BROADSTONE ADVISORS

Retirement Planning

# Trying to time the market?

## *Three biases that may be working against you.*

By Kevin Reich, CFA®

Imagine coming home from work after a long, hard day. You pull into your driveway, ready for the next chapter of your day, and – imagine - you walk up to your front door, and right above your front door is a big sign with your home's value on it, which gets updated minute-by-minute. Would you be stressed, worried, or tempted to control the performance of your real estate?

This is not how real estate works, but capital markets do generally have more liquidity and price transparency. And with this, they present the opportunity for some of our behavioral biases to kick in. With our investments, we may question if we have done the right thing and try to make a change. We may feel our perspective gives us some advantage that we can use to our benefit. Our wiring can be triggered to try to time a buy just before prices rise, and a sell just before they drop.

As tempting as it is to try to control performance by timing the markets, let's look at our own wiring – our own behavioral biases – to help get us grasp what's going on and why the data shows it doesn't work.

## The Risks of Trying to Time the Market

### 1. Overconfidence Bias

We may overestimate our knowledge, our insights into the world, the accuracy of the information at our fingertips, and at the same time underestimate the information advantage that others might have over us.

### 2. Recency Bias

Our default belief is that the immediate past will repeat in the immediate future. This bias is particularly rough with investing because it may be coupled by regret and/or envy. If something else has performed better recently, we not only are lulled into the belief that this trend will continue, but we feel a need to take action to correct a prior decision.

### 3. Loss aversion

Studies[1] have shown that when giving an investor a gain of some dollar amount, and a loss of that same dollar amount, they would disproportionately rate the loss as more painful than the gain was enjoyable. In plain English, we tend to not like losing, far more than we like winning.

These common biases, embedded into our wiring, are difficult to overcome. Like a scratch on a lens, they can warp our perspective and lead to an adverse outcome, and lead us to do the exact opposite of what market timers attempt to do – perfectly time a purchase and a sale.

We think that there is a better way: to abide by a disciplined investment process. Having a purpose and staying consistent with your investment account is, admittedly, not as exciting as stepping into the ring with our age-old biases. But it is also less rattling. After all, isn't having a purpose and staying consistent more like how we treat our homes? We establish our ownership with intention, and we are consistent in maintaining our home and managing risks along the way. In the end, we maximize our chances of walking away with not only an outcome that has accomplished a goal, but much more peace of mind along the way.

## Take Away:

Think about these 3 questions to combat behavioral biases, the next time the temptation to time the market arises:

1. What evidence is there that I have an information advantage over the sum total of all other market participants? (Overconfidence bias)

2. Is my perspective on what the future holds tainted by my knowledge of recent performance in the markets? (Recency bias)

3. Am I making decisions more out of fear of loss, than out of pursuing a passion, goal, or lifestyle? (Loss aversion)

## Bonus Question:

Do my investments reflect the proactive pursuit of a goal, or a reactive attempt to control short-term performance?

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[1] **Source:** Kahneman, Daniel, and Amos Tversky. "Prospect Theory: An Analysis of Decision under Risk." Econometrica, vol. 47, no. 2, 1979, pp. 263–291.

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