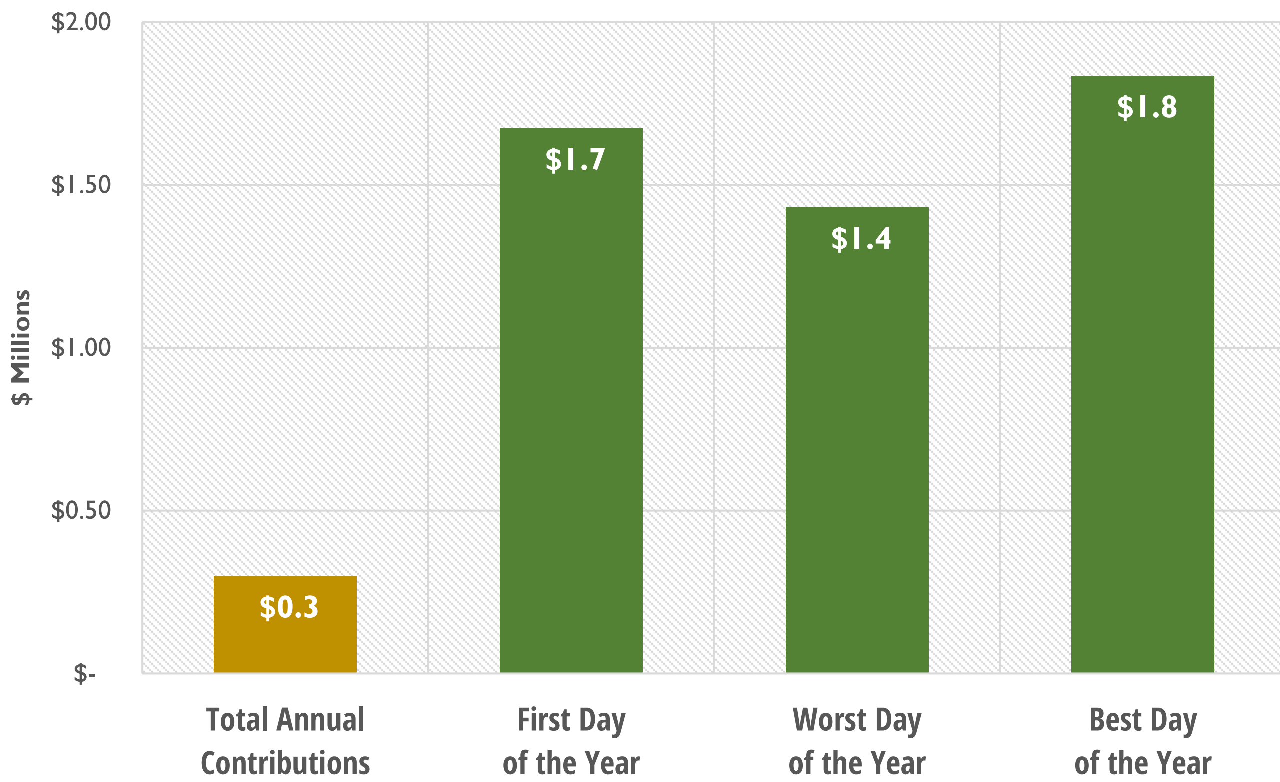
behavioral
ADVISOR

Don’t Hesitate to Build Your Wealth

Volume 41 | November 2020

Investors often fret about the market environment and ask if they should invest now or hold off for a better time. For long-term investors, making regular contributions is more important than when the contributions are made each year. The table below shows there is not much gained by perfectly timing contributions each year.

30-YEAR OUTCOMES OF CONTRIBUTING CAPITAL ON SELECTED DAYS (S&P 500 TR INDEX 1990-2019)



Source: AthenaInvest, Inc. and S&P Dow Jones Indices LLC

The chart summarizes the outcomes of making annual contribution of $10,000 over three decades encompassing a diverse array of market conditions. In the first scenario, each annual contribution is made on January 1st. The second scenario shows the result of contributing on the day of the market high for the year, “the worst time”. Finally, the third scenario shows what happens when the annual contribution is perfectly timed at the market low for the year, “the best time”.

If you simply make the investment on January 1st each year, the $300,000 contributed over the 30-year period will have grown to an impressive $1.7 million. Absolute perfect timing either way, best or worst day each year, results in a range from $1.4 to $1.8 million. Investing on exactly the right or wrong day every year for 30 years in a row is inconceivable.

This shows that making regular annual contributions and compounding are the main drivers of wealth, not the timing of the contributions. Sticking to a long-term plan and making regular contributions is the most reliable way to build wealth over time and, more importantly, contributions are squarely within an investor’s control.

behavioral
ADVISOR

From the Behavioral Viewpoint

What is going on?

1. We have a hard time thinking long-term and are prone to **recency and availability bias**, where we give the endless supply of rhetoric, headlines, and short-term events more relevance and weight than they deserve.
2. We are hardwired to be **loss averse**. By nature, we feel twice as bad about a loss as we do an equivalent gain and are constantly on the lookout for potential threats and want to believe we can identify and avoid every threat.
3. We want assurance that our investments will not go down in value to avoid **regret**. The **fear** of initial loss literally outweighs any potential long-term benefits in our minds.

What can we do?

1. Have a needs-based financial plan that separates short-term and long-term investments. For long-term investments make contributions as early and often as possible and withdraw funds as late as possible.
2. Develop and follow a plan to invest pre-determined amounts at pre-determined times.
3. For large lump sum or one-time contributions, invest 50% right away and the remaining 50% in 3 months to enter the market in a disciplined way and to mitigate random market events, emotional turmoil, and regret.
4. Work with a professional financial advisor who can provide valuable guidance to help you stay on track.

Behavioral Finance straight to your Inbox

Behavioral Viewpoints features new topics each month which are intended to help advisors and investors gain a deeper understanding of how behavior shapes the investing landscape.

www.athenainvest.com/subscribe