

# Investors' 10 Most Common Behavioral Biases

Posted on [July 16, 2012](#)



Barry Ritholz (of [The Big Picture](#) and a Sunday Business columnist at [The Washington Post](#)) recently contributed [Investors' 10 most common mistakes](#) to *The Washington Post Business Section* quarterly investing section. It's a commentary that he has been working on for a while — the ten topics are listed with links to longer discussions of each common mistake [here](#). I created my own investing “checklist” ([here](#)) in response to Barry's [original list](#). For yet one more iteration of the theme, I offer my list of *Investors' 10 Most Common Behavioral Biases*. There are a number of others, of course, and more will continue to be uncovered. But I think that these are the key ones. Your suggestions of important ones I have missed are welcome.

1. **Confirmation Bias.** We like to think that we carefully gather and evaluate facts and data before coming to a conclusion. But we don't. Instead, we tend to suffer from [confirmation bias](#) and thus reach a [conclusion first](#). Only thereafter do we gather facts and see those facts in such a way as to support our [pre-conceived conclusions](#). When a conclusion fits with our desired narrative, so much the better, because narratives are crucial to how we make sense of reality.
2. **Optimism Bias.** This is a well-established bias in which someone's subjective *confidence* in their judgments is reliably greater than their objective *accuracy*. Indeed, we live in an overconfident, [Lake Wobegon](#) world (“where all the women are strong, all the men are good-looking, and all the children are above average”). We are [only correct](#) about 80% of the time when we are “99% sure.” Fully 94% of college professors believe they have [above-average](#) teaching skills (anyone who has gone to college will no doubt disagree with that). Since [80% of drivers](#) say that their driving skills are above average, I guess none of them drive on the freeway when I do. While 70% of high school students claim to have [above-average](#) leadership skills, only 2% say they are below average, no doubt taught by above average

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[sums things up](#), 85-90% of people think that the future will be more pleasant and less painful for them than for the average person.

3. **Loss Aversion.** We are highly loss averse. [Empirical estimates](#) find that losses are felt between two and two-and-a-half as strongly as gains. Thus the disutility of losing \$100 is at least twice the utility of gaining \$100. Loss aversion favors inaction over action and the status quo over any alternatives. Therefore, when it comes time for us to act upon the facts and data we have gathered and the analysis we have undertaken about them, biases 2 and 3 – unjustified optimism and unreasonable risk aversion – conflict. As a consequence, we tend to make bold forecasts but timid choices.
4. **Self-Serving Bias.** Our [self-serving bias](#) is related to confirmation bias and optimism bias. Self-serving bias pushes us to see the world such that the good stuff that happens is my doing (“we had a great week of practice, worked hard and executed on Sunday”) while the bad stuff is always someone else’s fault (“It just wasn’t our night” or “we simply couldn’t catch a break” or “we would have won if the refereeing hadn’t been so awful”).
5. **The Planning Fallacy.** In his terrific book, *Thinking, Fast and Slow*, Nobel laureate [Dan Kahneman](#) outlines what he calls the “planning fallacy.” It’s a corollary to optimism bias and self-serving bias. Most of us overrate our own capacities and exaggerate our abilities to shape the future. The planning fallacy is our tendency to underestimate the time, costs, and risks of future actions and at the same time overestimate the benefits thereof. It’s at least partly why we underestimate bad results. It’s why we think it won’t take us as long to accomplish something as it does. It’s why projects tend to cost more than we expect. It’s why the results we achieve aren’t as good as we expect.
6. **Choice Paralysis.** Intuitively, the more choices we have the better. However, the sad truth is that too many choices can lead to decision paralysis due to information overload. For [example](#), participation in 401(k) plans among employees decreases as the number of investable funds offered increases. We are readily paralyzed by too many choices.
7. **Herding.** We all run in herds — large or small, bullish or bearish. Institutions herd even more than individuals in that investments chosen by one institution predict the investment choices of other institutions by a remarkable degree. Even [hedge funds](#) seem to buy and sell the same stocks, at the same time, and track each other’s investment strategies. That affinity fraud (e.g., Bernie Madoff fleeced the Jewish community to which he belonged) is so common is definitive evidence of herding.
8. **We Prefer Stories to Analysis.** As noted above, narratives are crucial to how we make sense of reality. They help us to explain, understand and interpret the world around us. They also give us a frame of reference we can use to remember the concepts we take them to represent. Perhaps most significantly, we [inherently prefer](#) narrative to data — often to the [detriment of our understanding](#). Keeping one’s analysis and interpretation of the data reasonably objective – since analysis and interpretation are required for data to be actionable – is really, really hard even in the best of circumstances. A corollary to this problem and to confirmation bias is what Nassim Taleb calls the “narrative fallacy” — looking backward and creating a pattern to fit events and constructing a story that explains what

