Emotional Biases

Check Them at the Door of Your Portfolio

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ARE YOU A NERVOUS NELLY OR A RISKY RALPH? Maybe a little of both? Neither character is particularly suited for making good investment decisions. Still, few of us can ignore their influence.

Investing can trigger all sorts of emotional reactions. Markets are unpredictable and uncertainty causes anxiety — especially when you're talking about the money you're saving for retirement, your children's education, or that second home on the beach. Emotion-based biases and behaviors and unavoidable, but just being aware of them might help you keep them from standing in the way of reaching your financial goals.

Some of the characters that live inside us who can negatively impact our investment decisions:

- **Scaredy-cat Carey:** Carey doesn't want to see any losses in his portfolio, even short-term dips. He knows markets go up and down, and some periods are quite volatile. But he would prefer to avoid short-term fluctuations than to invest in ways that can produce long-term gains. Carey is so averse to loss, he refuses to take any risk at all, and loses out again and again on opportunities to grow his investment portfolio.
- **Blue-sky Billy:** The markets are doing well, and the rising tide has lifted Billy's boat. He's imagining even greater returns and wants to take on more risk, more than advisable. He'll also hold on to an investment too long, not willing to take a loss. But when the makes one of its inevitable corrections, he's likely to sell — at the worst possible time.
- **Rumor-mill Rachel:** Rachel makes investment decisions based on a friend's advice, or when she sees some "expert" on TV recommending a particular stock or fund. She doesn't see the value in working with an unbiased advisor who has access to information and analysis, and will take the time to understand her investment goals and tolerance for risk.
- **Predetermined Patty:** Patricia relies on preconceived notions to support her decisions and avoids arguments and statistics that contradict her staunch position. She'll discount information or ignore it, making decisions before she understands the full, unbiased picture about an investment.

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- **Myopic Mike:** Mike makes judgments based on his personal observations, not realizing there is a broader, greater reality. Recent events weigh more heavily on his decisions than historic performance. When he feels comfortable with his own financial position, he has a rosy view of the entire economy. When things turn sour for him, he sees doom all around and will sell his investments for no other reason. What's happening to him now seems to be the long-term rule.
- **Soft-hearted Sadie:** Sadie inherited company stock that has been in her family for decades and has grown in value to be worth more than the rest of her investments combined. But she doesn't look at the stock as part of her portfolio, or is concerned that she has too much concentration in one company. The inherited stock is different. She's emotionally connected to it. She'd feel guilty selling it.

There's likely a little bit of all these characters in all investors. But being aware of that and recognizing them as emotional biases, you can check your behavior and stay on track toward your financial goals. Have an interactive conversation with your advisor, express those thoughts and feelings, and avoid making emotional decisions. You'll be a lot more likely to have a portfolio that suits both your goals and your comfort level.

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