Let Logic, Not Emotion, Prevail Over Your Portfolio

Imagine this scene: You're at your favorite clothing store when you see a shirt. You pick it up, consider it, then put it back. It's not your color.

As you move away, you notice another customer picking up that same shirt. Suddenly, you think that maybe it would look good on you. But it's *the last one*. You can't wait for the other customer to set it down so you can snatch it up.

It's a fact of human nature that emotions can wreak havoc on our decision-making abilities. A growing field of study called *behavioral finance* seeks to identify the pitfalls of the human psyche to help people — in this case, investors — minimize the effects that emotions can have on their investment portfolios.

For example, UCLA's Anderson School of Management launched the Interdisciplinary Group in Behavioral Decision Making in 2003 to study how humans make decisions and how it affects business and markets. Professor Shlomo Benartzi testified before Congress to share his knowledge of participant behavior in 401(k) plans to help increase retirement savings.

Benartzi has found that certain "behavioral obstacles" can undermine the retirement security of many people. These include the tendency to buy high and sell low, focus on short-term losses even if they have 20 or 30 years to retirement, and place too much weight on past market performance.

In a perfect world, investors would make important financial decisions only after conducting thorough research and analysis. But it's not a perfect world and the truth is, everyone succumbs to the emotional side of decision-making from time to time.

Think about the last time you caught wind of an irresistibly hot stock tip. What was your next move? Did your emotions get the best of you, if even just for a while?

Understanding the study of behavioral finance can help you and your financial advisor put this information to work for you. Here are three ways to help separate your solid investment decisions, the "wheat," from the emotional "shaft":

1. Go Contrarian First. If you're considering a stock purchase, first write down three reasons why it's *not* a good idea. If you're thinking of selling a stock, jot down three reasons why you should hang on to that investment. This exercise forces you to look at the other side of the equation — and challenge the reasoning behind it — before you make your final decision.

2. Think Objectives, Not Investments. Rather than fixating on specific investments, consider your overall goals -- both short and long term. Zooming out to the big picture and revisiting your investment path can help keep you from being swayed by the market's day-to-day fluctuations and stay the course.

3. Talk with Your Advisor. Engaging in frank discussions with your financial advisor is key to keeping your investments on track.

Every investor is prone to emotional swings. Even professional money managers have to put themselves in check from time to time. Insights from the field of behavioral finance may be able to help you and your advisor understand and minimize the effects emotions have on your portfolio.

Do You Have an Investment Personality Type?

Gaining some insight into your investment tendencies can provide a safeguard in moments when your emotional side wants to take over. Check out the profiles — and the emotional pitfalls — of these five investment personality types:

- **The News Hog.** This investor zeros in on the biggest headlines of the day almost to the point of obsession — especially if the news pertains to one of his or her holdings. *The mistake:* Short-term market fluctuations often iron themselves out over the long haul.
- **The All-Day Trader.** Perhaps the latest movements of the Dow Jones Industrial Average are displayed at the bottom of this investor's computer screen, where he or she can keep an eye on them throughout the work day. Or maybe the stocks are on a "watch list", set so that even minor movements in the price trigger an e-mail alert. *The mistake:* Monitoring investments this closely can be the path to anxiety rather than financial gain.
- **The Explorer.** This investor is certain that every new invention is the next Post-It note, or that he or she has discovered the next superstar management team. It may be so, but it is still wise to look carefully before you leap.
- **The Formula Fiend**. This investor believes the future of the stock market lies in numbers — and has the complex formulas to prove it. *The mistake:* No mathematical analysis is foolproof.
- **The True Blue.** This investor often allows familiarity to breed trust. But it's never wise to put all of your eggs in one investment basket.

The Law Office of Eugene Gorrin, LLC
17 Watchung Avenue, Suite 204
Chatham, NJ 07928
973.701.9300
egorrin@gorrinlaw.com
www.gorrinlaw.com