Assante WEALTH MANAGEMENT

Assante Capital Management Ltd.

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Emotional Investing

After many years in the investment industry, one topic that continues to interest me is the "psychology of investing". The theory behind this helps identify how we all act in different investment situations, and how we perceive risk differently in different environments.

While we are all aware of how others react when discussing markets and investing logically, how do we actually react in these same situations? Can we detect this erratic behaviour in ourselves when we are actually making financial decisions for our future? It is very difficult to detect, and we can seldom realize until its too late! That's because the financial industry is the best place for herd mentality to earn its place in history. Why do you want to consider purchasing a "penny stock" when you hear it could go up 10 times? Why did so many people hold on to Nortel, when they knew the valuation was at extreme levels? Why did nobody want to purchase stocks in March 2009, when they were at historic lows? Because every time, there was some theory, some common element that told you "this time is different".

Here are the most common issues that have been proven.

- The investor under-performs the investment the vast majority of the time. In fact, the average investment return is 4% higher than investor return* Why? The investor gets nervous and sells often as the investment is falling or just starting to regain some growth.
- When markets are in a decline and we've already lost money in our own portfolio, we believe the likelihood of losing more money is higher than it actually is. Therefore, we make irrational decisions based on our emotional state and not on logical fact.
- Headline bias. We only use the information that is easily available, and make decisions based on that, rather than on proper complete research. Often, this means a rash reaction, and quick sell or purchase, even when it's not best for your portfolio or risk profile.
- Holding on to your losers. While sometimes it's not worth selling them, often we hold on just in case they come back. By selling, we are acknowledging our investment mistakes, and admitting them. By re-allocating these resources to other areas, we can again focus on growth.

The key here is to understand what you are doing to sabotage your investment performance!

How can you manage this in the future?
As we have now lived through the 2008-2009 market meltdown, and have lost the confidence that we used to have that the markets always perform, it's important to know how we react and identify what we can do to improve on rash decisions.

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Ask yourself:
Did you react when things went down? Statistics say that most of us will get out when it has already dropped, but not have the courage to get back in until it's already risen. Often, we re-enter above the point where we got out. That's why 'timing the market' doesn't usually work. This is why many market experts suggest choosing an appropriate balance (or asset allocation) and then re-balancing to retain that level. This approach forces you to take profits on the asset class that have risen more than everything else, and purchase the lowest returning items at certain points as well. By removing the emotional side of the equation, many believe you make better decisions.

Statistics also say that often working with an advisor will help, and it's not because we're perfect in calling the market, it's because we help you to stay on track with your original intent. Often an outsider can remove some of the emotional impact and help you to make more logical decisions.

Another way to combat investment nerves is to consider a "wrap" or managed money program. I know these investments can take away some of the decision-making, but for investors who are really unsure of when to buy and sell, and almost freeze in the decision-making process, these programs help investors to focus on the things they can impact. The program allows us to take away the emotional decisions and focus on the logical ones based on the client's comfort level. They will usually smooth the ride.

To determine what investment biases are holding you back…consider asking yourself these questions.

Am I considering all information, or just what backs my opinion?
Can I afford this if the investment loses money?
What's my exit strategy? For gains, taking profit at a certain point. For losses, selling out when it drops by 10-15%. Go in with a gameplan, and follow through with it.
Does this match my timeline? How much flexibility do I have if things don't move as expected.

These questions can help you be more logical about your decisions.

Overall, have a long term plan. Identify how you can meet that plan and what's required to get you there. Knowing things (both lives and markets) never go exactly as expected, ensure you have some flexibility in meeting your plan that can be accommodated as markets shift and your life situation changes. Focus on what you can control; spending, savings targets, expenses and asset allocation and work on strategies to manage what you cannot control, such as returns. As long as you do this, and keep investments within your tolerance levels, your long-term planning should remain on track.

So, enjoy emotional decisions in many parts of your life, but leave those affecting your finances to the "logical" side of the brain.

Janine Purves is a Senior Financial Advisor with Assante Capital Management Ltd. (a member of the Canadian Investor Protection Fund and is registered with the Investment Industry Regulatory Organization of Canada). Please contact me at 905-707-5220 or email at jpurves@assante.com to discuss your particular circumstances prior to acting on the information above.