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DARE TO BE DULL

Emotions lead to asking the wrong investment question

By far, the most common question I've been asked during the past month is "Should I get back into the stock market?"

My answer: Absolutely not. Yet, do I think this is the most irrational question?

My answer: Absolutely not.



A look back at the market

Between 2002 and 2007, the stock market soared, with U.S. stocks doubling and international stocks tripling. It was a new paradigm of easy money based on the belief that real estate would never decline.

Money was pouring into the stock market while gurus were busy predicting more good times to come. Risk profile surveys led investors to believe that they could take tons of risk, and they did. They were advised to put most of their nest eggs into the stock market, and they did.

The market has historically been full of surprises, and 2008 brought its share, not the least of which that titans like Lehman Brothers and AIG faltered badly.

On March 9 of this year, the surprises continued, with the U.S. and international stock markets bottoming out, losing more than 50 percent of their value compared to their height.

A new paradigm of prosperity bites the dust.

Since that time, however, markets recovered dramatically, with U.S. markets up about 65 percent and international markets gaining 90 percent.

I wish the math worked out that a 50 percent loss followed by a 65 percent gain was a positive return, but it doesn't. Stock markets are

still down more than 25 percent from their all-time high.

Reliving our painful past

Before I explain the folly of asking whether the time is right to get back into the market, let me relive some painful moments from the recent crash.

The stock market was in free fall and "The Great Depression Ahead" was a best-selling book. The new paradigm was that capitalism was dead.

Our 401(k)s had become 201(k)s and the experts were telling us to jump ship before they became 001(k)s.

You might realize where I'm going with this.

The most common question I was getting at that time was: "Is now the time to get out of the stock market?" And this was only from people who hadn't already panicked and bailed out.

Irrationality of our statements

From an emotional standpoint, both questions make perfect sense. But from an economic standpoint, here is what we are really asking:

■ After the plunge — Now that the stock market is having a half off sale, should I sell?

■ Today — Now that the half off sale is finished and prices have skyrocketed, should I buy?

When you think about the economics of these statements, investors might as well be saying that they actually like to buy stocks after they have gone up and then sell them after they plummet for a big ol' loss.

Would those same people stand in line for a "Black Friday" sale with a 75 percent price mark up, then return to the store later to return the purchases at half price?

Both questions are irrational and driven by our emotions, rather than pure economics,

but they also are predictable.

That's why, on average, investors underperform the market by about 1.5 percent annually, over and beyond costs. This timing penalty is virtually identical whether you do it yourself or use a professional.

The tendency to buy high, only to sell low, is so predictable that you can practically set your watch by it.

My advice

Our human instincts have served us well and kept us alive. Yet fear and greed fail us miserably when it comes to investing.

Buying high and selling low feels like the thing to do at the time, despite the fact that it is never the thing to do at any time.

Don't make your decisions based on feelings. Pick an asset allocation and stick to it.

If, for example, you were going to be 50 percent in stocks and 50 percent in fixed income, you would have been forced to sell some of your stock portfolio during 2007 because that portion of your portfolio bulged to become more than 50 percent of the total.

Then, after the plunge during 2008, you would have been forced to buy equities. It would have taken a lot of courage, however, to buy in the face of the "capitalism is dead" new paradigm.

The "pick and stick" strategy is the one way you can avoid getting dragged along by the herd. But "sticking" requires rebalancing, and rebalancing requires that you buy when everyone is selling and sell when everyone is buying.

It's simple, sensible and effective. What it isn't, is easy.

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