As Stock Markets Peak, Check Your Emotions

Emotions often drive investors to make poor decisions and underperform

Successful investing and overall fitness both often come down to discipline (and planning). Why aren't you reaping the investment returns you read about in the financial press? Why aren't you reaping the benefits of going to the gym? One obvious answer that you might not want to think about is this: your emotions get in the way.

That's what advisors (and personal trainers) are for – to help you stay the course and make rational decisions.

Emotions Can Get in the Way

A research firm named Dalbar does tons of research on investor behavior. If you're a fan of behavioral finance and economics, you should read some of Dalbar's reports, but here is a summary: Emotions too often drive investors to make poor decisions.

According to Dalbar, investors consistently get returns worse than those of the market because they buy high and sell low. If you ever have a conversation with a friend about being scared after a downturn, you fall into this category.

You are going to underperform, even if you completely track the market with index mutual funds, because of yearly fees. They could be as low as 0.5% of your assets or as high as 2.5%. But if you have low-cost funds and you still do less than half as well as the market, the problem is probably you, not the fees. You made bad choices, such as panicking during a slump.

It's really hard to stay the course when the world seems to be falling apart. You might feel that, if you don't get out when your investment drops, all of your money might disappear.

Recognizing Recency Bias

This brings us to another behavioral trap called recency bias. This fancy term means that we tend to pay a lot more attention to what happened in the recent past than what happened historically or what is likely to happen.

This is why, when the market goes down, you think it's going that way forever. When the market is hot, you believe that there is only one way it can go – up.

If history is any guide, getting out when things look really bad is not a great idea. An experienced investor certainly knows that when the market seems at its worst, it's a time to buy. Better yet, just keep investing, and let the market do what it's going to do.

Research shows that staying the course is most likely to help you reach your goals. If you're looking to invest for five to 10 years or more, what happens this month, this quarter or even this year doesn't make a big difference in your final outcome.

It all comes down to discipline and circles back to the role of advisors. Your advisor helps investors understand the history of the market and talk with them when they get over-excited or scared.

If you have great self-control, a financial advisor might not be less necessary. But if you are not a disciplined investor, you might get some great value from an advisor who can talk you off the ledge. This is the role advisors play with their clients.

It's the most valuable service we can provide.