Behavioral Biases

INVESTMENT DISCIPLINE

ALLODIUM® INVESTMENT CONSULTANTS

Behavioral Biases Chart for Investors

THE BIAS	ITS SYMPTOMS	THE DAMAGE DONE
Anchoring	*Going down with the proverbial ship* by fixing on rules of thumb or references that don't serve your best interests.	"I paid $11/share for this stock and now it's only worth $9. I won't sell it until I've broken even."
Blind Spot	*The mirror might lie after all.* We can assess others' behavioral biases, but we often remain blind to our own.	"We are often confident even when we are wrong, and an objective observer is more likely to detect our errors than we are." (Daniel Kahneman)
Confirmation	*This "I thought so" bias* causes you to seek news that supports your beliefs and ignore conflicting evidence.	After forming initial reactions, we'll ignore new facts and find false affirmations to justify our chosen course… even if it would be in our best financial interest to consider a change.
Familiarity	*Familiarity breeds complacency.* We forget that "familiar" doesn't always mean "safer" or "better."	By overconcentrating in familiar assets (domestic vs. foreign, or a company stock) you *decrease* global diversification and *increase* your exposure to unnecessary market risks.
Fear	*Financial fear is that "Get me out, NOW" panic* we feel whenever the markets turn brutal.	"We'd never buy a shirt for full price then be O.K. returning it in exchange for the sale price. 'Scary' markets convince people this unequal exchange makes sense." (Carl Richards)
Framing	*Six of one or half a dozen of another?* Different ways of considering the same information can lead to illogically different conclusions.	Narrow framing can trick you into chasing or fleeing individual holdings, instead of managing everything you hold within the greater framework of your total portfolio.
Greed	*Excitement is an investor's enemy* (to paraphrase Warren Buffett.)	You can get burned in high-flying markets if you forget what really counts: managing risks, controlling costs and sticking to your plan.
Herd Mentality	*"If everyone jumped off a bridge …"* Your mother was right. Even if "everyone is doing it," that doesn't mean *you* should.	Herd mentality intensifies our greedy or fearful financial reactions to the random events that generated the excitement to begin with.
Hindsight	*"I knew it all along" (even if you didn't).* When your hindsight isn't 20/20, your brain may subtly shift it until it is.	If you trust your "gut" instead of a disciplined investment strategy, you may be hitching your financial future to a skewed view of the past.
Loss Aversion	*No pain is even better than a gain.* We humans are hardwired to abhor losing even more than we crave winning.	Loss aversion causes investors to try to dodge bear markets, despite overwhelming evidence that market timing is more likely to increase costs and decrease expected returns.
Mental Accounting	*Not all money is created equal.* Mental accounting assigns different values to different dollars—such as inherited assets vs. lottery wins.	Reluctant to sell an inherited holding? Want to blow a windfall as "fun money"? Mental accounting can play against you if you let it overrule your best financial interests.
Outcome	*Luck or skill?* Even when an outcome is just random luck, your biased brain still may attribute it to special skills.	If you misattribute good or bad investment outcomes to a foresight you couldn't possibly have had, it imperils your ability to remain an objective investor for the long haul.
Overconfidence	*A "Lake Wobegon effect,"* overconfidence creates a statistical impossibility: *Everyone* thinks they're above average.	Overconfidence puffs up your belief that you've got the rare luck or skill required to consistently "beat" the market, instead of patiently participating in its long-term returns.
Pattern Recognition	*Looks can deceive.* Our survival instincts strongly bias us toward finding predictive patterns, even in a random series.	By being predisposed to mistake random market runs as reliable patterns, investors are often left chasing expensive mirages.
Recency	*Out of sight, out of mind.* We tend to let recent events most heavily influence us, even for our long-range planning.	If you chase or flee the market's most recent returns, you'll end up piling into high-priced hot holdings and selling low during the downturns.
Sunk Cost Fallacy	*Throwing good money after bad.* It's harder to lose something if you've already invested time, energy or money into it.	Sunk cost fallacy can stop you from selling a holding at a loss, even when it is otherwise the right thing to do for your total portfolio.
Tracking Error Regret	*Shoulda, coulda, woulda.* Tracking error regret happens when you compare yourself to external standards and wish you were more like them.	It can be deeply damaging to your investment returns if you compare your own performance against apples-to-oranges measures, and then trade in reaction to the mismatched numbers.