Let's talk investing: emotional investing

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VO Voice Over

GS Welcome again to our listeners. I'm Greg Sweet, Director, National Sales. Today, we'd like to bring you a new podcast, to help empower our customer when making important financial decisions.

Throughout this year we've seen increased volatility in both equity and fixed income markets. Right around now, Canadians are receiving their first quarterly statements in 2022. Many are battling the emotional toll uncertain markets can take on their peace of mind.

We know that customers crave advice during these times to help them manage their emotions. Today, our special guest is Jason Gibbs, Vice President, Portfolio Manager and Co-Lead of 1832 Asset Management's Equity Income team. Jason often provides us with great insights on market events in the funds that the Equity Income team manage, but today we're going to tackle another area, emotional investing.

Welcome Jason!. Let's jump into it. In the world where access to information has never been easier and the volume of information and data has never been so vast, the emotional side of investing often doesn't get enough attention in the news. Why is this such an important topic for our investors and advisors alike?

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JG It's fascinating. The emotional side of investing, I've always thought that it's the difference between success and failure when it comes to investing. You can read all the books, you can have a lot of degrees, but if you can't handle your emotions when it comes to investing, you're going to have a lot of trouble.

With all the research I've done looking at the best and worst investors in history, what you tend to find is that the best investors are stoic. They tend to be calm. They don't get too carried away on the highs of the market. They don't get too down on the lows of the market. They have a plan, a process, and they stick with it.

The worst investors are the investors that are the opposite, where when things are going really well, they take on too much debt, they pile into assets when they are already at their high prices, and then suffer the lows. On the flipside, when things are going down, they tend to get very depressed and they sell just to make themselves feel better. So, they're constantly always buying high and selling low.

When I think about it, I always try to simplify things. Warren Buffett had this famous saying where he said investing is simple but it's not easy, and that goes for a lot of things in life. If you think about playing hockey, the simple part is you've got to score more goals than the other team but the hard part is actually doing that every game.

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With investing, there're a few things that never change. One, start early, two, diversify, three, have a plan that's yours. So, talk to an advisor and have a plan for the future that is tailored to what you need and what you want, whether it is education, financial independence or retirement. And, four, and this is probably the most important, let the miracle of compounding be.

What that means is if you have a great business or a great financial asset, it has earnings, it has cash flows and it's growing over time and before you know it, if those earnings grow and compound, you may have a business that started off, I'm just going to use an example, with earnings of $1 per share and if you don't do anything over three, five, ten years, that great business will now have, I'm just making this up, $3, $5, $10 per share and now you have a business that's worth a lot more. So, just let the miracle be.

The hard part, and this is where Buffett has said it's not easy, is that markets are volatile. The markets for bonds, especially this year, stocks, other financial assets, they don't go up in a straight line. If you stick with it, the data is pretty conclusive that if you own the right businesses, you're going to do very well over the long-term. The data is very conclusive on that. But, in the short-term, you're going to have to deal with volatility. And what does volatility mean? It means some days you're going to be up a lot, some days you could be down a lot, some weeks, some years, who knows, and no one really knows.

The problem is, and this is what it makes it not easy, is we're not really built, as humans, to handle that too well. We are humans and I think we should be gentle with ourselves. We do have emotions. We're not all emotionless characters who just deal in rationality every day. We are humans, so we have emotions and they run the gamut. Some days you're happy. Some days you're sad. Some days you might be despondent or feel despondent. Some days you might be in a state of euphoria where you think nothing is ever going to go wrong again.

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When it comes to investing, there's some issues with all these things. I won't get into all of them because of the time we have but probably two of the most important are loss aversion and the way humans can be tribal. With loss aversion, this simply means that we have a hard time accepting losses when it comes to investing.

The problem is you're going to have to get used to it if you want to be successful. You're going to suffer losses in the short-term, that's just the way it is or the way it always has been, but what you cannot do is interrupt your plan. I see this constantly and it causes me great grief when I see this.

