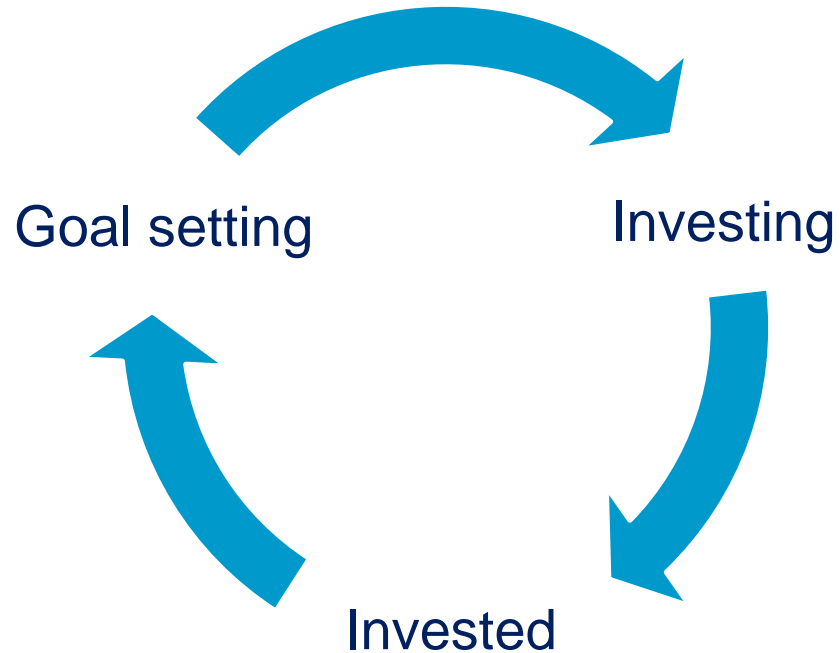


## CISI Event: Biases and investing

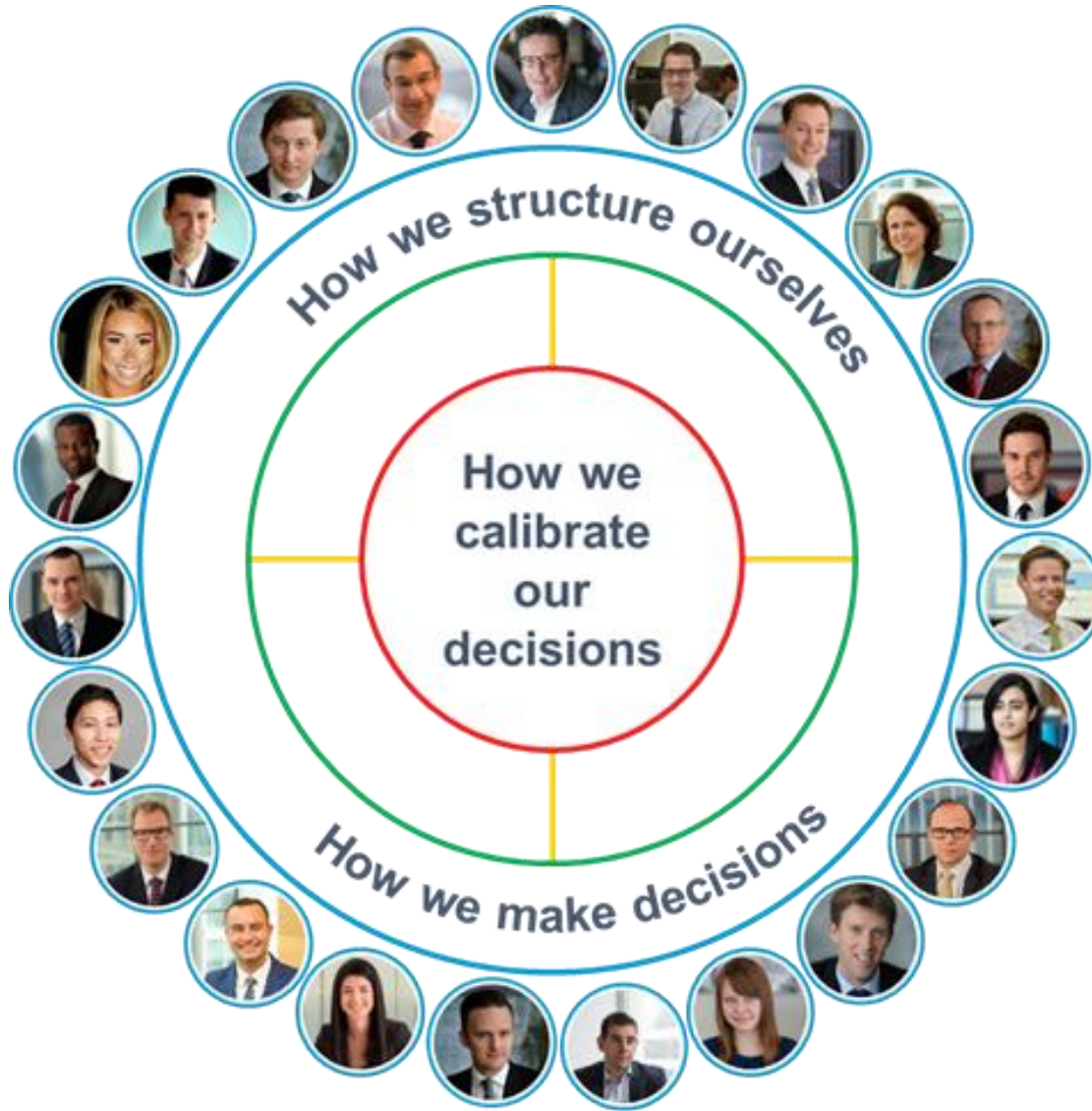
John Roe, Head of Multi-Asset Funds

# Biases can sneak in at all stages of investing



1. Short-cut keys to make decisions faster
2. Evolution takes 100,000+ years
3. Better suited to hunter-gathering than investing

