Episode #246: How to Think like a Successful Investor

Video Transcription

Welcome back, everyone. My name is Jack Cockrell here with another "Money Script Monday" coming from LifePro Asset Management.

I work with the trading and research team here at LifePro Asset Management, and today I want to take you through three mental barriers to investing and ways to combat them, and how you can utilize all the proper tools to make sure your investing approach becomes successful.

So, the first one we're going to jump into here is called loss aversion. And basically, what that means is that investors will try anything to avoid realizing a potential loss, right?

I'm sure we've all done this, whether it's investments, or, you know, any aspect of life, I'm sure I've tried to avoid a loss before. And really what it is, is that, in our minds, as humans, we feel losses much greater than we feel gains.

If you've ever been up on a stock, you know, it's great, it's fine, you log in, it's there, you're happy.

But if you are down on a stock, you're logging in every day, you're looking at it, it's front of your mind all the time, and you want to know what's going on, what I should do next, versus when you're up, it's, kinda, just, you know, don't worry about it as much.

It really breaks down to the break-even mentality. And what that is, is basically we'll try anything to make sure we don't realize that loss so much to the point where maybe we'll set, you know, we're going to break even on it, and then we see it drop a little bit more.

We're like, "Okay, well, maybe if I just get back to where it was before when I thought I was going to break even on it," and then it might drop a little more.

Then we're just setting these arbitrary levels all the way up trying to just make ourselves feel better about taking this loss. And we might follow something down way more than we should and it just shows improper risk management, honestly.

The next one that we're going to talk about here is commitment. And you might feel this whether it's a commitment to something in your personal life, or in this case, we're going to talk about investments, obviously.

What this really boils down to is maybe you've had a stock, whether or not it's working for you or not, or you just have the hardest time letting go of it, right?

Maybe it's been passed down from generations, from your grandparents or something of that nature, or it's just a company you really like and for whatever reason, the stock just is or is not working for you, is generally where this commitment factor comes in.

Really what happens is that we're afraid of the unknown, we're afraid of that opportunity cost and transitioning out of this and saying, "Oh, as soon as I sell this thing it's going to go up." Again, it's just taking way too much risk because of a mental bias when really we should be more focused on finding what's working.

Secondly, you have this confirmation bias. So, basically, you will look at the stock, you know, every day you'll want news feeds, you want news flow, but really, you're looking to stay where you're at, right, you like this stock.

You're not looking for reasons to necessarily leave this position, you're looking for reasons to stay in it. So, when you're in a position like this where you have this commitment bias going on, you're going to weigh the information that is confirming that you should be in this more than confirming that you should consider alternatives and it leads to a skew in your thinking.

The final one we're going to talk about here is the effects of groupthink. And it's fairly self-explanatory here. But basically, you have a situation where the flow of information or the flow of ideas is not open and honest.

So, you might have repercussions if you bring up a negative aspect of an investment or you might have repercussions if you bring up positive aspects of whatever it is you guys are discussing. And I'm sure you've all been in a group like this at your job, whatever it might be.

This comes up very often when you're scared to step up and speak out against a group. It's a very strong psychological thing that does not just present itself in investments.

Now that we've covered the three actual biases, let's talk about ways that we can, kinda, diagnose them and start to combat these things. They're nasty and we need to get rid of them.

The first one for loss aversion, we want to be able to set defined risk management parameters both on the upside and the downside, so we don't get overconfident or start clinging to straws when we're down. The first way to do this is you set some limit orders.

You have a plan when you go into an investment of how much do I ideally want to take if I'm down, how much of a loss do I want to take, or if I'm up, how much do I want to make? You basically set some hard limits here.

It ensures that it takes the bias out of your thinking because it's just the computer at that point making sure you follow your thinking on day one of the investment versus when it's euphoric when it's up or when it's really bad when it's down and you wish it wasn't.

The next thing you can do about loss aversion is to have a long-term mentality. And it really helps to think of these periods of volatility as simply that, just a period of a long-term trend that looks less than okay but will eventually return to trend, historically speaking, at least.

With commitment, there's a very simple fix in theory but very hard in reality and that is to approach a situation as if you've never seen it before, what would a person who's never seen it actually do in this situation?

What you're trying to do here is diagnose issues without having that preconceived bias of, "Well, I like this because I have a personal interest in it." If you approach it with no personal interest, theoretically, you should be able to make a more logical decision and ultimately control your risk management better.

Finally, with groupthink, open and honest communication. It's as simple as that. You need to have an environment where you can discuss the positives and the negatives of an idea, whatever the idea might be, in this case, it's investments. And you need to be able to discuss that freely and make sure you've considered all aspects of a trade or of an investment strategy.

There's one final tool that you can use to address all three. And that's where a financial advisor comes in. When you introduce a financial advisor to your investment strategy or your investment accounts, you instantly get this jack of all trades in your toolbox that will offer... You can outsource your risk management.

Basically, they'll be in control of, you know, how your money is invested and take out some of that personal bias you might have when the advisor is ideally the more experienced person in this industry and has the know-how to basically weather through some volatile periods.

The second thing an advisor can help with, with that loss aversion at least, is they can help you through that long-term vision with your investment planning so that periods of volatility are, again, just simply periods and not your reality.

When it comes to the commitment, an advisor can step in as that unbiased, never-seen-the-situation-before third party, they can go in, diagnose the pain points and tell you right away if this strategy is for you, or if the risk is simply too much or too little for you, and they can make a very quick judgment whereas it's very hard to implement that strategy yourself.

Finally, with the groupthink, you have a personal representative you can go to for unbiased and very accurate information, both the negative and the positives of any investment strategy that you might be thinking of, and it's a very effective way to make sure your risk management and all aspects of a plan are considered before you fully invest your money.

With that, I want to ask you to reach out to a financial advisor. If you don't already have one, make sure you go and talk to at least a few, get a feel for the services they offer and how they interact, and make sure it's a good fit.

If you do have an advisor, reach out with any questions you might have regarding risk management, your plans, or what you might think is coming for your investments. If you have changes to your plans, advisors are here to listen help and make sure your risk management is controlled as effectively as possible without any of these biases happening behind the scenes.

Thank you, everyone.