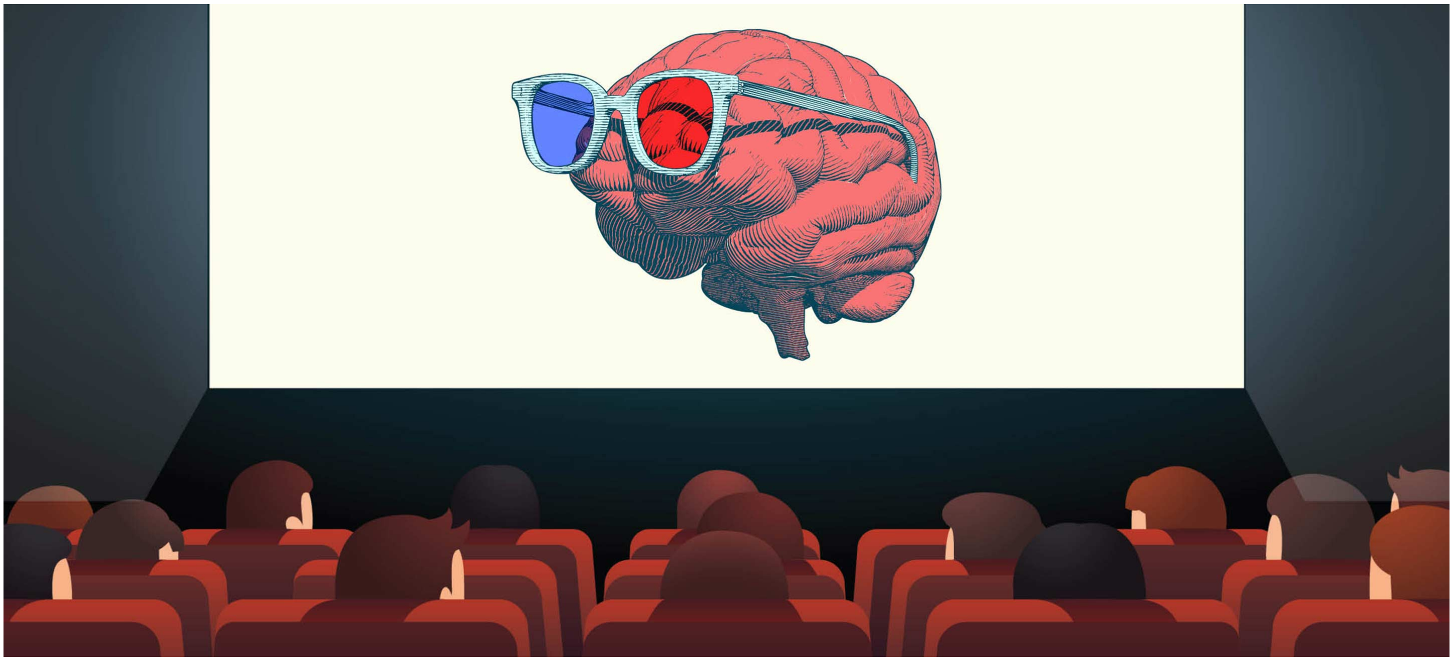

Fighting Recency Bias

If movie review website Rotten Tomatoes's readers are to be believed, the last decade was a golden age for moviemaking. In fact, 59 of the films in the website's Top 100 Movies of All Time list were released during the 2010s.

Apocalypse Now?

While the website's readers included several great films from the past decade, including *Parasite*, *The Shape of Water*, *Knives Out*, and a few other Academy Award Best Picture nominees, they also included nine superhero movies, 12 sequels, and any number of movies that will certainly fail the test of time.

Rotten Tomatoes's readers seem to have some fondness for classic films, as shown in Figure One, but the 50-year period from the 1960s through the 2000s appears to have been a vast movie wasteland—with only eight movies on the list. Surprisingly, *E.T. the Extra-Terrestrial* and *Schindler's List* are the only films on the list for the 30-year period from 1980 until 2009.

What about *The Big Chill*, *Titanic*, and *Million Dollar Baby*? More importantly, what is going on with Rotten Tomatoes readers?

Answer: Like most humans, they suffer from *recency bias*.

Figure One: Top 100 Movies by Decade

VESTED Money Mindset 2021

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Source: Rotten Tomatoes

Invasion of the Body Snatchers

Recency bias is a cognitive bias that causes us to place too much emphasis on recent events or experiences—even if they are less relevant. Conversely, recency bias causes us to deemphasize events further into the past. Specifically, recency bias is a *memory bias*, a type of cognitive bias that enhances, impairs, or alters the recall of a memory.

