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Principals of Investing

January 9, 2024



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Principals of Investing: Four Pillars

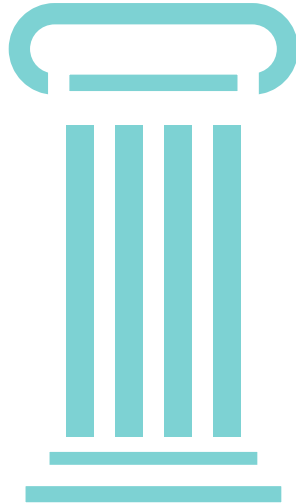
Liquidity

Maintaining cash reserves for short, medium, & long term needs



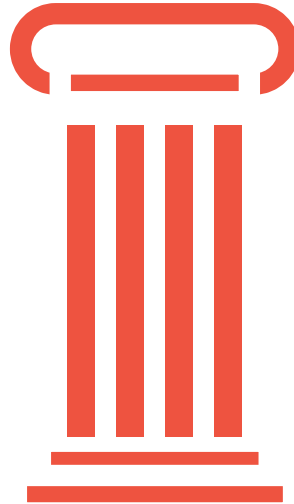
Diversity

Spreading investments across different asset classes, industries, and regions



Risk Management

Maintaining an appropriate asset allocation, and properly rebalancing



Cognitive Biases

Systematic behavioral patterns that influence our decision making



Biases and Making Decisions

- We make 11,000 decisions a day
 - Some take no time at all
- Heuristics are important
 - a mental shortcut that helps us make decisions and judgments quickly without having to spend a lot of time researching and analyzing information
 - We need these to get through our day
- Should these be driving factors when making investment decisions?



Principals of Investing

- Behavioral Finance and Investing
 - Our cognitive biases
 - Overconfidence
 - Confirmation Bias
 - Anchoring
 - Bandwagon Effect
 - Loss Aversion
 - How biases effect investment decisions
 - What to look for
 - Solutions



Overconfidence Bias Poll Question

- With 90% confidence, what age range would you say I was in? Low to high.
 - 30 – 34 years old
 - 35 – 39 years old
 - 40 – 44 years old
 - 45 – 49 years old



Overconfidence Bias Poll Question

- How many tennis balls could you fit in an empty 747 cargo plane?
 - 1,000 – 100,000
 - 100,000 – 700,000
 - 500 – 250,000
 - 10,000 – 1,000,000



Overconfidence Bias Poll Question

- When was the Mona Lisa painted?
 - 500 – 1920 A.D.
 - 100 – 1300 A.D.
 - 500 B.C. – 1500 A.D.
 - 25 B.C. – 1999 A.D.



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Overconfidence Bias Poll Question

- What is the diameter of the moon?
 - 2,500 – 100,000 miles
 - 250 – 2,500 miles
 - 10 – 900 miles
 - 500 – 10,000 miles



Overconfidence and Investing

- Impact on Investment decisions
 - Thinking you're better than average may fuel risky decisions.
 - Overestimating risk tolerance
 - Timing the market
 - No/low diversification

The big problem:

Thinking you're better than average may fuel risky decisions.



65%

of Americans think they have above-average intelligence**



73%

of Americans think they're better-than-average drivers***

















Source: [Fundamentals of behavioral finance: Overconfidence bias](#) | Schwab Funds ([schwabassetmanagement.com](https://www.schwabassetmanagement.com))



A diversified portfolio can work even though it never feels good

Returns for last 20+ years, by bull/bear market

Diversified Portfolio represented by 25% U.S. large stocks, 19% U.S. mid cap stocks, 7% international stocks, 5% U.S. small cap stocks, 4% emerging market stocks, 25% U.S. bonds and 15% high yield bonds

