

Traditional finance assumes we are rational and make objective decisions. Behavioral finance disagrees. It recognizes that we have cognitive and emotional biases and that we make subjective judgements. These biases work against us and can unduly influence our investing decisions.

Do You Suffer from These Common Biases?

Below are six common biases that many of us suffer from. We believe that if you can recognize and avoid these biases, you may be able to make better decisions in both investing and life.

	What Is It?	Do You Suffer From It?
Herding Bias	Your opinion is unduly influenced by a group.	You may if your investment decisions are based on opinions from your friends and acquaintances rather than independent work or help from a financial professional.
Optimism Bias	You're overly optimistic and you tend to forecast "best-case" scenarios.	You may if you make forecasts and decisions based on instinct, yet you find your decision often fails to live up to reality.
Representativeness Bias	You make judgments based on observable characteristics with little to no regard for prior probabilities or results.	You may if you have developed "rules of thumb" to make decisions on whether an investment looks promising or not.
Loss Aversion Bias	You feel the prospect of investment losses are more acute than the prospect of gains.	Y ou may if you avoid selling an investment at a loss despite the fundamental outlook being dim, or you may if you find it painful when an investment is down despite positive long-term prospects.
Availability Bias	You make forecasts or decisions based on easy or recent examples that come to mind.	You may if you relate issues to your own experience or recent data points and information rather than looking at a longer term history.
Confirmation Bias	You tend to seek data that confirms your existing beliefs and you ignore information that has a competing view.	You may if you tend to seek out opinions and data points that are supportive of your views and you dislike hearing opposing views.

Behaving Better Checklist

Now that you can recognize common biases that may affect your investment decision making, this checklist will help you with tangible actions you can take to overcome your biases.

Do	Don't
☐ Put your investment goals in writing. Assign short- and long-term timeframes to your goals.	☐ Chase recent returns for particular investments. You will be likely be disappointed as recent past performance may not be indicative of future results.
☐ Evaluate several scenarios as potential outcomes. What happens in a weak return environment as compared to one with strong returns?	☐ Make investments outside of the framework you agreed to with your financial professionals. Using your "gut" to make decisions is not a good idea.
☐ Build your portfolio using an agreed-upon asset allocation. Using a consistent framework helps remove emotional bias.	☐ Evaluate your portfolio's performance without comparing it to your game plan and your goals. Don't look at things in a vacuum.
☐ Implement a game plan with your financial professional. Don't chase after others' performance results.	☐ Base future investment decisions on recent past performance. It doesn't work.

Everyone can fall victim to their own biases, but we believe that recognizing and overcoming these biases may help you make better investing decisions. Navigating financial markets can become a calmer, more thoughtful and evidence-based experience of making better informed decisions.

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