



10 Negative Investment Behaviors

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A recent study from Dalbar found that over a 20-year period ended on 12/31/16, the S&P 500 averaged 7.7% a year, but the average equity investor averaged just 4.8%. And those that invested in Asset Allocation funds averaged a paltry 2.3% per year.

The Dalbar study was conducted over the 20 year period between 1997 and 2016. So, this was during a time that the stock market experienced not one, but two crashes. The first crash saw the S&P 500 lose over 37% in thirty months between 2000 and 2002. Then, the stock market experienced its worst performance since the crash of 1929, when it lost a remarkable 53 percent in the seventeen months between October of 2007 and March, 2009. But over that 20-year period, it still managed to average an almost eight percent return. However, most investors didn't make anywhere near what the markets did. So, had someone invested in all the stocks that are represented by the S&P 500, and invested \$100,000 total, over that 20 year period, between 1997 and 2016, \$100,000 invested in the S&P 500, which, of course, you cannot invest in directly, would have turned into \$439,000.

But the average investing do-it-yourselfer's \$100,000 only turned into \$255,000, a full \$184,000 less. And the asset allocation investor did even worse. He came out of those 20 years of investing with only \$157,000.

With those figures in mind, the question that has to be asked is why does the average investor do so much worse than the investment he's investing in? Dalbar suggests that investor behavior is the main culprit. They suggest that there are 10 distinct behaviors that tend to plague investors based on their personal experiences and unique personalities. These behaviors are;

Loss aversion, Narrow Framing, Mental Accounting, Herding, Regret, Media Response, Optimism, Diversification, Anchoring and Watchfulness.

This report discusses these different behaviors, then discusses the ways that we, as investors, can avoid or overcome these behaviors and get so much more from our investments because we stop sabotaging ourselves.

1. Loss Aversion

Loss Aversion is when someone expects to get high returns in the stock market without taking on any market risk. I've seen this numerous times as an advisor. Three years ago a guy I really like invested a large amount of money with me. It quickly went up over 10%, then it fell 4%. The investor really liked the 10% gain, but the 4% loss frightened him. He started calling on me to move his account to the money market fund until the market started going back up, like I knew when that would happen. I finally sent him his money, including what he'd made. He called me a few months later to ask if I'd take him back. I asked him if he was going to let me manage the account. He said yes, so he sent me a much bigger check this time. Again, the account went up a lot. Again, he was happy. Again, the market reversed on us and his account lost part of what it had made. And again, he called me to get out of the market. And... as before... I sent him his money and told him that real investing was probably not for him. When you put something out of your mind and don't think about it, it tends to have less effect on your emotions. But when you think about it all the time, it occupies a much bigger portion of your brain and it becomes much harder not to think about it.

2. *Narrow Framing*

Narrow Framing is when the investor does not consider all the implications of investing a certain way before he pulls the trigger on that investment. For example, some guy reads about a new product coming onto the market. He believes it's the greatest thing since sliced bread. He just knows it'll make a fortune, and anybody who invests in that company is bound to become filthy stinking rich. What he doesn't know, and what he never bothered to find out, is that the company that makes that great product is run by the founder's son, a coke-head high school dropout that doesn't know how to run a washing machine, much less a manufacturing company. So, no matter how good the product may be, the company has little chance of success because of poor management. The investor framed his entire narrative around one thing, the product. But there are so many more things an investor should consider before making such an investment.

First, if someone tells you that you have to invest right now or you'll die a penniless pauper, know that's just not true. I can't tell you the number of emails I get each week that tells me I only have days to invest before this or that opportunity will close forever. But after all that time out of my busy day, I got tired of the hype and clicked out. Then I went to the internet and googled the presenter's name, which is the first thing I should have done. Turned out this guy had been selling this same story for months, just changing the date you had to invest by when that day was getting closer. In other words, it was a scam. Narrow Framing keeps innocent investors from discovering that those investments are scams until it's too late. A good investment is a good investment. It doesn't change from one day to the next. If you are a person who may be subject to narrow framing, just make a commitment to doing your research first. In my business we call it doing our due diligence.

3. Mental Accounting

This is when someone invests in a company that's a huge risk, but then takes no risk on the rest of his money to, quote, balance things out, unquote. What I mean by that is, let's say that on a scale of 1 to 100, with 100 being like betting it all on red in Las Vegas, the investor puts half his money in a company with a 98-risk rating and the other half in a safe deposit box. In his mind, he's made a moderate investment because half his money has a 1 rating and the other half has a 98 rating, making his overall rating a very moderate 49, right? Wrong! With half this guy's money on one end of the investment spectrum, and the other half on the other extreme end of it, the chances of his making a moderately good return is very small. He'll either lose half his money or make a lot, one or the other. There's not much chance of a middle ground here. If you can be satisfied with a moderately good return on your investment, invest in companies that have a history of producing moderate returns. We have a software program that can help you calculate the risk on virtually any stock, bond or mutual fund on almost any exchange. It's part of our trademarked Wealth Toolkit. What this means is that an investor can send us a copy of his portfolio, or what he want's to invest in, and we can tell him the overall risk he is assuming on his current investments, or will assume if he invests in what he want's to. And that's some powerful knowledge for an investor to have.

