THE KEENE SENTINEL

How to Avoid Emotional Investing

By Stephen Davis Contributing Writer

Thursday, November 10, 2016

Listen to your gut. That little voice in your head. Trust your instincts.

These phrases have entered our collective vocabularies and speak to our primal selves, revealing something about us that has persisted since caveman times. Now don't ignore them altogether. After all, they've helped us survive all these generations by giving us important fight or flight signals. At various times, our emotions and instincts serve as great barometers and help us make successful life decisions such as whom to marry, what job to take or when we should try a leap of faith and move across the country. When should we not rely on our emotions? How about in making investment decisions. Picking stocks by virtue of whims or gut feelings follows the same path as buying a lot-tery ticket or playing a slot machine. In other words, you're relying on blind faith, and making sound financial decisions are anything but blind faith.

Our emotions, however, have a funny way of rearing up at unexpected times and shaping our behaviors and the following are bad habits to avoid:

• Tulip Mania. The first recorded economic bubble occurred in Europe in the 17th century when the price of some tulip bulbs were more than 10 times the annual income of the average skilled laborer. This tulip mania reached a fever pitch by 1637 when people were trading as much as 12 acres of land for a single bulb. The British journalist, Charles Mackay, described this phenomenon as "the mad-ness of crowds." We've seen this occur throughout history, most recently in our own housing bubble, which culminated in the financial crash of 2008. Just be-cause you see others benefitting from a particular investment doesn't mean that bubble isn't about to burst. It's better to take a sober, analytical approach and re-search the underlying economic indicators before throwing your money at some trendy pick.

• Bad Timing. By the time you hear an investment tip or hot market trend, chances are the smart money is already selling and moving on to the next investment. We might see or hear about a bullish market sector, but too often, by the time you enter that market, the easy money has been made. Trying to time the market in its bull or bear runs is a recipe for disaster. You are infinitely better off by making safe, sound investments that point you to long-term returns, not quick market cash ins that can just as easily wreck your portfolio.

• Overconfidence. Here's the old Vegas philosophy. You hit it big at your table and you keep playing because you're on a roll. Please, stop me if you've heard this one before because these are emotions running rampant. Just because you hit on a stock doesn't mean you will again. Past performance is not indicative of future results. Again, your best chance for success is by putting in the time and effort to study and understand a company or investment. Long-term success is found through undergoing rigorous strategic analysis before making an investment choice—and even that is no guarantee.

Once you tick those bad habits off your list, follow these rules to rid yourself of emotional investing for good:

• Goodbye Gut Feelings. Don't make financial decisions based on how you feel the market is doing. By doing so you are committing financial malpractice.

• No More Highs and Lows. As I wrote earlier, don't jump in and jump out of investments. With our longer life expectancies, your retirement could last decades so don't play Russian roulette with it. Instead, focus on the long term. Remember that individual statements are only a snapshot in time. So instead of looking at daily or even quarterly returns, chart your investments over years and decades to get a bigger picture view of what your nest egg will look like.

• Get Expert Advice. Even if you have done your due diligence, it's always better to get a second opinion, especially from someone whose livelihood depends on making sound financial decisions. So talk with an advisor who looks at long-term investments based on a comprehensive planning model not someone whose model is based on gut feelings and primal instincts.

Stephen Davis is the founder and president of S.G. Davis Financial Group, LLC, an independent financial planning firm with a Keene office.