

## Recency Bias in Investing: Meaning, Impact & How to Avoid it

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Recency bias in investing is a behavioural tendency where investors place too much emphasis on recent market movements while ignoring long term trends and fundamentals. This often leads to decisions like investing in a mutual fund just because it has performed well recently, without assessing its consistent performance over time. Such bias can cause investors to exit during short term market dips or chase returns during rallies actions that may derail long term financial goals. Being aware of this bias and maintaining a disciplined approach, such as sticking to your asset allocation and continuing SIPs, can help ensure relatively steady and goal aligned investment outcomes.

### Key Takeaways

- Recency bias is a behavioural tendency where investors focus too much on recent market performance, often ignoring long term trends and historical data.
- This bias can lead to impulsive decisions, such as switching mutual funds based on short term returns or stopping SIPs during market downturns.
- Investors may unknowingly increase portfolio risk by moving away from diversified schemes toward trending funds.
- Relying on short term results often goes against disciplined investing and may derail long term financial goals.
- Following a fixed rebalancing strategy, continuing SIPs, and evaluating [mutual funds](#) based on consistent, long term performance can help reduce the impact of recency bias.
- Awareness of this bias allows investors to stay focused on their financial objectives and make rational, goal based investment decisions.

### What is Recency Bias?

Recency bias is a behavioural finance concept where individuals give greater weight to recent events or outcomes while making decisions, often underestimating the relevance of historical data. In investing, this bias can significantly impact judgement, leading investors to assume that recent market trends whether positive or negative will persist. For instance, if an equity mutual fund delivers strong returns over the past few months, investors might rush to invest in it, believing the momentum will continue, without analysing its long term track record or risk profile. This bias can lead to poor asset allocation, frequent portfolio changes, and deviation from long term investment goals. Recognising and managing recency bias is essential for maintaining a disciplined investment approach, especially in volatile markets.

### How Recency Bias Shows Up in the Market

- Investor behaviour often shifts with market conditions, and recency bias plays a significant role in these changes. In a bull market, when equity markets rise for an extended period, investors may assume the upward trend will continue. This often leads to switching from conservative to high-risk mutual fund schemes, based solely on recent returns without considering long-term suitability or risk.
- During a bear market, when prices fall sharply, fear can cause investors to redeem units prematurely even if their goals are years away. This reaction, triggered by recent losses, may lead to stopping SIPs or exiting [mutual fund schemes](#) at a loss, undermining long-term plans.
- In volatile or sideways markets, where there's no clear trend, frequent switching between mutual fund schemes in search of short-term gains becomes common. This behaviour often results in poor timing and increased costs, affecting returns.
- Regardless of market type, recency bias can push investors away from rational decisions. Recognising this bias and focusing on consistent performance, proper asset allocation, and long-term financial goals can lead to better investment outcomes.

### **Impact on Mutual Fund Investors**

Mutual fund investors are especially prone to recency bias, often making investment decisions based on short term performance rather than long term consistency. For instance, if a fund delivers high returns over the past year, it may attract a surge of investments even when its long term performance or risk profile is not aligned with an investor's goals. This focus on recent gains can cause investors to shift from diversified schemes to high performing, trend driven funds, increasing overall portfolio risk. Without a clear understanding of [how mutual fund works](#), such decisions may result in poor asset allocation and potentially lower returns over time.

### **How to Deal with Recency Bias**

#### **1. Pause Before Acting**

Avoid making quick decisions. Take a moment to assess the situation calmly. Checking your investments too often during volatility can lead to rash moves.

#### **2. Look at the Long Term**

Don't base decisions only on recent returns. Consider how markets have behaved over years to keep your investment view balanced.

#### **3. Compare Performance Over Time**

Review fund performance across 1, 3, and 5-year periods. This shows whether gains are consistent or just short-lived.

#### **4. Stay Focused on Your Goals**

Each investment should align with a specific financial goal. Review progress annually and adjust only if your goal is impacted.

## **5. Rebalance When Needed**

Regular portfolio reviews help you stay on track. After a sharp rise in one asset class, rebalancing maintains your ideal mix.

## **6. Get Professional Advice**

A qualified advisor can offer clarity, remove bias, and help you make informed choices aligned with your objectives.

