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ASSET MANAGEMENT

INVESTMENT MANAGEMENT INSIGHTS FOR PROFESSIONAL FINANCIAL ADVISERS

FAMILIARITY BIAS: THERE'S NO PLACE LIKE HOME?

The line between knowledge and comfort can be dangerous territory for investors. It is the place where 'familiarity bias' lies ready to sway investors into making poor decisions.

Smart choices are underpinned by a combination of hypothesis, reason and testable evidence, but familiarity bias is a mental shortcut that substitutes the correct answer with what's familiar, rather than what's right.

Research even suggests that when people are faced with a choice between two gambles, they tend to pick the more familiar one – in some cases even if the odds of winning are lower.

As with other behavioural biases, familiarity bias often kicks in when investors are faced with complex choices, are experiencing high cognitive load, or face time constraints. Many portfolios betray the effect of familiarity bias.

For example, self-managed super fund (SMSF) portfolios are highly concentrated in Australian blue-chip stocks. The top 10 shares together account for almost one-third of SMSFs Australian shareholdings and include well-known names such as the big four banks, Telstra and Woolworths, according to admin provider **SuperConcepts.**

Financials dominate the Australian market and the **S&P/ASX 200 Financials Ex-A-REIT Index** is down about 12% over the year to date thanks to the Royal Commission into Financial Services, which has eroded confidence and the end of the eastern seaboard property boom.

Even when taking into account the lure of relatively high dividend payouts, this home bias – underpinned by familiarity – creates excessive risk. This can be seen in one simple risk measure (volatility) ranking the ASX20 against four popular individual stocks. While Australian shares account for more than one-third of SMSF portfolios, international shares make up just 13.1%.

Unfortunately, Australian investors who felt more comfortable sticking with the more concentrated Australian market missed out on the massive post-GFC boom which saw the **S&P 500** triple in value. US market valuations are now stretched but the benefits of holding a truly diversified portfolio remains.

Even experts are not immune from familiarity bias, which provides a **strong explanation** for the home bias exhibited by institutional investors around the world. Certain industry super funds also invest heavily in the same sector that their members are employed in. The argument is that it helps provide members with employment opportunities.

The flip side is it doubles down their exposure: human and financial capital are now concentrated in the one sector. A member could lose their job during a downturn in cyclical industries such as property construction, just