GLOBAL
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INSIGHTS

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7 Psychological Traps

Sometimes, when it comes to investing, volatile markets aren't your worst enemy, it's actually yourself. That's because money and logic don't always go hand in hand. Unfortunately, our brains often play tricks on us, causing even the savviest of investors to make decisions that don't really make a lot of sense, from panic selling to ignoring opportunities.

The problem of psychological investing traps is so pervasive, in fact, that there's a whole field dedicated to studying it called behavioral finance. Researchers in this discipline look at the way psychology affects how we make financial decisions, and some of what they've discovered is pretty interesting. Knowing about these traps can help you avoid them and make you a better investor.

Here are seven psychological traps to keep in mind.

Sunk Costs Bias — The sunk costs bias has to do with the all-too-common tendency to stick with something, whether a bad boyfriend or a bad investment, long after it's clear it's not worth it anymore. Still, because you've invested a certain amount of time or money, you're reluctant to give it up. In investing, you might end up hanging on to a stock long after you should in the vain hope you'll eventually come out ahead. But in these cases, it's better to cut your losses rather than hang on to a loser.

Familiarity Bias — Most of us are biased toward that which is familiar to us. We eat at restaurants we've been to before and follow the same roads to work because we know what to expect. With investing, familiarity bias involves favoring investments that are familiar to you. You might prefer to invest in the company you work for or big-name businesses that are in the news. That could cause you to overlook important opportunities you don't know much about.

Anchoring — Anchoring is the process of getting attached to a particular reference point — such as the price you paid for a stock — and using that to guide future decisions. Or you might fixate on a stock's previous high, even though that price was an anomaly. Anchoring is why you think you got a great deal when buying a car for $50,000 if the initial price was $60,000, even

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A Personal Note from Global Wealth Advisors

The much-politicized budget debt ceiling crisis was once again avoided when Congress and the President negotiated a deal in the late hours of the looming deadline. The deal was signed into law on June 3rd, just two days ahead of the deadline. Both sides spoke of the importance of their stance and how the deal will make the country's economic future brighter for all Americans. The US stock markets responded favorably to the news.

The Federal Reserve Board met on June 15th and decided to hold the Federal Funds Rate to its current level of 5.00% to 5.25%. They felt recent economic data reflected a reduction of inflation and wanted to give the economy more time to respond to the prior ten straight increases. However, they are concerned that inflation is still too high and want to see it back down to the target level of two percent. Therefore, it may be likely that we will see two more quarter-point interest rate hikes before year-end. The next meeting is July 26th.

Lastly, the budget deal, the Fed's decision to hold interest rates and good corporate earnings reports have helped the US stock markets reach strong positive gains year-to-date and recover from the late 2022 lows. That's why it is so important to stay focused on long-term goals and ignore the short-term volatility inherent in equity markets. We never know when the markets will fall but missing out on just a week or two of strong positive returns can dramatically lower a portfolio's return from year to year. For the long-haul, stay invested, and you will be glad you did. OOO

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though the car's really worth $40,000.

Whether you're buying stocks or cars, anchoring involves using a single piece of information to determine what a stock or other investment should be worth while also discounting more relevant information, such as a company's fundamentals or broader economic trends. Unfortunately, avoiding anchoring is difficult, but considering all available information before choosing an investment can help.

Focusing Too Much on the Recent Past — Recency bias is the tendency to make decisions or judgments based on relatively new or recent information. For example, during times when the market is up, people may ignore or discount the possibility of a market decline. Or, if a certain category of stocks has done poorly recently, people may conclude that those stocks *always* have negative returns, even if the dip is an anomaly. As with other psychological traps, you can avoid this one by doing your best to consider the entire universe of information at your fingertips, not just what happened yesterday.

Following the Herd — While following trends might be fine for fashionistas, it's not always a smart investing move. Yet herd investing is an all-too-easy trap to fall into. If everyone is telling you that now is the time to get into a certain hot investment, you may feel you need to act fast so you don't miss out. But just because something is popular doesn't make it a good investment. Blindly following the herd without first consulting your own financial goals and plan doesn't make you a smart investor.

Overconfidence — Most of us like to think we're smarter than the average person. Yet if you hit it big with a certain investment, you may attribute that success to your skill rather than what it really is — luck. This can cause you to repeat the same behavior again.

Panic — Investing isn't for the faint of heart. When the market takes a sudden dip, it's easy to panic, which can lead you to make bad decisions, such as selling at a big loss, rather than riding out the natural hills and valleys of investing. Making these emotionally-driven choices costs you a lot of money. When making investing decisions, make sure they're based on evidence, not your initial gut reaction to the day's events.

Please call if you'd like to discuss this in more detail. OOO

Giving Back

Leaving behind a legacy is important to many people. A charitable giving strategy can provide a number of tax-saving benefits, ultimately preserving more of what you're able to leave behind.

