Ameriprise Audiocast
Managing investment emotions in a bear market

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Guests:
Marcy Keckler
Anthony Saglimbene

Marcy Keckler:
Hello. I'm Marcy Keckler, vice president of Financial Advice Strategy at Ameriprise Financial. Thanks for joining our audiocast today. You can listen to our full audiocast series at Ameriprise.com/marketvolatility. Today, we're going to discuss financial planning and investment perspectives that can help you avoid any emotional biases that you might be prone to in a bear market, and we know that support from your Ameriprise financial advisor is really helpful in this environment. But today, I'm going to be talking with Anthony Saglimbene, who is my colleague and our global market strategist. Welcome, Anthony.

Anthony Saglimbene:
Hey Marcy. How are you?

Marcy Keckler:
I'm great. And Anthony, I know you are busy watching the market and economic conditions closely. I know that's a big part of how you're spending your days, and we're certainly seeing some sharp ups and downs in the market lately. And, you know, we know it can be really easy for investors to have emotional reactions to what we're seeing and to let those kind of gut instincts step in and maybe overweigh some of our more objective decisions.

Anthony Saglimbene:
Yeah, yeah, and I think during periods of market stress, that, that's when it really can crop up. And it doesn't matter if you're a conservative investor or an aggressive investor, it, it, it can be easy to let emotion start driving your investment decisions and one of the things that we've been focusing on is really establishing and launching a series of reports that can help investors kind of understand these investment biases that, that we'll talk about. Just over the last few weeks we, we've highlighted a few of them around time horizons, market timing, investor in bear markets, how to think about diversification. All of these can be very helpful and, and objective sound principles to follow when markets are aggressive. And I think that's really, that's really important. Not only do you, do you need to understand your investment biases, but you need to understand the principles that, that could kind of keep you invested. And one of the things that we've been really highlighting over this entire bear market is just the need, a) to understand your risk tolerance. So, you know, have a very good understanding of, of where you're conservative, moderate, or aggressive. Advisors can obviously help you navigate that and

get the right risk tolerance, but that's the key ingredient in leading into the type of diversified portfolio that you need to weather these storms. And diversification I, I think is, is probably the most important principle to lean on because it, it helps you weather the storm, it keeps you invis- - invested during a difficult period, and hopefully, on the other end, it has kept you invested so you can participate in, in that uptrend. And I think those are important principles along with rebalancing your portfolio, leaning on high-quality investments, these are all the things that advisors can help you with and it's what we've been, you know, promoting in a lot of our research, and you can ask your advisor for that research and they can share that with you because it is available for clients as well.

Marcy Keckler:
Thank you, Anthony. And, you know, that research I think is really important in it reinforces, as you just said, some key principles of sound and objective decision making for investments. One of the things we also know from extensive research on the human mind is that we do have ways in which our kind of unconscious mind influences our investment decisions and, you know, we bring some biases to the table when we are making decisions. And I do want to talk to you about some of them that are really important for investors and how these unconscious biases are things that we need to both be aware of and then take steps to counteract. And there are four that I'd love to talk to you about today. The first is overconfidence. The second is aversion to loss. The third is anchoring. And the fourth is pattern seeking. And I know they're all kind of related but distinct. And so I'd like to talk with you first about the, the bias of overconfidence. And this is really about people overestimating kind of their investment abilities and maybe underestimating risk that's present in the investment environment. Can you talk about how that overconfidence bias might be something we want to be thoughtful about in how we can think about overcoming it?

