

INSIGHTS FROM CFA SOCIETY SINGAPORE

From tweets to trades: Heeding the risks of social media in investing

Beware of confirmation bias where algorithm-driven content personalisation creates an environment that reinforces investors' view



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IN THE realm of finance, cognitive biases profoundly influence investor decision-making. Among these biases, confirmation bias remains particularly pervasive.

Confirmation bias is the inclination to favour information that aligns with pre-existing beliefs while discounting contradictory evidence.

The bias is exacerbated by echo chambers on social media platforms, where algorithm-driven content personalisation creates an environment that reinforces investors' views. Platforms such as X (formerly Twitter) and Reddit are especially prone to these dynamics, particularly among younger retail investors, significantly shaping market perceptions.

What follows is an exploration of the mechanisms through which confirmation bias and echo chambers influence investor behaviour on the platforms, and strategies for mitigating their impact.

The role of social media: X and Reddit

X and Reddit have emerged as crucial sources of financial information for retail investors. While these platforms provide real-time updates and foster community insight, they also serve as fertile ground for reinforcing confirmation bias.

X: The platform's algorithm curates user feeds based on interaction history. For investors, this means that following specific influencers often results in an information bubble dominated by like-minded content. This is a key point

made in the CFA Institute Research and Policy Center's report, *The Fin-fluencer Appeal: Investing in the Age of Social Media*.

An investor with a bullish outlook on tech stocks, for instance, is likely to receive a feed saturated with optimistic analyses, discouraging exposure to more sceptical viewpoints. This reinforcement of one-sided perspectives amplifies confirmation bias, leading to unbalanced decision-making.

Reddit: Finance-oriented subreddits like *r/WallStreetBets* exemplify how echo chambers operate. These communities are prone to groupthink, where popular sentiments are upvoted while dissenting views are suppressed. This effect was particularly evident during the GameStop and AMC short squeezes in 2021, where the echo chamber dynamics led investors to disregard financial fundamentals and make emotional investment decisions. Many retail investors who bought GameStop or AMC at peak prices suffered severe financial losses as the stocks subsequently collapsed.

Impact on financial decision-making

The interplay between confirmation bias and echo chambers has driven significant financial phenomena in recent years. A recent example also revolves around GameStop's flash rally of 2024. This recent event was sparked by the re-emergence of Keith Gill (Roaring Kitty) on Reddit and X after a three-year hiatus.

Gill's return prompted a sudden surge in GameStop's stock price, which rose by more than 70 per cent in a single day, reaching a peak of nearly US\$31 before plummeting by over 50 per cent within just a few days. This led to significant losses for many retail investors who bought in at elevated levels, reminiscent of the speculative mania of 2021.

Similarly, in the cryptocurrency



The recent flash rally in GameStop, when the stock rose by more than 70% in a day, before plummeting by over 50% within a few days, illustrates the speculative dangers of social media chatter.

PHOTO: REUTERS

market, platforms such as X and Reddit have fuelled speculative hype, particularly during bull runs. Many investors bought into projects like Cardano (ADA) without fully understanding the associated risks. Cardano experienced a sharp decline, dropping more than 40 per cent from its 2024 peak, highlighting the volatility and uncertainty surrounding even well-known projects.

Despite its ambitious promises of creating a scalable and sustainable blockchain ecosystem, Cardano's progress has often been ambiguous, leading to scepticism about its real-world utility.

The hype-driven environment, coupled with confirmation bias, led many investors to disregard warning signs, resulting in substantial losses during market corrections.

Mitigation strategies

Although confirmation bias and echo chambers are pervasive, platforms such as X and Reddit still

provide substantial value for staying informed. X offers rapid access to breaking news and expert opinions, while Reddit allows for in-depth discussions and diverse community insights. To fully benefit from these resources without falling victim to biases, investors must adopt strategies to mitigate the risks of engaging with these platforms. Here are some strategies that can assist:

Follow diverse perspectives: On X, consciously follow accounts that present differing opinions. If your perspective is typically bullish, include sceptics and contrarian voices in your feed to broaden the scope of content and challenge your views.

Diversify Reddit communities: Rather than rely on a single subreddit, explore a range of finance-oriented communities with varying viewpoints.

Engaging with diverse perspectives helps prevent the pitfalls of group thinking and encourages a more nuanced under-

standing of market dynamics.

Seek non-social media sources: To mitigate the effects of social media echo chambers, supplement your information sources with trusted financial news outlets, peer-reviewed academic papers, and market research reports. These sources provide more rigorously vetted information that is not influenced by the algorithms that curate social media content.

Challenge personal beliefs: Regularly adopt a devil's advocate approach towards your own investment ideas. For every positive argument, deliberately seek out and evaluate counterarguments, weighing evidence on both sides before deciding. It may even be worth engaging in discussion and actively asking trusted experts in your network or in online communities to challenge your investment thesis.

Key takeaway

In an era where information is

abundant yet algorithmically filtered to align with individual preferences, it is imperative for investors to recognise and actively counteract confirmation bias.

Platforms such as X and Reddit can offer valuable insight, but they also distort an investor's perception of financial realities, creating significant risk to their financial well-being.

By deliberately seeking diverse viewpoints and critically assessing their own beliefs, investors can foster a more balanced and informed decision-making process.

Maintaining intellectual flexibility in finance is not merely beneficial; it is also essential for navigating complex and rapidly evolving markets.

Let us commit to stepping outside the confines of the echo chamber and cultivating a broader, more informed perspective.

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