Reacting to news headlines

White paper

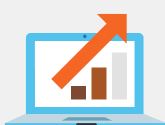
# Staying focused when headlines react

## The emotional influence of news headlines on investors, and the consequences of emotional investor behavior.

### Key highlights

- **News headlines lead investors to make irrational and emotional decisions,** many times due to the hard-wiring of the human brain.

- **The average investor has underperformed the market** as they have tried to time changes in performance trends. Frequent trading and short holding periods are driven by emotional reactions to news headlines.



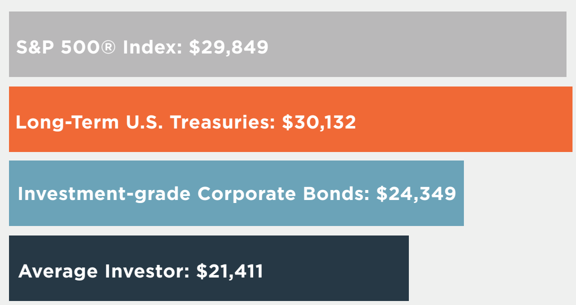
- **Investors can help avoid reactions to market headlines by sticking to investment basics,** seeking opportunities to buy when others sell, and working with a financial professional.

## Summary

Today's investors today have vast an abundance of information at their fingertips. News of significant market events arrives in real time—24 hours a day, seven days a week, easily accessible with a few clicks or the swipe of a thumb.

Despite the prevalence and access to investment information, individual investors still struggle to find success in the financial markets. The average investor continues to underperform broad market indexes—a trend that has been in place for many years and continues to this day. (See below.)

### Growth of a $10,000 investment, 1998-2018



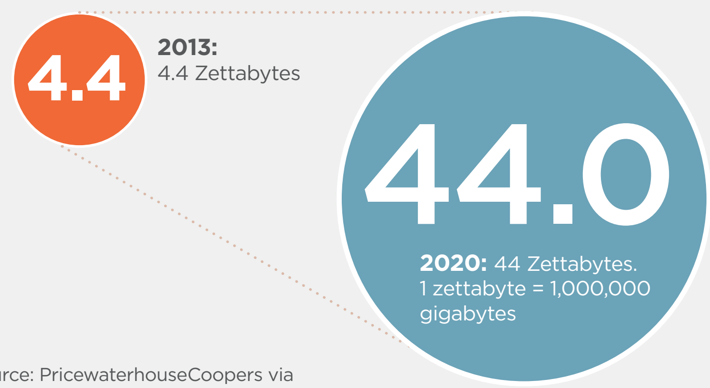

Based on average annualized total returns as of 12/31/2018. Average investor returns based on Dalbar, Inc. 2019 Quantitative Analysis of Investor Behavior, assuming a portfolio allocation of 50% large-cap blend and 50% fixed income. Source for index data: FactSet Research Systems.

While there are many causes for this underperformance, frequent trading (often at inopportune times) is the primary culprit. Much of the frequent trading happens as individuals investors react to news headlines.

This white paper examines the role of news headlines in driving emotional reactions and investment decisions. We'll discuss the consequences of headline-driven emotional investing, and share ideas to help investors tune out the noise from the financial media and focus on the basics of long-term investing.

# Too much of a good thing

We are currently living in an age of information abundance. For an investor, that can be blessing; anyone with enough curiosity and a few seconds to spare can unearth knowledge on any asset class, industry sector or company under the sun. Turn this information into intelligence and it can become a powerful resource for making informed investment decisions.



