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RETIREMENT INSIGHTS

FALL 2020

7 Psychological Traps

Sometimes, when it comes to investing, volatile markets aren't your worst enemy. You are. Unfortunately, our brains often play tricks on us, causing even the savviest of investors to make decisions that don't really make a lot of sense, such as panic selling or ignoring opportunities.

The problem of psychological investing traps is so pervasive, in fact, that there's a whole field dedicated to studying it called behavioral finance. Researchers in this discipline look at the way psychology affects how we make financial decisions. Knowing about these traps can help you avoid them and make you a better investor. Here are seven psychological traps to keep in mind.

> "Approximately 80% of adults over age 50 want to remain in their current home as they age, but only 50% expect that they will be able to do so."
>
> Source: Barron's, June 3, 2019

Sunk Costs Bias — The sunk costs bias has to do with the all-too-common tendency to stick with something, whether a bad boyfriend or a bad investment, long after it's clear that it's not worth it anymore. Still, because you've invested a certain amount of time or money, you're reluctant to give it up. In investing, you might end up hanging on to a stock long after you should sell it in the vain hope that you'll eventually come out ahead. But in these cases, it's better to cut your losses rather than to hang on to a loser.

Familiarity Bias — Most of us are biased toward what is familiar to us. We head to restaurants we've been to before and follow the same roads to work because we know what to expect. With investing, familiarity bias involves favoring investments that are familiar to you. You might prefer to invest in the company you work for or big-name businesses that are in the news. That could cause you to overlook important opportunities you don't know as much about.

Anchoring — Anchoring is the process of getting attached to a particular reference point — such as the price you paid for a stock — and using that to guide future decisions. Or you might fixate on a stock's previous high, even though that price was an anomaly. Anchoring is why buyers think they got a

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Take Time to Reassess

Periodically, you should reassess your portfolio, finding ways to increase your comfort level with your stock investments. Consider the following tips:

- ✔ **Develop a stock investment philosophy.** Approach investing with a formal plan so you can make informed decisions with confidence, knowing you have carefully considered your options before investing.
- ✔ **Remind yourself why you are investing in stocks.** Write down your reasons for investing in each individual stock, indicating the long-term returns and short-term losses you expect. When market volatility makes you nervous, review your written reasons for investing as you did. That reminder should help keep you focused on the long term.

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Take Time to Reassess

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✔ **Monitor your stock investments so you understand the fundamentals of those stocks.** If you believe you have invested in a company with good long-term prospects, you are more likely to hold the stock during volatile periods.

✔ **Review your current asset allocation.** Revisit your asset allocation strategy, comparing your current allocation to your desired allocation. Now may be a good time to rebalance your portfolio, reallocating some of those stock investments to alternatives.

✔ **Determine how risky your stocks are compared to the overall market.** You can do this by reviewing betas for your individual stocks and calculating a beta for your entire stock portfolio. Beta, which can be found in a number of published services, is a statistical measure of how stock market movements have historically impacted a stock's price. By comparing the movements of the Standard & Poor's 500 (S&P 500) to the movements of a particular stock, a pattern develops that gauges the stock's exposure to stock market risk. Calculating a beta for your entire portfolio will give you a rough idea of how your stocks are likely to perform in a market decline or rally. If your stock portfolio is riskier than you realized, you can take steps to reduce that risk by reallocating.

✔ **Keep the tax aspects of selling in mind.** While you may be tempted to lock in some of your gains, you may have to pay taxes on them if the stocks aren't held in tax-advantaged accounts. You'll have to pay at least 15% capital gains taxes (0% if your income falls below certain limits) on any stocks held over one year. If your gains are substantial, it may take longer to overcome the tax bill than to overcome a downturn in the market.

✔ **Consider selling stocks if you have short-term cash needs.** If you are counting on your stock investments for short-term cash needs, look for an appropriate time to sell some stock. With short-term needs, you may not have time to wait for your stocks to rebound from a market decline.

✔ **Don't time the market.** During periods of market volatility, investors can get nervous and consider timing the market, which typically translates into exiting the market in fear of losses. Remember that most people, including professionals, have difficulty timing the market with any degree of accuracy. Significant market gains can occur in a matter of days, making it risky to be out of the market for any length of time.

