

# Perspectives

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The power of narratives.





# How narratives influence us.

## Dear investor

“Linda is 31 years old, single, outgoing, socially engaged and intelligent. She has a degree in philosophy and has always had a strong interest in the topics of discrimination and social injustice.”

When you read this, does Linda come across as being a primary school teacher? Or a bookseller who goes to yoga classes? A social worker who's involved in the women's movement? Or is Linda a bank employee? A bank employee who campaigns for gender equality?

If you were asked to sort the above categorisations based on probability, the “bank employee” description probably wouldn't be in top place. A teacher, bookseller or social worker would seem much more likely.

Crucially, however, most readers would consider her more likely to be a bank employee who campaigns for equal rights than just a bank employee.

We view the narrative of a socially aware bank employee as significantly more plausible and in tune with the character description, and therefore also see it as having a greater probability – which is completely incorrect in logical terms. As the group of socially involved teachers is a subset of all teachers, the likelihood that Linda is a socially involved teacher may be equally great in logical terms – though certainly not greater.

The situation we describe gives a clear illustration of the power of narratives. Even if they make no

sense in logical terms, narratives can have a significant impact on account of their apparent plausibility. Not least, they have the power to shape developments in society, politics and the economy in general. In this publication we discuss the phenomenon as well as its significance for economic developments and the financial markets.

And going back to Linda, we can indeed all agree that she probably doesn't work for a bank.

We wish you an interesting read.



Christoph Boner  
Chief Investment Officer

# The impact of economic narratives

Narratives determine our understanding of economics and influence not only our personal behaviour but also politics in general. Such narratives are often no more than stories that supposedly help us to understand the world. They are significantly influenced by historical events, cultural imagery and media presentation.

These stories emerge from the interplay between facts, emotions and cultural context. They help us as individuals to understand and rationalise complex situations; in social terms they enable a society to develop and nurture shared ideas and values.

The desire for narratives that are as coherent and consistent as possible is derived from a basic human fear: uncertainty and coincidence make us feel uneasy. Narratives firstly help us to see an uncertain, complex world in simpler terms and therefore seemingly understand it. The fact is that in the world around us considerably more than we would care to admit is the result of pure coincidence. Our desire to blank out and ignore this unpredictability as much as possible makes us susceptible to consistent and plausible narratives – through to narratives that make no sense in logical terms or are even counter-factual.

While media presentation and distribution can be a fundamental

problem in the derivation and dissemination of many narratives, we already face multiple challenges in the development stages. As there are no circumstances in which we have full information and can therefore never be objective, we run the risk of developing narratives that are at best distorted – and often quite simply wrong. The same mechanism means that narratives brought to our attention are not assessed on the basis of objective credibility and factual correctness; instead, they are often assimilated to a greater or lesser degree based on personal preferences and characteristics.

In addition to a perpetual information deficit and lack of objectivity, two other aspects of the human

**“I confess that I need stories to understand the world.”**

Siegfried Lenz

character get in our way in terms of the development and adaptation of narratives. On the one hand, plausibility is of major importance to us. The more a narrative fits our experiences and expectations, the more likely we are to consider it to be true. Likewise, simplicity and coherence are key to us: The more consistent and simpler a narrative appears, the more easily it is spread and therefore gains credibility – in many cases totally regardless of whether or not it is true.

Given that narratives are subject to error at the development stage and are often problematic when being disseminated via the media, coupled with their impact, they can therefore have far-reaching consequences –

whether of a negative or positive nature. Narratives regarding a country's economic situation can shape its development on a lasting basis. The narrative of a cooling economy can cause economic actors to save a higher proportion of their income and rein in their consumption. Even if the narrative isn't necessarily correct yet seems sufficiently plausible, an economic downturn is the result. In its simplest form, we talk of a self-fulfilling prophecy.

Another current narrative that can be cited is the ubiquitous topic of the "green transition". A gross simplification of the situation, through to escalation and a focus on the human trait of the fear of losing makes this narrative potent in its direct form,

and thus gives it a crucial influence on our personal actions as well as politics.

Other narratives such as the "gig economy" are polarising: depending on the author's viewpoint, the term indicates workplace flexibility and independence or, alternatively, precariousness and exploitation. In all cases, none of these narratives explains the complexity of the situation – each narrative nevertheless has an impact that extends beyond the statement itself.



