Question #1 of 16

Question ID: 1574608

Rex Newman treats wages differently from bonuses when determining his savings and investment goals. As a result, he invests any available after-tax wages in low-risk investments while investing his bonuses in high-risk alternatives. Newman is *most likely* exhibiting:

A) availability bias.

B) mental accounting bias.

C) framing bias.

Explanation

An example of mental accounting bias is viewing money from various sources differently when making investment decisions. *Framing bias* refers to when decisions are affected by the way in which the data are presented. *Availability bias* refers to putting undue emphasis on information that is readily available, easy to recall, or based narrowly on personal experience or knowledge.

(Module 87.1, LOS 87.b)

Question #2 of 16

Question ID: 1574600

Which of the following *most accurately* describes cognitive errors?

A) They stem from feelings, impulses, or intuition.

B) They are due primarily to faulty reasoning.

C) They are not related to conscious thought.

Explanation

Cognitive errors are due primarily to faulty reasoning or irrationality. Emotional biases are not related to conscious thought and stem from feelings, impulses, or intuition.

(Module 87.1, LOS 87.a)

Question #3 of 16

Question ID: 1574601

Emotional biases are *most likely* to:

A) be mitigated rather than accommodated.

B) stem from feelings or intuition.

C) be related to faulty reasoning.

Explanation

Emotional biases stem from feelings or intuition; therefore, they are difficult to overcome and may have to be accommodated. Cognitive errors are due primarily to faulty reasoning.

(Module 87.1, LOS 87.a)

Question #4 of 16

Question ID: 1574606

Which of the following behavioral biases is *most likely* related to information processing?

A) Loss aversion.

B) Status quo.

C) Anchoring and adjustment.

Explanation

Anchoring and adjustment is a cognitive error related to information processing, whereas loss aversion and status quo bias are emotional biases.

(Module 87.1, LOS 87.b)

Question #5 of 16

Question ID: 1574613

Evidence that investors hold portfolios that are less diversified than traditional finance would suggest may be *best* explained by:

A) fear of regret.

B) anchoring.

C) overconfidence.

Explanation

Overconfidence bias may lead to overtrading, underestimation of risk, and lack of diversification. Anchoring may cause investors to believe recent highs are rational prices, even as they decline significantly. Fear of regret (of missing positive returns) may keep even skeptical investors in the market when analysis suggests assets are significantly overvalued.

(Module 87.2, LOS 87.c)

Question #6 of 16

Question ID: 1574603

Which of the following cognitive errors are *best* described as belief persistence biases?

A) Conservatism, representativeness, and hindsight biases. ✓

B) Mental accounting, framing, and availability biases. ✗

C) Illusion of control, confirmation, and anchoring and adjustment biases. ✗

Explanation

Mental accounting, framing, anchoring and adjustment, and availability biases are information processing biases whereas conservatism, representativeness, confirmation, illusion of control, and hindsight biases are belief persistence biases.

(Module 87.1, LOS 87.b)

Question #7 of 16

Question ID: 1574609

Greg Brown receives new information regarding one of his stocks. This information appears to be reliable and conflicts with Brown's earlier forecast of what the stock should be trading for at this time. However, Brown does not revise his estimate of the stock's value. Brown is *most likely* exhibiting:

A) conservatism bias. ✓

B) confirmation bias. ✗

C) hindsight bias. ✗

Explanation

Conservatism bias refers to failing to change a view as new information becomes available, and may result in investors keeping assets too long because they are slow to update a view or forecast. *Confirmation bias* refers to when investors seek out information that supports their beliefs, while avoiding conflicting views. *Hindsight bias* refers to selective memory of past events resulting in individuals believing these events were more predictable than they seemed before they happened.

(Module 87.1, LOS 87.b)

Question #8 of 16

Question ID: 1574602

Compared to emotional biases, cognitive errors are *more likely* to be:

A) difficult to overcome.

B) mitigated by information.

C) related to intuition or impulses.

Explanation

Cognitive errors may be reduced by increased awareness, better training, or more information. Emotional biases are related to intuition or impulses and may be more difficult to overcome compared to cognitive errors.

(Module 87.1, LOS 87.a)

Question #9 of 16

Question ID: 1574610

Sarah Kowalski bought a growth stock for $45 per share that subsequently fell by 35%, and she is reluctant to sell as she hopes the stock bounces back. Kowalski is *most likely* exhibiting:

A) availability bias.

B) self-control bias.

C) loss-aversion bias.

