Try not to be your own worst enemy

Research shows that unconscious biases can lead to bad decisions

By Anna-Louise Jack

Looking for someone to blame for the not-so-stellar performance of your investment portfolio? Try checking the mirror.

Decisions about money aren't always rational, even when we think we're acting logically. Common tendencies that make us our own worst enemies when investing include: selling winning investments too soon or holding onto losers for too long, loading up on too-similar assets or failing to assess the future implications of today's decisions.

Researchers have found dozens of unconscious biases that can drive people to make money decisions they, later regret. These behavioral economics concepts include things like "anchoring" - when a specific and perhaps arbitrary number you have in mind sways your decision- making, such as selling Apple just because the company's stock hit a round number, like $200 a share. Or, the "endowment effect" can cause you to overvalue something simply because you own it, leading you to cling to a stock that's tanking.

Here are some common human errors in investing, with strategies to overcome them:

Pursuing past predilections:

Financial institutions remind us that past performance doesn't guarantee future results. We don't always listen.

It's tempting to look at a stock's recent performance and conclude gains will persist in the near term, says Victor Ricciardi, a finance professor at Goucher College. "People take a very small sample of data and draw a major conclusion, and that's a pretty bad pitfall.

> ***How to overcome it:*** Don't base investing decisions solely on what's happened in the past; think about what will drive gains in the future. When investing for the long term, prioritize selecting companies with solid long-term potential.

Diversification that's not diverse:

You may interpret diversification to mean more is better. That's only half the story; what's important is owning a variety of assets (both stocks and bonds) with exposure to various industries, companies and geographies.

Sometimes investors exhibit "naive diversification" by owning too-similar assets, which does little to reduce risk, says Dan Egan, director of behavioral finance and investments at robo-adviser Betterment: “People will have three or four different S&P 500 funds and think they're diversified but don't look at how correlated they all are.”

> ***How to overcome it:*** Invest in a wide range of assets. This can easily be accomplished with a simple portfolio constructed of just a few mutual funds or exchange-traded funds.

Making emotional decisions:

When moneys on the line, it's hard not to let emotions creep into your decisions.

Prior to the 2016 presidential election, many professional investors expressed concerns about a market slump, if Donald Trump won. Betterment data suggested investors who supported Hillary Clinton might let politics shape their investment strategy - and cash out following the election, Egan says. So, after the election, the robo-adviser messaged investors with information about the importance of staying invested for the long haul, he says.

> ***How to overcome it:*** Think about individual investments in the context of your entire portfolio and craft a plan for when you'll sell that’s not triggered by short-term, factors (like emotions) alone.