EMPYRION™

WEALTH MANAGEMENT


June 10, 2021

# Monthly Insight

## What the Market Taught Us in 2020

It has been said that good decisions come as a result of experience, and that much of the time, experience comes as a result of bad decisions. Seen in this light, the experience of 2020, in the financial markets, at least, will no doubt provide opportunities for many investors and financial professionals to reassess their decision making as we move farther along into 2021.

Another often-repeated proverb is that those who do not learn from the past are doomed to repeat it. But what, exactly, were the lessons the markets offered us during what was unquestionably one of the most surprising, frightening, and volatile market periods in history?

Perhaps the most important and over-arching lesson is that human nature is still characterized by the same foibles, weaknesses, and vulnerabilities that have plagued us for centuries. We are prone to react without taking time for proper reflection, to be driven, in turns, by fear and greed, to be distracted by the loudest noise or the brightest flash of the moment, and to disregard wise counsel that conflicts with our intuitions or "gut feelings." In other words, we tend to be our own worst enemies, and this was at no time more in evidence than during the extraordinary market conditions we saw during the past year.

As we take a final glance backward at 2020, let's consider the mistakes and miscalculations that drove much investor behavior, contrasting them with the good decisions and sound practices that allowed other investors to survive and flourish, despite all the upheaval. In this way we can turn the experience of 2020 into wisdom that can lay a foundation for good decisions in the future.

**Lesson #1: Don't Panic.** To be fair, the chaos unleashed by the COVID-19 pandemic was on a scale we haven't seen since the deadly influenza pandemic of 1918–19. The speed and abruptness with which governments around the world shut down their economies in an attempt to arrest the spread of the virus has no parallel in modern history. We were clearly in uncharted territory, and no one could be certain how or when we would emerge from the worldwide recession that ensued. On the other hand, Daniel Kahneman, the first psychologist to win the Nobel Prize for Economics, stated years ago, "All of us would be better investors if we just made fewer decisions." Kahneman was among the first to study the psychological aspects of investor behavior, including how decisions made during periods of uncertainty tend to affect long-term portfolio performance. The executive summary of Kahneman's work is that when investors make decisions motivated by strong emotions—whether fear of losing or fear of missing out ("FOMO," as it's often called), those decisions tend to be counterproductive to long-term portfolio performance. And Kahneman isn't alone in his opinions; financial authors like Jason Zwieg and others have reflected at length on the importance of not allowing emotion to drive important financial decisions. Our emotional responses evolved to protect us from tangible, physical threats—like predators—and they are ill-suited to deal with the complicated, fast-moving world of the financial markets. Remember, our brains react to a plummeting market in the same way they respond to the presence of a rattlesnake. While you may be well-served to leap before you look at a snake, doing the same with your investments can bite you. Also, our financial fears are often misplaced. We tend to overcompensate for more memorable risks (like a flash crash), while ignoring more subtle ones that can be just as harmful or much easier to prevent (such as inflation, eroding your spending power over time). While the events of last February, March, and April were certainly upsetting, investors who were able to suppress their emotional reactions, stay focused on long-term strategy, and avoid making drastic changes to their portfolios have generally done very well. On the other hand, those who yielded to panic—and especially those who drastically liquidated their equity positions—may never recover the gains they would have otherwise enjoyed.

**Lesson #2: Don't Try to Outguess the Market.** Human beings are the dominant species on the planet because of our higher intellectual functions. One of the most important of these is pattern recognition, which has allowed us, through the millennia, to both avoid danger and take advantage of opportunity. Since prehistoric times, when our ancestors' survival depended on getting the right answer right away, evolution has been conditioning our brains to find and interpret patterns. However, our pattern-seeking impulses tend to treat even random events (like ten coin flips, all heads) as if they're orderly outcomes suggesting a predictive pattern. "Just as nature abhors a vacuum, people hate randomness," says author Zweig, as a result of our brain's dopamine-induced "prediction addiction." Too often, our tendency to assign patterns to events that are actually random causes us to perceive a pattern in financial matters that really isn't there. For example, a study at Southern Methodist University's Cox School of Business found that when reviewing a financial report, readers tend to react negatively to numbers printed in red, even if they are reporting a positive outcome. In other words, our pattern-seeking brains, knowing that it's bad to be "in the red," send "warning" signals, even when the underlying information doesn't warrant it. Is a stream of breaking financial news a predictive pattern worth pursuing, or is it a deceptive mirage? Given how hard it is to tell the difference until hindsight reveals the truth, investors are usually better off ignoring the market's many glittering distractions and focusing instead on their long-term goals.

