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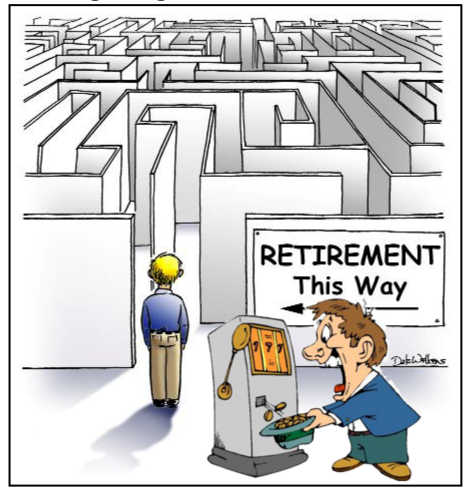
How not to be your own worst enemy

Navigating the Retirement Maze



"Investing is simple, but not easy."

- *Warren Buffett*

Ladies, let me first apologize that this month's column is not intended for you. It's aimed at the men in your life, particularly the ones who view stock picking as a non-contact sport (save for the noticeable bruises that it may leave on their bank accounts), and who envision themselves as the next Jesse Livermore. So feel free to clip this article out of the newspaper and slip it between the pages of your husband's copy of *Investors Business Daily* or *Wall Street Journal*, and hope that he reads it before firing up his E-Trade account on the computer.

Your brain on stocks

Guys, let's start out with a quick lesson in physiology and evolution. Our brains are essentially the same as those of our ancestors 30,000 years ago, who survived natural selection by being clever enough not to get eaten by saber-tooth tigers. Unfortunately, this gray matter is not optimized for stock trading, so you need to be aware of your inherent limitations. Daniel Kahneman, a psychologist, won the 2002 Nobel Prize in Economics for his work on the irrationality of economic decision-making. He identified nine specific biases that impair our judgment in financial situations. I'll touch upon a few of the more important ones, and hopefully spare you some stock market angst down the road.

Know when to fold 'em

Expert traders – the ones who make the really big money – often have more losing trades than winning ones, and still manage to come out ahead. (A well known Boston trader was successful enough at this to buy both the Boston Red Sox and the Boston Globe.) How do they do this? They let their winner run, and cut their losses short. Even the experts are wrong a lot of the time, and they stay solvent by selling their mistakes before they lose too much on them. The best professional poker players use the same approach. A single 100 percent gain can cover a lot of 15 percent losses.

Have you ever uttered the phrase: "I'll sell it as soon as I break even"? Then you're guilty of the behavioral bias known as "loss-aversion." It's where people tend to be more sensitive to losses than gains, and thus often delay selling a loser in the hope of eventually recouping their loss. Problem is, if a stock falls to half of what you bought it at, you now need a 100 percent gain just to break even. (Remember Enron?) Do what the pros do: Set a percent loss limit (e.g., 20 percent) and stick to it, taking emotion out of the decision. Sell your losers and move on.

Don't follow the herd

Merrill Lynch may highlight the "thundering herd" in its commercials, but you don't want to be part of it. If you find yourself glued to CNBC's "Fast Money" and buying or selling stocks based on that information, you've already lost. By the time you've heard the news, the pros have already made their trades. Individual investors also have a tendency to overreact to financial news, which is why the Dow Jones day chart looks like an EKG of investor emotion.

A study on business news determined that less than one percent of news items had a material long-term impact on the stock market. The other 99 percent? Fodder for day traders. The best strategy is to buy stocks when everyone else hates them and is out of the market. Then just hold on and wait for the market to come back. This not-so-secret (but seldom used) formula for successful investing means buying assets when they are cheap, and sellling them when they get expensive. Period.

Think outside your comfort zone

Ever wonder why conservatives like to watch Fox News, and liberals prefer MS-NBC? It's known as "confirmation bias," which is where people tend to be more receptive to information that confirms their preconceived opinions about a subject. In investing, discounting information that might indicate you've just purchased a lemon can be hazardous to your wealth. Try to stay open-minded, or else your beliefs may cost you dearly. Be willing to be proven wrong, and then correct your mistake.

Why women are better investors

I hate to break it to you, guys, but on average, women earn 1 percent more per year on their investments than men. Are they better researchers? More astute traders? Posses some sort of sixth sense of investing? No, it's mostly because they don't trade as often as you do. Bragging rights about a stock trade has a high price when it comes to investing. Consider the advantages of long-term investing, and use the time you've now freed up to do something fun.

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