You Just Made These 5 Investing Mistakes

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> *"Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing." – Warren Buffett*

According to the Oracle himself, what sets great value investors apart from the rest of the pack is not their tremendous analytical skills, but their ability to control their emotions and think rationally about their investments.

The first step in developing this trait of investing self control is to know the enemy: What irrational emotions and misguided ways of thinking are we prone to? Once we know what to be wary of it is much easier to start refining our investing discipline.

Luckily for us, a relatively new field, behavioral finance, has given us practical insight into what irrational cognitive biases we naturally employ in investing.

Here are my personal top five investing biases to avoid. I can guarantee you that just starting to think about when you fall prey to these biases will help your investment process.

1. Anchoring Bias

Anchoring refers to fixating to one's thoughts on a specific set of facts to the point where one does not consider other more relevant information.

My favorite (or least favorite?) example of this is fixating on stock price instead of intrinsic value. We think a stock must be expensive if it has doubled in the past year or that it must be cheap if it has fallen 50% in the past year. Of course, value investors know that whether a stock is cheap or expensive has nothing to do with what the stock price has done in the past year, but rather everything to do with intrinsic value of the business. Yet we have a hard time looking past the chart.

2. Confirmation Bias

Anchoring's evil cousin, confirmation bias, is the tendency to misinterpret new information in way that confirms one's initial idea about a subject.

Conformation bias can easily sneak in over the course of our stock research. We get excited about a company, form an initial investment thesis, and then begin to brush off any red flags we uncover. They usually come back to bite us later.

3. Overconfidence Bias

You may have heard of the research studies that show that far more than half of all investors think they are above average. Overconfidence can lead to all sorts of investing mistakes from ignoring warning signs about bad companies to holding on to losing positions too long. We need to have confidence in our abilities in order to invest well, but not the point where we become blind to contrary opinions.

4. Overreaction Bias and Availability Bias

These two tend to work together. Overreaction bias refers to a change in thinking induced by an event that is not correlated to the rational meaning of that event. Availability bias refers to putting greater weight on recent events than is rationally warranted.

These biases are at work in the common occurrence of investor overreaction to bad news. Investors react to a minor piece of bad news as if it were doomsday for a stock (overreaction bias) and think that the current bad news now means the company must be terrible despite whatever else has happened in the past (availability bias). Company news has to be viewed in a long term context with an eye for how it truly impacts intrinsic value.

5. Herd Behavior Bias

Value investors know the importance of staying apart from the pack and the latest investment fads, but it is easier said than done. We naturally enjoy the reassurance of a group and find it hard to stand apart. We have to use our adherence to value investing principles to make sure we are chasing intrinsic value and not the next bubble stock.

Elie Rosenberg is a value investor who runs Valueslant.com, a website featuring in-depth value investing analysis. Sign up here to receive the free ebook – 16 Ways to Find Undervalued Stocks.