Anthony Saglimbene:
Yeah, you know, I think investors, it, it, it's easy to become overconfident in an environment, particularly in the environment that we had prior to this down drop where we have, you know, 11 so years of really just rising stock prices. So you forget that markets can go down and they can go down for longer than just a brief period, so it, it's easy to start overestimating your ability to generate returns and the consistency of those returns. So when you look at the, the stock versus bond kind of return mix, generally stocks outperform bonds on a one-year rolling period about 67% of the time. That, that's a good average but, but it also means that 33% of the time bonds can outperform stocks and it's during those periods where markets are falling that if you are overconfident or you've over-allocated to equities or you've made investment decisions that, you know, include stocks that might not be well-positioned for that downturn, it can lead to, to poor returns. And, and, and we all inherently know that over, over the long period, stocks do outperform in fact over a rolling 30-year period, stocks outperform bonds 100% of the time. But it's in between the 30 years and the one-year that there's a mix, and you have to lean on diversification, you have to not be overconfident that your equity positions will always outperform bonds, so I, I think leaning on objective information, particularly understanding that stocks don't move in a straight line, that helps curb some of that overconfidence.

Marcy Keckler:
Can you talk a little bit more about maybe some of the impact for investors of that overconfidence bias that we all can be subject to?

Anthony Saglimbene:
Yeah, yeah. Herding mentality, right? I, I think about, I think about the last few years of particularly 2019 where the S&P 500 was up 30%. And if you're sitting at home and you're looking at your portfolio statements over the course of, of that year, and asking yourself why isn't my portfolio keeping up with an all-equity portfolio, you know, that can build in some of that overconfidence because you're, you're looking at I want to participate, I want to rally like the, like the S&P 500. I would point out, though, that it, it's during these downdrafts that, that really diversification adds value. So even though the S&P 500 was up 30% last year, a typical moderate portfolio was up almost 20%, so you participated in that rally and then when we got to this year, that moderate portfolio was actually outperforming the S&P 500, particularly in the middle of March, when stocks were moving straight down. So if you can kind of take away that overconfidence bias and, and kind of put aside that herding mentality, I, I think you alleviate some of this, this bias, and just understand that over time, your stocks, your portfolio will participate in the rally, they just won't participate as much when markets are moving in, in a one-way straight line. However, when they do generally fall over the short periods, your diversified portfolios generally insulating that risk, which I think is a, is a better, smoother ride for investors and their returns over time.

Marcy Keckler:
That's a great reminder, Anthony, that when we see news reports or we, you know, read things about the performance of a, an all-stock index like the S&P 500 or the Dow Jones Industrial Average, to remind ourselves that that's not really the right yardstick if you are not invested completely in stocks or just like that index, it's a, a useful frame of reference, but it's probably not the right direct comparison because as you said, for most investors, we'd recommend a portfolio that has many more sort of colors in the pie chart, so to speak, you know, more asset class exposure, so that's a really useful reminder of the value of diversification.

The second bias that I want to talk to you about is the aversion to loss. And, you know, research has demonstrated that people feel the pain of loss twice as acutely as they feel the, the joy of a, maybe a gain, and so we know that that bias can cause people to really feel stung by losses and, and maybe even miss out on opportunities because of that loss aversion. And, and certainly, as people have been tracking their portfolios over the last number of weeks, we, we may have a lot of people who are feeling that right now. Can you talk about how we can manage that bias and that aversion to loss that we all have?

Anthony Saglimbene:
Yeah, no, I mean, I, I think you highlight aversion as losses being innate, right? I mean, we all don't want to feel pain. And generally when it comes to investing, you know, the, the, the way investors look to minimize that pain is by reducing or taking quick actions in

their portfolio that may actually be detrimental to their long-term success. And I, I think the examples of 2000 and then 2008 and 2009 during the financial crisis, you saw a lot of investors pull away from equities. They reduced their, their equity exposure, they reduced their exposure to equity funds, and they piled into bonds and cash. And, you know, as you highlighted, you, you feel that loss much more than the gains, so I think investors during those two downdrafts were more eager to just move to the sidelines and, and let the smoke clear and then they would get back in. I think what we found over both of those periods was that getting back into the market was very difficult. It is very challenging for investors to return back to either their standard strategic mix or just return back to equities altogether. And what we've seen particularly in the 2008 and 2009 financial crisis is that investors were very slow to come back to the market and lost years of the, the upswing in the market and the recovery in stock prices, so their long-term returns were damaged by making those rash decisions to just try to avoid loss, and we published a committee perspectives paper a week or two ago that highlighted that just missing some of the best days of the market substantially reduces investors' returns, so if you just buy and hold over that downdraft and you participate in the recovery, the long-term average of the buy-and-hold strategy is about 11% annually. However, if you've missed the, the, the best 10 days, your return drops to 8.9%. If you missed the 25 best days, your average return drops to less than 7%. So by and particularly during volatile periods where big up days and big down days are sandwiched together, making those decisions during times of stress to avoid the loss, you generally don't get back in and participate in the up markets. And I think if you can just avoid making those decisions that you know it's tempting, you know, and over-allocating to cash and bonds, if you can kind of just maintain your investment profile, you will generally weather the storm and you'll participate in the upside that eventually comes. We don't know when it's going to come but it eventually comes and your portfolio will benefit from it.