Explanation

Loss-aversion bias arises from feeling more pain from a loss than pleasure from an equal gain. A consequence of this bias is that investors may hold onto positions with the hope of getting even rather than selling the position at a loss. Self-control bias occurs when individuals lack self-discipline and favor short-term satisfaction over long-term goals. Availability bias occurs when putting undue emphasis on information that is readily available, easy to recall, or based narrowly on personal experience or knowledge.

(Module 87.1, LOS 87.b)

Question #10 of 16

Question ID: 1574599

Which of the following statements would *most likely* be classified as a cognitive error? The investor:

A) has a tendency to place information into categories. ✓

B) tends to take more risk rather than sell a stock at a loss. ✗

C) acts defensively when asked why he made a poor investment decision. ✗

Explanation

This describes the cognitive error of "representativeness bias" where investors classify information into the most appropriate subjective category based on "if-then" heuristics. The other two answer choices describe "loss aversion" and "regret aversion."

(Module 87.1, LOS 87.a)

Question #11 of 16

Question ID: 1574607

Which of the following statements *best* describes the availability bias? An investor:

A) associates new information with an easily recalled past event. ✓

B) only notices information that agrees with their perceptions or beliefs. ✗

C) bases a decision on how the information is presented. ✗

Explanation

Investors who exhibit availability bias estimate future probabilities by how easily they recall a past event. An easily recalled event is more quickly associated with (fit to) new information. The problem is worsened by the fact that individuals' memories can be incomplete or biased. Investors who exhibit confirmation bias tend to notice only information that agrees with their perceptions or beliefs. They look for confirming evidence while discounting or even ignoring evidence that contradicts their beliefs or their perceptions. Investors who exhibit framing bias view information differently depending on the way it is presented and received.

(Module 87.1, LOS 87.b)

Question #12 of 16

Question ID: 1574611

Harvey Woodman invests in modern art. Occasionally, he sells a piece from his collection, but the process is often difficult because he gets insulted when potential buyers offer what he believes to be too little. Which bias is Woodman *most likely* exhibiting?

A) Mental accounting bias. ✗

B) Overconfidence bias. ✗

C) Endowment bias. ✓

Explanation

An individual who exhibits endowment bias considers an owned asset to be special and worth more than its actual market value. Overconfidence bias occurs when market participants overestimate their own reasoning. Mental accounting bias is viewing money from various sources differently when making investment decisions.

(Module 87.1, LOS 87.b)

Question #13 of 16

Question ID: 1574605

Which of the following are considered emotional biases?

A) Confirmation, control, and availability biases. ✗

B) Status quo and endowment biases. ✓

C) Anchoring and adjustment bias. ✗

Explanation

Status quo and endowment biases are emotional biases whereas the other biases fall under the category of cognitive errors.

(Module 87.1, LOS 87.b)

Question #14 of 16

Question ID: 1574612

Steven Murphy has a tendency of overreacting to current events and trading too much based on news or anecdotes. Which of the following biases does Murphy *most likely* exhibit?

A) Loss-aversion bias. ✗

B) Availability bias. ✓

C) Overconfidence bias. ✗

Explanation

Availability bias is putting undue emphasis on information that is readily available, easy to recall, or based narrowly on personal experience or knowledge. Loss aversion arises from feeling more pain from a loss than pleasure from an equal gain. Overconfidence bias occurs when market participants overestimate their own intuitive ability.

(Module 87.1, LOS 87.b)

Question #15 of 16

Question ID: 1574604

Which of the following are considered biases due to cognitive errors?

A) Loss aversion, self-control, and regret-aversion biases. ✗

B) Representativeness, mental accounting, and overconfidence biases. ✗

C) Conservatism, hindsight, and framing biases. ✓

Explanation

Conservatism, hindsight, and framing biases are examples of cognitive errors. Loss aversion, self-control, regret-aversion, and overconfidence are all emotional biases.

(Module 87.1, LOS 87.b)

Question #16 of 16

Question ID: 1574614

With respect to asset "bubbles":

A) behavioral finance provides an overall explanation. ✗

B) anchoring may cause investors to mitigate bubbles by reducing their market exposure.

C) hindsight bias can fuel overconfidence.

Explanation

With hindsight bias, investors may give themselves credit for recent market advances, fueling overconfidence bias. Behavioral finance has not supplied an overall explanation for the existence of market bubbles. Anchoring may cause investors to believe recent market highs are rational and keep them in the market even as market prices or company fundamentals have started to decline.

(Module 87.2, LOS 87.c)