

The ABCs of Behavioral Biases: A-F

Welcome back to our “ABCs of Behavioral Biases.” Today, we’ll get started by introducing you to four self-inflicted biases that knock a number of investors off-course: anchoring, blind spot, confirmation and familiarity bias.

Anchoring Bias

What is it? Anchoring bias occurs when you fix on or “anchor” your decisions to a reference point, whether or not it’s a valid one.

When is it helpful? An anchor point can be helpful when it is relevant and contributes to good decision-making. For example, if you’ve set a 10 p.m. curfew for your son or daughter and it’s now 9:55 p.m., your offspring would be wise to panic a bit, and step up the homeward pace.

When is it harmful? In investing, people often anchor on the price they paid when deciding whether to sell or hold a security: “I paid \$11/share for this stock and now it’s only worth \$9/share. I’ll hold off selling it until I’ve broken even.” This is an example of anchoring bias in disguise. Evidence-based investing informs us, the best time to sell a holding is when it’s no longer serving your ideal total portfolio, as prescribed by your investment plans. What you paid is irrelevant to that decision, so anchoring on that arbitrary point creates a dangerous distraction.

Blind Spot Bias

What is it? Blind spot bias occurs when you can objectively assess others’ behavioral biases, but you cannot recognize your own.

When is it helpful? Blind spot bias helps you avoid over-analyzing your every imperfection, so you can get on with your one life to live. It helps you tell yourself, “I can do this,” even when others may have their doubts.

When is it harmful? It’s hard enough to root out all your deep-seated biases once you’re aware of them, let alone the ones you remain blind to. In “Thinking, Fast and Slow,” Nobel laureate Daniel Kahneman describes (emphasis ours): “We are often confident **even when we are wrong**, and an objective observer is more likely to detect our errors than we are.” (Hint: This is where second opinions from an independent advisor can come in especially handy.)

Confirmation Bias

What is it? We humans love to be right and hate to be wrong. This manifests as confirmation bias, which tricks us into being extra sympathetic to information that supports our beliefs and especially suspicious of – or even entirely blind to – conflicting evidence.

When is it helpful? When it’s working in our favor, confirmation bias helps us build on past insights to more readily resolve new, similar challenges. Imagine if you otherwise had to approach each new piece of information with no opinion, mulling over every new idea from scratch. While you’d be a most open-minded person, you’d also be a most indecisive one.

When is it harmful? Once we believe something – such as an investment is a good/bad idea, or a market is about to tank or soar – we want to keep believing it. To remain convinced, we’ll tune out news that contradicts our beliefs and tune into that which favors them. We’ll discount facts that would change our mind, find false affirmation in random coincidences, and justify fallacies and mistaken assumptions that we would otherwise recognize as inappropriate. And we’ll do all this without even knowing it’s happening. Even stock analysts may be influenced by this bias.

Familiarity Bias

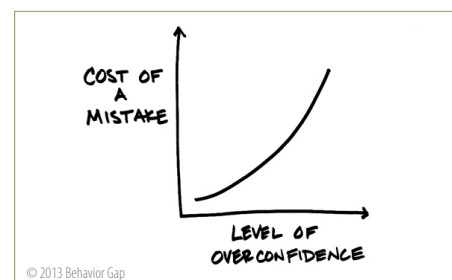
What is it? Familiarity bias is another mental shortcut we use to more quickly trust (or more slowly reject) an object that is familiar to us.

When is it helpful? Do you cheer for your hometown team? Speak more openly with friends than strangers? Favor a job applicant who (all else being equal) has been recommended by one of your best employees? Congratulations, you’re making good use of familiarity bias.

When is it harmful? Considerable evidence tells us that a broad, globally diversified approach best enables us to capture expected market returns while managing the risks involved. Yet studies have shown investors often instead overweight their allocations to familiar vs. foreign investments. We instinctively assume familiar holdings are safer or better, even though, clearly, we can’t all be correct at once. We also tend to be more comfortable than we should be bulking up on company stock in our retirement plan.

Ready to learn more? Next, we’ll continue through the alphabet, introducing a few more of the most suspect financial behavioral biases.

David Bromelkamp
President and CEO



Headlines

- We had a wonderful time with clients, friends and colleagues at the 2018 January Investment Forum – Thinking and Investing Like Warren Buffett.
- Allodium was pleased to welcome two new clients in the fourth quarter of 2017.
- Our office will be closed March 30th and May 28th for company holidays.
- You can now reach Allodium at www.allodium.com. We will be transitioning gradually over the next year, so you can still find us at www.aicria.com. Employee email addresses will also be transitioning to the new domain of @allodium.com over the course of the year.

Note: To find out more about Allodium's breaking news, please visit our website: www.allodium.com.

UPCOMING EVENT: MAY 1, 2018

2018 Spring Wealth Management Workshop – Tax Reform

What do the new tax reforms mean for you? Find out while enjoying a casual evening of pizza and beverages.

Allodium is excited to welcome Scott R. Hoyles and Joseph Mayer from Olsen Thielen & Co. as guest speakers. They will address many of the new tax changes. Some of the topics of discussion will include tax policy, individual tax updates, estate planning updates, new fringe benefit rules, and corporate tax changes.



Scott R. Hoyles
CPA/ABV/CGMA,
MBT Principal
Olsen Thielen & Co.



Joseph Mayer
CPA, MST Principal
Olsen Thielen & Co.

SAVE THE DATE:

May 1, 2018, 4:30 – 7:00 p.m.

For more information about this event, please contact Ilona Avraamides at (612) 230-3711 or iavraamides@allodium.com.

WE APPRECIATE YOUR INTRODUCTIONS

To optimize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers. If you know someone who may be looking for this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3702 or dbromelkamp@allodium.com to arrange a friendly, no-obligation introduction.

Steward is published quarterly by Allodium Investment Consultants. Please contact Ilona Avraamides at 612-230-3711 or iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.

NEW EMPLOYEE SPOTLIGHT:

Kari Cedergren



Role at Allodium:

Investment Consultant

Joined firm on: 1/1/2018

Hometown: Hancock, Minnesota

Favorite movie: We're the Millers

Favorite book: To Kill a Mockingbird

Favorite TV show: Saturday Night Live

Favorite food(s): Breakfast Burritos

Favorite news source: Wall Street Journal, Bloomberg, Marketplace Money

Favorite place in Twin Cities: Saint Dinette

Favorite gadget/technology: Bluetooth
Favorite activity: Spending time with friends riding horses.

Favorite music: Christmas Music

Person I admire most: My mom

What I'm most thankful for: Helping my Mom in the nursing home made me grateful that I am able to participate in the basic activities of living.

ALLODIUM
INVESTMENT CONSULTANTS

© 2018 Allodium Investment Consultants

Allodium Investment Consultants, LLC ("Allodium") is an SEC registered investment adviser with its principal place of business in the state of Minnesota. This newsletter is limited to the dissemination of general information pertaining to its investment advisory/management services and is not intended to provide investment, tax, legal or other advice. While taken from sources deemed to be accurate, the information contained herein is subject to change, and Allodium makes no representations about its accuracy, completeness or appropriateness for any given situation and disclaims any liability arising from use of or reliance on this information. Client satisfaction results and recognition by publications should not be construed as a guarantee of certain results when Allodium is engaged for investment advisory services, nor should it be construed as a current or past endorsement for Allodium by any of its clients. For additional information about Allodium, including fees and services, please request our disclosure statement as set forth on Form ADV using the contact information herein. Please read the disclosure statement carefully before you invest.