

# Financial EXCHANGE

Questions? - We invite your participation. Send inquiries to: [financialexchangefeedback@manulifesecurities.ca](mailto:financialexchangefeedback@manulifesecurities.ca)

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Most individual investors, no matter how knowledgeable or experienced, eventually fall prey to psychologically induced biases that cloud their judgment and lead to poor investment decisions. None of us wants to admit to being irrational. But human beings have emotions, and it is extremely difficult to keep these emotions from playing havoc with your investment program. In addition, investors generally lack the ability to measure risks and rewards ac-

curately; most people are simply not hardwired to understand probabilities. The good news is that there are simple strategies that prevent emotions and cognitive errors from derailing your investment program and keep you on track to meet your goals.

## 6 Common Investing Mistakes

### Loss aversion

If you are like most people, you are not risk averse. You are perfectly willing to take on risk appropriate to your circumstances in exchange for the potential for extra return. But what happens when instead of providing this extra return, your stocks go down? The natural tendency is to hang on to losing stocks in the hope

## Investing Mistakes

that they will rise again. This is because people are loss averse, not risk averse.

### Anchoring

This refers to our tendency to latch on to a figure that should have no bearing on our decisions. Investors often anchor to their purchase price and judge subsequent price changes in relation to this value. Anchoring can adversely affect performance, as investors are reluctant to sell investments for less than they paid and/or sell winners too quickly.

### Mental accounting

Investors generally look at investments separately rather than in aggregate. This can result in a cafeteria style of investing whereby their portfolio consists of a hodgepodge of poorly diversi-

fied investments with no overall plan.

### House money effect

Derived from the gambling term whereby gamblers take greater risks with winnings than their initial bets, in the investment world this refers to a version of mental accounting where investors have one mental account for their initial invested capital and another for profits or earnings. This often results in investors taking on undue risk after making a gain.

### Herding instinct

Also known as crowd psychology or peer pressure, we buy what everyone else is buying. That way, if the investment doesn't work out, our ego is protected, since everyone else was buying it too.

The technology run up of the late 1990s is a prime example of herd mentality in action. We all know the outcome of that story.

### Overreaction

Investor overreaction to new information and market events has a powerful effect on stock prices. Earnings announcements are a prime example. If a company's earnings fall below expectations, investors can be quick to express their dissatisfaction with management and oversell the stock. Taken to the extreme, investor overreaction can lead to stock market bubbles and crashes.

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With a new year upon us, this can be an ideal time to examine your financial health and update your financial plans. Your finances can be overwhelmingly complicated if you let it be complicated, otherwise, it will be as simple as eating your daily

## Finance Is Simple, Keep It Simple, 20 Simple Money Ideas

lunch if you are on top of it. I've listed some simple fundamentals to keep in mind starting from day one of this New Year.

- Live simple and buy used when possible, aspire less and consume less
- Earn more, invest more
- Pay off credit cards in full every month
- Spread your risk and diversify your investments
- Don't let a single cent go out of your pocket due to your negli-

- gence
- Make a budget and stay within, keep track of your spending every month
- Keep track of your net worth regularly
- Be insured for health, home, auto and life
- Teach your kids about finance as early as possible
- Involve your entire family in financial planning
- Set long-term and short-term saving goals

- Less clutter and more space in your home
- Less expensive vacations and more time spent on family outings
- Family first, money second
- Health first, money second
- Plan yearly targets to achieve goals
- Earn money by doing what you love
- Home cooked meals save money compared to dining out - remember most meals can be prepared in about 15

- minutes
- Sign up for lifelong learning - it keeps your mind active
- Be and feel rich socially, emotionally and spiritually

A new year is unfolding...Let 2012 be your most prosperous year yet!

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