

Fake Investment Beliefs

Over the last few years, there has been so much written about so-called fake news. But for investors is there such a thing as a fake investment belief?

All investors and even those that I consider savers as opposed to investors have a set of beliefs. Most have not thought much about their own beliefs and how these shape their investment strategy. But beliefs certainly do play a huge role in the ultimate outcome.

Traditional finance models assume a perfectly rational person - i.e. an investor always making perfectly rational decisions. But studying actual behaviours tells us a very different story and much has been written on this. People, in general, are far from rational, making many mistakes due to what is known as cognitive and emotional biases.

In addition to a low ability to process lots of information accurately, cognitive biases also include clinging to false beliefs. Behavioural psychologist will include here aspects such as overconfidence bias or confirmation bias etc

So, let's look at a few common phrases that could be linked to a certain false bias -

- ***I am waiting for when the economic outlook is a bit clearer before I commit more to my investments.***
This is a form of confirmation bias. An investor will want to "stock up" on information and data that supports his belief. If the prevailing news flow is negative, he will tend to ignore any positive signs. Conversely, once an investor has made up his mind to invest, he will often ignore any negative and conflicting news.
- ***The market has been going up for so long that it "has to" come down soon.***
This is a form of loss aversion bias. We feel the pain of a loss about twice as much as the pleasure of the same sized gain. This emotional "fear" will cause investors to check their portfolio too often and become overly concerned with short term losses - resulting in less than optimal risk and ultimately return.
- ***It would have been better for me to put all my money in cash over the last few years***
For sure hindsight is perfect vision. Hindsight bias irons out the various random paths that lead us to where we are now and sees things as more predictable than they actually were. This bias occurs due to our tendency to view events as inevitable and to believe that we could have foreseen certain events.
- ***I know this investment well - I have worked for the company for over 20 years***
Very often an investor will be unwilling to diversify a large investment position because of what is known as the endowment bias - i.e. placing a high value on what is already in one's possession, or possibly because of the overconfidence bias. This is the belief that with some degree of additional knowledge about a company, there is a higher degree of confidence in the performance outcome.

It is extremely difficult for investors to identify, let alone overcome deep-seated biases. This is particularly apparent in ongoing investment decisions. Partly because of such biases less than optimum outcomes are typically achieved. This is one very good reason to work with an investment advisor on a well-structured investment plan that is continuously monitored.

Kind regards,

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Performance has been calculated using net NAV to NAV numbers with income reinvested. Full performance calculations are available from the manager on request.

DEFINITIONS (where applicable)

Annualised Return Annualised return shows longer term performance rescaled to a 1-year period. Annualised return is the average return per year over the period. Actual annual figures are available to the investor on request.

Highest and Lowest Annual Return The highest and lowest returns, since launch, for any rolling 1-year period have been shown.