BE ON YOUR BEST FINANCIAL BEHAVIOUR

Investors are often their own worst enemy when trying to out smart the market and end up sabotaging their financial goals. Learn how to avoid these behaviours and how to keep yourself — and your money — on track.

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Despite our exuberance, enthusiasm and abundant self-confidence, learning any new skill can be a daunting experience. Golf looks deceptively easy on TV but becomes more difficult when you're the one swinging a club in your hand. Watching a master musician playing saxophone can only heighten your disappointment when you try and play a song for the first time. It's far too common that we under-estimate the thousands of hours of practice needed and overestimate our own abilities to master a skill.

The same is true with investing; most intelligent and diligent individuals believe they can succeed at making money in the stock market. However, without self-discipline and professional advice, losing money can all too often accompany any enthusiasm.

Brad Simpson, Chief Wealth Strategist at TD Wealth, with more than 25 years of experience as a strategist and portfolio manager for high net worth clients, is familiar with behaviours that can disrupt the investing goals of any well-meaning investor. Simpson helps identify and analyze the most common behaviours that derail investor's goals and offers methods to get investors back on track.

Brad Simpson
Chief Wealth Strategist
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Brad is one of Canada's thought leaders on portfolio construction. He has more than 25 years of experience as a strategist and portfolio manager for high net worth clients. He began his career as an investment advisor before progressing to a portfolio strategist role. Brad then advanced to the role of president and portfolio manager, and was most recently the chief hedge fund strategist at a Toronto-based asset management firm.

All That Glitters

Frank has a long, deeply-held belief that gold is the 'go-to' investment in times of political uncertainty. He prides himself on the depth of research he does before he makes an investment. He has seen time and time again how gold prices spike when unexpected news

hits. With the seemingly endless headlines on White House turmoil, Russian hacking and North Korean missile-testing, he is all-in on gold.

Brad: Frank is acting out the classic signs of what's called a *confirmation bias*. Instead of being open to other ideas, he is almost emotionally attached to his pet theory about gold and world politics. He has convinced himself of a potential outcome and then finds evidence to support his ideas — and bad news from newspapers and TV back up Frank's beliefs. Now, Frank is correct that having gold in his portfolio can be a hedge against world events. But Frank has carried it too far. He would be wise to have a broader portfolio approach and diversify his choice of investments. That strategy could reduce all kinds of risk and not just the risks around world events.

Hot Tip Gone Cold

Bernice has two portfolios, a regular portfolio and a 'play' portfolio where she likes to invest in hunches, long shots and hot tips. Her 'play' portfolio is only 10 per cent of the size of her other portfolio where she holds her longer-term investments. She tells her friends that, as long as she keeps the portfolios separate, it can't do any harm. So, she goes online when she's bored and sees what stocks are up or down and gets a big thrill when her 'hot' stock has surged. Two months ago she lost $2,000 in one week in her play portfolio and laughed it off. Unfortunately, she also lost $2,500 in her regular portfolio last month. She didn't find that funny at all and thinks she needs to make immediate changes to her portfolio.

Brad: Bernice's decision to make immediate changes to her portfolio is a classic example of a *framing effect*, where an investor allows a meaningless figure or threshold benchmark to affect their decision making. By calculating her losses in dollar terms Bernice is ignoring the fact that, in percentage terms, her losses in her regular portfolio are considerably less than her play portfolio. The framing effect blinds her to the fact that the two portfolios have different objectives. Bernice should remind herself why she has these two portfolios and why she invests different amounts in each.

Courage of Convictions?

Scott is a long-time veteran of the oil industry and considers himself an expert in all things oil and gas, including investing. Years ago, he made significant amounts of money investing in that sector. He has spoken with many of his old colleagues and followed research reports both from Canada and abroad. He thinks he's seen the current market dynamics play out in the past before, and is convinced that oil prices have hit rock bottom and are ready to rebound. He's ready to put some serious money in the oil market.

Brad: Familiarity is the main motivation for Scott to invest in what he knows and *familiarity* is the behavioural bias that is Scott's problem. Like Frank with his gold, Scott is in danger of putting all his eggs into one basket, the oil markets, and, like Frank, the solution is to diversify his investments with a portfolio approach, not concentrate on one market. Since Scott derives his employment income from the oil industry, he is actually doubly exposed to a major correction in energy markets, something that happens frequently. Scott's familiarity and confidence in his own knowledge on the topic may blind him to negative signs in the market, or to the notion that there may be factors at play that he may not understand fully.

Turning Down the Volume

Robert can't get enough of the news. He follows every headline coming out of Washington. He watches cable news outlets and monitors social media to catch all the breaking news, but is feeling depressed about the state of the world and is fearful that bad things are going to happen. Bombarded by so much media 'noise,' he can no longer figure out what news may actually be relevant to his investments.

