Lake Wobegon, where all investors are above average.mp4

Speaker1: In nineteen sixty five to Seattle, area psychiatrist asked 50 drivers to rate their skill, ability and alertness the last time they had driven, nearly two thirds said they were at least average. Many describe their most recent drive as extra good, or even 100 percent. Remarkably, they were being interviewed in hospital where each had ended up after an accident while driving. Hi, my name is Stan Clark. I'd like to talk about the danger of being overconfident in our abilities as investors. According to the police, thirty four of those drivers were directly responsible for their crashes. Twenty nine had at least two passed traffic violations. Twenty eight had totaled their vehicles. Twenty two faced criminal charges. Many had gastly injuries, yet they insisted they were good drivers. Were they crazy? Not at all. It's a basic characteristic of human nature to think we're better than we really are. Another survey of drivers with clean records found that ninety three percent believe themselves above average drivers. The tendency to think we're better than we are has been called the Lake Wobegon effect. After the fictional town where all the men are strong, all the women are good looking, and all the children are above average. Behavioral scientists have found that this phenomenon, the self enhancement bias, exists in almost every area of our lives. If you ask one hundred people compared with the other ninety nine here who's above average at X, roughly seventy five will raise their hands whether X is driving a car, playing basketball, telling jokes or scoring well on intelligence tests. This despite the fact that by definition, half the people must be below average. This bias certainly exists in the financial world. Consider this advertisement warning against speculative financial bubbles.

Speaker1: The ad mocks some gullible Frenchmen lured into a silly 18th century investment scheme. The ad says modern shareholders, armed with superior information, can avoid the pitfalls of the past. How different the position of investors today, the ad enthuses. The ad ran in the Saturday Evening Post on September 14th. Nineteen twenty nine. One month later, the stock market crashed, the start of the biggest one year decline ever. Everyone wants to think they're smarter than the poor souls in developing countries and smarter than their predecessors, says Carmen Reinhart, University of Maryland economist and co-author of This Time It's Different. In their book, Reinhart and Kenneth Rogoff looked at booms and busts over the past eight hundred years, as their title suggests, although every crisis seems different from the others, all are very similar. People do not learn well from history. They believe they're smarter than those who came before them, but they're wrong. Having confidence is normally a healthy trait. However, when combined with other traits such as filtering, hindsight, bias and confirmation bias, it leads to overconfidence and an unrealistic assessment of our abilities to analyze and predict. Overconfidence can get you in trouble with your finances. It can cause you to take risks you shouldn't and ignore information that disagrees with your pre-existing biases. It's tough to combat because most overconfident people are also convinced they're not overconfident. The more overconfident someone is and their beliefs about the future, the more likely they are ignoring important information or rationalizing facts to fit their beliefs. Beware the overconfident expert people are more likely to follow a very confident person. But keep in mind that the most dangerous predictions come from those who appear most confident about them.