

Our Perspectives: Avoiding the Pitfalls of Emotional Investing

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Our emotions can sabotage our good intentions when it comes to making investment decisions. CFP Raymond Scott offers tips for taking the emotions out of your financial actions.

Q. How do emotions materialize in investors?

In my client service role, I see it firsthand in the phone calls from our shareholders. The emotion that prompts the most calls is anxiety — our investors see a piece of bad news, or feel worried about politics or even seeing a weak return on their account statement for a particular quarter. Often, the question is along the lines of “I’m worried about x. Should I sell my investments?”

Q: What is your response when that happens?

Well, regardless of the exact market environment, the answer for shareholders is: focus on long-term goals. We can never be certain about what the market will do next, good or bad, and research shows that nearly everyone gets market timing wrong. In fact, the investors who set up their accounts with long-term goals in mind, and then forgot about their investments may have strong returns! I think it is often helpful to go back to your overall goals, and remember why you set up the long-term plan that you did, before making a change.

Q: Has emotion been a bigger driver in the current political environment?

Actually, while the election cycle and the incoming administration have been a time of high emotions, the volume of shareholder calls has been steady. We’ve seen an even balance of some investors who felt that stocks would go down, and some who felt that stocks would go up, regardless of which political view they had.

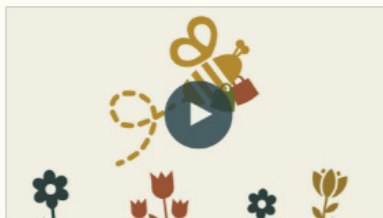
But one thing we think has made investing decisions more emotional is modern-day technology and availability of news. Someone turns on cable news, or opens Facebook, and there are constant headlines and opinions telling them it’s a good time to invest or a terrible time to invest.

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Q: Do you see other ways that emotions play into financial decisions?

Another emotion-driven tendency is the idea of holding a lot of cash, “just in case.” We can understand why that gives investors some peace of mind. But we also remind them of the costs of inflation. When you hold cash, the purchasing power falls over time because inflation is driving prices up a little every year. It doesn't feel like a loss, but it is.

Q: How can people work around emotional pitfalls?

Well, technology can aggravate investor emotions, but it can also help remove emotions from the process. My favorite tool is the use of automatic investing plans, which can make scheduled purchases, redemptions or exchanges for you.

I recall one study which said investors made better decisions when they kept a picture of a family member next to their computer — a visual reminder to go back to your original goals for your accounts. There's also evidence that using a financial advisor may help investors make better decisions mainly because they have an outside resource to help prevent emotional reactions. We are always happy to be that resource to our shareholders — our phone lines are always open.

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