Brad: Robert's predicament is understandable. In our world of 24-hour info-tainment, social media pundits and alternative facts, it's hard to not get overwhelmed. And while we are all concerned with the state of the world, the degree that Robert is sensitive to noise can disrupt an investment strategy as well as cause personal anxiety. A long-term commitment to a disciplined, thoughtful approach to investing, sound research and steadfast decisions, based on a comprehensive plan, is a good way to counteract this short-term noise. We also think it may be wise for Robert to turn off his social media a few hours before bedtime. It will be better for his mental health, financial well-being and sleep; studies show that the blue light emanating from electronic devices affects your rest!

Over-thinking It

Viviane has always invested conservatively and has been happy with her investments' steady performance, even though if she took on more manageable risk, her returns could conceivably be higher. But that's not her style — she would rather sleep well at night: so she sticks with her conservative investing approach. Unfortunately, one of her longest-held investments suddenly suffered a large and unexpected loss: nothing like this has ever happened before to

Viviane. Despite the fact her long-term returns on her portfolio are still excellent and suit her investment profile, the loss has shaken her. She decides she needs a new strategy that will make her portfolio completely risk-proof.

Brad: Financial losses are processed in the same area of the brain as mortal danger. Making matters worse, studies suggest that losses are twice as psychologically powerful as gains, leading to this negative behaviour called *loss-aversion*.[1] The danger for Viviane is that her over-reaction could push her to be even more conservative than she already is. Having a portfolio that has minimal risk exposure could mean her financial goals, such as having enough money for a comfortable retirement, may not be met. The fact is that no investing is totally risk-free. Negative things can happen even in the most conservative portfolios. And when these things happen, the best thing that Viviane can do is not to panic and jump to conclusions, but rather sit down with her financial advisor to look at the situation together, and stop the urge to throw the baby out with the bathwater.

Correcting Myopia

Natale likes to compartmentalize her world so she keeps her shorter-term investments in one account and her retirement investments in a separate account. That was the plan, but her life has become increasingly hectic with her new job downtown, a new relationship and now the responsibility for taking care of her ailing father. She knows she still needs to keep an eye on her short-term investments, and figures she doesn't need to pay that much attention to her retirement account. As a result, she hasn't reviewed her retirement investment strategy for years.

Brad: One of the great challenges of investing is the tendency to focus on your current state to the detriment of your future state, called a *short-term*

focus. In life, we typically make decisions based on whatever urgent event is currently happening, and, in investing, we tend to do the same: we often make decisions based on current values rather than an overall strategy. That is, it's easier and sometimes more exciting to follow the daily ups and downs of stocks and bonds and harder to concentrate on the bigger picture of growing your portfolio for retirement over many years. But, long-term investing should not be confused with doing nothing. Gains and losses could unbalance your portfolio over time, economic conditions change and your portfolio may shift significantly away from your ultimate goal. To keep your portfolio properly balanced, it helps to return to its original goals or switch to new goals if your outlook has changed, in consultation with your financial advisor, to help ensure that your portfolio is properly structured for returns and potential risks.

When Confidence Crashes

Brandon's friends call him a know-it-all because he'll tell you (often without asking), how everything works, why things are the way they are, and the best method of doing anything. This includes investing; he has repeatedly told his friends how his sharp investment moves — always one step ahead of the market — have made him some quick money. Now, Brandon believes he has spied an excellent investment opportunity and calls his investment advisor to get him to confirm his brilliance. The advisor thought there was significant risk to the downside, but Brandon thought he knew better, and made the trade anyway.

Brad: Some days we have an unwavering faith in our ability to predict outcomes. When we act on this in our day-to-day life, it can sometimes lead to poor, and sometimes disastrous results. Think of how many times you have bought an electronic device, didn't read the manual, only to be frustrated that you couldn't get it to work. The problem is that this

tendency — *overconfidence* — can be damagingly expensive when it comes to investing. Markets are as complex as they are unpredictable. Perhaps the best way to counteract overconfidence is to acknowledge that complexity with humbleness. When things work out, appreciate it, but don't be overzealous with self-praise. The same is true for the opposite. Sometimes investments don't work: learn and move on. This simple change in attitude can have a significant impact on investment success. Moreover, overconfidence will naturally cloud our perception of our investing skills. Everyone should discuss their strategies with a financial professional to ensure they are getting qualified — and non-biased — feedback.

[1]Tversky and Kahneman, "Advances in prospect theory: Cumulative representation of uncertainty," *Journal of Risk and Uncertainty*, October 1992, Volume 5, Issue 4, 297–323.

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