# YOUR FINANCIAL FUTURE

Your Guide to Life Planning

June 2011

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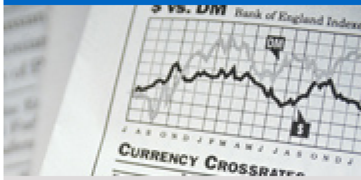
## In This Issue

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## Realizing Losses: The Psychology of Investing

*By Meir Statman*

I am reluctant to realize my losses and you are probably reluctant to realize yours. Rational investors follow the maxim "Cut your losses and let your profits run." They are eager to realize losses quickly while they are slow to realize gains. Why then are we disposed instead to sell winners too early and ride losers too long? The answer to the puzzle is in our cognitive errors of mental accounting and hindsight, our emotions of regret and pride, and our inner struggle for self-control.

Buying a stock marks a hopeful beginning. We place the stock into a mental account, record its $100 purchase price, and hope to close the account at a gain, perhaps selling the stock at $150. As stock fate has it, the stock's price plummets to $40 during the following month rather than increase to $150. This is only a paper loss, we console ourselves. The stock's price would surely recover very soon and climb higher. We do not need to acknowledge our loss fully because it is only a paper loss. We do not realize the loss yet by selling the stock. The mental account containing the stock is still open, keeping alive the hope that losses will turn into gains.

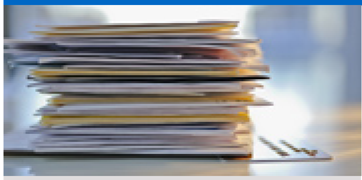
### Regret and Pride

We need not acknowledge our paper losses fully before we realize them, but we face them and they gnaw at us. We feel stupid. Hindsight error misleads us into thinking that what is clear in hindsight was equally clear in foresight. We bought the stock at $100 because, in foresight, it seemed destined to go to $150. But now, in hindsight, we remember all the warning signs displayed in plain sight on the day we bought our stock. Interest rates were about to increase. The CEO was about to resign. A competitor was ready to introduce a better product.

The cognitive error of hindsight is accompanied by the emotion of regret. We kick ourselves for being so stupid and contemplate how much happier we would have been if only we had kept $100 in our savings account or invested it in another stock that zoomed as our stock plummeted. Regret is painful enough when we face our paper losses, but the pain of regret is searing when we realize our losses because this is when we give up hope of getting even by recovering our losses.

Pride is at the opposite end of the emotional spectrum from regret. Pride accompanies the realization of gains. We congratulate ourselves and feel proud for seeing in foresight that our $100 stock would soon zoom to $150. Realizing gains by selling our stocks seals our gains and amplifies our pride. Regret is painful while pride is pleasurable, but both are teachers, warning us against behavior likely to inflict regret and encouraging us toward behavior likely to bring pride.

But sometimes the lessons of regret are overly harsh and the lessons of pride too encouraging. Stocks go up and down for many reasons and for no reason at all. We need not kick ourselves with regret every time stock prices go down, and we should not stroke ourselves with pride every time they go up.



**A rollover allows you to transfer your money from one qualified retirement account to another without incurring any tax consequences.**

## Rolling Over: The Benefits of Consolidating Your Assets

If you've recently changed jobs -- or maybe changed jobs a few times over the years -- you may be juggling multiple retirement plan accounts. While it's certainly acceptable to leave your money in your former employer's plan (as long as your balance is over $5,000, your old employer can't cash you out), in many instances it might be a better idea to consolidate your assets.

Consolidation can help make administering and allocating your assets much simpler.[1] Having your entire retirement portfolio summarized on one statement makes it easier to track performance and make changes.

But before you initiate a rollover, be sure to compare the investment options and their associated fees in your old plan with those in your new plan.

- Were you able to properly diversify your assets in your old plan?[1] If your investment choices were limited, you probably want to move your old account into your new account.
- Are the investment fees higher or lower than those in your current plan? If you were paying more at your old plan, it's a good reason to move your assets to a plan with lower investment fees.
- Are you satisfied with the investment choices and fees charged in your current plan? If you're not happy with your current plan -- and weren't crazy about your old plan -- you can always roll over your old plan assets into an IRA.

Initiating a rollover isn't difficult. First, check your current plan rules to confirm that rollovers are permissible (the vast majority of plans accommodate this feature). Then contact the administrator of your old plan (you can find this information on your quarterly statement) to get the ball rolling. Some plan providers have a simple online request process, while others require completion of a paper-based rollover form. Your current plan provider or IRA provider may even furnish a rollover service for you.

It's also important to know the difference between a rollover and a distribution. A rollover allows you to transfer your money from one qualified retirement account to another without incurring any tax consequences. A "qualified" account can be either your new employer's plan or a rollover IRA.

A distribution is essentially a withdrawal from your account. If you request a distribution, the account administrator is required by law to withhold 20% of your account balance to pay federal taxes. State taxes, if applicable, are also due. If you are under age 59 1/2, you will probably be hit with an additional 10% federal early withdrawal penalty.

If you have specific questions about your retirement plan distribution options, contact your employer's benefits coordinator or a qualified financial consultant.

[1]*Asset allocation and diversification do not ensure a profit or protect against a loss in a declining market.*