Marcy Keckler:
Thanks, Anthony. It's a good reminder that this bias of an aversion to loss is something that we can manage and by doing so, we, we really give our portfolios an opportunity to benefit from, as you said, those important days of the upswings that that's a little bit hard to guess exactly which days those are going to be, so that's a great reminder. And that, that aversion to loss is natural and so working to counteract it is going to help, help all investors.

The third bias that I want to spend some time talking to you about is, is called anchoring and that's really about relying too heavily on specific information when you're making decisions, and sometimes information that's outdated and an example I always think of around anchoring is that, you know, one thing many people do is think about purchasing a home and I remember the first home that my husband and I purchased at the time we did that, it was about 24 years ago, our interest rate that we thought might be a great deal, you know, we've been watching rates, it was in the upper 7% to lower 8% range at that time and now that would be a bad rate to anchor on if I were trying to make a mortgage, you know, decision today, whether I'm getting a new home or refinancing. And so, you know, circumstances change with mortgage rates and many other things, and so how can

people think about this bias of anchoring and, and how can we work to overcome it so that we are making the most objective investment decisions that we can?

Anthony Saglimbene:
Yeah, no. I think that, that, that's a great example. You know, and I think with, with investing, it, it, it becomes, anchoring becomes an issue of just relying too heavily on a, on a very narrow set of information or, or even recency bias. You know, taking the current market circumstances and applying that out to the future, that all kind of is involved with anchoring and an example I think about is just, you know, the way the market is trading over the last several years, you probably heard a lot about buy the dip, right? Just meaning that when stocks take a drop, you would, you would keep buying activity ensue because stock prices were going generally in an uptrend for so long that traders and investors just assumed that strategy would work. They also assumed that by, by doing that strategy over time, they would make money and they employed it, you know, generally because it was a convenient and easy thing kind of just think about right, our mind looks for we'll talk about patterns in a minute, it looks for ways to make sense of the world and compartmentalize the information that buy the dip was, you know, a strategy that worked. However, as a bear market if you were following that strategy, you would likely losing money. And so traders and investors that were following that strategy quickly had to, you know, put that strategy to the side because you need to, to avoid anchoring, you need to accept that market circumstances change and when they change, your outlook has to change accordingly. And I think that's the, the, the key thing to remember around anchoring is that the trends that are happening today don't happen in perpetuity, and when the market changes and the dynamics and the environment changes like we're in today, you have to think about things differently. So that, that buy the dip strategy turns in more to a rebalancing strategy or a maybe systematic way to invest in the market that's more cautious, right? So you don't just put all your money in the market and assume that it's going to come back in the next month or two months or three months, you look at high-quality companies and you systematically invest in those stocks over time and you expand your timeframe based on the dynamics that we're in today. I think that's, that's one of the ways that you can avoid that anchoring, which can be damaging to your portfolio longer-term.

Marcy Keckler:
Thanks, Anthony. Ands so let's turn to that, that fourth bias that I want to talk to you about today and you made mention of it just a minute ago, and that is the pattern-seeking behavior. We know that human brain really likes to find patterns. We seek them out, sometimes we see them where they don't exist and, and that really can lead us to, you know, mistakenly believe that we might be able to predict what's coming in the future based on what looks like a pattern but might not actually be a predictable pattern. Can you talk about how that bias can affect investors and, and what we can do about it?

