Client's Corner

On Black Friday Weekend, a Great Investing Lesson

THERE WERE, IN NOVEMBER OF THE YEAR JUST ENDED, ABOUT 340 million people in the United States.

Of them, the National Retail Foundation reported that 200.4 million (including some 75% of all adults) shopped—online or in brick-and-mortar stores—over the five days of Black Friday weekend.

Now, why on earth did they do that? Why did the huge preponderance of the American public rush to shop—and spend record amounts of money—over just those five days? The answer is obvious: because retailers dramatically lower their prices over that weekend. There's a potentially great investing lesson in this, if only investors will perceive and embrace it.

In every single aspect of our economic lives, we behave that same way. To wit, we are attracted to the goods and services we need (or just want) more and more strongly ***the more prices are reduced.*** Conversely, we postpone purchases—or actively seek less expensive substitutes—when prices are raised. This isn't something we have to think much about; it's essential to our nature.

Which makes it all the more intriguing that, when it comes to investing, we instinctively behave the opposite way. We fly toward markets (or sectors, or funds) that have experienced the greatest price increases. And we urgently sell out of even the soundest investments when their prices fall sharply.

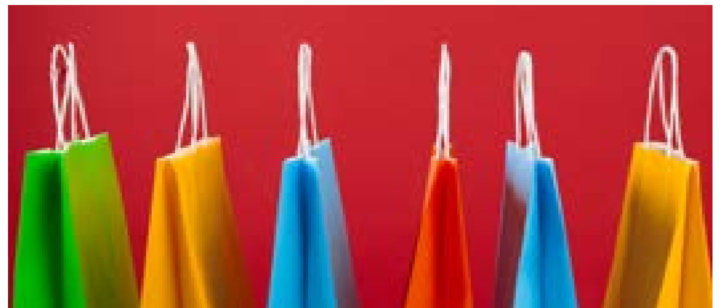
Again—and most ominously—this is intuitive. It's human nature. The problem is that it's quite clearly wrong. As one Wall Street humorist has observed, the stock exchange is the only place on earth where, when they have a big sale, everyone runs screaming out of the store.

What is the thought process (even though it's unconscious) that prompts this behavior pattern? It seems to run along these lines:

When the price of a financial asset rises significantly, chasing after it indicates a belief that it will keep going up, simply because it has gone up so much. In other words, our lizard brain seems to be saying that value is somehow directly correlated to price: an investment's potential to rise further is thus held to be a direct function of how much it's risen already. Stated another way: the higher an investment's price has gone, the greater its perceived value and the less its risk.

As soon as we bring this line of "reasoning" into the light—by stating it in so many words—we realize how little sense it makes. Because every fiber of our rational economic self tells us that, in fact, ***price and value are inversely correlated.*** (I repeat that the entirety of our other economic behavior is based on those six words.)

Even more egregious—and fearfully costly to investors—is the converse: the perception that the more an investment's price falls, the less potential value it has, and the greater its risk.



Take, just for example, the Standard & Poor's 500 Stock Index, which is composed of five hundred of the largest, most profitable, most soundly financed, most innovative and most transparent companies headquartered in this country. You are probably familiar with many if not most of their names; indeed you may purchase their products and services often—and have no intention of stopping just because their share prices go down.

Because these companies' stocks are trading every day, they're highly sensitive to current events and trends in the economy and the world at large. (My personal experience suggests that short-term price movements often are driven as much by the ebb and flow of investor sentiment as by companies' intrinsic value as successful businesses, but that's just one investor's opinion.) And the more prices decline, the stronger becomes the impulse to sell.

Stock prices are particularly sensitive to external shocks. When the COVID pandemic overran the world in early 2020, the S&P 500 went down by a third in the space of a month. Investor panic was rampant, so much so that the severely depressed share prices at the end of that month have never been seen again. This pattern has never ceased to repeat itself. Indeed, how could it? It's immutable human nature.

And it gives you the beginning of an idea as to what your financial advisor is really for. Simply stated, he/she is in your life not to forecast the economy nor time the markets—things no one can consistently do.

They're there simply to remind you, in moments of extreme market stress, to focus on the enduring value of superior companies rather than on their highly random market prices. And to approach your investment decisions as you do everything else in your economic life: gravitating toward lower prices, or at least not running out of the store when the great companies go on sale.

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