Ruminations on Decision Making

We are all prone to a variety of mental mistakes including (but not limited to) anchoring on irrelevant information, searching for confirming evidence rather than disconfirming data, extrapolating from small and recent data sets, etc. Some time ago I created a checklist of things to think about when making a decision – particularly an investment decision, but most of the factors generalize. Here is my checklist:

- Clearly define the question/problem. (not the symptom)
- Create a Pro/Con List (Ben Franklin).
- Determine the distribution of outcomes.
    - Best Case?
    - Worst Case?
    - Expected Case? (the sum of the possible outcomes times their probability)
    - Standard Deviation? (the spread or range of the outcomes)
    - Skewness? (the range of outcomes is skewed to the positive or negative)
    - Excess Kurtosis? (outliers occur frequently)
- Check for biases.
    - Do I have feelings of euphoria, excitement, fear, or worry? (decide when dispassionate)
    - Am I anchoring on irrelevant data?
    - Am I narrow framing? (decisions should be made in the broadest appropriate context)
    - Is "everyone" doing it? (be wary of "going along with the crowd")
    - Has the paradigm shifted? (past data may no longer be relevant)
    - Am I overconfident? (almost certainly unless suffering from clinical depression)
    - Have I considered sunk costs? (these are not relevant to the decision)
    - Have I searched for disconfirming evidence?
    - Have I overcome status quo bias?
- Is a decision required? Or is the lack of a decision a decision?
- Is there a correlation with another risk exposure?
- Have I identified all the alternatives?
- Is there empirical data? If so,
    - Is there data mining?
    - Have I tested out of sample?
- Are there theoretical underpinnings independent of the data?
- What if the decision is wrong?
    - Can poor outcomes be mitigated?
    - Can the bet be hedged?
- Does this decision maximize happiness?
- Does this decision minimize regret?

I should also note that a good decision is not the same thing as a good outcome, though they should be correlated. For example, investing all of your retirement funds in lottery tickets or one single stock is a bad decision even if you happen to win the lottery or the stock skyrockets. Conversely, investing in the market (prudently, with an appropriate asset allocation, etc.) is a good decision even if the market subsequently crashes.

Notes:

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This report was originally written in January, 2008 and was last reviewed/updated in April, 2012.