In a nutshell, recency bias results from our brain's preference for more easily accessible information over the harder work of analysis and decision-making. We prefer matching patterns from recent memory to deeper, intentional thought.

Maybe misremembering movies—like how good Road House really is—isn't such a bad thing, but, like many cognitive biases, recency bias can also keep us from making high-quality decisions in other aspects of our lives.

For example, after an hour-long job interview, you'll likely recall the last 20 minutes of your conversation more vividly than the first half. That means you will perceive a candidate who starts strong and finishes weaker more negatively than you would have otherwise. The converse is true as well. And candidates interviewed later in your process will be more likely to advance.

Meanwhile, in competitions such as the Eurovision Song Contest and world and European figure skating, Wändi Bruine de Bruin, provost professor of public policy, psychology, and behavioral science at the University of Southern California, found in her research that judges gave higher marks to competitors who performed last.

Wall Street

Of course, recency bias affects us as investors as well, and it can be hard to avoid, partly because it is informed by facts. Not just facts—but recent facts that may seem indisputable due to their freshness.

During a stock market selloff, it's easy to believe that stock prices will keep falling. Think back to early last year when the first coronavirus-induced waves of selling hit the market. It seemed like the bottom dropped out. And it did … right up until the breathtaking rally that recovered all of their lost ground (and more). Conversely, investors tend to jump on board during the tail end of a market rally only to be surprised that the rally doesn't continue.

Here are three investing narratives supported by recency bias that will be true right up until they aren't.

The market's at an all-time high, so it's not a good time to invest. If you're prone to believe this, you will find ample proof, even as the market continues to hit new record levels. Rather than failing to invest, it might be more productive to create a dollar-cost-averaging program to move into the market in increments. That way, you can both participate in any future records and take advantage of an eventual pullback.

Growth stocks are doing so well, I don't need to own value stocks. Growth stocks have, indeed, done well for the past several years when compared to value stocks. While it might be tempting to jump ship on your value stocks, mutual funds, or exchange-traded funds, ensuring that you have exposure to both is wise. This trend will end at some point, perhaps with a vengeance.

All I need is a simple portfolio of 60 percent U.S. stocks and 40 percent bonds. According to Morningstar, if you had invested $100,000 in a simple, cost-effective strategy like this in 1980, rebalanced it quarterly, and stayed the course—fees and taxes aside—your portfolio would be worth $6.8 million. That's a 10.86 percent annualized total return over a 40-plus-year period. Wow! Why wouldn't you just do that?

The easy answer is that the next 40 years cannot possibly look like the past 40 years. Much of the return of that minimally diversified portfolio came from exposure to U.S. bonds during an extended period of falling interest rates. During that period, the yield on the benchmark 10-year U.S. Treasury fell from 13.6 percent to 1.3 percent today. That literally cannot happen again.

Not Mission Impossible

While it might seem difficult to do, you can thwart recency bias—or at least minimize it—to help yourself make higher-quality investment decisions.

Get historical. In the immortal words of Mark Twain, "History never repeats itself, but it does often rhyme." Pulling back the lens to view the longer sweep of history is often a helpful input into decision-making. For example, in the turmoil of a market pullback, looking at the frequency of past corrections could inform your view. History tells us that 5- and 10-percent pullbacks happen every year or two and that a 20 percent pullback is likely every seven years or so.

Look downstream. Making sure that you understand the implications of your decision may be helpful. Are there transaction costs? Will you owe significant taxes if, for example, you sell a highly appreciated position? How will you reinvest the proceeds? The answers to these questions may cause you to think twice.

Revisit your plan. Your financial plan can also provide important information for investment decision-making. Knowing, for example, the portfolio hurdle rate needed to fund your important life goals can be invaluable. You may find that it will be quite easy to achieve, so you can worry less about market pullbacks and won't need to take an extraordinary amount of investment risk to get there.

Kick it around. You may want to seek opposing views to investment ideas you're exploring. Many people process their thinking by speaking, so having a trusted sparring partner (or partners) to debate with can be a helpful way to expand your thinking. The more viewpoints, the better. This will add nuance to your ideas and help ensure you are thinking rationally.

Successful tactics to address recency bias tend to have two complementary characteristics to help you make better decisions: They provide both additional perspective on a topic, and they slow down the decision-making process.

While it is unlikely that Rotten Tomatoes is concerned about the influence of recency bias on its Top

100 Movies of All Time list, you might want to slow down and gather more information before your next movie night.

Exploring other sources—like the American Film Institute’s 100 Greatest American Movies of All Time or the Academy of Motion Picture Arts and Sciences’ list of past Oscar-nominated best pictures—can provide a much richer picture of quality films to spend your time on.