Anthony Saglimbene:
Yeah, I mean, like you said, investors, just our, our human brain seeks patterns and I, I think that's the easiest way to kind of develop a strategy, but it, it's not always the necessary, necessarily the best way. What happens if you, if you see patterns in the

investing world that you think are happening, they could be false and they could actually prove detrimental to your portfolio. I, I, I think about just how we need to think about consumer behaviors going forward, right? It's an example would be if you look at consumer and leisure trends prior to the COVID-19 pandemic and you apply those same traits, same trends after the market reopens, I think that would be false. Right? People are going to come back to work slowly, the economy is likely to open up slowly, and their behaviors, consumer behaviors are going to shift. They may not want to travel on an airplane as soon as the economy reopens. They may not want to be in a theme park until there's a vaccine, so those trends that were pretty well established prior to this pandemic are, are not likely to be the trends going forward. And if you are investing with those trends in mind, you could make mistakes in your portfolio, so generally, the way is to, to kind of help alleviate that is, is really, you know, set real ex- - realistic expectations for your portfolio both from a return and risk perspective. I think you need to also understand that markets move in unpredictable ways and, and can incorporate that into your views. I would also say even though that the near-term is unpredictable, as I mentioned earlier, stocks move up and the - to the right over a long enough time horizon. If you have more than a couple years for your time horizon, then you will likely be able to take advantage of some of the opportunities that are market today. And I would also say that, that society is aging and the demographic shifts that are taking place are likely to lead to slower growth. So some of the trends that we saw prior to this pandemic are not likely to re-exert themselves or maybe even be relevant in, in the context of us moving forward. Recognize that and incorporate it into your views moving forward. Lastly, if you're following a diversified portfolio mix of stocks, bonds, cash, you're likely weathering the storm better and you're likely to come out on the other side by participating in some of the gains that will occur eventually.

Marcy Keckler:
Thank you, Anthony. And I, I think you've given us some great reminders that we have biases, our human brains can't help it, that's how we're wired, but also we know that there are some sound investment principles that we can stick to and, and you certainly reinforced the importance of a diversified approach and having the ability to stick with it because it was designed to help weather a storm, and so when you're in the storm, it's time to take advantage of that diversification but also to make sure that we are rebalancing with the evolving conditions in mind, so those are all great reminders. And of course, one of the most important things is we know that working with a financial advisor is a great way to make sure you are getting objective information and having help and partnership to make sure that you can overcome any of those biases. Any final thoughts you want to share with our listeners on how to think about their management of emotions in a bear market or kind of a volatile market environment?

Anthony Saglimbene:
Yeah, no. I would just say try to keep a level head. If you do have questions or concerns about what's happening in the market, a) our investment research group is, is covering that and we're providing daily insights into what's happening into the market and the economy. We're publishing reports, as I mentioned, that can kind of highlight some of these long-term trends. I would lean on your financial advisor to help navigate some of

that and get you access to some of those reports and just, you know, again, concerns or questions that you have. Lean on your advisor. That's what they're there to do. They're there to help support you and make sure that you can navigate this environment because we will come out on the other side and the environment will improve, making the sound right decisions today can help you navigate for the future and I would focus more on that than the, the present situation we're in right now.

Marcy Keckler:
Thank you, Anthony. It's always a pleasure to talk to you and thank you to all of our clients who joined us for today's audiocast. On behalf of everyone at Ameriprise, I want to say thank you. It's our privilege and honor to work with you. We appreciate the trust that you place in us to help you achieve your financial goals and dreams and your advisors are here to help you. Your advisor knows about you, cares about you, knows your goals, and they're here to help, and you can also take advantage of our capabilities at Ameriprise.com to help you see your accounts and your goals and how you're doing in terms of tracking to those goals by accessing the secure site at Ameriprise.com. And you aren't already doing that your advisor can help you get set up. So thank you for listening and continue to take good care of yourself and your loved ones in this challenging time.

Finally, before we leave, I'd like to share some important disclosure information.

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