# 5 Mental Money Mistakes

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A few years ago, I met with a young man who we'll call Sam. He asked me a very simple question: "Why can't I ever seem to get ahead financially?"

I asked Sam to tell me a bit more about himself. He continued: "I'm a college graduate. I have a good job. I pay my bills on time and don't use credit cards. I don't spend money on frivolous things. So why can't I ever get ahead?"

Fortunately, after a deep dive into the state of his finances, I was able to help him find the answer: he made too many of what I like to call, "*mental money mistakes*."

What are mental money mistakes? They're subtle errors in judgment like basic oversights and miscalculations. As a rule, they tend to be subtle and easy to miss. I'm not talking about big mistakes like taking on a bunch of debt, spending more than you can afford, or being too risky with your investments. No, these are the kinds of mistakes just about anyone can make, even if they're intelligent, hard-working types like Sam.

This report will identify *5 mental money mistakes* many people make, as well as how to avoid each one.

# Mental Money Mistake #1: Forgetting to Plan for Unexpected Expenses

We all know the line, "Expect the unexpected." But how often do we actually do it?

The fact of the matter is that many people do a good job planning for *expected* expenses, like mortgage payments, health insurance, gas, and groceries. But when it comes to saving for the future—whether for your retirement or just that trip you've always wanted to go on—we tend to forget about all the *unexpected* expenses life tends to throw our way. And that's a mistake, because a plan that assumes nothing will ever go wrong isn't really a plan at all. It's more of a prayer.

With that in mind, here are five very common but usually unexpected expenses that many people fail to plan for:

1. **Unemployment.** Sure, no one wants to think about losing their job. But what if the economy goes south? What if the company you work for gets bought out? What if you or a family member gets sick and it becomes hard to work your normal hours? You have to admit, none of these events are exactly unheard of. So ask yourself: do you have a plan for what to do if you lose your job? Do you have any fallback options lined up? Do you have enough money saved up to help you stay afloat until you get back on your feet?
2. **Long-term or life-changing illness.** If there's anything unpredictable in life, it's our health. But even if you have health insurance, an extended illness can drain your savings in a hurry.

3. **Car repairs.** You know it will happen one day: the strange *clunk-clunk* sound you start hearing from your engine ends up being a problem that will cost hundreds, maybe even thousands, to fix. If that happens more than once you could be in big trouble.

4. **Your bills keep going up.** What goes up does *not* necessarily go down. Anyone who has ever paid for an internet connection or satellite TV knows that prices tend to rise over the years. Your basic utilities are prone to price fluctuation as well. A really cold winter means your gas bill will go up. If you have children in the house who keep leaving the lights on, your electricity bill will go up. You get the picture.

5. **Household repairs.** When the toilet clogs or the faucet leaks; when a window breaks or the roof starts to degrade; when wood-boring beetles infest the tree in the backyard; unless you *really* like to DIY, that means paying for a professional … who usually aren't cheap.

The point of this is to show that unexpected expenses can come at any time, in many different forms. What's more, they can *really* pile up. Even by being prudent with your money, you can still have trouble getting ahead because you could be always having to allocate more money than expected to dealing with expenses. According to a study by Pew Charitable Trusts, *"more than 70% of Americans find it hard to save because of expenses they didn't plan for."*[1]

So what's the solution? Start a rainy day fund! When most people save, they tend to just throw everything into one savings account and withdraw money whenever they either need or want to. Instead, I suggest creating a separate type of savings account: one that can *only* be touched whenever the unexpected happens. Every month, devote a set percentage of your income to the rainy day fund *in addition* to your regular savings. Then, when your car inevitably breaks down, you won't have to worry about it interfering with that vacation you've been saving for, because you've already set aside the funds to deal with it.

By making a list of possible expenses in *addition* to the regular expenses you've already planned for, you can make real progress in regards to getting ahead financially.

## Mental Money Mistake #2: Irrational Accounting

If you're like most people, you get a paycheck every other Friday. A lot of it probably goes to covering your expenses. Another portion may go into your savings. Whatever's left over gets used for recreation.

Now imagine that you find a $100 bill under the couch cushions, you get a nice Christmas bonus from your employer, or receive a hefty tax refund. What do you do with *that* money?

Many people tend to look at these unplanned-for windfalls as "free money." As a result, they spend the money on luxury items, vacations, or even on a quick gambling jaunt to Vegas. To put it simply, they use the money on short-term wants instead of long-term goals.

It's perfectly understandable why people want to do this and every once in a while, it's probably okay. But when you do it too often—when you treat a $100 bill differently depending on *where* it came from—you are guilty of "irrational accounting."

Irrational accounting is a mental mistake because it means you are making financial decisions ***based off emotion and impulse rather than logic and planning*. ** Done too often, it can become a potentially damning habit.

