Market Brief

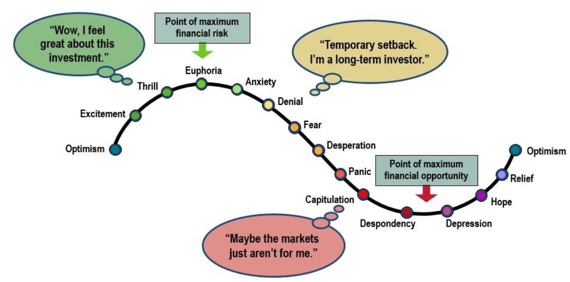
April 1, 2019

Market Snapshot	
Closing Values as of 04/01/2019	
Dow	26,234
S&P 500	2,862
Nasdaq	7,812
Gold	$1,293

April is National Financial Literacy Month, a month intended to highlight the importance of financial literacy and teach Americans how to establish and maintain “healthy” financial habits. With a growing number of American’s choosing to manage their own investments, financial literacy is more important than ever. Financial literacy takes many forms, from understanding how/why economies expand and contract to understanding how stock and bond markets work. The better a consumer understands these things the better prepared they are to establish and maintain healthy and constructive financial habits.

When it comes to investing, there are few things more important or powerful than experience. Being willing to embrace and learn from our experiences can inform and shape our approach investing in a positive way …or it can leave us with debilitating fear. Having been an advisor for 3 years before the “great recession” of 2008-2009 began, I experienced first-hand what irrational exuberance and euphoria look like. Having been an advisor during the great recession I know first-hand what utter despair and capitulation feel like. Without a doubt my first 5 years as an advisor did a lot to shape the advisor I am today and solidify my understanding of the markets and risk.

Cycle of Market Emotions



Source: Westcore Funds/Denver Investment Advisers LLC, 1998

In support of National Financial Literacy Month, I will be sharing several key concepts I think every American should know. These concepts may seem simple or basic but in my experience they are often forgotten or ignored. The first in this series will be a discussion about emotions, not exactly a financial concept but I consider it important none the less.

Cycle of Market Emotions

The single most important factor in successful investing may be emotions. More specifically, keeping your own emotions in check. Because emotions can be such threat to your financial health is it important to be aware of them. In many cases simply taking a moment to be aware of what you are feeling will provide some protection against the negative consequences of impulsive and irrational reactions to your emotions. Having an investment advisor to act as an emotional buffer can further temper our natural tendencies to take more risk when we feel good and overreact when we feel fearful.

The market cycle of emotions occurs in four phases. The first phase starts with optimism, we commonly expect things will go our way and we will get a return for the risks we are taking. As early expectations are met we get more excited about the potential for even greater returns, optimism becomes excitement. When the economy is “on-fire” and the markets are performing above expectations investors excitement becomes euphoria, this is the point investors are at the most financial risk. When investors are euphoric they become convinced that excessive returns are commonplace and that they can tolerate higher levels of investment risk.

Cycle of Market Emotions—Continued

The second phase of the cycle occurs when the market stops meeting our new, lofty, expectations and begins to flatten or turn downward. Anxiety turns to denial and then to fear, as the value of investments decline. Many investors will react defensively at this point and may think about switching out of "riskier" assets to more defensive or less risky asset classes.

In the third phase of the cycle, the magnitude of loss becomes more painful and the investor might become desperate. Many investors will panic at this point and pull out of the markets altogether – afraid of further loss. Those who remain invested often become despondent and wonder whether the markets will ever recover or maybe even whether they should be invested at all. It is at this lowest emotional point that investors will capitulate, giving in to the idea they may never recover their losses, choosing to either remain invested ("because I have nothing more to lose") or vowing to never invest again.

The cruel irony is, at the extremes, our emotions tell us to do the exact opposite of what a successful investor should do. When the markets are at their peak and we feel euphoric and invincible, we should be selling to capture the gains we have made and to prepare for the eventual downturn. At the market lows, when we feel our absolute worse and "blood is in the street", we should be buying the quality investments we owned before the peak. Essentially, our emotions would have us buying high and selling low when our goal is to do the opposite.

In the fourth stage of the cycle, investors experience some skepticism when the markets begin to rise. Having felt the pain of loss they are more cautious and may wonder if the markets will continue to grow. –and may be reluctant to invest money in the market at a point when prices are still relatively low and opportunities are attractive.

Emotions turn rational investors into irrational investors. With a growing number of investors choosing to manage their own investments using discount platforms it is no wonder the markets behave so irrationally at the extreme highs and lows.

You can help to avoid the emotional roller-coaster by being aware of the emotions you are likely to experience over your investing lifetime BEFORE you experience them. The five most common emotional pitfalls are:

Overconfidence – When investors over-rate their ability to choose winning investments or the markets ability to continue to grow.

Loss aversion – Becoming so afraid of loss that you are unable to invest. Investors experience twice as much pain from loss as they do pleasure from gains.

Chasing past performance - Abandoning a well-diversified portfolio for an investment or asset class that recently performed well or has historically performed well. This is similar to "rencency bias" where an investor assumes recent behavior indicates what future performance will be.

Timing the market – Market timing is a tricky beast. There is a difference between strategic asset allocation (increasing or decreasing your allocation to an asset class based changes in market conditions) and "timing" the market. Individual investors simply should not assume they can correctly predict the movements of the market.