There are many ways to build charitable giving into your estate plan. Here are just a few items to consider:

✔ **Lifetime Giving**: In addition to the rewarding experience of donating, you'll enjoy the added benefit of tax deductions as well. If you're concerned with exceeding state or federal estate tax exemptions, lifetime giving is an advantageous option, since you reduce your taxable estate while also receiving a current income tax deduction.

✔ **Charitable Trust:** There are several types of charitable trusts that are mutually beneficial for your selected charities as well as you and your family. Estate tax savings, income tax deductions, and even income payments are all possibilities while benefitting your favorite causes. For example, a charitable remainder trust (CRT) is a private fund you can establish to provide yourself or selected beneficiaries with taxable income over a designated number of years. After your death, the remainder is passed to your chosen charities tax free. Your contributions are tax deductible based on the projected remainder value allocated for charity.

✔ **Private Foundation:** This is an entity run in your name and funded throughout your lifetime, enabling you to endow others while deducting these contributions on your federal tax return. This can be an especially attractive option for people with a high net-worth or highly appreciated assets.

If you have many current and upcoming expenses, such as paying off debt, saving for your children's college education, or saving for retirement, beginning a charitable giving strategy now may not be feasible. There are still ways to donate after your death:

✔ **A Gift in Your Will:** Simply request that your last will be drafted or revised to include your chosen organizations. This not only benefits the causes near and dear to you, but also helps reduce or eliminate estate taxes.

✔ **Retirement Accounts:** Because retirement accounts are among the highest-taxed assets in your estate, listing your favorite charities as the beneficiary could be a good estate tax savings route (although you may need your spouse's written consent). The charities are not subject to income or estate taxes, enabling them to put your entire gift to good use. OOO

Understanding Stock Market Risk

Investing in stocks involves risk, but that doesn't mean they should be avoided. In exchange for being willing to accept the possibility of loss, you receive the potential of earning significant returns.

Risk and stock investing go hand in hand. When you are buying a stock, you are purchasing a small piece of a company. The value of that stock is not fixed. Because you can't know for sure what will happen to the stock's price in the future, the investment comes with a risk.

Stock values rise and fall for a variety of reasons. Once you understand the various factors that might affect a stock's price, you'll be better able to understand the risk associated with any particular investment and get a sense of whether it is a good addition to your portfolio. Risks associated with stocks fall into two broad categories:

Systematic risk or market risk: This is the type of risk that affects an entire market. It is typically unpredictable and unavoidable.

Unsystematic risk: This is the opposite of systematic risk. Unsystematic risks affect only certain companies or sectors of the market. For example, changes in energy prices might affect the price of energy stocks, while a political crisis in a certain country might affect stock prices in that region. Or a company might suffer a leadership shakeup that causes the stock to drop. It's easier to identify unsystematic risks than to anticipate systematic risks.

If you want to invest in stocks, you need to come to terms with risk. The key is to remember that risk or volatility in the stock market is natural. Rather than worrying too much about what the market is doing in the short term, you can insulate yourself by developing a clear investment strategy. Select stock investments based on your long-term goals. Then, keep your hands off your investments because one other major risk that stock market investors face is themselves. Letting emotions drive your investing decisions will almost always lead to less impressive returns.

You can also cope with stock market risk by diversifying your portfolio into asset classes other than stocks. By including bonds, cash, and other investments in your portfolio, you'll be better able to cope with the ups and downs of the market. ○○○

Watching Your Stocks

Here are five things to review as you monitor your stocks' performances:

✔ **Earnings** — Pay attention to the company's quarterly and annual earnings statements, which include comparisons with the recent past and often reviews of what management expects.

✔ **Price and dividends** — Follow the stock's price compared to its 52-week highs and lows. Examine its trailing total returns.

✔ **P/E and PEG ratios** — Price to earnings (P/E) and price/earnings growth (PEG) ratios are often better indicators than the stock price as to how relatively expensive or cheap a stock is.

✔ **Insider transactions and stock buybacks** — A company buying back its own stock or whose senior executives and directors are accumulating more shares is a bullish sign. When insiders are selling off major holdings of their own stock, it's quite often an indication of a stock price peak.

✔ **Sudden and large price changes on high volume** — When a stock makes a sudden, high-volume move it can be the start of a new, long-term trend. ○○○

Financial Thoughts

In 2022, the S&P 500 index experienced one of its most volatile years since the financial crisis of 2007-–2009. Through mid-October, the index had risen or fallen by 2% or more on 38 trading days. The post-financial crisis average is 14 days. Only 2020 saw more days with a daily change over 2% with 44 days. Though often thought of in terms of downside moves, volatility refers to both positive and negative fluctuations in price. There were nearly an equal number of days with big upward moves as downward moves. The volatility in 2022 is attributed to inflation, tightening monetary policy, the war in Ukraine, ongoing supply chain issues, and reactive investors (Source: *AAII Journal*, November 2022).

