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Wearing your investment heart on your sleeve?

Why emotions can get in the way of financial success

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Emotions can cause otherwise rational investors to make bad financial decisions. Remember the technology boom and bust of the late 1990s and early 2000s? Or the current and ongoing subprime mortgage crisis? In both cases, many people let their emotions get the better of them and lost significant amounts of money as a result. History is filled with examples just like these.

Emotions have their place in investing, but too often they're an impediment to good decision making. As smart investors know, a key to generating successful long-term performance is to stay objective and keep your feelings out of your portfolio decisions.

Greed, fear, stubbornness and too much information

One reason emotions can come into play is that people tend to extrapolate future performance from recent trends. When the markets are moving steadily upward, for example, they may think that the good times will never end. Investors become more susceptible to greed and tempted to buy stocks at too-high prices — setting themselves up for possible big losses down the road.

In contrast, when security prices are losing ground week after week, fear can kick in. In an effort to minimize their losses, investors may unnecessarily lock them in by selling otherwise good stocks at bottom-of-the-market prices.

In difficult economic times, investors also may overlook potentially good buying opportunities, instead seeking "safe" investments, such as ultra-short-term bond funds or money market investments. But because of their limited appreciation potential, these are a poor choice for many long-term investors who need to keep their assets growing faster than inflation.

On the other hand, people typically don't like to admit when they're wrong. That stubbornness can cause investors to hold onto a bad stock (one with little potential to rebound) rather than cut their losses and reinvest the remaining proceeds into a better opportunity.

Too much information focused on short-term market conditions — made possible by the Internet and 24-hour financial news networks — can also lead to poor financial choices. When investors don't know how to prioritize what they read or hear, they may become paralyzed with indecision or resort to unprofitable strategies, such as excessive trading.

Unemotional investing

Here are a few tips for investing unemotionally:

Invest on autopilot. Automatic investment plans, offered by most financial institutions, allow you to invest set amounts of money at regular intervals. By investing on a schedule, you can avoid the temptation to buy and sell at inopportune times, and actually buy larger quantities when prices are lower.

Develop an individualized financial plan. Your financial advisor can help you determine the appropriate asset allocation for your age, future goals and tolerance for risk. Be sure to record these goals, making them as specific as possible. Stick to your plan, regardless of what's happening in the market, and meet regularly with your advisor to discuss any needed changes to your plan.

Diversify your portfolio. As the truism goes, avoid putting too many of your eggs in one basket — whether it's your employer's stock, a "can't miss" opportunity your friend is touting, or just a successful investment held for many years. Owning various types of securities that have responded differently to changing market conditions is one of your best defenses against market volatility. Knowing your portfolio is well positioned can help reduce your temptation to make poor financial choices.

Get objective advice

Emotions aren't all bad for investors. For example, the desire to provide your children the best education possible or ensure a happy retirement for you and your spouse can be an important source of motivation to invest in the first place. Your challenge, therefore, is to harness the power of your emotions without relying too heavily on them for specific financial decisions.

One way to do that is to get an objective portfolio review from a knowledgeable financial advisor, like an Investment & Trust Services Officer at F&M Trust. He or she can give you a balanced view of your situation and help you make unemotional decisions based on sound investing principles.