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summaries

SIGMA INVESTMENT COUNSELORS

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THE PSYCHOLOGY OF MONEY

The Psychology of Money

"A genius is the man who can do the average thing when everyone else around them is losing his mind."

-Napoleon

I recently finished reading The Psychology of Money, Timeless Lessons on Wealth, Greed, and Happiness by Morgan Housel. It's a quick, simple read, but it's filled with practical real life stories involving the intersection of money and psychology. It has further solidified my belief that doing well with money isn't all about what you know. It's also heavily dependent upon how you behave.

The quote listed above struck me as being particularly timely. After 18 months of outrageously strong equity market returns, January brought with it a return of volatility. The S&P 500 Index was down 5.17% for the month, while the more tech-heavy Nasdaq 100 Index was down 8.49%. Some of 2021's highest flying growth stocks were down more than 50% from their all-time highs. Friends and acquaintances who had confidently shared stories of their own portfolio successes in 2020 and 2021 were suddenly texting me and asking if they should sell everything. Some investors seem to have gone from exuberant to miserable in a matter of weeks.

Sell everything?! Since 1980, the average intra-year peak-to-trough drawdown of the S&P 500 has been more than 13%. In other words, the market correction of January 2022 is completely normal, so long as one has been adequately diversified.

Housel dedicates an entire chapter of The Psychology of Money to market volatility. Chapter 15 is titled 'Nothing's Free' and its seven pages are well worth reading for anyone who is unnerved by recent volatility. The chapter contends that everything has a price and it is the job of the consumer to figure out what that price is and determine if they are willing to pay it.

For situations where the price is obvious, the decisions are easier. If a new car costs $30,000, a consumer who is in need of a car has three options: 1) pay the $30,000, 2) purchase a less expensive used car, or 3) steal the new car. Very few consumers choose the third option because the consequences of getting caught far outweigh the payoff.

In contrast, many investors are lured by the markets to choose the equivalent of the third option because the price is not as easily discernable. Option 1 involves accepting the market's volatility in return for the long-term benefit of compounding returns (buying the new car). Option 2 involves investing in an assets with lower returns and less risk (the equivalent of buying a used car). Option 3 is attempting to capture high returns without paying the price (stealing the new car). Housel goes on to explain:

"The S&P 500 increased 119 fold in the 50 years ending 2018. All you had to do was sit back and let your money compound. But, of course, successful investing looks easy when you're not the one doing it. Do you know how hard it is to maintain a long-term outlook when stocks are collapsing? Like everything else worthwhile, successful investing demands a price. But its currency is not dollars and cents, it's volatility, fear, doubt, uncertainty, and regret – all of which are easy to overlook until you're dealing with them in real time.

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Most investors with even a little bit of experience know that volatility is real and common. Many then take what seems like the next logical step: trying to avoid it. The inability to recognize that investing has a price can tempt us to try to get something for nothing. Which, like shoplifting, rarely ends well.

The trick is convincing yourself that the market's fee is worth it. That's the only way to properly deal with volatility and uncertainty – it's not just putting up with it, but realizing that it's an admission fee worth paying."

Of course, all of this is much easier said than done. The human mind is exceedingly complex. What becomes clear and obvious in hindsight can seem completely irrational in the present. Morgan Housel does an exceptional job of explaining how psychology and one's behavior can play a critical role in what has historically been a math-based field (personal finance). The Psychology of Money is well worth the read.

We're growing, again!

We are pleased to announce that Michael Mullenax will be joining our team full-time as a Paraplanner when he graduates from Michigan State University in May. Michael was an outstanding intern in the summer of 2021 and we are excited to have him back. Michael majored in Finance with a minor in Financial Planning and Wealth Management and will be our fourth full-time addition since February of 2021.

Eric Larson, another Spartan-grown Paraplanner, brought more than five years of wealth management experience to Sigma from Plante Moran Financial Advisors in early 2021. Eric has a degree in Finance with a minor in Economics and has spent the entirety of his career working with high net worth individuals and families in the areas of investment management, retirement planning, estate planning, and tax planning.

Audra Skaryd joined our operations team in mid-2021 as a Portfolio Administrator. Audra has a very diverse professional background. A graduate of Eastern Michigan University, Audra spent more than 20 years in pharmaceutical research focusing on compliance, technical support, legal, and accounting. Audra also worked as an Office Manager and Client Coordinator for an independent financial advisor before joining Sigma.

Last but not least, David Drogheo, CFA came aboard in late 2021 as our Director of Research. David graduated from Wayne State University with a Bachelor of Science in Mathematics and an M.B.A with a concentration in Finance. David previously worked as an Investment Research Analyst at Plante Moran and as a Senior Associate in business and intangible asset valuation at KPMG LLP.

It remains a top priority of the firm to attract and retain talented team members and we are confident that Michael, Eric, Audra and David have Sigma in a stronger position than it was prior to their arrival.

Christopher W. Frayne, CFA, CFP®