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Reacting to news headlines

White paper

If it's greed, it leads

The emotional influence of news headlines on investors, and the consequences of emotional investor behavior.

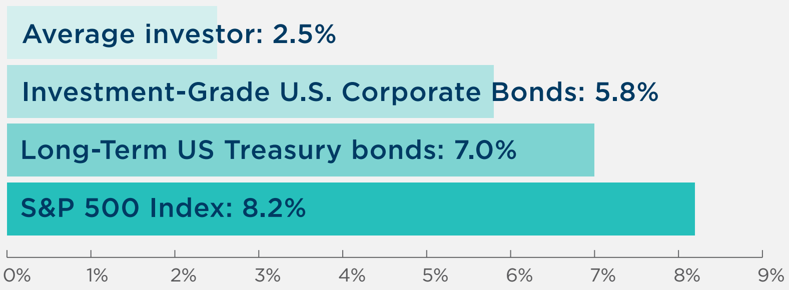
Key highlights

- **News headlines from the stock market and financial media lead investors toward making irrational decisions,** many times due to the psychological hard-wiring of the human brain.
- **The average investor has underperformed major market indexes** as they have tried to time good and bad performance in the market. Frequent trading and short-term holding periods have been driven in large part by emotional reactions to news headlines.
- **Investors should be aware of their emotions and the psychological aspects of investing.** Investors can help themselves avoid reactions to market headlines by sticking to investment basics, seeking opportunities to buy when others sell, and working with a financial professional.

Summary

Individual investors today are fortunate to have vast oceans of information at their fingertips, thanks to the rapid development of communications technology and the Internet. Information is easily available, often with just a few clicks or the swipe of a thumb. News of transformative market events arrives in real time—24 hours a day, seven days a week. Despite this, the proliferation of investment information has not made it easier for individuals to find success in the markets. On average, individual investors underperform broad market indexes—a trend that has been in place for many years and continues to this day. (See below.)

Annualized performance: 1995-2014



Source for index data: Morningstar.
Source for average investor data: Dalbar, Inc. QIAB study, 2015.

There are many causes for investor underperformance, but one of the primary reasons is frequent trading. Investors buy and sell holdings in their portfolio constantly—the average holding period for a mutual fund is under two years, shorter than the average length of a market cycle. This frequent buying and selling, often at inopportune times, is mostly due to emotional overreactions driven in large part by headlines from the financial media.

This white paper examines the role of financial and market news headlines in driving emotional reactions among investors. We will discuss the consequences that headline-driven emotional investing has on individual investors, and share guidance for helping investors tune out the noise from the financial media and focus on the basics of long-term investing.

Information everywhere, all the time

The rapid development of information technology and the rise of connectivity through the Internet and mobile devices has "disrupted" many industries. That would include businesses in the financial services sector and the traditional model of investment advisory and asset management firms. Investors now have more information at their fingertips than ever before. Not only is much of this data searchable and accessible, it also comes in real time and from far-flung regions of the world, across time zones and through language barriers.

Firms that are in the business of communicating financial information to investors have also been transformed by technology.

