

# Taking a timeout

Understanding the key pitfalls investors make, and how to avoid them

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Too often our emotions can be the biggest barrier to our investment success. In these situations, it's important to take a timeout and remember why you're investing — your retirement, your child's education, your legacy. A short-term market decline doesn't change these long-term goals.



A timeout can help you review your goals and objectives, recognize behaviors that could cause trouble and avoid making emotional investment decisions.

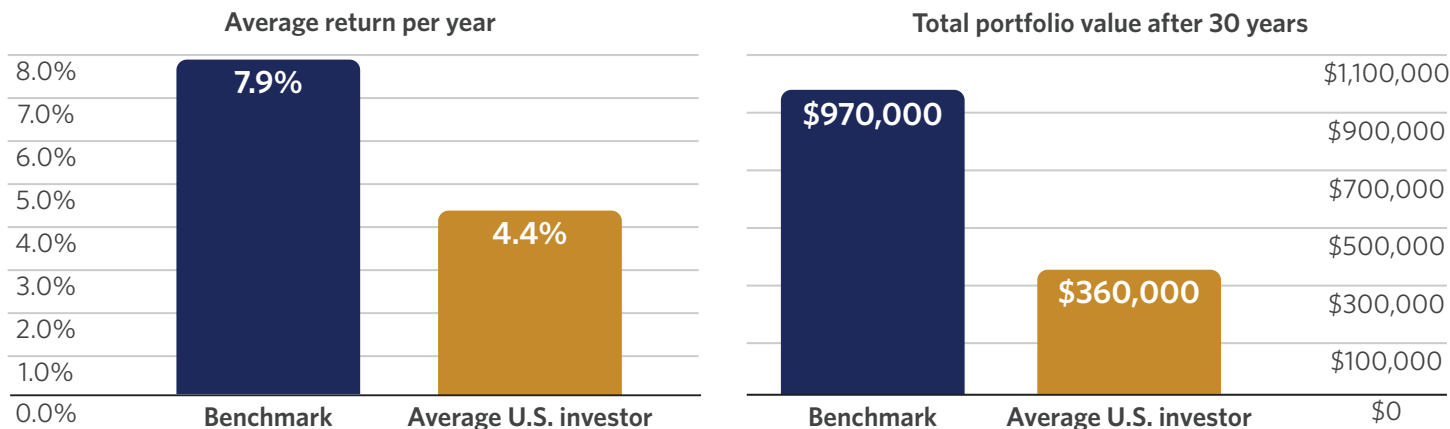
## The result of our investing behavior

Why is it so important to be on your best investing behavior? Poor investing behavior can lead to poor diversification, chasing performance and moving into and out of the markets (and often at the wrong time). The typical result of these behaviors is not a surprise — poor long-term performance, which could lead to the biggest risk of all: not reaching your long-term financial goals.

The consequences may be even more dramatic than you think. For example, the average annual return for a 65% stocks/35% bonds portfolio over the past 30 years was 7.9%. However, the average U.S. investor received a 4.4% return because of their investing behavior. But with the power of compounding, the difference wasn't simply 3.5% a year; it could have been more than \$600,000 over that 30-year time frame.

When you feel your emotions beginning to get the better of you, take a timeout and work with your financial advisor to review your goals before making what could be an emotional investing decision. Your portfolio and your future self will thank you.

## How investing behavior can lead to poor performance



Source: "Quantitative Analysis of Investor Behavior, 2023," DALBAR, Inc. and Edward Jones estimates. The average return per year is the annualized return for the past 30 years ending 12/31/2022, assuming a 65% allocation to stocks and a 35% allocation to bonds. To calculate the benchmark return, equity is represented by the S&P 500 TR USD Index and fixed income is represented by the Bloomberg US Aggregate Bond TR USD Index. An index is unmanaged, is not available for direct investment and is not meant to depict an actual investment. We assume reinvestment of interest and dividends back into the indexes. The average U.S. investor return assumes returns on equity and bonds equal to those of the average equity and fixed income fund investors, respectively. To calculate the portfolio value, we assume an initial investment of \$65,000 in equity and \$35,000 in fixed income, rebalanced annually. Historic average annual returns incorporate the impact of compounding over time. For illustrative purposes only, this portfolio is not available for investment. Diversification and rebalancing do not ensure a profit or protect against a loss in a declining market. This study was conducted by an independent third party, DALBAR, Inc., a research firm specializing in financial services. DALBAR is not associated with Edward Jones. Past performance does not guarantee future results. Values rounded to the nearest \$5,000.

