Topic : INVESTORS' EMOTIONS AND EXPECTATIONS
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"I no longer saunter down to pick up the paper at the end of my driveway. I find that I just don't feel as good as I used to—my whole mood has changed. I guess I'm feeling a sense of heaviness, uncertainty—maybe even a bit of depression."

"My statement sat on my breakfast table unopened for days. I just didn't want to look at the balance. I own a lot of shares of each stock and it's great when the market is going up because there are big gains. But when it's going down, I have to face large losses."

I had this conversation yesterday with a knowledgeable and confident investor who is generally quite comfortable with volatility. Her psychological profile is such that she is highly motivated by performance and tends to take higher but calculated risks. Her portfolio is diversified but with a leaning toward momentum stocks.

Often Bull markets are like blinders. Investors begin to believe in the fantasy that their stocks will always take good care of them and never disappoint them.

In my 20 years of experience, as a psychologist specializing in the psychodynamics of money management and investing, I've come to realize that there are certain important relationships which we must understand before can achieve a consistent degree of success in the world of investing and in the marketplace.

· The first and foremost of these is that the majority of losses in the marketplace result not from poor trading decisions but rather from emotional and attitudinal causes.

· Investing by its very nature is an emotional business. Few investors have the self-knowledge, emotional stamina or self-control to make rational, intelligent and profitable decisions, particularly in times of stress.

I'm reminded of one example in particular as the 13th anniversary of Black Monday approaches. One of my clients at the time lost $40,000 in the market and hasn't invested since. She deviated from her preferred investment strategy of real estate to capitalize on stock market gains but quickly found out that her inability to deal with loss prevented her from sustaining the market fluctuations of that drastic, but short-term point adjustment. She sold out immediately. The $40,000 only represented a small percentage of her 2 million dollar net-worth. So even small losses can be painful.

So often investors react wildly to bad news, often selling shares of perfectly good stocks. Had she held on, she would have realized that. But she, as many other investors, react with their emotional money minds rather than their rational ones.

Why is it what some investors make rational decisions, stick with their choices and strategies while others act out their emotions and make bad investment decisions?

The field of Behavioral Finance has given insight into the mental miscues investors make that sabotage and crimp their returns:

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· Fear of losing money

Psychologically, people give greater weight to a past loss than they do to a future gain. In fact, some folks such as this investor find losing money so distasteful that they psych themselves out of investing altogether.

Investors don't make reasonable trade-off's, The drive to avoid loss really sabotages any future gains or opportunities.

Solution: Determine ahead of time exactly how much your clients can "emotionally" afford to lose as well as "financially". They are often very different.

· Worrying about the wrong risks

Investors are held captive by unpredictable yet frightening events like the '87 crash. People are traumatized by dramatic events. They can't tolerate this anxiety.

Investors become blind and deaf to others' advice in these times and tune out advice from others, including their advisers. They exaggerate current crises. What's worse is that they forget the wisdom of lessons from the past. They overlook the fact that people who stayed fully invested during the '87 crash recouped their losses.

Solution: Help your clients base their decisions on what they can control, not on those they can't control. Give them the rationale for their current strategy and reiterate why it still makes sense. Repeat it several times and intermittently so they can hear it and use it as a guideline in regulating their knee-jerk and emotional reactions.

Basically, both my research into the attitudes and feelings that drive money management and investment behavior, and my work with investors and investment advisors tell me the following things:

• Successful investors are in control of their emotions and are more likely to act on facts as opposed to feelings.

• It is possible to learn successful investing just as it is possible to learn most other forms of appropriate business behavior. The first step is being self-aware; the second is to be self-confident; and finally self-motivated and responsible.

As you evaluate your clients' investment strategies and individual situations, consider these points:

• Investors are more prone to make or lose money as a function of their emotions and attitudes than on the basis of their stock selection or trading system.

• The best system can be rendered a losing proposition by inappropriate implementation due to emotional and behavioral limitations.

• Appropriate or successful investor behavior can be learned to a large extent.

• Education is essential to helping investors stay in control and continue to grow, particularly in learning self-regulation and self-control.

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In other words, there is a vast world of emotion under the surface structure of investing. To know and understand the motivating forces behind investing, to know and understand why one investor becomes tense about losses, why one becomes greedy about profits, and why one either overreacts or fails to react is, perhaps, more than half the investment battle won. There is a high price to pay for the kind of innocence many investors bring to their investments and the way they interact with their investment advisors. Unfortunately, in many cases, to help your clients continue to maximize their financial returns, you must first help them master their emotions.

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