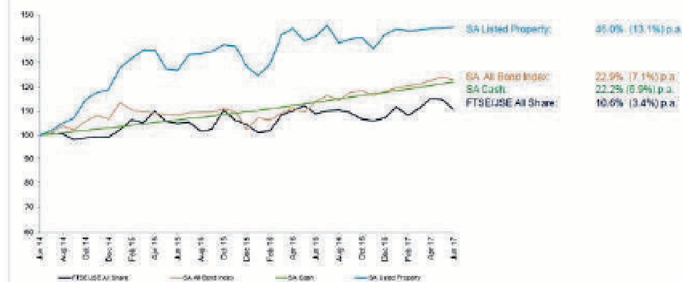
Be rational, not biased, in financial decisions

Money Matters

Mark Williams



SA asset class cumulative returns
3-years to end June 2017

A bias is defined as "not logical or reasonable . . . tendencies to think in certain ways that can lead to systematic deviations from a standard of rationality or good judgment".

Recency Bias refers to our expectation of future returns based on recent past performance. Investors project past returns forward, expecting more of the same and then base their investment decisions accordingly.

This explains why most investors invest at the top of the cycle and disinvest at the bottom of the cycle – i.e. getting the timing perfectly wrong by buying high and selling low.

The current cycle is once again proving that we don't learn from our mistakes. The average investor is either sitting in cash or, even worse, switching into cash after three years of flat returns from the JSE.

Three years ago, investors were piling into the market after several years of strong returns, in the expectation that this would continue.

Today, it is the exact opposite after three years of flat returns – investors prefer to hold cash, citing numerous factors, from the ANC elections to the weather, as reasons to stay in cash.

However, if truth be told, it is simply because cash has out-performed the market and investors expect this to continue.

In all, 116 years of real (inflation beating) returns from the JSE are simply overlooked, which brings me to my opening definition of a bias "not [being] logical or reasonable", "deviations from a standard of rationality or good judgment".

Switching out of the market and into cash is a classic recency bias story, from which we mere mortals suffer. Stand back and try to engage your rational brain before taking a decision, or else you will find yourself suffering from another behavioural financial bias called regret. – *www.markwilliams.co.za*