DG FINANCIAL SERVICES LIMITED

UNDERSTANDING THE PSYCHOLOGY OF INVESTING

Learn how it could support long-term investment success

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UNDERSTANDING THE PSYCHOLOGY OF INVESTING

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While investment decisions are often based on facts, figures and financial objectives, the human side of investing can significantly affect outcomes. Markets rise and fall, economic conditions change, and headlines can create uncertainty. Investors are often required to make important decisions while managing emotions such as fear, excitement, optimism or concern.

At DG Financial Services, we believe that understanding the psychology of investing can be just as important as understanding markets, funds, asset allocation and investment strategy. Even the most carefully designed portfolio can be undermined if decisions are driven by short-term emotions rather than a clear, long-term plan.

Investor behaviour matters because people do not always make purely rational financial decisions. This is not unusual; financial decisions are closely connected to personal experiences, beliefs, expectations and emotions. However, these natural reactions can sometimes lead investors away from decisions that support their long-term goals.

Some investors avoid risk entirely, even when their objectives may require long-term investment growth. Others may take excessive risk after strong market performance, assuming recent success will continue. Some investors sell their investments during periods of market falls because they fear further losses, while others follow popular trends without fully understanding the risks involved.

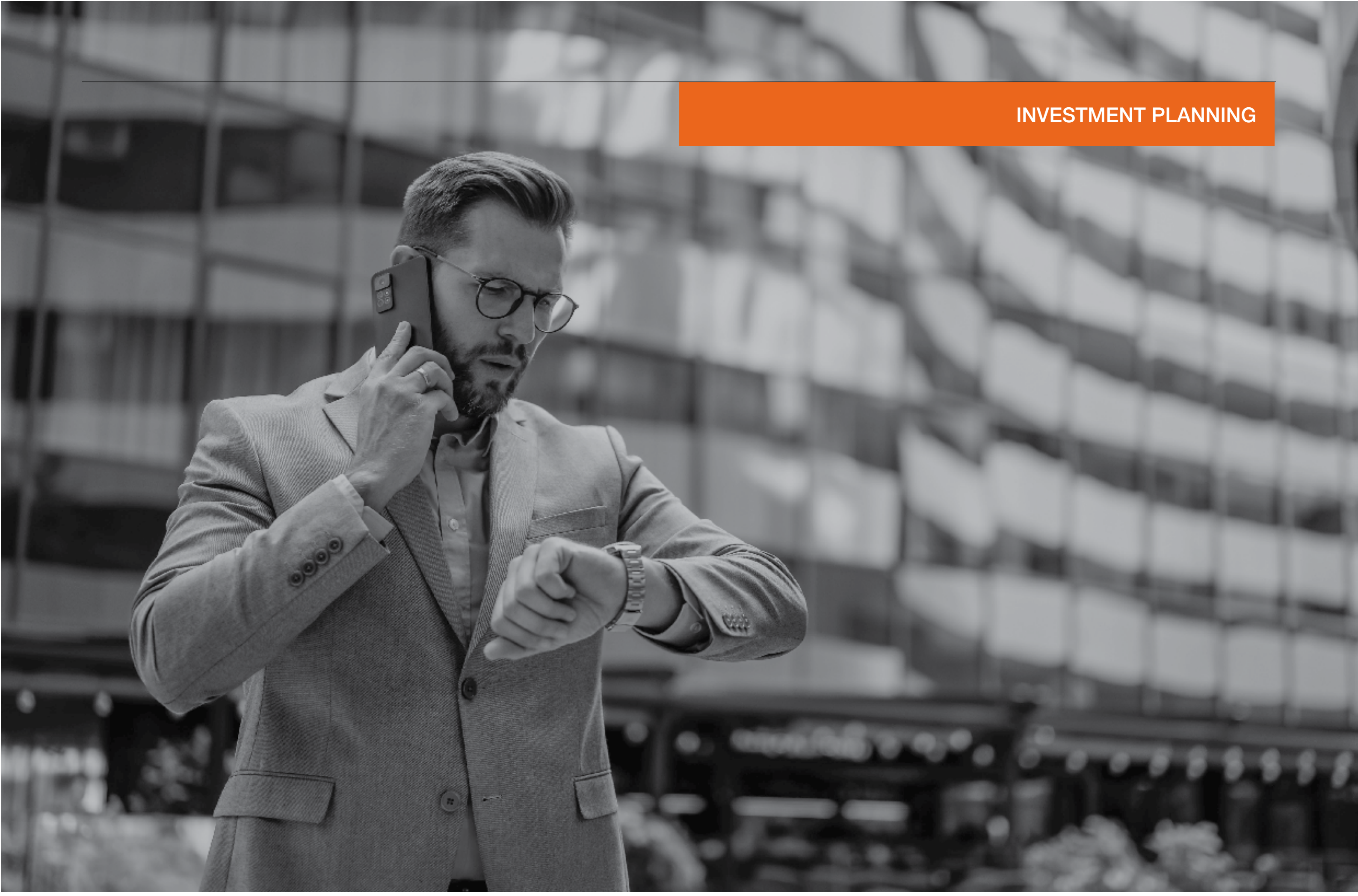
Financial Conduct Authority (FCA) Financial Lives data highlights the importance of understanding investment risk. It found that 45% of non-advised investors failed to recognise that losing some money was a risk of investing. This demonstrates why education, advice and disciplined planning can play a crucial role in helping investors understand the relationship between risk and potential returns.

