

MAKING BETTER DECISIONS BY AVOIDING RECENCY BIAS

Imagine something is coming at you quickly. You see it out of the corner of your eye, and you instinctively move so it does not hit you. You could have looked at it directly, determined how fast it was traveling and if the current path was going to intersect you. By the time you did that, however, the object would have either struck you or passed by. You acted intuitively because you did not want to take the chance of getting hit.

As humans we like short cuts or heuristics, which are cognitive processes (conscious or unconscious) that ignore part of the information available. Not all short cuts taken lead to a favorable result. Sometimes, despite our best efforts, we still get hit. Cognitive biases, or decision making errors, are likely to occur under stress. Most of the biases burdening us are related to decisions reached hastily or based on emotion rather than reason. We are vulnerable to biases that lead to irrational decisions because they are part of human nature.

The latest events and trends are more easily identifiable than the future unknown, and recency bias is the tendency to make decisions based on novel experiences and developments. A person that falls prey to recency bias will skew his perception to short term thinking at the expense of long term objectives. He will always be in fire-fighting mode, reacting to new data with some type of action, even if that data is no more relevant than past information.

It is difficult at this moment during the COVID-19 crisis to have a positive outlook. The death toll mounts, while our elected officials bicker like children. Governors Cuomo and Murphy have extended stay-at-home rules until May 15th, making it arduous for small businesses to remain afloat and eventually resume operations. The ramp-up for testing for antibodies, vital until a vaccine is introduced to the general populace, has not met the exigencies of the emergency. There is seemingly no end to the pain and suffering endured on a daily basis.

Recency bias for investors is exacerbated during times of distress and the concomitant volatility. Investors like to think every decision to buy, sell or hold is rooted in logic and discipline. Often that is not the case. Implicit in a sale of stocks in today's climate is the conviction that the bad times will persist. Anyone selling stocks so should ask themselves the following: Why do I assume the status quo will continue indefinitely? Have we not prevailed through adversity in the past? Why is this time different?

There are occasions for short cuts and heuristics, but also situations when rendering an informed and grounded judgement is prudent. We must understand when and how to employ the different decision making processes. Only then we will become better investors and, more importantly, better at making decisions.

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