

THE HARBOR OAK GROUP AT MORGAN STANLEY

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Confirmation Bias & Market Expectations

Mark Twain said it best, “It ain’t what you don’t know that gets you into trouble. It’s what you know for sure that just ain’t so.”

Confirmation bias is the tendency for humans to search for or interpret information in a way that confirms one’s preconceived beliefs or opinions. Unfortunately in today’s world, this problem has only been exacerbated since the advent of the internet and social media. If someone actually believes the moon landing in 1969 was filmed in a studio in Los Angeles then guess what ... there are plenty of articles on the internet confirming this outrageous hypothesis.

More realistically, if one believes that eating meat is unhealthy then there are plenty of sources that will confirm this vegetarian opinion. Conversely, there are just as many articles that will confirm that eating meat in moderation is actually healthier than being a vegetarian or vegan.

The problem is that we tend to avoid or ignore disconfirming information and focus only on the information that conforms to our existing opinions and beliefs. In addition, we tend to believe that our opinions and beliefs are the result of years of rational, objective analysis when in reality; our opinions are the result of years of paying attention to information which confirmed what we believed while ignoring information which challenged our preconceived notions.

Unfortunately in the world of investing, confirmation bias is something we all have to deal with on a daily basis. Whether you have a bullish or bearish view on the market or a particular investment; there are endless amounts of information that will certainly confirm that view. The key is to try and weigh ALL the evidence and constantly ask the questions such as what am I missing here or what is my biased opinion not allowing me to see?

In fact, famous hedge fund manager Paul Tudor Jones said he comes into his office every morning assuming every position or investment he owns is wrong and spends the first hour convincing himself he is right. Also sometimes the less we know the better as we don’t have a perceived opinion that clouds our judgement. For example, you could probably show my five year old a chart of the stock market over the past couple years and he’d say “Well it looks that line has been going up for a while and then it went the other way for a little bit but now it looks like it’s back on track; I guess that’s good, right?” That’s better than 90% of the market strategists on Wall Street.

In fact, there’s a market strategist with a major Wall Street firm that has been calling all year for a slowdown in the economy and a rolling bear market, even as the stock market reaches new all-time highs. The problem with making such a bold call is it clouds your judgement and creates major confirmation bias. Unfortunately, the ego only allows one to filter information that backs your original hypothesis and when that doesn’t work you sometimes need to bend the facts a bit.

In the end, if you allow your expectations to guide your search for information, you are nearly always bound to find what you’re expecting to find.



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Sources

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