Your investing behavior has more influence on the success of reaching your financial goals than any other aspect of investing.

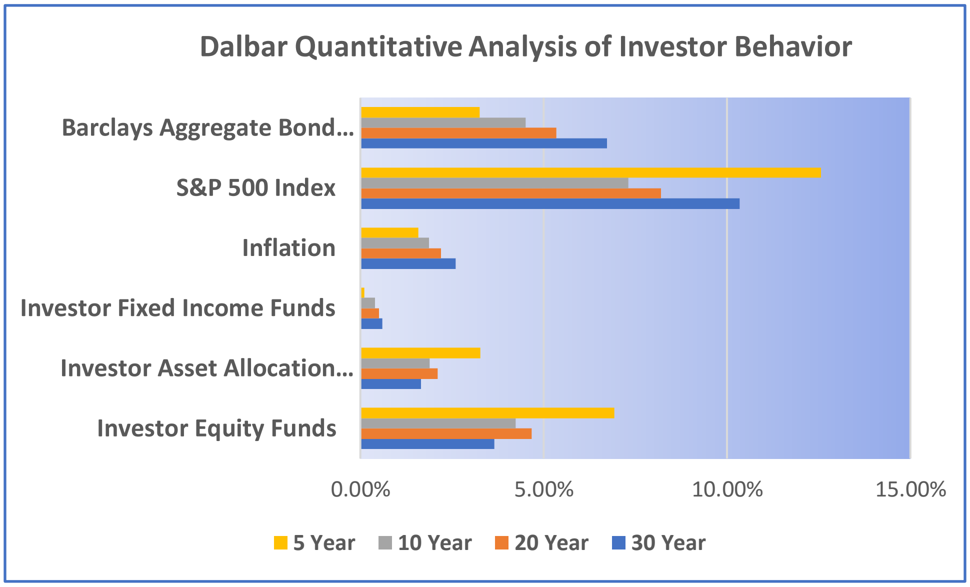
The Behavior Gap

Behaving for Financial Success

Eric Souders AWMA

You control what matters most in investing: your own behavior. Your investment behavior is the most significant predictor of reaching your financial goals. Market timing, and stock picking, have very little influence on portfolio returns while asset allocation has the most weight in influencing portfolio success. But your investing behavior is the key to reaching your long term financial goals.

According to Dalbar Inc., for 20 years ending 12/31/15 the S&P 500 Index averaged 9.85%/year while the average equity fund investor earned only 5.19%/year. This difference is called the behavior gap. Behaviors such as chasing returns, cashing out to stop further losses, and market timing, all result in buying high and selling low.



Risk is personal. We often talk about risk in terms of a portfolio's correlation to markets, but the real risk is the likely hood of not being able to do what matters most to you over a life time because your investments didn't provide. Successful investing requires discipline and preparation. Our expectations of what our investments can provide must be realistic, our risk management must be appropriate to our stage in life and our adherence to an investment strategy must be strong. If we are too risk averse early on, avoiding the markets' slings and arrows, we won't give our investments the opportunity to grow. Or even worse, we may be inclined to take on too much risk near the time that we need to spend our investments. Behaviors that are driven not by strategy, but by our two most sabotorial emotions, fear and greed, will have deleterious results.

We act on those two dreadful emotions when we are under stress simply because the amygdala, our emotional center, is sucking the blood from our prefrontal cortex, our center of logical decision making. Under stress we can lose up to 13% of our IQ. Stressed investors react to two thoughts; "I am losing too much money", or "I am not making enough money". This is how smart people make bad decisions.

We love the Jim Cramers of the world, but following market forecasters is not a strategy. For one thing, they are wrong most of the time and they are not required to disclose their track records. Like a stopped clock, market forecasters get it right once in a while. But because we are wired to be more efficient with the calories that we consume, we are prone to outsource our thinking.

When we are thinking hard and for long periods, our brains can consume up to 20% of our calories. By following loudly shouted random advice, we become physically more efficient, and therefore less intelligent. It is not intelligence or insight, but outmoded physiological survival responses that explain the herd mentality of investors. P.T. Barnum and the internet understand this well, "A sucker is born every minute".

Being clear about your financial goals and using those goals to define the investment strategy can remove reactive behavior during a market crisis. When we attach very specific goals to our investments we tend to follow the rules. Investing for a purpose, has proven to have better success. For example, in 2008 when an amazing amount of money was leaving investment accounts for cash, college saving accounts faired well. Because those accounts are tied to a specific goal, for the most important people in their lives, parent investors followed the rules; they didn’t panic, and stayed invested.

It has also been shown that investors who define how they invest by their personal values are more likely to stay faithful to their investment strategy. Our personal values come from our core beliefs about the world and our role in it. This commitment to our values drives our emotional responses to events around us. When we have developed an investment strategy that is rooted in our beliefs and values, that is part of an achievable financial plan based on realistic goals, our emotional responses to the market can be kept in check by the fact that we have outsourced our thinking to our financial plan.

This won’t eliminate the anxiety you might feel as the market declines or the elation you might feel when it climbs higher, but with the support of a financial advisor whom you trust with your financial plan in hand, it could eliminate your self-sabotaging behavior. I don’t know of any robo-advisor that can provide that kind of service.