RBC Global Asset Management

Insights

RBC Portfolio Solutions

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Inside the mind of an investor

The human brain uses shortcuts and patterns to process information and make decisions quickly. This can be effective when learning a new language, picking up a new skill or making dinner plans. But it can lead to behavioural biases that can cause us to think and act in curious ways. Particularly when it comes to investing.

This quarter we explore five common investor biases and how they can influence investment decisions.

98% of investors exhibit at least one behavioural bias.[1]

How investor psychology can impact investment decisions

Biases can shape many of the investment decisions an investor makes. If left unchecked, these biases can lead to deviations from long-term plans – particularly when markets are moving dramatically.

An investor's thoughts during Feb-June 2020 market swings[2]

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[1]Source: Morningstar report: Who's Influenced by behavioural biases? Everyone.

[2]Source: S&P 500 prices as of daily close February-July 2020. An investment cannot be made directly into an index. The graph does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results.

Understanding investor bias

Research shows that most people exhibit some bias in their investment decisions. Knowing about these biases and understanding their influence on investor behaviour is key towards curbing their impact on your portfolio.

In this issue, we explore five common investor biases and how they affect investors.

A number of investors exhibit these five common biases.[3]

Anchoring: 23%

Loss aversion: 30%

Recency: 35%

Familiarity: 27%

Confirmation: 24%

Anchoring

What it is:

Fixating on a specific reference point, like the price paid for an investment or market index level, and basing decisions around that one number.

How it affects investors:

Can cause investors to overvalue, or undervalue, asset prices or market performance based on an arbitrary number drawn from past experience.

Guidance

Follow a disciplined investment process no matter where markets are headed.

Loss aversion

What it is:

Feeling losses much more intensely than feeling the reward from an equivalent gain.

How it affects investors:

By prioritizing the avoidance of short-term losses over long-term gains, investors may put the success of their long-term goals in jeopardy.

Guidance

Stay focused on long-term financial goals.

Recency

What it is:

Placing too much emphasis on experiences that are freshest in one's memory — even if they're not the most relevant or reliable.

How it affects investors:

Believing that short-term trends will continue into the future may lead investors to ignore new information and be slow to react to changes in investment markets.

Guidance

Tune out short-term market noise and focus on the bigger, long-term picture.

Familiarity

What it is:

Preferring to invest in what is familiar – especially from domestic markets. For instance, the average Canadian has 92% of their wealth in Canada.[4]

How it affects investors:

Leads to concentrated portfolios that hold only the most familiar investments. This can increase portfolio risk and lead to a bumpier investment experience.

Guidance

Invest globally to increase diversification and reduce risk.

Confirmation

What it is:

Seeking, or accepting, only information that supports what one already believes.

How it affects investors:

By ignoring information that doesn't support one's decisions, an investor can form unrealistic expectations that can lead to portfolio concentration and increased risk.

Guidance

Ask big picture questions and develop a more holistic view.

How your investment in RBC Portfolio Solutions can help

At RBC Global Asset Management, we believe investment success comes from following a disciplined and well-diversified strategy every day. As an investor in RBC Portfolio Solutions, you benefit from the daily insight and expertise of over 350+ investment professionals globally. Our disciplined approach to managing and rebalancing portfolios is designed to help ensure that you remain well-positioned and on track towards meeting your financial goals.

[3] Charles Schwab: The Evolving Role of Behavioral Finance in 2020.

[4] Source: Investor Economics: Household Balance Sheet Report - Canada, 2021.

Portfolio manager viewpoint

Sarah Riopelle, CFA , Vice President & Senior Portfolio Manager, Investment Solutions

Economies are being challenged by the rapid spread of the delta variant as well as the eventual withdrawal of tremendous fiscal and monetary stimulus. Reflecting these factors, we have dialed down our global growth forecasts for 2022, but they remain quite good by historical standards. Bond yields fell significantly in the past quarter with the economy moderating and central banks remaining accommodative. In our view, yields are likely to move higher as normal conditions are eventually restored, resulting in slightly negative returns for sovereign bonds. Stocks continue to offer better upside, and rising profits propelled global equities to new records. Although valuations are demanding, we think stocks can still deliver modest returns in the current environment.

Markets this quarter[5]

-0.5%

Canadian fixed income

FTSE Canada Universal Bond Index

0.0%

Global fixed income

FTSE World Government Bond Index (CAD hedged)

0.2%

Canadian equities

S&P/TSX Composite Index

2.8%

U.S. equities

S&P 500 Index

1.9%

International equities

MSCI EAFE Index

-5.9%

Emerging market equities

MSCI Emerging Markets Index

For the complete Fall 2021 Global Investment Outlook, please visit rbcgam.com/gio

[5]All returns are in C$ except where indicated. Canadian, U.S., International and Emerging Markets index returns are total returns. An investment cannot be made directly into an index. The above does not reflect transaction costs, investment management fees or taxes. If such costs and fees were reflected, returns would be lower. Past performance is not a guarantee of future results.

We thank you for your ongoing trust in continuing to hold RBC Portfolio Solutions as part of your investment plan. If you have any questions or comments, please contact us or your advisor.

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