

PIMCO

ADVISOR EDUCATION

# Behavioral Science Reference Guide



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**PIMCO's Education team is dedicated to helping financial professionals address emerging issues and challenges.**

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Our courses aim to help financial professionals:



Deliver client-centric advice beyond investment management



Build the breadth and value of your services to successfully grow your practice



Enhance relationships with clients through more holistic offerings

**To see a full list of course offerings or to learn more about the program contact your PIMCO Account Manager or visit [pimco.com](https://www.pimco.com).**

# Why Behavioral Science Matters

Investors are prone to a host of behavioral biases that can effect decision-making and derail long-term financial goals. Financial professionals can help clients manage these biases and stay on track by incorporating behavioral science insights into their advice.

This reference guide provides common investment-related biases and outlines some implications of these biases on decision making. It also shares questions and thought-starters to help financial professionals and their clients identify biases and mitigate negative outcomes.

## BEHAVIORAL SCIENCE IN ACTION

PIMCO's deep commitment to behavioral science is embodied by our partnership with The Roman Family Center for Decision Research (CDR) at The University of Chicago Booth School of Business. Leaders in their field, CDR researchers are constantly engaged in studies investigating how people form judgments and make decisions. Many of these studies take place at the PIMCO Decision Research Laboratories – facilities on and off The University of Chicago campus that bring behavioral insights to the mainstream by fostering greater engagement with the public.

Learn more at [global.pimco.com/pimcolabs](https://global.pimco.com/pimcolabs)



Roman Family Center  
for Decision Research



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# Behavioral Biases

## ANCHORING BIAS

Occurs when investors are influenced by purchase points or arbitrary price levels

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>• Clients may cling to arbitrary numbers or values when they decide whether to buy or sell an investment</li> <li>• May prevent clients from viewing investments holistically</li> <li>• During a period of volatility, clients may anchor to a market highpoint or their last investment statement</li> </ul>	<ul style="list-style-type: none"> <li>• Retirees</li> <li>• Baby Boomers</li> <li>• Silent Generation</li> <li>• Low-risk investors/preservers</li> </ul>	<ul style="list-style-type: none"> <li>• What do you think this security should be valued at? How did you arrive at that figure?</li> <li>• How do you think this investment has performed and what are your expectations going forward?</li> <li>• Where does this asset fit in with your larger financial plan?</li> </ul>	<ul style="list-style-type: none"> <li>• Goals-based planning</li> <li>• Rebalance regularly</li> <li>• Long-term focus</li> </ul>

## RECENCY BIAS

When an investor looks at recent market returns when making important financial decisions

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>• Clients may choose an investment based on recent returns or some news that was recently heard rather than perform a thorough analysis</li> <li>• May cause clients to chase performance – buying high and selling low</li> </ul>	<ul style="list-style-type: none"> <li>• General/inexperienced investors</li> <li>• Generation X</li> </ul>	<ul style="list-style-type: none"> <li>• How do you decide where to invest your money?</li> <li>• What are the most common sources of information or guidance that you have relied upon?</li> <li>• What is your view on the direction of the market?</li> </ul>	<ul style="list-style-type: none"> <li>• Rebalance regularly</li> <li>• Investment policy statement</li> </ul>

## CONFIRMATION BIAS

When investors seek out information that confirms their claims

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>• Clients may ignore or devalue evidence that might discount their view on a particular security</li> <li>• May lead to an inappropriate allocation or risk tolerance</li> </ul>	<ul style="list-style-type: none"> <li>• Corporate executives</li> <li>• Business owners</li> <li>• Millennials</li> <li>• Generation X</li> <li>• Baby Boomers</li> </ul>	<ul style="list-style-type: none"> <li>• What is your view on the direction of the market?</li> <li>• What are the most common sources of information or guidance that you have relied upon?</li> <li>• How do you decide where to invest?</li> </ul>	<ul style="list-style-type: none"> <li>• Systematic processes</li> <li>• Investment policy statement</li> <li>• Broad framing (as opposed to narrow)</li> </ul>



# Behavioral Biases

## OVERCONFIDENCE

The tendency to overestimate or exaggerate an investor’s ability to successfully perform a given task

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>Irrationally high level of overconfidence</li> <li>Common among C-suite executives</li> <li>May lead to excessive risk-taking</li> </ul>	<ul style="list-style-type: none"> <li>Corporate executives</li> <li>Business owners</li> <li>Baby Boomers</li> </ul>	<ul style="list-style-type: none"> <li>Tell me about your past investment experiences.</li> <li>What has worked well, and what has not?</li> <li>Tell me about your greatest investment success and your most unfortunate investment?</li> <li>What did you learn from these experiences?</li> <li>How much of your time do you spend on investment and financial planning?</li> <li>How do you keep current or improve your abilities?</li> </ul>	<ul style="list-style-type: none"> <li>Investment policy statement</li> <li>Rebalance regularly</li> </ul>

## ILLUSION OF CONTROL

Investors believe they can control or influence investment outcomes that they cannot