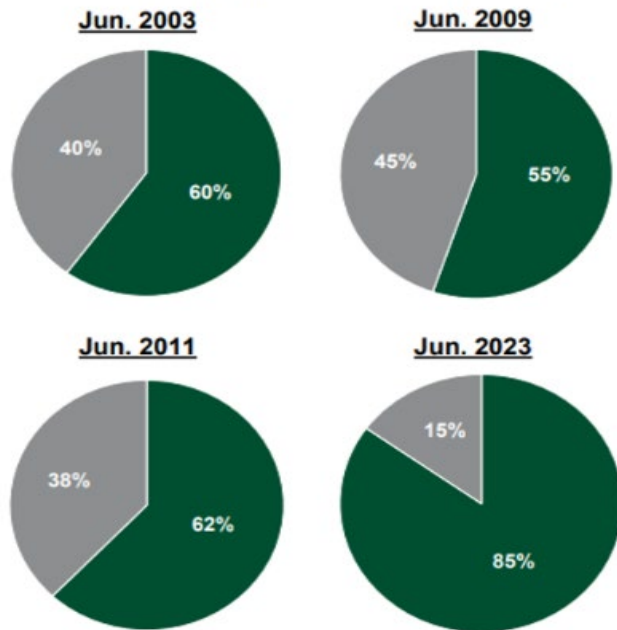
Years	S&P 500	Diversified Portfolio	
2000–2002*	-40.1%	-15.7%	  "I lost money"
2003–2007	82.9%	87.1%	  "Diversification worked"
2008	-37.0%	-26.6%	  "I lost money"
2009–2019	351.0%	219.7%	  "I didn't make as much"
Q1 2020†	-30.4%	-23.1%	  "I lost money"
Q2 2020-2021‡	119.0%	66.6%	  "I didn't make as much"
2022	-18.1%	-15.5%	  "I lost money"
Total Return	288.6%	301.6%	
Gr \$100K	\$388,610	\$401,550	  "Diversification can work even when it feels like its losing"

Source: Morningstar as of 12/31/22. *Performance is from 9/1/00 to 12/31/02. †Performance is from 1/1/20 to 3/23/20. ‡Performance is from 3/24/20 to 12/31/21. Diversified Portfolio is represented by 25% S&P 500 Index, 19% Russell Mid Cap Index, 7% MSCI EAFE Index, 5% Russell 2000 Index, 4% FTSE Emerging Stock Index, 25% Bloomberg US Aggregate Bond Index, 15% Bloomberg US Corporate High Yield Index. **Past performance does not guarantee or indicate future results.** Index performance is for illustrative purposes only. You cannot invest directly in the index.



Risk management: the importance of rebalancing

Actual portfolio drift in a buy-and-hold portfolio
Portfolio drift of a 60% equity, 40% fixed income buy-and-hold portfolio



Source: Standard & Poor's, Bloomberg, FactSet, J.P. Morgan Asset Management.

*Annual rebalance and buy-and-hold strategies are composed of S&P 500 and Bloomberg U.S. Aggregate total return indexes on a monthly basis. Annualized risk and return statistics are calculated from 6/30/2003 – 6/30/2023 using monthly data. The risk-free rate is represented by the Bloomberg 1-3 month Treasury Bellwether index.

Guideto the Markets – U.S. Data are as of June 30, 2023



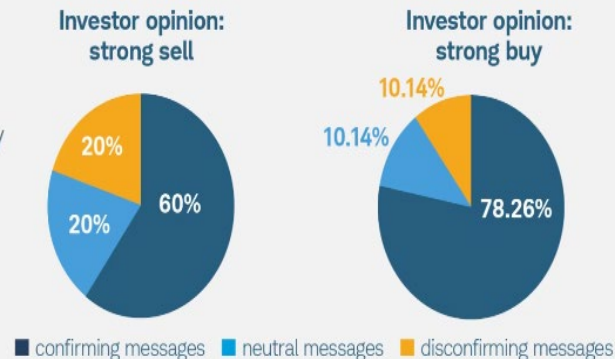
Confirmation Bias

- Confirmation bias is a cognitive shortcut we use when gathering and interpreting information. Evaluating evidence takes time and energy, and so our brain looks for shortcuts to make the process more efficient.
 - Oftentimes, humans need to make sense of information quickly however, forming new explanations or beliefs takes time and effort.

The big problem:

One-sided information may mean investors make decisions without a complete understanding of the situation, limiting their options and opportunities.

One well-known study of online stock trading message boards found that people overwhelmingly said the most convincing messages were ones that confirmed their pre-existing beliefs about whether to buy or sell a stock.*



* Park, JaeHong and Konana, Prabhudev and Gu, Bin and Kumar, Alok and Raghunathan, Rajagopal, "Confirmation Bias, Overconfidence, and Investment Performance: Evidence from Stock Message Boards," July 12, 2010. McCombs Research Paper Series No. IROM-07-10, URL: <https://ssrn.com/abstract=1639470>



Confirmation Bias and Investing

- Why it matters:
 - Concentrated holdings
 - Narrow sector visibility
 - Realistic view on the market



