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Today, part two of *Market Insight* about the various types of **cognitive and emotional biases** investors are prone to and how to mitigate them.

This is an excerpt from an internal letter new **Capital Ideas Media** contributor **John O'Connell** wrote to his

team as Chairman and CEO at money management firm, Davis Rea Investment Counsel.

He provides insights about the **questions and doubts raised** in taking care of their clients and their money.

Look for part two of *Market Insight* at the end of this Morning Note.

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Morning Need to Know

Getting you ready for your investing day

March 31, 2020

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Capital Ideas Media**



CANADIAN ANALYSTS' CALLS

Strad (TSX:SDY). Raymond James upgrades to “strong buy” with a very specific \$2.39 (Canadian) target.

TransAlta Renewables (TSX:RNW). TD Securities upgraded to “buy” with a \$17.50 target.

Inter Pipeline (TSX:IPL). Analysts have responded to the company's dividend reduction, exploration of

partnerships and the suspension of the sale of a European business.

Industrial Alliance Securities raised its rating to “speculative buy” and maintained an \$11 (Canadian) target price.

Stifel FirstEnergy raised the stock to “buy” with a \$22 target, jumping from \$16.

Canadian Western Bank (TSX:CWB) gets upgraded to "buy" by Desjardins Securities with the EPS estimates cut for this year and next and the target lowered to \$26 from \$30. **Scotia Capital** cut the target to \$22 from \$34.

National Bank (TSX:NA). In a broad call on the bank sector, Scotia Capital upgrades to "outperform" and slashes the target to \$63 from \$80.

Hydro One (TSX:H). TD Securities upgrades the following utilities with this one raised to “buy” with a \$28 target.

Fortis (TSX:FTS) upped to “action list buy” with a \$62 target.

Canadian Utilities (TSX:CU) goes to “buy” with a \$40 target, down from \$43.

Cronos Group (TSX:CRON;NASDAQ:CRON). Canaccord Genuity has soured on this name due to “*declining cannabis sales, deepening losses and material inventory write-offs*” and has made “*significant*” downward reductions to the company's financial projections with

the target dropping to \$7 from \$12. More on earnings from Cronos below.

BRP (TSX:DOO). Canaccord Genuity cuts the target to \$31 from \$40.



U.S. ANALYSTS' CALLS

Sarpeta Therapeutics (NASDAQ:SRPT). Mizuho starts coverage with a "buy" on optimism for the company's developing treatment for Muscular Dystrophy.

STOCKS THAT MAY MOVE

WELL Health Technologies (TSX:WELL) reported Q4 revenue of \$9.8 million (Canadian), ahead of expectations of \$9 million.

Valens GroWorks (TSXV:VLNS) has received conditional approval to graduate to the Toronto Stock Exchange from the TSX Venture Exchange.

Cronos Group (TSX;CRON;NASDAQ:CRON) reported a Q4 operating loss of \$63.8 million versus \$8.8 million in Q4 of 2018, and the cannabis producer confirmed that revenue was reduced during two quarters of 2019 by a combined \$7.6 million following an audit.

TC Energy (TSX:TRP) said it will go ahead with construction of the \$8 billion keystone XL pipeline.

RBC (TSX:RY) said it will not cut jobs in 2020.

Air Canada (TSX:AC) will cut capacity by as much as 90% and will place about 16,500 unionized workers and managers off duty or on furlough, while executives will cut their pay by 25-50% and board members agreed to a 25% cut.

WPP (NYSE:WPP). The world's largest advertising company has withdrawn its 2020 forecast and suspended its dividend and share buyback program, with the CEO saying the business fallout from the coronavirus outbreak has been much more rapid than the 2008 economic and financial crisis.

CommVault Systems (NASDAQ:CVLT). Activist investor Starboard Value has built a 9.3% stake in the company.

Amazon (NASDAQ:AMZN).

A number of warehouse, delivery and retail workers went on strike Monday to draw attention to safety and wage concerns for people continuing to work during the coronavirus crisis.

Alibaba (NYSE:BABA) plans to buy a 10% stake in Yunda Holding worth about \$790 million (U.S.), marking the company's fifth investment in a large courier.

Ford Motor (NYSE:F) and **GE (NYSE:GE)** are teaming up to produce 50,000 ventilators over the next 100 days and then 30,000 per month as needed to help treat patients afflicted with the coronavirus.

MARKETS

S&P/TSX and U.S. equity futures are modestly lower as investors get set to wrap up the most tumultuous quarter since at least 1987 and, by the numbers, some of the most volatile moves since the 1930s.

China's manufacturing index in March jumped to 52 from a record low of 37 and beat estimates of 45, indicating, based on the country's numbers, that there was a quick bounce back from the COVID-19 shutdown.

CURRENCIES

The Canadian dollar is down 0.6% to 0.7002 (U.S.).

COMMODITIES

West Texas Intermediate is up 4.8% at \$21.06 a barrel after the U.S. and Russian Presidents agreed to talks about stabilizing the oil market although Saudi Arabia plans to sell its oil at the steepest discount ever.

Gold is down 1.4% to \$1,620.90 an ounce as investors once again appear to prefer the U.S. dollar as a safety haven.

Market Insight



by *John O'Connell*, Capital Ideas Media Contributor
Chairman & CEO, Davis Rea Investment Counsel

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Today, more hi-lights of an internal letter written by John O'Connell to his team ahead of a meeting of Davis Rea's Investment Committee.

The thoughts expressed, insights provided and questions asked shed light on what this manager of hundreds of millions of dollars of client money is thinking about during this truly unprecedented time.

