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Status Quo Bias, Myopic Loss Aversion Biasand Investment Advisers

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Abstract: *In the context of stock market decision making and investment choices,the impact and significance of biases in favor of status quo and myopic loss aversion is vital.*
The present paper discusses thespecific biases in the framework of stock market processes and,via a research on the attitudes ofcertified market executives, demonstrates their impact on the subjects' rational investment decision making and choices and,thus, on the stock market equilibrium, given thatexecutivesplay an influential rolein stock market processes and manage a considerable number of portfolios.

Keywords: *Behavioral Finance,Status Quo Bias, Myopic Loss Aversion Bias, Investment Advisers, Stock Market*

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I. Introduction

Behavioral Finance has come to fill the gaps in the standard finance theory with the help of psychology, sociology, and other disciplines related to behavior and decision making issues.By examiningand discussingemotions, cognitive and emotional errors, heuristics and biases,it attempts to prevent irrationality in investing decisionmaking and establish rational behavior in stock market processes.

When investors and stock market executives do not always rely on profit making and utility maximization, but makeirrational and wrong investment decisions,the implementation of the Behavioral Financeenables them to identifythe rational routes and methodsandrealize that,apart from investors,they are also human beingssubject to psychological and personalityeffects.

In the ampleliterature of Behavioral Financethere are two majorbiaseswith a significant impact oninvestors' rational thinking, namely, status quo bias and myopic loss aversion.

The investors' tendency to avoid new investment processes and make partial rather than thorough portfolio evaluationsdemonstratesthe operation of the specificmajorbiases and irrational behavior,which exert a significant impact on investment decisions. The ability to identify and study the specific behavioral biases can prevent irrational thinking and contribute to profit making and maximum investment utility.

II. Status Quo Bias

Status quo bias describesindividuals'tendencyto avoid new processes andmaintain current or previousaffairs,which they consider more familiar. The specificbiasinvolves retainingprevious choices, attitudes, manners or actions,which it converts into status quo, despite the fact there are many otheralternatives.

The term 'statusquobias' was coined by Samuelson and Zeckhauser (1988) todemonstratetheindividuals' tendencyto maintain the current state of affairs.

Status quo bias may beepitomized in the phrase"There is no place like home", from the film "The Wizard of Oz", which describes everybody's need fora'home',a place which makes them feel comfortable and warm. Beyond the natural location, 'home' as awordadditionally signifiesa number of other activities ofeveryday life.

Adherence to familiar choices and conditionshas been a constraint to exploring new challenges.In contrast, the fear of anythingnew or unknown prevents people from engaging in new activities or processes and confinesthem intoa dailyroutine,which inhibitscreation, learning, or gooddecision making.

In the context of stock market investment, the status quo bias describes the investors' tendency to make decisions within a given and limited framework, and"default to the same judgment or accept the current situation"(Baker, Ricciardi, 2014) by making the same decisions. The investors' strong tendency to avoid any change or new decision is directly related to loss aversion and implies no new action (Nofsinger, 2001).Such inactivity, which iscaused by the investors' adherence to familiar investments,makes them unable tofollowfinancialprogress and change, and,by maintaining current positions and state of affairs,theymay sufferloss. The fear of change and the fear of being confronted with new conditions,which are likely tohave the worst outcomes,wasdiscussed by Benartzi and Thaler (1995).

One possible consequence of loss aversion is people's strong tendency to maintain status quo, as"the disadvantages of leaving it loom largerthan advantages" (Kahneman,Knetsch and Thaler, 1990).

Overall, the investors' rational attitudesprevent fear of loss and change, and producemultiple investment possibilities. Investors must be capableof implementingflexible investment strategies andalternative methodsboth with a view to achieving profit makingandalso surviving in the investment arena.

III. Myopic Loss Aversion Bias

Myopic loss aversion occurs when investors are temporarily unable to take a broader view of their investments, and are focused on the short term.

