



BEHAVIORAL FINANCE

Bad Habits and Good Practices

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Good investing results require more than just good investments. They need good investors, too. This article lays out the three bad habits that the authors believe are the most common hurdles that keep bad investors from becoming good ones.

The first and most widespread bad habit is the natural tendency of investors to buy multiyear winners and sell multiyear laggards — whether asset classes, strategy styles, single stocks or funds. (This error contrasts with the practice of buying stocks that have risen a lot *in the last few months* — a widely accepted strategy called “momentum investing.”)

The second bad habit is the sin of under-diversification. Many investors underappreciate or underutilize the potential benefits of diversification in various ways. Others value it, but still have less in their portfolios than they think. The authors assert that the most serious diversification problems for institutional investors are home bias and excessive dependence on equity market direction.

The third common bad habit is a bias toward “comfortable” investments — limiting oneself only to individual securities or asset classes that are familiar or convenient. Such investments can be overpriced, and thus deliver lower long-term returns. Investors willing to step out of their comfort zones — for example, by using leverage, shorting or derivatives — can measurably be able to improve their risk-adjusted returns.

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