## Investing behavior: Heading to (or staying on) the sidelines

Whether it's the economy, the national deficit or market fluctuations, there will always be headlines that may distract you from focusing on your long-term goals. Trying to avoid potential stock market declines may lead to the following bad behaviors:

### Trying to time the market

Some may try to time the market or sell to avoid additional declines. But to time the market successfully, you must get two decisions right: when to get out and when to get back in. Getting one right is difficult; getting two right is nearly impossible.

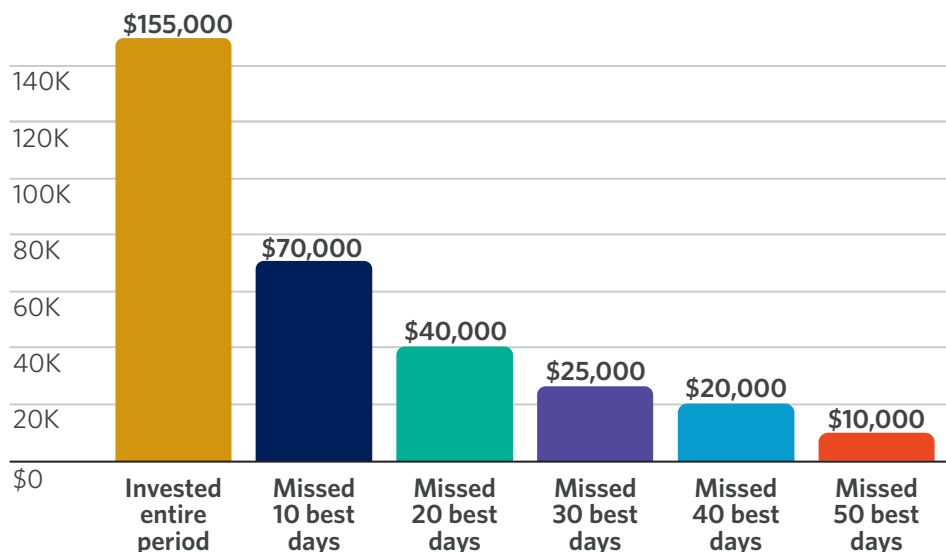
### Holding too much in cash

Others may hold too much in cash, thinking they're avoiding risk. However, this could increase the risk of not having enough growth in their portfolios to meet their goals or offset inflation.

Not staying fully invested or jumping in and out of the stock market can seriously affect performance, since many investors often get out after declines and then miss the positive moves. The effects of missing the best days can be substantial, as shown in the chart on Page 3.

## Missing the best days

Value of \$10,000 investment in the S&P 500, 1993–2022



Source: FactSet and Edward Jones calculations. Best days are defined as the top percentage gains for the S&P 500 TR USD Index during the entire period. An index is unmanaged, is not available for direct investment and is not meant to depict an actual investment. We assume reinvestment of dividends back into the index. Historic average annual returns incorporate the impact of compounding over time. Calculations do not include the impacts of trading, liquidity, costs, fees or taxes a client can experience when investing, which would lower performance results. Past performance does not guarantee future results. Values rounded to the nearest \$5,000.

## How to avoid this behavior

### Avoid the headlines

When negative events occur, the media can appear to add to the drama by using strong headlines or highlighting historical information about previous issues. At times, this includes emphasizing poor market performance in ways that can set off alarm bells among investors. However, the *BusinessWeek* cover shown here preceded one of the strongest equity markets in history. Focus on your long-term goals and not the ever-changing headlines, and remember we've successfully navigated tough periods before.

### Know yourself

Talk with your financial advisor to better understand your attitudes toward risk (and how you may react to specific events). By knowing how you may react in advance, you can be better prepared when the inevitable short-term declines occur.

### Understand the risks of not investing

The biggest risk you may face is not reaching your long-term goals. Assuming a modest 3% inflation rate, prices will double during a normal 25-year retirement period. Look to growth investments to help keep pace with inflation.\*

\* Investing in equities involves risk, the value of your shares will fluctuate and you may lose principal.



