More choice is always desirable. This maxim is widely accepted in the investment arena and in general. Certainly more choice can’t have drawbacks—can it?

In The Paradox of Choice, author Barry Schwartz, a professor of social theory at Swarthmore College, argues that constantly making decisions—whether it’s about health care options, televisions, or investment products—can result in behavioral biases, stress, and poor decisions. He suggests “the fact that some choice is good doesn’t necessarily mean that more choice is better ... there is a cost to having an overload of choice.”

This article shares insights from The Paradox of Choice and discusses implications of increased choice for investors. Investors cognizant of the pitfalls of choice may find success adhering to a disciplined investment strategy.

The Proliferation of Choice and Its Cumulative Effects

Schwartz acknowledges that American culture in particular treasures freedom of choice, variety, and self-determination. More choice may suggest more control, lack of restriction, and more opportunity. He notes, “Our culture sanctifies freedom of choice so profoundly that the benefits of infinite options seem self-evident.”

However, Schwartz asserts that having more choices may impair decision-making by awakening behavioral biases such as adaptation, regret, missed opportunities, raised expectations, and feelings of inadequacy.

Exponential growth in options and opportunities demands much more time and concentration on the part of decision-makers. Schwartz argues, with ubiquitous choice leading to three unfortunate effects:
1. Decisions require more effort
2. Mistakes are more likely
3. Psychological consequences of mistakes are more severe

He suggests there is a detrimental cumulative effect that can result in distress: “As the number of options increases, the effort required to make a good decision escalates as well, which is one of the reasons that choice can be transformed from a blessing into a burden. It is also one of the reasons why we don’t always manage the decision-making task effectively.”

In short, Schwartz argues that more choice does not always give the decision-maker more control or result in good decisions.

Decision and Indecision

Does too much choice really contribute to indecisiveness or poor decisions? Schwartz argues that pressure to select the best choice can be paralyzing. He shares results of a study conducted in a gourmet food store. Researchers set up a display of gourmet jams where shoppers could taste samples. Two settings were created. In the first, six of 24 varieties were set out for tasting. In the second, all 24 varieties could be sampled. In each setting, shoppers could buy any of the 24 jams.

The wider offering attracted more shoppers but only 3 percent of them made a purchase. At the more-selective display, 30 percent of shoppers who visited bought a jar of jam.

Why would shoppers be 10 times more likely to buy jam when they have fewer options?

Schwartz postulates these explanations:
• A wide range of options increases the effort needed to make decisions, thereby discouraging consumers.
• The effort that decisions require

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may detract from enjoyment of the choice.
• Thinking about the attractiveness of all the unselected options may lead to indecision—or regret after a decision is made.

These reasons could easily apply to investment and its myriad choices. Consider the migration of retirement plans from defined benefit (DB) to defined contribution (DC) and the shift in responsibility from employers to employees in selecting investment products. But unlike the shoppers in the jam study, employees cannot refuse to choose.

So how do they choose? Schwartz cites a study that found that when faced with many retirement-account options, employees tend to spread their choices over many options and/or defer to experts. But if most options are aggressive investments, a DC participant who simply divides contributions across them may falsely believe he has achieved diversification in his retirement portfolio. In other words, many participants may not understand the differences in investment products.

We believe that people generally profess an interest in more choices, more options, and more control. Schwartz suggests, however, that an array of options can be perceived as a burden. He cites a study in which 65 percent of people surveyed said if they were to get cancer, they would want to choose their treatment. However, the study found that among people who do get cancer, only 12 percent choose their treatment. Confronted with a high-stakes decision, one may see choice among a great variety of alternatives as a burden, and emotional biases may come into play.

**The Investor and Choice**

Schwartz’s book is relevant for investors because his insights are pertinent, even in a context outside of investments.

Schwartz observes that many national news sources (CNN, USA Today, etc.) tell the same stories. “When you look and listen,” he writes, “you assume it must be true.” Consider a company suffering a temporary setback, where many news outlets are writing the company’s obituary. Or consider a stock that grows hot after several rave reviews, thereby raising expectations. This incessant stream of “news,” Schwartz writes, “can create a bandwagon effect, leading quickly to a broad, but mistaken, consensus.”

Investment decisions also can be biased when choice is seen as a burden, just as in the jam study discussed above.

To illustrate, Schwartz cites a study where participants read about two investors. The first owns shares in Company A. He thought about switching to Company B but decided against it. At the end of year, he finds out he would have earned $1,200 more if he had switched to Company B. The second investor owned shares of Company B, but during the year switched to Company A. Likewise, this investor would have been better off by $1,200 if he had stayed with Company B.

Does one investor experience more regret than the other? Both decided against alternatives that would have made them richer by $1,200. In the study, however, 92 percent of respondents said they thought the second investor would feel more regret. This suggests that once the decision-maker takes action, the burden of that choice may sit squarely on his or her shoulders.

