# HOW TO BENEFIT
## FROM A MARKET 'SABBATICAL'


### Key Points:

- Emotional biases involve making decisions based on feelings, which may lead to irrational investment decision-making.
- Consider simulating a market 'break' to close the behaviour gap between what we *should do* with our money and what we *actually do*.
- A market 'break' forces you to stay invested and align your time horizon with your investment objective(s).

### Will we ever learn?

It really has been an extraordinary period for financial markets. Very few people thought 2023 would be a blockbuster year for global equities. They could hardly have been more wrong, not noticing how silly many forecasts seem to be – including my own.

A year ago, everyone was predicting a recession in the world's largest economy. The US Fed raised interest rates at the fastest rate since the 1980s, a regional banking crisis felled Silicon Valley Bank, and war broke out in the Middle East. Yet, shares kept going up and all the major indices are now at new record levels.

Investors trying to forecast markets and following daily market headlines often make investment decisions based on emotions and, to their surprise, not achieved the desired outcomes to meet their financial needs.

### The greed and fear trap

Whether we like it or not, emotions play – and will always play – a significant role in decision-making, and investors are no exception. At the same time, we need to appreciate that many investors have limited knowledge of financial markets and investing principles. This lack of understanding can make investors susceptible to emotional decision making.

Investors often have a short-term perspective for various reasons, such as the desire for quick gains or the need to meet immediate financial obligations. This short-term focus can overshadow long-term goals. Cognitive biases such as fear, greed, and herd mentality can influence investment decisions. For example, fear can lead to panic selling during market downturns, while greed can drive investors to chase short-term gains without considering long-term goals.

### Maybe it is time to be bold... 'pull' a Rip Van Winkle

Why not take a 'break' that disengages you from the daily noise of financial markets?

The story of Rip Van Winkle was a 19th-century American classic, written by Washington Irving and published in 1819. It creates an analogy of the American Revolutionary period through the tale of a man who falls asleep and awakes 20-years later to a changed world, having missed the revolution. When you do not watch the market every day, you can finally see with unquestionable clarity that what you would have expected to happen, did not. Rather, the unexpected happened. The gratification comes from never having been remotely tempted to act on any of those forecasts.

Research suggests techniques to take a market 'sabbatical' that can help avoid making decisions you might later regret. It can reduce the anxiety stirred up by negative news. While you 'cannot disappear' for several years, you can pretend that you did. Hal Hershfield, a psychologist at the University of California, Los Angeles and author of [1]"Your Future Self: How to Make Tomorrow Better Today," urges investors to use tools to get away from the domination of the present – envisioning how you will feel about your actions tomorrow can help prevent you from overreacting today.

## Honour the mandate

Consider your market 'break' as the time-period you 'signed up for' when you selected a fund/portfolio to meet your investment goal(s).

Different time horizons for different goals

### Example

A fund is expected to deliver real returns of 6% p.a. i.e. CPI+6% p.a. over the long term (net of fees). To minimise the chance of capital loss, investors should expect to invest over periods of at least seven years.

You may have to be Rip Van Winkel for seven years

By understanding and aligning investment decisions with both your investment objective **AND** your time horizon, you can significantly reduce the risk of unexpected outcomes. Understanding your time horizon is crucial because it impacts your risk tolerance. Generally, the longer your time horizon, the more risk you can afford to take. This is because you have a longer period in which to recover from any temporary market fluctuations. On the other hand, if your time horizon is shorter, you may need to prioritise capital preservation over potential gains. Ultimately, understanding and aligning your investment time horizon with your goals is crucial for successful investing.

Even if the time horizon is longer than say seven years, there is still the chance that the investment may not deliver according to expectations, or it may even make a loss. Therefore, the investment time horizon of a fund should be viewed as the very minimum holding period for an investor. It is important to understand that this is not a guarantee that the investor will not lose money if they hold on to the investment for that period of time. Rather, the chance of not losing money gets progressively better the longer an investor remains invested.

## The outside perspective

Seeking investment advice can also provide a valuable outside perspective that could help avoid making biased decisions – either by reminding you of your goals, risk profile and strategy; or by providing the information required to make more informed decisions and prevent costly mistakes.

Your financial adviser is there to provide objective guidance and help investors navigate through emotional biases. Advisers offer a rational/unbiased perspective and provide accountability to ensure investors stay focused on their investment goals i.e. allocate money towards investments that are aligned with your investment objective(s) **AND** time horizon(s).

## In summary

Let us be honest, it is not easy to take the emotion out of investing. By stepping back – taking a sabbatical – you can reduce the frequency of monitoring markets and avoid being influenced by the day-to-day noise, thereby allowing you to focus on the bigger picture. This can help you maintain a more disciplined and rational approach to investing. It allows you to focus on the fundamentals of your investment strategy and stay committed to your long-term plan.

[1] https://files.consumerfinance.gov/f/documents/cfpb_future-self-tool_2021-05.pdf.