Your Brain May Be HURTING YOUR INVESTMENT RETURNS

Submitted by Steve Giacobbe, CFA, CFP®, Co-Founder and Managing Partner at Accredited Wealth Management

Unfortunately, when it comes to investing, many investors tend to be their own worst enemy. Numerous studies have shown that investors on average earn returns well below the popular benchmarks, mainly because of the emotional investing mistakes they make. Emotional investors tend to make impulsive decisions, often buying at market tops based on hype, and selling at the bottom based on fear. According to the most recent Dalbar Quantitative Analysis of Investor Behavior (QAIB) study, the S&P 500 returned 10.65% over the past 30 years through 2021, while the average equity fund investor return over that period was only 7.13%. The disparity between the "average investor" return and the benchmark is startling and reveals the negative impact poor investment decisions, usually driven by emotions, can have on long-term returns. Fortunately, there are ways to improve your emotional intelligence when it comes to investing by learning some of the basic principles of behavioral finance.

The field of behavioral finance has grown rapidly over the past decade and is based on an integration of psychology and finance that can be used to understand how and why investors make decisions and the most common mistakes they make. Studying and learning from the mistakes of others, without making them on your own, is one of the smartest ways to improve your investment returns. Warren Buffett famously wrote in one of his annual letters, "You do not need to be a rocket scientist. Investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ." The point being that emotional intelligence and avoiding mistakes are just as important as IQ when it comes to investing. Here's a list of some of the most common behavioral mistakes investors make and a few tips on how to avoid them.

Overconfidence: Investors often over-estimate their knowledge and skill, leading to overly aggressive bets and lack of diversification.

Tip: Think critically, and evaluate investments from as many perspectives as possible. Ask yourself if you have the expertise or have done enough research to justify the level of confidence you feel. If the answer is no, you may want to hold off making that investment.

Herding: Though we are often unconscious of it, the human tendency is to "go with the crowd." This leads to investment decisions based on what everyone else is doing, which is often buying at the top of the market and selling at the bottom.

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Tip: Ask yourself what is the basis for a popular trend to continue, and if the trend is so well known is the value already reflected in the investment's price (think unprofitable tech and meme stocks!).

Confirmation Bias: The tendency to only seek out information that supports our current beliefs. For example, investors that believe the market will rise tend to only seek out news and information that support that view.

Tip: Play devil's advocate, and seek out opinions that differ from your own. If it still seems like a good investment, go for it.

Loss Aversion: The fear of loss often leads to the selling of assets at the worst possible time, also known as "panic-selling."

Tip: Evaluate each investment on its own merit, and ask yourself if the fundamentals have changed before hitting the panic button and selling. It's not unusual for stocks to experience periodic sell-offs, and if the fundamentals haven't changed, it may be time to consider buying more rather than selling.

Written by: Steve Giacobbe, CFA, CFP®, Co-Founder and Managing Partner at Accredited Wealth Management. Call if you have questions or want to discuss how to be a better investor.

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