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Is Fear Diluting Your Savings?

Everything you want is on the other side of fear.

-Jack Canfield, Author and Motivational Speaker

Fear of negative investment outcomes can severely damage long term gains for participants of 401(k) plans. With the economic uncertainty the United States has faced in recent years, some level of fear is not surprising. However, investing for a successful retirement includes a balance of risk and reward as well as an established, long term, financial strategy. Attempting to avoid all volatility and potential loss can influence an investor to allocate assets far too conservatively, possibly resulting in inadequate retirement savings in the future.

Loss aversion is defined as "valuing the avoidance of loss over the accrual of gains".[1] Simply put, investors choose to avoid the probability of losses and pass up on the opportunity of higher gains. Studies on human decision making have led psychologists to believe that the anguish humans feel after investment loss is twice as strong as the pleasure we feel from an experience of equivalent gain.[2]

The increased media coverage on today's economy plays an important role in intensifying investor feelings of unrest. Feelings of turbulence in the markets have led many investors to more frequently check their portfolios and balances and to second guess their long-term investment strategies. On March 9, 2009, the stock market reached its lowest point. Throughout 2008, with the initial shock of this loss, many investors chose to sell their stock holdings in favor of the more predictable bond market. As of April 30, 2014, the S&P 500 is up more than 178% above the March 2009 low. While the equities market ascended into years of exceptional performance, the money invested in it recovered. Many investors that diverged from their strategy and moved their money out of the equities market have yet to recapture the money lost in 2009.

Simply being mindful of aversion to loss can help investors combat their fear and keep them on the track for a successful retirement. Investment education can also assist participants in making sound, long-term financial decisions. Participants must be empowered to determine their personal risk and retirement needs in order to formulate a financial strategy that will allow them to achieve their goals.

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[1] Lawton, R. C. (2013, August 28). 3 obstacles on the road to retirement readiness. *Employee Benefit News*. <http://ebn.benefitnews.com/blog/ebviews/3-obstacles-road-to-retirement-readiness-2735711-1.html>

[2] Hofschire, D., Emsbo-Mattingly, L., Gold, E., & Blackwell, C. (2013, February). Is loss aversion causing investors to shun equities?. Fidelity Investments. <https://www.fidelity.com/bin-public/060_www_fidelity_com/documents/Is-Loss-Aversion-Causing-Investors-to-Shun-Equities-retail.pdf>

Target-date funds are professionally managed funds based solely on an investor's age. Although not appropriate for all investors, target-date funds may benefit those participants that struggle with determining their personal investment strategy or fear they are not informed enough to decide amongst a slate of investment alternatives. This indecision can frequently be remedied by equipping participants with the tools needed to become educated investors and empowering them to feel secure in their investment decisions.

Fear of poor investment results can inhibit 401(k) plan participants from attaining adequate retirement savings. Realization of this loss aversion is necessary to overcoming it. Plan Sponsors providing educational tools on balancing risk and reward and the importance of diversification and providing age and risk tolerance based asset allocation models can help allay participant fears.