



Behavioral Finance

- **Behavioral Finance:**
 - The study of behavioral economics allows us to understand the decisions we make.
 - Behavioral finance aims to influence and improve our financial decisions.
 - We are more sensitive to losses than gains and overly influenced by short-term considerations.
 - We seek to conform to group behavior and prevailing norms.
 - We overweight the importance of recent events.
 - We are poor at assessing risks and gauging probabilities.
 - We over-estimate our own abilities.
 - We focus on outcomes.
 - We are often persuaded by captivating stories.
- **Have a long-term investment plan. Automate your savings. Rebalance your portfolio. Don't check your portfolio too frequently. Don't make emotional decisions. Don't trade, invest.**
- Questions to ask:
 - What is the problem or issue?
 - What is our rational or optimal decision?
 - How do we actually behave?
 - What is causing this difference between what we should do and what we actually do?
 - How can we alter behavior to deliver better outcomes?
- Terms:
 - Save more tomorrow: individuals should build reserves that can provide an acceptable standard to living in retirement. To achieve this, they should start saving early. What's hurting us is our tendency to think that the present is more important than the future, and limits to our self-control.
 - Endowment Effect: our tendency to value things more highly when we own them.
 - Overconfidence: we overestimate our own performance level. We believe we are better than others. We believe we know the right answer.
 - Stories: stories are fundamental to how we understand the world. We use stories to try to explain and simplify the randomness of markets.
 - Noise: unconscious noise is irrelevant factors will influence our judgment and conscious noise is information that we believe is relevant, but actually should have no bearing on our judgments. To counteract the noise, have a systematic approach in place.
 - Bias: we can not rid ourselves of bias.

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- Solutions:
 - **Have a long-term investment plan.** Why am I investing? What is my time-horizon? Why have I chosen this particular portfolio/investment? Am I comfortable with the temporary losses that could result in difficult market conditions?
 - **Rebalance your portfolio.** A structured and consistent approach to rebalancing a portfolio back to target weights removes the need for human judgment.
 - If emotion is overwhelming your thinking, postpone the decision.
 - Time is your friend, impulse and urges are your enemies