Remember, mental money mistakes are a problem because they can keep you from getting ahead financially. In this case, while it might be fun to spend "free money" on luxuries, it's also counterproductive to reaching your long-term goals.

Taking that money and either saving it or investing it can *dramatically* shorten your timetable to retirement (or whatever else is most important to you).

Of course, none of this means you shouldn't ever buy that new gadget or enjoy a fun trip. What it does mean is that you should pay for those things the same way you do everything else—by saving and budgeting your normal income.

In this day and age, both our government and many private businesses are guilty of irrational accounting. We see the damage this causes every time we turn on the news. It's important that we as individuals avoid making the same mistake. No matter where our money comes from—whether from our regular paycheck or underneath the couch cushions—it's critical that we treat it the same. Always make financial decisions based off logic and planning rather than emotion and impulse. Always make long-term goals your highest priority whenever possible. This is the path to "getting ahead" financially.

And of course, once you're ahead, well … the sky's the limit!

# Mental Money Mistake #3: Being ***Too*** Afraid of Risk

Most investors know how important it is to avoid taking on more risk than they can afford. That's why advisors like me spend a *lot* of time going over concepts like "risk tolerance" with our clients. After all, no one wants to get burned by a bad investment and end up losing a hefty chunk of their nest egg.

But did you know that it's possible to be *overly* risk-averse? Some investors are so afraid of losses that they end up missing out on opportunity after opportunity, and in the end, simply don't have the funds they need to accomplish their financial goals. When that happens, they're really no better off than the investor who risked too much, are they?

For example……

Imagine two relatively young investors, both in their mid-thirties. Let's call one Jim and the other Alice. Both Jim and Alice know they need to save for retirement, and decide to invest $5,000 per year for the next 30 years. Unfortunately, Jim is extremely cautious (to the point of timidity). He's so anxious to avoid risk that he decides to put most of his money into Certificates of Deposit, or CDs. CDs are traditionally seen as fairly safe, so Jim feels good.

Alice, meanwhile, is also cautious but decides to invest more heavily in stocks. Over the next thirty years, she sweats the ups and downs of the markets like most of us do.

Now fast forward thirty years. Both Jim and Alice are in their mid-sixties and getting ready to retire. For simplicity's sake, let's say that Jim earned about 2% interest a year on his retirement savings. When you factor in compound returns, Jim ends up with about $211,000.

Alice, on the other hand, ended up earning about a 7% annual return. Some years were higher, some were lower, but the average is 7%. (This is a fairly conservative average, but it makes things easy to calculate.) She ends up with almost $510,000. That's over twice as much as Jim. That means she has a lot more money saved up for retirement … and lot more to apply to her financial goals. This is all because she was willing to take on a little more risk.

This same principle applies to retirees, too. Of course, retirees *should* invest more conservatively than younger investors. But again, that doesn't mean they should sacrifice all potential for growth. You see, many retirees often discover that the money they saved can dry up pretty quickly, especially on things like medical care. Retirees need *income*, and allocating at least a portion of your portfolio for growth is a good way to generate that income. That means accepting at least some risk, even when you're retired.

The fact of the matter is that *all* investing involves *some* risk. While it's crucial that you avoid taking on too much, it's also important to not take on too little. So as you save and invest for the future, take time to determine not only how *much* risk you can afford … but also how little.

# Mental Money Mistake #4: Following the Crowd

"Men, it has been well said, think in herds; it will be seen that they go mad in herds,

while they only recover their senses slowly, and one by one."

– Charles Mackay, *Extraordinary Popular Delusions and the Madness of Crowds*

You've probably heard of the phrase "buy low and sell high." In a nutshell, it means buying a stock when the price is low and likely to rise in value, and then sell when it's reached its peak but *before* it starts to fall.

Unfortunately, many investors do the opposite—they "buy high and sell low." They don't do it on purpose, of course. They do it because they follow the crowd.

Let's take a fictional company as an example. Imagine that the ACME Corporation (of Looney Tunes™ fame) has just announced a new product to help wily coyotes catch incalcitrant road runners. This excites investors and analysts both, who promptly decide to buy the stock. The stock price rises. More investors jump in. The stock price rises faster. Suddenly you start hearing news stories about how ACME is a "must buy!" or that it's "the hottest stock in decades!" Even your friends all talk about how many shares they've purchased. And since the stock just keeps going up, you decide it's too great an opportunity to miss.

In reality, though, the opportunity is likely to have already passed. Suddenly, you're buying stock at an absurdly high price. Well, so much for buying low. Worse, you're buying the stock not because you or your advisor did any research on the subject. You're buying it because that's what everyone else was doing, and you didn't want to get left behind.

