

## **The Difference Between Available and Useful**

Are you more likely to be killed by a falling airplane part or by an attacking shark? Are there more words that begin with the letter “r” or that have “r” as the third letter?

If you are like most people, you would say that a shark attack is a more likely way to die. You would also think about words like rat, raisin, run, recline, revolver and come to the conclusion that there are more words that begin with the letter “r.” But those two conclusions would be wrong. It is approximately 30 times more likely that you will be killed by a falling airplane part, and there are more words in the English language that have the letter “r” in the third position than in the first—car, dart, market, dark, turf, tart.

So why is it that we are so prone to answer incorrectly questions like that? It has to do with a phenomenon called the *availability heuristic* or the *availability bias*. And this may have much wider implications than whether you are good at answering random trivia questions or playing Scrabble. It might actually suggest whether you are a better than average investor.

### **Available, but Incorrect**

In the late 1960s and early 1970s psychologists Amos Tversky and Daniel Kahneman worked on examining how different mental shortcuts and biases affected the way people made decisions, especially in uncertain situations. One phenomenon they studied—which they called the available heuristic—was the strategy that people tend to make a judgment about the frequency of an event based on how many instances are easily brought to mind. This is based on the notion that if something can be recalled, it must be important, or at least more important than other alternatives that cannot be recalled as easily. Additionally, people tend to weigh their judgments toward more recent information, making those judgments biased toward the latest news.

In answering the questions above, most people try to think of which events come quickly to mind. In the case of words with “r” they try to think as many words as they can that start with the letter “r” and then do the same exercise with words that have “r” as the third letter. Go ahead and try it. You will find that it is much easier to come up with words that like “rain,” “rest,” “ramp,” and “rotate” than “afro,” “fury,” “part,” and “ward.” That greater mental “availability” of words that begin with the letter “r” makes people infer, incorrectly, that those words are more prevalent than words having “r” as the third letter.

### **Always Available in the News**

This mental shortcut has wide implications, from politics and public policy to business and investing. In this day and age of social media and the 24-hour news cycle, many people have fallen prey to the grasp of the available heuristic.



It seems all we hear about in the news, and from many politicians, is the terrible state the U.S. and the whole world is currently in. Several recent polls have shown that a large majority of Americans believe that global poverty has worsened or stayed the same for the last 20 years. But that notion is completely wrong. The number of people living in extreme poverty has actually dropped by half in the last twenty years, according to the World Bank. For the entire history of the human species until the 1960s, a majority of adults were illiterate. Now, 85 percent of adults worldwide are literate and that share is rising. In complete contrast to public perception, historians may infer that the most important thing going on in the world in the early stages of this century was a spectacular decline in human suffering.

### **Always Available in Investing**

A perfect example of the availability heuristic in action can be seen by the effect of the recent financial crisis. The stock market decline during this period left a lasting impression in the minds of many investors. Interestingly, Franklin Templeton did a Global Investor Sentiment Survey in 2010, 2011, and 2012 where they asked individuals how they believed the S&P 500 Index performed in 2009, 2010, and 2011. A large number of survey participants responded that they thought the benchmark was either down or flat in each of those three years. In reality, the S&P 500 Index increased each year: 26.5% in 2009, 15.1% in 2010, and 2.1% in 2011.

The recent housing crisis has also made a lasting impression on many Americans with respect to home ownership. The U.S. homeownership rate fell to the lowest level in more than fifty years in the second quarter of 2016. The proportion of households that are owner-occupied fell to 62.9%, a figure not seen since 1965. If what happened to the housing market were not so “available” in people’s minds, they might be able to recognize the fact that with interest rates at historic lows it is now more financially advantageous, with few exceptions, to be a home-owner than a renter.

The recent low interest rate environment is also creating an availability bias in the minds of many investors when deciding which stocks to buy. High dividend-yielding companies, such as utilities and consumer staples which are seen as good investments when interest rates are low, have seen shares rise to almost unprecedented valuations. This is greatly due to the fact that the recent Fed policy regarding interest rates is fresh in investor’s minds. But the most important fact to consider is not whether interest rates have been low—which is what is fresh in people’s minds—but what is likely to occur going forward. And in that case, betting on higher interest rates is probably a better bet, which is not necessarily a good thing for these stocks.

### **Conclusion**

Always be cognizant of the fact that you may be overly influenced by a constant barrage of information. Next time you’re thinking about making an investment decision based on a recent event or news story, take a step back and reconsider. Are you making the investment decision



because *all* facts support it? Or are you succumbing to the availability bias and giving more weight than is deserved to recent events? Just taking a little bit of time to re-assess the situation and avoid the mental shortcut of the availability heuristic may prove beneficial to your overall wealth.



Felipe Garcia, CFA  
Chief Investment Officer  
INKWELL CAPITAL LLC



Aaron Byrd, CFA  
President  
INKWELL CAPITAL LLC

