

Invest on an Even Keel

Sudden fluctuations in the financial markets can be unsettling, but try your best to resist the urge to invest based on short-term developments. Emotions can make it difficult to choose your investments rationally and can frequently lead to counterproductive decisions.

Researchers in the field of behavioral finance study the psychology of making decisions about money. Understanding their findings can help you avoid common investing traps so that you can stay on track for your long-term goals.

Common Pitfalls

Behavioral finance researchers have found that people tend to fall into specific psychological patterns when making investment decisions. For example, investors often are overconfident about their own investing knowledge and skill, and frequently overestimate their ability to predict short-term changes in the market.¹ In reality, a nearly infinite number of unpredictable factors can influence market movements, making it impossible for even the most experienced investor to predict short-term returns. Investors also tend to be excessively risk averse: They worry so much about short-term losses that they miss opportunities to earn long-term gains. Risk aversion prompts some investors to sacrifice potential long-term returns in stocks by holding a large portion of their long-term savings in cash and bonds.² Bear in mind that—barring extreme circumstances like the market crisis of fall 2008—if you're investing for a goal that is a decade or more in the future, the market's performance this week or this month may have little impact on your eventual results.

The Impact of Emotional Investing

These psychological pitfalls can significantly diminish the long-term growth of your savings. Research firm DALBAR, Inc. has found that individual investors tend to lag the market by a wide margin, largely because they tend to jump in and out of the market rather than investing for the long term.

In summary, it's easy to become flustered by short-term market performance. But try to keep the long-term view when crafting your investment strategy. A financial advisor can help you determine whether market changes call for action on your part.

¹*Why Smart People Make Big Money Mistakes* by Gary Belsky.

²DALBAR, Inc. "Quantitative Analysis of Investor Behavior 2008."