Reflection Leads to Better Investment Decisions

July 7, 2020

Matt Olver, CFP®, AEP®, CEPA
Partner

Years ago, when my son started first grade, his teacher gave us a "Getting to Know Your Child" questionnaire. She wanted to know our son's interests in and out of school. She also asked us to describe three of his strengths and two areas where there was room for improvement.

I found it interesting that she wanted parents' assessments of their children. I initially resisted the idea of sharing my son's "weaknesses." But then I realized, the more his teacher was aware, the more she could help him improve.

From a professional standpoint, it also made me realize that investors can make better investment decisions by taking time to reflect on their past actions and what drove those actions.

Understanding Your Investment Biases

Behavioral finance tells us we all have ingrained biases—it's part of human nature. The most successful investors are often the ones who recognize when they're being influenced by such biases and make the conscious decision not to respond to them. As Warren Buffett says,

"Investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ…Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing."

One bias I recognize in myself is called the **familiarity bias**, which is the tendency to choose options based on how familiar you are with them. In other words, to go with what you know. This bias can even extend to a particular experience. "I don't like shopping at store X, so surely I won't buy its stock." If you give into this bias, you might miss out on potential opportunities that could help you achieve your goals.

Another common bias is the **availability bias**, which is the tendency to place more weight on information (or opinions) you hear (or see) more frequently as well as those delivered more dramatically. For example, it's easier for the mind to recall "the market plummeted" than "the market declined." In today's politically charged world of 24-hour news channels, websites and bloggers, it's not surprising that this bias plays a significant role in financial markets.

Lastly, **confirmation bias** is the tendency to seek out, believe, or give more weight to information that supports our current line of thinking and to ignore or discredit alternative opinions. For example, after buying a stock, many investors latch on to information that reinforces their decision and disregard negative information about the company.

The Power of Reflection

Taking a step back and doing a self-assessment of your biases can be very beneficial in helping you avoid future missteps. Examine those instances when your decisions were detrimental to your success. You might also consider maintaining a "diary" of your thoughts and rationale to help you understand what influenced those decisions.

Self-assessments aren't fun, but they can make you a better investor.

For more investment insights and best practices, contact a Cerity Partners advisor or visit ceritypartners.com.

Matt Olver is a Partner in the Cleveland office and has over twenty years of experience working with families and business owners as a financial planner and investment advisor, helping clients grow, manage and preserve their wealth.