Five exabytes

5,000,000,000,000,000,000

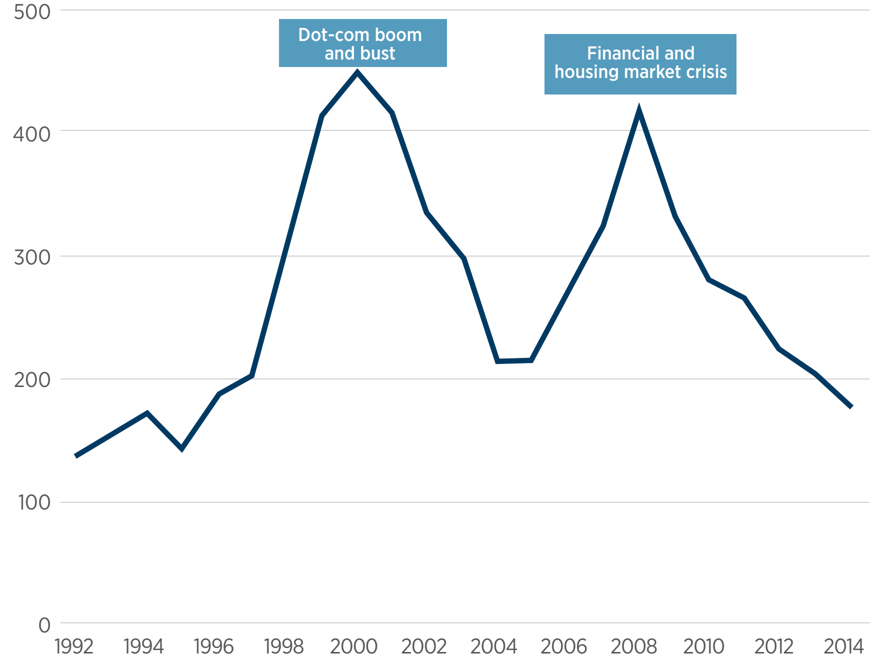
> "Every two days now we create as much information as we did from the dawn of civilization up until 2003. That's something like five exabytes of data each day."
>
> *Eric Schmidt, Google CEO in 2010*

Traditional financial market publications like *The Wall Street Journal* and *The Financial Times* and others have been in existence as long as the trading markets themselves, covering news from the major trading centers since the 1880s. The audience for these media outlets was primarily market traders, asset managers and wealthy investors.

Competition on the financial news beat spread with the launch of CNBC on cable television in 1989, then with the emergence of the Internet in the 1990s. This also coincided with the democratization of the investment markets, as investors took on greater responsibility for their financial future through 401(k)s, IRAs and other types of retirement plans. Online trading platforms such as E-Trade and Ameritrade emerged in this era as well, disrupting the traditional brokerage business model that controlled much of the trading in the financial market. Now, market data is streamed on tickers across a variety of media devices, and news of market events comes directly into the homes, offices, computers and smartphones of individual investors.

For many of the broadcasters and publishers of financial news and information, their purpose is not to inform investors, but to attract them. Their business models are driven by ratings and click-throughs—the more viewers or subscribers they have, the more attractive their media platforms are to advertisers. And for a financial media platform, nothing attracts individual investors more than bad news. (See Figure 1.)

Figure 1. CNBC total viewership ('000s)

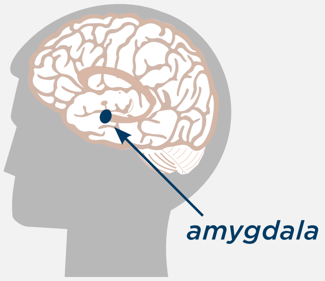


Source: Zero Hedge, based on Neilsen data (2015).

Bad news is good business

You only need to look as far as the financial markets themselves to see the effect that headlines and bad news have had on investors. It is often said investors climb a "wall of worry" as market cycles reach their nadirs, either at the bottoms of bear markets or near the peaks of bull markets.

