InSite
News and views for the online investor
SPRING 2008

Investing Without Emotion

Warning: Letting your heart rule your head can be hazardous to your wealth

Most people believe their investment choices are based on cool, calculated analysis. In fact, when it comes to financial decisions we may not always be as rational as we think.

A new field of economics called behavioural finance examines why some traders achieve phenomenal success while others gamble away fortunes. Behavioural finance attempts to understand and explain how emotions influence investing decisions. Its close cousin is neurofinance, an emerging field that combines economics, psychology and neuroscience to learn what goes on in the brain as it makes trading decisions.

MAPPING THE MONEY MIND

A groundbreaking Stanford University study used event-related functional magnetic resonance imaging to observe changes in people's brains as they took risks or held back in buying imaginary stocks and bonds. When they were trying to avoid financial loss, the anterior insula of the brain was activated. This area of the brain is linked to fear and anxiety. When participants were seeking risky profit, the nucleus accumbens lit up. This is the pleasure centre, which becomes active when one expects a financial reward.

THE FEAR FACTOR

It's human nature for people to feel more anxious if they lose $100 than happy if their stock returns the same amount. This can lead to overly conservative choices.

Fear can cause us to freeze, because we don't want to make a mistake. This attitude may be based on regret about past bad decisions. We may tell ourselves, "If I sell now, I'll only make five per cent profit.

continued on page 2

Thank You!

BMO InvestorLine would like to say thanks - thanks for making us the top rated online brokerage in client satisfaction and loyalty.*

NEW WEBCASTS

Learn more about investment products and strategies from a range of industry experts through our webcast series. Check out the new addition:

Investor Behaviour – how your behaviour can affect your returns

Visit bmoinvestorline.com to access new webcasts added to our already diverse lineup.

Investing Without Emotion

continued from page 1

I'll hold on, because I need to make at least 10 per cent to stay ahead." For example, Jérôme Kerviel, the rogue trader at France's Société Générale, refused to cut his losses after the markets turned against him.

People will often take more risks to avoid losses than to realize gains.

Fear can keep us out of the market if we've been burned before. We say, "I lost money in that sector 10 years ago, so I'll never invest there again." Yet nervously sitting on cash is not the answer, since inflation will steadily erode its buying power. Inaction creates its own set of problems: holding on to losing stocks for too long; missing opportunities with other investments; earning lower returns; and paying taxes too soon.

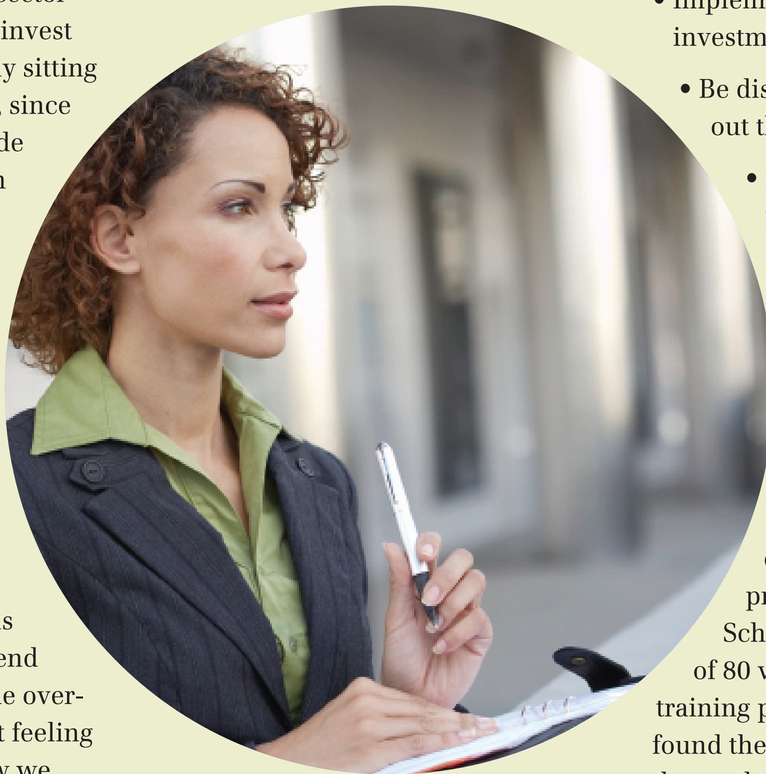
OVERCONFIDENCE

"Something tells me this company's a winner." This kind of thinking should send up a red flag. If we become overconfident, we may let that feeling determine where and how we allocate our resources. Overconfidence can lead investors to believe they can consistently time the market, but strong evidence demonstrates that this is a pipe dream.

MENTAL ACCOUNTING

Instead of viewing every dollar as identical, many investors carry out a form of mental accounting: they relegate some cash for low-risk investments and some for risk capital.

