

Why smart people make bad money decisions ?

By AK Rao Personal Finance Advisory

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Why Smart People Make Poor Financial Decisions

It's Not a Lack of Knowledge. It's a Cognitive Bias.

Understand the 6 common biases that impact your money choices – and how to protect yourself from them.

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HERD MENTALITY
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Why do highly educated, experienced, successful professionals who analyse complex data at work every day make surprisingly poor decisions with their own money?

- It is not a lack of information. In the age of the internet, financial data has never been more available.
- It is not a lack of intelligence. Many of the worst financial decisions are made by the smartest people in the room.

It is called a **cognitive bias**. I have identified six of the most common ones below. I have experienced most of them myself.

What Is a Cognitive Bias?

Our brain is brilliant, but it is also lazy. It processes an enormous amount of information every second and, to cope, it takes shortcuts, called heuristics, that allow fast decisions without deep analysis.

This works beautifully when you are deciding whether a dark alley looks safe at night. It works **less** beautifully when you are deciding whether to put ₹20 lakh into a real estate scheme because the presentation had nice slides.

"The investor's chief problem — and even his worst enemy — is likely to be himself."

— Benjamin Graham, Father of Value Investing

He wrote this in 1949. We are still proving him right.

Six biases that show up most in financial decisions

Here is how each one appears in real life, and what to do about it.

1. Confirmation Bias

What it looks like: *You believe real estate always beats equity. So you read articles that confirm this, share them with friends, and dismiss the studies that show otherwise. Your view feels increasingly well-supported, because you built a one-sided library.*

The Fix: Actively seek out the opposite view. Before every major financial decision, ask: what is the best case against what I believe? A good financial advisor will challenge your assumptions, not just validate them.

2. Anchoring Bias

What it looks like: *You bought a stock at ₹800. It falls to ₹500. Every rational signal says move on — the business has changed, the sector has headwinds, better opportunities exist. But ₹800 is burned into your memory. So you wait. And wait. Sometimes for years. Not because of logic. Because of a number.*

The Fix: Ask yourself this question before every hold or sell decision: if I had never owned this and saw it at ₹500 today, would I buy it? If the honest answer is no, you are being held hostage by an anchor, not by investment merit.

3. Herd Mentality

What it looks like: *In 2021, everyone around you was talking about a particular stock or crypto. You felt the fear of missing out. You invested — near the peak. When it corrected sharply, you were left wondering why you did not see it coming. The answer: you were watching the crowd, not the fundamentals.*

The Fix: Price is not the same as value. Popularity is not the same as quality. Before following a trend, ask: do I understand this investment? What is the underlying logic? If the only reason to buy is that others are buying, that is a warning sign, not a recommendation.

4. Recency Bias

What it looks like: *After three years of strong equity returns, investors assume markets will keep rising. They shift heavily into equities, just before a correction. Equally, after a sharp fall, they exit entirely, just before a recovery. In both cases, recent experience has overridden long-term evidence.*

The Fix: Zoom out. A single year, or even three, tells you very little about the long-term trajectory of a well-diversified portfolio. Investment decisions should be based on a time horizon of years, not on the last quarter's performance.

5. Overconfidence Bias

What it looks like: *Research consistently shows that most individual investors believe they are above-average stock pickers. The data tells a very different story: the vast majority of active retail traders underperform simple index funds over a 10-year period. The confidence feels real. The results do not match.*

The Fix: Humility is a financial strategy. A simple, low-cost, well-diversified index portfolio beats most active attempts at stock selection over the long term. Knowing what you do not know is one of the most valuable edges in investing.

I include myself in this. Early in my career I was convinced I could read the market better than most. The market patiently and repeatedly showed me otherwise. Index funds became considerably more interesting after that education

6. Status Quo Bias

What it looks like: *You know your ULIP is underperforming. You know your health insurance has a room rent cap that will hurt you in a real emergency. You know you should review your portfolio. But changing anything feels complicated and uncertain. So you do nothing — and the cost of inaction quietly compounds.*

The Fix: Inaction has a cost, it is just invisible. Set a calendar reminder once a year to review your financial plan. Not to make major changes every time, but to ask: is this still working for me? Small course corrections made regularly prevent large corrections made urgently.

Why smart people are not immune?

Intelligence does not protect us from these biases. In some ways, it makes them worse.

Intelligent people are better at constructing arguments. So when a bias leads them to a flawed conclusion, they are also better at finding smart reasons to justify it. The bias gets a better lawyer!

"It is not what you don't know that gets you into trouble. It is what you know for sure that just ain't so."

— Charlie Munger, Vice Chairman, Berkshire Hathaway

The professionals who tend to make the best long-term financial decisions are not necessarily the ones who know the most. They are the ones who have built a system. A process, a plan, a set of rules that reduces the role of in-the-moment emotion.

Building a system that protects you from ‘yourself’

You cannot eliminate cognitive biases. But you can build guardrails that reduce their impact.

Practical steps that help:

1. Write down WHY you are making a financial decision before you make it. Revisit it later.
 2. Automate your SIPs. Remove the monthly decision..
 3. Review your portfolio once a year. Not once a week. Frequent checking amplifies anxiety, not returns.
 4. Find someone who will disagree with you. A good advisor should challenge you, not just agree with you.
 5. Use your written financial plan as your reference. Not the news, not your friend’s portfolio.
 6. Before selling in panic or buying in excitement, sleep on it for 48 hours. Many decisions improve dramatically.
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Bringing It All Together

I wrote this article partly as a reminder to myself.

After many years of working with investors and markets, I still catch myself anchoring to a price, or nodding at an article that conveniently supports what I already think.

A reasonable plan, consistently followed, will outperform a brilliant plan that gets abandoned the moment markets get uncomfortable

If any of this resonated or reminded you of a decision you are currently sitting with, I would be happy to talk it through.



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