Someone will have this great plan to buy a stock, to buy a business and they'll put it all together and they'll stick with it for a while and then if the markets go down in two weeks, a month or a month and a half, they suddenly lose all confidence and they just sell it all at the exact wrong time. This will kill a portfolio and will kill a financial plan over time. So, you've got to find a way to deal with that. That's loss aversion.

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The last thing is really the tribal nature of humans, where we survived as a species over hundreds of thousands of years by being in groups, cooperating, which is all good, and this is why we're social. But the problem is, when it comes to investing, if everyone is buying the same stock or the same sector, like technology or something, people will start to crowd into that and they'll buy way too high in a state of euphoria.

On the flipside, if you find that everyone is selling, everyone is despondent, the markets are down a lot, people get this itch in their brains to join the rest of the club and sell with them, which is the worst thing you can do. To sum it all up, Greg, it's handling your emotions, and thinking about emotions, and thinking about the behavioural part of investing is probably the most important thing you can do to be successful in the future.

GS Thanks for that, Jason. I love that you started with it's about a plan, starting early, good discipline and diversification in your strategy. These are all the core tenets of the advice we give retail customers every single day.

So, really happy to hear that our thinking is aligned in that direction and our advisors are in good shape with the advice that they're providing. We just need to do it more often, certainly during these periods of time. What are some of the traps that you see investors fall into and why does it seem to happen time and time and time again?

JG It's amazing, Greg, isn't it? It's fascinating and I always say when we're interviewing people for jobs in our group, I always say to them, if you want to be an investor, you have got to know your history. I guess I'm a bit lucky. That was always one of my favourite courses. To this day, it remains one of my favourite things to do, is read about history.

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Why is it so important? It's because when you think about history, you'll realise that things repeat, actions repeat. It's never the same. The actors are different but what they do tends to be exactly the same throughout history. Nothing is really that new when you look at the history books.

I've followed markets for about almost 30 years now and I read a ton a books and some books I re-read. It's like Charlie Munger has said, some of the best things you can do is just read books all day if you can or spend as much time as you can reading books, and you'll see the same mistakes.

So, Greg, to your question, there's a few common traps that I see constantly made in this business. The first is market timing and forecasting. Humans like patterns. This is why, Greg, something like Wordle is so successful, whey crossword puzzles are so successful. Unfortunately, it's why gambling has become so popular.

Humans like to try and predict the future. We think we can take patterns from the past, from the recent past, and assume that they will repeat in the future. Unfortunately, it's not that easy. Forecasting the immediate future is incredibly difficult. Timing the markets, I can tell you, is impossible.

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Again, I've been doing this for about 30 years. Every single year someone will come on TV or the internet or social media and they'll say I know what the market is going to do. They sound very confident. They're very intelligent. They have lot of degrees and they'll say I hate to tell you but the market is going to crash or we're going to have a recession, or I'm getting out now, I'm going into cash.

This is 100% impossible to do. Don't even think you can try. Stay away from this at all cost. You're going to be bombarded by it. It's very unfortunate but the people that try to predict these things and say it with 100% certainty, it's impossible.

Why is it impossible? Because if you're trying to predict the markets, you're trying to predict over 10,000 stocks, you're trying to predict an economy that is one of the most complicated machines that you'll ever try to figure out. It's next to impossible, other than economies over the long-term tend to go up. There's more productivity, there's more labour force growth, there's companies that buy and sell things. We know that over time but what it's going to do in the short-term is impossible.

Unfortunately, Greg, what I see is a lot of times people will just buy too high, sell too low. They'll interrupt the compounding by saying, you know what, I don't like the market this week, I'm going to get out. I'll be able to get in later at a lower price. It never happens, never ever happens. Often you're going to be buying back higher.

A quick example of that. We're going through a period right now where interest rates have gone up a lot and if someone from the future, like remember that movie Back to the Future, if someone had said, hey, I'm telling you interest rates are going to go up a lot this quarter. You would have said, okay, I'm going to short sell, which means bet against utilities.

