# Crowder Wealth Management Group's Quarterly Comment

Wealth Management Dominion Securities

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Investing shouldn't be hard. Buy quality companies at good prices and hold them for a long time. Not much more to it than that. Yet so many investors - maybe most - fail to achieve investment success. Why is that?

Blame your brain. Many studies have been done that examine some interesting facts regarding investor psychology. Apparently, we come hardwired with all kinds of psychological biases that cause us to misinterpret information or that emotionally push us into regrettable decisions. There are a bunch of these biases, but here are a few of the biggest ones.

**Confirmation or Anchoring bias:**
This is when we – without even realizing it - start with an answer, and then search for evidence to back that answer up. In other words, we tend to pay more attention to information that supports our opinions while ignoring the rest. If you're convinced an economic recovery is at hand, you'll probably search for other bullish opinions. In a way, this tendency causes your emotions to blind you from reality.

Charles Darwin, who regularly tried to disprove his own theories, and was especially skeptical of his own ideas that seemed most compelling. The same logic should apply to investment ideas.

**Recency bias:**
This is the tendency to let recent events skew your perception of the future.

When we're in a bull market, you think it'll last forever. When we're in a recession, you think we'll never recover. After a banking crisis, you think another is right around the corner. Rarely is that actually the case -- it's usually the other way around -- but it's what feels right when memories are fresh in our minds.

**Hindsight bias:**
This common bias leads investors to believe, after the fact, that this onset of a past event was predictable and completely obvious whereas, in fact, the event could not have been reasonably predicted.

Out of literally millions, only a handful of investors truly saw the 2008 financial crisis coming.

If you disagree with that statement and respond, "No, any idiot could have seen it coming from a mile away," you're suffering from hindsight bias. Only after the fact do all the puzzle pieces make sense. That's why bankruptcies outnumber billionaires.

**Skill bias:**
When education and training causes confidence to increase faster than ability. The best example is the hedge fund Long Term Capital Management.

Staffed thick with PhDs and two Nobel laureates, the fund exploded in 1998 under an incomprehensible amount of leverage.

Behind the failure was raging overconfidence. "The young geniuses from academe felt they could do no wrong," Roger Lowenstein wrote in the book *When Genius Failed*.

Warren Buffett said this about Long Term Capital Management's sixteen-person management team:

*"They probably have as high an average IQ as any sixteen people working together in one business in the country ... just an incredible amount of intellect in that group. Now you combine that with the fact that those sixteen had extensive experience in the field they were operating in ... in aggregate, the sixteen probably had 350 or 400 years of experience doing exactly what they were doing. And then you throw in the third factor: that most of them had virtually all of their very substantial net worth's in the business... And essentially they went broke. That to me is absolutely fascinating."*

**Pessimism bias:**
Underestimating the odds of something going right. Financial advisor Carl Richards writes:

*"We focus so much on protecting ourselves from negative surprises (job loss, disability, divorce, death, the whole catastrophe) that we forget to factor in the positive ones (a raise, a business that works out, a new career, a new bull market) that can sometimes change our entire outlook."*

**Illusion of control:**
Thinking that your decisions and skill led to a desired outcome, when luck was likely the big factor.

If you've ever made money day trading and patted yourself on the back for a job well done, you're probably a victim of the illusion of control.

**Escalation of commitment:**
This is the classic "throwing good money after bad." Doubling down on a plunging stock, not because you believe in its future, but because you feel the need to make back losses. Happens all the time at blackjack tables, too.

**Negativity bias:**
Assuming perpetual doom, that problems will never be fixed, and that all hope is lost. This bias has been rampant with some investors, and has caused many to forgo investing opportunities of a lifetime.

**Risk perception bias:**
Attempting to eliminate one risk, but exposing yourself to another, potentially more harmful, risk.

In the year after 9/11, air travel fell, and car travel jumped. Understandably, people suddenly felt planes were more dangerous than cars. Of course, statistics show that that is clearly not the case.

Today, an untold number of investors are probably choosing perceived "riskless" assets, because they don't want the perceived risk of volatile stocks. Ten years from now, there's an uncomfortably high chance they will be victims of risk perception bias.

**Summary:**
These and other psychological biases often impact investor behaviour. They can be cognitive, causing distortions in information and the way it gets interpreted. They can also be emotional and cause investors to take action based on feeling rather than fact.

Arguably, we believe that the most successful investors have the ability to recognize and overcome psychological biases, and rely heavily on facts and rational thought processes that guide their decisions.

**IMPORTANT TEAM NOTICE:**

Effective mid-August, Jennifer Squires will be taking time off for a one year maternity leave. During that time, her position will be covered by Beatriz (Bea) Cuellar. We are delighted to have Bea with us, and wish Jennifer and her family all the best!

Bea can be reached at 519-675-1141, Beatriz.cuellar@rbc.com.

As always, my team and I thank you for the opportunity to work together. Should you have any questions or concerns, please don't hesitate to contact us.

Sincerely,

Wayne Crowder, B.Sc.(Agr), CFA
Vice President and Portfolio Manager
Crowder Wealth Management Group

| Index | YTD | 1 Year | 5 Year |
|---|---|---|---|
| S&P/TSX Composite Total Return Index | 16.2% | 3.9% | 4.7% |
| S&P 500 Total Return Index ($CAD) | 13.8% | 10.1% | 15.3% |
| S&P 500 Total Return Index ($USD) | 18.5% | 10.4% | 14.7% |
| MSCI World Price Index ($CAD) | 11.0% | 3.9% | 8.9% |
| Broad Composite Cdn. Bond Index | 6.5% | 7.4% | 3.9% |

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