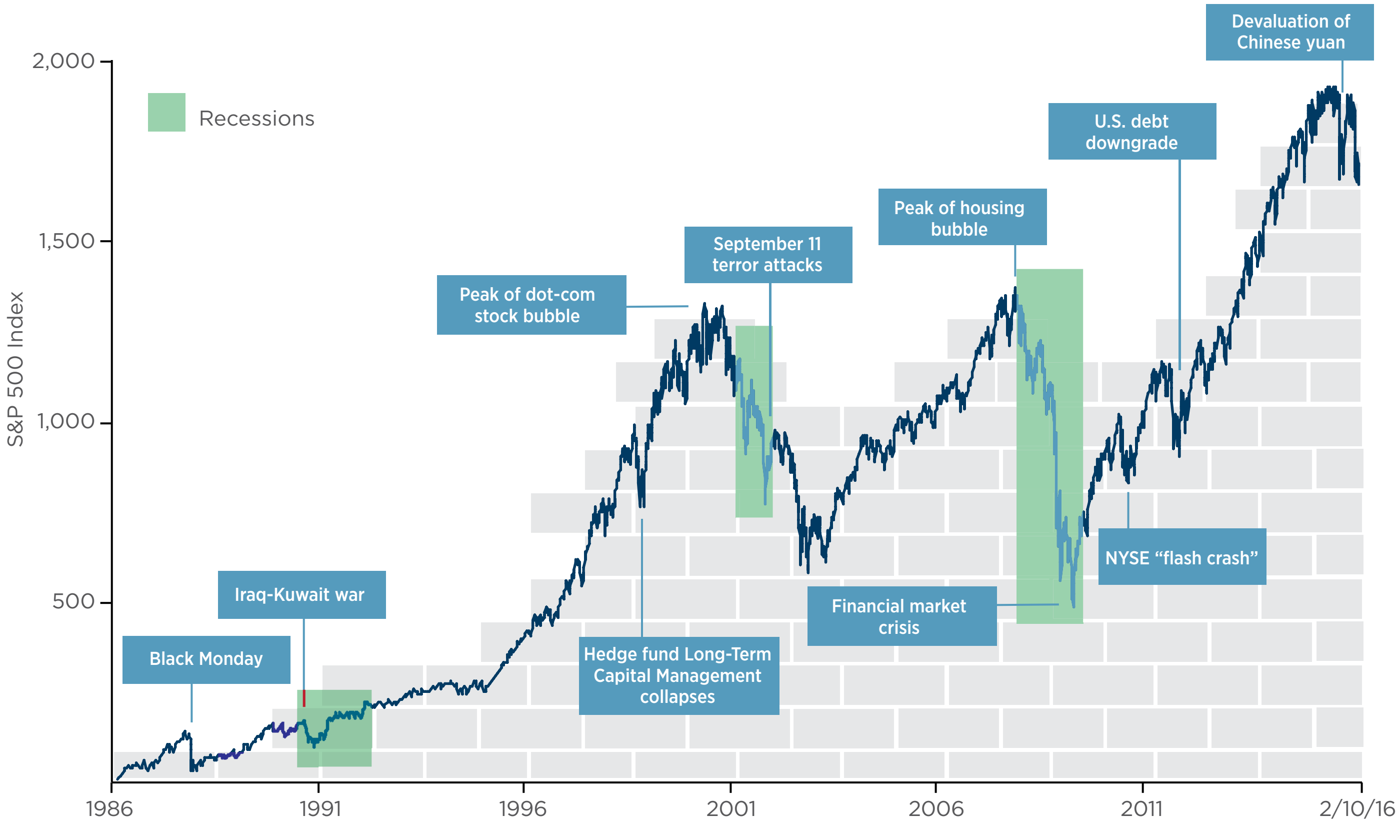
The worries that build this wall are usually economic, political or international events that sway investor sentiment toward optimism or pessimism. Eventually, investors overcome these worries and market cycles transition from growth to consolidation (or vice versa). But during these late-cycle spells, the accumulation of news headlines drives the wall of worry higher—this is when investors are most vulnerable to making emotional and irrational decisions.