Schwartz points out that the more time spent thinking about opportunity costs (i.e., the alternatives not chosen), the less satisfying the chosen alternative. It can be emotionally unpleasant to think about opportunity costs and the losses they imply.

### How Decision-Making May Go Wrong

Perceptions and experience can create behavioral biases that may distort decision-making. For example, people may be biased by a most-recent experience and neglect a history of experiences.

Schwartz cites a laboratory study that demonstrates the extent to which the recency bias can overpower logic. Participants listened to a pair of very loud, unpleasant noises through headphones. The first noise lasted eight seconds; the second lasted 16 seconds. The first eight seconds of the longer noise were identical to the first noise, and the second eight seconds were less loud but still loud and unpleasant. Indeed, the second noise was worse because the unpleasant sounds lasted twice as long.

Surprisingly, when participants were told they would have to listen to one of the noises again, the “overwhelming majority” chose the second noise, which was twice as long. While both noises were abrasive, the second noise had a less-unpleasant ending, which apparently is what the participants remembered.

Similarly, we believe that an investor may base decisions on most-recent experience, such as a manager’s short-term performance, without fully weighing the potential effect of the decision on long-term strategy.

Schwartz notes that resources that people often believe help them make decisions can lead to an overload of information that may be biased or conflicting. The Internet, for example, allows immediate access to an avalanche of information.

“...it’s not just the amount of information available but the...”
frequency with which people are exposed to new information that presents a challenge. The average American is exposed to 3,000 advertisements every day—or about 200 ads per waking hour—between the Internet, radio, magazines, newspapers, and television. For an investor who doesn’t understand the importance of disciplined, long-term investing, this barrage of information may represent an obstacle to maintaining a disciplined investment strategy.

Anecdotal information, such as a stock tip, also raises biases. Often the temptation to act on anecdotal information can outweigh logical, more-objective conclusions. Consider Schwartz’s example of a consumer shopping for a new car. The consumer may review a respected magazine to gather information on model reliability. This magazine bases its conclusions on the experiences of thousands of people.

But what happens when a friend shares one negative experience about a model that the consumer is considering? This information is based on one experience, not thousands of experiences, and therefore should carry much less weight, or none at all, compared with the magazine review.

However, that’s typically not what happens.

In our opinion, people typically pay substantial attention to this type of anecdotal information, whether it’s about a stock tip or a car, even to the extent of letting it cancel their objective research. Why? As Schwartz explains, because the anecdotal stories “are extremely vivid and based on a personal, face-to-face account.”

This tendency, commonly labeled the “availability heuristic,” suggests that people overweight information that is more vivid or more recent. Schwartz cites an example of college students mulling which courses to take next semester who tended to overweight one videotaped interview with a student, even when it contradicted a summary of course evaluations from hundreds of students. Thus a whispered stock tip, especially one delivered by a relative or close friend, or a television interview with a charismatic chief executive officer, may carry more weight than an objective investment strategy that would demand a more sober, detached, and integrative assessment.

Schwartz also investigates other behavioral biases that may interfere with objective decision-making, including the following:

- **Anchoring.** A comparative price or number is offered to influence the appeal of another price. For example, an appliance company may introduce a more expensive model to make the first model seem a bargain.

- **Framing.** Two choices may be identical, but presentation can influence which seems more appealing. For example, a gas station might raise prices by 3 percent, then offer a 3-percent discount for paying with cash (appealing) rather than a 3-percent surcharge for paying by credit (less appealing).

- **Sunken costs.** People may be sensitive to realizing a loss and thereby reluctant to acknowledge missteps. For example, a sports fan buys a ticket to a soccer game, then loses the desire to attend, but still goes because he doesn’t want to “lose” the money spent buying the ticket. The bottom line is the money was already spent—the focus should be on the best course of action now.

- **Endowment effect.** People dislike giving up things they see as already theirs. For example, car buyers were offered a car loaded with options and asked to eliminate the options they didn’t want. Next, car buyers were offered a car with no options and added the features they wanted. The first buyers ended up buying many more options.

For some people, this tendency, commonly labeled as “Maximizers,” is often seen as being more successful. To what extent can this impair decision-making?

Schwartz identifies research that shows that positive emotion, or a “good mood,” strengthens thinking in making decisions and allows us to be more open to considerations and broader understanding. Negative emotion, however, leads to fear, closed-mindedness, and a focus on the emotion rather than the decision itself.

Schwartz observes:

This creates something of a paradox. We seem to do our best thinking when we’re feeling good. Complex decisions, involving multiple options … demand our best thinking. Yet those very decisions seem to induce in us emotional reactions that impair our ability to do just the kind of thinking that is necessary.

In addition, we believe that as the number of options increases, the need to justify decisions also tends to increase.

