

# Don't Let the Market Psych You Out

Baird's Wealth Solutions Group

<https://www.rwbaird.com/wealth-solutions/do-not-let-the-market-psyche-you-out>



## What You Should Know About the Way You Make Investment Decisions

If you're relatively new to investing, sudden and dramatic swings in major indexes like we saw late in 2018 may feel like the end of the financial world. Or perhaps you've been in the market long enough to remember the crash of 2008 and you start imagining dire scenarios based on that experience.

Such responses are completely natural because we're human. Our hearts, minds and memories often conspire against us – especially when we feel pressure to process and respond quickly to unforeseen situations. Understanding the way our innate tendencies affect the decisions we make can help you be a smarter investor in any environment.

### Know Your Biases

A 2018 study by the Nielsen market research group found American adults spent more than 11 hours a day interacting with media. That's a whole lot of information coming at us for the majority of the time we're awake. And while we all want to make objective, rational decisions – especially when it comes to our investments – our strong desire to be right and avoid the embarrassment of being wrong can skew the ways we seek and process information:

**Confirmation bias** can attract us to information that supports our existing views or beliefs. Pick virtually any election cycle in U.S. history and you'll find evidence of this at play.

**Cognitive dissonance** often encourages us to deny or rationalize away information that challenges our desires or assumptions. If you've ever eaten or drunk anything that you knew was bad for you, then you've experienced this.

**Anchoring and adjustment** is a common strategy for estimating things we don't know, but it can lead us to overweigh the significance or relevance of what we do know. This is why investment marketing materials carry disclosure about past performance not guaranteeing future results.

## Understand Your Emotions

You've probably heard it said that smart investors are counterintuitive. But perhaps even more important than recognizing when things aren't as simple as they seem is the ability to keep your emotions in check when things don't go as expected. For example, after the market crash of 2008, many investors panicked and pulled their money out of the market. This probably felt like a good call in the moment. However, those investors actually locked in their losses (most of which would have been recovered by mid-2012), and many missed out on the decade of strong returns that followed.

You probably don't have to go back to 2008 for an example of when emotions might have clouded your judgment. But behavioral finance uses a theory developed in the 1970s to explain the ways your emotions can impact investment decisions.

Tests of **Prospect Theory** found that the fear of losing money is twice as intense as the joy of winning money, leading Nobel laureate professors Daniel Kahneman and Amos Tversky to conclude that people are inherently loss-averse. This aversion is so strong that it could lead you to make a riskier decision than you otherwise would if you thought it might prevent additional losses.

## Control Yourself

If you remain aware of and on top of the often unconscious tendencies that can impact your thinking, you can make smarter investment decisions. However, in the market, you're one of many, and herd mentality can be a difficult force to resist.

Just keep in mind that following the crowd is almost never a smart idea when investing. Selling when prices are dropping pretty much ensures a loss and buying when everyone else is almost always means you'll pay more per share.

Perhaps the most important thing to keep in mind is why you are investing. For most of us, investments are a means to achieve what we want – near- and long term – for ourselves and those who rely on us. You can count on your Baird Financial Advisor to keep those goals front and center in the plans you make together and to help ensure your investments are working toward them.