Financially Speaking

Don't Let Recent Market Volatility Scare You Away from Investing

My oldest son is a senior in high school this year, which brings with it lots of excitement and also lots of decisions. Helping him to look at colleges and think about what he wants to study made me think a lot about my own education, and how what I learned all of those years ago has helped me assist my clients over the years.

You might be surprised to read this, but if I were to go back and schedule my college courses again the thing that I would study more would be psychology.

Understanding how psychology impacts investor behavior is such an important issue that it has literally developed into a whole new branch of academic research, known as behavioral finance. I find many of the concepts in it fascinating, both in their simplicity and in how often I see examples of them occurring.

In September, the US stock market experienced a bit of volatility and ended up declining by a few percent for the month. For me, a twenty-five-year veteran of investing, this was virtually a non-event. The decline wasn't enough to present what I considered a buying opportunity, and the stock market was still up substantially since the start of the year, so it was just a bit of normal price fluctuation.

Several clients that I spoke to in the first couple of weeks of October though brought up the markets falling in September and expressed some amount of worry about the volatility.

I realized that one of the drivers of this concern was a concept known as Recency Bias. Recency Bias is a concept that places greater emphasis on recent events than historical ones – in other words it means that we tend to expect what has been happening most recently to continue and we don't think about the longer history.

In this case, it was easy to understand why Recency Bias could make investors nervous. Afterall, September was the first time the stock market experienced a monthly loss since August of 2020, and that was only a very slight dip, so the last memory most investors had of a monthly stock market decline was in February of 2020.

Seventeen months of nearly uninterrupted gains had led to an inherent expectation that the stock market "should" go up every month. A longer-term perspective though says that periodic dips of a few percent in the stock market are very normal, and on average, happen a few times per year. The unusual aspect had actually been the long stretch without significant volatility, not the other way around.

This same concept can apply to more than just the stock market.

For example, I recently had a discussion with someone who was considering an adjustable rate mortgage because he said that, “interest rates on mortgages seem to go down every year”. While that may have been his recent experience, that is certainly not always the case, especially with the low starting point he was looking at.

We are all impacted by our emotions but when it comes to investing it is important to not let those feelings get in the way of your long-term plan.

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