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SEARCHING FOR CONFIRMATION

"Can you tell me which stocks to buy?"

Jumping in the deep end before you can swim investment questions aren't a new thing. People have always contacted us to ask questions that only prompt more questions. Ones they haven't considered. It's only natural that if your job involves money, someone will inevitably ask you about their stock or want a financial forecast. More and more, these questions have gravitated to the internet. A little anonymity means you don't have to feel embarrassed to ask a straightforward question.

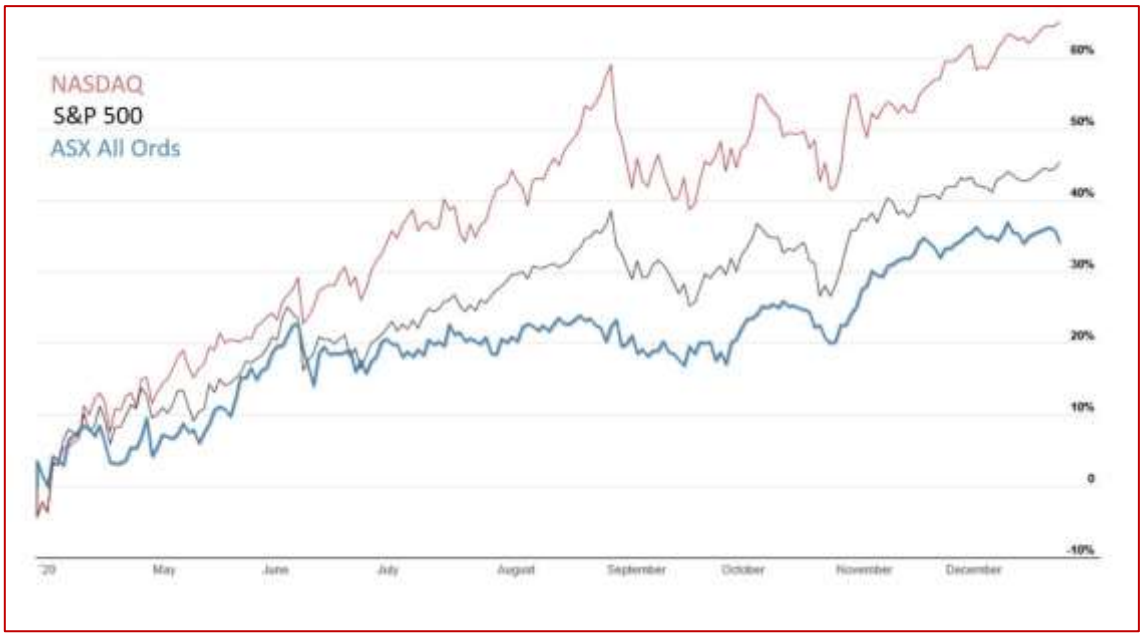
The more seasoned investors would always snigger, but we all have to start learning somewhere. Over the past year, these types of questions have become almost a staple around social media and investment forums. No longer are they as straight forward and innocent as they have been historically. They've become a little more ridiculous.

"Just bought this company, heard good things. Can anyone tell me more about it?"
"Looking for an ETF, which one should I buy?"
"Looking for a safe stock to put my house deposit in for a couple of years, any suggestions?"
As strange and alarming as these sound, variants of these types of questions are popping up across social media and investment forums. People are becoming more comfortable being cavalier with their money.

Why?

At their half year results in February, Commonwealth Bank reported 230,000 new broking or pocket app accounts were opened in the second half of 2020. If you were to add in signups across other broking platforms, it's no stretch to roughly estimate that more than 1% of Australia's population has decided to start investing, trading or gambling on financial markets for the first time during the second half of 2020.

When the extent of your investment experience is the chart below, minimum 30% returns from the moment you tuned into financial markets sometime in 2020, then you may have developed some unrealistic expectations. Worse, there have been some outsized rewards for ignorance. There's nothing wrong with being a lotto winner, but it's important to make the distinction between luck, skill and the prospect of future returns.



Back to the questions. Most of them are loaded, the people have already made a decision. They are searching for confirmation to take action or someone to pat them on the head and reassure them it's a good decision. They aren't looking for contradictory information that might drain the blood from their face. As the lyric goes, "a man hears what he wants to hear and disregards the rest".

This isn't just ours and Paul Simon's belief, in 2013 there was a study done on confirmation bias on stock message boards in South Korea. It asked how investors valued information found on message boards and how did that information shape their expectations. While stock message boards do offer the opportunity to pursue and consider varied opinions, investors with particularly strong opinions tend to seek out the information that confirms their existing beliefs.

Nearly 70% of message board users with a strong buy or sell opinion on a stock would gravitate to view the messages that aligned with their view. Only 19% would click to view a message that contrasted their beliefs and less than 12% would click to view a neutral message. For users who believed a stock was just buy or a sell (without a strong belief) the numbers were similar, with 63.5% of users clicking on a message aligning with that view and only 20% clicking on messages that contrasted their beliefs.

The other interesting finding from the study was the return gap. Basically, the difference between the expected return the investor had over the next month and their actual return. The average expected return by investors was 28.43%, which would be a healthy return for two years, let alone a month! However, the average actual return by those investors was -4.92%. Expectation and reality differ by a wide margin.

The authors found that seeking out preferred information tended to result in overconfidence which resulted in more trading and outlandish expectations about future returns.

This is quite a strong representation of confirmation bias, which is one of the big behavioural pitfalls in life and for investors. We would prefer not to hear information that doesn't align with our pre-existing beliefs and we deliberately seek out information that confirms what we already believe. It's a comfortable, but lazy state of affairs.

For investors, particularly new ones, a bucket of cold water upfront should be preferable to being dunked in the arctic when hopes and dreams fall apart. No one ever invests with the expectation they'll lose, but for inexperienced investors dabbling in individual stocks, that should be the expectation. A search for all conflicting information should be the mindset.

In our experience, we find that people are more sceptical after they've been punished. They or a family member did something crazy once, which results in a "I don't trust the stock market" mentality. This means accepting some hard truths about their prior gambling exploits and learning about the difference between speculating and investing.

Risks certainly exist when investing in broader market indices, widely diversified funds or building a portfolio spanning various asset classes, but in a sense an investor has the luxury of being lazy. They are placing their faith in capitalism and human progress, which have historically worked and offered positive outcomes. We should expect this state of affairs to continue long term or it will be more than our investing lives that will change!

If an investor is concentrating in sectors or stocks due to beliefs or hunches about the next big thing, then they don't have the luxury of excluding negative information. It is positive the past year has seen an increased interest in investing. It would be a shame if poor outcomes, due to taking shortcuts in high-risk areas, led to discouragement and a distrust of markets.