What are Behavioral Biases?

Worksheet

Behavioral biases are psychological patterns that distort judgment: overconfidence bias, loss aversion, anchoring, confirmation bias, and recency bias lead to irrational investment choices.

Questions

1. Overconfidence bias typically leads to…
A) Lower trading frequency
B) Excessive trading and risk-taking
C) Holding cash
D) Avoiding stocks

2. Loss aversion explains why investors…
A) Quickly sell losing positions
B) Hold losing stocks hoping to break even
C) Avoid all risk
D) Only invest in bonds

3. Anchoring bias occurs when investors…
A) Ignore price history
B) Rely too heavily on an initial reference price
C) Chase trends
D) Follow the herd

4. Recency bias leads investors to…
A) Buy at lows
B) Sell at highs
C) Overweight recent events
D) Ignore recent performance

5. An investor, convinced of their stock-picking ability, trades 50% of portfolio monthly. Bias?

6. A trader bought at 100, sells at80 loss, then delays selling at $50. What is this?

7. Investor reads only bullish news about their holdings. What is this phenomenon?

8. Define: What is overconfidence bias?

9. Define: Define loss aversion.

10. Define: What is anchoring bias?

Answer Key

1. B) Excessive trading and risk-taking — Overconfident investors overtrade, believing they can beat the market.
2. B) Hold losing stocks hoping to break even — Loss aversion causes investors to hold losers, hoping prices recover.
3. B) Rely too heavily on an initial reference price — Anchoring to purchase or prior high price distorts future valuations.
4. C) Overweight recent events — Recent events disproportionately influence decisions, ignoring historical trends.
5. Overconfidence bias Belief in superior skill Excessive trading (churn) Underperforms due to costs and turnover
6. Loss aversion + anchoring Stuck to purchase price anchor Refuses to accept loss Hopes to break even (unlikely)
7. Confirmation bias Seek supporting information Ignore contradictory evidence Reinforce existing beliefs regardless of reality
8. Belief in one's knowledge and predictive ability beyond actual skill, leading to excessive trading.
9. Psychological tendency to avoid losses more intensely than pursuing equivalent gains.
10. Relying too heavily on an initial value (e.g., purchase price) when making future decisions.