TURNER INVESTMENTS COMMENTARY

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FEAR ITSELF

"There is a time to take counsel of your fears, and there is a time to never listen to any fear."

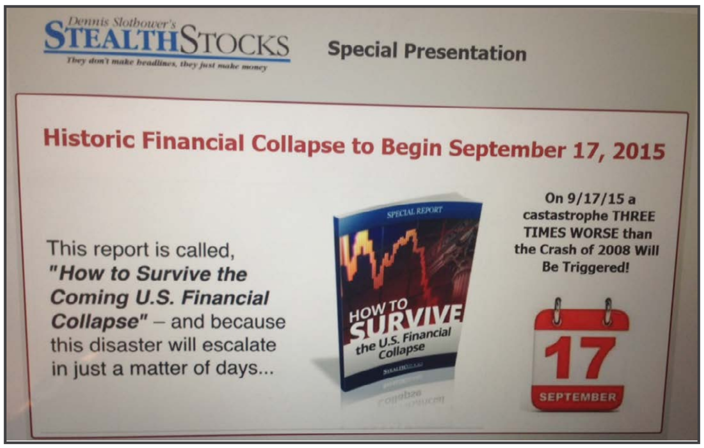
—George S. Patton

FEAR APPEAL THEORY

Some advertising tricks are obvious. For example, if you're promoting a lottery you don't show the masses of people walking every week into the corner store to, once again, learn that they've lost. Instead, you show winners holding giant cheques, piloting luxury sailboats or picking out homes in the south of France. Look also at the new flood of TV commercials for fantasy sports sites FanDuel and DraftKings on a typical Sunday afternoon during football season. Naturally, they're highlighting members who have won big, not the presumably equal number who have lost it all. Investment firms are no different: they show their successes, not their failures. However, when the underbelly of the investment world switches its focus to emphasize negative outcomes to incite fear, that's when investor manipulation can become more serious and, unfortunately, often more effective. Typically, this fear is generated by predicting, with table-pounding certainty, a stock market disaster. In advertising circles this is referred to as "fear appeal theory" and it's not being employed to protect your wealth: more often it's being used to either enhance a pessimistic analyst's profile or make that analyst a profit.

Fear appeal theory posits that there is an imminent threat facing an investor and that unless the investor takes immediate action they will not be able to avoid this negative (often catastrophic) consequence. Fear appeals are practiced across all levels of the investment world. Sometimes they are used by more established personalities such as Marc Faber, who, appropriately, publishes the Gloom Boom & Doom Report newsletter or economist Nouriel Roubini whose forecasts have earned him, also appropriately, the nickname "Dr. Doom". Often, however, less established and more manipulative market players employ a fear appeal to make a quick buck. We recently came across the below presentation from "StealthStocks". As the example slides indicate, the technique employs classic fear appeal theory—the pitch is designed to maximize investor distress and make the consequences appear inescapable unless the recommended action is taken. As California State University noted in a detailed 2012 report on fear appeal theory, “in general, the more frightened a person is by a fear appeal, the more likely he or she is to take positive preventative action.” The positive preventative action, of course, is to buy the recommended risky penny stocks, newsletters, books, etc. In other words, line the pockets of the fear-appeal practitioner.

It's the End of the World as We Know It...



Source: StealthStocks presentation

Consider the language in the StealthStocks presentation. It’s absolute (“unavoidable disaster”), imminent (“just a matter of days”) and it combines nonsensical, yet severe, consequences (“THREE TIMES WORSE than the Crash of 2008”). To put their claim in perspective, the S&P 500 Index, a broad measure of the US equity market, lost 889 points from peak to trough during the financial crisis, so this future “unavoidable” market collapse will apparently take the S&P 500 down 2,667 points or actually below zero, making corporate America worthless. Dire consequences indeed.

AVAILABILITY BIAS

A fear appeal is usually closely associated with availability bias, which is an aspect of behavioral finance that can affect our better judgement and be detrimental to wealth creation. Availability bias, according to investment firm Vanguard,

…suggests that recently observed or experienced events strongly influence decisions. Researchers found that individuals were likely to overestimate the chances of being in a car crash if they had seen a car crash on a recent journey. The recent memory made the prospect more vivid—available—and therefore more likely.

Based on this, think how much more effective the StealthStocks appeal would be right after the 2008 financial crisis or, as a more recent example, the current market correction we’ve just experienced. It’s no surprise that we came across this presentation during the most recent bout of market turmoil this past summer.

COMBATING A FEAR APPEAL

Consider the True Odds

A fear appeal is designed to cause investors to make impulsive decisions and quickly reach for the trade button (or their credit cards) to remove the fear. To combat this impulse, first focus on the basic probabilities. The S&P 500 has data going back decades over countless economic cycles. Without over-complicating the matter, look simply at full, calendar-year returns. How often does the market trade higher? Over the past 75 years, more than 73% of the time. In other words, the odds are clearly in your favour that during any given year, you're likely to make money. If your holding period is longer—10 years for example—the odds of a positive return are even more stacked in your favour. The S&P 500 virtually never records an annualized loss over a rolling 10-year holding period. Historically, the odds of the S&P 500 recording an annualized positive gain over 10 years are 90%. (Create a balanced portfolio with some bonds and fixed income exposure to offset the negative equity periods and your odds of recording a positive annual gain increase even more.) And what has the S&P 500 given investors, on average, over the past 75 years? A quite attractive 7% annual return. What all this adds up to is an extremely low likelihood that those calling for a market apocalypse will be right.

