Investing - The Solution To The Investment Roller Coaster

Contributed by
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By Jeffery Voudrie

Does investing put you on an emotional roller coaster? If so, you are not alone. The fluctuations of the market are hard for most investors to stomach, and many suffer from financial ‘motion sickness’ as a result. But making investment decisions under these circumstances is a recipe for disaster. Read on to find out how you can get off the emotional roller coaster of investing.

If you feel that you are on the investment roller coaster—if you lie awake at night worrying about your investments or get a knot in your stomach when you hear the markets have fallen—then you most likely have not allocated your portfolio so that it matches your emotional risk tolerance. Changing the allocation of your portfolio should alleviate this problem.

Investors find themselves on an investment roller coaster when their ‘intellectual’ risk tolerance doesn’t match their ‘emotional’ risk tolerance. This creates a ‘fear/greed’ cycle that causes many investors to constantly adjust their portfolio based on short-term circumstances instead of a long-term strategy.

For instance, an investor intellectually agrees with the benefits of equity investing and he decides to put a significant percentage of his money into stock market-based investments. But when the market starts going down, fear grips him and he can’t take it. He wants out.

Once the market recovers, his fear turns to greed. The market went up, so why didn’t his account? He blames his advisor for not telling him to buy, when in fact the investor didn’t act because of fear.

Don’t get me wrong. There is nothing wrong with tactically reducing the amount you have invested in equities to protect your money. That’s exactly what my proprietary money management system is designed to do. But in this case, I am talking about rapidly changing the long-term strategy based on normal market fluctuations.

The problem isn’t necessarily that the investor panics and sells, but that fear then keeps them from getting back into the market when they should. Instead of buying when everyone else is afraid, they wait until the market recovers and it’s too late. They sell low and buy high.

Let me give you a real-life example. After meeting together countless times, one of my clients agreed that having approximately 40% of his portfolio allocated to high-quality equities was the best way to help him achieve his goals. We talked extensively about the implications, did extensive research on each investment used, and invested the money.

Within a couple of months, this client was beside himself because he had lost $20,000!
But let’s put this loss in perspective. Although the market was down several percentage points, his account was down less than 1%. If you can’t tolerate a fluctuation of 1% then you shouldn’t be in equities.

We reduced his equity percentage down to 7% so he could sleep at night. By the end of that year, the market was up 8%. Most of that gain (as it usually does), came very quickly in a short period of time. And it started (as it usually does) right when nobody thought it could go up.

This client allowed the fear over a 1% loss to prevent him from achieving an 8% gain.

You will only know your true emotional risk tolerance after it has been tested. When tested, we learned that this client’s emotional risk tolerance was much lower then expected. Only then were we able to achieve the appropriate portfolio allocation.

That’s why it is so important that you have the ability to easily make changes to your portfolio without significant cost. That’s why I so adamantly oppose investments that have surrender charges—they cause you to lose your flexibility.

Also, your comfort with investment risk will change over time based on your experience and your situation. This client is becoming more comfortable with normal market fluctuations. We are increasing the percentage he has allocated to equities, but we are doing it slowly.

Recognize that your emotional risk tolerance is probably much less then your intellectual risk tolerance. Start slowly.

Build up over time. Be flexible. And work with an advisor who understands and is able to help guide you along the way.

Have a financial question? Send me an email and I’ll personally respond, free of charge. Go to http://www.guardingyourwealth.com and click on ‘Ask Jeff’.

In addition to being a nationally syndicated columnist and Certified Financial Planning Practitioner, Mr. Voudrie provides personal, private money management services to clients nationwide.

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