UNDERSTANDING BEHAVIORAL BIAS

LAMCHICK FINANCIAL GROUP
OF
RAYMOND JAMES®

LEARNING HOW EMOTIONS AFFECT DECISIONS CAN MAKE YOU A BETTER INVESTOR

Are you a better-than-average driver? Chances are, you answered yes. That's because nearly three-quarters of people think they are better-than-average drivers.* Besides being mathematically impossible, this statistic is an example of overconfidence—and is just one illustration of how certain biases can influence our thought patterns.

These behavioral biases sometimes help us make smart decisions. But they also can cloud our judgment and lead us to make irrational decisions. That's especially true when it comes to investing. At a time when markets are down and it's impossible to predict what tomorrow will look like, our perceptual distortions can make a difficult situation worse.

The good news is recent evidence suggests that we can learn to overcome these biases and improve our decision-making. But first we have to understand how they work. Here's a look at three of the most common behavioral biases that can impair our investment decisions.

Anchoring

You've fallen victim to anchoring when your emotional attachment to the past value of an investment keeps you from recognizing its present value. For example, let's say you own stock that was recently selling for $100 per share but has since dropped to $60. But you may be anchored to that $100 figure, convinced that's the right value for that stock. As a result, you may hold onto your stock convinced it will soon rebound. However, there's no guarantee that it will.

When assessing your investments, ask yourself whether your evaluations are based on the current reality of the assets or your past feelings about them. Weigh the merits of keeping an investment based on current information and whether it's still a good fit for your financial plan.

Recency bias

Recency bias can lead to putting too much emphasis on the latest information—and often ignoring other important data. For example, say stocks begin to climb and that uptick inspires a surge in buying. As more investors pile on, prices climb even higher, surpassing historically expensive levels. Yet investors may ignore this red flag, assuming recent trends outweigh long-term data. However, bubbles like these can pop and falling prices can potentially leave investors with heavy losses.

You can avoid recency bias by taking a long-term approach to investing. Strategies such as dollar-cost averaging, when you make a series of regular investments regardless of the market's ups and downs, can help erase the temptation to chase returns or panic when prices fall.

Overconfidence

Confidence is useful and, in many cases, necessary. Investing a chunk of your income in the stock market takes confidence. And it's confidence that allows you to keep risks in perspective and sit tight in a turbulent market rather than rushing to sell your assets and locking in losses.

But overconfidence can be dangerous. It can lead you to believe that you know better than experts, that you can predict market movements successfully (spoiler: you can't), or that you can spot investment opportunities others have missed. Worst of all, it can lead to emotional decisions in response to market moves, such as buying when prices are high and selling when prices are low.

Combat a tendency toward overconfidence by basing investment decisions not on emotion, but on careful research. Once you've made a decision, stick with it and avoid the temptation to try to outsmart the market by jumping in and out of investments.

Recognizing how behavioral biases influence investing can help you keep them in check. As a result, you'll be more likely to make investment decisions that align with your long-term financial plan—and to avoid the irrational decisions that may knock you off track from that plan.

Sources

*AAA, "More Americans willing to ride in self-driving cars," 2018.
https://newsroom.aaa.com/2018/01/americans-willing-ride-fully-self-driving-cars/

ABOUT US

At the Lamchick Financial Group of Raymond James, we're experienced financial advisors who will treat you like an extension of our own family, getting to know you on a personal level in order to create a comprehensive financial plan that fits your life. Our family business and South Florida roots give us a better understanding into the needs of growing families here in this thriving, affluent area we call home.

We help you pursue your financial goals with experienced guidance. Along with challenges, the market also brings new opportunities – you just have to know where to look and when to take action. Over the years, we've helped clients navigate through challenging times with purpose and confidence toward their financial goals, and I'm here to help you, too.

We can offer you an array of personalized financial services, support and guidance that can help make a positive difference in the pursuit of your financial goals.