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WEALTH MANAGEMENT

Monthly Insight

Your Emotions and the Markets: Why They Don't Mix

March 2020 is likely to go down in the books as one of the most emotionally taxing periods of all time for investors. We began the month with several huge point declines, in many cases followed the next day by almost-as-huge increases. But over the month, we watched as the major indexes fell by more than 30% from their peaks in mid-February. It's impossible to witness moments like these and remain unaffected.

This is a good time, then, to revisit a few fundamental facts about emotions and the markets—what we would call “behavioral investing.” Even the most experienced and savvy investors are not immune to the temptation to make investment decisions based on emotion. Whether we call it “gut instincts,” “an intuition,” or “a feeling,” we all have a tendency to allow certain parts of our central nervous system to take more control of our financial decisions than we should.

The investment writer Bob Veres is a favorite of mine, and he recently offered some very candid remarks that illustrate the tendency to let our emotions take control. He related the experience of riding a roller coaster with his children:

As soon as the roller coaster car crested the top of the tracks and I looked down, the lizard-like part of the back of my brain took over total control of my thought processes, and it screamed, against all logic and against many things I knew to be true, that I and my children were about to die, and it sent a surge of adrenaline and signals of dread into my system so strongly and thoroughly that it was a few minutes before I could stand up…

Bob’s humorous story illustrates pretty accurately how many investors felt on these days in March when the major stock indexes were down by lots of points and big percentages. It felt as if there was no bottom, and we might keep going down forever. No doubt, many of us heard that lizard-brain scream that Bob describes coming from inside our own heads. Actually, Bob’s description has a basis in science. The seat of most of our basic emotions—fear, love, anger, or anxiety—is the amygdala, positioned just above the top of our spinal columns. Neurologists believe that the amygdala is the most primitive part of the human brain; it shares many characteristics with the brains of creatures like reptiles. In other words, when we are allowing our emotions to control our behavior and decisions, we may be thinking like lizards!

While our emotional responses to certain situations can be helpful in some cases, in the financial markets they are almost always a hindrance. The human brain and nervous system evolved to deal with threats that do not exist in the modern, computerized world of investing. Consequently, when we allow that part of our brain to drive our investing decisions, the outcome is usually not good.

For clients already following a sound, evidence-based investing strategy, here are a few important points to remember as the markets continue to take us on that roller coaster ride of exhilarating ups and panic-producing downs:

1. Remember that you have a globally diversified portfolio that does not directly reflect the performance of any single market index;

2. Remember that your portfolio is carefully structured to capture a measure of the markets' long-term returns;

3. Remember that tolerating a certain amount of risk now is required in order to enjoy those long-term returns later;

4. Remember that your assets are allocated in a ratio of equities and fixed-income investments matched to the amount of risk you can accept in your portfolio.

Especially in times of market uncertainty and volatility, it's important to keep these principles in mind. When your "lizard brain" is screaming at you to take some action, you can return to these principles and know that the current volatility is part of your long-term strategy. It's already built into your assumptions. Recalling that important fact can help to calm your emotional instincts and allow the more logical, reflective parts of your brain to remain in control.

In this unprecedented crisis brought on by the spread of the coronavirus, it is unlikely that we have seen the last of the market volatility that characterized much of March. We might wish that this wild ride was over and we were coasting into a period of relative calm. However, until the virus is brought under control and our economy returns to a more normal footing, there are probably some ups and downs ahead of us. As an investor, you cannot possibly predict exactly when those ups and downs will occur or how deep and high they will be. In fact, no one can successfully predict such market movements with any consistency. What you can do, however, is continue to place confidence in your long-term strategy, knowing that it is built on the same principles that allow the markets to operate as they do.

Right now, you can also continue to do your part to slow the spread of the coronavirus: maintain social distancing in public, stay at home as much as you can, wash your hands thoroughly and frequently, and get your information from reliable sources such as the CDC and WHO. If we all do our part to promote public health, we'll come through this crisis healthier, stronger, and more well informed for the future.

Finally, if you have questions or concerns about your portfolio, the markets, your investment strategy, or any other financial matter, I am here to listen, advise, and help. Please get in touch with me and let me know how I can best assist you.

Stay Diversified, Stay YOUR Course!

And... Stay Your Social Distance, and Wash Your Hands!

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