## What do we do to control this?



# Goal setting



**Too little risk**

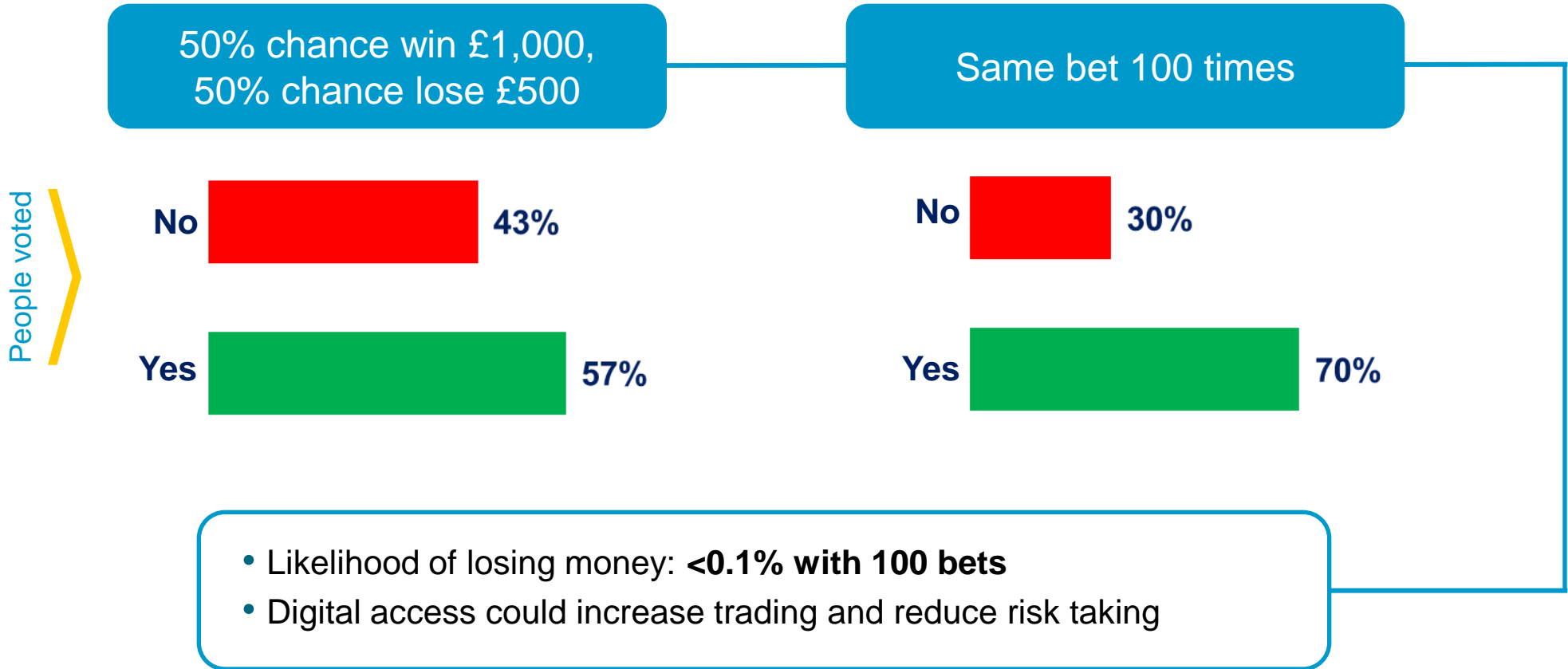


**Paths matter**



**Under the influence**

# 1. Too little risk – Myopic risk aversion (reckless prudence)



Be wary of making decisions in isolation, leading to too little risk taking



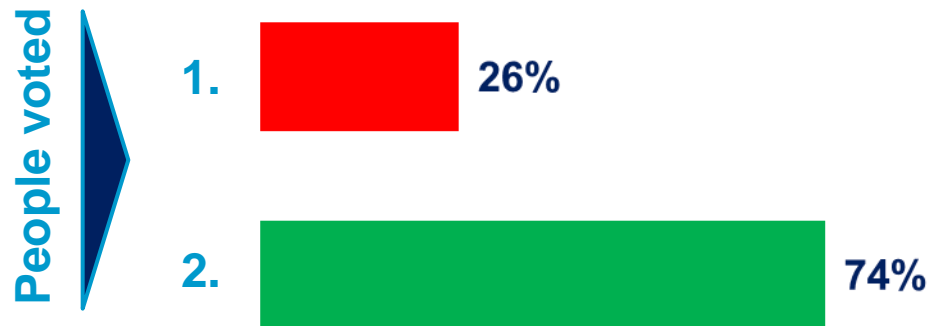
## 2. Paths matter – Prospect theory

**People evaluate decisions from their current states**

- So paths of investment returns matter