## **Conclusion**

Recency bias in investing is a common but often overlooked behavioural tendency that can impact long term financial outcomes. By giving undue importance to recent market trends, investors risk making emotional and impulsive choices that may not align with their financial goals or risk tolerance. Recognising this bias is the first step toward building a disciplined investment strategy. Staying focused on long term objectives, evaluating mutual funds based on consistent performance, and avoiding reactionary decisions can help you navigate market fluctuations more confidently and build a portfolio suited to your needs.

## **FAQs**

### **1. What is recency bias and how does it affect mutual fund evaluation?**

Recency bias is a behavioural tendency where investors give more importance to recent performance rather than evaluating the long term track record of a mutual fund. This can lead to choosing schemes that may have performed well in the short term but lack consistent returns over time, potentially affecting investment outcomes.

### **2. Why is recency bias dangerous for SIP investors?**

SIP investors benefit most from staying invested across market cycles. Recency bias can lead them to pause or stop SIPs during market downturns due to fear or negative sentiment, which disrupts the power of compounding and rupee cost averaging, ultimately affecting long term wealth creation.

### **3. Can recency bias ever be useful?**

In rare cases, recent data can help investors adapt to changing market conditions. However, relying too heavily on short term trends without a holistic view of the market or a scheme's fundamentals can lead to impulsive decisions and misaligned portfolios.

### **4. How do I spot recency bias in my decisions?**

If you find yourself choosing funds solely based on recent performance charts or reacting quickly to short term market movements, you may be influenced by recency bias. Reviewing your

decisions to check if they are driven by recent news or data, rather than long term goals, can help identify this behaviour.

### **5. Does a fixed rebalancing schedule reduce this bias?**

Yes. A fixed rebalancing schedule ensures that you maintain your intended asset allocation, regardless of recent market performance. It brings discipline to investing and prevents overexposure to asset classes that may have rallied recently, thus helping counter recency bias.

### **6. How can I avoid recency bias when choosing mutual funds?**

Focus on a fund's long term performance, consistency across market cycles, and risk adjusted returns. Avoid switching funds based solely on short term returns. Stick to your investment plan and use tools like SIPs to maintain regular investing without reacting to short term trends.

### **7. Why is long term performance more important than short term gains in mutual fund evaluation?**

Short term gains can be influenced by market sentiment or temporary factors. Long term performance reflects the fund's ability to deliver consistent returns across different market conditions, making it a more reliable indicator for informed investment decisions.

### **8. Why is it important to be aware of recency bias?**

Awareness helps you make better investment decisions by focusing on long term objectives rather than reacting emotionally to recent events. It promotes rational thinking, helps avoid frequent portfolio churn, and supports a disciplined approach to wealth creation.

### **9. How does recency bias affect financial future?**

If not managed, recency bias can lead to poor investment choices, unnecessary risk taking, and deviation from your financial goals. Over time, this may result in lower returns, missed opportunities, and an unstable investment journey that hinders long term financial planning.

### **10. Why does recency bias hurt long-term returns?**

Recency bias is a behavioural tendency where investors give undue importance to recent market events while ignoring long term trends. This can lead to decisions based on short term performance, such as exiting investments during a temporary market dip or increasing exposure during a rally. Such reactive behaviour can disrupt compounding, increase the risk of buying high and selling low, and negatively impact long term returns. Staying focused on long term goals and maintaining a disciplined investment approach is essential for better outcomes.

### **11. Does recency bias affect SIP performance?**

Yes, recency bias can influence how investors manage their [Systematic Investment Plans \(SIPs\)](#). For example, if markets decline, an investor affected by recency bias may stop or pause their SIPs out of concern, potentially missing out on the benefit of buying more units at lower prices. SIPs are

designed to help investors navigate market volatility through rupee cost averaging and long term discipline. Ignoring short term fluctuations and continuing SIPs through market cycles can enhance the potential for long term wealth creation.

## **12. What is an example of recency bias in behavioural finance?**

A common example of recency bias is when an investor exits mutual fund investments after a few months of poor returns, assuming the trend will continue indefinitely. However, markets are cyclical, and this decision may result in missing a recovery phase. This behaviour reflects how recent experiences can override long-term data and rational judgment, leading to emotionally driven investment decisions. Recognising such biases is an important step toward becoming a more informed and disciplined investor.

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