



Sometimes we are our own worst enemy

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Agenda

- Understanding the basics of behavioural economics
 - Framing & Prospect theory
 - Mental accounting
 - Paradox of choice
- Common behavioural biases and how to overcome them

Theory vs reality relating to consumer choice

Economic theory: We will make rational decisions that will maximise utility.



The reality: Behavioural economists have shown we behave in predictably **irrational** ways.



WHY?

Why doesn't human behaviour perfectly align with economic theory?

- We find complex decision making hard
- Self control can be difficult, our emotions can get in the way
- We feel the pain of a loss twice as much as the pleasure from a gain
- How options are framed can influence our decisions
- We rely on short cuts to help us make decisions

Decision Making and Framing

Theory: Decision making should not be affected by the way alternatives presented.

Reality: this is the most violated axiom! We are **STRONGLY** influenced by how options are presented to us

The Importance of Framing: The Way a Situation is Presented to Us Influences the Conclusions We Draw



90% chance of survival or 10% chance of mortality?



4% full fat or 96% fat free?

The Importance of Framing: We can be influenced subconsciously



French wine in countryside



Traditional German band

Decision making: simplifying the complex

Economic Theory: People see money as fungible

Reality: People treat money differently depending on;

- 1. Origin of the money
- 2. Intended use of the money (utility)

Mental Accounting: separate buckets to simplify the complex



Relative value

Transaction utility

Opportunity costs

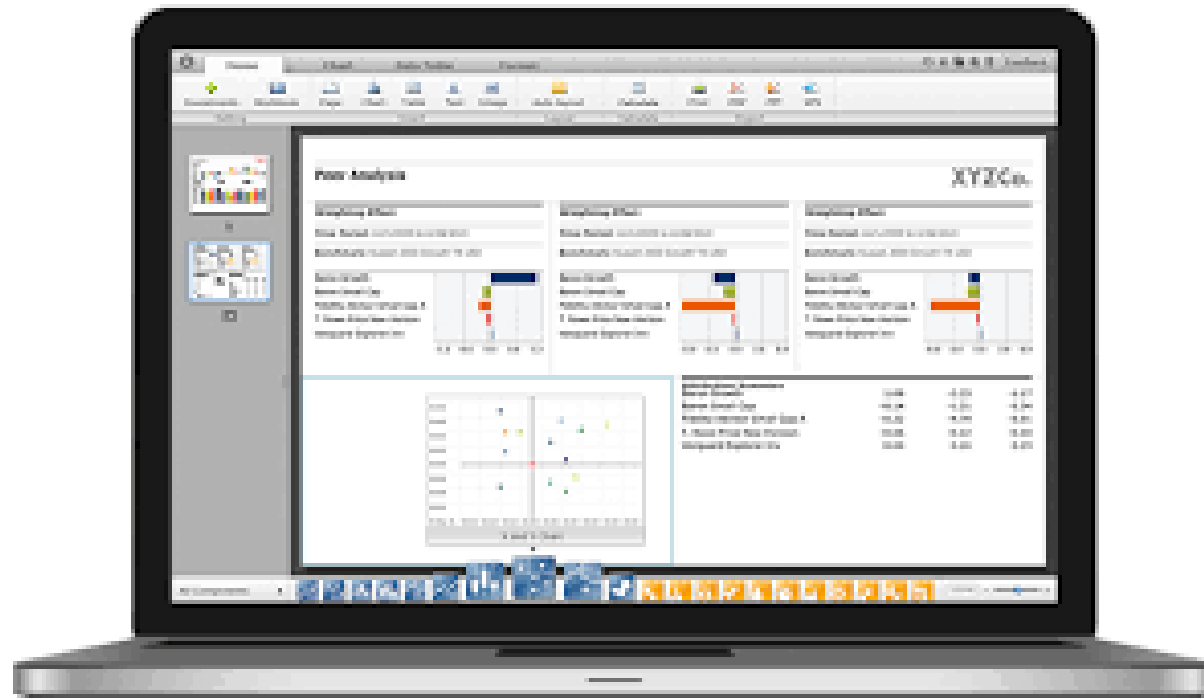
Transaction decoupling

Budgeted expense?

Weber Fechner law

Source: <https://faculty.chicagobooth.edu/Richard.Thaler/assets/files/MentalAccounting.pdf>

Paradox of Choice: Too many choices, less likely to make a decision.



- 3,632 superannuation strategies
- 2,399 pension and annuity strategies

Source: Morningstar Direct

Behavioural Biases

Behavioral biases are shortcuts our minds use to avoid spending extra time and mental energy on a decision.

They are often the cause of **seemingly irrational behaviour.**

Past Performance Can Mislead Us: Recency Bias



We Follow the Crowd: Herding



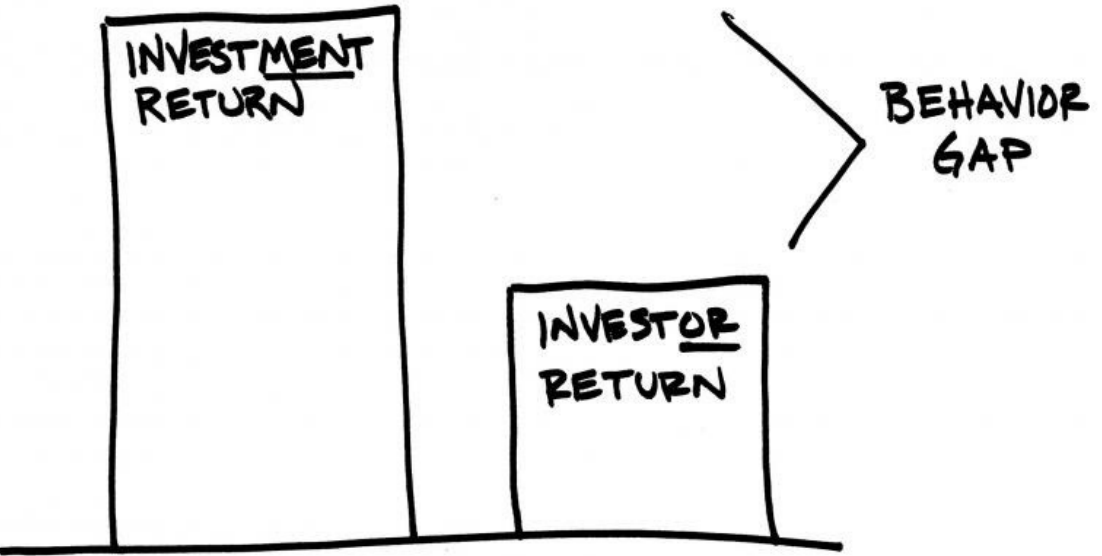
Confirmation bias: we seek out evidence that backs up our point of view



Action bias: to do something is better than doing nothing at all



Understanding Behavioural Biases Can Help You make Better Decisions



BEHAVIOR | GAP

Control what you can

You can't control investment markets', but you can control **your behaviour**.

- How much you save
- How much you spend
- Your investment plan
- Your asset allocation / where you invest
- How much risk you want to take
- Your investment time horizon

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