Opinion

Serial panicker when markets fall? Here's what to do

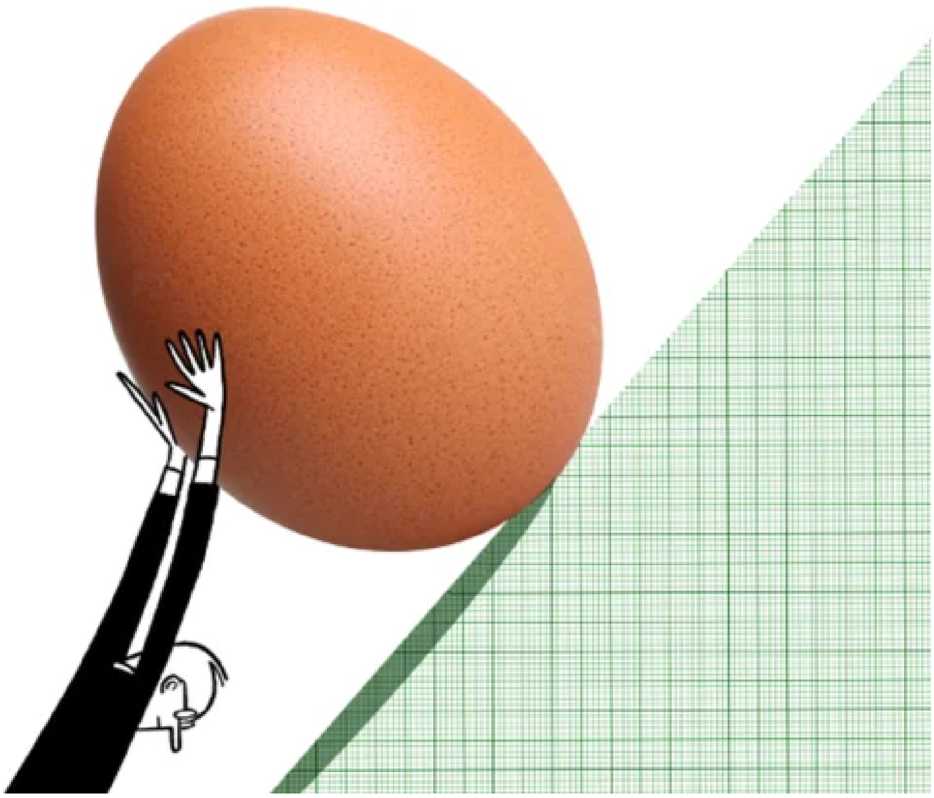
How to override your "flight to safety" gut reaction that will inevitably lead to even more financial pain.

Ben Smythe
Contributor

Sep 12, 2022 – 5.00am

Constructing and drafting an investment strategy for your self-managed super fund [https://www.afr.com/link/follow-20180101-p5bflg] is typically the easy part. The process of actually implementing the strategy and selecting the underlying investments is not as straightforward as our emotion or human biases kick in.

So how do you switch off the emotions and think like a rational investor when it comes to your SMSF investments [https://www.afr.com/link/follow-20180101-p5bdka]?



Another key piece of information is to remember that the market is forward-looking and constantly pricing and repricing data as information becomes available. **Simon Letch**

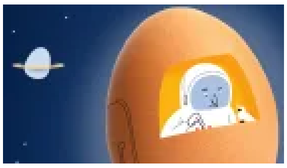
First, it is incredibly difficult always to think rationally when it comes to investment markets because the world is constantly testing our emotions. The 24/7 news cycle and growing role that social media plays in our lives leads to a heightened sense of emotion in everything we do, including investing. However, what we do know based on actual evidence is that accurately forecasting “what will happen next” is incredibly difficult, and history shows us that in the majority of cases, predictions about the future when it comes to investment markets are wrong.

So when we read compelling arguments and see interesting charts in our feeds which try and convince us that the “expert” knows what is going to happen, take it with grain of salt.

Second, behavioural studies show that humans have an action-bias when we feel nervous or fearful. The flight to safety mechanism kicks in as we look to sell higher risk investments and replace them with perceived safer investments. This reaction or action in “going to cash” can kick in when markets suffer a downfall and we are told the world is coming to an end. Selling down your equity investments at, or near, a market bottom can be a very costly mistake.
This also plays out in the active funds management world as we see professional fund managers making changes when there is volatility. Most of their unitholders are expecting them to act and as a result believe this is the right thing to do when markets are volatile. Once again, the evidence shows that selling equities and trying to time your re-entry is incredibly difficult and in the majority of cases, it is impossible to get both sides of the transactions (ie the sell and then re-purchase) right. We also know that as humans we suffer loss much more than we enjoy gains and this – coupled with our action bias when things are going wrong – makes it more likely that we will make emotional (and wrong) decisions when the market is volatile.

RELATED

My ex wants to take my super, what can I do?
https://www.afr.com/wealth/personal-finance/my-ex-wants-to-take-my-super-what-can-i-do-20220905-p5bfly



RELATED

Eight biggest mistakes made by DIY super funds
https://www.afr.com/wealth/personal-finance/eight-biggest-mistakes-made-by-diy-super-funds-20220906-p5bfvo

Another key piece of information is to remember that the market is forward-looking and constantly pricing and repricing data as information becomes available. If you look at the top 100 companies on the ASX, the market is incredibly efficient and the price of these companies will already be taking into consideration forward-looking projections. As an example, there is some discussion around whether we are headed for a recession. Equity markets will “price in” the effects of recession before the economy goes into recession as the sharemarket is forward-looking, while economic indicators are backward-looking.

If you really believe that you know something that others don’t and can take advantage of that information in relation to the company’s share price before the market does, then you might have a very rare hidden talent. It is no coincidence that the overwhelming trend of the past decade has been toward “passive” broad-market investment products that track an index. The benefit for investors from these products is the provision of easy access to capital market rates of return at low cost and without the guesswork.

It is alright to feel anxious or nervous when investment markets are jumping around. The important distinction is that a rational investor doesn’t panic and make decisions based on emotion which can end up being not only emotionally but financially quite painful.

Ben Smythe is a partner and principal adviser of Minchin Moore Private Wealth.