The specific aversion is a combination of greater sensitivity to loss than gains and the investors' tendency to evaluate outcomes more frequently (Thaler, Tversky, Kahneman and Schwartz, 1997).

In the context of stock market processes, it demonstrates the investors' short-sighted tendency to evaluate investments. By evaluating portfolio performance on a daily basis investors are likely to suffer lossevery day and,as a result, pain deriving from loss; thus,bytakinglower riskstheymake lower gains.

Bernartzi and Thaler (1995) describe myopic loss aversionas the investors' tendency to apply more conventional strategies in short- rather than long-term processes. Despite the fact thatlong-term investment decisionsare more efficient than short-term ones, investors are more concerned about short-term losses.

In addition, myopic loss aversion affects how investments are perceived and evaluated. Investors have an individual attitude towardseach investment. They tend to evaluate the performance of specific investments (e.g. stocks) and do not take into account the bigger picture,that is, a portfolio as a whole, which entails maintainingthe specific investment in case of loss until it recovers. It is worth noting that when the investment horizon is also taken into account,the complete form of myopic loss aversionbecomes manifest.

Myopic aversion can also explain the high demand for bonds rather thanstocks, although, historically, stock returns have outperformed fixed securities. The investors' tendencyto invest in fixed-rate investment products (i.e. government bonds), despite theminimal return differences withstockswerediscussed by Mehra and Prescott in 1985 as an 'equity premium puzzle'. By using historical data from US stock and bond returns, they concluded that historical returns of non-fixed rather than fixed securitiesare not only slightly lower but sometimes greater than bond returns. The combination of heavy loss aversion with frequent evaluation of investment portfolios can explain this phenomenon (Benartzi and Thaler, 1995).

IV. The Research

The research investigates status quo bias and myopic loss aversion on the basis of a questionnaire delivered from 6 February to 19 March 2015 to Capital Market Commission registeredexecutives working in stock market companies in Athens.

Samplingdistribution and representativeness are sufficient:

• 23 companies participated in the research (43% - out of 53 companies)

• Representativeness: the participants are responsible for managing ~ 75% of the total value of transactions, (ASE, ATHEX - March 2015).

The corpus of data is comprised of 81 questionnaires including questions on a nine-item scale, adapted from relevant questions in the extant literature.

The question which investigates and attempts to demonstrate the advisors' tendencyto maintain a position, despite its negative and harmful impact on investment processes, is based on Samuelson and Zeckhauser, 1988 ('Status quo bias in decision making') and Nofsinger, 2001 ('The Psychology of Investing'), whereas the investors' myopic loss aversion and whetherfrequent portfolio evaluation causes sensitivity to loss is investigated via a questionbased on Benartzi and Thaler, 1995 ('Myopic Loss Aversion and the Equity Premium Puzzle'), and Gneezy, Kapteyn, and Potters,2002 ('Evaluation Periods and Asset Prices in a Market Experiment').

V. Status Quo Bias: Results

Toinvestigatestatus quo bias in relation to loss aversion in the investment behavior of the participating stock market executives,the respondents were asked to answer the following question:

"Do you tend to stick to loss-making investment choices and do not sell stockssimply because you wish to avoid loss? Answer the question on a scale from 1 to 9, where 9 is "Yes, I certainly do" and 1 "No, I definitely do not".

The results demonstrated that only 16% of the respondents (the total of percentages for items 7, 8 and 9) definitelytend tomaintainloss investing positions and try to avoid selling losses.Adherence to specific positions,especiallyto risk-related ones,derives from fear and aversion to the final outcome.

On the other hand, the number of negativeanswers is large. In detail, 50% of the executives are confident that they do not retain loss-making positions to avoid recording losses, and, thus, their negative answers to maintain negative returns reflectrational processes.

It is also worth noting thatneutral attitudestowards loss (10%, item 5) reflect a rational approachto maintaining loss-making positions.