4. Herding

Herding is when you copy the behavior of others, even in the face of unfavorable outcomes. Think about all the Enron employees who were investing all their 401-k money in Enron stock a little over 20 years ago. That gravy train was running at full steam and nobody wanted to get left behind. Then one day they went to work... and it was over. These folks lost both their job and their retirement. Why? Because they were doing what everybody else was doing. They were following the herd. They were paying no attention to the warning signs that Enron was in trouble. Everybody around them was getting rich quick and they wanted to get rich quick, too. Some good advice here is that if everyone where you work, or all the guys on your bowling team, or everyone at your church are investing in a certain way, do just the opposite.

Be the contrarian. Or at least do your own research into that investment, or that way of investing. The crowd rarely knows, so it's best not to bet on them. But if you do find yourself caught up in the hysteria of the crowd and you make a bad investment, don't let the regret of making the wrong decision keep you from trying again. See, regret is the 5th negative investor behavior reported on by the DALBAR Research Group.

5. Regret

Regret of having done something bad can keep you from ultimately becoming successful. If you play over and over in your head the bad decision you made long ago, it can keep you from looking at your future with the hope and optimism you need to be successful. Regret is a powerful emotion, and we can use it to either power us brightly into our future, or hold us in the darkness of our past. In all honesty, we all have regrets, or we should have. I certainly have a bunch. But dwelling on them gets me nowhere. But using my regret as a lesson of what not to do again can keep me out of trouble and make my next decision much better. Have you ever made an investment in something, maybe a certain stock, and maybe it went way down, so you got scared and sold it. But then it rallied and shot the lights out to make all-new highs, and you regretted ever selling it out? You know, some people get mad at the investment for tricking them like that. They take no responsibility for their own behavior. And that's a shame. Anyone who blames others for their own mistakes cannot learn from those mistakes. They have to own them to ever learn the lessons those mistakes are trying to teach. So, don't let regrets keep you from learning and then trying again.

6. Media Response

Do you know people who don't invest because of what's happening somewhere in the world, because the news is bad? Our next negative investor behavior is called Media Response, and it's when the investor fails to invest because of their tendency to react to the news without doing a reasonable examination of how that news will affect the investment they are considering. If you ever want to have an excuse not to invest, just look at the nightly news. Riots, wars, rising taxes, inflation, corruption in politics, lawlessness, child grooming; you see them all when you turn on your TV at night.

Let me ask you this, what chance would a little computer company, started in the garage of some geek's mom and dad have of becoming the most valuable company in the world? Well, Steve Jobs and Steve Wozniak did it with Apple Computer company, starting in the mid-70's. Do you think they could have achieved that accomplishment had they been paralyzed by the Vietnam War, Watergate and the possible impeachment of President Nixon at the time they were getting this little computer company started? And today, if you were to put all your concentration on all the negative things happening in the news, what chance do you think you'd have of being a successful investor? Now I'm not saying to ignore what's happening in the world. It's always good to be aware of the world around us. Just don't let it take up so much space in your head that it crowds out your common-sense ability to reason and analyze when it comes to investing. Don't be subject to the negative investor behavior of Media Response.

7.Optimism

When it comes to investing, can we be overly optimistic? Can we believe that bad things just happen to others? Too much optimism is, as strange as it may sound, a negative investor behavior. Now we all know that for the most part, you need a certain level of optimism to be successful with your investments. If you're always thinking that investing is crooked, or evil, or rigged against you, you just can't be successful at it.

In fact, if someone feels that way, they won't invest to begin with. But having a pollyannish outlook can keep you from seeing the negatives of a certain investment, so you invest in it, or stay invested in it anyway, and wind up losing because you thought everything would just work out. This behavior is much like the Narrow Framing behavior. One can be so optimistic that he blocks out all the tell-tell signs that this may not be such a good thing to invest in. In my career as a Professional Financial Advisor, I am usually able to help temper a client's over-optimism. I can work with that person much easier than I can with a pessimist. But when an overly optimistic person is a do-it-yourselfer, and there's no one there to temper his enthusiasm, he can wind up leading himself down a destructive path and lose a bunch of his money before he learns his lesson. So, if you have a tendency to be too optimistic, I would suggest you find a good, experienced, credentialed financial advisor. You can call me. I've helped a lot of overly optimistic people over my 40-year career. If you do, we will most likely cost you a lot less than your over-optimism will. So, being overly optimistic is a negative investor behavior.

8. Diversification

Now, we've all been taught that diversification in our investments is a good thing, right? Don't put all your eggs in one basket. Spread your money out in many directions. And for the most part, I agree. Putting all your money in just one company, or just one sector of the economy can wind up hurting you if you pick the wrong one. Spreading the money you have among many different investments and types of investments serves to reduce your risk.

