

The Biggest Investment Risk You Face Might Be Your Own Behavior

When you think about investment risk, market volatility or economic uncertainty likely come to mind first. But one of the most influential—and underestimated—risks is how you respond emotionally to what's happening around you.

Decades of behavioral finance research show that investor behavior plays a meaningful role in long-term results. Even with a sound investment strategy, emotional decisions can quietly detract from outcomes over time. Understanding common behavioral biases—and the research behind them—can help you recognize when emotions may be influencing your choices.

Loss Aversion: Why Losses Feel So Powerful

You may notice that losses feel more painful than gains feel rewarding. This tendency, known as loss aversion, was identified by psychologists Daniel Kahneman and Amos Tversky in their foundational work on Prospect Theory. Their research found that losses are felt approximately twice as strongly as equivalent gains (*Kahneman & Tversky, Econometrica*).

This instinct can lead investors to sell during market downturns in an effort to avoid further discomfort. While this reaction is human, acting on it can make it harder to remain aligned with long-term goals—particularly when markets recover after periods of stress.

Recency Bias: Letting Recent Events Shape Expectations

It's natural to expect recent trends to continue. Strong markets can create confidence that gains will persist, while downturns can make losses feel permanent. This pattern is known as recency bias.

Research highlighted by Vanguard and Morningstar shows that investors often move money into asset classes after periods of strong performance, which can lead to buying high and selling low over time. These studies help explain why investor returns frequently lag the returns of the underlying investments they hold.

Herd Behavior: The Pull of the Crowd

When a particular investment or market trend dominates headlines, it can feel reassuring to follow along. Behavioral finance research has shown that investor decision-making is strongly influenced by social signals and market sentiment, particularly during periods of market stress or enthusiasm.

Dalbar's long-running *Quantitative Analysis of Investor Behavior (QAIB)* report consistently finds that investors tend to increase trading activity during emotional market environments—often to their detriment. Following the crowd may feel comfortable in the moment, but it doesn't always align with your personal goals or time horizon.

Overconfidence: Believing You Can Time the Market

You may feel confident in your ability to anticipate market shifts or identify the right moments to act. While confidence can be helpful, overconfidence can lead to excessive trading or concentrated positions.

A well-known study by economists Brad Barber and Terrance Odean, published in *The Journal of Finance*, found that individual investors who traded most frequently earned lower returns than those who traded less. The performance gap was largely attributed to overconfidence and unnecessary activity.

Why This Matters More Than You Might Expect

The impact of behavioral mistakes can be significant. According to Dalbar's QAIB studies, the average investor has historically underperformed the broader equity market by a noticeable margin over long periods—primarily due to emotional decision-making rather than poor investment selection.

These outcomes are often driven by timing decisions: selling during downturns, chasing recent winners, or reacting to headlines. Over time, these behaviors can have a greater effect on results than modest differences in fees or portfolio design.

Staying disciplined, maintaining perspective, and keeping decisions aligned with your long-term objectives are critical parts of investing. A clear plan—and guidance from a trusted advisor—can help you navigate periods when emotions are most likely to influence decisions. Markets will fluctuate. How you respond can shape your experience over time.

A Closer Look for Pre-Retirees and Retirees

As you approach retirement—or are already living in it—market movements can feel more personal. After years of saving, protecting what you've built often becomes just as important as continuing to grow it. This shift can make behavioral biases even more influential.

Loss aversion may feel stronger when withdrawals are involved, as market declines can raise concerns about sustainability. Recency bias can cause recent market performance—good or bad—to overly influence expectations about income and longevity. Headlines and herd behavior may feel louder when your portfolio is supporting your lifestyle, and overconfidence can lead to unnecessary adjustments at a time when consistency matters most.

At this stage, investing is no longer just about returns—it’s about alignment. Aligning your portfolio with your income needs, time horizon, and personal priorities requires discipline, perspective, and a clear framework for decision-making.

Behavioral awareness plays a critical role here. A thoughtful plan, paired with guidance from a trusted advisor, can help you manage emotional reactions, avoid unnecessary changes, and stay focused on what your investments are designed to support—your life, not the market’s latest move.

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