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Asset class returns

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2008 - 2022		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	YTD
Ann.	Vol.																
Large Cap	REITs	Fixed Income	EM Equity	REITs	REITs	REITs	Small Cap	REITs	REITs	Small Cap	EM Equity	Cash	Large Cap	Small Cap	REITs	Comdty.	Large Cap
8.8%	23.4%	5.2%	79.0%	27.9%	8.3%	19.7%	38.8%	28.0%	2.8%	21.3%	37.8%	1.8%	31.5%	20.0%	41.3%	16.1%	13.1%
Small Cap	Small Cap	Cash	High Yield	Small Cap	Fixed Income	High Yield	Large Cap	Large Cap	Large Cap	High Yield	DM Equity	Fixed Income	REITs	EM Equity	Large Cap	Cash	DM Equity
7.2%	23.2%	1.8%	59.4%	26.9%	7.8%	19.6%	32.4%	13.7%	1.4%	14.3%	25.6%	0.0%	28.7%	18.7%	28.7%	1.5%	7.6%
REITs	EM Equity	Asset Alloc.	DM Equity	EM Equity	High Yield	EM Equity	DM Equity	Fixed Income	Fixed Income	Large Cap	Large Cap	REITs	Small Cap	Large Cap	Comdty.	High Yield	High Yield
6.6%	23.0%	-25.4%	32.5%	19.2%	3.1%	18.6%	23.3%	6.0%	0.5%	12.0%	21.8%	-4.0%	25.5%	18.4%	27.1%	-12.7%	5.0%
Asset Alloc.	Comdty.	High Yield	REITs	Comdty.	Large Cap	DM Equity	Asset Alloc.	Asset Alloc.	Cash	Comdty.	Small Cap	High Yield	DM Equity	Asset Alloc.	Small Cap	Fixed Income	Asset Alloc.
6.1%	20.2%	-26.9%	28.0%	16.8%	2.1%	17.9%	14.9%	5.2%	0.0%	11.8%	14.6%	-4.1%	22.7%	10.6%	14.8%	-13.0%	4.5%
High Yield	DM Equity	Small Cap	Small Cap	Large Cap	Cash	Small Cap	High Yield	Small Cap	DM Equity	EM Equity	Asset Alloc.	Large Cap	Asset Alloc.	DM Equity	Asset Alloc.	Asset Alloc.	Cash
5.4%	20.0%	-33.8%	27.2%	15.1%	0.1%	16.3%	7.3%	4.9%	-0.4%	11.6%	14.6%	-4.4%	19.5%	8.3%	13.5%	-13.9%	3.7%
Fixed Income	Large Cap	Comdty.	Large Cap	High Yield	Asset Alloc.	Large Cap	REITs	Cash	Asset Alloc.	REITs	High Yield	Asset Alloc.	EM Equity	Fixed Income	DM Equity	DM Equity	Small Cap
2.7%	17.7%	-35.6%	25.5%	14.8%	-0.7%	16.0%	2.9%	0.0%	-2.0%	8.6%	10.4%	-5.8%	18.9%	7.5%	11.8%	-14.0%	2.5%
DM Equity	High Yield	Large Cap	Asset Alloc.	Asset Alloc.	Small Cap	Asset Alloc.	Cash	High Yield	High Yield	Asset Alloc.	REITs	Small Cap	High Yield	High Yield	High Yield	Large Cap	EM Equity
2.3%	13.0%	-37.0%	25.0%	13.3%	-4.2%	12.2%	0.0%	0.0%	-2.7%	8.3%	8.7%	-11.0%	12.6%	7.0%	1.0%	-18.1%	2.2%
EM Equity	Asset Alloc.	REITs	Comdty.	DM Equity	DM Equity	Fixed Income	Fixed Income	EM Equity	Small Cap	Fixed Income	Fixed Income	Comdty.	Fixed Income	Cash	Cash	EM Equity	Fixed Income
1.0%	12.4%	-37.7%	18.9%	8.2%	-11.7%	4.2%	-2.0%	-1.8%	-4.4%	2.6%	3.5%	-11.2%	8.7%	0.5%	0.0%	-19.7%	-1.2%
Cash	Fixed Income	DM Equity	Fixed Income	Fixed Income	Comdty.	Cash	EM Equity	DM Equity	EM Equity	DM Equity	Comdty.	DM Equity	Comdty.	Comdty.	Fixed Income	Small Cap	Comdty.
0.6%	4.2%	-43.1%	5.9%	6.5%	-13.3%	0.1%	-2.3%	-4.5%	-14.6%	1.5%	1.7%	-13.4%	7.7%	-3.1%	-1.5%	-20.4%	-3.4%
Comdty.	Cash	EM Equity	Cash	Cash	EM Equity	Comdty.	Comdty.	Comdty.	Comdty.	Cash	Cash	EM Equity	Cash	REITs	EM Equity	REITs	REITs
-2.6%	0.4%	-53.2%	0.1%	0.1%	-18.2%	-1.1%	-9.5%	-17.0%	-24.7%	0.3%	0.8%	-14.2%	2.2%	-5.1%	-2.2%	-24.9%	-5.6%