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Guess what? That would have been the exact wrong thing to do because utilities are one of the best performing sectors this year. This is just what markets do. They can be random on the short-term. So, market timing and forecasting don't do it. If it was that easy, someone would have written the book and said, look, this is how you do it, and we'd all be out of a job if it was that easy.

Kind of like if you go and buy a frozen pizza or something and it comes with directions to put it in a microwave for whatever it is, five or eight minutes. You do it and it comes out fine. There's no such thing when it comes to the markets. Unfortunately, it's not that easy.

The next thing I see happen a lot is the trap of predicting markets when it comes to politics. They may not like the leader of the day, they may not like the prime minister or president of a country and they say I'm going to get out because I don't think this person is good for the country. Set your politics aside. Talk about that amongst your political friends, whatever you want to do, it's all good, but don't change your entire financial plan because you don't like the leader of a country.

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Remember, investing is about companies, it's about Apple's iPhones, it's about the internet, so buying companies like Rogers or Bell and having internet bills every month that are being paid. It's about buying bank stocks, as an example, long-term oligopoly businesses that have been around a long time. They're going to be around a long time. It's not about trying to predict the politics of the day.

Finally, the last thing we can talk about is people trade too much. They see all this information, all this data and, Greg, we're going through a data storm right now in this world we live in. You've got to try and get away from that because what happens often is people trade with that data.

Something happens today or tomorrow and they respond to it by trading, often the worst thing to do. Trading too much when it comes to investing is a sure fire way to fail. If you're trading too much you're speculating and if you're speculating you're gambling. And who wins when it comes to gambling? The house, the broker.

So, don't be on that side. If you're trading, you're thinking about the long-term. You're not responding to what's on the news that day. I can guarantee you that the best investor of all time, Warren Buffett, doesn't stare at a TV all day and trade his stocks based on what people are telling him to do because what can happen is you're going to get caught up in euphoria, you're going to sell on the lows.

Greg, when I think about the problem there with euphoria, I think of all the people that probably bought Peloton at the highs. That stock got to $170 a share almost during the peak. You know where that is today? Almost $24. So, if you followed that euphoria, you would have followed it all the way down.

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The marijuana stocks, 2016-2017, huge euphoria. If you bought then, if you traded then, you would have been buying, there's one stock that was at $80 a share, $80 a share. Today it's below $8. That's the pain of trading too much and getting caught in euphoria.

On the flipside, and I'll finish with this, selling into despondency is a bad, bad thing to do and when we went through the COVID scare, March 2020, look back what happened to stocks back then when, if you were trading too much, you would have selling on the lows. People assumed that we'd be locked down forever, planes would never fly, no one would travel, and the markets got crushed.

Again, if you traded too much and sold into that, you would have pretty near destroyed your long-term financial plan. Those are some of the traps that I see, Greg, and everyone should do all they can to try and avoid that, obviously.

GS It's kind of amazing when you think of it, Jason, the reality is the more the headlines change, the more the advice we need to give our customers remains the same and it really comes back to let compounding do it's magical thing. Spend more time in the market and less time trying to time the market.

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And think of yourself as taking long-term equity positions in great, stable companies that will be here for a long, long time. I think that's a really good thoughtful way to manage your emotions but also for advisors to help customers manage their emotions when this plethora of new and media is in front of us every single day.

Jason, I'd like to extend a massive thank you, not only from myself but from the customers that learned a great deal from our conversation today. This kind of conversation can help provide our customers with the knowledge and the confidence to tackle these issues, leading them to make smart decisions with their long-term investments and ultimately helping maintain the health of their long-term financial plans. So, thanks so much for you time today.

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To all the listeners of this podcast, I want to thank you for investing your time in this discussion today. Our goal is to lead with advice and help our customers 'For every Future.' Thanks so much for spending your time with us today, all the best.

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