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by Standard Chartered's Chief Investment Office

Are you fighting the last war?

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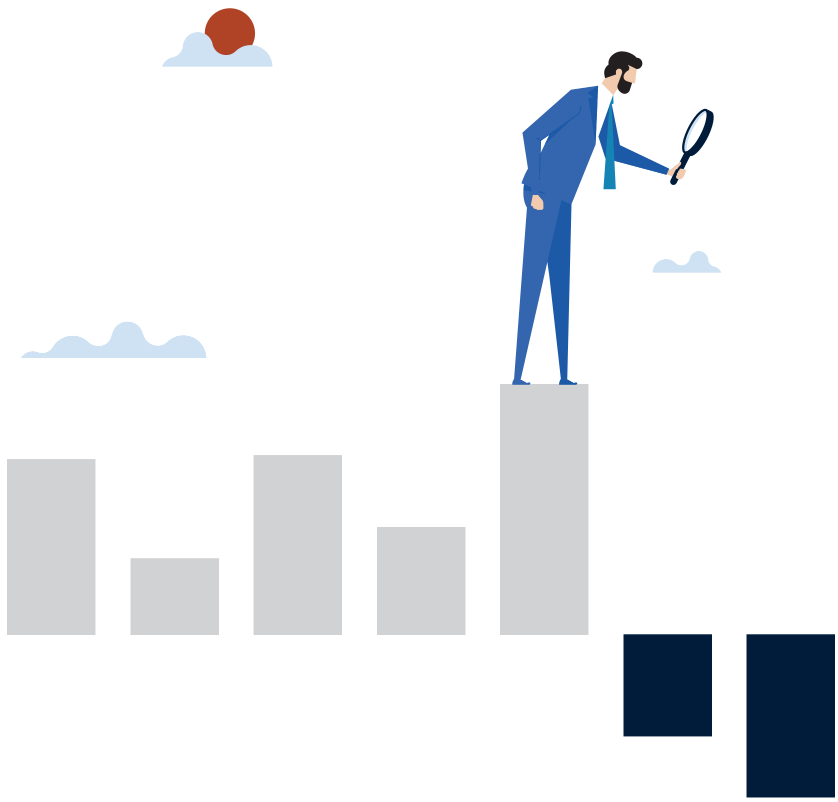

You most probably remember what you had for breakfast this morning. Can you recall, though, what you had for breakfast a week ago? A month ago?

Many of us find it easy to recall events that occurred most recently, or the last thing someone said at the end of a meeting – an outcome psychologists call the 'recency bias'. However, it is much harder to recall what occurred further back in time, or in the middle of a particularly long meeting, unless one took the effort to take notes and commit key points to long-term memory.

For financial market investors, this can be a particularly troubling bias that can work against us in making good investment decisions. Today, for example, many of my own conversations with colleagues and clients are very focused on the first half of the year and whether the gloom we experienced in the form of a correlated fall in both equities and bonds is likely to continue for the foreseeable future. Many have asked the question about whether one should indeed just 'wait out' this uncertainty in the supposed safety of cash – an approach that history would caution can significantly hurt long-term returns and the preservation of wealth, especially during times of high inflation.

This approach is, however, a reflection of recency bias. It is possible, of course, that recent market trends could continue for a while longer – indeed some have made that case based on an assessment of macroeconomic data today. However, history shows us that a continuation of the current slump would be an exceedingly rare event. Several investor surveys in recent weeks have shown sentiment and positioning is already exceedingly bearish. If anything, this makes a continuation of H1 2022 market trends less likely. What is important, in our view, is to step back and make a fresh assessment based on economic and market data today, as opposed to falling prey to the bias where we assume recent financial market trends would simply extend, since the latter can ultimately hurt long-term returns.

The following example may help clarify the recency bias that cloud most investors' judgement. A 2008 study found that insurance demand tended to rise after the occurrence of a natural disaster. A statistician looking at historical data would argue that the chances of a specific natural disaster, for example, does not rise just because someone has just experienced such an event. In this case, individuals would be better off purchasing insurance at any given time (ideally before, rather than after, a natural disaster) rather than rushing to do so in the immediate aftermath of a disaster – the classic recency bias at play.

What can we as investors do to overcome this bias?

1. **Start with historical data and facts.** In the example of natural disasters, potential insurance buyers should look at the historical occurrence of natural disasters to gauge the likelihood of experiencing one in the future. Similarly, for market investors, a look-back at the past century's data would show us that calendar years of negative equity and bond market returns are exceedingly rare.

2. **Seek out a broad range of perspectives.** Today, for example, several investor surveys would argue investor positioning is far too one-sidedly bearish for H1 trends to continue, although a forecast for a deep recession would argue that the current bearish trend may continue for a while longer for some risky assets. In our insurance example, it is possible that the chances of some types of natural disasters (such as weather-related ones) may indeed be rising due to climate change.

3. **Ensuring we're aware of the range of credible outcomes** helps us mitigate the risk that we automatically assume the most recent trends are the ones that are most likely to continue.

Keep a clear-headed focus on the goal. A goal-based analysis can help place any historical data and possible near-term outcomes in perspective. For instance, if your investment objectives are long-term, over-responding to short-term shocks can detract from these goals.

Start with historical data and facts

Seek out a broad range of perspectives

Aware of the range of credible outcomes helps to mitigate the risk

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