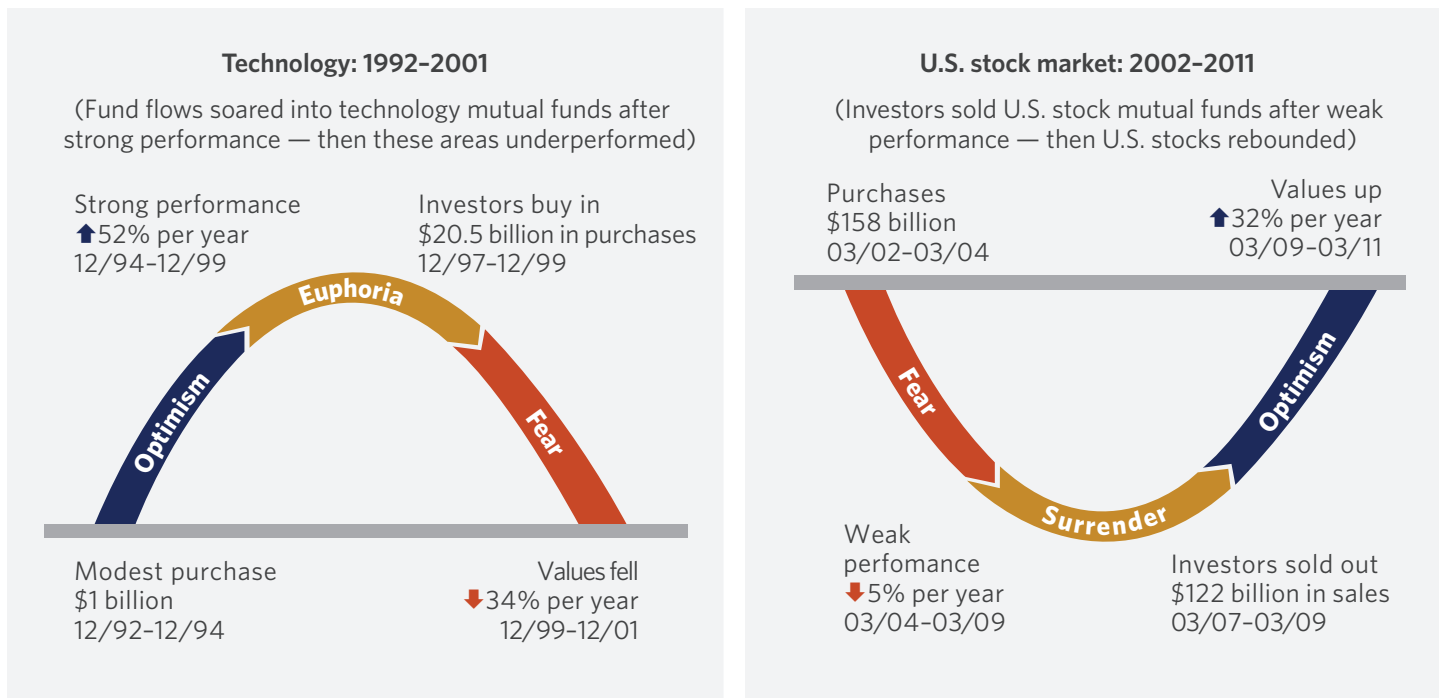
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## Investing behavior: Chasing performance

When the media hype the latest hot investment or highlight dramatic declines in the market, we're often tempted to chase the winners and sell the losers. However, this emotional response can lead to buying investments at market peaks and selling them at the bottoms — a recipe for underperformance.

### Chasing winners vs. selling losers



Source: Morningstar Direct. Technology sector performance represented by the S&P 500 Information Technology TR USD Index and U.S. stocks performance represented by the S&P 500 TR USD Index. An index is unmanaged, is not available for direct investment and is not meant to depict an actual investment. Past performance does not guarantee future results.

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## How to avoid this behavior

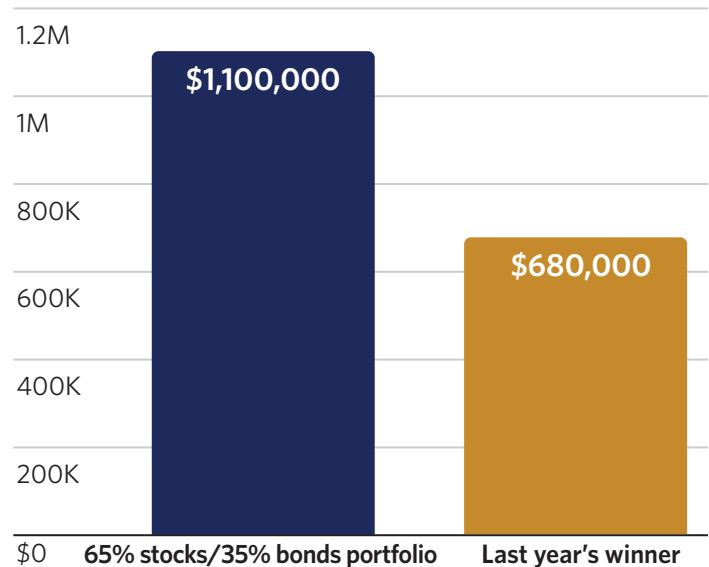
### Stay diversified

Instead of trying to find the next hot investment and chasing performance, it's important to have a broad asset allocation and remain diversified. This helps ensure you have different types of assets and investments — each of which may perform differently at different times. By chasing the leading asset class, portfolios may not only end up with a lower return but may also end up much less diversified than we would recommend. While diversification cannot guarantee a profit or protect against loss, it can help smooth out market ups and downs, potentially providing a better long-term experience.