✔ **Remember you are investing for the long term.** Even though short-term setbacks can give even the most experienced investors anxiety, remember that staying in the market for the long term, through different market cycles, can help manage the effects of market fluctuations.

Please call if you'd like help implementing strategies to keep you comfortable with your stock holdings. ✔✔✔

Financial Tips for the Sandwich Generation

If you are caring for young children and aging parents, you are part of the sandwich generation. Developing a financial plan for your parents, your children, and yourself will help you navigate the challenges you face.

A Retirement Income Plan for Your Parents — In addition to understanding their wishes for medical treatment and long-term care, you should also understand if your parents have adequate retirement income.

Research Long-Term Care Options — You should research ways to pay for long-term care if your parents need it. If your parents are in good health and still relatively young, they may want to consider purchasing a policy.

Prepare an Estate Plan — If your parents do not have an estate plan, it's time to create one so that their wishes are met. Help them through this process, or find someone who can, including establishing a will, trust, advanced healthcare directives, and medical and durable powers of attorney.

Inventory Assets — Help get your parents' financial assets in order by locating all important documents.

Develop a College Savings Plan — As you switch the financial focus from your parents to your children, start by planning for their largest expense: their college educations. In addition to college savings, you should help your children plan for their life after high school. Engage your children in this process by having them research scholarships, grants, and work-study programs to assist with college expenses.

Your Turn — Because you are sandwiched between your parents and children and taking care of their needs, you may not have developed your own financial plan. It is important that you take the time to put yourself first and get your own financial house in order. Creating a financial plan with long- and short-term goals will give you peace of mind that your own financial life is on track. Once it is created, it will give you more time for the other competing priorities in your life. Please call if you'd like to discuss this in more detail. ✔✔✔

Your Risk Tolerance and Retirement

To gain a better understanding of how we're affected by risk when building a retirement portfolio, it's important to learn about risk tolerance and what it means for you as an investor.

What Is Risk Tolerance?

Risk tolerance essentially refers to an investor's ability — both emotionally and financially — to deal with major upswings and downswings in the market. If a person is said to have high risk tolerance, he or she likely tends not to worry so much about the potential risk of certain stocks or having a large amount of stocks in a portfolio. Those with low risk tolerance are on the other end of spectrum, often too cautious to deal with volatile stocks or the market in general.

Risk Tolerance and Age

While plenty of factors must be taken into consideration when considering your own risk tolerance, age is one that can be seen as an important anchor to help risk-takers avoid getting in over their heads. This is especially true of those who are working towards building an effective retirement plan. When people are young, it makes more sense to take risks with investments than when they reach retirement age.

What's important to recognize is that risk tolerance *must* shift with age to avoid making costly mistakes at a time when it may be potentially too late to recover.

Adjusting Risk Tolerance

It may seem as if adjusting risk tolerance is challenging, but often it simply means taking a realistic approach to your investments. If you're nearing 60, for example, it's generally considered unwise for your portfolio to be comprised of 70% stocks — the number should be closer to 40%. Many successful investors find moving away from stocks to bonds is an effective later-in-life strategy.

The Importance of Working with a Financial Planner

The best way to get a better sense of what is a realistic risk tolerance for you at this point in life is to work closely with your financial planner. Please call if you'd like to discuss this in more detail. ✔✔✔

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great deal when buying a car for $50,000 when the initial price was $60,000, even though the car's really worth $40,000.

Whether buying stocks or cars, anchoring involves using a single piece of information to determine what a stock or other investment should be worth while also discounting more relevant information, such as a company's fundamentals or broader economic trends. Unfortunately, avoiding anchoring is difficult, but considering all available information before choosing an investment can help.

Focusing Too Much on the Recent Past — Recency bias is the tendency to make decisions or judgments based on relatively new or recent information. For example, during times when the market is up, people may ignore or discount the possibility of a market decline. Or, if a certain category of stocks has done poorly recently, people may conclude that those stocks *always* have negative returns, even if the dip is an anomaly. You can avoid this mistake by doing your best to consider the entire universe of information at your fingertips, not just what happened yesterday.

Following the Herd — While following trends might be fine for fashionistas, it's not always a smart investing move. Yet herd investing is an all-too-easy trap to fall into. If everyone is telling you that now's the time to get into a certain hot investment, you may feel you need to act fast so you don't miss out. But just because something is popular doesn't make it a good investment. Blindly following the herd without first consulting your own financial goals and plan doesn't make you a smart investor.