A neurological view

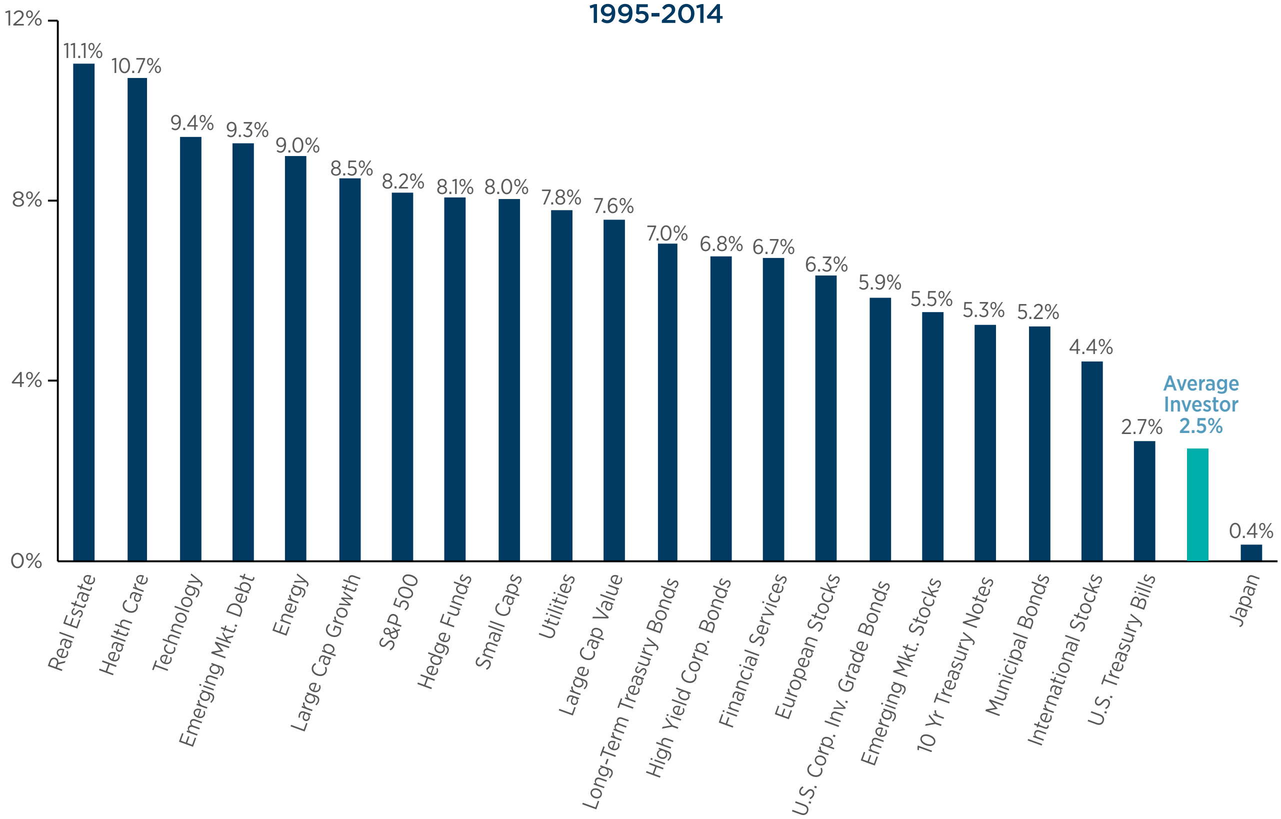
The same part of the brain that regulates emotion—the amygdala—is also used for decision making. In stressful situations, emotions can take over the amygdala and influence decision-making processes. **This leads to behaviors that are less rational and more impulsive.**

Figure 2. "Wall of Worry": When the news influenced the S&P 500 Index



Source: Factset (Feb. 2016).

Figure 3. Annualized index returns 1995-2014



Source for index data: Morningstar (Feb. 2016).
Source for average investor return data: Dalbar QAIB study, 2015.

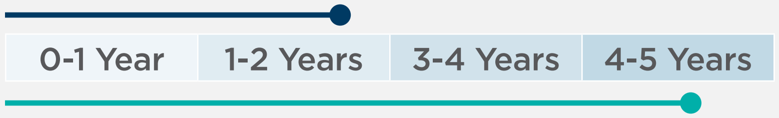
Turn on, tune in, drop out

Individual investors get caught in this vicious cycle: news headlines drive investor emotions, which drive individuals to make irrational investment decisions. What comes next is poor performance. Over the 20-year period from 1995 to 2014, individual investors have underperformed the market in nearly every way—from stocks to bonds, from broad indexes to industry sectors, from the U.S. to developed and emerging international markets.

