



## 'Poor' Behaviors

### Avoiding irrational investment behaviors

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As financial advisors, managing assets is only part of the equation. Managing investors' expectations/ psychology is often just as big of task. Professional or novices, we all have inherent weaknesses when it comes to managing our finances. The first step to improvement is awareness of these shortcomings before they occur. Obviously, there is very little investors can do about macroeconomic events like energy prices or rising interest rates but we can all control our emotions. I know: easier said than done. Well, let's examine some of the more common investor pratfalls and how to avoid them. In the interest of full disclosure: I was one credit hour short of a minor in psychology.

- **(Cost basis) Anchoring** – This is the tendency of investors to become attached to a specific price as fair value. The markets have no idea what you paid for a stock. Lucent is not going back to \$70 anytime soon. Consider this: say you paid \$50,000 for your home 25 years ago and now it is worth \$500,000 – will you argue with the current valuation versus what you paid?
- **Attachment Bias** – This is natural with inherited stocks. Company XYZ might have been great when your grandfather bought it 40 years ago but not now. Stock certificates are unaware of who owns them.
- **Fear of Regret** – The tendency to take no action for fear of making a mistake. This also can cause investors to hold onto a stock losing value, because if they sold and it rebounded they'd feel even worse. One lesson learned long ago is that stocks I sold immediately would go up and stocks I bought would immediately go down. This trend would usually reverse itself but it just confirms you rarely sell at the top or buy at the bottom.
- **Overconfidence/Under confidence** – This can be resolved by doing solid due-diligence research. Understand the risks/rewards involved and maintaining a neutral attitude.
- **Tax Phobia** – Sometimes there is more economic value in selling to take a loss than the value in the stock itself – especially true in non-retirement accounts. **Fear of Selling** is the first cousin to Tax Phobia.
- **Mental Accounting** - Otherwise known as Cocktail Accounting. Interesting how everyone makes 25% and never buys a losing investment at Friday Night Happy Hour. This is a confirmation bias that investors avoid admitting to losing investments for fear of looking 'dumb'. Trust us: if you haven't had a losing investment, you haven't invested.
- **Representative heuristic** – Investors, especially novices, assume good companies make good investments. "Feel good" names are bought. Don't believe me? Go check out the 5-year chart of General Electric - down almost 50%. This is a difficult behavior that can taint professionals as well.
- **Avoidance** – Possibly the worst of all investment behaviors – shutting out your finances altogether. Of course, those with this malady probably aren't even reading this newsletter.
- **Status Quo Bias** – The tendency to do nothing when action is actually called upon. The economy and markets are naturally dynamic, not stagnant. Periodic tweaking, not heavy turnover, is healthy. Consider it weeding and nurturing your financial garden.

Obviously this list is not all-inclusive but it does point out some of the more prominent self-defeating behaviors. Studies have shown that the most successful investors are deemed "investor psychopaths" – they show little, if any, emotion towards investing. They are *not* indifferent; rather, they can effectively separate their feelings from their finances and make productive, unbiased decisions. Hopefully, we have provided a starting point to improving financial behaviors – if not, feel free to call us for an attitude tune-up.