

Recommended Read: Noise: A Flaw in Human Judgment by Daniel Kahneman, Olivier Sibony and Cass R. Sunstein



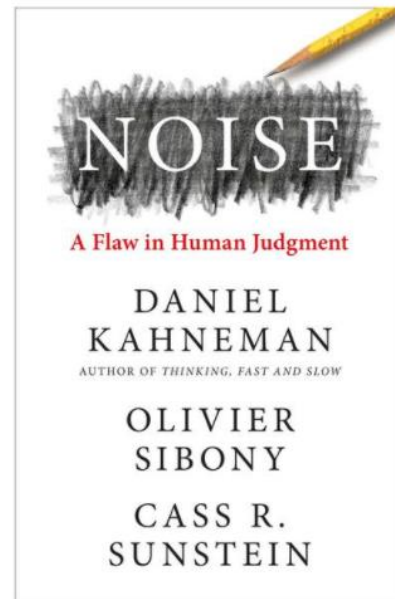
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Wherever there is judgment there is bias and noise. Our biases in decision-making have received a lot of airtime in the last decade, and particularly in the financial markets most of us are familiar with the human tendencies around seeking evidence to confirm what we have already done; anchoring to things like previous share price highs and lows; and even general tendencies to be either bullish or bearish. However, very few people are aware of noise in their decision-making, which is inconsistency in a decision outcome without a specific tilt to it like a bias. Would you definitely make the same decision about a stock or change in portfolio weighting or employee hire today and in a few weeks? Would the other members of your team or organisation make the exact same decision as you based on the same evidence? Probably difficult to answer because the idea of noise is not even on our radar.

This book provides evidence that noise exists across multiple industries and is relevant even to experts in their respective fields. From court judges to forecasters of all types to forensic fingerprint experts, the contribution of noise to errors in decision-making is not insignificant and noise audits suggest that depending on the environmental circumstances it can contribute as much to errors as bias – although it's far harder to post-adjust for because it doesn't lean in a particular direction like bias.

However, the authors go on to provide preventative measures to reduce noise which they term "decision hygiene", which, like washing your hands, protect you against you-know-not-what. One of these is teaming, but only if the experts in the team are truly independent, like sell-side analysts forming a consensus forecast. Within your organisation, anonymous voting and a culture that encourages people to adapt their decision as new information arrives, rather than doubling-down on an initial call, can increase independent thinking and thereby reduce noise.

In the financial industry, where rational assumptions underlie so much of the theory, the book is a thought provoking read that will have you re-evaluating how you and your team iron out more of the human kinks and resultant errors in your decisions.



Listen to this great interview with Daniel Kahneman entitled Why We Contradict Ourselves and Confound Each Other. It's not a summary of the book, but rather some insight into the person behind the Nobel Prize winning work we have come to associate him with.

<https://onbeing.org/programs/daniel-kahneman-why-we-contradict-ourselves-and-confound-each-other/>

If you're in the mood for a good story, we've previously reviewed and recommend The Undoing Project: A Friendship That Changed Our Minds by Michael Lewis. Lewis is a great storyteller and the partnership between Kahneman and Amos Tversky, whom he worked alongside for decades, is fascinating. Together they created the field of behavioural economics as we know it today and introduced us to our biases and irrationality.