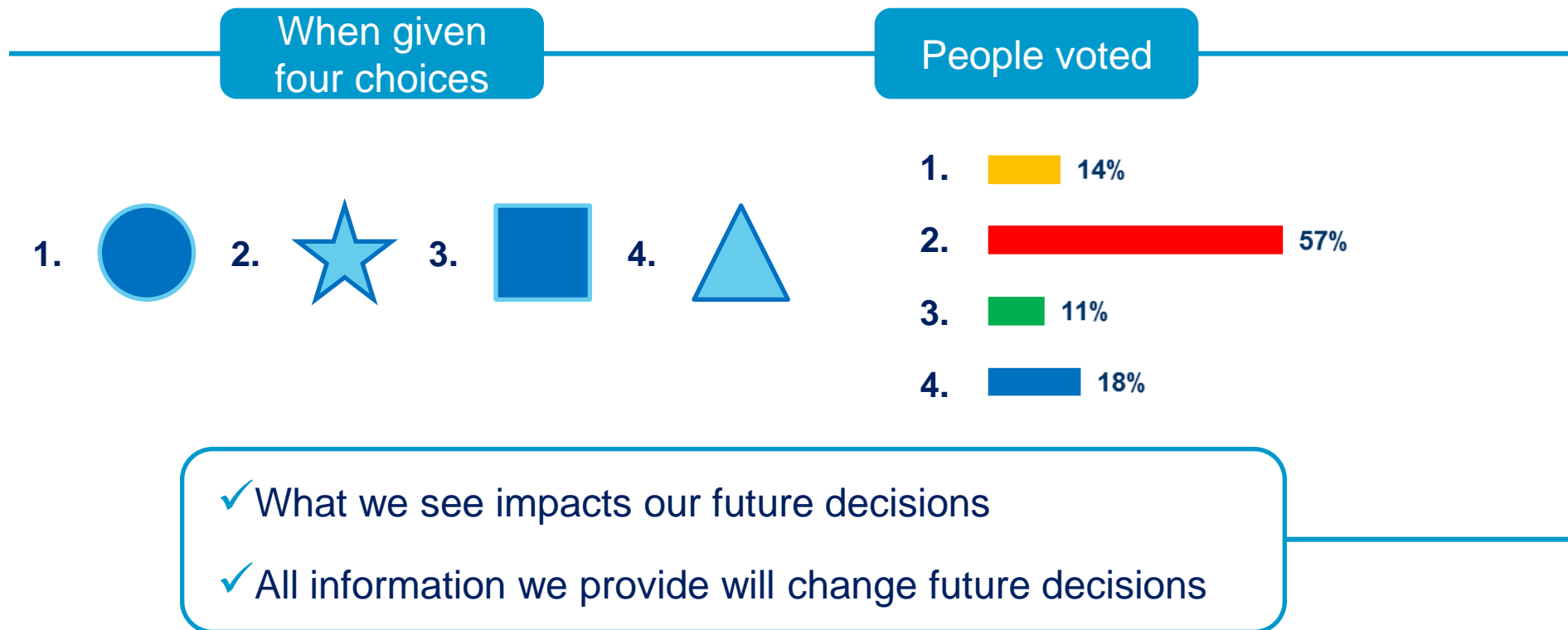
**Q:** *Which of the following is intuitively more appealing?*

1. Win £10m, then lose £9m
2. Win £1m



**Investors will accept lower outcomes for a smoother ride**

### 3. Under the influence - Framing



How information is presented impacts decisions investors make

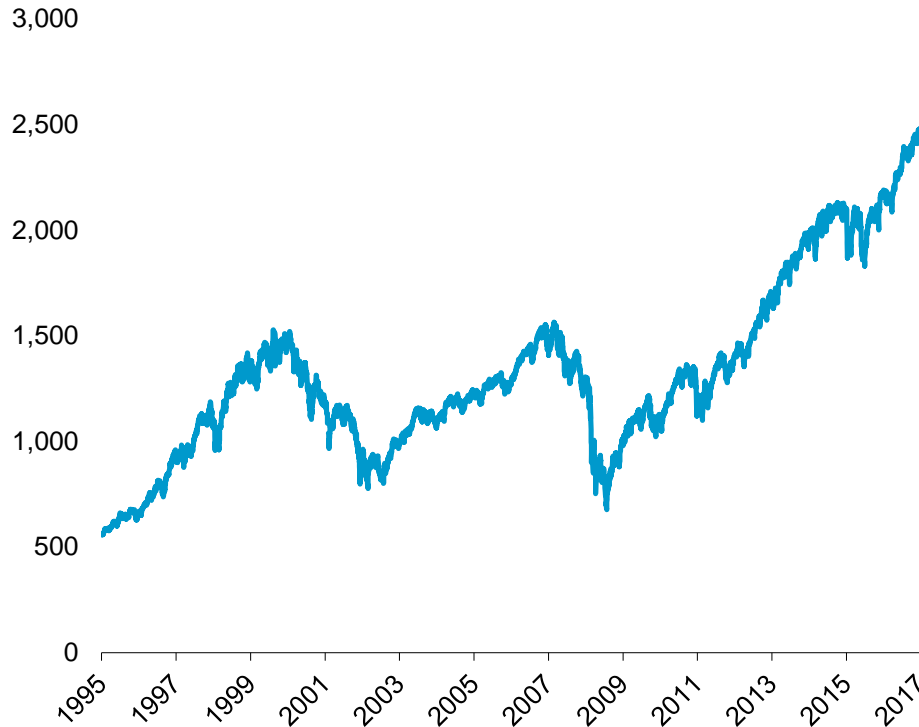
# Putting asset classes into competition