Source: PricewaterhouseCoopers via Visual Captialist

**But information abundance can also become a curse when it turns into a glut.**

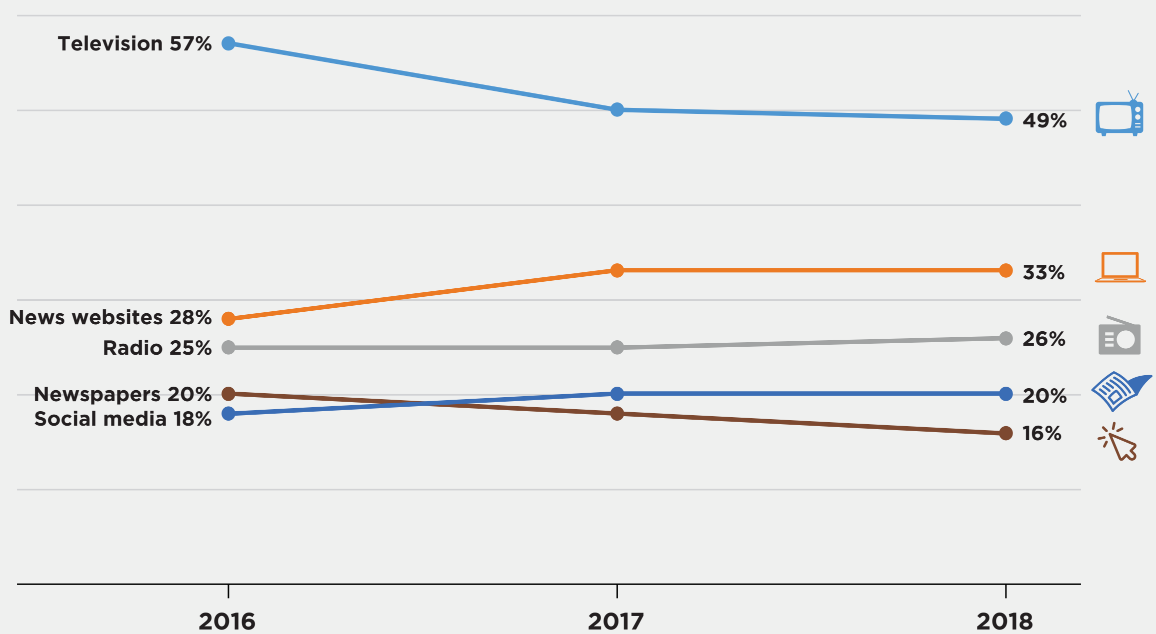
These days, it can be said investors have too much information at their fingertips. While some of it is valuable, a lot is simply "clickbait" that distracts people's attention or sensationalism that provokes emotional reactions.

The information glut did not appear overnight—it has accumulated over the last four decades. A confluence of forces has brought us to this point of saturation, from the rise of round-the-clock news, to the broad adoption of technology, to the spread of interconnectivity through the Internet.

Also significantly, the growth of the information glut has occurred alongside the democratization of the financial markets. Starting in the 1980s with the introduction of 401(k) plans and individual retirement accounts (IRAs), investors have assumed greater responsibility for preparing for their financial futures and making their own investment decisions.

**Investors must rely on their judgment to sort through the information glut and extract the good data from the bad.** That can be a challenge as news headlines demonstrate strong emotional influences over the ability to make rational investment decisions.

**How are Americans staying informed about current news events?**

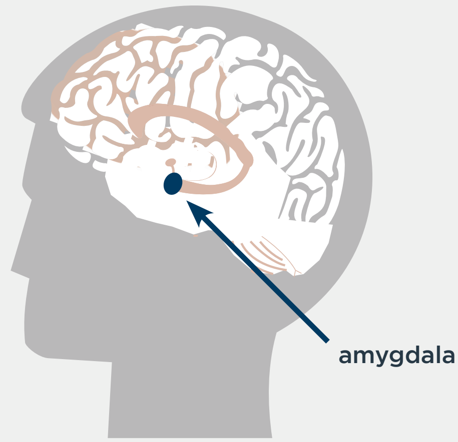


Source for chart data: Pew Research Center survey July 30-Aug 12, 2018

# Bad news is good business

In the information glut, attention and diversion are more valuable than knowledge and intelligence. For the most part, broadcasters and publishers of financial news strive not to inform investors but to attract them. Their profits are driven by ratings and click-throughs—the more viewers or subscribers they have, the more attractive their media platforms are to advertisers. And nothing attracts individual investors more than bad news.

