https://www.unionleader.com/news/business/money_sense/marc-a-heberts-money-ense-don-t-let-fear-greed-affect-your-investment-practices/article_38018323-f957-5e53-93a3-56613942b49f.html

Marc A. Hebert's 'Money $ense': Don't let fear, greed affect your investment practices

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MOST PEOPLE who invest feel they are rational and disciplined. But studies have concluded that when the market moves erratically in the short term, investor behavior can be influenced by emotions such as fear and greed.

Since it is difficult to stay calm when the unexpected occurs, it can help to know the most common psychological traps investors face. By becoming aware of these, you might be better able to manage your portfolio when the market isn't going your way. Here are a few traps to watch out for:

Herd mentality

This is the trap when you think "but everyone is doing it!" Following your peers instead of what might be in your own best interest could lead you to a financial setback. Peer influence may mean excessive pursuit for a hot asset that drives up the demand for and the price of an investment until it gets too expensive for what it really is. Investors are chasing the return. In this case, investors may get caught buying near the peak of the investment's value.

As many have heard, past performance doesn't guarantee future returns. If the demand for an asset creates a bubble, it will eventually burst. Investors get hurt by following the crowd. Examples of this include fleeing the stock market after it falls or waiting too long to reinvest as prices have already risen.

When making investment and allocation decisions, make sure to still consider your individual needs and invest for yourself. Your goals, risk tolerance and time horizon are unique and you will need a plan tailored to your situation.

Availability bias

This refers to using a mental short cut. Someone mentions an investment and an example of it immediately comes to mind. Once this happens, your judgment concerning the investment comes from your perception rather than research on the actual opportunity. To use a non-investing metaphor of this effect, watching a shark movie doesn't make swimming in the ocean any more or less dangerous. The same goes for watching the talking heads on TV — following their advice doesn't necessarily produce excellent investment results. Seek advice from fresh sources of information.

Confirmation bias

Do you have a firm belief about a particular investment? Confirmation bias will steer you toward information that will further confirm your preconceived beliefs. If you have a good feeling about an investment, you are more likely to be drawn to information that will confirm its value than information that will challenge your idea. To counteract this tendency, it will be helpful to keep an open and flexible attitude toward any investment you may own or consider owning.

Overconfidence

When people attribute the rise in their portfolios to superior skills, knowledge and ability to predict the future and not to that fact that results may be due to rising markets lifting all boats it signals overconfidence. Trading excessively and downplaying the risks involved are other signs of overconfidence at work. Uncertainty never vanishes and should be considered in making any investment choice.

Loss aversion

Do you dislike losses more than you love gains? While it is painful to deal with a financial loss, selling the loser may just be the way to go. Try not to focus on your cost basis when determining how to best allocate your money.

So how should you deal with these behavioral influences? First, remember that all investments are subject to market fluctuation, risk and loss of principal. When sold, investments can lose money. Second, slow down. Evaluate the process, the investment, and the possible outcomes. When you are calm, develop an appropriate investment strategy to help you avoid the expensive emotion driven mistakes when the market throws you a curve. When in doubt seek competent professional advice regarding your portfolio.

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