The chart shows \$25,000 invested each year into either a 65% stocks/35% bonds portfolio or the last year's best-performing asset class (winners).

## Don't chase performance

Data range 2003–2022



Source: Morningstar Direct. The 65% stocks/35% bonds portfolio is rebalanced at the beginning of each year. Stocks are represented by the S&P 500 TR USD Index. Bonds are represented by the Bloomberg US Aggregate TR USD Index. An index is unmanaged, is not available for investment and is not meant to depict an actual investment. We assume reinvestment of interest and dividends back into the indexes. Investing in the last year's winner assumes that, at the beginning of the year, the entire portfolio is allocated to the asset class with the highest return in the previous year. Historic average annual returns incorporate the impact of compounding over time. Calculations do not include the impacts of trading, liquidity, costs, fees or taxes a client can experience when investing, which would lower performance results. For illustrative purposes only, not a portfolio available for investment. Diversification and rebalancing do not ensure a profit or protect against a loss in a declining market. Past performance does not guarantee future results. Values rounded to the nearest \$5,000.

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## Investing behavior: Focusing on the short term

It's important to focus on the long term, but day-to-day fluctuations can often get in the way, causing us to:

### Fixate on a certain point in time

Depending on the vantage point, the same situation may look very different. For example, some investors sold in 2008 because their portfolios had fallen from the all-time high value, even though their performance may still have been on track and well above where they initially began.

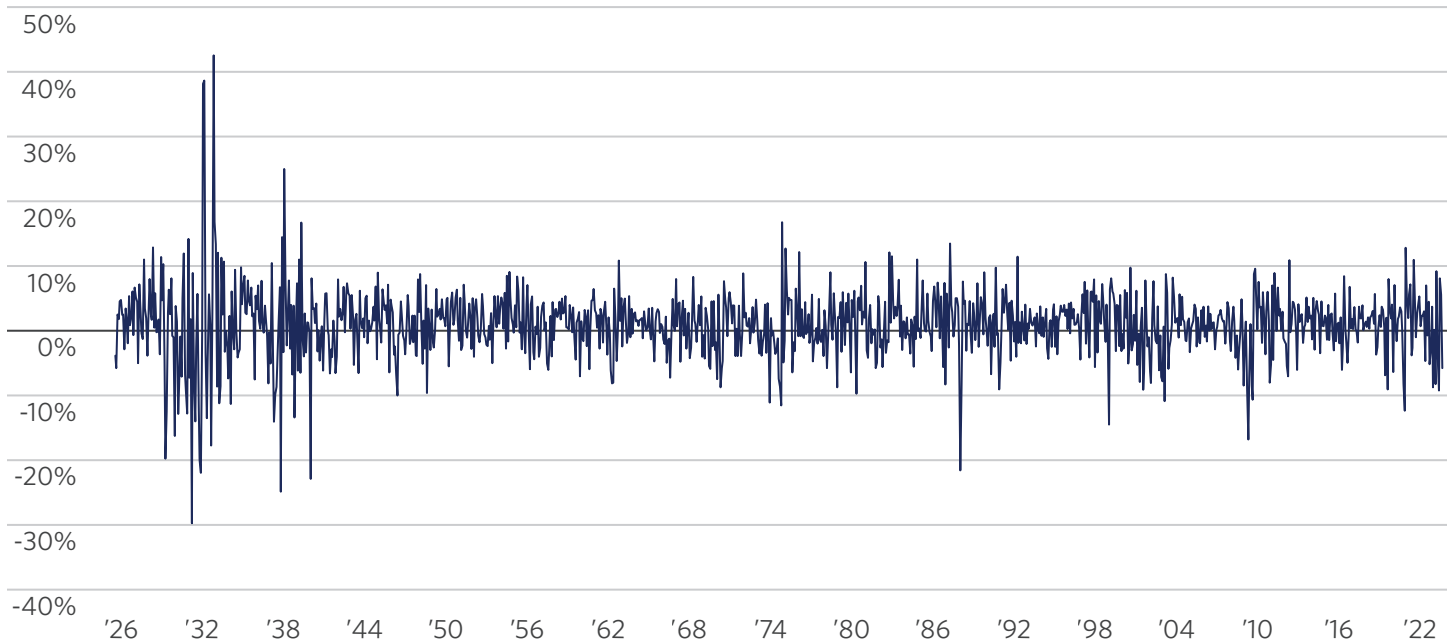
### Base decisions on how the information is framed

Decisions can be influenced by how a situation is presented. For example, assuming a Dow value of 30,000, one can say "Dow plummets 300 points" OR "Dow declines 1%." Both describe the same situation, but the first sounds worse. With the Dow over 30,000, we should expect larger point moves, but how the media present market movements can lead investors to make emotional short-term decisions.

