Understanding How Social Media Affects Investor Biases

By April Rudin
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The concept of behavioral bias has long existed in the investment industry. Wealth managers know that clients come to them with preconceived notions about how they want to approach their investment strategies—whether or not they actually know it. For advisors this means dealing with the biases of their clients, conscious and unconscious, as they find appropriate investments and manage risk appetites.

Understanding Behavioral Biases

When we speak about economics and financial theory, we assume that individuals act rationally, making decisions after considering all the available information. But the market is not rational, and neither are individuals. Behavioral finance takes that reality into consideration, as the CFA Institute writes. All investors experience common cognitive biases including mental accounting, familiarity, overconfidence, and loss aversion.

U.S. financial services firm Raymond James in March 2019 found in a study that more than two in five self-described “calculated” respondents say that their emotions are extremely or very influential in their investment decisions. About 45 percent also say that news headlines are a significant factor in their decision-making. Those numbers show that even investors who consider themselves rational and logical may be letting emotions and outside influences sway their financial choices.

Behavioral biases change, depending on what investors are exposed to. It will certainly be no surprise to anyone that since the internet was introduced, investor behaviors have changed drastically. Social media has spurred even more changes, as has been evident in recent global elections. In theory, the vast amount of information available online should help individuals become better educated and expose them to new ideas and information. But the prolific use of Twitter as an information platform by politicians and others demonstrates how important social media is in sharing facts—and also falsehoods and opinions. Now investors have to deal with their own biases as well as the permeation of the biases of others, as iSPYETF founder Simon Maierhofer pointed out in a MarketWatch article. Every headline, blog, or tweet conveys someone else’s bias and has to be filtered through our own.

But people continue to look to social media for information. Analytics provider Greenwich Associates found in a 2015 study that four out of five institutional investors frequently use social media at work. Of the 250 asset owners interviewed for the report, almost one-third said that the information they consumed through social media has influenced their investment decisions.

Likewise, LinkedIn found that a fourth of U.S. high-net-worth (HNW) individuals say that they turn to social networks for financial purposes, including keeping up to date on trends, seeking advice and gathering information in relation to a financial decision, and gathering information about financial products and institutions.

And that just takes into account the conscious biases. It should not be hard to imagine from one’s own social media use just how much posts from friends, media headlines, and advertisements can seep into one’s thoughts.

Headline risks are amplified when individuals see constant flashes of news across their phone screens. Online conversations can help educate investors, but at the same time they can create insulated bubbles of information that are not always accurate. Today’s investors live in an era of “fake news” and misinformation. Many will be able to filter information as it comes to them, but wealth managers need to be prepared for the challenges associated with this type of news consumption.
So, how then does the 24–7 cycle of information living on the internet and through social media affect our understanding of behavioral finance?

**FACING CHALLENGES IN A 24–7 WORLD**

With easy access to a vast array of websites, blogs, infographics, and photos, anyone who uses the internet faces an information overload. Sometimes it’s a slippery slope of Wikipedia pages as we research a new topic. Other times it’s headline after headline on topics such as the U.S.–China trade war. When information is presented as “breaking news” it adds another layer, overwhelming or confusing people.

It seems unlikely though that the overload of information is going to turn people away from the internet. According to a survey from research provider Global Web Index, internet users spend an average of two hours and 22 minutes per day just on social networking and messaging platforms. Younger investors spend more time on these platforms, with those between ages 16 and 24 averaging three hours per day on social media. Those older than age 45 spend less than two hours, but still more than one, on average.

The reality is that just about everyone, no matter their age, gender, or wealth, has adopted the internet as a part of their lives. In many ways, it has become a great democratizer. A PwC study found that 98 percent of HNW individuals access the internet daily, and they expect online and digital access to be incorporated in many aspects of their lives, including their investments. Even though these wealthy individuals tend to be older, they also use social media. LinkedIn reported that 70 percent of U.S. HNW individuals use social media. About half access social media on a tablet, and two in five use mobile phones, which makes access even easier than a desktop.

Likewise, many HNW individuals consider themselves to be quite tech savvy, because they often can afford to be early adopters of new technology. New technology is usually more expensive than the average person can immediately afford. Accenture Consulting found that more than 40 percent of the wealthy investors they surveyed consider themselves to be early adopters of technology.