Two-thirds of people in the United States were not optimistic about their personal finances in 2022, with 87% of Americans stressed about personal finance. Approximately 61% of Americans live paycheck to paycheck (Source: moneytransfers.com, 2022).

A recent gallup poll found that about 32% of Americans maintain a household budget and 30% have a long term financial plan that includes savings and investment goals (Source: Gallup, 2022). ○○○

Market Timing vs. Buy and Hold

Market timers say they have built complex models that analyze all factors affecting a stock's price. But too often, unforeseen factors can quickly send a stock's price up or down. Also, market timing is a more time intensive strategy. You need to monitor your investments closely to stay on top of all the factors that can affect them.

For the average investor, a buy-and-hold strategy is much more practical. While buy-and-hold investors will suffer in market downturns, by staying invested in the market your investments will recover when the market recovers. Although there is no guarantee that will happen, historically, the general direction of the market has been upward.

The benefits of a buy-and-hold strategy include:

- ✔ It doesn't require constant monitoring of the market.
- ✔ It's less complex. You'll typically make far fewer trades with a buy-and-hold strategy.
- ✔ There are fewer tax consequences. Since you have fewer trades, you'll have fewer taxable transactions.

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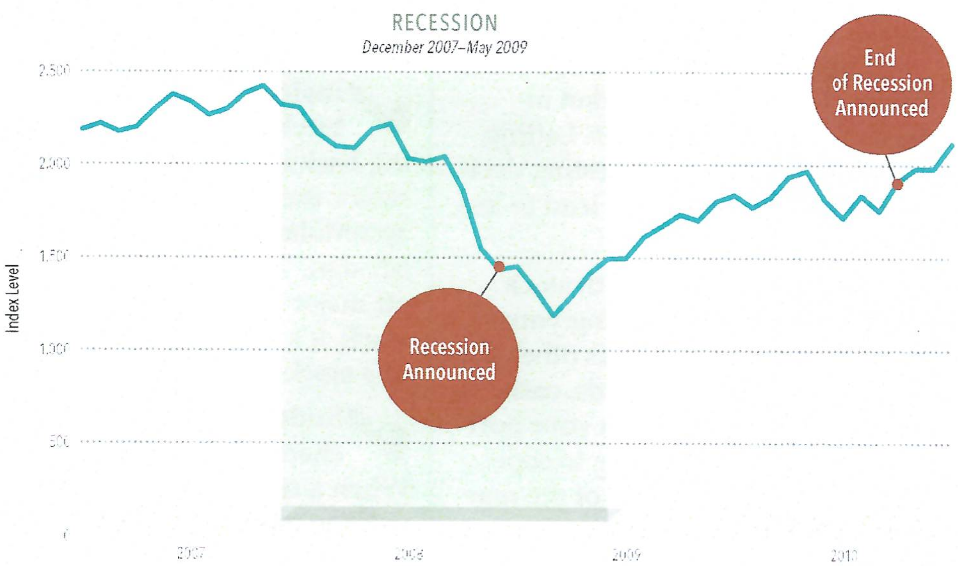
Markets Don't Wait for Official Announcements

US RECESSION AND STOCK PERFORMANCE DURING THE GLOBAL FINANCIAL CRISIS
S&P 500 Index, January 2007-December 2010



Some investors may worry about the stock market sinking after a recession is officially announced. But history shows that markets incorporate expectations ahead of the news.

- The global financial crisis offers a lesson in the forward-looking nature of the stock market. The US recession spanned from December 2007 to May 2009 (shaded area).
- But the official "in recession" announcement came in December 2008–a year after the recession had started. By then, stock prices had already dropped more than 40%.
- Although the recession ended in May 2009, the announcement came 16 months later, by which time US stocks had rebounded.

Investors who look beyond after-the-fact headlines about markets and the economy and stick to a plan may be better positioned for long-term success.

Past performance is no guarantee of future results. Investing risks include loss of principal and fluctuating value. There is no guarantee an investment strategy will be successful. Indices are not available for direct investment. Index returns are not representative of actual portfolios and do not reflect costs and fees associated with an actual investment.

Start and end dates of US recessions, along with announcement dates, are from the National Bureau of Economic Research (NBER). nber.org/research/data/us-business-cycle-expansions-and-contractions and nber.org/research/business-cycle-dating/business-cycle-dating-committee-announcements

Stock price decline of more than 40% from December 2007-December 2008 is based on the S&P 500 Index's price difference between the actual start of the recession in December 2007 and the official "in recession" announcement 12 months later.

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