A few weeks go by or maybe even a few months. Then, one day you turn on the TV and learn that ACME's new roadrunner catcher doesn't work nearly as well as people thought. In fact, at least one coyote has died—blown himself up, in fact. Now you're thinking…….Sell, sell, sell.

Since most investors now want nothing to do with the stock, you'll likely have to sell your shares at a much lower price than you bought them for. And before you know it, you've lost money. That's what following the crowd can get you.

Now, most savvy investors know this already, and they do a good job of avoiding simple "hot stocks." But that doesn't mean they're immune to making this mental mistake. Let's take the above example and apply it to something bigger. For example:

- During times of market volatility, following the crowd and getting spooked by the markets altogether … and then missing out on the inevitable rally that comes later.
- Buying/investing in a commodity because that's what the crowd is doing—like gold or real estate (this has happened on many occasions over the past decade).
- Taking out a second mortgage or engaging in some other type of fancy financial tactics because that's what everyone else in the neighborhood, church, club, or company is doing.

The point is that following the crowd is *easy*, even if you are an otherwise smart, savvy individual.  It's so easy to be caught up in emotion.  It can be so easy to let yourself be influenced by "the madness of crowds."

To avoid making this mental mistake, follow these easy steps:

1. Remember that if something sounds too good to be true, it always is.
2. Whenever an exciting investment idea comes to you, give yourself a few days before taking any action (if possible).  Then, when you return to the idea, you can examine whether it still seems as promising as it did before.
3. Write out a list of investing/financial rules for yourself, like a "Ten Commandments" list for your personal use.  An example: *I will never discuss my investments with my friends, nor listen to them discuss theirs.*
4. *Always* get a second opinion from an independent, unbiased financial professional before making a major financial decision.

## Mental Money Mistake #5: Pride Goeth Before the Fall

"Too many people spend money they haven't earned … to buy things they don't want … to impress people they don't like."  – Will Rogers

It's been said that men never want to ask for directions.  But that's nothing compared to men and women who:

- Never want to admit when they've made a mistake
- Never want to admit when they don't know something
- Never want to admit they may not own—or have the money to buy—something that their peers have
- Never accept advice

And that's especially true when it comes to your finances.

You see, it's not often that you hear the word *pride* associated with financial matters—but there's a connection all the same.  That's because it's very easy to be too prideful when it comes to our money.  That's a shame, because being too proud can be a dangerous mistake to make where your money is concerned, because it can lead to very poor decisions.

For instance:

### Holding onto Bad Investments for Too Long

Let's say there's a particular investment or company out there that you really feel strongly about. You put a lot of money into it, you've pinned many of your hopes and dreams on it, and you've even bragged about it to your friends. But what happens if the investment turns out to be a bad one?

Sadly, many investors would rather hold onto a losing investment then admit they made a mistake. What all investors must understand, though, is that *no one* has a perfect track record when it comes to investing, and that making a mistake isn't the worst thing in the world. What matters is how you react to that mistake.

### Spending Money Just to Keep Up Appearances

I've seen this happen more times than I can count. Someone wants to buy a sports car or a sailboat just because their neighbor just got one. Someone wants to go on a long, luxurious vacation just so they can post pictures of all the exotic places they've been to. Someone wants to join a prestigious club just so they can be in with the "right" people.

Now, there's nothing wrong with *wanting* any of these things. But there is something wrong with spending money on those things if you *don't* truly want them … or even worse, if you don't actually have the money to spend. Before you know it, vanity purchases can turn into a habit. And as we already discussed in *Mental Money Mistake #2*, this type of habit can seriously impact your long-term goals.

### Preferring to Be Wrong Than Right, Or Ignorant Than Educated

Whether most men truly hate to ask for directions, I don't know. But it's not hard to see why they would. Nobody enjoys admitting they don't know something, and few people want to ask for help when they feel like they *should* be able to do something on their own.

But here's the thing: finances are complicated. In this day and age, there's so much to know, so much to plan for, so much to be wary of. Unless you want to spend the majority of your time conducting financial research, it just doesn't make sense to think we can do everything on our own. Even financial professionals like me rely on *other* experts to help with keeping our affairs in order.

That's why there's no shame in asking questions whenever you don't know something. There's no shame in seeking advice when it comes time to make an important financial decision. This is how the smartest people achieve success. What's more, it's how they *stay* successful.

In the end, the old proverb "Pride goeth before destruction, and a haughty spirit before a fall" applies to more than just our souls. It applies to our finances, too.

[1] Ann Carrns, "Unexpected, but Not Unusual Expenses Thwart Efforts to Save," *New York Times,* January 8, 2016.
http://www.nytimes.com/2016/01/09/your-money/unexpected-but-not-unusual-expenses-thwart-efforts-to-save.html?_r=0

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