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>During bouts of volatility, clients may try to time the market, sitting with cash on the sidelines waiting to get back in</li> <li>Common among trading-oriented clients who may believe that they have more control over a particular outcome because they’ve pulled the trigger on the decision</li> </ul>	<ul style="list-style-type: none"> <li>Corporate executives</li> <li>Business owners</li> </ul>	<ul style="list-style-type: none"> <li>How do you define risk?</li> <li>What do you do to manage risk?</li> <li>What is your view on the direction of the market?</li> </ul>	<ul style="list-style-type: none"> <li>Systematic processes</li> <li>Investment policy statement</li> <li>Broad framing as opposed to narrow</li> </ul>



# Behavioral Biases

## MENTAL ACCOUNTING

When investors treat various sums of money differently based on where these sums are mentally categorized

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>Risk-averse clients may prefer to segregate assets into safe buckets such as college, vacation, retirement, etc.</li> </ul>	<ul style="list-style-type: none"> <li>Retirees</li> <li>Low risk investors/preservers</li> <li>Generation X</li> <li>Baby Boomers</li> </ul>	<ul style="list-style-type: none"> <li>What if you received new funds today, how would you invest them?</li> <li>How do you expect to invest your assets during the withdrawal phase in retirement?</li> <li>What are your top concerns surrounding your retirement assets?</li> </ul>	<ul style="list-style-type: none"> <li>Investment policy statement</li> <li>Rebalance regularly</li> </ul>

## FRAMING EFFECTS

The tendency of investors to respond to situations differently based on the context in which a choice is presented or framed

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>Clients may avoid looking at the facts themselves and out of two equal choices, select the one that suggests a gain rather than a loss</li> <li>Risk tolerance questionnaires can lead to greater risk taking or less risk, depending on how questions are framed</li> </ul>	<ul style="list-style-type: none"> <li>General/inexperienced investors</li> <li>Millennials</li> <li>Silent Generation</li> </ul>	<ul style="list-style-type: none"> <li>What action would you take if your portfolio increased 10% next month? Declined 10% next month?</li> <li>Shall we create an investment policy statement? This will allow us to create a written document that states your investment objectives, asset allocation guidelines, and rebalancing methodology.</li> </ul>	<ul style="list-style-type: none"> <li>Systematic processes</li> <li>Investment policy statement</li> <li>Broad framing (as opposed to narrow)</li> </ul>



# Behavioral Biases

## LOSS AVERSION BIAS

Investors typically feel the pain of loss more profoundly than the joy of an equivalent gain

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>• May prevent clients from unloading unprofitable investments</li> <li>• Causes investors to take on additional risk to avoid pain from losses</li> </ul>	<ul style="list-style-type: none"> <li>• Retirees</li> <li>• Low risk investors/preservers</li> <li>• Baby Boomers</li> <li>• Silent Generation</li> </ul>	<ul style="list-style-type: none"> <li>• What would be more disturbing: selling a security that continues to rise or holding one that continues to fall?</li> <li>• If you were presented with cash equal to the value of your stock, how much would you allocate to your stock?</li> </ul>	<ul style="list-style-type: none"> <li>• Systematic processes</li> <li>• Investment policy statement</li> <li>• Broad framing as opposed to narrow</li> </ul>

## ENDOWMENT EFFECT

Causes an investor to value an owned security higher, often irrationally, than its market value

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>• Clients are more likely to retain an object that is owned than acquire the same object when it is not owned</li> <li>• Common among inherited portfolio holdings</li> <li>• May lead to inappropriate asset allocation or risk tolerance</li> </ul>	<ul style="list-style-type: none"> <li>• Corporate executives</li> <li>• Retirees</li> <li>• Low risk investors/preservers</li> </ul>	<ul style="list-style-type: none"> <li>• Describe your strategy for managing your assets?</li> <li>• What steps have you taken to reduce the inherent risk of holding a concentrated position?</li> <li>• What is your view of your company stock?</li> <li>• If you didn't work at your current company, how much of the stock would you own in your portfolio?</li> </ul>	<ul style="list-style-type: none"> <li>• Goals-based planning</li> <li>• Rebalance regularly</li> <li>• Long-term focus</li> </ul>

## STATUS QUO BIAS

When faced with an array of options, investors are predisposed to select options that keeps conditions the same

Implication	Client Type	Questions for Clients	Potential Solutions
<ul style="list-style-type: none"> <li>• Principle of inertia – resistance to change</li> <li>• Common among C-suite executives with company stock</li> <li>• May lead to lack of diversification</li> <li>• May cause clients to avoid rebalancing especially after market gains or declines</li> </ul>	<ul style="list-style-type: none"> <li>• Corporate executives</li> <li>• General/inexperienced investors (e.g. 401ks)</li> </ul>	<ul style="list-style-type: none"> <li>• When was the last time you reviewed your portfolio allocation? Rebalanced your portfolio?</li> <li>• If we chose to work together, how would you define success?</li> <li>• What services do you want or would you expect?</li> <li>• Tell me about the relationship you had with your previous financial professional?</li> <li>• What did they do well, and where did they fall short?</li> </ul>	<ul style="list-style-type: none"> <li>• Rebalance regularly</li> <li>• Investment policy statement</li> <li>• Team decisions/devil's advocate</li> </ul>



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