Client's Corner

One Year, Three Classic Mistakes

THIS LITTLE ESSAY IS BEING WRITTEN ON FEBRUARY 19TH, AND with good reason: it was February 19th of last year when the S&P 500 Index made its last all-time high, just prior to a 33-day, 34% plunge as the COVID-19 pandemic burst upon the world.

These 12 months have been as instructive as any within living memory—and just possibly ever. Specifically, this period offered investors the opportunity to make one or more of three classic behavioral mistakes—unforced errors that have the potential to damage one's long-term plan irreparably.

Before reviewing each of these mistakes in detail, let's make sure we're on the same page as to what the equity market actually did in the year between its February 19, 2020 close at 3,386 and last night's at 3,914.

As noted above, the first thing it did was to go down further than it ever has in a 33-day period, closing on March 23rd at 2,237 as the economy was forcibly shut down in reaction to the pandemic. But then, responding to monetary as well as fiscal stimulus on a scale hitherto unimaginable, the market soared, recapturing its February peak in six months less one day, on August 18.

From there, as the economy recovered more vibrantly than virtually anyone forecast, and as two vaccines have gone into broad distribution with a number of others in the pipeline, the market has pushed relentlessly into new high ground. It closed last night 16% higher than its 2/19/20 peak—not to mention 75% higher than its 3/23/20 trough. Of course, this ignores dividends; add about a point and a half to the foregoing gains to fully appreciate the genuinely astonishing performance of mainstream equities over the course of these tumultuous 12 months.

That's what the market did. The focus of this essay is on what investors did—or, with the wise counsel of a seasoned financial advisor, what they refrained from doing. Because this year, as I suggested, offered investors the opportunity to make at least three potentially fatal mistakes. They can be recounted in three P's: Panic, Politics and Performance-chasing. And what they all have in common is one or another iteration of fear. Observe:

1. PANIC. Yes, the pandemic represented a hundred-year public health crisis, unrivaled since the 1918 flu event. And yes, governments responded by locking their economies down and setting off a deep and almost instantaneous recession. And yes, the S&P 500 went down further and faster than it ever had before. Those were stimuli. ***Panic is a response.*** It is always the wrong response, as the market demonstrated to a fare-thee-well in six months less one day...and ever since.

2. POLITICS. The presidential election cycle which culminated on Election Day—or, if you prefer, when the Electoral College certified the result in January—was surely the most bitterly partisan (and, on occasion, violent) in living memory. Quite large swaths of the population on both sides of the political divide feared that the election or re-election of the other side's candidate would represent an existential threat to American democracy. Many responded to that fear by liquidating their equity portfolios. I think it's fair to say that the equity market has rarely if ever punished that decision more quickly or savagely.

3. PERFORMANCE-CHASING. Throughout the market's February/March cataclysm, and for many long months afterward, the stocks of the largest half-dozen tech companies not only led the market, but at times were the only investment thesis that was working ***at all***. Some number of investors surely used this anomaly as an excuse either to get out or to stay out of the market; it's at least arguable that their retirement plans may never recover. But others surrendered to FOMO—the dreaded Fear of Missing Out—and narrowed their portfolios down to the stocks which had been hottest over the last block of time. In 50-odd years of professional investing, I've personally never identified a strategy that offered greater assurance of substandard performance than buying ***whatever was hottest in the six months before you bought it.***

What, if anything, might have prevented an investor from falling into any and all of these traps? That's easy: having a goal-focused long-term plan going into the chaos—and remaining true to that plan throughout.

I can't be objective about this—for no better reason than that I'm one of them—but I believe the most successful investors lo these 12 months past were those who had a plan-driven, well-diversified equity portfolio last February 19—and who were still holding that portfolio when the sun came up over the Republic this morning.