HOW to Stay Invested During a Pandemic?

July 3, 2020

Wes McComb, MBA, CIM, PFP

We have discussed why we should stay invested in the equity markets, but often it is HOW do we stay invested when news headlines seem to be implying that the few of us that survive this pandemic will be homeschooling and avoiding face to face contact (and never mind the bad hair!). HOW means we must "know thy self". We humans have many heuristics or biases that keep us from staying rational. These heuristics are what make us emotional, impulsive and fun so we don't want to entirely eliminate them from our lives, but we have to recognize them and override them when they are detrimental to our best interests. Two of these biases that are directly involved in our current investment environment are loss aversion and recency bias.

Loss aversion was first identified by Amos Tversky and Daniel Kahneman and it is the effect that a loss hurts us much more than an equivalent gain. The example often cited is that a $100 loss by an investor hurts much more-- twice as much seems to be the consensus-- than the positive feeling of a $100 gain. We all recognize this in ourselves once it is pointed out to us. When I have gone to a casino (which is few and far between), I play craps since it is the one game you can get close to 50/50 odds if played correctly and it is also very social. If I lose money it is more emotionally upsetting than winning, though I only talk about the times I win. By knowing this bias, we are able to insulate ourselves from its effects to a certain degree. We may still feel the emotions of a loss, but we can override it with the rational part of our brain.

Recency bias is when we extrapolate recent events into the future. I still remember after the 2008/2009 Great Recession and its huge market sell off, investors for several years subsequent got twitchy every time the market corrected a bit thinking this would be the next crash. And now here we are with 11 years gone by and we finally had our crash, but again entirely unforeseen by the market oracles. This sell off was so quick and severe that it likely wiped out most of the speculative money so the markets going forward should not have the "fast money" participating. Generally this is a good thing for an orderly market with less gambling and short term bets on the market direction.

Investors also need to be reminded of their financial plan and the details discussed when that plan was being put together. These decisions about long term goals are done without emotion and are designed exactly for moments like this when rare events can cause investors to make mistakes that can be severely detrimental to reaching their goals. Talk to your advisor and review that with him/her. Just the conversation and knowing that someone is there with your best interest in mind helps alleviate some of the worry and stress that these moments bring.

Talk to you soon! Have a great day!

Wes