Market Nosedives and Consumer Missteps

I probably don't need to spend time painting a vivid macroeconomic picture unless you've recently been doing your best impression of an ostrich. So, let me briefly spell it out: Not since Richard Nixon was in the Oval Office have we had a year in which the stock market had a worse six-month start.[1]

If you're not up on your presidential chronology, that's more than 50 years ago. At the time of this writing, the S&P 500® Index is down about 20% since the start of the year. And a similar story can be told for other major indices, with the NASDAQ shedding approximately 30% and the Dow Jones dropping about 15%.

To top things off, it's not just the markets that have been a little scary. Between ever-rising inflation, a virus that doesn't seem to want to quit, and continued sociopolitical upheaval worldwide, some (or a lot?) of anxiety is warranted. Yet that anxiety, while normal, can be the source of painful investment missteps.

To illustrate, let me share a relevant conversation between a financial advisor and a journalist regarding a recent market crash. It's an exchange that Gary Belsky and Tom Gilovich highlighted in their accessible and informative book, *Why Smart People Make Big Money Mistakes and How to Correct Them*:[2]

> "Bill (the advisor): I have 180 clients; guess how many have called me over the last two days?
> Gary (the journalist): I don't know, 100?
>
> Bill: Wrong. 158. Guess how many of them told me to sell some or all of their stocks?
> Gary: I don't know, half?
>
> Bill: Wrong, 156. Guess how old the other two are?
> Gary: Huh?
>
> Bill: Both of those clients are older than 80. Both told me to buy. You know why? Because they've seen this before."

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Even though it sounds like a conversation that could have taken place in the past few weeks, it occurred in October 1987, two days after Black Monday. If you weren't alive then or have forgotten, global markets took an unexpected nosedive, losing more than 20% of their value in a single day.

There can be times when it makes sense to act like most of Bill's clients, adjusting our portfolios in response to market downturns. If we have a shorter investment horizon, then selling might be appropriate. (Of course, if we are operating on a short timeline, we probably shouldn't be in risky asset classes to start.)

But in other cases – like when we hold longer-term investment horizons – selling off our investments might mean we'll end up hindering our long-term success. If, for instance, you sold investments in the fall of 2008 or March of 2020 and failed to get back in the market, you would have missed out on some of the biggest stock market gains in history.

Why do we so often react in this way? Why do we get overly antsy, pulling our money out when we might be better off staying put, and what can we do about it? I could have written this article at least five other times in recent memory, but once the markets cycle out of loss territory into the context of gains, it can be easy to forget the lessons of past crashes. So, let's cover two major lessons while the volatility is fresh.

Availability

My colleague Craig Fox, who teaches the managerial decision-making class at UCLA, is fond of asking his students this question: What's more common – blue cars or orange cars? If you answered "blue," you'd be right. You didn't need to consult DMV records or rely on a fancy algorithm. You answered off the top of your head, relying on a mental shortcut known as the *availability heuristic*. The gist is that it's easier to remember having seen blue cars, so we correctly conclude that blue cars are more common.

Trouble arises, however, when we rely on biased or faulty memories in trying to make predictions about future states of the world. That's when the availability heuristic turns into an availability *bias*. Applied in the context of investing, when markets seem to be in a freefall, it can be easy to assume they will continue to travel that path for months or years to come. And indeed, markets may continue to trend downward for quite some time. But if we hold a long investment horizon, history suggests that market performance will eventually trend upward.

Past performance is no guarantee of future results.

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Two solutions are readily apparent here.

- First, let's redefine "recent." Sure, things will appear to have been extra volatile and perhaps scary if we pay attention to returns of the last six months. But if we can zoom further out – perhaps considerably so – it may be easy to see how downturns aren't forever. Painful as recent losses have been, let me remind you that the markets skyrocketed in 2021, and their current value is still higher than their pre-pandemic S&P 500 levels of early 2020.[3]
- Second, if you hold a long-term investment goal and know you'd be better off not making major adjustments – or if you've already made some – then it may make sense to dial back your news consumption. Reading regular coverage of market volatility is like adding oxygen to the burning fire. But shying away from this coverage may lessen the prominence of recent market events in our mind's eye, leading us to rely on them a little less when making important decisions about our next investing steps.

Protection for Whom?

In a previous column, I touched on the relationships we have with our future selves, noting that we often feel a disconnect between who we are now and the people we will be in the years to come. Consider it this way: Our future selves may at times seem like different people altogether, almost as if they are strangers to us.

So, let me ask you: When we react to market downturns by selling risky assets, in whose best interest are we acting? I suspect the easy, knee-jerk response to this question is something like "Me in the future!"

"After all," you might tell me, "If things continue to go south, wouldn't I be wise to play it safe?"

If things continued to go south from now until you retired, then yes, it would probably make sense to play it safe. But that's a mighty big "if."

My argument is that reacting suddenly to volatility might be a case in which we think we are doing something for ourselves in the long run. In reality, though, the chief function of taking immediate action may be to give ourselves a sense of control – pacifying our current anxiety about the prospect of losing more money now.

By way of solutions, let me offer two more.

- First, before reacting, think carefully about your future self. Who are they? And how will they feel if you've stayed in the market? How will they feel if you've gotten out?
- Second, if you're unsure of what the best course of action may be, consider consulting an outside party, like an advisor. An independent, objective voice can allow the opportunity to voice your concerns, get feedback, and perhaps hear an alternate perspective.

Endnotes

[1] Hamza Shaban and Aaron Gregg, "Stocks slide, with Wall Street closing out its worst first half since 1970," *The Washington Post*, June 30, 2022.

[2] Gary Belsky and Thomas Gilovich, Why Some People Make Big Money Mistakes – *And How to Correct Them* (New York: Simon and Schuster, 1999), 61.

[3] Data as of 6/30/2022. Source: FactSet.