M&G Investments
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4 Ways we Fool Ourselves when Investing

While we may enjoy fooling our family and friends on April Fool's Day every year, nobody ever likes to think that that they fool themselves. We like to think that we're rational beings who make logical, unbiased decisions by weighing all the facts and then reasoning to make the most sensible choice. While this might be true in some situations, research has found that the more complex the choice, and the more uncertainty around the subject matter, the more emotions can influence a decision.

There is no doubt that investing can be complex: there are numerous variables to consider when choosing how to invest. Equally, conditions are largely uncertain, since no one knows the future, and financial markets reflect these uncertainties, as well as human biases and sentiment, in their pricing. This is how mispricing arises in securities, creating buying and selling opportunities for astute investors. These investors take advantage of the "foolishness" that can arise in market prices from time to time.
So, what are some of the ways that we fool ourselves when investing?

We're overconfident
A common pitfall to be aware of when investing is overconfidence. It can make investors overestimate their knowledge, underestimate risks, and exaggerate their ability to choose the right investments and predict the future. In many aspects of our lives, confidence is considered a strength. In investing, however, a little humility can go a long way towards making good investment decisions.

We think we can separate our emotions from our thinking
A long-held view in the field of social psychology is that emotions and thoughts are separate entities. This led to the idea that people can make decisions without any emotional influence.

However, more recent research has shown that while emotions and thoughts are different processes, emotions continually interact with and inform thoughts, judgments and decisions. There's no escaping our humanity, even given the best training and information.

We're attached to our investments
When people invest in anything, there's the risk of becoming attached to it. This holds true for a property investment, an investment of time and effort in a relationship, and an investment into the markets. This is especially so if we've spent time investigating and weighing up our options before finally making a decision. The problem, of course, is that our ownership can blind us to the fact that our decision hasn't turned out well, and then we may end up "throwing good money after bad," and not only losing our original investment, but possibly more as well.

We indulge in wishful thinking
Sometimes we want something so badly we simply don't pay enough attention to the facts. This can be driven by desperation: perhaps you didn't start saving early enough for retirement and now you need your portfolio to generate higher than normal returns to make up for lost time. So, you convince yourself that a particular investment will 'go through the roof', and you take a big bet on it, i.e. you invest a lot of your hard-earned capital. You're riding high on adrenalin, and you've persuaded yourself there's no way this investment can lose. But then it does.

What is the solution? Well, there are a few things you can do to mitigate the impact of these pitfalls, the first of which is awareness. If we're aware that we can be influenced by these and other ways that we deceive ourselves, we can watch out for them. Of course, that can be easier said than done, so strive for progress, not perfection!

Second, make sure you have a plan. It's very easy to second-guess yourself when markets are being driven by sentiment. Fear and greed are very strong emotions that can have disastrous effects if you let them take hold. Having an investment plan that encompasses short-, medium-, and long-term investment goals can keep you on track.

Then, engage the services of a qualified, independent financial adviser, who can help you check your thinking and your plan, and ensure that your decisions are sound. We've laid out the benefits of having a financial adviser in our article "What's the value of a financial adviser?".

Avoiding the foolish mistakes can be challenging, especially when we're unaware of it as an investor. Why not consider investing with a global investment manager that has a track record of consistent investment performance generated by a team of experienced professionals, as well as access to Artificial Intelligence (AI) backed funds. Visit our website for more information.

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