Behavioral biases can impede returns on your stock investments. Do you exhibit any these latent biases?

Individuals are often creatures of habit (i.e. lazy) or may let emotions affect their decision making. Below are seven of the most common behavioral bias, gleaned from personal experiences, general observations of fellow investors and stock forums.

01 **Anchoring Bias**

- What it is: May take several forms, such as a target buy price or a target sell price. It often occurs when an investor seeks to sell (buy) a stock only when it has reach a high (low) point reached in the recent past.
- How to tell: If you find yourself saying that you would not sell a stock until it reaches $X

(which could be based on either a broker's target price, the 52-week high or simply a nice round number), then you may be suffering from anchoring bias.

02**Loss Aversion Bias**

- What it is: Occurs when an investor is more affected by a loss than a gain of the same magnitude. A good example is an investor who is happy to take profit on a 10% profit, but reluctant to cut a loss at 10%. The result is often thus that the investor holds a stock that continues to fall well below 10%, in the hope that the stock would rebound, simply because he is not willing to convert the paper loss into an actual loss. {loadposition advert1}
- How to tell: You hold in your portfolio one or more stocks that have fallen by more than 50% but you still habour hopes of selling them for what you paid for. On the other hand, you have probably never held on to a stock that has risen more than 50%.

03**Confirmation Bias**

- What it is: Usually, an investor suffering from such a bias actively seeks information (however minor) that supports his past decision to purchase a stock, but yet conveniently discards any negative information that he might find.
- How to tell: To justify continued vesting in a stock, you regularly look up a company's announcements on new contract wins, but neglect any adverse outlook provided by the company's management.

04**Belief Perseverance Bias**

- What it is: Occurs when an investor continues to maintain an existing opinion about a stock, even when there are clear signs that the underlying fundamentals have changed.
- How to tell: You regularly wave off negative signals provided in earnings announcements (such as decreased margins over 2 or more quarters) as short-term blips, because you have trust in the company's past track record.

05**Naïve Diversification**

- What it is: Most simply put, this is diversification for the sake of diversification.
- How to tell: If you buy a stock simply because you do not have a similar stock in your portfolio and/or you hold more way than more 20 stocks in your personal portfolio, then you are likely guilty of naïve diversification.

06**Availability Bias**

- What it is: May either take the form of making “shortcut” judgments based on information that is easy to obtain or information that is most memorable. {loadposition advert1}
- How to tell: For example, if you find yourself relying on the P/NAV or P/E ratios (price over net asset value and price over earnings respectively) when selecting stocks because these ratios are easy to obtain, then you would have been guilty of availability bias. Even though P/NAV and P/E are useful indicators of stock value, they should be used with other indicators that may not be as readily available.

07**Hindsight Bias**

- What it is: This occurs when for instance an investor perceives that an actual performance of a stock is as expected (even when this really wasn't foreseeable when a stock was purchased).
- How to tell: If you are vested in stock that has fallen sharply in price, but console yourself that this is what you have expected all along. Alternatively (but less common), a stock you bought has risen sharply and you have no difficulty in finding "success factors" for the stock

Mitigating Effects of Behavioral Biases and Conclusion

Of course, the above is not an exhaustive list of behavioral biases, but should cover more than 90% of investment decisions faced by most private investors.{loadposition advert1}

Behavioral biases are inherently difficult to address, as could be expected when it comes to critiquing your own performance. This is why sometimes even the most successful fund managers prefer to let a third party manage their personal portfolios.

Besides removing oneself from decision making in investments, one of the best ways to conduct self-discovery of your biases is still to regularly ask if you exhibit any of the above traits when evaluating an investment decision. In other words, would you have made a different investment decision if the portfolio concerned belongs to someone else?

If this is not possible, it might just be best to seek a second opinion from time to time from an objective person you can trust. After all, acknowledging that you suffer from behavioral bias (as we all do), is already winning half the battle.

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