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How to beat behavioural bias when markets are volatile

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Investors can be influenced by behavioural biases that pull portfolios away from rational, long-term decisions, particularly when markets are volatile. Putting structural processes, systematic tools and built-in challenge mechanisms in place can help counter these biases and turn behavioural discipline into an investment edge.

In theory, asset allocation is a rational, data-driven exercise based on long-term return expectations and risk tolerance. Yet in practice, investor behaviour is often heavily influenced by predictable psychological biases which can materially distort portfolio outcomes over time, with such actions often particularly pronounced during bouts of market volatility. Below we outline five common behavioural tendencies that can influence asset allocation decisions – and explore how we manage their impact in multi asset portfolios.

Key takeaways

- Behavioural biases - such as recency bias, loss aversion, inertia, social pressures and groupthink - can pull portfolios away from rational, long-term positioning.
- Strategic frameworks, systematic signals, disciplined reviews, and deliberate challenge mechanisms can help counter these biases by anchoring decisions to long-term objectives rather than short-term market noise or peer influence.
- By intentionally designing processes that mitigate bias, investors can make more consistent, forward-looking decisions - creating a repeatable edge in an uncertain and competitive market.

1. Recency bias: overweighting the latest market narrative

Recency bias is the tendency to give excessive weight to the latest data while discounting longer-term evidence. In portfolio terms, it can encourage investors to chase recent winners – such as US equities after a strong run, or bonds after equity volatility. Allocations drift towards what has recently worked, even when valuations are stretched or long-term expected returns have deteriorated. When markets turn, investors may fold, reallocating into perceived safe havens after much of the damage is done.

Recency bias can also distort diversification decisions. Short-term movements in correlations can feel like permanent structural shifts, leading investors to abandon diversification when they need it most. The growing participation of retail investors in markets has sometimes reinforced these dynamics, as their trading often concentrates in narrow themes and reacts quickly to recent price moves or narratives.

Our approach - Anchoring decisions to a strategic asset allocation framework informed by long-term capital market assumptions can help to mitigate recency bias.

Our long-term asset allocation experts help with the creation of a strategic framework by providing capital market assumptions (expected returns, volatilities and correlations) across a broad range of asset classes and by supporting the construction of optimised portfolios subject to defined risk-return constraints.

Our experts focus on long-term horizons (typically, five to 10 years), which helps reduce the risk that portfolio decisions are overly influenced by recent market developments.

By focusing on long-term characteristics rather than recent performance we can build a broadly diversified portfolio. For example, in the past we've added Chinese bonds, which helped in 2022 when most markets fell, and European and emerging market equities, which allowed us to benefit from the shift away from US market dominance in 2025. By using long-term assumptions as a disciplined starting point for portfolio construction, we aim to reduce the influence of recency bias and maintain focus on long-term client outcomes.

2. Loss aversion: why losses hurt more than gains help

Loss aversion can leave investors feeling the pain of losses far more acutely than the satisfaction derived from gains. This asymmetry can profoundly shape portfolio construction. Loss-averse investors may overweight cash or low-volatility bonds – not because these assets maximise long-term outcomes (they generally don't), but because avoiding losses feels like the safer emotional choice. They may also underweight equities or other higher-risk return drivers even when those exposures are required to meet long-term financial objectives such as retirement or intergenerational wealth transfer.

Our approach - One way to reduce the emotional strain of investing is to adopt a systematic approach to tactical asset allocation decisions. We use quantitative trend signals to identify opportunities and adjust a portfolio's asset mix accordingly. For example, our trend signal encouraged us to allocate to gold in 2024 and 2025, allowing us to capture a historic rally, despite it being an asset class that had been painful to hold in earlier periods.

Markets often trend upwards or downwards because participants initially underreact to new information, so the signal increases exposure as markets rise and reduces it during sustained declines. This helps counter a key consequence of loss aversion: holding losers and selling winners too early. Behaviourally, it supports investors in avoiding impulsive decisions and staying aligned with their long-term strategy.

3. Status quo bias: how inertia shapes allocations

The status quo bias (or default effect) is the tendency to stick with preset options rather than actively reassessing decisions. In asset allocation, it shows up as "inertia": investors stay close to existing weights even when the opportunity set changes.

