

We're Only Human

By Steven Mayo, April 2019

With so much more stock market volatility, the way we “humans” react is very often the difference between investing successfully or not. It's how we process information that separates investors.

As humans we get caught up in the moment and are wired to make emotional assumptions on the future. It is my job to remind clients that we should be aware of our biases, and that rational investment decisions pay off.

Humans are a funny bunch! Here are some examples of our psychological make up. There are many fascinating studies in this area that I encourage readers to look into.

Anchoring Bias:

This is a term used in psychology to describe the common human tendency to rely too heavily on one trait or piece of information when making decisions. Usually once the anchor is set, there is bias toward that value.

This can be dangerous in investing since using external information to affect decisions may have no actual correct input value. Just because you believe it's important doesn't actually make it so. Judgement tends to be made by adjusting away from the original anchoring point.

Endowment Effect:

This is where we irrationally ascribe a higher price value to something just because we own it. This is because we identify with it, it's part of our “value”. This is also known as “Divestiture Aversion”. This may not be healthy when one should be selling a stock or when one is trying to clear out their house but can't part with all the nick-knacks.

Not too long ago a study was done on lottery players who had just bought their ticket. When they walked out of the store, they were offered 2x, 3x, and 4x the value of their purchase. In short-, 78% said NO to selling their ticket out of fear of regret, and the possibility of giving up winning. Clearly this is irrational. They had already identified with the lottery ticket. They would have doubled/tripled their original investment but that wasn't enough! And apparently taking the extra money to buy more tickets wasn't enough either. Wow!

Representative Bias:

The more familiar something is, and tells a story similar to an old situation the more we tend to fit it into the new situation. This is using familiarity to help decision making. This is an area that I find similar to having experience.

As humans, we are always trying to connect the dots and find meaning. We even use biases to try and find an answer. In reality, the brain does not interpret data correctly all the time. Experience, the ability to accept change, the need to learn, and the use of emotion as a tool to recognize opportunity are all helpful skill to successful investing.

Quote: It is an acknowledged fact that we perceive errors in the work of others more readily than in our own.

~Leonardo Da Vinci

This information is not investment advice and should be used only in conjunction with a discussion with your RBC Dominion Securities Inc. Investment Advisor. This will ensure that your own circumstances have been considered properly and that action is taken on the latest available information. The information contained herein has been obtained from sources believed to be reliable at the time obtained but neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers can guarantee its accuracy or completeness. This report is not and under no circumstances is to be construed as an offer to sell or the solicitation of an offer to buy any securities. This report is furnished on the basis and understanding that neither RBC Dominion Securities Inc. nor its employees, agents, or information suppliers is to be under any responsibility or liability whatsoever in respect thereof. The inventories of RBC Dominion Securities Inc. may from time to time include securities mentioned herein.

