Keeping Up with the Joneses

Make yourselves sheep and the wolves will eat you."
- *Benjamin Franklin*

Ask a professional money manager, what are the greatest forces driving investor behavior and you will likely receive the following response – "Greed and Fear." Broadly speaking this is true. As a group, investors tend to load up on risk when the investment environment appears benign in an attempt to capture a bigger share of the spoils. Conversely, investors predictably run for the hills as word of danger spreads. Separating the news from the noise is almost always easier said than done.

Closely related but much less appreciated is the concept commonly referred to as the "Fear of Missing Out" or "FOMO" for short. No one likes to miss out on a good thing, especially when they see their friends, neighbors or rivals cashing in. Many investors will not tolerate underperforming their peers in bull markets. However, as markets decline and losses mount the same comparisons seem to go by the wayside. Rarely does one brag about losing less money than the next guy. But maybe they should, as limiting losses in down markets is the key to long term growth.

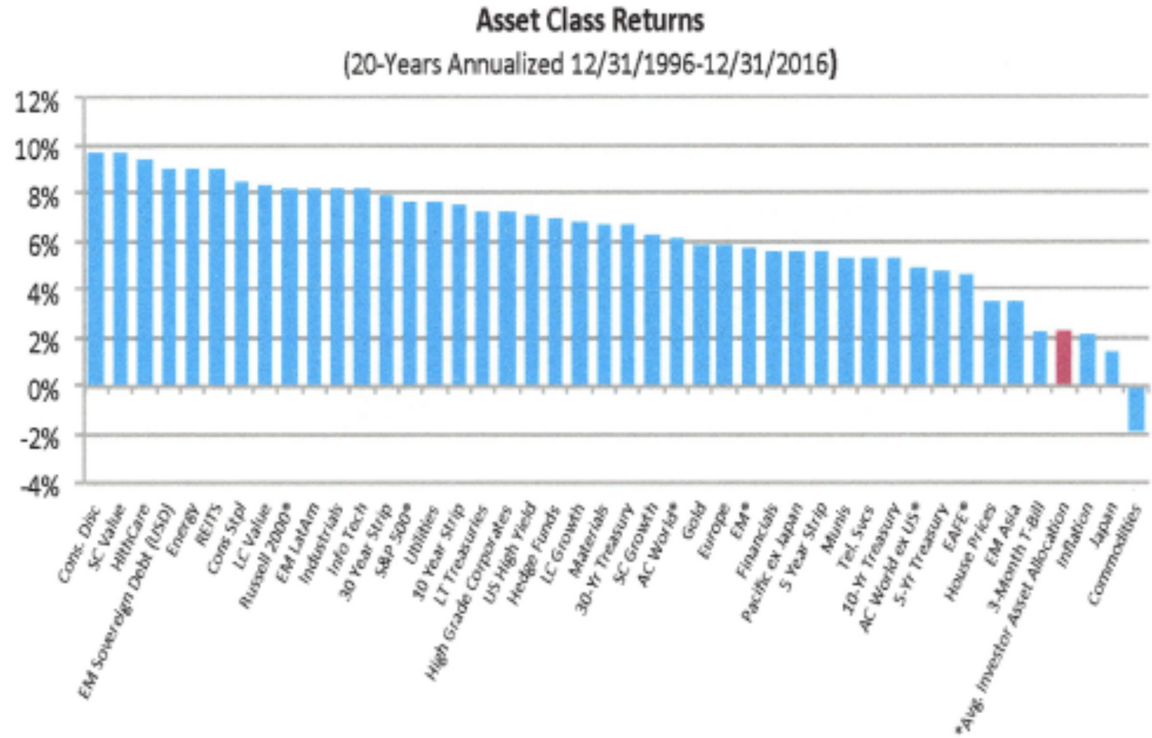
Much of the above feelings may be driven by concerns about relative wealth, or how much you have compared to those in your peer group. This theory was explored in a 2007 study, "Relative Wealth Concerns and Financial Bubbles," by Peter DeMarzo and Ilan Kremer of Stanford University and Ron Kaniel of Duke University.

The authors found that even when investors believe prices are high relative to fundamentals, they often remain fully invested due to a fear of missing out on a further extension of valuations. "Relative wealth concerns help support the existence of financial bubbles by increasing the risk of trading against the crowd." Investors who strive to keep up with the "Joneses" may be adding to their anxiety while ignoring seemingly obvious risks.

Since 1994, the Dalbar Group has studied the effects of investor decisions to buy and sell mutual funds over various time horizons. The results consistently show that individual investors earn on average much less than mutual fund performance reports would suggest. The chart below, courtesy of Richard Bernstein Advisors, shows the annual performance of the average investor over the past twenty years has failed to exceed the minimal returns on cash as measured by 3-month U.S. Treasury bills. There are a few factors related to this historical underperformance but mistiming investment decisions (investor behavior) had the greatest effect on the results (see link to audio interview here).

As a group, individual investors are often late to the party – they tend to buy and sell at the wrong time. Numerous studies have shown that trying to time financial markets on a short-term basis is an exercise in futility. On the other hand, investing with a long time horizon has a high probability of success – after all, investors usually demand to be compensated for tying up capital and bearing risk.

My advice for investors is to work with a professional. When volatility is low and markets are rising, investing mistakes are easily washed away or swept under the rug. Given time, these trends will reverse and investor anxiety will return. In this case, the mistakes of the past are doomed to be repeated. Securing the counsel of an investment manager/advisor can make the difference between being the average investor described above or achieving one's goals.



Source: Richard Bernstein Advisors LLC., Bloomberg, MSCI, Standard & Poor's, Russell, HFRI, BofA Merrill Lynch, DALBAR Inc., FHFA ,FRB, FTSE. Total Returns in USD. *Avg Investor Asset Allocation returns are represented by the DALBAR Inc. Average Investor Asset

Sincerely,

Justin Kobe, CFA
Founder, Portfolio Manager & Advisor

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