Market timing has much to do with this poor performance. Individual investors tend to trade frequently and hold investments for short-term periods, shorter than the length of the average market cycle. They buy high and sell low—the exact opposite of what they should do according to basic investment principles. A lot of this activity is driven by emotion, and many times these emotions are triggered by market events and headlines from the financial media.

All of this movement in and out of the market means investors will often miss the best days in the market. Missing those days can significantly reduce the returns investors achieve, and ultimately cost real money relative to the outcomes investors who remain fully invested would achieve.

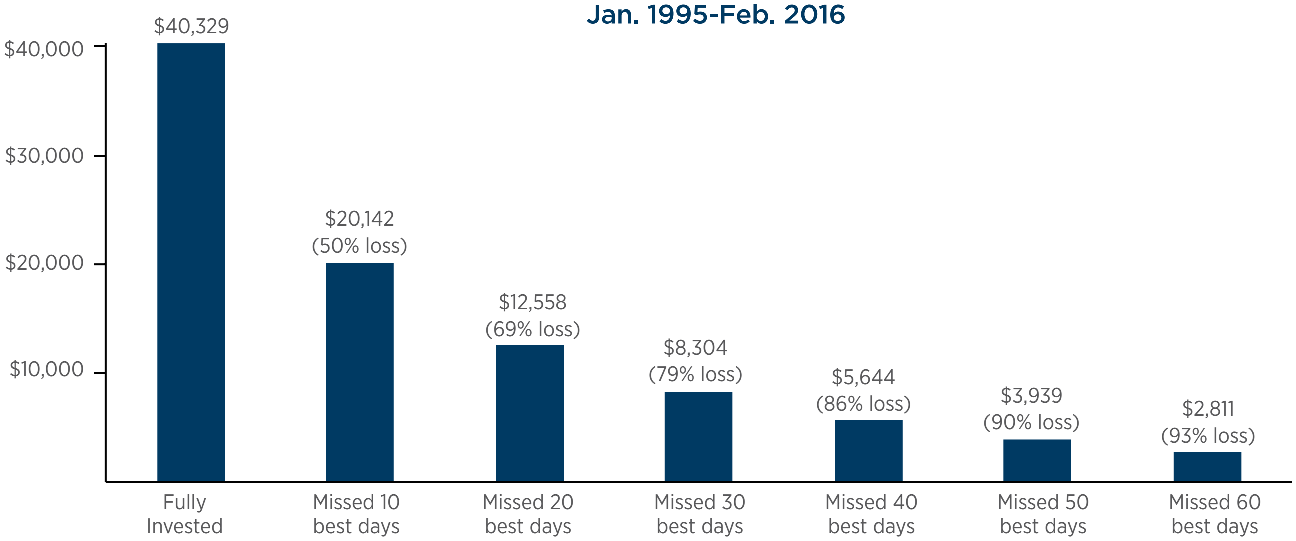
Average holding period for stocks on the New York Stock Exchange: 1.9[1] years.



Average length of a market cycle (peak-trough-peak): 4.7[2] years.

[1] Source: Ned Davis Research, Dec. 2014.
[2] National Bureau of Economic Research (NBER), Sept. 2010.

Figure 4. S&P 500 Index (daily price return) growth of $10,000 Jan. 1995-Feb. 2016



