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Dealing with loss is vital to financial recovery

BY ANDREW MENACHEM
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In her landmark book, *On Death and Dying*, psychologist Elizabeth Kübler-Ross identified five stages of grief that in my opinion can be applied to any loss: denial or disbelief; anger; bargaining; depression; and acceptance of the past with a readiness to face the future.

In the past year, many investors have traveled this same emotional path when faced with a significant loss of net worth. After an unprecedented 34.4 percent plunge in the S&P 500 index in 2008, it's certainly understandable that most investors are grieving about their losses, despite the recent stock market rally.

Being able to move through the five stages of grief and not getting stuck somewhere in the process provides the key to staging a successful financial comeback this year and in the future.

There is an old saying that fear and greed are the true rulers of Wall Street. Certainly, emotions far more than facts move the financial markets up, down or sideways, especially over short periods of time.

For investors still grieving their losses, the first and perhaps most important step is to take a good look at the value of their current investments. Sit down with your financial advisor and see how well your asset allocation matches your goals and your risk tolerance. If your portfolio has dropped 30, 40 or 50 percent, this will be a difficult process. But as Kübler-Ross says, you can't start moving anywhere if you're still in denial. Like it or not, you have to look at the facts and use them as your new starting point. For instance, you might select a different financial advisor who addresses risk even before return. As investors have learned, bull markets can hide the actual risks. Warren Buffet recently said, "It's only when the tide goes out that you learn who's been swimming naked.'"

The next stage in the grief process is usually anger. For many investors, letting off steam can be a healthy step in the grieving process—unless that negative emotion starts driving financial decisions. While an investor may be tempted to dump equities or put more money into Treasuries, try to resist those impulsive decisions.

It's also all too easy for investors to get stuck in bargaining and depression—the third and fourth of Kübler-Ross' emotional stages. Think about it: How can one individual ever hope to "bargain" with Wall Street? And trying to rectify past mistakes in hopes of controlling the future—another form of bargaining—is just wishful thinking.

Next we come to the almost universal emotion in the current financial world: Depression. As one person told me recently, "I think the economy is going to get even worse before things get better. I'm probably going to have to work now until I'm 80."

That is a depressing thought for anyone. But it's another example of "herd thinking," which is letting emotions rather than rational thinking drive investment decisions. Depression right now is dangerous, because it can lead to paralysis. Just remember that it does take courage to be an investor, just as it does to achieve other goals in a well-rounded life.

It takes time for a battered investor to move through these five stages of grief. But it's important to remember that the markets don't wait for anyone. There are plenty of opportunities every day to begin rebuilding wealth, not only in the stock market but also in many other asset classes that this bear market has created. Once an investor has moved to the emotional stage of acceptance, it's time to review long-term goals, re-examine tolerance for risk and adopt a diversified strategy that makes sense for today's market conditions. If that sounds familiar, it's because the basics of sound investing are just as important today as they were in the past.

Don't be fooled by statements from so-called experts who claim that diversification and asset allocation don't work anymore. The basic investing principle of not putting all of your eggs in one basket was developed back in 1952 by Nobel Prize winner Harry Markowitz, and it is just as applicable today as ever.

In my many years of experience in the capital markets, happiness depends more on developing, following and understanding a customized, written investment plan, which gives you a road map for the future, rather than the actual level of wealth you have achieved. Regardless of financial circumstances, an investor's level of expectations should come close to matching reality — that's what makes people feel comfortable and allows them to make logical and intelligent decisions.

The bottom line then becomes: Respect your emotions, but don't let them drive investment decisions. As the financial markets move through their bull and bear cycles, investors will undoubtedly feel anger, denial and fear—just be sure that it's the brain, not the heart, that's driving the portfolio.

Andrew Menachem is a Morgan Stanley senior vice president. He teaches a course at the University of Miami called Preserving and Transfering Wealth.