Relative valuation is important to help avoid framing

A

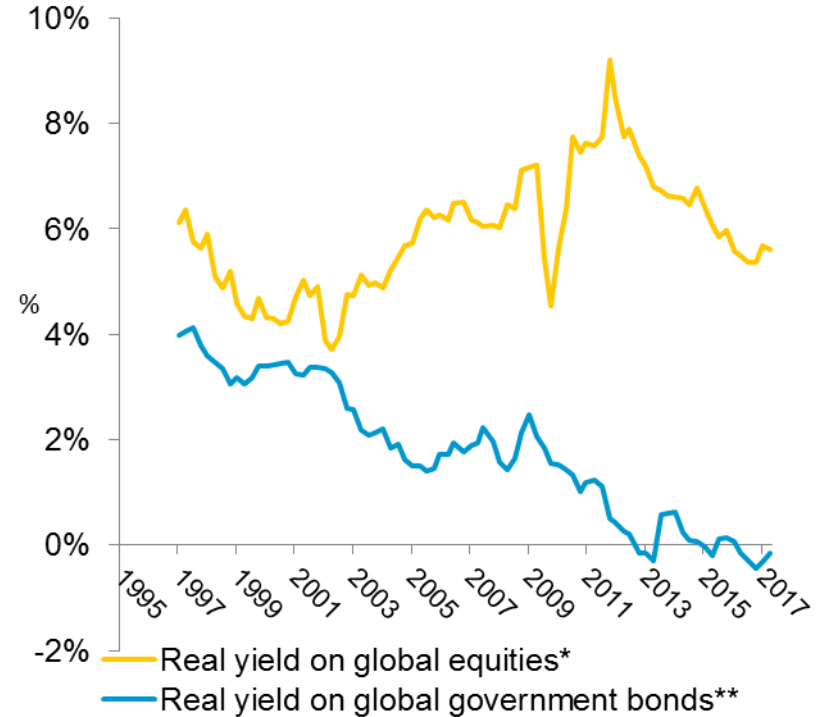
## Equity valuations

S&P 500



B

## Compared to bonds



\* Earnings before interest and taxes over enterprise value for MSCI World

\*\* Updated version of King & Low (2014) global real yield





**Gut feel**



**Anchored**



**Neglectful**

## We are influenced by what is in front of us

***“UK seeks Brexit legal disputes deals”***

***“Trump to expand US military intervention in Afghanistan”***

***Trump “I’ll close government” to build a wall***

***“EU is ‘confused and puzzled’ about UK’s post-Brexit trade plans”***

## 4. Gut feel – Recency effect

People extrapolate recent events into the future indefinitely

Survey Period	Net% FM OW Global Equities	Change From Previous Month	Performance of Global Equities Between Survey Periods
07/11/2014 13/11/2014	46%	12%	4%
05/12/2014 11/12/2014	52%	6%	2%
09/01/2015 15/01/2015	51%	-1%	1%
06/02/2015 12/02/2015	57%	6%	4%
06/03/2015 12/03/2015	58%	1%	1%
02/04/2015 09/04/2015	54%	-4%	1%
08/05/2015 14/05/2015	47%	-7%	0%
05/06/2015 11/06/2015	38%	-9%	-1%
02/07/2015 09/07/2015	42%	4%	-1%
07/08/2015 13/08/2015	41%	-1%	2%
04/09/2015 10/09/2015	17%	-24%	-8%
02/10/2015 08/10/2015	26%	9%	-1%

Everything we see, read or hear, unduly influences our decisions

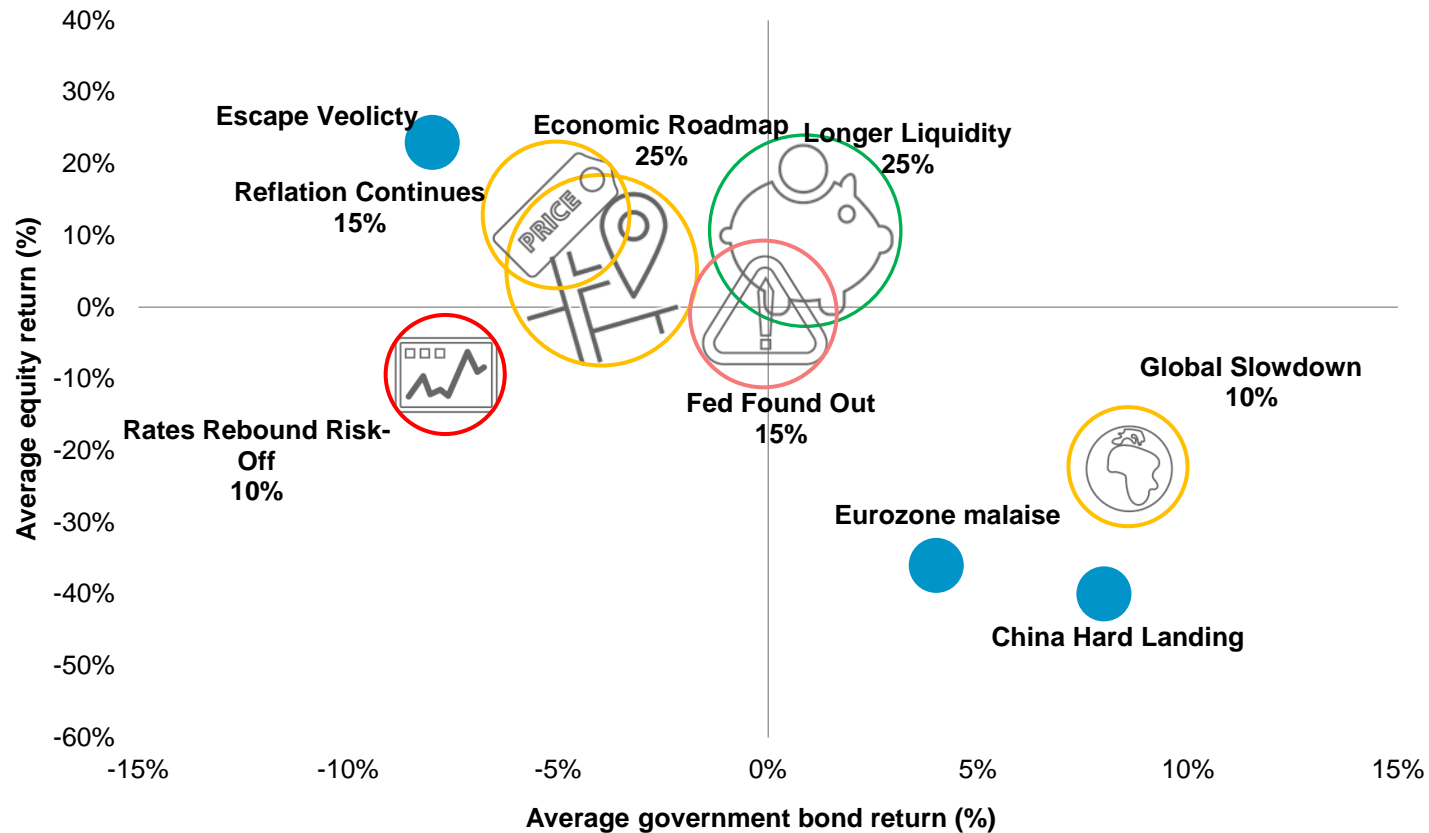
...which can lead to too much emphasis on one thing

