How Cognitive Bias Can Affect Investing

Why do investors sometimes fall into the trap of buying high or selling low? Why do many of us procrastinate in saving for retirement, despite knowing its importance? Behavioural economists have shown that cognitive biases can prevent us from making the best decisions. Our brains operate in two cognitive states: automatic and reflective. Our automatic system is uncontrolled, fast and unconscious. Our reflective system is controlled, effortful and deductive. Cognitive biases occur when the automatic system, often influenced by the current environment, dominates the reflective system.

These behavioural biases can affect the way we invest. "Herd behaviour," the tendency to follow the actions of a larger group, can cause investors to buy or sell due to pressure from others who are doing the same. "Recency bias" causes investors to believe that recent patterns or events in the markets will continue into the future. According to scientists there are 188 known cognitive biases that can lead us astray. The visual shows just a handful. See the full infographic at: www.visualcapitalist.com/every-single-cognitive-bias/

The good news? With a bit of effort, we can learn to control these behaviours. Some of the most seasoned investors have trained themselves to avoid emotional impulses. We can also integrate techniques into our investing programs, like regularly rebalancing portfolios, using managed products to put buy and sell decisions in the hands of experts, or incorporating systematic saving or investing programs to avoid market timing.

The Cognitive Bias Codex: An Excerpt

Source: Visual Capitalist, attributed to designhacks.co; www.visualcapitalist.com/every-single-cognitive-bias/

Most importantly, don't forget the influence these biases can have on investing and plan ahead before they can have an impact. This may include sticking to your wealth plan during volatile times or avoiding the urge to react to social and media pressure. We are also here to help as we work with you towards achieving longer-term success.