

Investor behaviors

Investing for your retirement

Computer models may react logically and rationally to the market, but not all investors can say the same.

Investors are real and imperfect people who react with social, cognitive and emotional biases. Because these behaviors tend to be systematic, investors can analyze and learn from past mistakes in order to avoid negative behaviors when it comes to our own investing.

Overconfidence

Do you rate yourself "above average" when it comes to investing?

If so, you are part of the majority. Confidence is a great behavior, but too much of a good thing can be bad. When it comes to investing, overconfidence can lead investors to focus only on the upside and to underestimate the possibility of poor performance. This false perception could lead to poor investment decisions.

Hindsight Bias

If investors were psychic, investment portfolios would surely look very different.

If an investor begins to believe they should have realized a certain negative investment event was obvious and predictable, it can lead to feelings of anger and regret. Beating oneself up over an unpredictable outcome can lead to irrational future investment decisions. Trying to foresee outcomes that are impossible to predict only wastes time and frazzles nerves.

Short-Term Focus

Are you online checking your portfolio performance daily, noting every daily market fluctuation?

Today's technological advancements make it easy for investors to constantly monitor investment performance. It is always recommended to regularly evaluate a portfolio to be sure it is achieving its goals, however constant scrutiny could lead to short-term investor behavior such as frequent trading. If retirement is 30 years away, a portfolio may be better able to handle typical market volatility. An investor must remember that daily fluctuations are not necessarily indicative of long-term performance and resist the urge to act upon short-term volatility.

Regret

What investor wouldn't regret making an investment decision that did not go as expected?

Unfortunately, this is part of investing. However, some investors allow this regret to alter their investing behaviors. Some investors may become risk-averse, feeling if they "play it safe" they can avoid negative outcomes. Others may actually take on more risk, thinking it may be necessary to reach their investment goals. Sticking to your investment strategy helps avoid either error.

Mental Accounting

Asset allocation and diversification can help to balance a portfolio's performance.

If one type of investment performs poorly, another could be performing well and counter the negative results. Mental accounting is when an investor compartmentalizes investments and ignores the portfolio as a whole. Such a narrow perspective could lead an investor to overlook various asset classes. Asset allocation and diversification cannot assure or guarantee better performance, and cannot protect against loss in declining markets.

Hot-Hand Fallacy

Investing certainly would be easier if there were patterns and trends to follow.

For this reason, some investors may see a pattern where none exists and take action based on this perception. Investors may want to chase the "hot" returns assuming they will remain positive or even select a "hot" manager who happened to have a good year. Unfortunately, these may not be the best strategies when it comes to managing a portfolio. Short-term performance is not a true testimonial of long-term performance.

Negative investor behaviors can be quite damaging when creating and managing a portfolio.

By identifying and understanding these behaviors and misperceptions, an investor can avoid making similar mistakes. A basic investment education, a properly constructed portfolio and clear objectives can help in sticking to the proper investment strategy.

Source: Morningstar

Talk to your financial professional about what investment strategy may be right for you. For a simple approach with built-in diversification, you may want to consider asset allocation funds.

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