### The Roadmap Central Scenario



We're not always as in control of our decisions as we believe we are

# Considering a wider range of possibilities

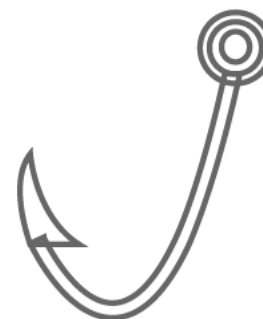
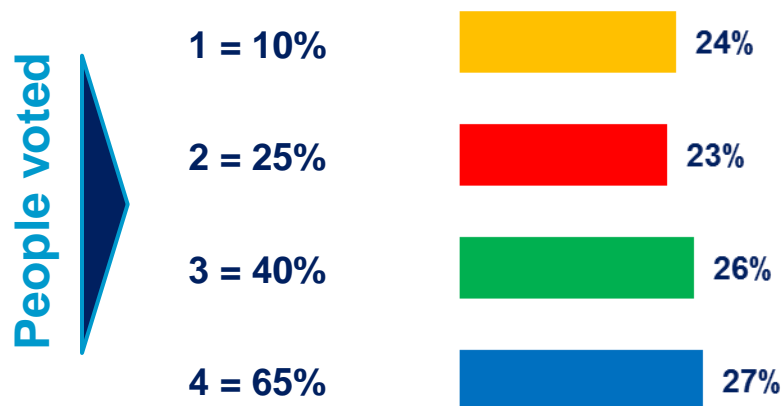


12 ...helps us avoid the availability bias

## 5. Anchored – anchoring and adjustment

**Q1:** Are more or less than 10% of African countries members of the United Nations?

**Q2:** What percentage of African countries are members of the United Nations?



**We tend to anchor first, and then never adjust enough**



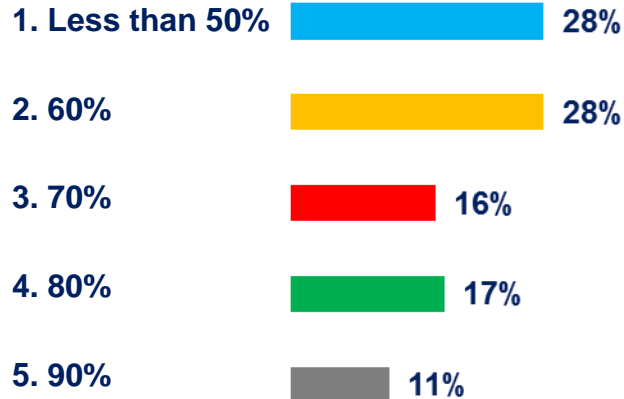
# How do we structure ourselves to avoid this?