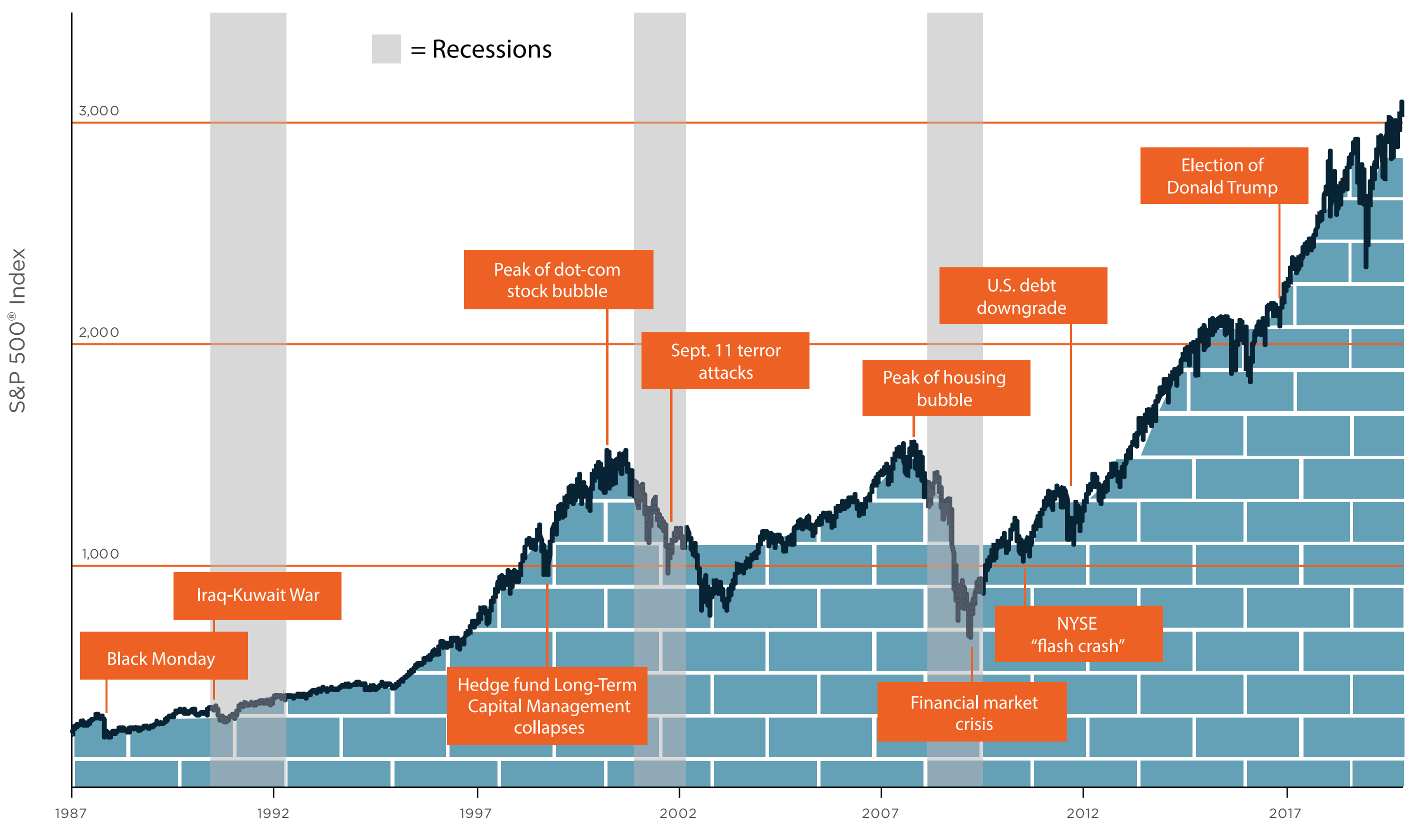
Look at the financial markets to see the effect that news headlines can have on investors. It is often said investors climb a "wall of worry" as market cycles reach their final stages, either at the bottoms of bear markets or near the peaks of bull markets.