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internet bubble in early 2001 while the lowest recommended weighting came just after the lows of the financial crisis. That's recency bias.

10. **The Bias Blind-Spot.** I [have written](#) many times about the cognitive biases which plague us and make it difficult for us to make good choices, including (obviously) here. Knowing about them is imperative if we are going to deal with them. We would always be wise to factor in these biases when performing analysis and making decisions. Unfortunately, we all tend to share a "bias blind spot" — the inability to recognize that we suffer from the same cognitive distortions that plague other people. [Here](#) is a wonderful (both hysterically funny and achingly sad) example.

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I feel sorry for all the people that suffer from these biases.



**rpseawright**

on **July 17, 2012 at 1:04 pm** said:

Brilliant. Thanks for reading and commenting.

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**Shantesh Hede**

on **July 20, 2012 at 3:58 pm** said:

In my understanding the point is between Investor Biases and Parties with God Complex and extensive influence!. Those with influence have the Complex while the rest of us have biases.

[http://www.democracynow.org/2012/7/19/matt\\_taibbi\\_libor\\_rate\\_fixing\\_scandal](http://www.democracynow.org/2012/7/19/matt_taibbi_libor_rate_fixing_scandal)



**Shaun**

on **July 20, 2012 at 5:22 pm** said:

Wow. Was that maybe one of the most insightful but concise blog posts I have seen in years? I think it might be. Good job.



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Randy Schwickert

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jjsocrates

on **January 17, 2013 at 9:35 am** said:

Everybody else suffers from these biases, but not me! Um, well...

[http://en.wikipedia.org/wiki/Bias\\_blind\\_spot](http://en.wikipedia.org/wiki/Bias_blind_spot)



rpseawright

on **January 17, 2013 at 9:43 am** said:

Thanks for reading and commenting. Wiki is a decent place to start, but if you follow the links in my posts on the subject you can see some of the actual published research on bias blindness. See [here](#), for example.

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**Daniel**

on **March 27, 2013 at 9:20 pm** said:

Wow that is a great list of biases that we can have. As a [Financial Planner](#) not only have I experienced these in my professional life many of them came up in my personal life too. In the last 7 years I have been researching the effect of money scripts on our behavior and our relationship with money. Many of us have not had any formal education on money before we entered the work force. From my research I have learned that 95% of our subconscious programming was done by the age of 12. If we don't realize that we live only 5 to 1% of our life in conscious realm we are setting ourselves to fail in every are of life especially in finance. I believe many of the biases you have listed in your article come from our past programming. We must become aware of this fact before we can change anything.

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**Carolyn McRae**

on **June 24, 2013 at 12:16 pm** said:

Thanks for the list, Bob. I can’t help but think of clients when reading bias #6. Advisors face a choice bias, but for clients it turns into a bias from information-overload. I see it often. Too much info crammed into a report actually reduces their understanding and ultimately hurts the advisor/client relationship. Fewer choices paired with more consolidated reporting = magic.

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on [September 11, 2014 at 5:45 pm](#) said:

Another common one is the home country bias. Americans invest overwhelmingly in domestic stocks when domestic stocks make up less than 50% of global market capitalization. You invest in what you know and what is close to you. I would estimate that many people from other countries likely do the same by investing the majority of their money in companies in their home country.



**Bob Seawright**

on [September 12, 2014 at 6:05 am](#) said:

The research has confirmed home country bias worldwide. Thanks for reading and commenting.

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**researching investing**

on [February 18, 2015 at 12:54 pm](#) said:

This is a really good point you make here. Too many investors don't recognize the power of their own biases. Really great to bring this up and remind us that we need to watch out for biases creeping into our decision making process.

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