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summaries

SIGMA INVESTMENT COUNSELORS

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ALL TIME HIGHS – WHY DOESN’T IT FEEL LIKE IT?

In recent financial news the S&P 500 index has surged to an all-time high. On the surface, this milestone may appear to be cause for celebration among investors, signaling robust economic growth and market optimism. However, beneath the veneer of success lies a complex interplay of psychological biases and emotions that may leave many investors feeling uneasy. One such phenomenon at play is loss aversion.

The cognitive bias of loss aversion has the ability to exert a powerful influence on investor behavior, even in the face of record-breaking market highs. Psychologists Amos Tversky and Daniel Kahneman developed the concept of loss aversion and were later awarded the Nobel Prize for their discoveries. Investopedia defines loss aversion as, “a phenomenon where a real or potential loss is perceived by individuals as psychologically or emotionally more severe than an equivalent gain”. In the context of investing this means the pain of losing $100 hurts significantly more than the pleasure associated with gaining $100. Some studies suggest losses may even be twice as painful as the joy.

When the S&P 500 hit an all-time high recently one would expect investors to be excited. However, for many, this uncharted territory was met with trepidation. Despite the market’s upward trajectory, recent scars from 2022 and March 2020 still haunt investors. The fear of the possibility of a downturn creates a mindset unwilling to fully embrace bullish sentiment for fear of potential losses in the future. This creates an environment where investors may be more prone to making irrational decisions such as selling winning stocks prematurely or refraining from taking on additional risk even when the potential for further gains could be high.

On the opposite side of the spectrum, loss aversion amplifies the fear of missing out (FOMO), causing investors to act impulsively in an attempt to chase returns and not be “left behind.” Faced with new all-time highs, those investors who remained on the sidelines may feel a growing sense of anxiety and regret, grappling with the prospect of having missed out on significant gains. FOMO can also lead to investors getting greedy, chasing gains in excess of those they actually experienced, resulting in levels of investment risk outside the investor's normal parameters. These emotionally driven decisions are often out of touch with the investors long term financial goals.

So how does an investor avoid falling into such traps?

The key is developing a long-term plan centered around your goals and sticking to the plan regardless of external factors. By recognizing the influence our psychological biases have over us investors can work to actively mitigate their impact. Easier said than done, certainly, but a key role of your Sigma advisor is removing emotion and these biases from the equation. Setting clear investment objectives, focusing on fundamentals, and remaining patient are all key tenets to a successful plan, and are all key aspects of Sigma's approach to portfolio management. Will markets continue to rise from here? No one knows! What we do know, and what we have seen time and time again over the last 50 years of serving clients, is sticking to the long-term plan is a recipe for success.

If you're feeling uncertain in the face of these all-time highs, please reach out to your Sigma advisor directly so they may address your concerns.

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