

WEALTH WISDOM

BY HUDSON FINANCIAL SERVICES



NAVIGATING FOMO AND PANIC

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During Market Cycles: Lessons for Smart Investors

The world of investing is as much about psychology as it is about numbers. Two of the most prevalent emotions investors face are **FOMO (Fear of Missing Out)** and **Panic** during market cycles. These emotional responses, when unchecked, can lead to suboptimal financial decisions. Understanding the history, recognizing the signs, and applying rational strategies can help investors stay on course for their long-term goals.

1. WHAT IS FOMO IN INVESTING?

FOMO refers to the anxiety that an investor feels when they believe others are gaining profits they are missing out on. This often leads to impulsive buying of assets during market peaks, driven by hype rather than sound analysis.

HISTORICAL EXAMPLES OF FOMO IN ACTION

- **Dot-Com Bubble (1995-2000):**
 - During the late 1990s, internet-based companies saw skyrocketing valuations, often without solid business models. Retail and institutional investors piled into these stocks, fearing they would miss the "next big thing." When the bubble burst, the Nasdaq Composite lost nearly 78% of its value between 2000 and 2002, wiping out trillions in market capitalization.
- **Cryptocurrency Boom (2017 & 2021):**
 - Bitcoin and other cryptocurrencies experienced explosive growth, attracting a rush of investors convinced they were witnessing a financial revolution. In 2017, Bitcoin surged to nearly \$20,000 before crashing below \$4,000 in 2018. A similar pattern occurred after the 2021 peak, with Bitcoin dropping from \$68,000 to under \$16,000 by 2022.

WHY FOMO HAPPENS

- **Herd Mentality:** Seeing others profit can create a sense of urgency to act.
- **Media Hype:** Overexposure to headlines about huge gains magnifies the fear of being left behind.
- **Recency Bias:** Investors focus on recent market trends, ignoring historical patterns of corrections.



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STRATEGIES TO COUNTERACT FOMO

- **Stick to a Plan:** Develop a diversified portfolio aligned with your risk tolerance and goals, and resist deviating from it during market hype.
- **Focus on Fundamentals:** Assess whether an asset's value is supported by its fundamentals.
- **Limit Exposure to Noise:** Avoid excessive consumption of speculative news and social media discussions about "hot" investments.

2. THE DANGER OF PANIC

Market declines often trigger fear-driven reactions, leading investors to sell assets to avoid further losses. This behavior is rooted in loss aversion, where the pain of losses outweighs the pleasure of gains.

HISTORICAL EXAMPLES OF PANIC SELLING

1) Great Depression (1929):

The stock market crash wiped out 89% of the Dow Jones Industrial Average's value by 1932. Panic selling intensified the downturn as individuals and institutions rushed to exit positions.

2) 2008 Financial Crisis:

Following the collapse of Lehman Brothers, global markets plummeted. The S&P 500 lost more than 50% from its peak in October 2007 to its trough in March 2009. Many who sold at the bottom missed the recovery, as the market rebounded over 60% in the following year.

3) COVID-19 Crash (March 2020):

In the early days of the pandemic, the S&P 500 fell nearly 34% in just a month. Panic selling was rampant as fear of economic collapse gripped the market. However, those who stayed invested witnessed a dramatic recovery, with the market reaching new highs by August 2020.

WHY PANIC HAPPENS

- **Fear of Further Losses:** Investors anticipate that declines will continue indefinitely.
- **Short-Term Focus:** Many overlook long-term trends and focus solely on immediate price drops.
- **Confirmation Bias:** Investors are more likely to seek out information supporting their fears.

STRATEGIES TO PREVENT PANIC SELLING

- **Keep Perspective:** Historical data shows that market declines are typically followed by recoveries. For example, the S&P 500 has delivered an average annual return of about 10% over the past 50 years despite numerous corrections and bear markets.