**Lesson #3: Stick to the Plan.** Not all of the investor mistakes of 2020 were related to falling stock prices. Another error committed by many was the greed-induced impulse to chase performance. This was particularly evident during the period, beginning in February and continuing for months afterward, when a handful of big tech companies—notably the "FAANG" stocks: Facebook, Amazon, Apple, Netflix, and Google (ABC)—were the only stocks showing consistent gains (due largely to their importance for maintaining daily life during the shutdown). As a result, many investors began "piling on" in an effort to participate in what looked like the only game in town. Unfortunately, investing in whatever trend is hot at the moment is rarely a recipe for long-term success, and the price adjustment in tech stocks that took place in September of last year demonstrated why. This was a classic example of investors succumbing to recency bias: the tendency to place greater trust in information that is more recent, while ignoring longer-term trends or older facts. By reacting to the most recent jolts instead of remaining positioned as planned for long-term expected growth, investors end up overweighted in high-priced, hot holdings, often locking in losses by selling low during the downturns. They allow recency to get the better of them and their most rational, evidence-based investment judgment. By failing to adhere to their established strategy, they too often end up outsmarting themselves.

**Lesson #4: Get Help.** While no financial advisor, regardless of certification, experience, or other qualities, is perfect, one of the biggest lessons from 2020 may be the importance of having reliable, professional, fiduciary advice for your investing and wealth management strategies. A fiduciary financial advisor is professionally and ethically obligated to act always in your best interest. Instead of taking advantage of your emotional impulse to buy or sell—and generate commissions—a fiduciary financial professional must utilize experience, world-class financial research, and detailed knowledge of your particular goals, priorities, and needs to "talk you down" when emotions are running high, and to prompt careful, judicious action when conditions warrant. Over and over again during the ups and downs of 2020, such financial advice saved investors from their own worst impulses, allowing them to stay on track for meeting their long-term financial goals.

To learn more about how emotional decisions and other common investor mistakes can hinder the performance of your portfolio, click here to read my white paper, "The Informed Investor." For information on the benefits of working with a fiduciary advisor or wealth planner, click here to read "The Fiduciary Standard and the Individual Investor." And if I can help you or someone you know with making better plans for the financial future, please contact Empyrion Wealth Management.

**Stay Diversified, Stay YOUR Course!**

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**SOCIAL MEDIA DIGEST**

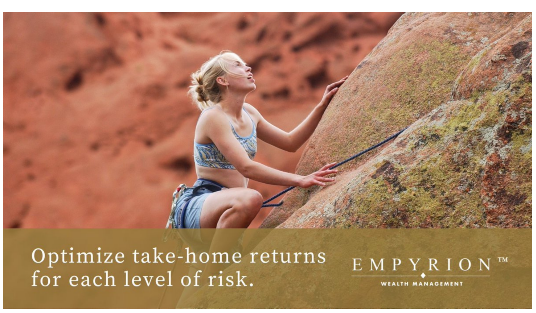
In case you missed them, here is a roundup of my latest posts on social media:

Does the thought of inflation make


you wary of investing? In my latest @FOX40 appearance, I discuss #inflation, #valuestocks and the record low interest rates available now.

Teaching #philanthropicvalues is critical to ensure that the next generation of family leaders understands the central importance of #philanthropy. In my blog, I share specific ways to impart to children the qualities of generosity and empathy for others.


On @FOX40, I discuss how the stock market is strong despite rumors of a White House tax hike and mention the impact of price spikes on everyday #investors.




Created with you in mind and grounded in disciplined investment techniques, the EWM Digital Investing platform is designed to optimize take-home returns for each level of risk. Discover more.

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#SocialSecurity is central to virtually everyone’s retirement strategy. In my latest blog, I share some special considerations that women in transition should keep in mind when thinking about Social Security.

**KIMBERLY FOSS**

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