# Dealing with narratives in the world of finance

Economic narratives also shape the way we approach financial markets. Narratives are not only developed retrospectively in order to supposedly explain the course of financial markets, but in their attempt to issue forecasts, financial market pundits and analysts create a multitude of different narratives.

While these narratives not only entail a high degree of entertainment value and can also guide investors at an emotional level, it is all the more important to be aware of the limitations and above all the incorrect assessments and conclusions that could potentially arise from these narratives.

We should be aware of following three aspects at all times:

## Coincidence

Developments on the financial markets are influenced by a raft of factors: however, many of these influences are random and cannot be predicted. The predominant narratives usually obscure this coincidence. Taking account of probability spaces and scenarios is already so challenging for us humans that many narratives simplify matters by neglecting these dimensions.

## Causalities

Ignoring the element of coincidence results in a direct, additional risk in the form of perceived predictability. As coincidence is replaced by supposed causality and in extreme cases monocausality, narratives in direct form can lead to incorrect conclusions.

## Behaviours

Even if coincidences are recognised, people nevertheless tend to look for patterns among these unpredictabilities. In particular, due to selective perception, the availability heuristic and the existence of confirmation bias, excess confidence in the narratives can arise, which in turn fuels potentially incorrect conclusions.

**Due to our human tendency to construct – and believe in – coherent narratives to explain the past, we constantly overestimate our ability to predict the future.**

In all cases, caution is required when dealing with narratives. The more plausible and simpler they appear, the more people should be aware of the dangers and risks. The world – and thus the financial world, too – is more complex and above all significantly more susceptible than we want it to be. Narratives are a simplification that can appear attractive but present grounds for concern in terms of both development and consequences.

On a positive note, the more an economic narrative takes hold, the more the impacts of that narrative on financial markets can be identified. Due to its impact, the narrative itself becomes a potential forecasting model for market developments – notwithstanding logical nonsense and any counterfactuality.





## Narratives: Why are they so powerful?

**Christoph Boner**  
Chief Investment Officer

### **What does narrative mean?**

A narrative is a story that helps us – or is intended to help us – understand our surroundings and current circumstances. This understanding in turn constitutes the basis for our actions, as a result of which such narratives can have a major impact.

The narrative itself is heavily influenced by historical circumstances, cultural aspects and media presentation and is usually based on a mixture of factors, emotions and context.

### **What makes narratives so attractive?**

Narratives help us understand complex situations. They serve to help us comprehend and interpret situations and phenomena by presenting them in an understandable way. This means in particular that the narrative creates plausibility and simplicity, with the deliberate far-reaching masking of coincidences engendering the illusion in causality and deterministic dependencies. The world seems to be more predictable and controllable than it actually is.

### **Where does the impact of narratives come from?**

The attractiveness of narratives can have far-reaching impacts. Due to their simplicity in terms of explaining the world, (supposedly) simple approaches and solutions can be derived. As a result, narratives can have a major impact – even if in terms of content they can range from (over)simplified to quite simply counterfactual and incorrect.

### **What risks are we exposed to in the development of narratives, and why are we too ready to believe in good narratives?**

Narratives do more than simplify things and do not go far enough in most cases. In addition, different human peculiarities and characteristics also lead to imbalances and distortions in the development and adaptation of narratives.

An initial, significant distortion can arise via the availability of information. Data that is more easily available, more user-friendly, and appears on a more regular basis results in these aspects being given excessive



consideration – because they are more present, not because they are thought to be more relevant. Behavioural psychologists talk of the availability heuristic.

The sequence of information can also result in distortion, as the initial information in particular can act as an anchor and subsequent aspects are seen in relation to this starting point.

Confirmation bias means that information that is close to our own thoughts and feelings is given greater consideration. The distortion towards a subjective view is clear here.

### **What role do the media play in the spread of narratives?**

Narratives can have an unimaginable impact – in some cases regardless of their consistency and truth. This creates a not inconsiderable risk that bearers of narratives – the media being a classic example – instrumentalise narratives in a manipulative and sometimes fraudulent way. In particular, the framing effect is a frequently tried strategy: The same information, if worded differently, can change the credibility of the narrative and therefore have a different influence on the recipient's behaviour.

Privatbank IHAG Zürich AG  
Bleicherweg 18  
P.O. Box  
8022 Zurich

Tel. +41 44 205 11 11

[info@pbihag.ch](mailto:info@pbihag.ch)  
[pbihag.ch](http://pbihag.ch)

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