Default portfolios can also act as psychological anchors. Deviating from a default can feel risky or irresponsible – even when alternative allocations are demonstrably better aligned with the prevailing opportunity set. Investors may avoid the cognitive effort required to reassess their allocation, allowing portfolios to drift out of sync with the evolving market environment. As a result, static allocations can limit portfolios, preventing them from taking advantage of market dislocations and valuation anomalies.

Our approach - The processes used by the two pillars of our Multi Asset offering – fundamental and quantitative philosophies – are designed to counter inertia:

- Our fundamental approach uses deep research and a disciplined review process to ensure allocations are consistently challenged. Our Fundamental Multi Asset Investment Committee (FMAIC) meets weekly to assess new market information, providing a forum where views are refreshed and debated. Asset-class preferences expressed through a process of scoring and voting are deliberately taken to the extreme, so views are fully represented, reducing the pull toward the default or excess caution.

- Our quantitative approach applies ideas systematically and updates them as conditions change. These tools are treated as living frameworks, reviewed to stay relevant across regimes. For example, the quantitative trend framework includes a mean-reversion component that limits excessive exposure in late-cycle bubbles by nudging risk lower when valuations look stretched.

4. Herding bias: the pressure to conform to "normal" portfolios

Humans are inherently social decision-makers, and asset allocation is no exception. Social norms – ideas about what is common, acceptable or "normal" – shape portfolio choices. Retail and institutional investors alike can anchor to what peers, colleagues or industry leaders are doing or talking about – typically, the latest headlines, the largest asset classes and recent winners. This dynamic can drive herding behaviour, increasing the risk of crowded trades and elevated valuations. The reverse is equally powerful: holding assets that have fallen out of favour can feel socially uncomfortable even when valuations are attractive.

These social-norm dynamics are reinforced by structural features of modern markets. The widespread use of benchmarks encourages convergence toward commonly held exposures. And the growth of passive investing directs capital toward assets that have already risen in size, reinforcing recent winners and potentially amplifying herding behaviour and crowded positioning.

Our approach - To counter the power of social norms, we have a Trade Library working group to identify opportunities that are not widely held. An accepted position within the library must be supported by a clear investment rationale, be implemented within at least one portfolio, and remain consistent with our macro outlook as a firm.

The Trade Library encourages portfolio managers to look beyond the most popular parts of markets and to test whether less crowded opportunities can improve portfolio balance. Example trades have included: (i) identifying gold-mining equities as significantly undervalued in July 2021 and maintaining exposure through the subsequent recovery in 2025; and (ii) a relative- value trade going long Australian government bonds while short South Korean government bonds, based on the working group's assessment of differing fiscal and rate expectations (June 2025).

5. Groupthink: the risk of consensus-driven decision-making

Groupthink occurs when decision-making groups place excessive value on consensus at the expense of critical evaluation. In institutional investment settings, it can materially distort asset-allocation decisions – encouraging fashionable exposures, understating downside scenarios, and underappreciating risks.

Effective mitigation involves deliberately incorporating challenge into the decision-making process. Anchoring to long-term objectives, rather than consensus views, can help preserve strategic integrity.

Our approach - Our FMAIC seeks to challenge the risk of groupthink. The committee assigns one person the role of “devil’s advocate” to challenge the group’s views. In addition, the process incorporates surveys, formal voting mechanisms, and independent input from elsewhere in the firm such as our internal team of economists and the trading desk.

Conclusion: behavioural discipline as a competitive edge

Behavioural biases are unavoidable – every investor, from individuals to large institutions, is influenced by them to some degree. The danger lies not in their existence, but in allowing them to shape decisions unconsciously. The behavioural biases outlined above can all nudge asset allocation away from rational, long-term optimisation and toward emotionally comfortable but financially suboptimal choices.

The good news is that each bias can be mitigated by building thoughtful design, clear rules and careful framing into an investment process. Combining strategic and tactical allocation approaches helps investors balance long-term goals with near-term opportunities. Regularly reviewing investment processes can ensure their robustness. Finally, the process should create space for independent (and sometimes unconventional) thinking and be underpinned by deliberate structures to generate challenge. Adopting these rules can help ensure portfolios are driven by long-term objectives rather than short-term emotions.

In a world of persistent uncertainty and intense competition for returns, behavioural discipline is not merely a psychological curiosity – it is a genuine and repeatable source of investment edge.

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