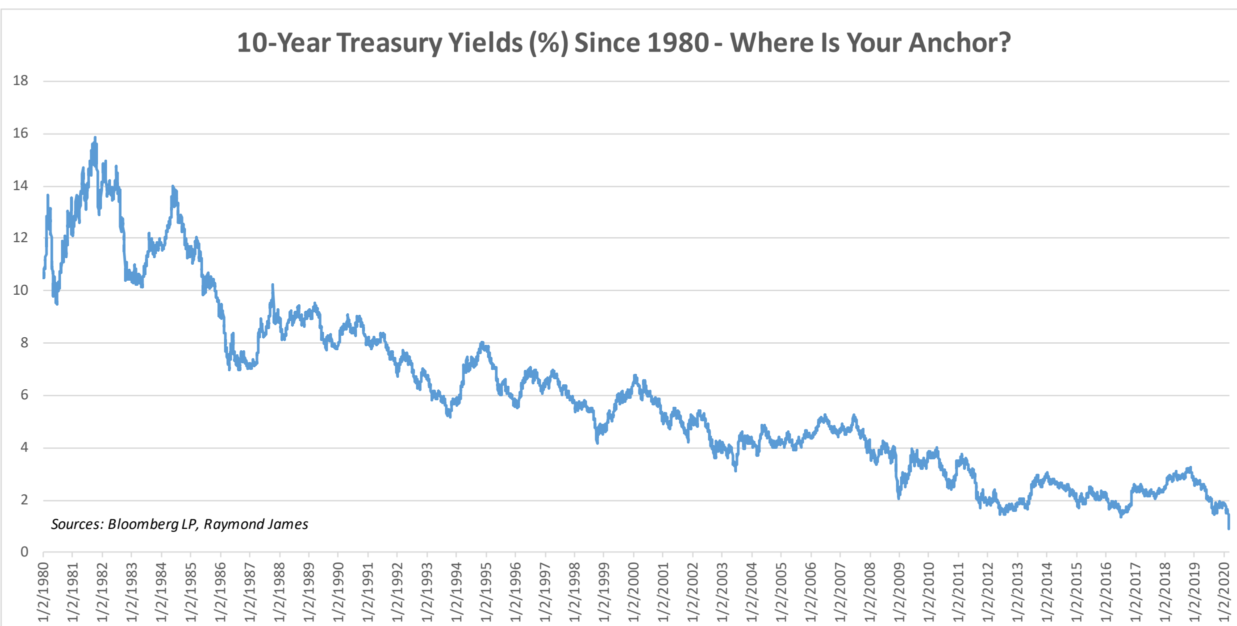
RAYMOND JAMES

Anchoring Bias and Fixed Income Investing

Fixed Income Solutions

As investors, unfortunately, we do not dictate the price at which we purchase an investment from the marketplace. As we know, the opposite is true: the market determines the price. We can wish all day for the market to let us purchase shares of Amazon stock at a price of $100/share, but no matter how hard we wish, it's not going to happen. Amazon has not traded in the $100 range in over 10 years. Does this mean that investing in Amazon at its current price is not a good idea and you should wait until it drops back down to $100 before investing? Probably not, Amazon may never again drop down to that price. If Amazon stock fits into your overall allocation and long-term plan, then purchasing at today's price is a perfectly fine decision.

The same logic applies to investing in fixed income. Just because you remember the 10-year Treasury being at 5% back in 2006, does not mean that you should wait until yields return to 2006 levels before investing in fixed income. Yields have been falling steadily for nearly 40 years. No one knows what the future holds, but there is no certainty that we will ever see yields back at 2006 (or 1996, or 1986…) levels again in our lifetimes, simply because we want to see those levels or because we remember when that interest rate environment existed.



Viewing current price or yield levels and making a judgement of value based on what we considered a "normal" level in the past is referred to in psychology as an **anchoring bias**, meaning that our minds are "anchored" to the past value and use it as a benchmark to determine value. Every investor is going to have a different “anchor” for interest rates. This is commonly tied to some point in the past that our minds are anchored to, but could also be linked to what “experts” claim a *normal* level for interest rates is.

When deciding as to what to invest in and when to invest, investors are oftentimes letting these mental anchors guide their decisions, which can be very dangerous. It is easy to let this mentality lead to allocating money that should be allocated to fixed income into other asset classes because as the investor, we want to wait until yields return to more *normal* levels. These *normal* levels may never return, leading to a chronic over-allocation into riskier assets. It is important to remember that each asset class has its purpose in a portfolio. Fixed income is often meant to be the stable ballast that a portfolio is structured around, focused on consistent income, cash flow, and return *of* principal (not necessarily return *on* principal); something that fixed income substitutes often struggle to replicate.

A prudent investor should look around at the current landscape and assess where the best current value is and determine how to best take advantage of the current situation to help reach one’s long-term goals. Instead of waiting and trying to predict when yields will return back to desired levels, investors should be asking more useful questions. Taxable or municipals bonds? Where on the yield curve should I position? What are my liquidity needs? What is my risk tolerance? What is the long-term goal for my portfolio? Answering these questions can be much more productive than letting your brain be pulled on by an anchoring bias and wishing things were like the good ole days.

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