Source: Bloomberg, FactSet, MSCI, NAREIT, Russell, Standard & Poor's, J.P. Morgan Asset Management. Large cap: S&P 500, Small cap: Russell 2000, EM Equity: MSCI EME, DM Equity: MSCI EAFE, Comdty: Bloomberg Commodity Index, High Yield: Bloomberg Global HY Index, Fixed Income: Bloomberg US Aggregate, REITs: NAREIT Equity REIT Index, Cash: Bloomberg 1-3m Treasury. The "Asset Allocation" portfolio assumes the following weights: 25% in the S&P 500, 10% in the Russell 2000, 15% in the MSCI EAFE, 5% in the MSCI EME, 25% in the Bloomberg US Aggregate, 5% in the Bloomberg 1-3m Treasury, 5% in the Bloomberg Global High Yield Index, 5% in the Bloomberg Commodity Index and 5% in the NAREIT Equity REIT Index. Balanced portfolio assumes annual rebalancing. Annualized (Ann.) return and volatility (Vol.) represents period from 12/31/2007 to 12/31/2022. Please see disclosure page at end for index definitions. All data represents total return for stated period. The "Asset Allocation" portfolio is for illustrative purposes only. Past performance is not indicative of future returns. Guide to the Markets - U.S. Data are as of September 30, 2023.

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Anchoring

- *Becoming attached to information that may not be accurate or relevant in the decision-making process.*
 - *The anchoring bias is a cognitive bias that causes us to rely heavily on the first piece of information we are given about a topic*
 - *We interpret newer information from the reference point of our anchor instead of seeing it objectively. This can skew our judgment and prevent us from updating our plans or predictions as much as we should.*
- Michael Jordan - Game 5 of the 1997 NBA Finals “Flu Game”



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Anchoring

- Jordan scored 38 points in 44 minutes, and hit the game winning 3 pointer.
 - The Bulls ended up winning the Championship, and the moment became iconic.
 - His shoes from that game sold at auction for \$1.38 million
 - No other athlete has replicated his “flu like” performance



Anchoring and Investing

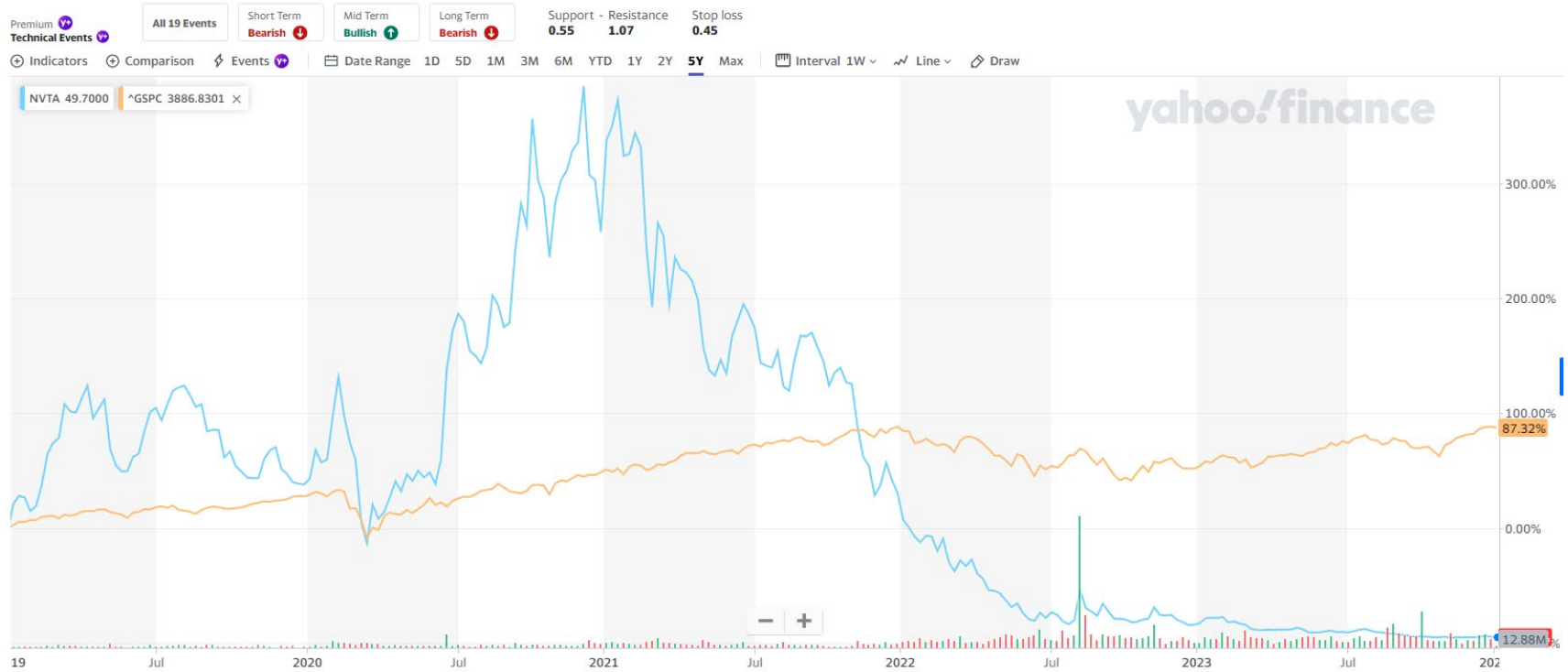
Tversky and Kahneman explained in their 1974 paper: "People make estimates by starting from an initial value that is adjusted to yield the final answer."

