

Solomon's Paradox

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I'm extremely excited that because inefficiencies breeds opportunities, and if we fully understand the competitive moats of the companies that we study, we can uncover a lot of opportunities to deliver alpha for our clients.

Whose advice should you trust? Actually, research suggests that you can trust yourself if you are able to distance yourself from your own situation. This self-distancing can enable you to make wiser decisions in investing and in life.

The ancient ruler King Solomon was said to be one of the wisest monarchs in history. However, he was much less wise in dealing with his own affairs. He did several imprudent things, including taking hundreds of wives and amassing more wealth than he ever needed.

One's ability to reason more sensibly about someone else's problems than one's own is known in psychology as Solomon's Paradox. Research shows that the act of removing one's ego or circumstances from a situation may lead to better decision-making.

Dr. Igor Grossman and Dr. Ethan Kross designed an experiment that found people who reasoned from a self-distanced perspective showed higher wisdom scores in various situations. The takeaway is that simply distancing yourself from your situation can help improve your reasoning ability.

We believe that self-distancing applies to investing as well. Investors have many biases that interfere with rational decisions. For example, when people consider

buying or selling a stock, they may be influenced by their own experience, such as whether they have embedded gains or losses. Now this should not impact a rational decision in a non-taxable account, yet time and again it comes into play. Investors who incorporate this type of extraneous information into their decision-making suffer from loss aversion such that it is harder to realize a loss than a gain, even when the prospective future returns remain the same. Others may get so caught up in a rising stock price that they fall victim to confirmation bias and ignore important fundamental developments or stop doing research altogether. Finally, some investors may even be biased by not having any exposure to an investment that performed strongly and join the investing herd at an inopportune time, driven by regret aversion, commonly referred to as fear of missing out.

These biases are the reason individual investors often underperform the underlying asset class in which they invest. The average U.S. investor in diversified equity funds underperformed those very same funds by more than 75 basis points annually over a decade.

A distanced perspective may be a good way to combat biases that lead to underperformance. We aim to adopt a distanced perspective at Alger so that we can achieve the best potential returns for our investors in our disciplined, research-oriented approach.

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