## 6. Neglectful - base rate neglect

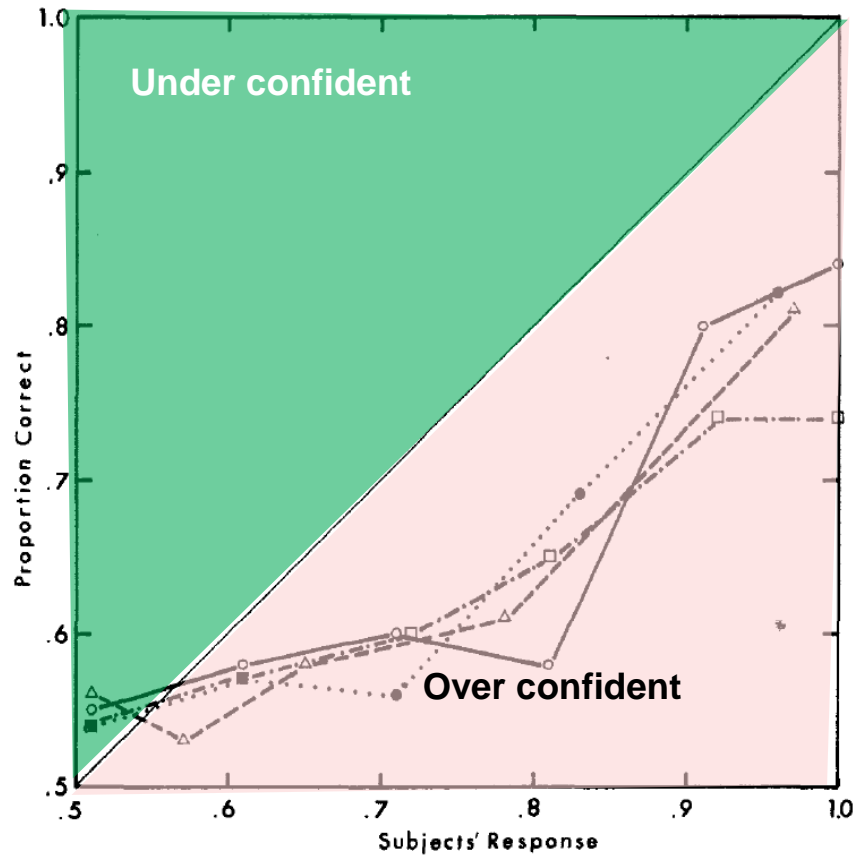
Based on the SPIVA report, the percentage of active European funds beaten by their benchmark ranged from 57% to 80% depending on the period<sup>1</sup>

**Q:** *What do you think your success at selecting active European equity managers is?*

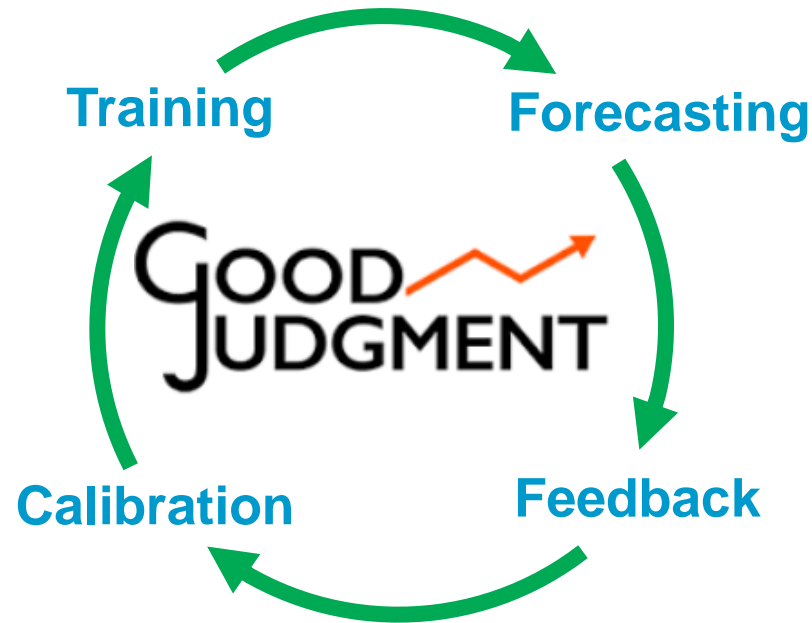


**Remember, you can't all beat the odds!**

## Miss-calibration is common, but dangerous



## Evaluation leads to innovation



Helping us hone our forecasting skills

# Variation is key

Key Risk Scenario Analysis team



**Independent** decision-making

**Discuss** differences in opinions, don't take average

**Rotate** 3 key inputters and lead input coordinator

**The lead** input coordinator rotates

# Stupidity of crowds



Discussion about  
**European credit markets**  
between experts from the  
asset allocation and active  
fixed income teams





**Single-minded**



**Attached**



**Egocentric**

## 7. Single-minded - confirmation bias

**Facts are then found to support our conclusion, while evidence to the contrary is ignored (c.90% of voters were unaffected)**

E.g. Additional information on African countries:



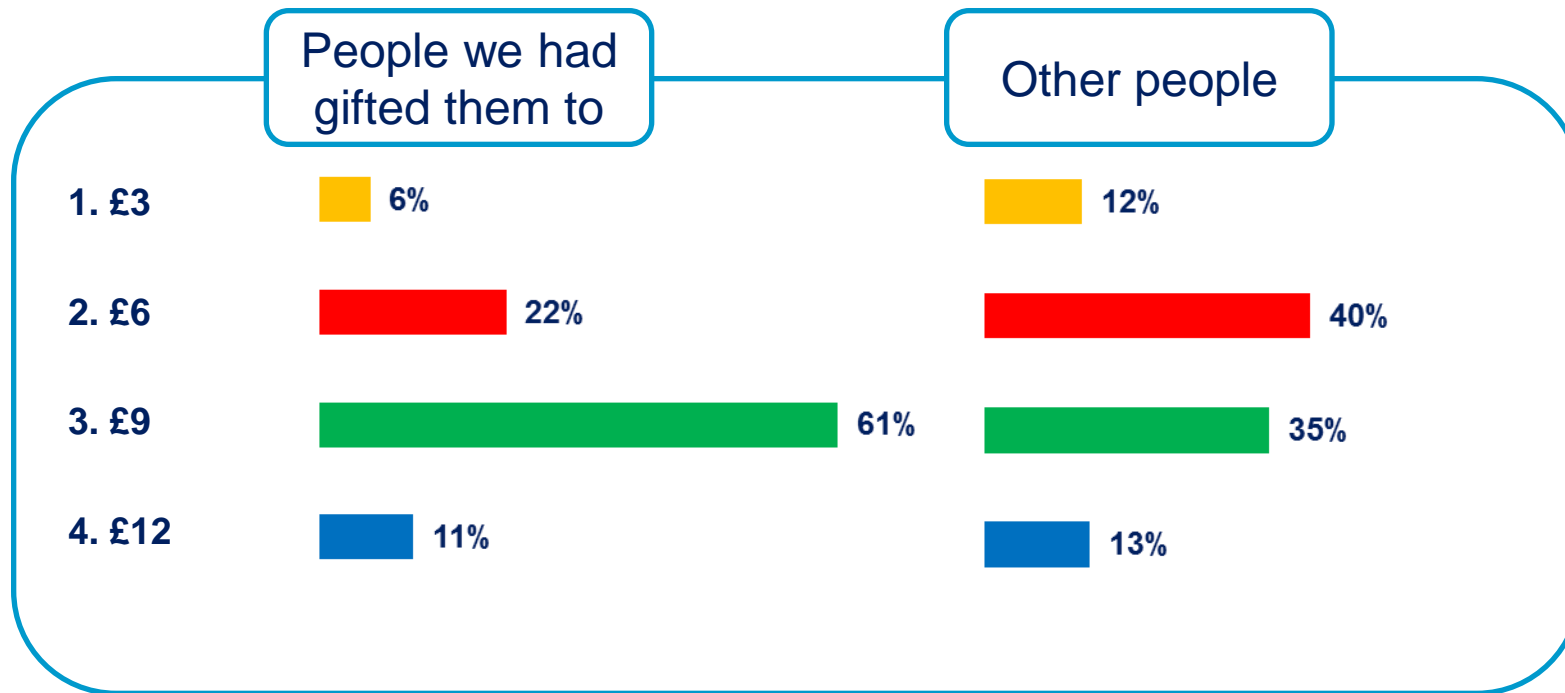
- Somalia and Sudan are in the bottom three countries globally for corruption. There are three long-running African wars that claimed over 1,000 lives each since 2014
- + Real GDP has more than doubled in 20 years and average years of school education more than doubled since 1975

**Are you making sure you're considering all the facts?**

## 8. Attached - endowment effect

### Owning something makes it more valuable to you

- We asked people to value a book:



Start with a blank piece of paper!

# Looking at the whole universe

Multi-Asset Scorecard	Macro and Fundamentals	Long-term factors	Tactical factors	Scenario Analysis	Tail risks	Overall score
Equities	●	●	●	●	●	●
Real estate	●	●	●	●	●	● ●
Duration	●	●	●	●	●	●
GBP	●	●	●	●	●	●
Credits	●	●	●	●	●	●
Inflation	●	● ●	●	●	●	● ●
Commodities	●	●	●	●	●	●