Anchoring bias may be found at any point of the trading decision-making process and could happen for a few reasons. These include, among others:

- Limited time and attention for decision-making
- Over-reliance on heuristics or mental shortcuts
- Cognitive biases and irrational thinking
- Emotional attachment to prior prices or positions



Anchoring to a Price Point



Source: www.schwabassetmanagement.com



Time, diversification and the volatility of returns

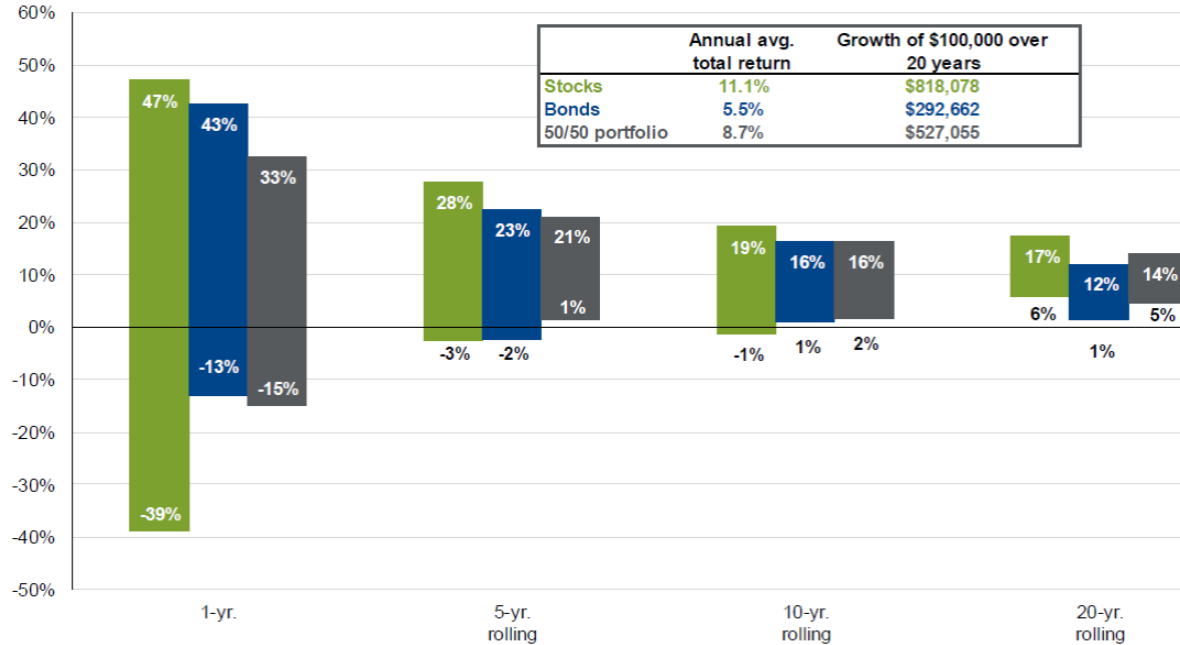
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Range of stock, bond and blended total returns

Annual total returns, 1950-2022



Source: Bloomberg, FactSet, Federal Reserve, Robert Shiller, Strategas/Ibbotson, J.P. Morgan Asset Management. Returns shown are based on calendar year returns from 1950 to 2021. Stocks represent the S&P 500 Shiller Composite and Bonds represent Strategas/Ibbotson for periods from 1950 to 2010 and Bloomberg Aggregate thereafter. Growth of \$100,000 is based on annual average total returns from 1950 to 2022. Guide to the Markets – U.S. Data are as of September 30, 2023.

