As Brightworth wealth advisors, we feel we have a unique and special role in the lives of our clients. We are able to work with our clients to develop plans for helping them achieve their family’s goals and oftentimes see their dreams come true. It is rewarding to watch a client’s child graduate from college or go to our client’s retirement party, knowing we helped craft and execute the plan to help make that a reality. As you can see, beyond its analytical and numerical surface, financial planning is an emotional undertaking. This can be especially true when it comes to investments. Unfortunately, in some cases, emotions get in the way of an
investor’s ultimate success.

**Most Common Emotional Mistakes**

Emotional mistakes can keep good plans from working and cause investors to make less than they could have. Over the years, we have had a front row seat to see both good and bad decisions made by clients and others. One of the most common mistakes is simply panic. An example of a phrase depicting this is: “I can’t afford to lose anymore.” Panic most often happens during market downturns. If the downturn lasts long enough, the constant drip of negativity from the media and emotional burden becomes too much and the investor gives in. Changes made to one’s long-term portfolio strategy from this short-term state of mind most often results in locking in temporary paper losses to permanent and unrecoverable losses of capital.

The inverse of panic is performance chasing. This usually happens at the height of a bull market, after prices are approaching or have reached new highs. Investors will want to buy more of what has gone up the most, assuming that investment will continue to increase. This thinking disregards statistical truths like reversion to the mean and is based more on temporary momentum. For example, if the mall had a “Double the Original Price” sale, I doubt sales would do well! Yet with many investments we have witnessed investors chase performance over the last twenty years – from tech stocks to real estate to gold. The emotion on display here is a perceived lost opportunity. Also at play is a sense of competitive spirit and keeping up with others. The media and social buzz fuel these emotions. Performance chasing is a sure way to lose money.

Another emotional mistake we see is that investors mentally anchor the value of a particular investment on what price they paid for it. By doing so, many hold on to investments that are no longer suitable nor fit into their overall strategy, because they either do not want to take a loss or pay taxes on the gain, whichever the case may be. A good question to ask yourself is “If I did not own it, would I buy it today?”

**Have a Comprehensive and Disciplined Strategy**

One of the primary reasons it is difficult for many investors to avoid making these emotional mistakes is a lack of a comprehensive wealth strategy. An investment portfolio is a tool for achieving goals within the context of a disciplined financial plan. Serving as an end to itself, a
portfolio for most investors is only successful when it beats markets and competitors. This often leads to a competitive consumer mentality, dumping “bad” investments in favor of “better” ones. The main goal is not growth or conservation, it is victory. Unfortunately, continually replacing “bad” investments with “better” ones is just a form of performance chasing and leads to poor long-term performance, not victory.

Without the compass of a comprehensive wealth strategy, investors are unable to confidently construct and monitor an investment portfolio with a long-term focus. Their performance is based on what they made, not what they need. Within a disciplined strategy, one that looks at what you need from your portfolio to accomplish your long-term goals, investors are more prepared emotionally to weather the ups and downs in the market and the over and underperformance of their individual investments.

A good strategy starts with realistic goals. If we go through the planning process, only to find out that you need a 12% annual withdrawal from your investment portfolio to accomplish your goals, it is likely we will need to make adjustments to those goals. Working a year or two longer, saving a bit more annually or lowering your lifestyle expectations are good options. Putting unrealistic expectations on your investments to either make up for lost time or accelerate a retirement plan is a recipe for making mistakes. Your emotions will hang on every day’s returns and your investment experience will be stressful, and ultimately disappointing.

The next component of a disciplined strategy is asset allocation. This is the mix of stocks, bonds, cash and other investment asset classes that make up a portfolio. An investor’s asset allocation primarily determines the amount of short-term volatility and long-term growth a portfolio is likely to have. Traditionally asset allocation was based solely on the age and stage of the investor. While this is still a factor, we look at the current and future cash flow needs of
a client and their propensity for making emotional mistakes with their portfolio. For example, a typical allocation for a 75-year-old widow might have a high allocation to fixed income investments. But, what if she is cash flow positive between her Social Security and pension and does not need the assets in her portfolio to support her lifestyle? Additionally, she understands that the time horizon for her wealth is not her own lifetime, but that of her children. Given this scenario, she might be better served to have more growth-oriented investments in her portfolio for her kids’ long-term needs. Conversely, we have to recognize that while short-term volatility is a product of long-term growth investments, it may cause an emotional response in many investors. This is when understanding what you need from a portfolio becomes critical.

For some clients, a lower exposure to short-term volatility when more growth is warranted might be a good compromise, if we mutually recognize the emotional stress volatility creates. This works if our client can still accomplish their goals with less long-term growth or if those goals are adjusted to compensate for less short-term volatility.

Diversification also plays a critical role in building a disciplined investment portfolio. Not “having all your eggs in one basket” reduces overall portfolio volatility. We get a macro level of diversification from our asset allocation selection, but we take that a step further with the manager selection process. Within each major allocation area, we are looking for managers that have different roles in our portfolio and have a diversity of opinion. We like this diversity and believe it helps our portfolio in its ability to be an “all-weather” portfolio.

**Value of Advisory Relationship**

Finally, building a comprehensive strategy is a great starting point, but when it comes to avoiding the mistakes that so often come from emotional reactions, having an advisor you can trust is going to be the difference maker. Everyone has emotional reactions, including us, to the uncertainty surrounding the economy, markets and financial media. There is no reason to try to weather all of the noise and sift through the multitude of decisions on your own and in a vacuum. For us, we have an Investment Committee, so no one person’s opinion drives our collective decisions. For our clients, we serve as a filter of sorts. Our value to our clients is not in our ability to predict markets or economies. Our value is to help our clients develop a comprehensive plan of action, construct an investment portfolio as a tool to move the plan forward, and keep our clients from making the emotional mistakes that so often derail the plan, and in the process, the ability to achieve their ultimate financial goals.

*The information contained in this article is intended to be educational and informational in nature. It should not be construed as specific investment, legal or tax advice for your particular situation. Please consult a Brightworth Wealth Advisor with any questions. Also remember that with investing, past performance is not a guarantee of future results.*

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