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Good Riddance 2020 – Keep Your Investing Emotions in Check

By Elaine F. Phipps, MBA, CFA
Managing Director and Portfolio Manager

We are all glad to bid 2020 adieu. It was a year unlike any other as the ravages of Covid 19 and a plunging global economy took an emotional and financial toll. We look forward to 2021 with optimistic anticipation. The promise of a Covid vaccine, continued global stimulus, and a recovering stock market have brought calm to many.

The past year has forced us to grapple with emotions such as fear, panic, depression, and indecisiveness. We may have been forced to make quick decisions involving our family, health, employment, housing, and finances. While many of these choices were based on incomplete information regarding what path the virus would take, they all had an emotional component. Now that 2021 is upon us, we want to make sure we don't let emotions take control of our portfolio.

Here are some basic investment principles to keep in mind – and keep the emotions at bay.

Keep your confidence under control – Don't be too optimistic or pessimistic. 2020 delivered it all in terms of highs and lows. Many investors began the year overconfident, expecting the market to continue its upward trend. That all changed with the appearance of the virus in late February. The market declined close to 40% before hitting its low on March 23. That early confidence certainly seemed misplaced. Investors rode the confidence train south, dumping stocks and thinking the market would never recover. Fast forward to today, where the market has recovered all that loss and then some. Too much pessimism was not the best course of action either. Keep a level head, as difficult as that often is.

Stick with your asset allocation and always rebalance – Your asset allocation should change only due to major events in your life such as retirement, a job loss, or health scare. Don't change your allocation based on what the market does. Of course, 2020 felt like more than just a market adjustment, but it was a virus caused event. Once the virus could be brought under control, there were reasons to believe the market would follow. While that was difficult to predict back in March, investors who took the opportunity to rebalance their portfolios by adding stocks were handsomely rewarded. It required a solid gut check but was the right call.

Always think long-term – We can't outrun market volatility as it is always a potential risk. Don't focus on your portfolio's daily swings. This will cause you to lose sleep and make poor decisions, such as excessive trading. Think instead of where you want your portfolio to be in 10, 20, 40, or even 60 years as it helps you meet your life's goals. You will be more patient.

Diversification is your friend – It cannot be stressed enough how important it is to diversify your holdings. Some investors only want to chase the high-flying tech stocks but forget how that market fell apart in 2000. Some think their employers' stock is a sure bet but forget what happened to

Enron employees who held most of their 401k balances in Enron stock. Some want to stay heavily weighted in the sector that employs them, thinking they are an expert on industry trends. Those who worked for banks in 2008-2009 found their overexposure to the sector catastrophic. Today, many are asking why they should bother investing in bonds given the sub 1% return on the 10-year treasury. They will be thankful for bonds' stabilizing presence in their portfolio the next time the stock market enters bear territory. You need a little bit of everything – the whole kitchen sink – in your portfolio to ride out the volatility certain portions may exhibit at any given time.

Market timing is not your friend - The greater your age and grayer your hair, the more personal experience you have with market timing. Many of us can relay war stories of how we bought at the market high or sold at the market low, doing substantial damage to our portfolio's return. Sure enough, 2020 offered another shining example and another opportunity to be on the wrong side of the market. A savvy investor with a clearer crystal ball may have made a good call by exiting the market in late February as rumblings of Covid 19 began to hit the news. Perhaps they saved themselves the ride down to the March 23 lows. But did they know the right time to hop back in? More than likely, they stayed on the sidelines with their assets sitting in zero-yielding cash. Unless you need to use the assets in the near-term period of 6-12 months, stay invested and try not to panic.

Don't chase the winners and hot trends – Human nature loves to tag along with the winners. We wear the latest fashion and buy the hottest stock. We don't appreciate that what has outperformed in the past does not offer a guarantee that it will do so in the future. This is especially true when the herd mentality takes over and everyone is buying into a particular stock. Valuations get stretched, competitors flood the market and the stock becomes vulnerable. Perhaps looking at a company that is out of favor is the better way to go,

Lose the focus on losers – Investors are obsessed with the stocks that didn't work out. They either hold on for dear life hoping it will get back to their purchase price, or bail too early figuring they will never make their money back. The best approach is to view what you paid for an investment as a sunk cost, not relevant to what you decide to do in the future. If a stock has taken a substantial tumble, its recovery may also be substantial even if it doesn't get you back to what you paid. Your purchase loses 50%, but the stock may have the potential to recover 40% of that loss. Isn't that a better return than buying a new stock which might stay flat? Analyze the investment's future performance as if you don't already own the name.

Investing is both an analytical and emotional process. While we all can read the financial news for economic and company specific data, we often come to different conclusions. Part of that is based on our emotional IQ. Appreciate your personal financial history and learn from it. You likely have made some great calls and some not so great ones. Figuring out which were made purely on an emotional basis is difficult, but worth deciphering for the future.

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