

PERSPECTIVES

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Behavioral finance

Avoid confirmation bias – be open to contrary evidence

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What do the following all have in common? Wishful thinking, first impressions, radical talk-show hosts and poor investment decisions.

They're all related to a strong psychological tendency called *confirmation bias*.

In this issue, I'd like to examine confirmation bias – and how important it is not to reject evidence that goes against our beliefs.

Confirmation bias has been studied extensively for over 50 years. One expert thinks this natural human bias, "by itself, might account for a significant fraction of the disputes, altercations, and misunderstandings that occur among individuals, groups, and nations."

Confirmation bias is our tendency to search for, interpret or remember information in a way that confirms our preconceptions.

Consider this puzzle. Four cards are set out on a table. We're told that each card has a letter on one side and a number on the other. The four cards we see have A, C, 2 and 3 facing up. We are also told that all cards with vowels have even numbers on the other side. Which cards would we need to turn over to prove that statement true?

Most of us would choose A and 2. These seem consistent with the statement about vowels and even numbers. But turning over the 2 won't help prove the case! If a vowel were on the other side of the 2, it would be consistent with the statement. However, if a consonant were on the other side, it would not disprove the statement – because *the statement said nothing about what's on the other side of a consonant*.

We can best solve the puzzle by trying to disprove the statement. To do that, turn over the A and the 3. A vowel on the other side of the 3 would immediately disprove the statement.

Our puzzle shows that, when asked to test a theory, we have a natural tendency to look for information that confirms rather than disproves it.

All of us have difficulty holding conflicting ideas at the same time. This difficulty is known as *cognitive dissonance*. If we believe something to be true, we have a strong tendency to seek and remember information that supports our belief – and to ignore or forget information that argues against it.

When we first meet someone, we tend to quickly form an opinion about them. After that, we filter additional information based on our first impression, favouring only what supports that impression. The saying "first impressions are lasting" is based on this human tendency.

We also tend to subscribe to publications, tune into TV or radio shows and do Internet searches that support our beliefs. In the United States, how many Democrats listen to Rush Limbaugh or watch Fox News? How many Republicans watch Jon Stewart or Stephen Colbert or any MSNBC host?

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Confirmation bias affects many areas of our lives, including investing. It causes us to be overconfident, and to make mistakes in our decisions. Confirmation bias is something we should be on guard against in ourselves – and in those we rely on.

It's a good ideal to practise keeping an open mind and searching for information counter to our views. It might be uncomfortable, but it can help us see the world more clearly and prevent us from making mistakes. ■



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