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Behavioral Finance

THE RESTRAINT BIAS: HOW MUCH CONTROL DO YOU REALLY HAVE?

By Stan Clark, Senior Wealth Advisor

In an episode of the classic TV show *Seinfeld*, Jerry follows George's hot stock tip and buys some shares. George tells Jerry to be patient. The ever-confident Jerry is sure he can.

But the stock is slow to develop. Jerry starts obsessively reading the daily stock market reports, wincing every time he sees the stock drop another point or two. (If it were today, he would be checking online every few minutes!) Finally, in a panic, Jerry sells – losing more than half his money. A day or two later, George reports that the stock is soaring.

In this article I'd like to discuss the *restraint bias*, that is, the bias that leads us to over-estimate our ability to withstand temptation. In looking at this bias, we'll consider just how much control we really have over our urges.

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Clearly, Jerry should have restrained his urge to sell. Perhaps that's not a perfect example of restraint bias, but it comes close. As you may recall from reading previous issues of *Perspectives*, we humans have a number of ingrained psychological biases. These biases all lead to patterns of poor judgment. They can profoundly affect the way we behave in the stock market and in other areas of our lives, too.

The restraint bias is one of the key behaviours that makes it so hard for people to quit smoking, to stop over-drinking (or any other addiction), to lose weight – in short, to avoid any number of harmful habits.

People trying to lose weight are sure they can restrain themselves. They continue buying favourite snack foods, such as ice cream, thinking, "I'll just have one spoonful every now and then." Smokers may keep a few cigarettes on hand just in case, so they rationalize, something stressful happens. Or, they continue to engage in behaviours closely associated with smoking, like going out for drinks with friends.

Then there's the person who needs to get out and exercise. They intend to, sure. But first they switch on the hockey game for a few minutes "just to check the score" – only to end up sitting in front of the TV for the rest of the day.

The tell-tale snacks

In one study, researchers asked students both arriving at and leaving a cafeteria to rate a number of snacks, from least desirable to most. They then asked the students to select one of the snacks but not to eat it. The researchers told the students that if they brought the snack back in two weeks, they would receive a desirable reward.

Hungry students entering the cafeteria tended to pick a less desirable snack to avoid the temptation to eat it right away. But students leaving the cafeteria after a meal felt they could easily resist any snack because they were no longer hungry. So, they tended to confidently choose one of their favourite snacks. Guess which group resisted temptation best and exchanged their snacks for the promised rewards? That's right: the ones facing the least temptation.

On a personal financial level, simply carrying your credit card increases the likelihood that you will be tempted to buy something instead of saving your money. Listening to hot tips can tempt you to make bad choices about buying or selling. And following the news too closely can tempt you to abandon a carefully thought-out, objective investment strategy in hopes of – like Jerry – achieving a quick gain, or avoiding a loss.

It's a rare person who can resist temptation. Studies show the very people who believe they have the most willpower or self-control are the ones most likely to behave impulsively. And that brings us to the *overconfidence bias*, one of the most dangerous of all. We will talk more about this bias next time!

Stan Clark is a Portfolio Manager and Senior Wealth Advisor for The Stan Clark Financial Team at CIBC Wood Gundy. Stan has direct responsibility for the team and oversees all areas of financial planning, investment selection and investment management.

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Phone: 604 641-4361 | Toll-free: 1 800 661-9442 | Fax: 604 608-5211 | Email: stanclarkfinancialteam@cibc.ca | www.stanclark.ca

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