WISE INVESTING

Investment bias

You may think you're a rational investor, but if you're human, you're probably not

By ANDY FISHMAN
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Unless you've you been living under the proverbial rock, you likely know that the stock market — for the purposes of this article, the S & P 500 — is up. Way up, as in reaching historic highs. This is unequivocally a good thing.

And yet you may find yourself worrying. What will happen next? Will it continue to climb? Level off? Come crashing down? You might be holding off on investing, or maybe even taking money out of the market.

If this describes you, you may be suffering from negativity bias. This means you tend to give more credence to bad news than to good news, and fear the outcome of taking a risk more than you believe in the possibility of reward.

The truth is, it's totally impossible to predict the future behavior of financial markets.

The good news is that it's a bit easier to predict the behavior of human beings, at least in one respect: Humans have biases, and they definitely have biases when they invest in the stock market. However, being aware of your biases means you can take steps to counteract them. As your financial advisors, we can help you do both.

Below are some common investment biases.

Anchoring bias

Having an anchoring bias means you become attached to a particular number as a reference point. Say you bought a stock at a certain price, but it declines instead of going up. You refuse to sell because you can't bring yourself to acknowledge its real (current) value, thinking instead that it will come back up to what you think is the "real" price.

Loss-aversion bias

Loss aversion is feeling that the pain of losing is greater than the pleasure of winning. It's the inability to let go of a losing stock because when you sell it, you acknowledge that you made a mistake and lost. Some people have the same trouble throwing out spoiled food in the fridge. It's not going to get any fresher, but throwing it out confirms that you will never eat it.

Confirmation bias

A confirmation bias refers to people's tendency to pay attention to information that supports their beliefs and ignore that which contradicts them. For instance, if you research a stock you feel positive about — maybe because you heard good things about it from someone you trust — you will likely tend to ignore or give less weight to any negative information you find.

Recency or availability bias

Having a recency bias means you make decisions based on the fact that you have recently heard about something and it's therefore fresh in your mind. We remember what's most relevant, or even more likely, what's most dramatic. Hearing good news about a stock makes you want to buy; bad news gives you the opposite impulse. Recency bias is a tendency to react in the short-term, while losing the long-term view. One solution: before you make a decision, sleep on it.

Status-quo bias

Having a status-quo bias means you lean toward doing nothing. Most people have a tendency to do what's familiar and comfortable — and that's not always a bad thing. But if you are feeling paralyzed by past errors, that's a problem. You are likely missing out on opportunities.

Hindsight bias

Hindsight bias refers to our tendency to evaluate past events in light of present knowledge. It likely has to do with wanting to make sense out of our mostly random world. The problem is not a knowledging the role that additional information brings to our analysis and instead believing that we are brilliant experts — that is, becoming overconfident.

So how can your financial advisor help?

As a financial planner, my first job is to reassure my clients about the markets. Despite our inability to predict its future behavior, I can tell you that historically, the market has gone up. Of course it will go down once in a while; but during the past 87 years, which is how far back the stock market's historical data goes, the market has been on the upswing 72 percent of the time.

Second, we can help identify biases. And once we've done that, we can help clients guard against them. Specifically, we can help them do the following:

• Recognize that the market is unpredictable and full of randomness.

• Identify your big-picture goals .

• Identify the amount of your goal to act as your anchor. (If your long-term goal is retirement, don't get caught up in the short-term ups and downs.)

• Create a strategy and stick with it. (Don't chase the market.)

• Develop a policy to address risk. This may involve writing down action steps, including selecting a percentage decrease or increase (loss or gain) at which you will sell, or creating some other specific plan.

Finally, your overall bias about the market may well be influenced by the time frame that you choose to view. It's more rational, not to mention almost always more positive, to compare the amount you have today to the amount you originally invested, rather than to all the peaks and valleys in between.

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Investors cannot invest directly in indexes. The performance of the S&P 500 is not indicative of the performance of all investments and does not take into consideration the effects of fees and expenses associated with investing.

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