In addition, the executives applying a more aggressive investment strategy do not adhere to loss-making positions (42%), whereas 35% of the respondents state their certaintyabout this tendency. As regardsportfolio managers, the resultsare encouraging, as 77% of themdo not adhere toloss-making positions and 46% state that they definitely do not.

Remarkably, the majority of the participating investment advisors' answers were negative(60%). Fear and loss aversion does not cause adherence to status quo, and portfolio management and counseling relies onrational attitudes.

The fact that there is a similarapproach towardsprofit-making and loss-making positions suggests a rational attitude towards portfolio restructuring andprofit maximization.

VI. Myopic Loss Aversion: Results

The question investigating loss aversion attitudes is related tothe bias which causes people to focus on the current state of affairsrather thanthe general conditions and processes.

"Do you think that frequent evaluation of your investment decisions makes you more sensitive to loss?"

The results demonstrate that one third of the subjects are more sensitivewhen they evaluate portfolio performance on a daily basis, and fear of loss is evident in investment processes. In addition to 12% (item 6) of those who demonstrate positiveattitudestowards frequent assessment, answer ratesreach 43% (31% + 12%).

Frequent portfolio control and evaluation is reasonable and necessary. However, it is likely tocausebiases and negative emotions as regards theprogressof investment processes.Fund managers, investment advisors and,overall, stock market stakeholders must be cool and rational, unaffected by emotions and fear, given that daily portfolio performance evaluation is a necessary task.By stating they aresensitive, 39% of the researched advisors and, equally,fund managers claim they accept pain, fear, and panic in case of negative returns, which may be both temporary and accidental.Thus, they are notcool and rational, as negative emotions will definitelycausewrongevaluationof their ownand their customers' negative returns. Accordingly, sensitivity to loss is interrelatedtoloss aversion.

Neutral attitudes demonstrated by 21% of the respondents (item 5) and negative answers about sensitivity(25% - the total number of answers for 1, 2 and 3, L3B) areconsistentboth with cool and impartialbehaviour,which is required in hard investment conditions, and also with rational thinking.

In addition, executives with poor experiencein investment processesstate that frequent control and evaluationof investmentsare sensitive to loss (66%). The respondents of a higher educational statusclaim they are sensitiveto loss when making frequent evaluationsof portfolio performance(48%), which suggests that their educational status could not prevent irrationality. The results demonstrate myopic loss aversion among the executives whoopt for long-term investments (51%), and,thus, admit they are wronglysensitive. Thespecific high ratecorroborates the argument that long-term investment decisions are treated as short-term ones.

Evaluation of decisions requires a calm, impartial and serious attitude, regardless of the time horizon in which itis placed.

VII. Conclusions

Rational investment decisions and choicesareprevented by the investors' bias to adhere to previous stock market processes and choices / decisions or make suitableportfolio restructuring bymaintaining loss-making positions as a result of fear and aversion to final decisions. In addition, rational thinking isinhibited by negative emotions and biasesin relation tothe progressof investment processes and frequentportfolio evaluation.

The present research, carried out on the basis of the answers given by the participating certified stock market executives, emphasizes the significant role of the two biases under research, namely, status quo bias and myopic loss aversion.

Sampling was based onconsiderations, such as themajor roleof the stock market executives, who, as influential and responsible for managing a considerable number of portfolios,are likely to upsetstock market equilibrium.Agreat number of the researched executives are sensitiveto portfolio performance evaluation on a daily basis, andtheir processes and decisions are governedbyfear of loss.

On the other hand, the number of respondents who state that they maintain negative returns and, thus,rely on rational decisions is very large. More than half of them do not stick to loss-making positionsin order to avoid recording loss. Remarkably, the irrationaltendency toadhere to specific investing positions is not typical of rational advisors and fund managers.

To conclude, the present research demonstrates the significance of the researched biases in investment decisionmaking and choices. Thus, it corroborates the vital role of thebehavioral paradigm andthemorecomprehensiveoutlook it provides against themainstream theory;in addition, it emphasizesthe fact that it must be employed as the dominant approachin investment decision-making processes and choices.

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