The Paradox of Choice shows how even successful results can lead to regret when decision-makers dwell
on the "nearness" effect, or how close they came to an even more compelling result. One would expect, for example, that Olympic silver-medalists would be happier than Olympic bronze-medalists. Schwartz cites a study, however, that found that, on average, bronze medalists are generally happier than silver medalists, who tend to focus on their greater nearness to gold. Bronze medalists, on the other hand, think about how close they came to winning no medal at all. This suggests that how you perceive and compare results, whether in Olympic performance or in investments, can affect your satisfaction and objectivity.

According to the insights of The Paradox of Choice, how are people likely to respond when making investment decisions? Certain amounts of fortitude, commitment, and discipline are needed for investment success. As legendary value investor Benjamin Graham noted, taken as well as outcomes of their foregone options (the roads not taken).

Regret also may surface in investing decisions involving sunk costs. Investors may be tempted to hold a losing investment to avoid acknowledging a misstep. Instead, Schwartz says, "What should matter in decisions about holding or selling stocks is only your assessment of future performance and not (tax considerations aside) the price at which the stocks were purchased."

Several studies cited in The Paradox of Choice have documented this sunk-cost bias. Respondents in one study were given a hypothetical situation where they had purchased nonrefundable lift tickets for two different ski resorts, and then found the tickets were for the same day. One of the tickets cost $50, while the other ticket cost $25. They also were told there was good reason to believe they would have a better experience on the $25 trip. However, the majority of respondents chose to go on the $50 trip, ignoring the fact that the money was already spent.

Schwartz argues that sunken-cost regret is greater when:
• a person bears responsibility for the initial decision, be it lift tickets or stocks; and/or
• an individual can easily imagine or measure a better alternative.

An increase in the number of choices, Schwartz contends, can exacerbate both factors. For example, where there are no competing options, one may have disappointment over the results but not regret. However, the more alternatives that were present in the beginning, the greater the regret in hindsight (as Schwartz puts it, the more "if only’s" you will be able to generate).

Investment decisions usually carry more weight and importance than daily decisions such as what to eat, who to call, and what toothpaste to buy. As investment results unfold, investors may have emotional reactions, good or bad, to the outcome. It would make sense for investors to manage their expectations so they are not taken by surprise, or likely to panic, if the interim performance is less than favorable.

However, behavioral bias may interfere with their level of expectations. Schwartz notes that "human beings are remarkably bad at predicting how various experiences will make them feel." He also suggests that nearly every decision involves a prediction about future emotional response.

For investors, the challenge of trying to predict their responses to outcomes can impair their ability to objectively evaluate investment performance. "If people err systematically and substantially in making those predictions, it's likely they will make some bad decisions," Schwartz writes.

In Closing

Behavioral biases may affect how people make investment decisions as well as how they evaluate these decisions. Schwartz offers four comparisons that investors are likely to make in evaluating decisions. Following each comparison is an example that applies to investors.

1. Comparing an actual experience to what the investor expected it to be—"I thought this manager delivered

2. Comparing the experience to what the investor expected it to be—"I thought this manager delivered

The Paradox of Choice, Schwartz observes that people often choose the options that minimize the chance of regret. Investors learn the outcome of their investment choices (the road
annual returns of roughly 15% over time; that’s not what I got recently.”

3. Comparing the experience to other experiences the investor has had in the recent past—“This stock was doing well for a while, but now that the price has retreated, maybe it’s time to sell.”

4. Comparing the experience to others’ experiences—“My brother-in-law is bragging about the biotech stock he owns. Why have none of my investments gone up three-fold in the past two years?”

Schwartz shares the valuable insight that comparisons often lead to high expectations, which can result in changing investments at the wrong times for the wrong reasons instead of staying the course. As Schwartz reminds us, high expectations can be counterproductive. He notes that “how am I doing?” always carries “compared to others” in parentheses.

The logical lesson is to avoid or limit comparisons, especially regarding investment decisions, when they may be misleading or are short-term oriented. However, ours is a social world, as Schwartz notes, one that constantly bombards us with information about how others are doing. He posits that “overwhelming” choice may lead one to look over one’s shoulder at what others are doing. “The more social comparison you do,” Schwartz says, “the more likely you are to be affected by it, and the direction of such effects tends to be negative.”

Schwartz advises us to first decide which choices or decisions are most important, then focus time and energy on those decisions. For example, an important decision for investors may be to meet with a financial professional and develop a long-term, disciplined investment strategy. Conversely, limiting the attention given to speculative investments, short-term comparisons, opportunity costs, and unrealistic expectations may help insulate investors from behavioral biases in making choices.

Decision-making and choice involve a process, and like any process, careful analysis and strategy can improve the process and its outcome.  

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Endnotes

2. All statements, opinions, and data presented in this article are gleaned from The Paradox of Choice unless stated otherwise.
3. Relying on heuristics in decision-making may not always be a liability. According to researcher and social psychologist Gerd Gigerenzer, many people have limited time, knowledge, and computational capacities and cannot always pragmatically operate as “omniscient” rational beings. His research suggests heuristics and instincts can be effective in decision-making.
5. For related readings on this topic, visit www.brandes.com/Institute/BiResearch.