WHY EMOTIONS AFFECT INVESTMENT DECISIONS

Financial markets can trigger a powerful emotional cycle. When markets perform well, investors may feel confident and become more comfortable taking on additional risk. Rising prices can foster optimism, sometimes prompting people to invest for fear of missing out on further gains.

However, when markets fall, confidence can quickly change. Seeing the value of investments decline can cause anxiety, uncertainty and a desire to take action immediately. For some investors, the instinctive response may be to sell and avoid further losses.

The difficulty is that emotional decisions are often based on short-term developments, whereas investing is



usually designed to achieve longer-term objectives. Reacting to every market movement can lead to buying after prices have already risen and selling after they have fallen, a pattern that can harm long-term investment performance.

The challenge is not eliminating emotions. Emotions are a natural part of being human and cannot simply be removed from financial decisions. The key is recognising when emotions may be influencing decisions in ways that undermine your wider financial plan.

One of the most common behavioural patterns is loss aversion. This describes the tendency for people to feel the pain of losing money more strongly than the satisfaction of gaining the same amount. As a result, a temporary fall in investment value can feel more significant than it may be in the context of a long-term strategy.

A well-designed investment plan can help provide perspective. When your portfolio is built around your objectives, investment timeframe and attitude to risk, short-term market movements are easier to view in the bigger picture.

RECOGNISING COMMON INVESTOR BIASES

Behavioural biases are mental shortcuts that can influence how people process information and make decisions. They are not signs of poor judgement; they are normal human tendencies. However, understanding them can help investors recognise when they may be affecting their choices.

RECENCY BIAS

Recency bias occurs when people place too much importance on recent events and assume they will continue into the future.

For example, after a period of strong market performance, investors may believe further growth is likely and increase their exposure to riskier assets. Conversely, following a market downturn, investors may assume losses will continue indefinitely and make decisions driven by fear rather than by their long-term objectives.

History shows that markets move through cycles. Periods of growth and decline are a normal part of investing, and short-term conditions do not always reflect long-term opportunities.

HERD BEHAVIOUR

Herd behaviour occurs when investors follow others rather than making decisions based on their own circumstances and objectives.

This can happen when certain investments, sectors or market trends become popular. The growth of online investment platforms, social media discussions and easily accessible trading information has made it easier than ever for people to react quickly to market movements or investment trends.

However, popularity does not necessarily mean suitability. An investment that is appropriate for one person may not be appropriate for another, depending on their goals, timeframe and ability to tolerate losses.

