



CORNERSTONE
WEALTH MANAGEMENT

Investment Misbehavior

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We tell our clients that three of the most important words they may hear from us are “Don’t do that.” We say this because investment success depends more on investor behavior than any other single factor. One reason for this is the well-documented psychological principle of recency.

The principle of recency is a phenomenon that causes human beings to place greater weight on recent events than on earlier events.

To illustrate, very few investors were concerned about risk during a decade of double-digit returns in the 1990s. Our experience during this period of double-digit U.S. stock market returns was that almost no one was asking questions about risk.

Since 2000, the conversation has shifted. Now, when we discuss the investment return needed to achieve one’s goals, we are often asked, “Is that realistic?” Humans tend to think things are likely to continue in their current pattern and can make investment mistakes as a result.

For perspective, we are sending a picture of a 1975 ten-cent stamp marking the linkup in space of an American spacecraft with one from the Soviet Union. Today, a similar commemorative stamp costs forty-nine cents. So, the cost has increased by a factor of 4.9 in 40 years. To keep pace with inflation, your investment returns had to equal or exceed that multiple.



Interestingly, the S&P 500 is 21 times higher today than it was on the day the stamp was issued in 1975. The S&P earnings are more than 16 times higher. The S&P dividend today is 11 times higher than it was in 1975. Yet, many investors are frightened out of the very markets that can enable them to keep pace with inflation.

One of our goals at Cornerstone is to help our clients maintain a long-term perspective and avoid the mistakes of investment misbehavior. That is why “Don’t do that” is often our best investment advice.

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