

Emotional Rescue

How do emotions influence the investing public?

By Sidney A. Blum, Kevin Paulsen and Michael Thompson

Ask anyone about their financial goals, and you get a glimpse into not only the way they spend their money, but also something far more personal—how they see themselves. Financial planning is inextricably linked to emotion—positive emotions when returns are high, negative emotions when returns are low.

Emotional intelligence is a learned skill, hinging on the concept of four basic emotions—glad, sad, mad and scared—that guide our actions and decisions. These emotions determine just how risk averse a client will be.

As we said, people react emotionally to market downturns. The first emotion to hit them may be fear (scared), followed by anger (mad) and dejection (sad). When a person is experiencing these emotions, it's all too easy to lose perspective, focusing too closely on short-term salves that may have a negative impact in the long term.

At the other end of the spectrum, when there's a market upturn, optimism reigns—so much so that investors may be lulled into the belief that things will always be this good. They're so caught up in their euphoria (glad) that they lose sight of their underlying strategy and goals, perhaps even buying shares that are, in fact, overpriced.

Furthermore, pulling out of the market to protect temporary downside losses in value means not participating in the upside, which eventually will come around. From the major downturn in the spring of 2009 to the fall of 2009, for

example, the market recovered better than 35 percent. Those who pulled out of the market and stayed out missed out.

People also lose sight of the fact that fund investments are made in actual companies, some of which survive and some of which fail. There are no guarantees when it comes to return on investment. That said, a certain amount of volatility is normal, and, in fact, it's the price we pay for the opportunity to earn a higher return than "safe" investments would give us.

And how safe are safe investments, anyway? If they're earning 1 percent while inflation is running at 3 percent, you're losing purchasing power. A bucket with a slow leak will still end up empty.

How does an advisor help to keep investors focused on the right strategy, rather than reacting emotionally to market conditions? The answer is to give them perspective. Markets tend to return to the norm, whatever the current downturn. Market conditions are fluid and as such subject to change. This sense of natural and cyclical ebb and flow brings with it a sense of emotional stability that allows investors to make studied rather than reactionary financial decisions. After all, it's far more productive to keep your eyes on your goal, not on the dollar value of your portfolio. In the end, your net worth is not the same as your self-worth. □

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