Overconfidence — Most of us like to think we're smarter than the average person. If you hit it big with a certain investment, you may overattribute that success to your skill rather than what it really is — luck. That can cause you to repeat the same behavior.

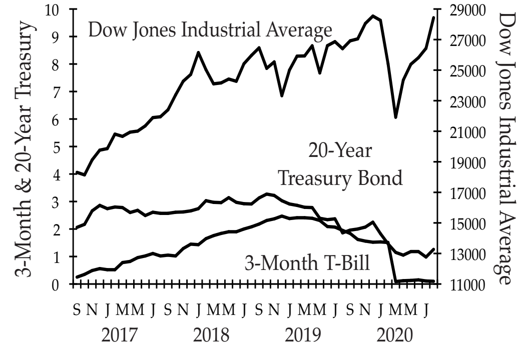
Panic — Investing isn't for the faint of heart. When the market takes a sudden dip, it's easy to panic, which can lead you to make bad decisions, such as selling at a big loss, rather than riding out the natural hills and valleys of investing. Making these emotionally driven choices costs you a lot of money. When making investing decisions, make sure they're based on evidence, not your initial gut reaction to the day's events. ✔✔✔

Market Data

	Month End			% Change	
	Aug 20	Jul 20	Jun 20	YTD	12 Mon
Dow Jones Ind.	28430.05	26428.32	25812.88	-0.4%	7.7%
S&P 500	3500.31	3271.12	3100.29	8.3	19.6
Nasdaq Comp.	11775.46	10745.27	10058.77	31.2	47.9
Wilshire 5000	35661.56	33323.80	31576.79	7.9	19.8
Gold	1970.00	1964.90	1768.10	29.3	28.9
Silver	28.11	24.10	18.19	56.9	52.9
				Dec 19	Aug 19
Prime rate	3.25	3.25	3.25	4.75	5.25
Money market rate	0.23	0.26	0.28	0.58	0.72
3-month T-bill rate	0.10	0.11	0.15	1.52	1.95
20-yr. T-bond rate	1.26	0.98	1.18	2.25	1.86
Dow Jones Corp.	2.22	2.06	2.50	2.84	2.86
Bond Buyer Muni	3.56	3.53	3.63	3.63	3.53

Sources: *Barron's, Wall Street Journal* *Past performance is not a guarantee of future results.*

4-Year Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield September 2016 to August 2020



Sources: *Barron's, Wall Street Journal*

A Dividend Investing Strategy

Dividend investing creates both an income stream from dividends as well as portfolio growth from asset appreciation. Following is an overview of dividend investing and the strategies investors use:

Safety — The first thing dividend investors look for is safety, which is measured by the dividend coverage ratio. Typically, dividend investors don't want to see companies pay out more than 60% of their profits as dividends to investors to ensure the company has the resources for operations. For example, if a company earns $50 million and pays out $15 million in dividends, it would be more prudent than if the company paid out $40 million. If the company's profit dropped by 10%, there wouldn't be much left for the company's operations. Dividend investors look for companies that have good cash flow and stable income, because they can get a higher payout ratio and don't have to worry about the company's ability to pay the dividend.

Two Dividend Investing Strategies — There are two different dividend investing strategies — **a high dividend yield strategy** and **a high dividend growth strategy**. Each has its own purpose in a portfolio.

When an investor follows the **high dividend yield strategy**, he/she is investing in companies with yields at the top of the range that will provide a predictable income stream. These are typically found in well-established companies that have substantial cash flow to fund the dividend payments.

Investors that focus on a **high dividend growth strategy** are investing in companies whose dividend payments are significantly lower than average, but the company is growing at a very fast rate. After a period of time, these fast-growing companies can increase dividends to an equal or much higher level than what would have been collected using the high dividend yield approach.

Walmart, when it was in its expansion phase, is a perfect example of a high dividend growth investment. It was trading at a very high price-to-earnings ratio with a small dividend yield. However, it was growing so rapidly that the per-share dividend grew just as quickly as profits soared.

Please call if you'd like to discuss whether a dividend investing strategy makes sense for your portfolio. ✔✔✔ FR2020-0420-0096

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