# Six Strategies to Take Your Emotions Out of Investing

"Buy high, sell low" has never been a recipe for successful investing, but it's a practice far too many investors follow. The reason? They're letting fear and greed influence their decisions, even though many may not be aware of how feelings impact their decision making.

Emotions and successful investing seldom mix; they cloud people's judgment, spur hasty decisions with insufficient analysis and lead investors to fall back on their personal biases.[1] And, emotional investing has consequences. Oxford Risk, a behavioural finance and investment risk advisor, found that investors on average give up about 3% a year[2] in returns due to emotionally-driven investment decisions. During high-stress times, like the intense periods of market volatility we've experienced in recent years, losses could rise as high as 7% per year, according to the authors.

These findings are consistent with what Boston research company Dalbar has been highlighting for years in its annual report on *Quantitative Analysis of Investor Behavior*. The latest report[3] showed that over the past 30 years, the average American equity fund investor performed 2.84 percentage points lower than the S&P 500 Index's performance of 9.65% because too many of those investors reacted emotionally to markets. That's not insignificant. Compounded annually over three decades, the same sum invested in the Index would have grown to more than twice what the average investor ended up with.

## Understanding emotional biases

Fear of loss, overconfidence, choice overload and herd mentality are a few of the emotions that lead investors astray. Fear, especially, is a potent emotion. It causes us to panic and sell investments when their value drops, which only serves to lock in our losses. Greed is another hard feeling to tune out when our emotions prompt us to buy an asset rising in value without knowing why.

While fear and greed are at the extreme end of the investor emotional investing cycle, it's easy to look past some of the subtle emotions and biases that might be doing just as much harm to your decision making. Overconfidence, for instance, can prompt you to make more trades than you should, causing you to incur high transactional costs while hurting your returns.

Confirmation bias, where you might seize on pieces of news that conform to your assumptions while dismissing information to the contrary, is another emotion that can be hard to detect in the moment.

## Keeping emotions in check

It's not just the emotional decisions that make us buy or sell an investment that can be harmful, the emotionally-driven choice of not changing course can impact investors as well. For instance, research[4] by behavioural economist Richard Thaler has demonstrated that many of us will take the first or most familiar option given to us rather than investigate alternatives that may better serve our interests.

This type of emotion may prompt you to hold onto an investment long after the evidence shows it's facing headwinds or fail to deploy cash that has been accumulating in your brokerage account. Fortunately, there are tried-and-true ways of taking emotions out of our investing by handling our investments more systematically:

1. **Have a plan**. Draw up a road map for how you are going to achieve your investment goals. Consider your savings rate, the returns you can reasonably expect and your risk tolerance, then design a portfolio with a diversified mix of assets that will get you where you need to go with an eye to your comfort along the way.
2. **Contribute regularly**. The practice of dollar-cost-averaging – buying smaller amounts of stocks, exchange-traded funds and mutual funds at regular intervals regardless of price – ensures you'll never overpay for investments. Indeed, you'll buy more shares or units of a fund when the price is down and fewer when it is up. You can't pick and choose where to deploy the cash, though it should be broadly invested across your entire portfolio each time.

3. **Rebalance your portfolio**. Over time, parts of your portfolio will grow faster than others. If left unchecked, it can expose you to more risk. Review your holdings every six months to a year to ensure your investment mix is still in line with your plan and personal situation. If necessary, you may have to buy or sell different holdings to bring your allocations back into line with your investment plan investor profile.

4. **Do your research**. A good defence against emotional decision-making is informed decision-making. Research any investment you're considering buying and consult your financial professional to ensure it is consistent with your objectives and risk tolerance. Importantly, ask yourself what happens if your expectations prove to be wrong.

5. **Consider a passive approach**. Be honest with yourself: have your investment choices kept pace with comparable benchmarks in the same asset class? If you can't beat the index, you can try to match by investing with low-cost index exchange-traded or mutual funds. They're less expensive and will help you avoid the stress of finding time to keep up-to-date on individual companies and market trends.

6. **Work with a financial professional**. Among their benefits, a financial professional can provide a second opinion on your investment ideas, as well as come up with alternative strategies you may not have considered. They will help you create a plan and keep you accountable, since they're trained to help you invest rationally rather than emotionally.

**For more information, please speak with your BMO**

BMO Private Wealth

1 Ontario Securities Commission. "Behavioural insights: key concepts, applications and regulatory considerations". https://www.getsmarteraboutmoney.ca/resources/publications/research/behavioural-insights-key-concepts-applications-regulatory-considerations/

2 Embark Group. "Pandemic deals blow to unadvised investor confidence, with retirement confidence worryingly low". https://embarkgroup.co.uk/insights/pandemic-deals-blow-to-unadvised-investor-confidence-with-retirement-confidence-worryingly-low/

3 Index Funds Advisors Wealth Management. "Dalbar QAIB 2023: Investors are Still Their Own Worst Enemies". https://www.ifa.com/articles/dalbar_2016_qaib_investors_still_their_worst_enemy

4 The Decision Lab. "Defaults". https://thedecisionlab.com/reference-guide/psychology/defaults



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