Investment Commentary

August 2022

Global stocks rallied in July, helping to recover some of the significant losses taken in the first half of the year. US stocks led the way with close to double-digit gains, while global developed markets had close to 5% returns. Concerns about a slowing economy and a potential recession led to lower bond yields, which helped bond markets around the world generate solid results.

Return (%)	1 MO	3 MO	YTD	1 YR
S&P 500	9.22	0.39	-12.58	-4.64
Russell 2000	10.44	1.51	-15.43	-14.29
MSCI EAFE	4.99	-3.88	-15.22	-13.86
MSCI Emerging Markets	-0.16	-6.28	-17.61	-19.77
Bloomberg U.S. Aggregate Bond	2.44	1.49	-8.16	-9.12

Data as of 7/31/2022, Performance in USD. Source. Morningstar.

- The S&P 500 soared to a 9.2% gain in July, its best monthly return since November 2020. Better than expected corporate earnings and hopes for a slower pace of Fed Tightening contributed to the rally.
- All sectors of the S&P 500 advanced in July. The technology and consumer discretionary sectors led the way with double-digit gains.
- US inflation surged to 9.1% (YOY) in June, the largest increase since November 1981. European inflation rose to a record 8.9%
- Amid news the US economy contracted for the second consecutive quarter, bond yields declined in July. This dynamic and a belief that inflation may have peaked contributed to widespread gains for bonds.
- Emerging market stocks were one of the few asset classes that declined for the month, although losses were modest at (0.25%).

This month we are focusing on the topics of behavioral mistakes investors make, and the lessons we've learned over our investing careers.

Behavioral Mistakes

Unfortunately, when it comes to investing, many investors tend to be their own worst enemy. Numerous studies have shown that investors on average earn returns well below the popular benchmarks, mainly because of the emotional investing mistakes they make. Emotional investors tend to make impulsive decisions, often buying at market tops based on hype, and selling at the bottom based on fear. According to the most recent Dalbar Quantitative Analysis of Investor Behavior (QAIB) study, the S&P 500 returned 10.65% over the past 30 years through 2021, while the average equity fund investor return over that period was only 7.13%. The disparity between the "average investor" return and the benchmark is startling and reveals the negative impact poor investment decisions, usually driven by emotions, can have on long-term returns.

Fortunately, there are ways to improve your emotional intelligence when it comes to investing by learning some of the basic principles of behavioral finance.

The field of behavioral finance has grown rapidly over the past two decades and is based on an integration of psychology and finance that can be used to understand how and why investors make decisions and the most common mistakes they make. Studying and learning from the mistakes of others, without making them on your own, is one of the smartest ways to improve your investment returns. Warren Buffett famously wrote in one of his annual letters "You don't need to be a rocket scientist. Investing is not a game where the guy with the 160 IQ beats the guy with the 130 IQ." The point being that emotional intelligence and avoiding mistakes are just as important as IQ when it comes to investing. Here's a list of some of the most common behavioral mistakes investors make, and a few tips on how to avoid them.

Overconfidence- Investors often over-estimate their knowledge and skill, leading to overly aggressive bets and lack of diversification.

Tip: Think critically and evaluate investments from as many perspectives as possible. Ask yourself if you have the expertise or have done enough research to justify the level of confidence you feel. If the answer is no, you may want to hold off making that investment.

Herding- Though we are often unconscious of it, the human tendency is to "go with the crowd." This leads to investment decisions based on what everyone else is doing, which is often buying at the top of the market and selling at the bottom.

Tip: Ask yourself what is the basis for a popular trend to continue, and if the trend is so well known is the value already reflected in the investment's price (think unprofitable tech and meme stocks!).

Confirmation bias- The tendency to only seek out information that supports our current beliefs. For example, investors that believe the market will rise, tend to only seek out news and information that supports that view.

Tip: Play devil's advocate and seek out opinions that differ from your own. If it still seems like a good investment go for it.

Loss aversion- The fear of loss often leads to the selling of assets at the worst possible time, also known as "panic-selling."

Tip: Evaluate each investment on its own merit and ask yourself if the fundamentals have changed before hitting the panic button and selling. It's not unusual for stocks to experience periodic sell-offs, and if the fundamentals haven't changed it may be time to consider buying more rather than selling.

Lessons Learned

In my 30 years of investing experience, I've learned a lot of lessons. Many have come through hands-on experience (some good and some not so good), while other lessons learned have come from studying history, behavioral finance, and learning from the wisdom and mistake of others. There's no doubt I'm a far better investor today than I was 30 years ago, and much of that is attributable to the lessons learned along the way. When markets are challenging and emotions are running high, I often refer back to this list of 'Lessons Learned' to keep me focused on what matters and filter out the noise of the markets. I hope you find it useful as well.

- **Focus on executing your process, not short-term results**
  Chasing short-term performance and the latest investment fad is a recipe for long-term investment failure. I've yet to meet a short-term 'investment trader' with great long-term results. The best investors always have a well-thought-out philosophy and process that is time-tested, and they stick to it.

- **Asset allocation is the most important decision**
  Deciding how much to invest in different asset classes (cash, bonds, stocks) will have a far bigger impact on your investment results than picking a single hot stock or mutual fund ever will. Focus on what matters.

- **Markets will tend to mean revert over time**
  Markets reflect the collective emotions and sentiments of investors and often swing to extremes, both up and down. Markets will tend to revert from the extremes back towards average and beyond. The wise and patient investor will capitalize on this reversion.

- **Volatility is a friend to the long-term investor**
  The price and the value of something are two very different things. Prices tend to swing much more wildly than value does, highly volatile markets often create great opportunities for long-term investors to either buy or sell at great values. Don't be afraid of volatility, take advantage of it.

- **Contrarianism works when markets are at extremes**
  Some investors want to always do what the majority of investors are doing (the herd) and others try to always be contrarian and do the opposite of the herd. The reality is being a contrarian usually only works when the herd has gone to extremes. Be patient and take decisive action when markets reach extremes.

- **Don't be emotional, know your strengths & weaknesses, and have a plan**
  Emotions and overreacting to market movements are the downfall of most investors. Developing an investment policy and having a strategic plan in place will help to avoid the emotional mistakes of others.

- **Admit mistakes- sell your losers and let the winners grow**
  No investor is always right, we all make mistakes... simply admit it and move on. Don't double down on mistakes and hope the markets will bail you out.

- **Valuation wins in the long run**
  Valuation is not a helpful predictor of performance in the short term, however long term it is the best predictor of future returns. It may not feel like it, but when valuations are low so is your risk. The converse is also true.

- **Costs matter**
  Costs are controllable and keeping them low may be the easiest way for investors to improve their investment results. Don't overpay for investments, a simple but helpful reminder.

- **Risk cannot be avoided, be decisive when opportunities arise**
  It's easy to get paralyzed with fear when risks seem high in the financial markets, however, this is often the best time to invest. Remember the old adage "be greedy when others are fearful and fearful when others are greedy."

- **Wall Street is not your friend- avoid hype and complexity**
  Wall Street is in the business of selling investments, we know because we get pitched investment strategies every day. If it sounds too good to be true or is overly complex, you should probably avoid it.

- **Avoid intellectual arrogance, it is the enemy of good decision making**
  Being a good investor requires hard work and discipline. If someone acts as if they know everything (they don't!), and has a sure-fire strategy or product to beat the market, you should run.

If you have any questions about your portfolio or investment strategy don't hesitate to give us a call. Best regards,

Steve Giacobbe, CFA, CFP®