

# Research links negativity bias, investment apprehension

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What do your worries about public health have to do with your financial well-being? Maybe a lot more than you realize, according to new research from Colorado State University's College of Business.

Psychologists have long known that people tend to focus more on bad than good news and amplify adverse outcomes when thinking about the future. This phenomenon, known as negativity bias, is an inherent trait that influences individuals' behavior. In "The Negativity Bias and Perceived Return Distributions: Evidence from a Pandemic," the Department of Finance and Real Estate's Harry Turtle and his co-authors examine the relation between people's attitudes toward swine flu and predictions about the market.

"If you overestimate your belief of dying from swine flu, you're also more likely to be negatively biased in your beliefs about stock market returns," Turtle said. "Those overly negative return beliefs then seem to dampen people's willingness to invest in the stock market."

Participation in beneficial financial opportunities is central to improving social welfare, including the mitigation of severe wealth inequality. Understanding why individuals shy away from beneficial investment opportunities may help to foster the behaviors necessary to grow wealth among those traditionally not benefiting from the market.

## **Modeling on a prior pandemic**

The research, which is available as a working paper in the *SSRN Electronic Journal*, used historical survey data from the 2009-2010 swine flu pandemic as a gauge of negativity bias. Although the illness was widespread, it claimed relatively few lives of patients who weren't struggling with other [health conditions](#). Despite that, 93% of respondents overestimated their risk of dying from swine flu.

More striking, individuals' risk assessments of the illness were wildly exaggerated, with the median perceived swine flu risk calculated at 270 times greater than the actual risk posed to respondents. Conditions around the swine flu pandemic provided researchers the chance to dig

into attitudes and better understand investor behavior.

"The swine flu pandemic allowed us a nice opportunity to study the fear in a pandemic without the many adverse impacts on the economy and health that we see in the current COVID environment," Turtle explained.

As the research team analyzed perceptions around the '09-'10 pandemic, they also examined data regarding people's attitudes about the stock market. They found similarly exaggerated negative outlooks: Where historically the market posts year-over-year increases 74% of the time, respondents' mean estimate for the chance of future growth was a measly 39%.

The common thread between the two? Negativity bias. Turtle and his co-authors dug deep to move beyond a casual correlation.

## **Drawing on a wealth of historical data**

To make those connections, the research team turned to additional data collected as part of the RAND American Life Panel, a panel of more than 5,000 respondents who researchers regularly survey. The organization follows the same group of panelists over years, collecting deep data on a staggering number of topics. Because of the panelists' history, the dataset allows researchers to connect seemingly unrelated data points through historical responses.

That meant the researchers could look at more than simply the relation between [swine flu](#) and bearishness to eliminate other possibilities for the observed correlation, by accounting for other psychological aspects. Tapping into additional data from the panel, the research team accounted for risk aversion, optimism, ambiguity aversion, the impact of media coverage and naturally evolving views on stock market participation.

Even with those many considerations factored in, a correlation between negativity bias and bearish views of the market remained. They also found that respondents' risk assessments on another low-probability event, death by a [terrorist attack](#), produced similar findings consistent with a negativity bias.

"The panel ends up being a really rich resource," Turtle said. "For instance, in our research we are able to look back at previous studies with data on individuals' ambiguity aversion, perceived likelihood of dying of terrorism, anxiety levels, and optimism."

## **New tactics to help grow wealth in nontraditional investors**

Turtle's findings have implications toward fighting poverty, helping [lower-income families](#) build wealth, and improving general financial decision-making. Because long-term investment in the stock market tends to outperform savings, overcoming reluctance to participate in the stock market can improve individuals' long-term financial well-being.

The [research](#) finds that lower-educated and lower-income individuals harbor an even stronger negativity bias on average, making these findings potentially important in mitigating wealth inequality. The quickest way for that to happen, Turtle argues, is for financial innovation to develop products that restructure returns.

For example, financial products like defined-benefit pension plans—those in which investors receive a standard monthly benefit, rather than variable earnings pegged to [market](#) performance—may be a useful tool in overcoming [negativity bias](#).

"Negativity biases are very sticky," Turtle said. "It might take a lot of

work to alter beliefs to get people to invest. Rather than trying to educate people to invest in the [stock market](#), we might be better off creating new investment vehicles where people do not need to worry about risks that they often misunderstand."

**More information:** Richard W. Sias et al, The Negativity Bias and Perceived Return Distributions: Evidence from a Pandemic, *SSRN Electronic Journal* (2023). [DOI: 10.2139/ssrn.4337907](https://doi.org/10.2139/ssrn.4337907)

Provided by Colorado State University

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