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Wealth Advisers, LLC

Polaris Educational Series

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Think You're a Great Investor?

Chances are, you probably think you're at least above average.

Most of us have a bias known as illusory superiority. It is the cognitive preconception at work when individuals overestimate their own qualities and abilities as compared to others.

There have been numerous studies on the subject.

- In 1981, Ola Svenson conducted a study of 161 students in Sweden and the United States who were asked about their driving skills. Ninety-three percent of the U.S. sample and 69% of the Swedish sample ranked themselves above average.
- In a 1977 survey of faculty at the University of Nebraska, 68% rated themselves in the top 25% for teaching ability, and 90% rated themselves as above average.
- And in a similar study, the overwhelming majority (87%) of MBA students at Stanford University rated their academic performance as above average.

These studies illustrate how skewed some people's beliefs are about their abilities. The results from all of these studies are statistically impossible.

I could quote several other surveys, but they simply state similar outcomes. The bottom line is that most of us tend to overstate our abilities.

I was curious about how the concept of illusory superiority affects investing, so we conducted our own study of individual investors who were managing some (or all) of their personal portfolios. We asked 65 individual investors who were not clients of Polaris Wealth Advisers to complete a survey prior to attending educational speaking engagements that we conducted.

Consider these results:

- Only 10.77% of those surveyed considered themselves to be "below average" investors.
- 60% of the investors surveyed expected to get "market-like" or better returns.
- More than 55% of those surveyed spent four hours or less a week managing their money.
- None of our investors considered themselves to be "very aggressive." Less than 25% considered themselves "aggressive," and the rest thought they were "moderate" or "conservative" investors.

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At Polaris, we consider "very aggressive" to be a 100% exposure to the stock market. "Aggressive" investors hold, on average, 70% of their portfolio in equities, with the remainder in bonds and cash. A "moderate" investor would have an equal split between stocks and bonds. And a "conservative" investor would hold approximately 30% of their portfolio in stocks. This means that even though more than half of our survey participants expected to get "market-like" returns, their investing habits could not produce those results!

This represents a huge disconnect. Surveyed participants overwhelmingly believed that they were good investors, yet they spent four hours or less a week managing their portfolio. Sixty percent of them expected to get "market-like" returns or better, yet none were willing to take "market-like" risk.

Throw in a little "selective memory" and the lack of skill for most investors to properly calculate their returns, and you've created that one friend who always brags at cocktail parties about how well they are doing in the stock market. If their accounts were ever properly audited, they'd probably be sitting in the corner without much to say.

Unlike our boisterous cocktail party friend, Polaris has a dedicated Investment Team that works full time to help you accomplish your long-term financial goals. We constantly assess risk in the markets as well as each individual holding in your portfolio in an attempt to give you the best risk-adjusted performance possible within the guidelines you have set for us. And your performance is calculated in accordance with industry standards. So, unlike my scoring of my own golf games (where I take a few mulligans and tend to remember only my good shots), our firm uses a standard, consistent calculation methodology to determine your performance results.

So, from now on when you hear someone bragging about how well they are doing in the stock market, consider the possibility of Illusory Superiority. (Chances are they think they're an amazing driver, too!)

I hope you have enjoyed this e-mail. Please feel free to share it with anyone you know who might be interested in Polaris' services.

We look forward to speaking with you soon. As always, I welcome your questions and comments.

Sincerely,

Jeffrey J. Powell
Managing Partner

The following are the sources for the widely-cited studies on illusory superiority: Svenson, O. (February 1981). "Are we all less risky and more skillful than our fellow drivers?" Acta Psychologica 47 (2): 143–148; Cross, P. (1977). "Not can but will college teachers be improved?" New Directions for Higher Education 17: 1–15; Zuckerman, Ezra W.; John T. Jost (2001). "What Makes You Think You're So Popular? Self Evaluation Maintenance and the Subjective Side of the "Friendship Paradox." Social Psychology Quarterly 64 (3): 207–223.