MAKING INVESTMENT DECISIONS

Are your choices based on evidence or emotion?

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Information vs. instinct. When it comes to investing, many people believe they have a "knack" for choosing good investments. But what exactly is that "knack" based on? The fact is, the choices we make with our assets can be strongly influenced by factors, many of them emotional, that we many not even be aware of.

Deal du jour. You've heard the whispers, the "next greatest thing" is out there and YOU can get on board, but only if you hurry … sound familiar? The prospect of being on the ground floor of the next big thing can be thrilling. But while there really are great new opportunities out there once in a while, often those "hot new investments" can go south quickly. Jumping on board without all the information can be a bit like gambling in Vegas … the payoff could be huge, but so could the loss. A shrewd investor will turn away from spur-of-the-moment trends and seek out solid, proven investments with consistent returns.

Risky business. Many people claim NOT to be risk-takers, but that is not always the case. Most proficient investors aren't reluctant to take a risk, they are reluctant to accept a loss. Yes, there's a difference. The first step is to establish what constitutes an acceptable risk by determining what you're willing to lose. The second step is to always bear in mind the final outcome. If a taking a risk could help you retire five years sooner, would you take it? What if the loss involved working an extra ten years before retiring … is it still a good risk? By weighing both the potential gain AND the potential loss (while keeping your final goals in mind), you can more wisely assess what constitutes an acceptable risk.

The crystal-ball approach. Some investors attempt to predict the future based on the past. As we all know, just because a stock rose yesterday, that doesn't mean it will rise again today. We know this, but often we "shrug off" this knowledge in favor of hunches. Instead of stock picking, you can exercise a little caution and seek out investments with the potential for consistent returns.

The gut-driven investor. Some investors tend to pull out of investments the moment they lose money, then invest again once they feel "driven" to do so. While they may do some research, they are ultimately acting on impulse. This method of investing can result in huge losses. For example, let's say you have $100 and are given 10 opportunities to bet $10 on a 50/50 chance event. If you lose the bet, you lose the $10. But if you win the bet, you make $25. What would you do? How many times would you bet? While the outcome is based on chance (and therefore impossible to predict), we do know this … if you were to bet at every single opportunity, you'd stand an 87% chance of ending up with more than $100. If you bet sometimes and not other times (based on your gut), the probability is that you would not do as well. So this is yet another argument for long-term investing.

Eliminating emotion. Many investors "stir up" their investments when major events happen … including births, marriages or deaths. They seem to get a renewed interest in their stocks and/or begin to second-guess the effectiveness of their long-term plans. It's a case of action-reaction: they invest in response to short-term needs, instead of their long-term financial goals. The more often this happens, the more incoherent their so-called "financial strategy" becomes. If the financial changes they make are really dramatic, it can lead to catastrophe. Many times, there is no need to fix what isn't broken, or make a U-turn away from what they've done right. By enlisting the assistance of a qualified financial professional (and relying on their skill and expertise) you can be sure that investment decisions are based on facts, and made to suit your long-term objectives rather than your personal, changing emotions or short-term needs.

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