

AVOIDING DECISION TRAPS IN BUSINESS AND FINANCE

HOLISTIC

FINANCIAL ADVICE

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ENJOY THE FUTURE

Can we all be above average?

What is wrong with the following results from studies conducted in the U.S?

1. 80% of drivers say their driving skills are above average
2. 94 % of college professors rated themselves above average relative to their peers

Something is not right. We know that statistically speaking only half of us can be above the median in a given range of data.

Results such as these highlight that by and large people can be illogical. That's no surprise to anyone with teenage children, but I added the 2nd result to emphasise that very intelligent adults are also prone to fuzzy thinking.

So if these types of cognitive errors are not necessarily a function of IQ, what causes them, and what are the implications for how we make day to day decisions in our businesses?

Markets go up and they also go down. When we have long periods of gains in any market the talk/commentary comes to a pull back or correction. Pull back/correction is code for you will lose money.

1. Ancient Brains in a modern world

The field of Behavioural Finance gives us some clues by looking at how people's emotions affect investment decisions, and introduces the possibility of irrational behaviour occurring due to common psychological traits and mental mistakes.

A possible explanation behind this is that millions of years of evolution has hard wired our brains to make decisions based on pattern recognition, risk avoidance and quick broad generalities which are not always compatible with sound decision making in a complicated modern



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3. All about Awareness

The good news is we don't need to be gripped by fear and never commit to making a decision. Many times our reasoning powers, intuitions and experiences will serve us well. Much can be gained by simply remembering to consider these biases before making final significant decisions.

The fact is that humans are amazing at assimilating and acting on incredible amounts of information. The key is to keep an open mind and to act with some humility. When making decisions with large consequences seek extra information that disproves your own point of view. If it does not exist you can act with genuine confidence. Also try to get some impartial advice from someone a little removed from your situation. A fresh set of eyes (or a fresh brain) can make all the difference!

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world. After all, the business environments we operate in have only existed for a fraction of human history.

With this in mind it's no surprise our minds act to make illogical decisions from time to time.

2. Behavioural Biases

1. **Overconfidence Bias** - Overconfidence or Illusory Superiority (as indicated in above studies) can cause people to overestimate their knowledge, underestimate risks and exaggerate their ability to control events. This can spill over to decisions in all areas of life.
2. **Confirmation Bias** - Rather than base a decision on carefully collected facts and data, we often reach a conclusion first then gather evidence to support it. That's the wrong way around.
3. **Hindsight Bias** - Events often seem obvious after the fact, and it is very hard to imagine not knowing something once you know it. This can lead to individuals believing they have predictive powers leading to excessive risk taking.
4. **Anchoring** - Attaching significance to an arbitrary or no longer relevant starting point to base a decision. Think of how car salespeople start with a high price quote. We then judge any reductions relative to that price, regardless of how off the mark it might have been.
5. **Herding** - The tendency for individuals to be driven by the desire to be part of the crowd and simply do what those around us are doing without proper consideration.
6. **Fear of Change** - An excessive bias for the status quo even when strong evidence exists that a change is the best option.