Perspectives

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9 Costly Investing Behaviors — and How to Avoid Them

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Over the past 20 years, the average investor has underperformed the S&P 500 Index by 3.75%. Why? The old adage "buy low, sell high" sounds intuitive in theory, but in practice, it often means buying an underperforming asset and selling an asset that's performing well. It is hard to fight our innate emotional tendency to buy high (when markets are going up) and sell low (when markets are going down), but that's why it is so important to work with a financial advisor you trust.

Below are nine common behaviors that prevent investors from maximizing returns, as well as how your advisor can help you overcome them.

1 **Loss aversion** refers to the tendency to prefer avoiding loss to risking acquiring gains (i.e., losses create a larger psychological impact than gains of the same size). Working with your advisor can help determine how you personally balance risk versus reward and build a financial plan around this information.

2 **Narrow framing** occurs when one defines choices too narrowly, without considering all implications; think of it as considering decisions one at a time instead of part of a larger context. This can include everything from checking your portfolio performance too often, causing anxiety from market movement, to varying investment approach from account to account. Your advisor can help you take a broader, more comprehensive approach to financial planning.

3 **Mental accounting** refers to the tendency to perceive value in relative versus absolute terms. For example, many see a tax refund as a windfall versus part of a larger financial picture and spend accordingly. Your advisor can help you see how all pieces of your financial puzzle fit together.

4 **Diversification** seeks to reduce risk by spreading your assets across different investments, but it is ineffective when done improperly, such as by spreading assets evenly across all investment options in a 401(k). Your advisor is able to work with you to weigh your risk tolerance and time horizon for investing in order to determine a diversified approach suited to your needs and goals.

5 **Anchoring** occurs when one relies on an initial piece of information to make later decisions, relying on the familiar even when it doesn't make sense. For example, an investor might be "anchored" by the price at which they purchased a stock, regardless of how reflective that purchase price was to the stock's ongoing performance. Working with your advisor can help you overcome this and focus instead on the long term.

6 **Optimism bias** is the tendency to believe that something is more likely to result in a favorable outcome or, conversely, that bad things only happen to other people. Working with your advisor can prevent the excessive risk taking and excessive trading characteristic of optimism bias.

7 **Media response** is perhaps the hardest behavior to fight. When stock analysts or TV pundits use words like "plummet" and "boom" to describe the market on a daily basis, it's incredibly hard to remain calm and focus on the long term. However, it's important you trust your advisor, not a TV pundit who doesn't know your personal financial situation.

8 **Regret** involves making a decision based on fear of making a wrong choice. It can make investors risk averse (hesitant to take future risks because of a past mistake that caused regret) or, conversely, risk seeking (taking unnecessary risk to avoid regret of missing out). Your advisor can help you overcome this fear of regret by crafting a plan around your level of risk tolerance and engaging in tactics such as dollar cost averaging and automatic rebalancing.

9 **Herding** is exactly what it sounds like — acting a certain way because everyone else is. It is what contributes to investors buying assets when they are most expensive and selling when they are least expensive. Working with your advisor helps you to determine your unique goals and customize a plan to achieve them.

While it can be hard to fight the innate behaviors mentioned above, there is one instinct you should remain firm on: *the trust you have placed in your advisor.*

Source: 2019 Quantitative Analysis of Investor Behavior Report

Common Sense Investing and Sustainability

By Dimensional

As citizens, individuals can express their political preferences around sustainability through the ballot box. As investors, they also can express their preferences through participation in global capital markets. One key question these investors face is how to do this without compromising their desired investment outcomes. For instance, how can they reduce their portfolio's environmental footprint while maintaining sound investment principles and achieving their investment objectives?

Sustainability preferences are not generally restricted to greenhouse gas emissions. Many investors may also have concerns about land use and biodiversity, toxic spills and releases, operational waste and water management, among other issues. Thus, it is a challenge to achieve the dual goal of efficiently considering sustainability preferences while building investment solutions that help meet investors' financial goals.

Using the approach below may allow for substantial reduction in exposure to greenhouse gas emissions and potential emissions from fossil fuel reserves — important goals for many investors — while providing a robust investment strategy that is broadly diversified and focused on the drivers of expected returns.

A Suggested Approach to Sustainability Investing

1. **Apply a methodology** that emphasizes the sources of higher expected returns while minimizing unnecessary turnover and trading costs.
2. **Systematically evaluate** company sustainability metrics across all major industries.
3. **Emphasize investment** in companies acting in more environmentally sound ways than their industry counterparts.
4. **Exclude or underweight companies** based on other key environmental and social considerations while maintaining broad diversification.

Investing well and incorporating values around sustainability need not be mutually exclusive. Using a patented investment methodology, Dimensional has effectively implemented sustainability strategies with this dual goal in mind for more than a decade.[1] By starting with a robust investment framework, then overlaying the considerations that represent the views of sustainability-minded investors, this allows for a cost-effective approach that provides investors the ability to pursue their sustainability goals without compromising on sound investment principles or accepting lower expected returns.

[1] Dimensional's approach to sustainability investing is protected by U.S. Patent Nos. 7,596,525 B1, 7,599,874 B1 and 8,438,092 B2.

Diversification does not eliminate the risk of market loss. There is no guarantee an investing strategy will be successful. Investment risks include loss of principal and fluctuating value. Sector-specific investments can also increase these risks. Environmental and social screens may limit investment opportunities.

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