THE DANGERS OF EXTRAPOLATION

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Achieving long-term success as an investor can be challenging. When it comes to investing, our emotions heavily impact our decision-making ability and usually tell us to do the wrong thing at the wrong time. This happens when our emotions guide our subconscious to extrapolate the future based on recent experiences.

Webster's Dictionary defines *extrapolate* as, "to draw from specific cases for more general cases." For example, while stuck in traffic you may have thought, "It has taken me 30 minutes to go one mile. At this rate, I won't get home until tomorrow afternoon." Or perhaps after closing three successive sales at work you thought, "If this keeps up, I'll make enough money to retire by the end of the year." Both of these are examples of extrapolation – basing a longer-term forecast on an emotional reaction to short-term developments.

This can be very detrimental when making decisions relating to your investments and financial security. After working with investors over the past decade and experiencing both advancing and declining stock markets, I have been a party in many conversations where clients looked at negative short-term investment performance and thought, "If this continues, I am going to lose all my money." Alternatively, when they experienced positive short-term investment performance, they thought, "I need to get more aggressive with my investments so I don't miss out on the rally." In either case, investors are prone to change their long-term investment strategy, in many cases to their own detriment, when the actual outcome is rarely as good or bad as they originally envisioned. Investors often set themselves up for disappointment or surprises when reality differs from their expectations.

So what can you do to reduce the dangers of extrapolation? First, learn to recognize when you are having an emotional reaction to unfolding events and do your best to remove them from your decision-making process. Second, identify and rely on material information pertinent to your unique situation when making investment decisions. Malcolm Gladwell said it best in his book <u>blink</u> – "W*e live in a world saturated with information. We have virtually unlimited amounts of data at our fingertips at all times, and we're well versed in the arguments about the dangers of not knowing enough and not doing our homework. But what I have sensed is an enormous frustration with the unexpected costs of knowing too much, of being inundated with information. We have come to confuse information with understanding."*

By honing these two skills, you should be able to improve your long-term investment success and ultimately your personal financial security.

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