## A neurological view

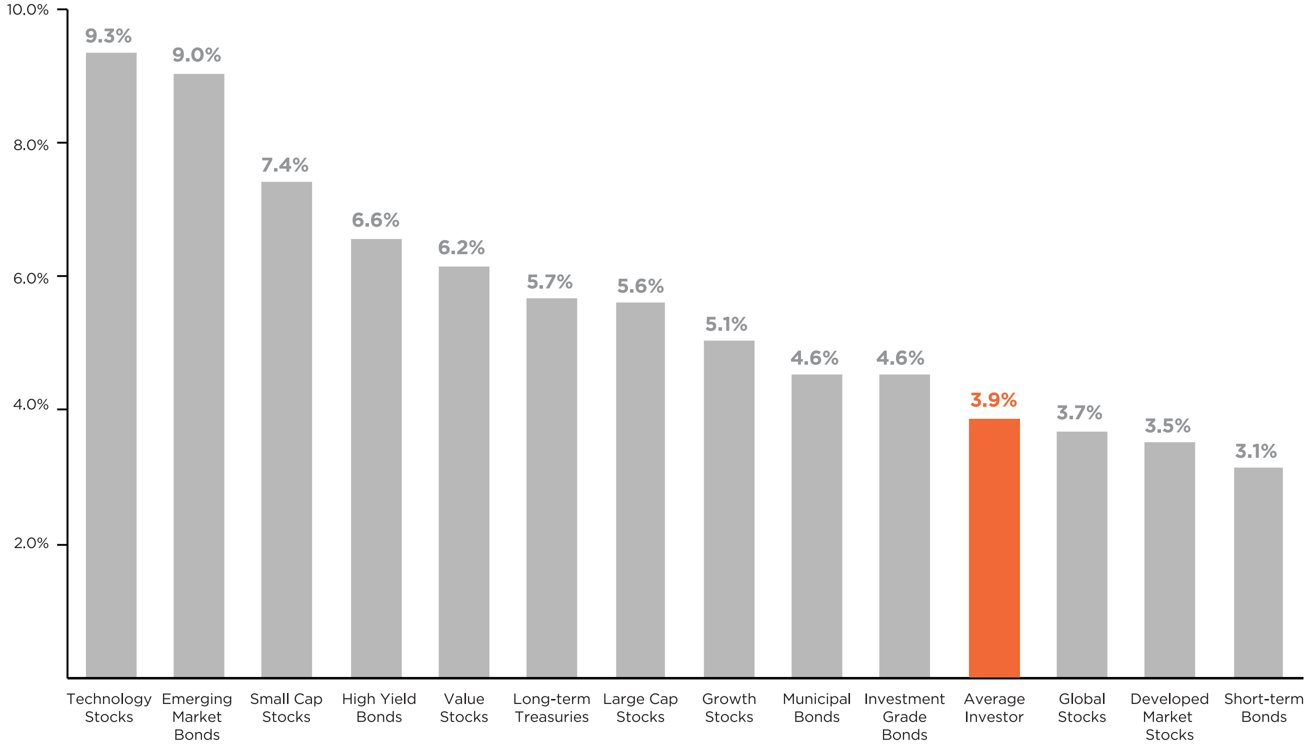
The same part of the brain that regulates emotion—the amygdala—is also used for decision making. In stressful situations, emotions can take over the amygdala and influence decision-making processes. **This leads to behaviors that are less rational and more impulsive.**

**"Wall of Worry": When the news influenced the S&P 500® Index**




Source: FactSet (March 2018).

**Figure 3. Average annualized returns by asset class 1998-2018**




**Past performance does not guarantee future results. Current performance may be lower or higher than the past performance shown.**

Based on average annualized total returns as of 12/31/2018. Average investor returns based on Dalbar, Inc. 2019 Quantitative Analysis of Investor Behavior, assuming a portfolio allocation of 50% large-cap blend and 50% fixed income. Source for index data: FactSet Research Systems.

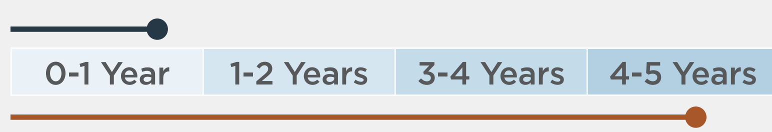
The worries that build this wall are usually economic, but political or international events can also sway investor sentiment as well. Eventually, investors overcome these worries and market cycles transition from growth to consolidation (or vice versa). But getting through those transitions takes time. Meanwhile, the drumbeat of news headlines drives the wall of worry higher—this is when investors are most vulnerable to making emotional and irrational decisions.