Another of the most common challenges investors face in the social media era is that of “herding.” Herding is the “everyone else is doing it” mindset, or “fear of missing out” at its finest. Social media marketing company Buffer calls it the “bandwagon effect.” Buffer looks at such groupthink through a marketing lens with regard to product sales, but the effect is similar with investors. “The idea is that the rate of uptake of beliefs, ideas, fads and trends increases the more that they have already been adopted by others,” the Buffer team wrote in a recent blog post.

After all, as Buffer points out, “people prioritize products and ideas that are popular with a group they’ve aligned themselves with.” These groups are easy to spot on social media, through friend connections, professional contacts, and group pages, be it alumni groups, neighborhood associations, or other factions that people self-select to associate with.

IT’S NOT UNCOMMON FOR PEOPLE TO EMBRACE THE HERD MENTALITY IN LIFE IN HARMLESS WAYS, SUCH AS JUMPING ONTO A NEW FITNESS TREND OR VISITING A CERTAIN CAFE FOR THE SAKE OF A GOOD INSTAGRAM POST. FOLLOWING FRIENDS INTO THESE TRENDS IS NORMAL AND INNOCENT. BUT AS SEATTLE-BASED MILLENIAL WEALTH POINTS OUT ON ITS WEBSITE, MARKETERS AND “INFLUENCERS” USE THIS EXACT TENDENCY TO TARGET INDIVIDUALS AND INFLUENCE BUYING DECISIONS.

For those who are loss averse, frightening headlines about market downturns or impending volatility can cause knee-jerk reactions. These investors will be prone to hasty decisions, driven by their emotions after they see a headline or post bemoaning the fall of commodities, for instance. It can be challenging to keep a client focused on long-term goals when all they see is near-term self-offs and market corrections that leave them feeling hurt.

Investors know it too. Seven out of 10 investors say that news headlines influence their investment decisions, according to a study from Raymond James. About 35 percent of investors say that their emotions are extremely or very influential to their investments.

This challenge is especially prevalent among younger investors, as CNBC pointed out in a recent article. The millennial investors that were interviewed remember how the financial crisis hit right around the time that they were looking for their first jobs. Some of them also remember the tech bubble bursting. Even though they likely weren’t investing at the time of those market downturns, the echoing effects have left millennials feeling sensitive about losses in their portfolios and may have led them to cautious investment strategies.

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choices directly target self-conscious readers, telling them that they’re missing out on something that they should be a part of, as marketing company HubSpot pointed out in a blog. People have an innate need to rid themselves of the tension they may feel if they think they are out of the loop on something important.

Similarly, people are motivated by the potential to receive a reward, according to HubSpot. If they think they’re going to get special knowledge, they’re going to feel the need to click a link and read about the latest investment trend. Or, if a social media post or headline is worded in a way that makes a person feel like there is a standard that they need to be participating in, they’re going to click to learn more. A post from a friend that says, “10 terrible pieces of advice your wealth manager is telling you” is going to be enticing to read. No one wants to fall behind their peers, whether or not their peers are correct.

But when it comes to investing, following the herd could mean following an investment trend when it’s too late to benefit from the potential rewards. Additionally, what’s right for one person may not be right for another. The trend may go against the tailored plan that a financial advisor has for a client.

It’s certainly been seen before. Just look at the dot-com bubble of the late 1990s and early 2000s, as Millennial Wealth points out. During that time, investors flocked to technology stocks, fearing that they were missing out on the boom and returns from which others were benefiting. But looking back, it’s easy to see that many of the stocks that people bought into at the time were drastically overvalued. Eventually, as we now know, the tech bubble burst, leaving behind only the companies with fundamental value.

More recently, global attention has turned to the failed Fyre Festival, a luxury music festival set to take place in 2017 that promised much and delivered little. In the documentaries, articles, and discussions that have happened since, many people have questioned how so many affluent millennials literally bought into a promise that was so doomed to fail. As written in Forbes recently, the festival showed how far people will follow social media influencers, how much they need to feel like they have exclusive access, and how much they need to share it on social media themselves. It’s a cycle that catches many people in its wake.