Ignore Market-Mastery Promises

Fear purveyors also usually claim to have solved the market, and promise spectacular investment returns because, naturally, they have to provide a method for removing the fear that they've created. But why would they share this information? As Burton Malkiel in his classic book, *A Random Walk Down Wall Street,* points out:

If such a regularity [for solving the market] was known to only one individual, he would simply practice the technique until he had collected a large share of the marbles. He surely would have no incentive to share a truly useful scheme by making it available to others.

In other words, if you believe you're the best poker player at the table, would you stop mid-game to let everyone else in on your strategy? The salesmen flogging these sure-fire, market-beating techniques would suggest that they're simply sharing this information out of goodwill. Unlikely.

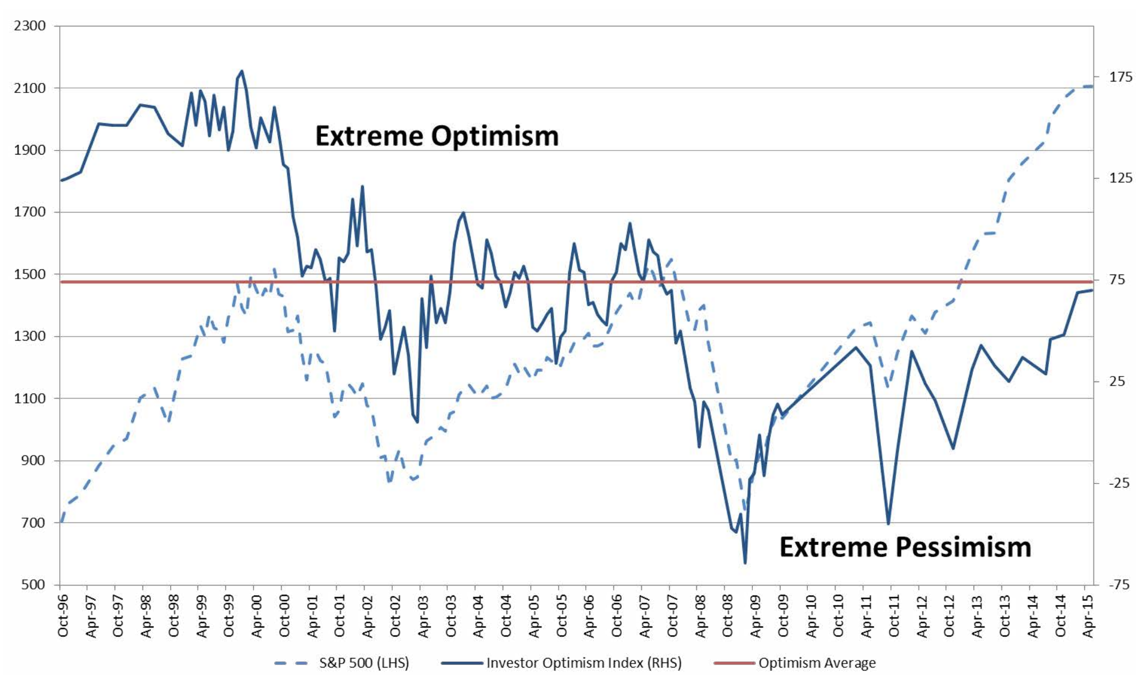
Ignore Back-Patting

"Experts" referencing past accurate predictions to legitimize their more recent forecasts should be treated with caution. Keep in mind that there are literally thousands of analysts making predictions every day. Some predictions will inevitably come true, but this doesn't mean that they're repeatable. A famous example of this was Oppenheimer bank analyst Meredith Whitney who correctly called the 2008 financial crisis, but then went on in 2010 to make a similarly dire prediction about the municipal bond market. Five years later, no such municipal bond crisis has developed. The same difficult-to-repeat forecasting is evident across all money managers, supported by the more than 80% of them who underperform their benchmarks (check out the evidence here). They may be right for one or two years, which affords them the opportunity to promote and congratulate themselves to gather assets, but ultimately they will underperform and either revert to the index averages or fall below, weighed down by their extravagant management fees.

Beware Availability Bias

Investors must also make a deliberate effort to acknowledge and disregard their availability biases, as these will repeatedly lead them astray. The Wells Fargo/Gallup Investor Optimism Index clearly shows this danger. The Index reflects investor optimism levels, which are predicated on recent (or "available") newsflow. But the recent, sensational headlines can obscure the true risks and opportunities in the market. The Index was established with a baseline score of 124 in October 1996 and currently sits at about 70. It peaked at 178 in January 2000, at the height of the dot-com bubble, and hit a low of *negative* 64 in February 2009, right at the precipice of one of the greatest buying opportunities in a generation. Put in the context of availability bias, investors were gazing directly at a car crash in 2009, which made them automatically assume the crash would be repeated. Of course, it wasn't repeated and markets have gone nearly straight upwards since. The Optimism Index isn't an infallible contrarian market indicator, but at extreme levels it can be a powerful reminder to beware of both your own euphoria and pessimism—neither let you think straight.

Wells Fargo/Gallup Investor Optimism Index—How We "Feel" Is Often Not a Good Predictor of Market Direction



Source: Wells Fargo/Gallup, Bloomberg. Note: no survey data was collected during 2010.

RELAX: WE'RE HERE

Fear is dangerous and there will always be opportunistic salesmen trying to exploit and stir up this emotion. Ignore them. Just as hardly anybody wins the lottery, hardly anyone will get caught in a financial tsunami that will destroy their finances. Maintain the balanced, globally diversified portfolio that you have with Turner Investments and rest easy. There are more important things to worry about than money. And besides, it's our job to do the worrying, not yours.

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