

Minimizing the effects of emotions to guarantee investment success

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Having a solid plan and sticking to it are the keys to investing successfully, according to Warren Buffett's introduction to the Intelligent Investor. Although many people invest with a plan in mind, Buffet has observed that investors often have difficulty sticking to that plan. It can be difficult to follow through on a specified path when detours, such as volatile markets, present themselves.

In this series on behavioral finance, we will highlight the key behavioral traps that investors fall into, which may impede their ability to follow through on their longer-term investment strategy. The first we will discuss is anchoring. Anchoring causes us to preoccupy ourselves with the price we paid for an investment, whether or not that price has retained its significance. Although the world may have changed significantly since our initial purchase, we often cling to the price we paid or focus on what the investment was worth at its peak. Investors might focus on the value of their portfolio or a specific fund during the last market peak with the idea that they must hold onto it until it ultimately recovers. It is important not to be anchored down when the best strategy may be to sell an underperforming fund during a down market in order to reposition the available funds for a healthier, more robust recovery.

Anchoring can also involve fixating on feelings you experienced at a certain point in the past, which control your decision making in the present. For example, those who lived through the Great Depression or those who are influenced by someone who did may feel the need to hoard cash during times of market uncertainty. When an investor is anchored to a need for cash, it is our job to respect the emotions of the investor while helping to work through the hoarding bias. This can be done by creating a plan to rationally pay down debt and invest for the future, understanding the potential for and importance of capital appreciation through investing.

It is important to acknowledge the effects of emotions on one's investment well-being and we are here to assist you in working through emotional traps, which may impede your long-term economic prospects.