The Most Misunderstood 4 Letter Word in The World!

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Emotions can be a great asset in life. But…when it comes to investing, they may be one of our worst enemies. In volatile times (like now!) it can feel a lot like riding an out-of-control roller coaster. Of course, there is the thrill and excitement when the market goes up and fear and panic when it falls. As our emotions increase in intensity many investors forget that the market tends to move in cycles. Instead, too much focus is put on short-term returns leading us to feel overconfident during bull markets (the Up times!) and downright confused and even depressed during bear (the negative times!) markets. These strong emotions can cloud judgment resulting in costly mistakes. What to do? Below are some thoughts to help during volatile times.

1. IMPATIENCE

We live in a time where the expectations of instant success are at the forefront. This holds true in situations where your web page doesn't load fast enough, you haven't lost any weight after dieting for a week or…when your investments haven't increased in value over night. Trying to enhance performance by moving in and out of sectors, chasing the next 'easy money' big thing often comes with no success.

Ask yourself this question: If my house went down in value would I sell it? I think it's safe to would assume the answer is NO. I have yet to find any type of asset that goes up day after day, month after month or year after year with no corrections or crashes. Expecting things to go up year after year just isn't realistic.

2. OVERCONFIDENCE

Could our emotions be affecting the type of investments we choose? Do we just have to have the 'hottest pick' because cousin Joe or buddy down the street said it was a no brainer? While we do hear some success stories with this strategy it comes with a lot of risk. For example, that top asset class in 2007 was international stocks, earning a return of 11.2%. In 2008 (a year most remember like it was yesterday) its returns dropped to the bottom of the rankings with a loss of -43.4%*. What worked in the past may not be positioned for the now or the future. What works one year may not be positioned for the future.

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3. FEAR

In bear markets or times when the markets are volatile many become fearful with investing because of early losses and the fear that they'll make more costly mistakes. Some people delay making investment decisions and wait for definitive signs that things are OK. This approach may seem sensible at the time but many of the gains of a new bull market are made early in the recovery rebound. No one has a crystal ball or sure-fire way to time the market. Warren Buffett stays invested and buys when others are fearful, and I think he's a pretty smart cookie! I'm not saying it's easy but controlling fear can be one of the single most important factors in your success.

4. PANIC

Equity values can most certainly drop over the short term, but they are also one of the few investments that offer the long-term growth potential that people need to reach their retirement goals. Numerous wars, recessions, financial crisis, Presidents and 'events' have taken place year after year. The press, whether it be in print or online, reminds us day after day how 'bad' things are – helping push that panic button! I would encourage you to go back and look at the stock market the year you were born…where is it at today? What events have taken place in that timeframe? Is it up? I think so.

Research conducted by Dr. Daniel Kahneman (one of the founding fathers of behavioral economics), who is the only Nobel Prize winner for economics suggests that when faced with uncertainty investors tend to make decisions based on their emotions and subjective experiences, not logic or objective reality. As a result, investors can easily make the wrong decision for their individual situation.

"The more emotional the event is, the less sensible people are." - Dr. Daniel Kahneman 2002 Nobel Prize Winner for Economics.

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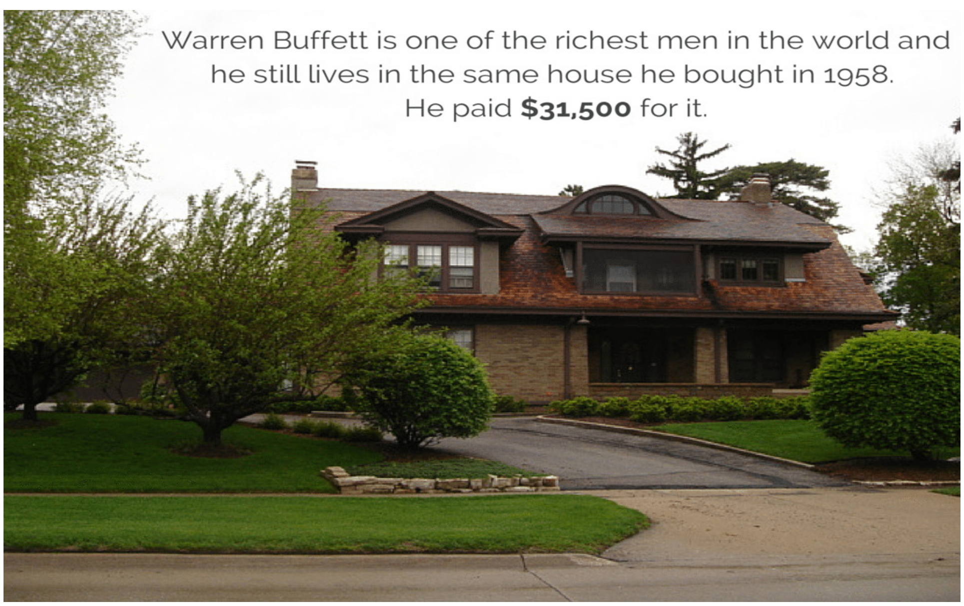
The Answer

The most misunderstood 4 letter word in investing is <u>RISK</u>. Risk is not just driven by numbers or ups and downs. Not controlling the risks of being Impatient, Overconfident, Fearful and Panic will, in large part be the deciding factor in determining your success with investing.

Our role is more than simply building portfolios – we are behavior coaches. Investing can be challenging and our emotional responses in periods of uncertainty can undo years of past or future success.

There is a huge difference between ease of access to information versus the value of that information so feel free to use us when those emotions start to rear their ugly heads!



*Source: Callan Associates 2014

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