

# The Seven Deadly Sins of Investing

September 8, 2022

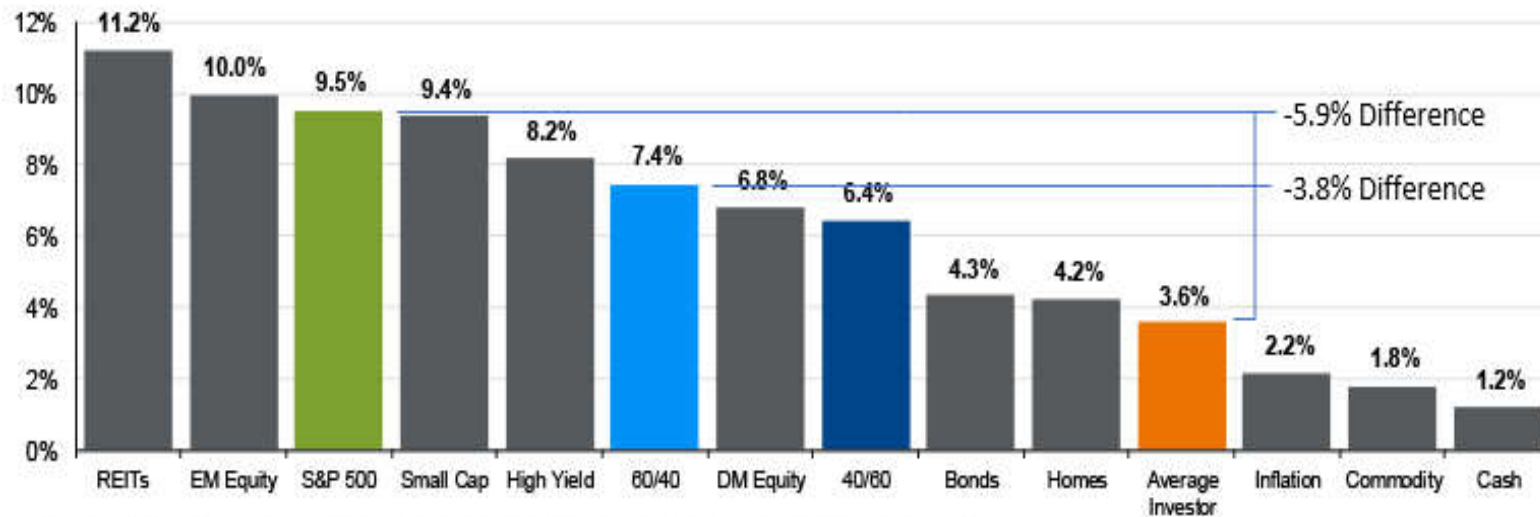
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# Investors Underperform

20-year annualized returns by asset class (2002 – 2021)



Source: Bloomberg, FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Bottom) Dalbar Inc., MSCI, NAREIT, Russell.  
 Indices used are as follows: REITs: NAREIT Equity REIT Index, Small Cap: Russell 2000, EM Equity: MSCI EM, DM Equity: MSCI EAFE, Commodity: Bloomberg Commodity Index, High Yield: Bloomberg Global HY Index, Bonds: Bloomberg U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Cash: Bloomberg 1-3m Treasury, Inflation: CPI, \*60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high-quality U.S. fixed income, represented by the Bloomberg U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior.  
 Guide to the Markets – U.S. Data are as of July 31, 2022.

**J.P.Morgan**  
 ASSET MANAGEMENT



“Awareness is the greatest agent for change.”

-Eckhart Tolle



# Lust: Chasing Recent Performance

- Inherently, we remember the most recent events better than previous ones and place more importance on recent events.
- This leads our minds to extend the pattern that has developed and forget that patterns can change.



# Lust: Chasing Recent Performance

- Examples of asset classes that investors rushed into because they were “hot.”
  - Crypto
  - Technology stocks
  - Gold & Silver



# Pride: Being Overconfident

- People tend to overestimate their abilities
  - 80% believe they are above average\*
    - Driving ability
    - Sense of humor
    - Getting along with others
- They misperceive their ability to control events
- They seek confirmation of their abilities and find it in random events

\*Source: National Bureau of Economic Research, Inc; *Financial Decision-Making in Markets and Firms: A Behavioral Perspective* by Werner F.M. DeBondt, Professor School of Business, University of Wisconsin-Madison and Richard H. Thaler, Gwinn Professor of Behavioral Science & Economics, Graduate school of Business University of Chicago



# Sloth: Overlooking Details & Costs

- Many investors only make investment decisions based upon past performance and totally disregard the cost(s) of the investment.
- More expensive investments tend to underperform less expensive ones over long periods of time.
- Average investors tend to ignore the investments inside of a fund.