Confident investors can get caught up in another bias—overconfidence. With the amount of information investors have access to, it’s easier for them to become overconfident in their investment knowledge. These investors may just think that they’ve done their research before speaking with their wealth managers. But instead of being open to their advisor’s opinions about how a strategy would work for them personally, these investors may dig in their heels, citing the information they read online or heard from friends. In these cases, investors won’t be looking to their advisors for information to weigh the pros and cons of potential portfolio changes. They’re coming straight in with instructions of what they want their advisor to do next.

Understanding the role of social media

All of this isn’t to say that wealth managers should encourage investors to stay off social media and put on blinders. Fortunately, there are always ways to battle investor biases, and financial advisors are key to that.

Most investors seem to know better than to seek out financial information from companies on social media. A 2018 article in Lehigh Research Review, published by Lehigh University, noted that financial disclosures on social media lead to investors being skeptical of the management’s credibility, as opposed to when the information is read on the company’s website. This shows a healthy amount of questioning on the part of investors, and it also shows that social media can backfire on companies that are trying new ways to communicate and keep up with technology trends.

There is also a lot of value in the use of the internet, as far as opportunities to educate investors. Financial advisors themselves should think about the opportunities for using social media as a way of communicating with current and potential clients. The conversational tones and ease of access on these platforms can allow wealth managers to inform and educate.

This can help battle another common investor bias known as familiarity. Clients with this bias tend toward strategies or investments that they feel comfortable with because they know it. Advisors should try to encourage investors to look at options outside their realm of familiarity by educating the investors, expanding their financial fluency, and introducing them to new ideas. Financial advisors posting on social media may find that their clients are digesting material better, or at least differently, than from email or print. What better way to start the move to outside an investor’s comfort zone than by communicating on platforms that an investor is familiar with? But, as PwC found, only one in 10 wealth management firms uses social media with clients. That seems to be a significant gap, considering how many clients use these platforms.
After all, as Raymond James found, 85 percent of survey respondents with a financial advisor report being influenced when making decisions by research and ratings reports published by investment firms.\(^1^8\) Data coming from advisors can put the risks and rewards of investment changes into a better perspective.

**BATTLING BIASES HEAD-ON**

Advisors have many options for inspiring healthy investment behavior and encouraging clients to think for themselves. Such conversations may need to be more proactive on the part of the advisor during times such as bonus season or tax season, when personal finance is more prevalent in headlines and chats with friends and family.

Likewise, advisors should speak with clients about prioritizing the quality of the information they consume over the quantity. Advisors should make sure that clients know they are readily available to identify which information will be most relevant to their portfolios and financial plans, allowing them to filter out information to ignore. It’s easy for investors to be inundated and overwhelmed, which allows biases to surface. According to Buffer, “This is the effect where our mind searches for, interprets, favors and recalls information that confirms or amplifies beliefs that we already have.”\(^1^9\) It’s undoubtedly easier for people to stick with beliefs that they already had, or cling to ideas that friends have proposed, rather than take the time and energy to challenge those ideas. Advisors will need to sort through this by strategically using questions to add clarity for clients.

For instance, advisors should ask their clients to consider the following: What are you hearing that is cause for your concern? What do you propose we do based on this concern? How much of that is in response to the news or markets, versus your particular plan or goals? These questions will help clients know what they don’t know. This allows an advisor to add more value for clients, redirecting their attention to ways they can succeed and stay on track with their investment goals.

Advisors also may find it useful to try a test scenario with clients, helping them to visualize the cause and effect of a strategy or investment they are suggesting before making the change. This helps expose gaps in an investor’s plan and allows the advisor an opportunity to show other options that are a better fit for an individual’s portfolio.

**CONCLUSION**

We have no debate about the continued prominence of the internet and social media in our lives going forward. But how technology, information, and communication on social media platforms plays a role in investment decision-making is up for grabs. Financial advisors can hope that with time every investor will become more internet savvy, ready to filter out bad information and absorb the good, all while educating themselves on personal finance. Sadly, it seems that it will be quite some time before that happens. In the meantime, wealth managers are well-positioned to use their knowledge of behavioral finance and apply it to the internet era to move their clients forward through the twenty-first century.

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**ENDNOTES**

2. All Raymond James references came from an interview with Frank McAleer, senior vice president—wealth, retirement, and portfolio solutions for Raymond James in March 2019.
8. See endnote 5.
10. See endnote 2.
17. See endnote 7.
18. See endnote 2.
19. See endnote 12.

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