The Positive Use of Negativity Bias

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In an article last week, I discussed how an understanding of three behavioral biases (in-group, confirmation and illusion-of-control bias) can help you gather more assets. Today, I will tackle another prevalent bias – negativity bias – and provide suggestions for how to use knowledge of its effects to your advantage.

An overview

Before examining negativity bias, it is important to revisit a fundamental misunderstanding of the decision-making process used by many advisors.

Decisions are most commonly made emotionally, not rationally. Numerous studies have demonstrated that most people rely on gut instinct rather than objective analysis when making important decisions.

When I was an advisor trying to gather AUM, I frequently ran into this issue. I have always been an advocate of evidence-based investing, but most of my prospects invested actively (by which I mean that they attempted to pick outperforming stocks, time the market or select the next “hot” fund manager). At the time, I was unaware of the role that emotions play in the decision-making process.

My approach was to inundate prospects with the overwhelming academic data and research supporting my investment philosophy. I couldn’t understand why logic and reason didn’t carry the day. I was rarely able to change the minds of prospects coming into the meeting with an active-management mindset, even though they couldn’t articulate any effective rebuttal to the points I was making.

Don’t fall into this trap.

Negativity bias

Negativity bias reflects our inclination to pay more attention to bad news than good news. It manifests itself in a variety of ways. According to psychologists who have studied this bias, we tend to remember insults more than praise. We also recall negative experiences more than positive ones. We are programmed to be “vigilant and wary.”
It’s not difficult to understand the prevalence of this bias among investors. The stock market is volatile. The financial news is filled with predictions of doom and gloom. Terrorist attacks, both in the United States and abroad, appear to be a constant threat. Global instability seems everywhere. Our trade deficit with China recently reached an all-time high.

Negativety bias causes us to ignore or minimize good news. By some estimates, instances of crime, violence and war are actually declining, but you would never know it from the media. Surveys have shown we are interested in war, weather, disaster, money and crime. The media is just giving us massive doses of what we want.

Dealing with negativity bias

Your prospect likely believes in some sort of a “doomsday” scenario, which heightens his anxiety. It’s clear to him that “trouble is waiting in the wings,” and he believes he should hold off “until things settle down” before making a decision about switching advisors.

Sound familiar?

The first step toward maximizing the possibility of converting a prospect with negativity bias into a client is to recognize the existence of the bias. Ignoring it won’t make it disappear.

Next, don’t fight it. Trying to persuade someone with negativity bias that his or her views are misplaced is a loser’s game.

Focus on the positive. Instead of debating the current state of world events, put them in perspective. If you have a 40-year-old prospect concerned about saving enough for retirement, explain that her focus should be on the value of her portfolio in about 25 years. Show her long-term risk and return data. It will demonstrate that the markets have shown an ability to recover surprisingly fast from major declines.

Above all, empathize with a prospect’s concerns. Empathy requires you to understand the feelings of others. The anxiety of your prospect is real. The worst thing you can do is trivialize it. Your goal is not to explain why their concerns are unfounded, but rather to help them understand and cope with the effects of negativity bias.

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