## Turn on, tune in, drop out

Many individual investors get caught in this vicious cycle: news headlines drive investor emotions, which may drive individuals to make irrational investment decisions. What comes next is poor performance. Over the 20-year period from 1998 to 2017, individual investors have underperformed the market in nearly every way—from stocks to bonds, from broad indexes to industry sectors, from the U.S. to developed and emerging international markets.

Market timing has much to do with this poor performance. Individual investors tend to trade frequently and hold investments for short-term periods, shorter than the length of the average market cycle. They buy high and sell low—the exact opposite of what they should do according to basic investment principles.

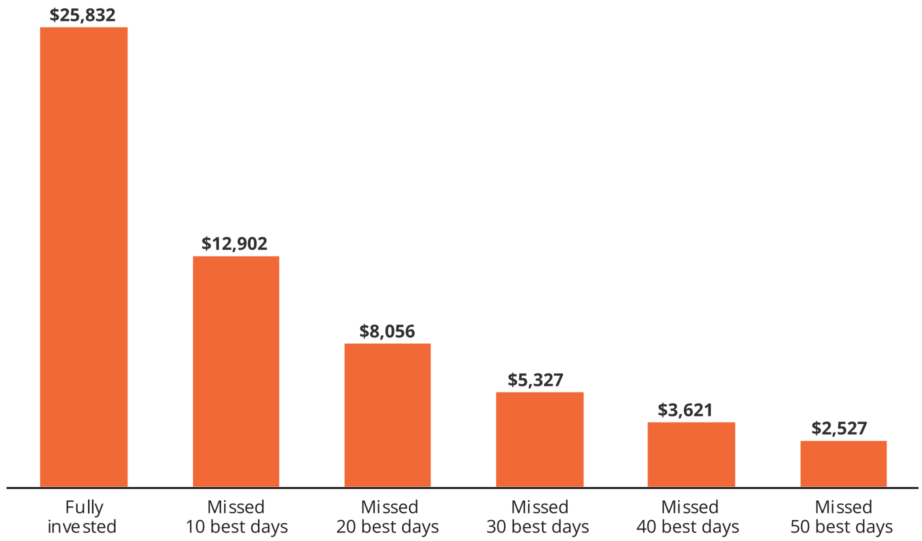
**Average holding period for stocks on the New York Stock Exchange: 8.3 months as of 12/17.[1]**




**Average length of a market cycle (peak-trough-peak): 4.7 years.[2]**

[1] Source: Ned Davis Research, Dec. 2017.
[2] National Bureau of Economic Research (NBER), Sept. 2017.

Figure 4. Growth of $10,000 in the S&P 500® Index (daily price return) 1998-2018




**Past performance does not guarantee future results. Current performance may be lower or higher than the past performance shown.**
Source for index data: FactSet Research Systems (Octobr 2019)

A lot of this activity is driven by emotion, and many times these emotions are triggered by market events and headlines from the financial media.

