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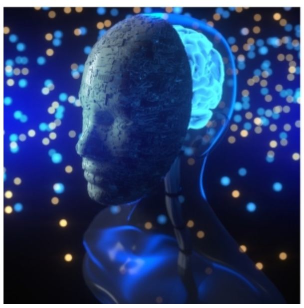
Coping with Market Volatility: Understand How Your Biases Can Affect Investment Decisions



Understanding your biases may help you avoid questionable calls in the heat of the financial moment.

When it comes to your finances, "go with your gut" might not be the wisest adage to follow. In fact, it may work against you, particularly in periods of market turbulence. Before jumping to conclusions about your finances, consider what biases may be at work beneath your conscious radar.

Recency bias refers to the tendency for recent events to have a stronger influence on your decisions than more distant events. For example, when the market was in the midst of an 11-year bull run, you may have increased your investments in equities, hoping to take advantage of any further gains. By contrast, if you were severely burned by market performance during the past several weeks, you may be hesitant about continuing or increasing your investments once the market settles down. Consider that neither of these perspectives may be entirely rational given that investment decisions should be based on your individual goals, time horizon, and risk tolerance.

Loss-aversion bias describes the tendency to fear losses more than celebrate equivalent gains. For example, you may experience joy at the thought of finding yourself $5,000 richer, but the thought of losing $5,000 might provoke a far greater fear. Loss aversion could cause you to hold on to a losing investment too long, with the fear of turning a paper loss into a real loss. In a down market, of course, most of your investments may show paper losses, so you might consider whether you are holding on to an investment that would be wise to sell within the context of your overall strategy.

It's only natural to be concerned when the market drops. But expecting volatility and having a sound financial strategy in place may be the best defense when events roil the markets. This might also help prevent you from making investment decisions influenced by biases.

If you think you might be basing your decisions on biases rather than facts, contact us. We can offer an important third-party perspective.

All investing involves risk, including the possible loss of principal, and there is no guarantee that any investment strategy will be successful.

Although there is no assurance that working with a financial professional will improve investment results, a professional can evaluate your objectives and available resources and help you consider appropriate long-term financial strategies.