- **Revisit Your Financial Plan:** Ensure that your portfolio is designed to weather volatility based on your time horizon and risk tolerance.
- **Embrace Dollar-Cost Averaging (DCA):** Regularly investing fixed amounts reduces the impact of market timing and takes advantage of lower prices during downturns (i.e. IRA and 401k ongoing contributions).
- **Consult a Professional:** A financial advisor can provide objective guidance and help you avoid emotionally driven decisions.

3. BALANCING EMOTION & RATIONALITY: KEY LESSONS

UNDERSTAND MARKET CYCLES

History demonstrates that markets operate in cycles of booms and busts. While short-term volatility is inevitable, long-term trends favor growth. For example:

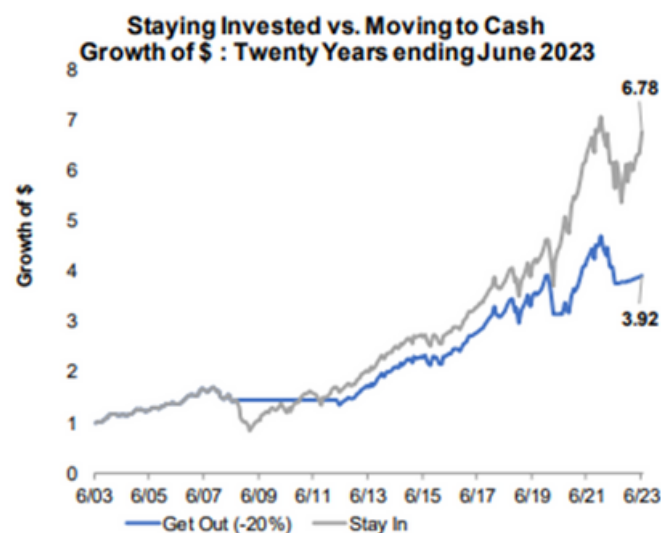
- The S&P 500 has experienced 27 bear markets since 1928, with an average decline of 33%. However, the average bull market gain was 112%, lasting much longer than the bear phases.

LEVERAGE DIVERSIFICATION

A well-diversified portfolio may help to mitigate risk and reduce emotional responses to individual asset price fluctuations. Combining stocks, bonds, and other asset classes can smooth returns over time.

TIME IN THE MARKET IS BETTER THAN TIMING THE MARKET

When the market experiences those large falls, we feel sick to our stomach as we see our portfolio values shrink. It's like being on a rollercoaster, and you've gone over the peak. You're riding that first dip and your stomach churns. The larger the fall, the more the stomach churns, and the emotions take over, screaming, "Get me out." But, those decisions can have a significant impact on the value of a portfolio. Getting out is only half the decision – knowing when to get back in is the harder part of the decision, and most investors wait too long.



In the example, we show the impact of getting out once the market passes the bear market definition of -20% and then staying out until the market recovers to its prior high. There have been three bear markets in the past 20 years, and stepping out of the market and moving into cash costs the portfolio. In the past 20 years, it cost a portfolio almost half of its potential value.

PRACTICAL TAKEAWAYS FOR INVESTORS

1. **Create a Written Investment Plan:** Outline your goals, risk tolerance, and strategy for responding to market movements. A clear plan can serve as a guide during emotional periods.
2. **Automate Your Investments:** Use tools like automatic contributions and rebalancing to reduce the influence of emotions on decision-making.
3. **Educate Yourself:** Understanding historical market behavior can provide confidence during periods of volatility. For instance, in the past century, U.S. markets have recovered from every major downturn.
4. **Practice Patience:** Avoid frequent portfolio monitoring during volatile times, as this can amplify stress and trigger impulsive actions.



FOMO and panic are two sides of the same emotional coin, both capable of derailing an investor's long-term success. By studying historical patterns, adopting a disciplined approach, and maintaining a clear perspective, investors can navigate these challenges effectively. Remember, the greatest returns often come to those who can resist emotional impulses and stay committed to their financial plan. Mastering your emotions may not be easy, but it is a crucial skill for achieving lasting financial success.

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