# Sloth: Overlooking Details & Costs

## Example

- Fund A – owns 50 companies (25% is in Tesla company stock)
  - Expense Ratio = 2%
- Fund B – owns 2500 companies (Target Ret. Date of 2025)
  - Allocated 25% stocks/75% bonds

## Analysis

- Digging deeper, performing due diligence will eliminate many choices and potentially save cost(s).





# Envy: Following the Herd

- Investors have a tendency toward “herd behavior”
- They may even disregard their own beliefs to follow the herd
- Study of the effects of herd behavior:
  - Participants were asked to answer easy questions about the lengths of lines
  - About 1/3 changed their answers to be part of the herd
- This can describe the disproportionate flow of money into top-rated funds despite ratings’ lack of predictive value



# Wrath: Failing to Admit Failure

Example:

- You need to make a withdrawal from your portfolio for a college tuition payment. To generate cash, you must liquidate one of two stocks.
- You have held both stocks for two years:
  - Company A: bought at \$10/share, currently \$13/share
  - Company B: bought at \$12/share, currently \$10/share
- Which would you sell?



# Wrath: Loss Aversion

A friend wants to make a bet with you. If you accept the bet, you will have a 50% chance of losing \$10,000 and a 50% chance of winning \$\_\_\_\_\_.

How much would you want to have a chance of winning before you would take the bet?



# Wrath: Loss Aversion

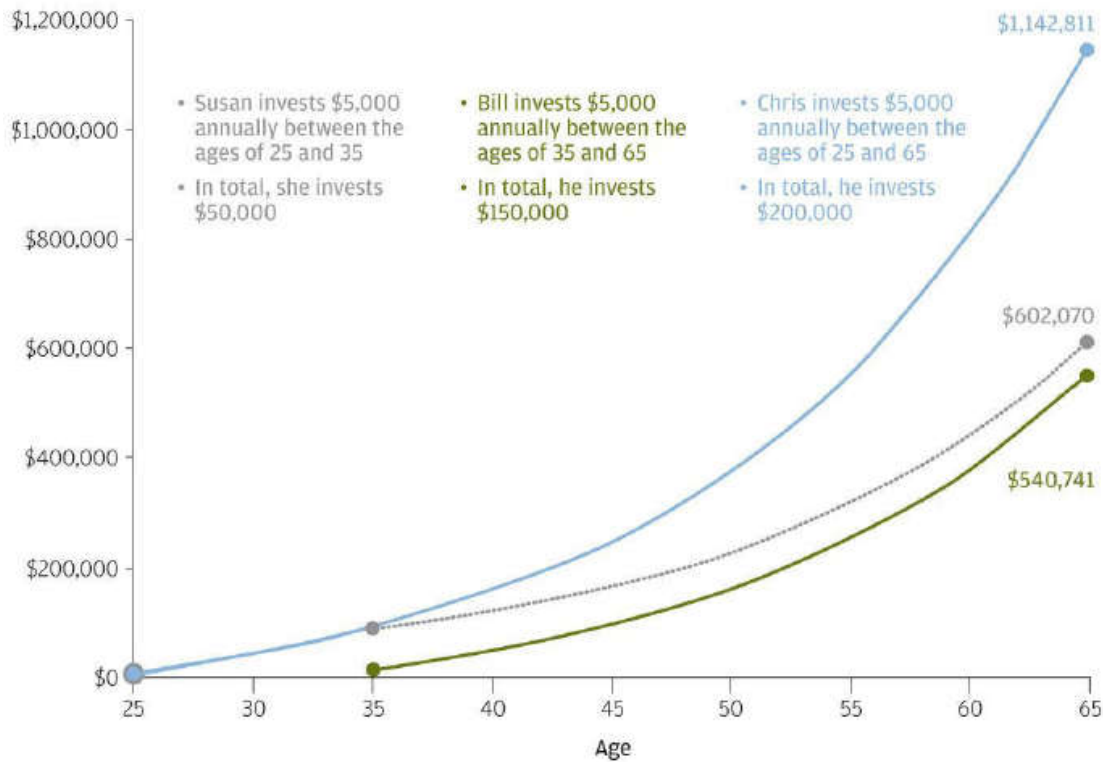
## Explanation

- The disproportion of gain and loss
- Most people want to gain between 2 and 2½ times as much as they put at risk
- Most people will want a chance to win at least \$20,000 before they will play
- Simply put, people don't like to lose money!



