Decision Regret

One of the hardest parts of the decision-making process in any endeavor stems from the fact that there are no counterfactuals. You can't simply run a simulation and create a decision tree to show how different decisions and variables would affect the outcomes of each and every big decision you make.

This leads to what psychologist David Bell calls decision regret. In terms of our finances, this occurs when we focus on what might have been if we would have made a different decision with our money.

Bell performed a study where he offered two choices for a lottery. One would pay out $10,000 if you won or nothing if you lost. The other would give you a certain gain of $4,000. They found the subjects who chose to play and lost told themselves they were being too greedy while those who accepted the $4,000 wished they never would have known about the potential to win $10,000.

The money is always greener on the other side (or words to that effect).

Basically, there is always going to be *something* you can look back on with regret in regards to your money decisions. Sometimes you sell an investment that continues to rise. Other times you hold on and watch it come crashing down. Then there are all of those investments you failed to make which saw crazy gains.

This same decision regret permeates investor minds during almost all market environments:

What if I would have sold right before stocks fell?

Maybe I should hold off on contributions for a while until the dust settles?

What if I sell too early or hold on for too long?

How will I know if my strategy is just out of style or broken for good?

Maybe I'm taking too much risk...or maybe it's not enough?

There are always what-ifs in the investing game because there's no such thing as a perfect portfolio, optimized asset allocation, market equilibrium, or best time to make purchases or sales.

This second-guessing can really ramp up during market corrections as well (as markets have been known to do as of late). The biggest problem for investors in these instances is the dreaded hindsight bias, where we start to play the I-knew-it-all-along game.

My favorite anecdote on this issue comes from an old Warren Buffett letter from his partnership days in 1966. Following a huge bull market in the 1950s and early-1960s, stocks experienced a minor bear market from February through October of 1966, falling more than 22%.

Following this swift decline, some of Buffett's investors in his fund called to tell him they were nervous the market was going to continue its downward trajectory. Buffett's response to these worries was a great way to think through these market downturns:

(1) if they knew in February that the Dow was going to 865 in May, why didn't they let me in on it then; and, (2) if they didn't know what was going to happen during the ensuing three months back in February, how do they know in May?

Let me again suggest that the future has never been clear to me (give us a call when the next few months are obvious to you -- or, for that matter, the next few hours).

When losses begin to pile up in the markets investors invariably talk themselves into opinions and ideas that make no sense. We're pattern-seeking creatures who grasp for certainty, especially during those times when uncertainty seems highest.

But you don't know any more about the future when markets are falling as you do when they're rising.

A few thoughts on how to get over this idea of decision regret:

Diversification gives you a better chance of owning the top performers. Concentration can allow you to hit it big but diversification all but guarantees that you won't miss out on the biggest gainers.

Write it down. Keeping a log of your investment decisions -- why you're making them, how you'll measure the success or failure of said decision, the process behind it all, etc. -- is a great way to remind future you of the feelings you had *at that time* to avoid assuming 20/20 vision in hindsight only.

Let it go.[1] At some point you have to trust your process and build into it the fact that random outcomes can occur over the short-term. It's a strange feeling to allow for uncertainty in your process but it can also be extremely freeing in terms of stressing out and constantly trying to overthink the markets.

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Now here's what I've been reading lately:

- 35 steps to a market bottom (Irrelevant Investor)
- Worrying about market declines and valuations (Oblivious Investor)
- Be terrified (Reformed Broker)
- Strategic faith (Dan Egan)
- 3 social media tips for advisors (Think Advisor)
- When stocks and bonds go down together (Pension Partners)
- People get creative when explaining the market correction (Bloomberg)

[1]Yes this was probably a subliminal reference to Frozen since my 3-year-old has watched that movie roughly 496 times.