Canaccord Genuity Wealth Management

The Psychology of Investing

According to recent reports, investors using a U.S. discount brokerage platform are checking their portfolios at an alarming rate of seven times per day.[1] It's not difficult to do. Today, often all it takes is one quick swipe on our smartphones. However, frequent portfolio checking may be hazardous to your investing health.

Modern behavioural economists have determined that our cognitive biases can sometimes cause us to make decisions that may not be in our best interests. 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. This is why going grocery shopping while hungry can lead to unhealthy food choices: our reflective system is easily overridden by a state of hunger.

By checking portfolios frequently, there is a greater chance that we will trigger these biases. One reason is that frequent checking means a higher probability of seeing a loss, which may drive us to want to take action. By checking S&P/TSX Composite Index performance on a daily basis, there is a 48 percent likelihood of seeing negative performance. If you were to check only once per year, this would decrease to 28 percent.[2] However, even seeing positive performance may trigger us to make certain decisions, such as selling a well-performing investment too early.

In investing, being aware of these biases can help us to make better decisions. "Herd behaviour," the tendency to follow the actions of a larger group, may 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. "Confirmation bias" suggests we put more emphasis on information that agrees with what we believe, discounting opinions and data that disagree with these beliefs.

Chart: An Excerpt from the Cognitive Bias Codex

Source: Visual Capitalist, attributed to designhacks.co; www.visualcapitalist.com/

In fact, according to scientists there are 188 known cognitive biases that can affect our thinking and our actions. The visual above shows just a handful of the complete list of biases as published on visualcapitalist.com. The full infographic, found at www.visualcapitalist.com/every-single-cognitive-bias/ presents an interesting look at how our brain can sometimes work against our better judgment.

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 different 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.

Most importantly, don't forget the influence that human behaviour can have on investing and plan ahead before it 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. And, remember, we are here to help provide support as we work with you towards achieving longer-term success.

1. On average. www.reuters.com/breakingviews/chancellor-robinhood-is-more-sheriff-than-rebel-2021-07-15/; 2. S&P/TSX Composite Index 1985 to 2020.

Compliments of John W. Warnke — Canaccord Genuity Wealth Management

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