Insights, Tacit Thought | Weekly Investment Insights

Recency Bias

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TACIT THOUGHT LIVE RECORDING

We held a client Webinar on 27th November, where our Chief Investment Officer, Raj Basra, covered the current economic and market environment and the rationale for the recent changes that we have made to portfolios as we head into 2024.

A recording of the event is available using the links below.

Part 1– About Tacit and our range of portfolios.

Part 2– Our Investment Approach.

Part 3 – Current Thinking & Positioning

Investors, just like everyone else, tend to focus more on what's happened recently rather than looking at the bigger picture. This tendency is known as recency bias, and it can affect the way people make decisions about their investments.

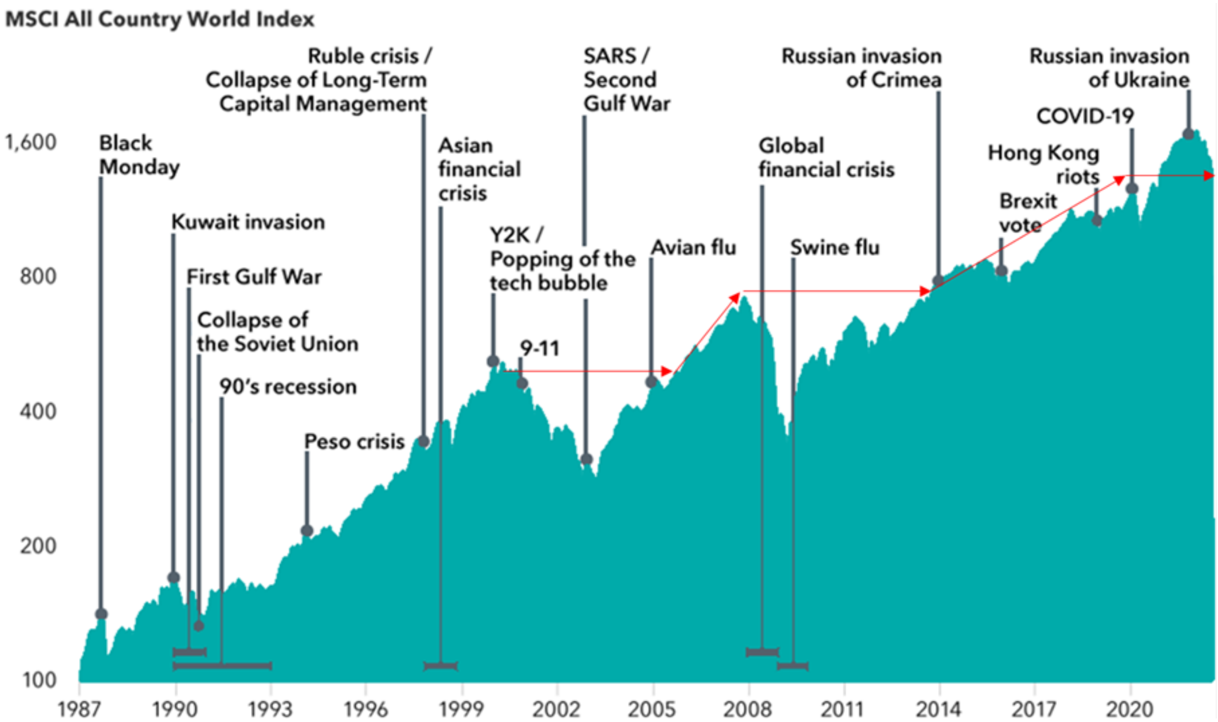
Think of it this way: imagine you have a favourite football team. If they've been winning their last few games, you might feel really confident that they'll keep winning. On the other hand, if they've been losing, you might start to doubt their abilities. This is an example of recency bias.

In the world of investing, recency bias means that people pay a lot of attention to what's been happening in the market recently. If the stock market has been going up for the past few months, investors might think it's going to keep going up and want to invest more. Similarly, if it's been going down, they might get worried and want to sell their investments. In reality, neither is a correct judgement.

So why does this happen? Well, our brains like to take shortcuts to make decisions quickly. Recent events are fresher in our minds, so we give them more importance. It's like remembering what you had for breakfast today but forgetting what you had a week ago – the recent memory is just more vivid.

The news also plays a big role. When you turn on the TV or scroll through news apps, they usually talk about what's happening right now. If the news is saying the stock market is doing great, investors might get excited and want to join in. But if the news is full of worries about a downturn, people might get scared and want to sell their investments.

This focus on the short term can lead to decisions that are not in your best interests for the longer run. Markets go up and down all the time, and what happens in the short term doesn't always reflect what will happen in the future. The chart below, which we have updated to illustrate how equity markets tend to move in phases, illustrates why recency bias is a human behavioural trait that must be controlled, especially during periods such as now when recent returns from equities have been poor and cash rates are higher than they have been.



To have a successful investment strategy, it's important to step back and look at the bigger picture. Instead of just thinking about what's happening right now, investors should consider the overall health of the economy, the strength of the companies they've invested in (be it company debt or company equity), and their own long-term goals. This way, they can make decisions that aren't swayed too much by the ups and downs of the recent past and thus manage any tendency to recency bias.