## 9. Egocentric bias

**There is a tendency to ascribe more responsibility to the things that you do**

**Q:** How impacted were you by the biases?

**1. Less than the average person**



**2. More than the average person**



- People will over-weight successes and their contributions to group outcomes

**Objectively consider everything and everyone that contributes to an outcome**

# Record trade rationales

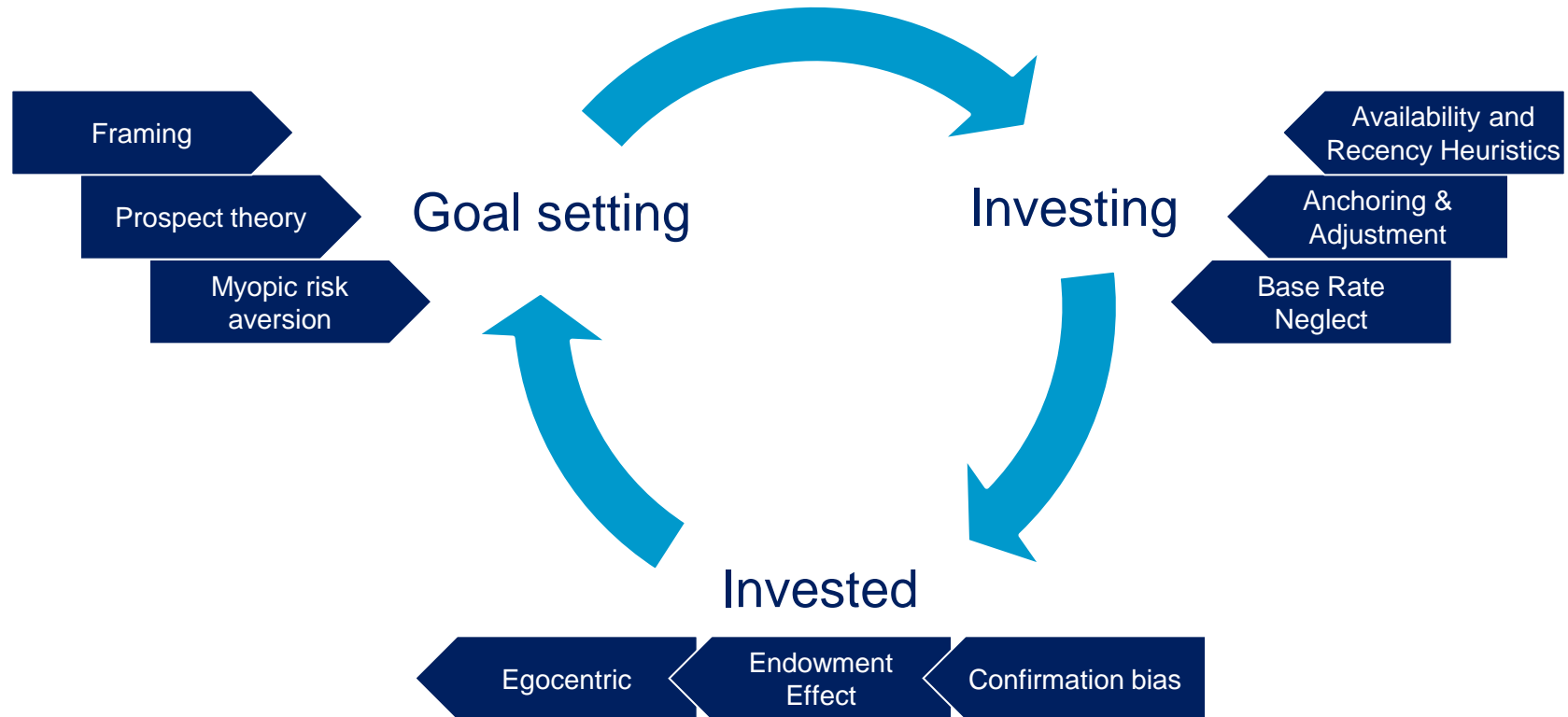
Long Russian ruble vs. commodities

- Why do we like it?
- What do market signals tell us?
- What do we expect next?
- What could go wrong?

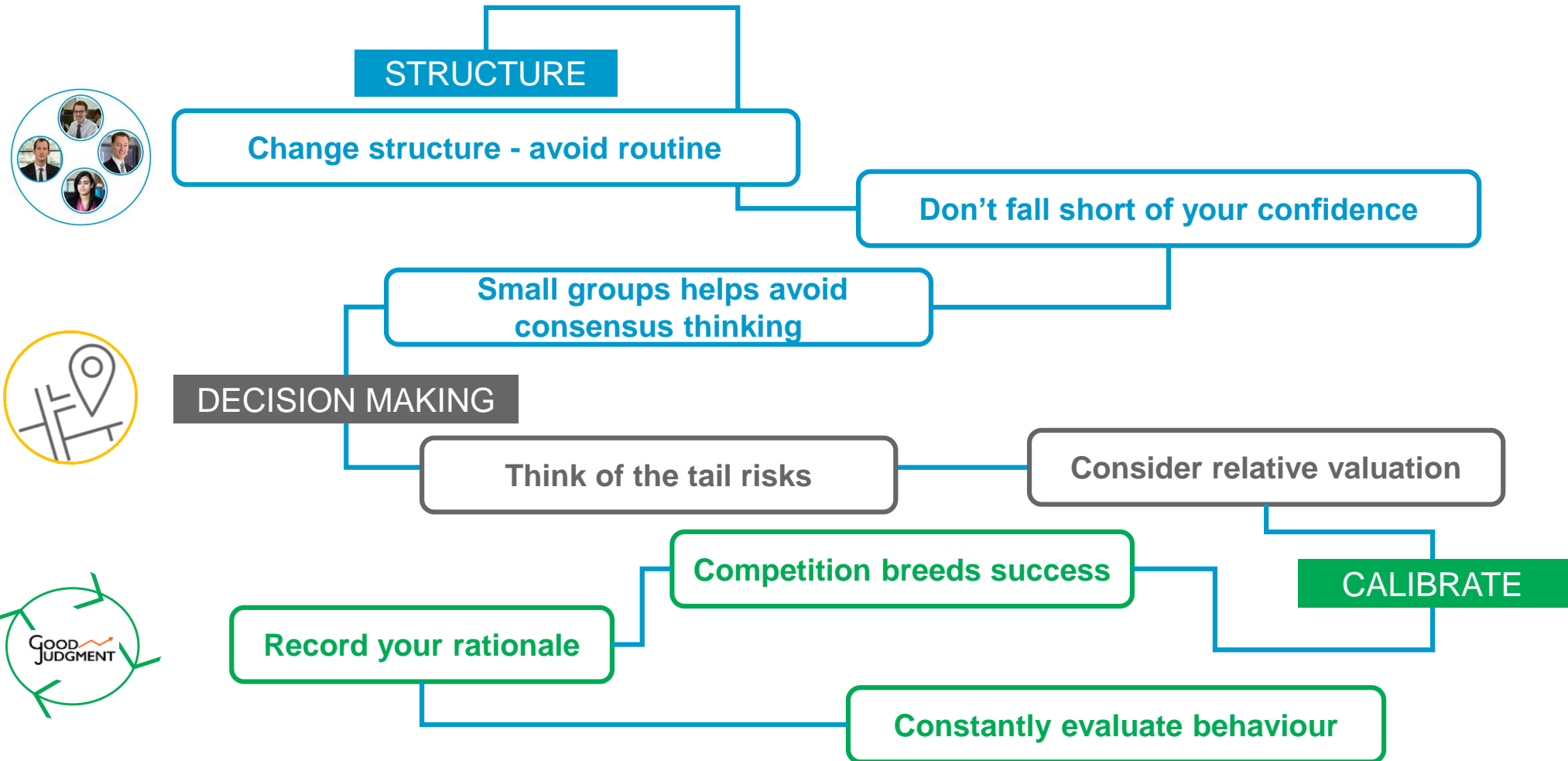




# Summary



# Lessons learned



# Legal & General Investment Management

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