



Emotional Investing – It Can Be Costly



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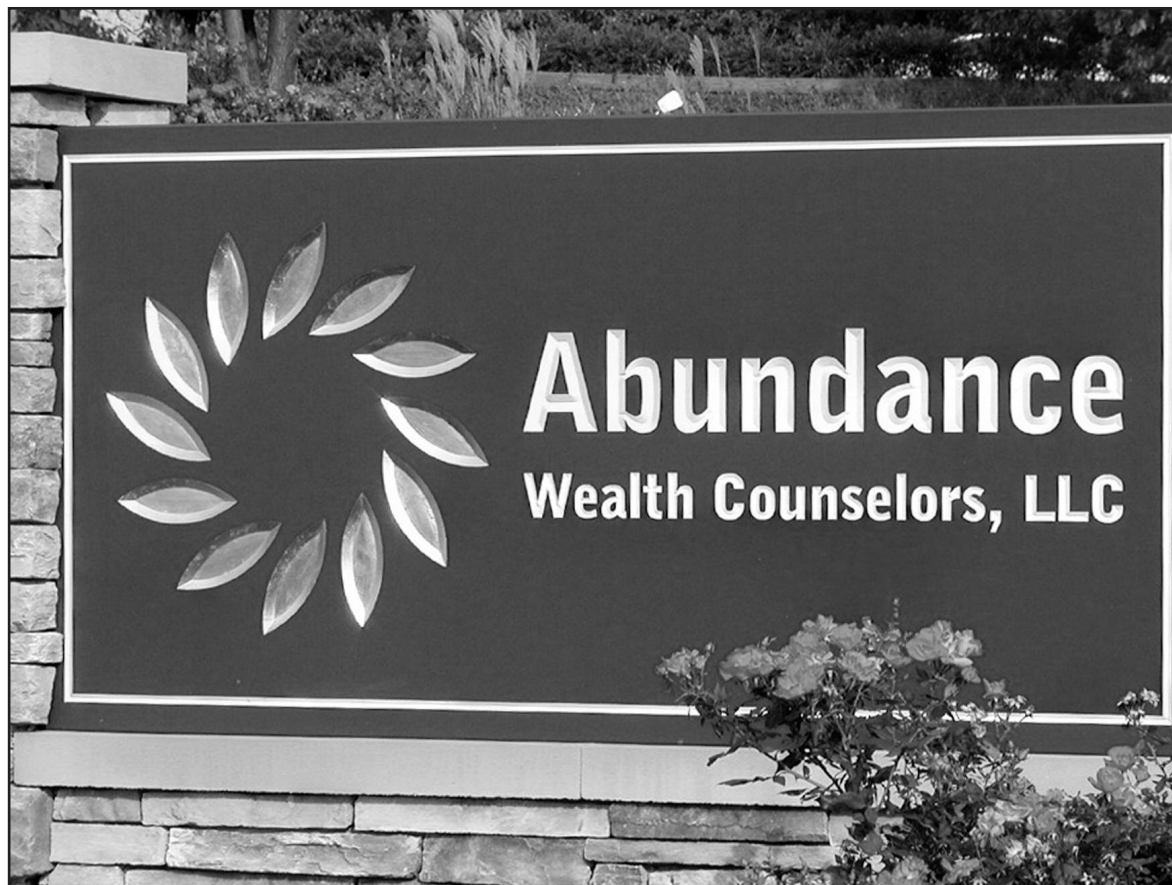
many of which are justified since money, or lack thereof, can profoundly influence our lives. The problems start when emotions become a driving factor in our investment behavior and the ability to act rationally is compromised. In fact, emotional investing has become such a well documented occurrence that a new discipline within the field of finance was created, behavioral finance.

Fear can manifest itself in several ways, a historical framework that affected many people was fear of another depression and thus these investors put too much money into bank savings accounts, and watched inflation greatly impact their long-term purchasing

In part two of this series on common investment mistakes, I will discuss the perils of emotional investing and focus on two aspects: fear and mental accounting. A 2005 study by Dalbar, Inc. showed that between 1984 and 2004 the average stock investor returned 3.7% versus 13.2% for the S&P 500 stock index. Emotional investing most likely played a key role in the results.

For some individuals there are strong emotions linked to money issues,

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power. For others there is the fear that they are missing out on “easy money”, recently this has been observed with the tech stock and the real estate bubbles.

While there is not an easy cure for fear affecting your investments, it is helpful to analyze your past investment behavior and note whether you have succumbed to this mistake.

Mental accounting is meant to describe how people focus on what they paid for an investment versus the fundamental reasons they purchased it in the first place. For many this means that they will hold on to investments that have lost money for too long, waiting for it to at least get back to where they bought it; and thus don't have to admit making a mistake. The flip side of this behavior is the investor who has a gain but sells too quickly, wanting to cash in on their success, only to then watch the investment continue to increase in value. In both instances, the action needs

to have the discipline behind it that shows why the investment is or is not priced to sell, having nothing to do with what you paid for it. To avoid this mistake your investment decisions need to follow a process, not that the process can not be altered as you gain experience and knowledge.

Just like having a plan is essential to investment success, having the discipline and processes to help you avoid emotional investing are critical. While we can not remove emotions from how money affects us, we can keep those emotions from costing us money.

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