The Easter Bunny Rally and April Fools Day, Part Two

Thoughts for an Investment Committee Meeting

As a quick and fast primer here is a run down of all the things our clients will be soon running through their minds when they get their next quarterly statement.

Consider if the markets finish where they closed this evening versus where they were several days ago and ponder how they may feel under both situations and the context of conversations we will soon be having.

I would hazard a guess the conversations would be illuminating in their thought process. I bet what follows will help you think the way our clients and

perhaps we think.

Everybody has biases. We make judgments about people, opportunities, government policies, and of course, the markets.

When we analyze our world with our own biases, we put our observations through a number of filters manufactured by our experiences, and we're not just talking about stock screeners.

We're talking about the filters we put our decisions through that sometimes make them biased. Individuals may or may not necessarily rationalize that their decisions are being made based on biases they have developed.

In general, all kinds of day-to-day activities are primarily driven by behavioral patterns. These same behavioral patterns can also influence investing actions.

For most people, it is impossible to be unbiased in investment decision-making. However, investors can mitigate biases by understanding and identifying them, then creating trading and investing rules that mitigate them when necessary.

Broadly, investing biases fall into two main categories: cognitive and emotional. Both biases are usually the result of a prejudice for choosing one thing over the other.

KEY TAKEAWAYS

Identifying and understanding unprofitable cognitive

and emotional biases can help a trader improve their total return.

Cognitive biases generally involve decision-making based on established concepts that may or may not be accurate.

Emotional biases typically occur spontaneously based on the personal feelings of an individual at the time a decision is made.

What Is Cognitive Bias?

Cognitive biases generally involve decision-making based on established concepts that may or may not be accurate. Think of a cognitive bias as a rule of thumb that may or may not be factual.

We've all seen movies where a thief wears a police uniform to pass through a security checkpoint. The real police officers assume that because the person is wearing a uniform like theirs, he must be a real police officer. That's an example of a cognitive bias.

What does a fake cop have to do with your investment choices? You make the same types of assumptions that may or may not necessarily be true.

Here are some examples:

Confirmation Bias: *Have you noticed that you put more weight into the opinions of those who agree with you? Investors do this too.*

How often have you analyzed a stock and later researched reports that supported your thesis instead of

seeking out information that may poke holes in your opinion?

Gamblers' Fallacy: Let's assume that the S&P has closed to the upside five trading sessions in a row. You place a short trade on the SPDR S&P 500 (SPY) because you believe chances are high that the market will drop on the sixth day.

While it may happen, on a purely statistical basis, the past events don't connect to future events. There may be other reasons why the sixth day will produce a down market, but the fact that the market is up five consecutive days is irrelevant.

Status-Quo Bias: Humans are creatures of habit. Resistance to change spills over to investment portfolios through the act of repeatedly coming back to the same stocks and ETFs instead of researching new ideas.

Although investing in companies you understand is a sound investment strategy, having a short list of go-to products might limit your profit potential.

Risk-Averse Bias: The bull market is alive and well, yet many investors have missed the rally because of the fear that it will reverse course. Risk-averse bias often causes investors to put more weight on bad news than good news.

These types of investors typically overweight in safe, conservative investments and look to these investments more actively when markets are rocky. This bias can potentially cause the effects of risk to hold more weight than the possibility of reward.

Bandwagon Effect: Warren Buffett became one of the most successful investors in the world by resisting the bandwagon effect. His famous advice to be greedy when others are fearful and fearful when others are greedy is a denouncement of this bias.

Going back to confirmation bias, investors feel better when they are investing along with the crowd. But as Buffett has proven, an opposite mentality, after exhaustive research, may prove more profitable.

What Is Emotional Bias?

Emotional biases typically occur spontaneously based on the personal feelings of an individual at the time a decision is made. They may also be deeply rooted in personal experiences that also influence decision-making.

Emotional biases are usually ingrained in the psychology of investors and can generally be harder to overcome than cognitive biases. Emotional biases are not necessarily always errors.

In some cases, an investor's emotional bias may help them to make a more protective and suitable decision for themselves.

Here are a few examples:

Loss-Aversion Bias: Do you have a stock in your portfolio that is down so much that you can't stomach the thought of selling? In reality, if you sold the stock, the money that is left could be reinvested into a higher-quality stock.

But because you don't want to admit that the loss has gone from a computer screen to real money, you hold on in hopes that you will, one day, make it back to even.

Overconfidence Bias: *“I have an edge that you (and others) do not.” A person with overconfidence bias believes that his/her skill as an investor is better than others' skills.*

Take, for example, the person who works in the pharmaceutical industry. He/she may believe in having the ability to trade within that sector at a higher level than other traders. The market has made fools out of the most respected traders. It can do the same to you.

Endowment Bias: *Similar to loss aversion bias, this is the idea that what we do own is more valuable than what we do not. Remember that losing stock? Others in its sector may show more signs of health but the investor won't sell because he/she still believes, as before, it's the best in its sector.*

Key Differences

In general, a bias is usually the result of prejudice when choosing one thing over another. Biases can be influenced by experience, judgment, social norms, assumptions, academics, and more.

Cognitive biases *generally involve decision-making based on established concepts that may or may not be accurate.*

Emotional biases *typically occur spontaneously based on the personal feelings of an individual at the time a decision is made.*

Emotional biases are usually not based on expansive conceptual reasoning. Both cognitive and emotional biases may or may not prove to be successful when influencing a decision

Tomorrow, **16 questions and answers** about the markets during COVID-19, based on O'Connell's experience, opinion and conversations with clients.

Disclosure: Bunting Media has provided marketing services to Davis Rea.

Please email questions, comments or concerns to:

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