Retirees: Stop Paying Attention to the Markets

Those who ignore the markets perform better than those who don't

By Mark Hulbert | May 24, 2018

Retirees: Turn off the TV and shut down your computer.

Ignoring the markets' short-term gyrations not only will reduce your anxiety and stress and thereby enable you to better enjoy your retirement, it also will most likely help your portfolio perform better.

That seems too good to be true, I know. But it's the clear implication of decades of academic theorizing and, now, a fascinating empirical study.

The reason to stop paying attention to the markets' short-term gyrations is something known as "myopic loss aversion," which is in turn a combination of two personality traits: We hate losses more than we love gains, and, given the chance, we can't resist looking to see how our investments are doing. As a result, those of us who more frequently check our portfolio's net worth will have higher subjective perceptions of risk. That in turn translates into a lower allocation to riskier funds.

Think about it this way: Short-term returns are mostly noise, and noise—by definition—largely cancels itself out over time. When you focus on longer-term periods, therefore, you will be inclined to see the markets as more placid than when you focus on shorter-term periods. That in turn means you will be more willing to invest in risky assets to the extent you focus on performance over those longer periods.

The last six months are a good illustration. You're suffering from whiplash if you focused on the stock market's daily gyrations; the market has been extraordinarily volatile on a day-by- day basis. But if you instead focused on six-month returns, you'd notice that the S&P 500 isn't far from where it stood last December. With that focus, you'd be excused for thinking that the stock market has been awfully quiet—a yawnfest, if you will.

Shlomo Benartzi, an accounting professor at UCLA, and Richard Thaler, a behavioral economist at the University of Chicago, are widely credited with first hypothesizing the existence of Myopic Loss Aversion. It's one of the reasons Thaler won the Nobel Prize last year. But, up until recently, the primary evidence supporting the existence of this behavior pattern came from elaborate laboratory simulations of how investors would act in the real world.

We now have real-proof, thanks to a regulatory change in Israel in 2010. That's when mutual-fund companies were prohibited from reporting returns over any period shorter than 12 months.

Before the change, one-month returns were prominently reported in brokerage statements. This new regulation… “caused reduction in fund flow sensitivity to past returns, decline in trade volume, and increased asset allocation to riskier funds.”

What’s so compelling about this finding is that the experiment holds everything else constant.

Israeli investors collectively didn’t change their risk preferences, for example; they didn’t suddenly become more sanguine in the face of short-term volatility or more willing to incur more risk. The only thing that changed was whether they were presented with one-month returns. That seemingly insignificant change led to a dramatic change in their investment behavior.

To be sure, reducing the frequency with which you focus on your portfolio’s performance is not a panacea. It won’t transform a terrible portfolio into a top performer, for example. Before taking this recent research to heart, you first need to have a solid financial plan in place that is catered to your financial situation and long-term goals.

But, once you do, the best advice may be to simply forget about your portfolio, letting your financial planner take care of it.

My wife is a clinical psychologist, and she suggests framing the task we face as identical to the one faced by Odysseus when his ship was sailing by the Sirens. He knew he would be unable to resist their alluring singing, and yet he also knew that succumbing to that temptation would be fatal. He nevertheless wanted to listen to the Sirens’ beautiful songs, so he had his men tie him to the mast of the ship on which he was sailing so that he could listen and still be able to resist.

Each of us needs to figure out what the investment equivalent of tying ourselves to such a mast.

If you don’t have some way of tying yourself to the mast, then you should ignore the markets’ daily, weekly and even monthly gyrations. Only if you have discovered how to resist the allure of constantly making portfolio changes can you safely listen to the investment arena’s Sirens—CNBC and other sources of saturation coverage.

But even if you truly are one of the rare investors who can resist, ask yourself: If you’re not going to make any changes to your portfolio anyway, why bother with the saturation coverage?

Did you really save and invest for retirement over many decades to just sit in front of the television?