If one thing you're invested in does poorly, another one may do well, evening out your return. So, where does diversification become a bad, or negative, behavior? It's when the investor hires two or more financial advisors. Now you may think I'm saying that for competitive reasons, but I'm not. The investor, has the best of intentions when he invests through two or more financial advisors. He just wants to see who will be able to make him the best return. To him, that's diversifying his chances of a good outcome. But most times it doesn't work that way. Financial advisors are unique, just like everybody else. We all have our own biases and prejudices. We all believe we have the best answers and solutions for our clients' wellbeing. And we're all likely to give different advice. Because we're all different we can make a good case for the investments we are recommending. So, getting advice from several different, quote, experts, unquote, can serve to confuse rather than enlighten. And sometimes different advisors may recommend the same investments, so while the investor has diversification among his advisors, they are putting him in the same investments, thus keeping his investments

undiversified. I can't tell you how many times I've seen it. An investor hears something on my radio show that catches his attention, so he gathers up his statements from all his other advisors and brings them in. One of our services here is to do a deep analysis of your current portfolio, letting you know exactly what you own. And during that analysis we discover that he is overweight in a certain stock or fund, and he doesn't even know it. He thinks he's highly diversified. But it turns out he's not very diversified at all. Now if this investor had given his entire portfolio to one of those advisors, his investments inside that portfolio would probably be well-diversified, because as financial advisors, that's what we're trained to do. Now, just one more thing as it relates to diversification. I believe there is such a thing as over-diversification. Not long ago an investor came in with his three-million-dollar portfolio.

He was invested with one of those big wire houses you find in the middle of town. This guy's portfolio had over three hundred different investments in it. And some of those investments had just a few hundred dollars each in them. I was amazed. Shares of a particular stock worth \$800 in a three-million-dollar portfolio? How did the advisor keep up with all those investments? And how much effect can \$800 worth of stock have on a \$3,000,000 portfolio? That's a clear case of over-diversification. So, diversification can be a negative investor behavior if used in the wrong way.

9. Anchoring

Anchoring is when you relate a familiar experience, even though that experience may be inappropriate, to an investment you made, or may make. When I was a little kid, when I'd get in a tickle fight with one of my siblings, we called that googling. If I googled you, I was tickling you in the ribs. Then along came tech giant Google and the meaning of that word changed for me, and for everyone. Since I never lost a tickle fight with a sibling, the word Google leaves me with a pleasant memory. So, what if I wanted to invest in Google simply because that word evoked that nice memory? It's stupid. But that's what anchoring does to many investors.

They use something familiar in their memory, and anchor it to an investment. It's like you remember that Grandpa invested in XYZ company and he did very well with it. So, you want to do the same, because if it was good enough for grandpa, it's good enough for me. But what you're not considering is that XYZ company makes car tires, and when grandpa invested in that company, they were the first company to switch to making bias ply tires and they made a bunch of money. However, they are still making bias ply tires, even though the whole world has switched to steel-belted radials, and XYZ is about to go under. Your anchoring experience of listening to grandpa talk about all the money he made with XYZ may be causing you to make a bad investment. Financial Advisors are trained to look for good investments now, not something that was good in the 80's. Anchoring is a negative investor behavior and one most advisors won't let you make.

10. Watchfulness

Our 10th and final negative investor behavior is the habit of watching your investments too closely. This behavior is closely related to Loss Aversion. The fellow I spoke of earlier, the one who liked it when his investments went up, but was frightened when they went down, used to get up early every morning and look up what his investments did the day before. And that was before he got his shower, brushed his teeth, got dressed or had breakfast. I know, because his wife told me. And he did that every single day that the market had been open the day before. Watching your investments too closely can drive you nuts. It can make you want to do things like selling when they're down, or buying after they've gone up. They can make you nervous, they can cause you not to sleep well. One of my favorite people is a client that was in the habit of watching his account every day. I never heard from him when his account was going up, but I heard from him a lot when it was going down. We would email, or talk on the phone pretty often.

We are an active management shop. We don't mind getting in the market or getting out of it. We follow the trends. And it has worked well for us over the years.

However, if someone calls us to tell us to invest his money in a certain way, we give up the management of it and do not take it back over until the client tells us he wants us to manage it again. Well, this client called me one day last year and asked me to move his money to the money market account. So, I did. I told him I'd leave that account in the money market until he called me to take it back over.

During that time he was in money market, the model I had had him in made a very good run, but he didn't get any of it... because his account was in the money market. He finally called me to take the account back over, and he's been very good about not peeking at his account too much. The result, however, of his watching his investment too often, and jumping around like he did, was that his account performed the worst of any client I had in that model in 2022. So, this is my recommendation; if you have a good financial advisor, let him and trust him to do his job. If you suspect your advisor is not doing what he should be doing for you, give me a call here at ProVest Wealth Advisors.

<https://darnallsikeswealth.com/wp-content/uploads/2022/07/DSWP-The-Behavioral-Effect-on-Investor-Returns-2022.pdf>

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