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Loss Aversion and Fighting Fear

Loss aversion sounds like a good thing — trying to avoid losing. What could be wrong with that? Unfortunately, if taken too far, it can actually be a threat to retirement plan participants' long-term financial health. Loss aversion is the tendency to prefer avoiding potential losses over acquiring equal gains. We dislike losing $20 more than we like getting $20. Yet, this common bias can come with a heavy cost.

Excessive risk avoidance can hurt participants when, for example, it keeps their money out of the market and tucked away in low-risk, low-interest savings accounts — where purchasing power can be eroded by inflation over time. Delaying enrollment in an employer-sponsored retirement plan due to fear of market downturns can cripple opportunities for future growth.

Loss aversion can also lead to undue stress and anxiety. Participants stay invested, but worry constantly, which can create health and other problems. Finally, it can result in short-sighted decision making, causing participants to jump ship during volatile and down markets rather than staying in for the long term. All these things can greatly compromise retirement preparedness.

Fortunately, the fact that people are susceptible to loss aversion doesn't mean they have to succumb to it. It's especially important not to during periods of high market volatility. Here are five things you can recommend your participants do to fight the fear.

1. Understand it. Merely knowing about and identifying loss aversion tendencies can give greater insight and conscious control over decision making. Your participants should consider the potential consequences of loss aversion before making important financial decisions.

2. Take the long view. Maintaining a long-term outlook on markets can be helpful. Let your participants know they should look at historical trends and how investments have performed over extended periods of time. Otherwise, it's just too easy to get caught up in the latest financial fear mongering on the nightly news.

3. Don't obsess. Recommend setting limits on how frequently your participants check the performance of their portfolios and limiting consumption of financial news reporting. If the daily ups and downs of the stock market make their stomachs turn, suggest trying to limit reviews to quarterly performance reports instead.

4. Get an outsider's perspective. Your participants should consider speaking with your advisor — someone with more experience and greater objectivity. Participants tend to get very myopic when it comes to their own finances; it can help to seek out the advice of experts when they may be losing perspective.

5. See the big picture. Take a balanced view of the overall economy, which comprises a lot more than stock market performance. Factors like increased growth, low unemployment and low interest rates are all

favorable economic indicators during periods of volatility.

No one likes to lose, that's for sure. It's perfectly normal to prefer upswings over downturns, but the lesson is to not let fear take hold when it can compromise financial decision making and hurt long-term best interests.