Different pots for different purposes may seem organized and efficient, but it isn't. Cafeteria-style investing can undermine a disciplined approach. Keeping a separate mental account for initial principal and one for gains often leads to taking more risks after a gain. It can also impede diversification and cause investors to disregard their overall portfolio performance. Those who use this approach may either take excessive risks – or not enough.



REMAINING RATIONAL

Whatever your investing style and your goals, keeping these questions in mind can help you make intelligent rather than impulsive choices.

KEY QUESTIONS

1. How has emotion affected your past investment decisions?
2. Do you own a collection of stocks – or an investment portfolio?
3. Are you holding on to losers in the hope of a turnaround?
4. Do your individual investments fit your overall profitability plan?
5. Are your emotions getting in the way of your financial goals?

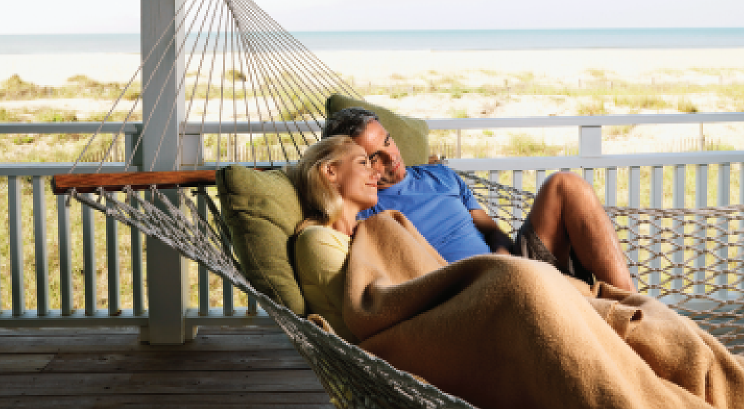
UNDERSTAND YOUR OWN INVESTMENT NEEDS

You can take steps to guard against acting on emotion. A well-thought-out strategy is the starting point.

- Develop a rational wealth strategy.
- Implement a consistent investment process.
- Be disciplined about carrying out the process.
- Incorporate risk-management practices.
- Use solid research.
- Review your tactics regularly to ensure they support your goals.

Investing rationally increases your chances of investing more profitably. An MIT Sloan School of Management study of 80 volunteers from an online training program for day traders found the most successful were those who kept their emotions on an even keel, whether they were making money or losing it.

The field of behavioural finance explains why investors can sometimes be their own worst enemies. To fight back, create a disciplined strategy and stick to it. When it comes to maximizing your wealth through investing, take steps to ensure your head rules your heart.



>MAKE A ROAD MAP TO NAVIGATE MARKET UPS AND DOWNS

A disciplined approach to long-term investment planning is crucial, especially with today's unpredictable market conditions. A financial road map points the way to your destination, and helps you avoid wrong turns that could cost you time and money. Yet an InSite eNewsletter poll[1] showed that 25 per cent of investors don't even have a plan. With BMO InvestorLine's user-friendly online tools, developing one is simple and straightforward.

If you already have a plan, this may be an ideal time to update it. Does it still meet your needs and long-term vision? As your situation changes, revisit and adjust your plan to reflect your current and new goals.

> *"A disciplined approach and a solid plan will help you ride out volatile markets and still reach your goals"*

DECIDE WHERE YOU'RE HEADED

The starting point in developing a plan is to know your destination. Are you saving for a house? A child's education? A vacation property? Perhaps you're thinking about a comfortable retirement. Once you've established your goals, use our effective online planning tools to determine what type of investor you are, the current state of your finances, and the specific steps to get you where you want to go.

GET INTO GEAR WITH THE ASSET ALLOCATOR

By using the Asset Allocator, you can assess your current financial situation by taking an inventory of all of your registered and non-registered investments, and determine your Investor Profile.

This will help you establish the most direct route to your goals, and ensure that you stay on track. Depending on how savvy an investor you are, you can simply select your Investor Profile type from the choices provided, or complete a short questionnaire to determine it. By answering some key questions, you can evaluate your level of investing knowledge and risk tolerance, set your time horizon, and understand what type of investor you are, from the Aggressive Growth profile to the Capital Preservation type.

