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Your Usual? Familiarity Bias Means Sticking With What You Know – but There May Be a Lot That You Don't

Presented by Chris Long

Are you a creature of habit? When you visit the store, do you fill your cart with the products and brands you've bought for years? Is that because they're the best of the options… or because they're what you know best? It can be hard to tell.

GET FAMILIAR WITH FAMILIARITY

A familiarity bias is the subconscious tendency to gravitate toward what we know, often without realizing it. It's why you might place the same coffee order every time without thinking twice, or perhaps why you've consistently owned a particular brand of car.

Going with what you know isn't always a bad thing. However, when it comes to your financial plan, leaning too heavily on what's familiar can lead to an underdiversified portfolio and gaps in your wealth plan. In playing it safe, you could be putting yourself and your hard-earned wealth at risk.

HOW CAN A FAMILIARITY BIAS DISRUPT YOUR FINANCES?

Familiarity can sway people to make decisions that aren't aligned with their holistic financial picture. In investing, this often leads to a lack of diversification in portfolios. For example, if someone is selecting investments based on familiarity, they might be overweighted in domestic securities, or a disproportionate number of investments could be large, well-known companies.

Just because you like a company as a consumer doesn't mean it is the best fit for your portfolio. And just as we shouldn't overestimate what's familiar, we shouldn't necessarily underestimate what's unfamiliar. For example, someone might not know much about certain estate planning solutions but that doesn't mean these specialized vehicles aren't a good fit. Similarly, an individual may opt for a traditional savings vehicle instead of considering alternative solutions like tax-free savings accounts.

THE GUARDRAIL

While we all enjoy taking the path more traveled, that doesn't mean familiarity needs to get in the way of your long-term financial success. Fortunately, there are several steps you can take to help avoid the potentially negative effects of familiarity in your financial plan.

Seek out objective research in all elements of your wealth strategy. For your investments, this can help you vet a security for its risk level and historical performance. Your advisor can provide research about individual investments and can also offer guidance and recommendations to help ensure you have a well-balanced portfolio that fits into your larger wealth plan.

A review of your comprehensive financial plan can look at incorporating strategies and solutions that may be a good fit for you – including those you might not be familiar with. Using sophisticated planning software, an advisor can monitor your progress and adjust as needed to make sure your financial plan is aligned with your long-term goals.

Put simply, there are many factors to consider when crafting a healthy financial plan. Your financial advisor can provide you with the experienced insight and knowledge you need to address each of your objectives.