BEHAVIORAL & FINANCIAL INSIGHTS

Improving Investment Skill

Portfolio returns and achieving financial goals are largely a function of two inputs: investor skill and luck. Oftentimes, those inputs get confusing – identifying what is skillful and what is luck/chance.

A basic rule of thumb is that anything you cannot personally control is luck. Investors dedicate a significant amount of time, attention, and energy to things beyond their control; in other words, we often confuse luck for skill. We should be focusing more on the things we can control – the things that rely on skill.

Investment skill is often demonstrated through patience and discipline. These are not easy qualities to develop. The three tips below may make it a bit easier to improve investment skill.

1. **Increase Conviction in Your Strategy**. Many investors make investment decisions based on a "gut feeling," expected quick gains, or perhaps something they heard or read. If we don't know why we own something, we are much more likely to be influenced by short-term news, market movements, and our emotions. Having conviction in your strategy can provide the strength and courage to remain disciplined during difficult times.

2. **Know Your Emotional Limits.** Everyone is different. Some people are more susceptible to uncertainty and loss than others. Don't pretend to be someone you are not; a lot of money is lost because we act like the person we wish we were rather than the person we are. Once you identify your limits, we can tailor an action plan to give you the best probability of achieving your financial goals in the desired time frame.

3. **Create a "What If" Plan.** The markets never go straight up. Significant pullbacks, recessions, and even crashes are inherent features of capital markets. It's not a question of if, it's a question of when they will happen. During those times our emotions run high and making a thoughtful decision is very difficult. For that reason, it is helpful to create a "precommitment plan" – a decision plan for what to do if X happens. That way when things become difficult, it's not about deciding what to do, it is simply acting on what you have already decided to do.

Taking the emotion out of decision-making helps us think more clearly and deliberately about our choices and their tradeoffs. Increasing investment skill isn't about ego or brute strength. It is about thinking realistically about who we are, what we are going to face, and having a plan to get us through the tough times. That's what we do, and we do it well.