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REGRET AVERSION: FIGHTING FINANCIAL "FOMO"

Regret aversion is a construct in behavioral finance theory that suggests investing decisions are, at least in part, driven by fear of later regretting a "wrong" choice. And this isn't just some psychological mumbo jumbo. Functional MRI neuroimaging studies of the brain have demonstrated a biological correlation to this phenomenon. The fear is real — and it can have serious consequences for investors.

HOW DOES REGRET AVERSION IMPACT INVESTORS?

There's no singular effect of regret aversion on investor decision making because the fear of regret may relate to either taking action or not taking action. And that fear may translate into greater risk-taking — or excessive attempts to minimize risk.

Carried on a wave of exuberance and fear of missing out (FOMO), investors may jump on a "hot stock," even when the purchase is not rationally justified by its underlying fundamentals. Or they may avoid engaging in the market altogether after going through a painful downturn, missing out on typical recovery cycles. Regret aversion can also lead investors to hang on to a poorly performing investment too long, not wanting to lock in losses, even when that's exactly the decision that's called for to achieve a better long-term result.

While regret aversion can motivate us to take positive action, such as starting up a fitness routine to avoid regretting the health consequences of not taking care of ourselves years from now, it's not a sensible approach to making most investment and retirement planning decisions.

SO, WHAT CAN BE DONE?

1. Recognize regret aversion. Learning to identify and combat faulty thinking can help you make better personal finance and investment decisions. Remember, staying invested in times of market turbulence will help you participate fully in potential market gains. While there is never any certainty in the market, it is worth noting that some of the sharpest market declines were followed by steep rebounds.

2. Review Your Portfolio. Focus on establishing and adhering to a sound investment decision-making approach rather than trying to see around every corner along the way. Know your investment mix and be sure you are invested in the appropriate asset classes (based on your risk tolerance and time horizon to retirement). Volatile market periods reinforce the need to diversify (while diversification does not guarantee against loss of principal, it can help spread your risk among different asset classes and market segments).

3. Foster an attitude of acceptance. An investment strategy wholly oriented around the goal of avoiding regret might not yield the results you desire. Taking on some degree of risk is inherent in pursuing higher returns. Just because an investment decision didn't pan out doesn't necessarily mean that it was a "bad" one. No one has a crystal ball. And we shouldn't abandon sound principles just because they can't promise success 100% of the time.

4. Leverage regret aversion to improve your beneficial investor behavior. Even with education, sometimes you simply can't completely "deprogram" regret aversion from your brain. And if it's going to exert some influence, make sure you use it to foster positive behavior such as taking advantage of your company's retirement plan enrollment as soon as available, increasing your contributions, and investing appropriately.

5. Consult with a Professional. Don't go it alone. Financial planning resources are available through MCF Advisors, at no additional cost to you. Take advantage of complimentary individual meetings with our dedicated MCF Retirement Planning Specialist today!

Bottom Line

We've all had situations in life when we did the "right" thing but didn't get the result we wanted. Regret is natural. And it can even be helpful when it motivates us to make better future decisions. Regret in itself isn't the problem — the excessive fear of regret is.

Source: https://www.researchgate.net/publication/7645216_Regret_and_Its_Avoidance_A_Neuroimaging_Study_of_Choice_Behavior

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