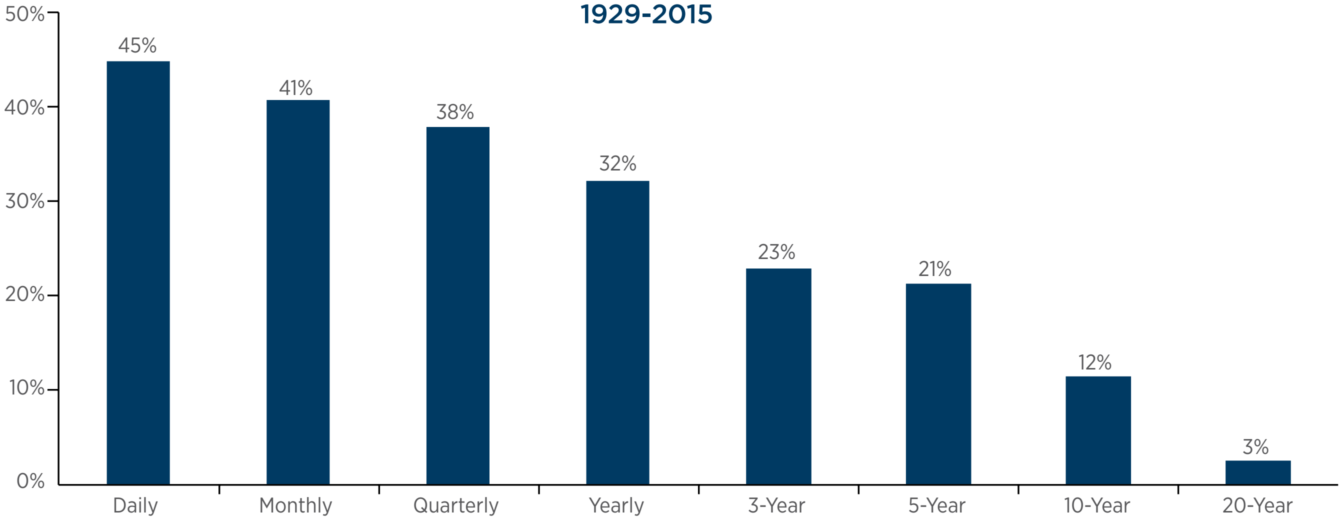
Source: FactSet (Feb. 2016).

Countering the lure of news headlines

The solution for countering the influence and effects of headline-driven emotional investing lies within the individual. By understanding the true role of the financial media and recognizing how sensational reports of market events can push our emotional buttons, individual investors can tap their own willpower to avoid making emotionally charged decisions and stick to the investment plan they established with their financial advisor.

Historical results from the financial markets can also show investors the value of maintaining a long-term perspective and help them downplay the influence of short-term performance. Looking at returns for the S&P 500 Index back to 1929 shows how the probability of positive returns increases with the length of the period. Negative returns are more likely for shorter periods—nearly every other day in the market is a down day, according to historical S&P 500 data. Even on an annual basis, one in every three years is negative. But over longer periods, 10 years and beyond, the probability of negative returns declines dramatically.

Figure 5. Probability of negative S&P returns 1929-2015



Source: FactSet (Feb. 2016).

Maintain a disciplined approach to investing

Perhaps most important of all, investors should become their own best advocates to help regulate their emotions when facing news headlines and dramatic events in the financial markets. By avoiding emotional decisions and maintaining a disciplined approach to investing, investors can seek to keep more of the money they save and earn and be positioned for opportunities to buy when prices are low.

Recalling these basic principles of investing can help investors manage the onslaught of financial news headlines:

☑ **Stick with investments for the long-term** to help achieve long-term goals.

☑ **Tune out the noise from the financial news media,** and don't take any action in response to news events without first consulting a financial advisor.

☑ **Maintain a diversified portfolio** that's suitable for your investment goals and risk tolerance to help lessen the impact of market fluctuations.

☑ **Take advantage of opportunities to invest** when other investors display emotional behaviors, buying when they are selling in falling markets.

Key takeaways for investors:

Be aware of the role the financial media plays in the industry and understand how headlines of dramatic market events can trigger investor emotions and influence behavior.

Individual investor performance consistently lags the markets because investors trade frequently and try to time the market in reaction to news headlines.

Stay invested for the long-term to achieve long-term goals, and follow basic investment principles to downplay the role that emotions can have on investor behavior.

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