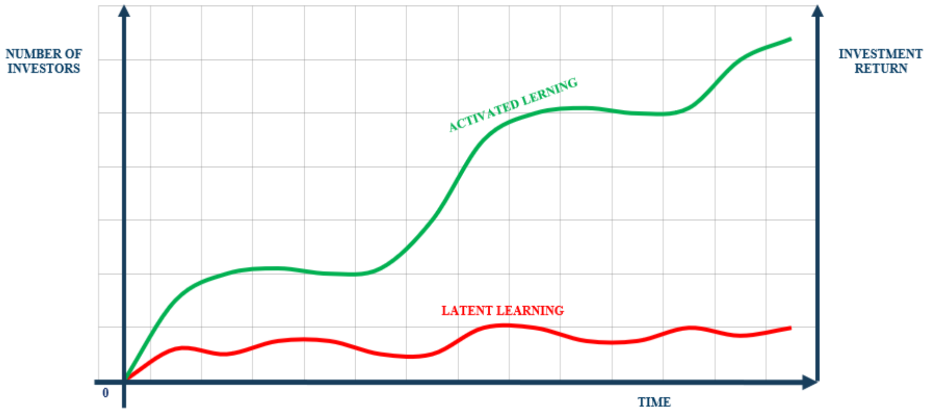

Fig. no. 1 Activated learning versus Latent learning
Source: Own processing

A potential relation scheme of investment determinants supporting the heuristic model for the generation of the investment decision is graphically represented in Fig. no. 2.

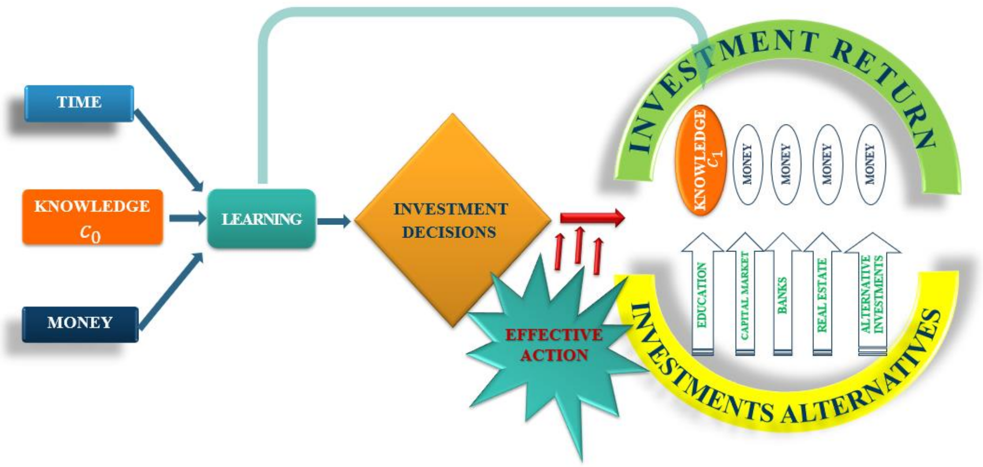

Fig. no. 2 Relation scheme of investment determinants
Source: Own processing

About potential investors

What defines them? What concerns them? What they might be interested in? These are questions that force us to synthesize based on the individual investment experience and to observe market trends, as follows:

- decreased confidence in financial services – especially after the 2007/2008 crisis and the clear outline of new crises;
- low degree of solving the ethical problems in the financial industry;
- culture specific to the (capital) market, mentioning the mentalities related to savings/investments, as well as the prospects on the stock market;
- expectations of potential investors – generally high expectations, reflected in obtaining high, fast returns, without any high risks and certain, if possible;
- we may think that some of the potential investors are the beneficiaries of an education system poorly coordinated with the economic realities;
- why is it important to clarify the differences between the capital market investment and bank system savings/investments each and every time? why do we witness, most of the times, the preference for bank deposits with low/negative interests against capital market investments with a significantly higher potential return requiring the proper risk-taking?
- we are witnessing the emergence of new investor segments oriented towards artificial intelligence and block chain; since we are talking about growing segments, they shall not be neglected;
- not all new investors have limited specialized professional knowledge; the number of sophisticated, highly professional investors is rising constantly;
- young people shall not be neglected; people born after 1990 become, slowly, but surely, investors; not all of them thirst for the “virtues” of the consumer society – a large part will want to settle their social and professional situation, to generate higher incomes and take investment risks.