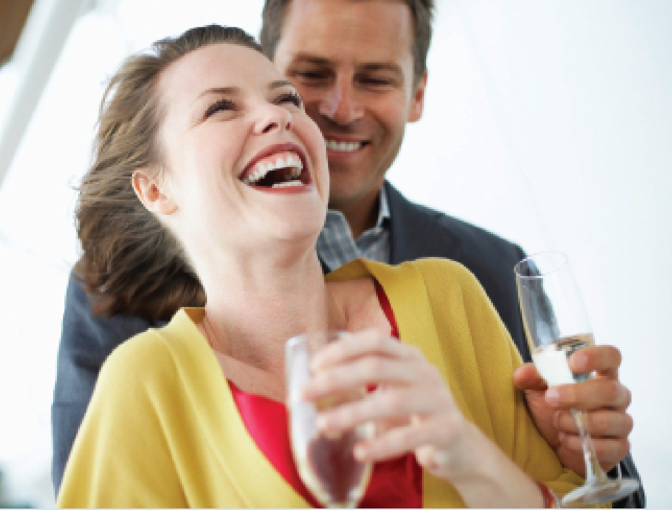
Are you a beginner or a sophisticated investor? Can you accept periodic declines in portfolio value as a trade-off for potentially higher returns down the road? How long will you have to invest before you'll need the money? Based on your Investor Profile, the Asset Allocator shows you a mix of investments – cash, fixed income and equities – that are right for you. You can compare your current investing strategy with the asset mix you've just created.

You may need to rebalance your portfolio, save more, or take other steps to stay on track. You can test different scenarios or compare your results with other Investor Profiles. Whatever the case, you'll have the critical information you need to put your plan into action.

IT ALL STARTS WITH YOUR PLAN

A disciplined approach and a solid plan will help you ride out volatile markets and still reach your goals. You can always modify it to meet your goals as circumstances change. By identifying where you are and where you want to go, you can develop the right portfolio strategy and reach your personal investing goals sooner.

[1]Based on results from the poll question in the July 2005 issue of BMO InvestorLine's InSite eNewsletter.



Pay Yourself First Get into the PARC Habit

Spring is finally here. The warm weather is on its way, and, like winter's snowing and blowing, the RSP season seems like a distant memory. But for those of you who scraped together your funds in the last few days of February and scrambled to make your RSP contributions on time, have you stopped to consider that there might be a more efficient strategy for next year?

When you invest this way, you're always playing catch-up.

You effectively stay a year behind in receiving your hard-earned tax benefits, and see a smaller overall return on a lower RSP balance.

The sooner you start investing, the longer your money has to grow. With a Pre-Authorized Registered Contribution (PARC), BMO InvestorLine automatically draws a fixed sum from your account – monthly, quarterly or annually – and deposits it to your RSP, making RSP investing a habit instead of a chore.

With as little as $100 a month, you can start building your RSP cash account, or complete the Automatic Purchase Plan (APP) form, and we'll direct your money to the mutual fund of your choice.[1] It's an affordable and important savings plan that you can easily maintain, and increase in the future.

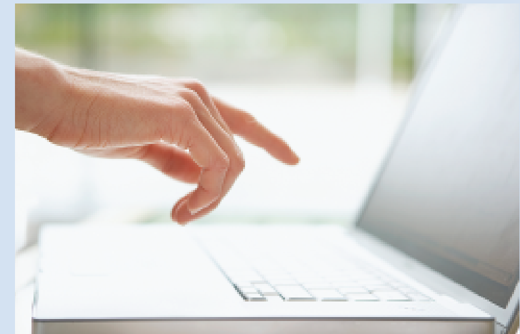
BMO INVESTORLINE PARC LETS YOU:

Choose how often: Monthly, quarterly or annually – whatever works best for you.

Choose how much: Open a PARC for as little as $100 a month.

Choose your account: Make regular contributions from any Canadian bank account and have them deposited to your RSP cash account.

Take control of your investments.
Pay yourself first.
*Visit **bmoinvestorline.com**, access the PARC form under* Account Services, *and set up a PARC today.*



[1]From the approved list of mutual funds.

InSite is published quarterly by BMO InvestorLine Inc., and is distributed with BMO InvestorLine account statements. To request additional copies of this issue, please send an email to **insite@bmoinvestorline.com**. To view past issues of the newsletter, visit the *Education Centre* at **bmoinvestorline.com**.

Please send comments and suggestions to insite@bmoinvestorline.com.

The articles in this newsletter are prepared as a general source of information. They are not intended to provide legal, investment, accounting or tax advice, and should not be relied upon in that regard. If legal or investment advice or other professional assistance is needed, the services of a competent professional should be obtained. The information contained in this newsletter is based on sources believed to be reliable, but its accuracy cannot be guaranteed. The views expressed and information provided in the articles are attributable solely to the authors.

*Rated by clients in an independent online brokerage study conducted by Phase 5. *(Competitive Online Brokerage Report, December 2007).*

BMO InvestorLine is a member of BMO Financial Group. †As ranked by *The Globe and Mail,* 2002, 2003, 2004, 2005 and Feb. 4, 2006; by Gómez Canada, Q1, Q3 2002, and Q2, Q4 2003; and by Watchfire GómezPro, Q2 2004. ®Registered trade-marks of Bank of Montreal, used under licence. BMO InvestorLine Inc. is a wholly owned subsidiary of Bank of Montreal Holding Inc. Member CIPF and IDA.
5122168 (04/08)

BMO InvestorLine®

★★★★★®
Leading Online Investing Firm†