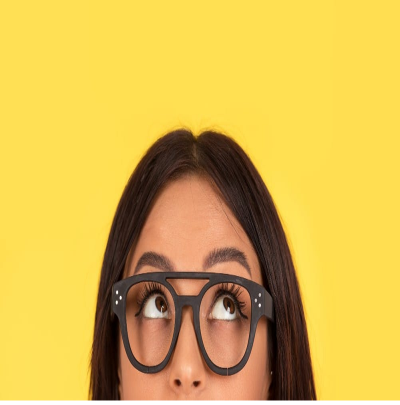

Beginner Investors: Avoid These 6 Cognitive Biases When Stock Picking

Description

The current market correction (or, arguably, bear market) has tested many investor's mettle and risk tolerance.

New investors who enjoyed the low interest rate environment bull market of the last few years were subject to nasty shocks, as growth stocks and the tech sector fell sharply. By overweighting their portfolios to these investments, many of these aforementioned investors displayed a set of investing biases.

An investing bias is an irrational preference that affects one's investment decisions and outcomes. We unconsciously know what we're doing isn't for the best, but, for one reason or another, we convince ourselves that it is the right thing to do.

Having an investing bias distorts our thinking and prevents us from making the kind of cool-headed, scientifically driven decisions that smart stock picking requires. Instead of making an objective, rational decision on facts and evidence, we act emotionally off distorted or illogical patterns of thinking.

Today, I'll go over six common biases new investors (including me at one point) typically have. Learning how to recognize and avoid them can boost your returns significantly.

Herding bias

Remember the **GameStop** and **AMC** short squeeze and how everyone piled in at the peak? Did you feel the same urge? If so, you experienced herding, or the urge to jump on the proverbial bandwagon and be "in" with the crowd. Just because everyone is in on it doesn't make it more likely to be right in the end. When it comes to the stock market, the majority can be on the losing side quite often.

Fear-of-missing-out bias

At its height, GME hit over $400 per share. Investors who bought at the peak are now nursing heavy losses, as the stock trades around $90 per share. These investors fell prey to the fear or missing out, or FOMO. FOMO can cause investors to buy into pump-and-dump scams or overvalued stocks that inevitably crash, leaving them with big losses.

Confirmation bias

Go to the subreddit for **Palantir Technologies**, which has fallen from roughly $26 per share to $7 per share and check out the due diligence (DD) posts there. See how few of them actually make a bear case for the stock as opposed to blindly parroting press releases and cherry-picking favourable metrics. This is an example of confirmation bias, where investors unconsciously seek out and give more credibility/weight to information that supports their investment and avoid information that could discredit it.

Overconfidence bias

Let’s use Reddit again. Head to the Ark Investors subreddit and scroll to posts two years back, where posters were proclaiming Cathie Woods to be “the next Warren Buffett” and crowing about how **ARK Innovation ETF** would run-up even more. Fast forward to today, where ARKK is now down 57% YTD. This is a prime example of overconfidence, which can lure investors into making risky, speculative bets detached from reality and fundamentals.

Recency bias

FANG stocks have done incredibly well over the last decade. So, it’s a no-brainer to just invest in those winners, right? A portfolio of FANG has historically beaten the S&P 500, so why would it be different now? This is an example of recency bias. We have a tendency to infer future outcomes from past performance and overweight their importance. However, there is no guarantee this trend will continue. Case in point, look at **Meta Platform’s** and **Netflix’s** share price crash after their recent lacklustre earnings reports.

Survivorship bias

Investors also have a tendency to focus on the investments that did well, as opposed to seeing the often larger group of failures; this is called survivorship bias. This can lead investors to eschew diversification to bet their portfolio on a small handful of stocks that have a higher-than-expected risk of failing. Case in point, a study found that while a handful of market-beating stocks outperform, the majority fail to beat risk-free Treasury bills.

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