# Gluttony: Living For Today, Putting off Tomorrow

Growth of savings accounts



The above example is for illustrative purposes only and not indicative of any investment. Account value in this example assumes a 7% annual return.

Source: J.P. Morgan Asset Management.



# Greed: Overly Optimistic

- People believe it is likely that:
  - Good things will happen to them
  - Bad things will happen to others
- Others are more likely to:
  - Become an alcoholic
  - Have a heart attack
  - Develop cancer
- Others are less likely to:
  - Become rich
  - Become famous



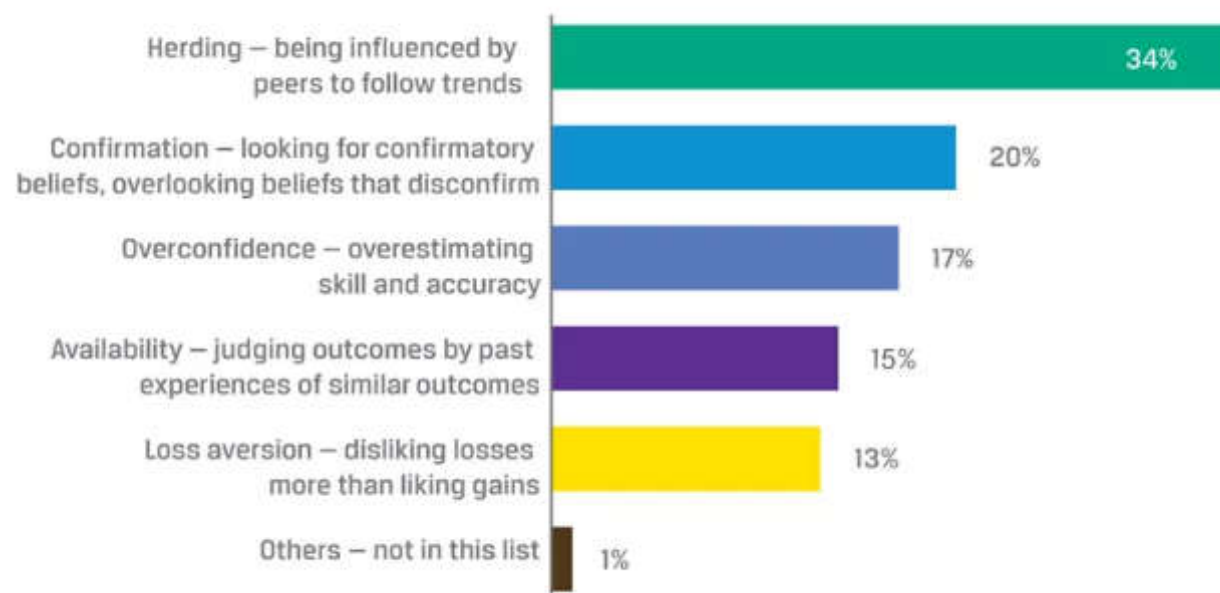
# Summing Up The Problems

- You are your best asset, but also your worst enemy
- Many people tend to buy high and sell low
- Lack of confidence caused by pressure from the herd
- Overconfidence, optimism and minimization of uncertainties and the role of chance
- Tendency to mischaracterize their own beliefs at the time a decision was made and blame others



# Survey Results Are In!

**Poll: Which of the following behavioral biases affects investment decision making the most?**



CFA Institute Financial News Brief Survey week of August 6 2015.  
The survey generated responses from 724 practitioners from across the world.





# Become a Better Investor

- Be aware of these sins and which ones affect you the most
- Focus on overall state of wealth
- Focus on what you can control
- Focus on long-term results
- Focus on probabilistic nature of investing
  - No sure things
  - Not every investment will pay off
- Be patient and understand the hazards of overreacting



# Conclusion

- Behavioral issues play a significant role in the investment decision-making process
- The more you understand about behavioral issues, the better investor you will likely become
- Working with a behavioral investment coach can help you gain a different perspective and may help you frame your decisions in a better way



# Predicting the Future

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# Upcoming Seminars

## Medicare Open Enrollment – What You Need to Know

Tuesday, October 4, 2022

1:00 PM

## Cybersecurity

Thursday, October 20, 2022

11:00 AM



# Thank You!

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