Investments: Psychology of Regret and Investing

The Psychology of Regret and Investing

By: Joe the Investor

Do you find that you make investment decisions and regret doing them after the fact? Do you find that this situation becomes paralyzing and you feel as if you cannot earn the most from your decisions? Alternatively, do you find that you set out on one investment course, only to find yourself changing it as the waves of the situation change, and the results are not very productive?

This situation may be illustrated best by an example. You decide that ABC stock is a good investment, and it is trading at $10. You buy 1000 shares which means that you invest $10,000 in the stock. You expect it to go up 30%, and then you want to sell it for $13,000 within a year's time. A month passes and the stock goes down to $9. Are you feeling any regret at this stage? Are you willing to sell the stock at $9, and take a $1000 loss?

Many people will look at this situation and go into some sort of denial. They will say things like "Yes, I expected to sell it within a year, but it is now a long term investment." Another common thought is "when the stock goes back up to $10, I will sell it." This last statement does not account for the possibility that the stock may not reach $10 for years, and you will have to sit and wait. You will notice that the original strategy was changed to suit the new reality since the stock was purchased. The path has been altered both in time and in dollar amount expectation. Instead of selling at $13, the person is now willing to sell at $10 to get their money back. Instead of 1 year, this person is now willing to wait indefinitely to see a return on their money. This represents an opportunity cost - should that stock stay down for many years, those years of return would be lost on another opportunity that might have been more profitable.

If we take this example further, assume the stock tumbles down to $6 a share. This person may now stop watching the stock, and call it a "tax loss opportunity". The stock is now been written off and the money is called "dead money". Should an opportunity arise for a sale at a higher price, the person may take the opportunity, even if the price of the stock was sold at less than the buy price! This mentality is justified by saying: "this stock was dead, and now I received some unexpected gain from it, so I am pleased."

What actually happens is that people start with an initial strategy, and then adjust for the expected reality that they face later in time. As the reality changes, so does the next expectation. If we went the other way, and the stock surged to $15, what would be the mindset? If this happened in about a year, the person might say "I know I said I would sell it after 1 year, but since the stock is higher than I thought, let's wait longer and see what happens. The minute the stock goes below $13, I will sell it." This has gone from regret to greed. But regret can occur for losses or lost profits that you didn't expect initially, but then start expecting once you believe you would receive them. Let's say this stock continued on up to $20. The greed may become overwhelming, and the person might say "Gee, I made $7000 more than expected ($20,000 less $13,000 originally). This thing might go to the moon. I should double down on the investment. If it starts to go down, I can sell the whole lot and still come out ahead." Should this stock then plummet to $11, the person may go back into regret, saying "I was up $7000, and now I am down $2000. I will have to wait until the stock goes back up above my breakeven price, and then for sure I will sell it." This may lead to more "dead money" as people would hang onto larger losses using the same regret analogy as before.

There was a situation when the author purchased some options on JDS Uniphase stock back in the mid 2000's timeframe. These were long term options which lasted 2 years until expiry. The stock itself plunged more than 50%, making the options worth something only as a possibility of the stock rising again in 2 years. The stock did not rise again until the very last trading day before expiry, so these options which were worthless for 2 years, actually had a positive value on the final trading day of their existence! The options were sold with 2 hours left until their expiry, yielding a grand total of $50 US after fees. The author who sold these options bought a steak dinner with this money, and was elated because this money was "free". The money was not free – it resulted from a loss of $2000 on the original investment which was cut to $1950 in the last trading session. Since the expectation was for a loss anyway, this steak dinner was wonderful indeed. Such as how regret works!

What to do about this psychology? When you are thinking about buying a stock, go through the possible scenarios in your mind. What if the stock goes up? Will I be disciplined enough to sell at the price I am thinking about today? If I don't, what reason would allow me to change my course and expect a higher price? You would in effect be re-evaluating the situation as if it was new and asking yourself again: Why would I buy this stock? Then go through the alternative scenario: what if the stock goes down? At what point would I give up and sell? What reasons would allow me to keep the stock and expect it to rebound? This does not mean that you never change your mind after investing money. What it means that you would change your mind if there is a good reason to do so, and you are not just covering up some poor decision by justifying a change in expectation. If the original stock in this example went from $10 to $20 because the earnings tripled and this is likely to continue, you will likely have to change your initial analysis. If this stock goes down due to some structural event within the company, and the value of the stock should be lower, than you should change your analysis there as well.

You have to be honest with yourself here. If you say you will sell at a given price, and you have seen greed take over you in the past, you may not keep your promises in the future. Ask yourself what promises you can keep and stick to those limits. If you are very risk averse, and you tend to hang onto losses for a very long time, you may either buy fewer stocks, or may want to automate the sells so that once a target is hit, you will sell automatically so your mind does not play games with you. How you handle decisions with investing will also be how you handle other decisions in life, since the mind does similar tricks in all areas of life. If you tend to hang onto a lot of clutter, you may also be hanging onto a lot of old losses, or other past regrets. If you tend to sell out at the first sign of any gains, you may be shortchanging or sabotaging your life in other areas as well. It is the same mind that decides things in all scenarios, so unless there is some specific trauma when it comes to investing, these patterns will serve to allow you to know yourself better in all decisions.

Contact me, Joe Barbieri by email at joetheinvestor.today@gmail.com, or by telephone at 647-286-8020 for an independent consultation on what your options are. **Note: This article is intended for people who want to learn about the world of finance and how to research for themselves. If you would like to buy or sell investment products, or specific advice on investment products, tax or legal issues, please consult your investment advisor, accountant or legal counsel.**