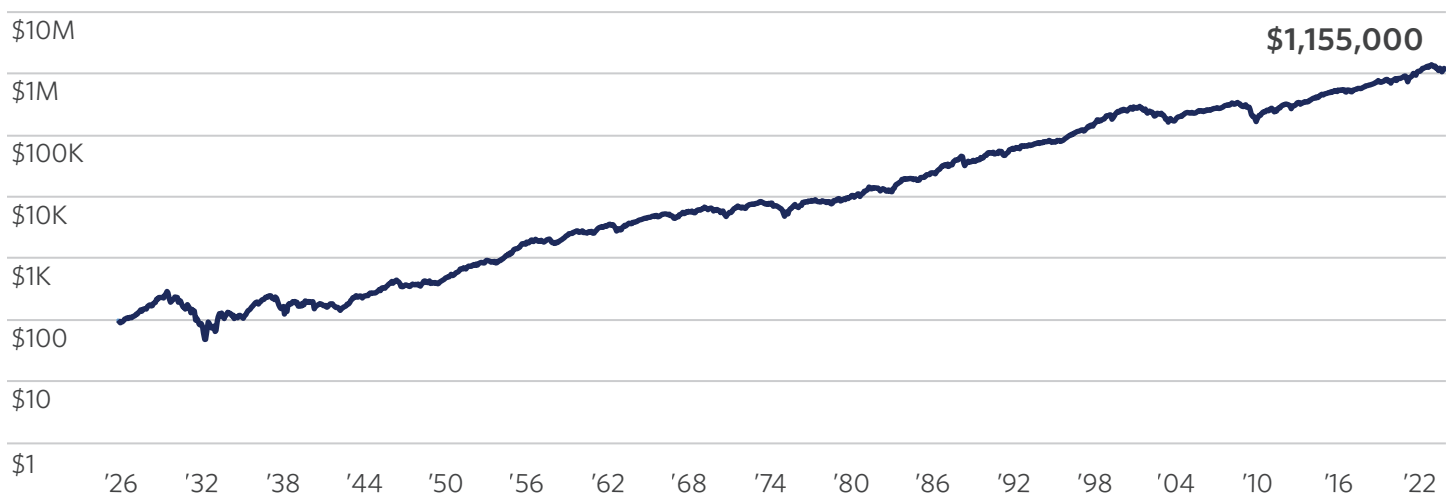
It all depends on your perspective, as highlighted below. The graphs show the same performance but a different perspective. The first graph shows monthly fluctuations in the S&P 500; the second shows the long-term performance — illustrating why it's important to keep a long-term focus.

## A monthly perspective vs. a long-term perspective

S&P 500 monthly total returns, 1926–2022



Value of \$100 invested in the S&P 500, 1926–2022



Source: FactSet and Edward Jones Calculations, 1/1/1926–12/31/2022. S&P 500 is represented by the S&P 500 TR USD Index and by the IA SBBI US Large Stock TR USD Index prior to 1988. Total return includes reinvested dividends. An index is unmanaged, is not available for direct investment and is not meant to depict an actual investment. Calculations do not include the impacts of trading, liquidity, costs, fees or taxes a client can experience when investing, which would lower performance results. Past performance does not guarantee future results. Values rounded to the nearest \$5,000.

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## How to avoid this behavior

### Set realistic expectations and focus on your goals

As the chart on Page 6 shows, although the stock market has averaged about a 10% annual return since 1926, rarely is the return in any year average. In fact, over that nearly 100-year period the stock market has gone down in 26 years — about once every four years. Over a 25-year retirement, you could experience six to seven down markets.

So market declines, while unpleasant, are in fact normal. Measure your performance as progress toward your long-term goals, not in day-to-day fluctuations.

### Understand the purpose of your investments

In retirement, some investments are there for your income today. Others are there to help provide income many years from now. Each serves a critical role in ensuring your money lasts as long as you need it.

#### Near-term income

Cash and short-term  
fixed-income investments

#### Medium-term income

Intermediate- and longer-term  
bonds and fixed-income  
investments

#### Long-term income

Stocks and growth  
investments