



Investment Biases – Know Them to Tame Them

Whether we like it or not, we live in a biased world, and financial markets are no different. It has been proven over time that investors buy high and sell low, precisely because their cognitive and emotional biases prevent them from taking rational decisions.

It is fear and greed that takes markets through booms and busts — a roller-coaster that investors could mitigate by simply being aware of which are the most common investment biases and how to address them.

May 2022

- Concept
- Manifestation
- Consequence
- How to Overcome



COGNITIVE

These biases stem from our informational, computational or rational limitations. They may be overcome with information, advice, experience and education.



	Concept 	Manifestation 	Consequence 	How to overcome 
Conservatism →	Fail to adapt to new information.	React slowly to new data, ignore information that is complex to process. Stick to previous ideas.	May hold investment too long.	Look carefully at new information.
Confirmation →	Look for information that supports one's view; focus on the positive, ignore the negative.	Reject new information that provokes discomfort (cognitive dissonance).	May hold investment too long.	Seek out contrary views.
Representativeness →	Turning a single point / data / event into a wider trend.	A company may have positive earnings and an investor may conclude that the business has good momentum, when profits could have been driven by one-off events.	Wrong decisions: investors may also sell too soon following a corporate one-off negative blip, missing potential future gains.	Have a long-term view.
Illusion of Control →	Think you can control an outcome when you can't.	A person owning a large part of his/her corporate stock in his/her pension portfolio because they believe they can have an impact on the firm's future.	Asset concentration, failure to diversify.	Seek other people's opinions outside one's circle.
Hindsight →	Selective memory of past events / seeing events as more predictable than what they really are.	"I knew it all along"-mentality. Investors overestimate the rate at which they correctly predicted events.	Overconfidence in one's abilities.	Keep a record of pre-event predictions, not post-event.
Anchoring & Adjustment →	Anchoring one's views to a specific point.	Investors may be stuck on a price: If an investor buys at 15 and the price is 20, they are happy; but if the stock falls from 25 to 20, they are not, even if the gain would be the same.	Decisions are not taken based on rational investment logic.	Reference back to one's original goal or plan.
Mental Accounting →	Money is treated differently depending on how it is categorised.	People feel they can freely spend bonus money, but not wage income, when money is fungible (indivisible).	Portfolios may be structured in layers, with an overweight on income as people believe that income money can be spent; they are more reluctant to withdraw any money generated by capital gains, hence reducing capital-generating allocations.	See one's portfolio as a whole, focus on total return. This will also improve the variance/correlation profile of the portfolio.
Framing →	Decisions are affected by the order in which the question/data is framed.	People tend to choose the first option.	Fail to properly assess risk.	Ask whether the decision is based on whether it will generate a gain or a loss.
Availability →	Putting more emphasis on information that is readily available.	Favour the data/events that are easier to recall.	Portfolios may be undiversified; investors may overreact to market conditions or too much media attention. May lead to concentrated portfolios.	Keep a long-term mindset.

EMOTIONAL ▶

These biases are more deeply ingrained in our minds than cognitive ones, and therefore more difficult to eradicate. Simple awareness may be the best way to mitigate their effects.



	Concept 	Manifestation 	Consequence 	How to Overcome 
Loss Aversion →	People usually get more pain from a loss than pleasure from a gain.	People may take risks to avoid losses, but are conservative in terms of gains. It usually takes a gain of \$20 to offset the pain of losing \$10.	We may hold on to losing investments because it is too painful to realise the loss, but may sell winners too quickly as we don't mind taking a small profit, forgoing potential upside.	Focus on investment prospects, not perceived gains or losses.
Overconfidence →	Overestimate one's capacity.	Believing we know and/or are more experienced / wiser than others, or just more than what we really do / are.	Underestimate uncertainty and overestimate return. Under-diversify. Excessive turnover and transaction costs.	Have a better review process.
Self-control →	Lack of self-discipline, favour short-term, immediate gratification gains rather than long-term goals.	Incapacity to save or invest in a disciplinary manner.	Insufficient savings for retirement; too much risk in the portfolio, too much emphasis on income.	Establish a plan and a budget.
Status-quo →	Unwillingness to make changes.	Focus on keeping what one has.	Holding portfolios with inappropriate levels of risk. Invest by inertia, losing out on new and better opportunities.	Seek education about other options.
Endowment →	Believing that the assets that we hold are better than what they really are.	Keeping assets for sentimental reasons, even if they are not sound investments. Common in situations of inheritance.	Holding on to assets at a high opportunity cost.	Ask oneself: would I buy this asset today?
Herding →	Doing what the others do.	Following market noise or friends' advice.	The loudest voices may not be the soundest. Many investors buy at the top of the market, only to see the price of their asset drop.	Ask whether the decision is taken based on fundamentals.



CQS (UK) LLP

4th Floor, One Strand, London WC2N 5HR, United Kingdom
T: +44 (0) 20 7201 6900 | F: +44 (0) 20 7201 1200

CQS (US), LLC

152 West 57th Street, 40th Floor, New York, NY 10019, US
T: +1 212 259 2900 | F: +1 212 259 2699

CQS (Hong Kong) Limited

1308 One Exchange Square, 8 Connaught Place, Central,
Hong Kong, China
T: +852 3920 8600 | F: +852 2521 3189

CQSClientService@cqsm.com

www.cqs.com

Important Information

This document has been issued by CQS (UK) LLP (FRN 400496) which is authorised and regulated by the UK Financial Conduct Authority and/or (as the case may be) CQS (US), LLC which is a registered investment adviser with the SEC. The information is intended solely for sophisticated investors who are (a) professional investors as defined in Article 4 of the European Directive 2011/61/EU or (b) accredited investors (within the meaning given to such term in Regulation D under the U.S. Securities Act of 1933, as amended) and qualified purchasers (within the meaning given to such term in Section 2(a)(51) of the U.S Investment Company Act 1940, as amended).

This document has been prepared for general information purposes. The information contained herein is not warranted as to completeness or accuracy and no representations are made in such respect, nor should it be deemed exhaustive information or advice on the subjects covered; as such, the information contained herein is not intended to be used or relied upon by any counterparty, investor or any other party. The information contained herein, as well as the views expressed herein by CQS professionals made as of the date of this document, is subject to change at any time without notice.

CQS uses information sourced from third-party vendors, such as statistical and other data, that are believed to be reliable. However, the accuracy of this data, which may also be used to calculate results or otherwise compile data that finds its way over time into CQS research data stored on its systems, is not guaranteed.

If such information is not accurate, some of the conclusions reached or statements made may be adversely affected. CQS bears no responsibility for your investment research and/or investment decisions and you should consult your own lawyer, accountant, tax adviser or other professional adviser before entering into any Transaction. CQS is not liable for any decisions made or action taken by you or others based on the contents of this document and neither CQS nor any of its directors, officers, employees or representatives (including affiliates) accept any liability whatsoever for any errors and/or omissions or for any direct, indirect, special, incidental or consequential loss, damages or expenses of any kind howsoever arising from the use of, or reliance on, any information contained herein.

This document is confidential and not intended for distribution to, or use by, the public or any person or entity in any jurisdiction where such use is prohibited by law or regulation. In accepting receipt of this information, you represent and warrant that you have not been solicited, directly or indirectly, by CQS and are receiving this information at your own request. It is your responsibility to inform yourself of and to observe all applicable laws and regulations of any relevant jurisdiction.

PRI Note: PRI is an investor initiative in partnership with UNEP Finance and the UN Global Compact.

Signatory of:

