Your Emotions When Investing Can Cost You Big

By Karen Riccio

A single Truth Social post by President Donald Trump about Greenland sent the stock market into free fall on Jan. 20. Twenty-four hours later, another one sparked a 700-point rally on the Dow.


Riccio

Inflation figures hadn't spiked unexpectedly. **Nvidia (NVDA)** didn't warn investors about the imminent downfall of AI. Nothing concrete or measurable happened. Trump simply changed his tune from one day to the next, something that investors should expect at this point in his second term.

It wasn't the first time a few words triggered schizophrenic market reactions, and it won't be the last.

We know this thanks to independent research firm Dalbar, publisher for more than four decades of the annual Quantitative Analysis of Investor Behavior (QAIB) report.

The findings are sobering and consistent. For the past 20 years, the average investor underperformed the S&P 500 by 1.11% annually. The evidence points to behavioral mistakes as the cause.

In 2024, the S&P 500 delivered 25.02%. The average equity fund investor? Just 16.54%.

So, if you're of the mindset that you can time the market better than professionals, think selling during downturns protects your wealth, or assume that market-beating investors do so by picking better stocks, you're in for a rude awakening.

The biggest threat to your portfolio may just be your own behavior. You might want to invest in a mirror.

The 2024 gap is the fourth-largest underperformance by retail investors since Dalbar began tracking behavior trends in 1985. The only years with larger gaps were 1995, 1997, and 2021.

And it's not because people picked bad stocks. It's because they bought high and sold low, letting fear and greed dictate their decisions and timing.

But that single-year gap (10.35% vs. 9.24%) barely hints at the real damage.

It gets far worse. The more assets you own, the more damage your emotions can inflict on your long-term goals.

Let's say you started with $1 million 20 years ago. You bought the S&P 500 through an index fund and held it. You didn't panic or chase hot stocks. You stayed on top of the news, but didn't react to every popular or unpopular headline. In that case, your cool million would be an ice-cold $6.88 million today.

However, if you had a heated reaction to news and moved in and out of positions based on how you felt, you'd be left with $5.84 million. That's more than $1 million in lost wealth due to your own emotions and behavioral slips.

Even over just the past decade, investors who reacted to every market scare underperformed disciplined investors between 1% to 2% annually, according to Dalbar and Morningstar's "Mind the Gap" research.

That difference over a 10-year period can cost hundreds of thousands of dollars in a typical retirement account.

Bad Timing

Here are a few examples showing how behavioral mistakes often show up at the worst possible times.

2008-2009 financial crisis: You might recall when U.S. stocks plunged 50% during the 2008-2009 financial crisis. Investors who panicked and sold locked in those losses. Investors who stayed the course — or better yet, bought more — recovered and then some.

March 2020 COVID-19 crash: The S&P 500 fell 34% in five weeks. Investors who sold in late March and waited for "clarity" missed the fastest recovery in market history, a 100% gain from the March 23 low through year-end 2021.

The 2022 bear market: The S&P 500 fell 18% by midyear. Dalbar data shows the average investor underperformed by 1.5% that year. Again, not because their funds did poorly. Instead, they sold in June and didn't get back in until late 2023.

Dot-com bubble (2000-2003): Investors who chased tech stocks at the peak and then sold during the decline underperformed buy-and-hold investors by an average of 7% annually during that period.

The historical pattern is consistent and predictable: Fear drives selling at the bottom. Greed drives buying at the top. Combined, they destroy long-term returns.

Don't beat yourself up if you can relate to this type of irrational behavior. You're human, and as such, you are wired to make these exact mistakes.

How does his happen? What behaviors set us up for failure? No one wants to lose money, which is why the behavioral problem known as "loss aversion" is the first culprit.

Research shows we feel the pain of a loss approximately twice as much as the pleasure of an equivalent gain. So, when the market drops, even temporarily, panic kicks in. You want to stop the bleeding, so you sell. That locks in the loss right before the recovery begins.

Another culprit that compounds the problem is "recency bias." Whatever happened most recently feels like it'll keep happening forever. When markets rise for months, it feels like it'll last forever. You get aggressive. Then when stock prices drop, it feels like they'll never recover — again, even though decades of market history say they will. Stop feeling, and start thinking rationally.

Finally, following the herd can really cause trouble. Everyone's buying? You buy. Everyone's selling? You sell. And that guarantees you're buying at market peaks and selling at market bottoms. To build wealth, you should do the exact opposite, but it's not easy to contradict a herd in which you yourself are moving.

The Greenland whipsaw showed all three behaviors happening at once. Loss aversion created panic selling on the tariff threat. The herd mentality convinced investors that dumping stocks made sense. Finally, assuming that the worst would last forever, they lost out when markets turned euphoric just 24 hours later, a classic example of recency bias.

Even Small Losses Are Critical

Keep in mind that losses are asymmetric. By that, I mean the bigger the loss, the bigger the gain needed to recover. For example:

- A 10% loss requires only an 11% gain to recover.
- A 20% loss requires a 25% gain.
- A 30% loss requires a 43% gain.
- A 50% loss? That requires a 100% gain just to get back to even.

This mathematical reality makes managing risk and minimizing losses the foundation of long-term wealth building.

More importantly, while you're waiting for that recovery just to break even, you've lost something you can never reclaim: time.

Time is key to compounding. Time allows for doubling or tripling your wealth instead of just recovering from a self-inflicted wound. Unfortunately, I think most investors misunderstand this mathematical reality, underestimate it, or simply ignore it.

We live in a world of constant change. You name it, investors are worried about it: geopolitical threats, natural disasters, policy surprises, social media firestorms, tariffs, inflation, and recession, among others. Trump is simply a symptom of the problem.

The news cycle never stops. Every headline seems capable of triggering the next crash, or the next boom. New research from George Mason University suggests the behavior gap is actually widening in this age of constant online news flows.

Before COVID-19 struck in 2020, poor market timing cost investors approximately 0.53% per year, according to Dalbar. Since then, headline-driven panic has regularly triggered emotional reactions, short-changing investors roughly 2% to 3% per year in the post-pandemic period. That's huge.

Each headline tempts you to do something. You sell because it feels safer. You jump in because you fear missing out, the so-called FOMO trade. And each time you react based on emotion instead of a predetermined plan, you chip away at your long-term compounding potential.

The most successful investors won't be the smartest. They'll be the ones who are disciplined. The ones that follow rules and plans and strategies, who didn't let a single post cost them $1 million. ■

Karen Riccio has had a long career in journalism covering the financial and technology industries for InvestorPlace.com, ChangeWave, Business Financial Publishers, ETFtrends.com, Global Trends, Wall Street Daily, and Equities Magazine.