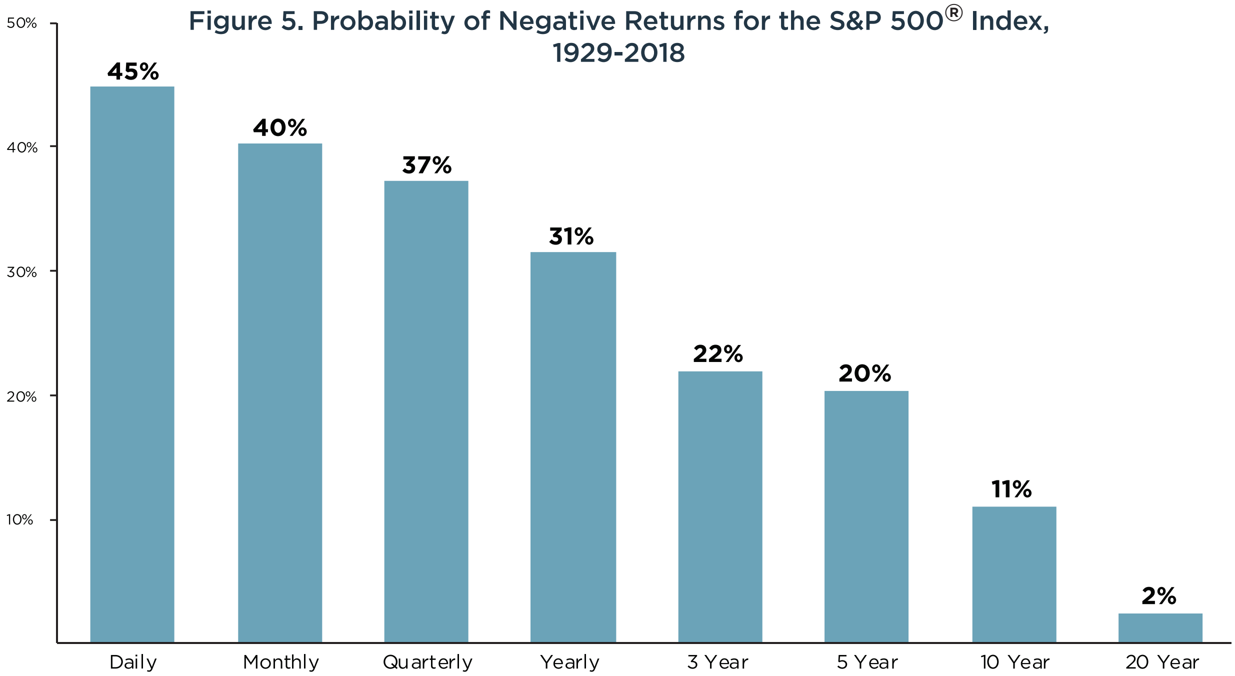
All of this movement in and out of the market means investors will often miss the best days in the market. Missing those days can significantly reduce the returns investors achieve, and ultimately cost real money relative to the outcomes investors who remain fully invested would achieve.

## Countering the lure of news headlines

The solution for countering the influence and effects of headline-driven emotional investing lies within the individual. By understanding the true role of the financial media and recognizing how sensational reports of market events can push our emotional buttons, individual investors can tap their own willpower to avoid making emotionally charged decisions and stick to the investment plan they established with their financial advisor.

Historical results from the financial markets can also show investors the value of maintaining a long-term perspective and help them downplay the influence of short-term performance. Looking at returns for the S&P 500 Index back to 1929 shows how the probability of positive returns increases with the length of the period. Negative returns are more likely for shorter periods—nearly every other day in the market is a down day, according to historical S&P 500 data. Even on an annual basis, one in every three years is negative. But over longer periods, 10 years and beyond, the probability of negative returns declines dramatically.

Figure 5. Probability of Negative Returns for the S&P 500® Index, 1929-2018




**Past performance does not guarantee future results. Current performance may be lower or higher than the past performance shown.**
Source for chart data: FactSet Research Systems (Oct. 2019)

# Maintain a disciplined approach to investing

Perhaps most important of all, investors should become their own best advocates to help regulate their emotions when facing news headlines and dramatic events in the financial markets. By avoiding emotional decisions and maintaining a disciplined approach to investing, investors can seek to keep more of the money they save and earn and be positioned for opportunities to buy when prices are low.

**Recalling these basic principles of investing can help investors manage the onslaught of financial news headlines:**

- **Stick with investments for the long-term** to help achieve long-term goals.
- **Tune out the noise from the financial news media,** and don't take any action in response to news events without first consulting a financial advisor.
- **Maintain a diversified portfolio** that's suitable for your investment goals and risk tolerance to help lessen the impact of market fluctuations.
- **Take advantage of opportunities to invest** when other investors display emotional behaviors, buying when they are selling in falling markets.

## Key takeaways for investors:

**Be aware of the role the financial media plays in the industry** and understand how headlines of dramatic market events can trigger investor emotions and influence behavior.

**Individual investor performance consistently lags the markets** because investors trade frequently and try to time the market in reaction to news headlines.

**Stay invested for the long-term to help achieve long-term goals,** and follow basic investment principles to downplay the role that emotions can have on investor behavior.

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S&P 500® Index: An unmanaged, market capitalization-weighted index of 500 stocks of leading large cap U.S. companies in leading industries; gives a broad look at the U.S. equities market and those companies' stock price performance.

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