About the potential profile of the future professional investor

Professional investors are important for the market not only because they support the investment decisions and professionalise – by all their actions – the whole market, but also because they can effectively help improve the investors class; I believe that professional investors represent the true “key functions” of the (capital) market.

The profile of such investors would include a series of basic elements, such as:

- the practical approach prevails both in financial education and in solving market issues;
- their investment activity is based on the compliance with ethical standards and ethical conduct; thereby they are reliable suppliers within the financial industry;
- they are visionary and pragmatic at the same time – they are shaping the financial industry according to the investors’ interests and not the other way around;
- the solutions and investments made are rational, plausible and become true models to be followed;
- they permanently adapt to the new professionalization requirements of the market (behavioural finances, financial technology, artificial intelligence);

- they make important efforts to shape information (used and/or delivered) for the simple presentation of the scientific foundations of the market.

About investment decisions

I am highlighting a series of behavioural aspects influencing decisions and decision strategies:

- decision strategies are influenced by a series of individual and cultural characteristics such as cultural features, knowledge, experience, emotional factors, cognitive skills, sex, etc.
- the election process implies the existence of several decision options/alternatives, being a difficult process; it is required to develop decision strategies in order to generate investment decisions;
- essentially, practical studies have shown the following:
    - people avoid strategies requiring many calculations;
    - people use simple and smart decision strategies;
    - in case of limited knowledge, simpler strategies may prove to be more efficient;
    - a potential solution would be to convince people that no complicated calculations are required in order to invest;
- adaptation strategies prove to be useful, especially when we make decisions based on limited time and knowledge;
- within the investment process people believe that the relation between the allotted time and the estimated gain is important; the study of this report may be relevant in understanding the saving/investment behaviour in a bank deposit in relation to the purchase of shares on the capital market (for example);
- creating behavioural patterns (theoretical, as well as supported and validated by practice) can significantly help in the generation and multiplication of investment decisions;
- understanding the achievement of (investment) performance levels according to the bell-shaped distribution (Gauss curve) might help in understanding the involvement/lack of involvement in the investment activity and identifying – on these lines – the segments of the most probable “future investors”; therefore, we can use psychology and statistics in the process for the generation of the investment decision;
- when we determine and face the scarcity of the investment vocation we do not fail – we have another reason to identify simpler ways for the generation of the investment decision, adapted to each class of potential investors.

Fig. no. 3 shows schematically how heuristic simplification may contribute to the generation of investment decisions.

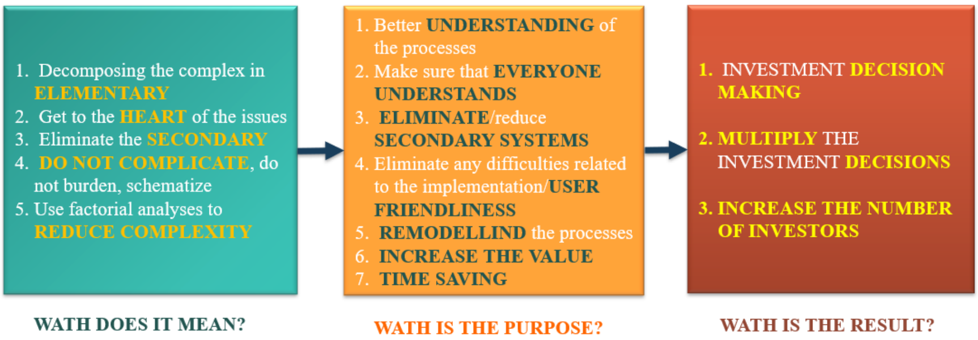

Fig. no. 3 Heuristic simplifications for the generation of investment decisions
Source: Own processing

If we simplify and provide a good and wide understanding of the investment processes, we can look forward to favourable results materialized in decision-making, multiplying them and the increase in the number of investors.

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