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Think Smarter, Not Faster

7 Steps to Better Decision Making Through Behavioral Finance

Cognitive biases are the enemy of good long-term strategic decisions. To mitigate or eliminate our cognitive biases, it is important for us to know them and plan ahead with a strategy to avoid sub-optimal decisions. The following checklist of 7 questions is designed to help slow down decision making and manage our biases.

1 Are the reasons that I want to take this action emotional or rational?

Every behavioral bias has deep roots in your emotions, so it is worth taking time to determine why you are experiencing the urge to act. Anchoring bias is a particularly pernicious example, as it tends to make you look backward when you should be looking to the future based on fresh information.

2 Do I have all the information I need to make this decision now?

Overconfidence and recency bias, both of which can result from something like a successful stock pick, can promote short cuts in decision making. Take the time to make sure you have fully thought through and analyzed an opportunity, focusing on only the most relevant information to make the best decision.

3 Have I carefully weighed the gains and losses that could result from this decision?

Just as overconfidence can lead to overlooking negative consequences, loss aversion bias can lead to impulse selling and inaction when an opportunity arises, potentially diminishing returns.

4 Is this decision based on a fundamental change in underlying factors?

Recency bias and the bandwagon effect can easily prompt a fear of missing out on an opportunity that seems to be making a lot of people rich. Take the time to study the fundamentals driving the ups well, however, because oftentimes a goldrush turns out to be a dangerous asset bubble.

5 What is the long-term outcome if I do not make this decision now?

An overreaction to market volatility can lead to a tendency to oversimplify—for example, trying to solve an immediate concern with a rash buy or sell decision. Remember what was important to you when you established your financial plan. Make sure every decision you make meets the long-term goals of that plan.

6 Is this decision consistent with the basic tenets that factored into the creation of my financial plan?

With memory bias, recent events can weigh more heavily on your decision making than more distant experiences. While financial plans should be flexible when they need to be, remember that the blueprint for the financial plan exists for a reason, and deviating from it can lead to negative consequences.

7 Is this decision something I want to incorporate into my plan going forward?

Every decision you make should be deliberate, and in line with the long-term vision for your portfolio. Hindsight bias may have you looking at past successes as if they were inevitable, but they weren't. They were smart decisions you made when the future was uncertain. Be sure to bring to the fore the process that led to good decisions and bring in all relevant information to your next decision to seek a positive outcome.

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