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Human Behavior And How It Impacts Your Finances

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Decisions regarding finances are often most consequential when we are busy, troubled, and flat out overwhelmed. In the past few months, many investors have made tough choices on the things most important to their financial goals, and this will likely remain in the months ahead. A large portion of the population is struggling to feed their family, let alone contemplating large life expenses such as buying homes, cars, saving for college or retirement and so forth. So the question is…how does decision making change during these times? Or, how often do investors choose to do nothing and "ride out the storm"? And, is that the right decision? This is where diagnosing your own decision making can help improve the chances of creating better outcomes in the midst of the chaos that is life.

We want to make easy decisions, which is how habits are formed. Think about where you would sit for dinner at home, order from a restaurant, or buy coffee. The booth by the window, the #9 at the lunch place, and a breakfast blend with 2 sugars and no cream. Habits are easy to keep and even more difficult to change. Are habits always what we really want to be doing? The benefit of these routines is that they dramatically decrease the amount of decisions that are necessary to make in a day. Habits fortunately are maintained with little mental effort involved, which is why they are so easy to repeat.

These easy decisions fit within our behavior and intuition when we are confronted with multiple, new choices.

If a coffee and donut cost $1.10 together and the donut costs $1.00 more than the coffee. How much does the coffee cost?

Many immediately answer with 10 cents, it's intuition and automatic thinking. When you take a moment to think through the problem and do the math, you see the coffee is 5 cents. Our habits, gut instinct, and quick thinking can lead us to decisions that feel right initially but when you look back on the choices and slow down you see you could have done things differently.

Investors find themselves in these situations frequently these days. Is it time to sell? Is it time to take risk? Is it time to stay the course? The common response to the questions are usually a part of quick thinking and habits that have been learned along the way.

If an investor is holding on to a position that's down 20 percent from its original value. How willing are they to hang on to that investment to see it back to a profit? Generally, investors are risk takers when they see losses recover to break even. Is that the investment that's most likely to return the best going forward? Or, should they look for alternatives?

If an investor is at all-time highs in their accounts. How quickly will losses affect how they feel about their portfolio? Does that cause and investor to sell to keep what they had gained? Investors are generally risk averse with gains they've created to protect them.

As the markets, policies, and needs for the investor change does it make sense to just do nothing? Is what they have the right thing for the current markets? Are they taking too much risk? Are they on track for what they need? The inefficiencies with quick decision making have measurable impact on performance over time.

From 1990-2016, an individual investor on average lost 1.6% on returns against equity benchmarks and 1.3% against bonds each year. A person who owned a mix of stocks and bonds typically underperforms by 1.8% in that same time frame, according to a 2017 report from Advisor Perspectives.

Investing is a coordination between your financial goals, the amount you've saved, and the time to grow those assets to reach said goals. This means they must slow down and consider all the parts of an investment decision to give yourself the best chance to reach the ultimate vision of success.

Continue to ask yourself the tough questions, like how much risk is needed to realize my goals. How do investors adapt to changes in markets and policies to keep their money moving in the right direction? Has a plan been created and written down to help an investor stay disciplined to their goals?

The more we can slow down our thinking and consider our financial choices, the more we can objectively make decisions and hopefully lead to a better outcome.