OVERCONFIDENCE

Overconfidence can also influence investment behaviour. Some investors may believe they can consistently predict market movements, select the best-performing investments, or buy and sell at the right times.

While confidence can be helpful, excessive confidence may lead to unnecessary trading, a lack of diversification, or taking on more risk than is appropriate.

Successful investing is rarely about making frequent decisions or trying to predict every market movement. It is often about developing a suitable strategy and maintaining discipline over time.

HOW CASH CAN BECOME AN EMOTIONAL COMFORT ZONE

Investor psychology does not only affect people who take excessive risks. It can also influence those who avoid investing altogether.

Cash often feels reassuring because its value does not fluctuate as much as investments. For short-term needs, emergency savings, and planned expenditure, holding cash can be an important part of a financial plan.

However, keeping too much cash for long-term goals can create another type of risk. Over time, inflation can erode the purchasing power of cash, meaning the same amount of money may buy less in the future.

FCA Financial Lives data found that 61% of adults with £10,000 or more in investable assets held all or at least three-quarters of those assets in cash. It also found that 75% of adults with £5,000 or more in cash savings had no plans to withdraw a substantial amount over the next three years.

These figures suggest that some people may be holding significant amounts of cash for reasons beyond immediate financial needs. Among non-advised adults with significant cash savings and no investments, 54% said they had not considered investing, while 34% cited concerns about losing money and 29% cited a lack of knowledge, limited access to support, or feeling overwhelmed by the available options.

For some people, the barrier is not a lack of financial ability but uncertainty about where to begin. Understanding your options and receiving appropriate guidance can help make investment decisions feel more manageable.

USING DISCIPLINE TO SUPPORT LONG-TERM INVESTING

A disciplined investment approach can help reduce the impact of emotion and behavioural bias. This does not mean ignoring markets or pretending that change does not occur. Instead, it means responding thoughtfully rather than reacting impulsively.

One of the most important steps is defining your investment purpose. Understanding why you are investing, when you may need access to the money and what level of risk you are comfortable accepting can provide a clearer framework for decision-making.

For example, money needed in the short term may require a different approach to money intended to support retirement many years in the future. Aligning investments with specific objectives can help ensure your strategy remains appropriate.

Diversification is another important principle. By spreading investments across different asset classes, regions and sectors, you reduce reliance on any single area of the market. This can help create a more balanced portfolio and may make it easier to remain invested during periods when certain investments perform poorly.

Regular reviews are also essential. Circumstances change, markets change and financial goals can evolve. Reviewing your investment strategy allows you to check whether your portfolio continues to reflect your objectives, timeframe and attitude to risk.

Importantly, reviews should focus on whether your plan remains suitable

rather than simply reacting to recent market performance.

BUILDING CONFIDENCE THROUGH ADVICE

Professional financial advice can help investors separate emotion from strategy. An adviser can help you understand your attitude to risk, assess your capacity for loss, and create an investment approach that fits within your wider financial plan.

Advice can also offer valuable perspective during periods of uncertainty. When markets are volatile, it can be helpful to revisit the rationale for your investment strategy and assess whether anything has genuinely changed, rather than making decisions based solely on headlines or short-term market movements.

At DG Financial Services, we help clients invest with structure, discipline and a clear understanding of risk. The aim is not to remove emotion from investing entirely; that would not be realistic, but to ensure emotions do not take control of decisions that could affect your long-term financial future.

A successful investment strategy combines knowledge, planning and patience. By understanding both the financial and psychological aspects of investing, you can make decisions that are better aligned with your goals and give yourself greater confidence in your financial journey. ■

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Could your investment decisions benefit from a clearer plan?

Understanding investor behaviour can help you recognise emotional influences, avoid unnecessary reactions, and stay focused on your long-term objectives. Contact DG Financial Services to review your investment strategy, assess your attitude to risk, and create a structured approach tailored to your goals.

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