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Bandwagon Effect & Loss Aversion

- Meme Stocks



- The snowballing popularity of a stock, and people's subsequent decision to support and buy that stock, is an example of the bandwagon effect. Yes, the stock is popular and going up, but the reason you bought that stock is because so many people already had. Not because it was a good stock to own.

Source: www.schwabassetmanagement.com



Bandwagon Effect

Why it happens: The bandwagon effect describes that when an idea or belief increases in popularity, we are more likely to adopt it. There are a few reasons behind this, the first of which is efficiency:

- Our brain uses shortcuts
- We want to fit in
- We want to be on the winning side

Key Takeaway: Investors should try and resist putting too much faith in popular opinion as a tool for judging the worth of ideas and behaviors. What is good for the majority may not be good for you.



Bandwagon Effect



Herd Mentality: We are hard-wired to herd

One of the things to be very wary of is that we often find it emotionally or psychologically painful to go against the crowd.

- Fear of missing out – F.O.M.O.
- Fear of being wrong – F.O.B.W.



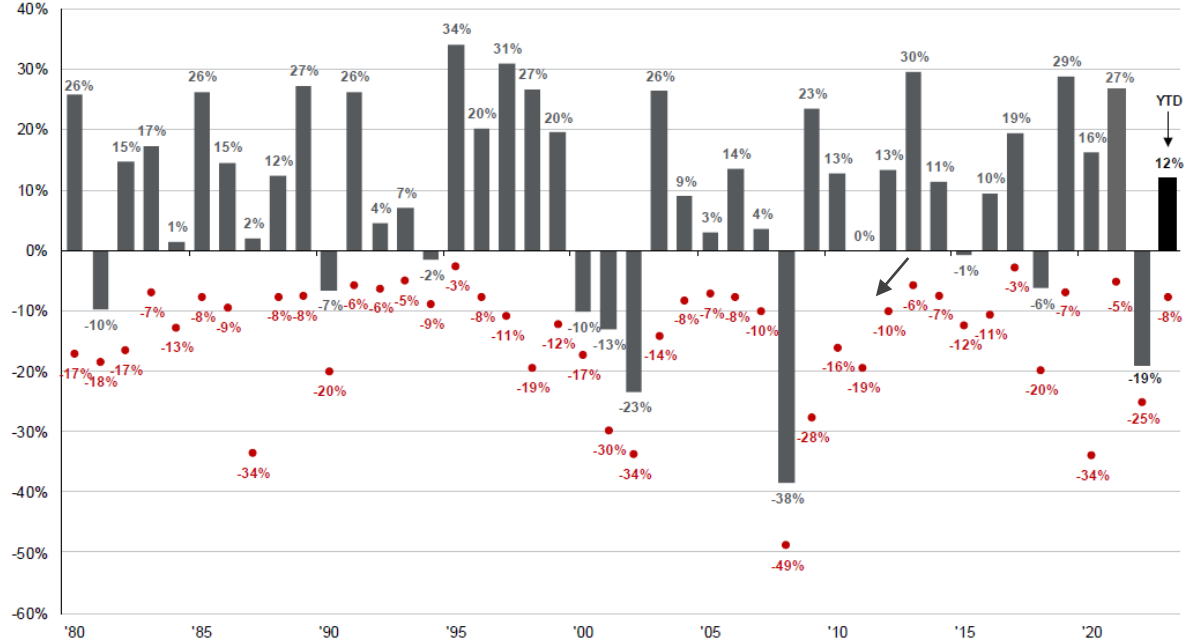
How to combat herd mentality

Slowing down the decision-making process
Have buy/sell disciplines
Always see the opposing viewpoint



S&P intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.3%, annual returns were positive in 32 of 43 years



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2022, over which time period the average annual return was 8.7%.
 Guide to the Markets – U.S. Data are as of November 01, 2023.



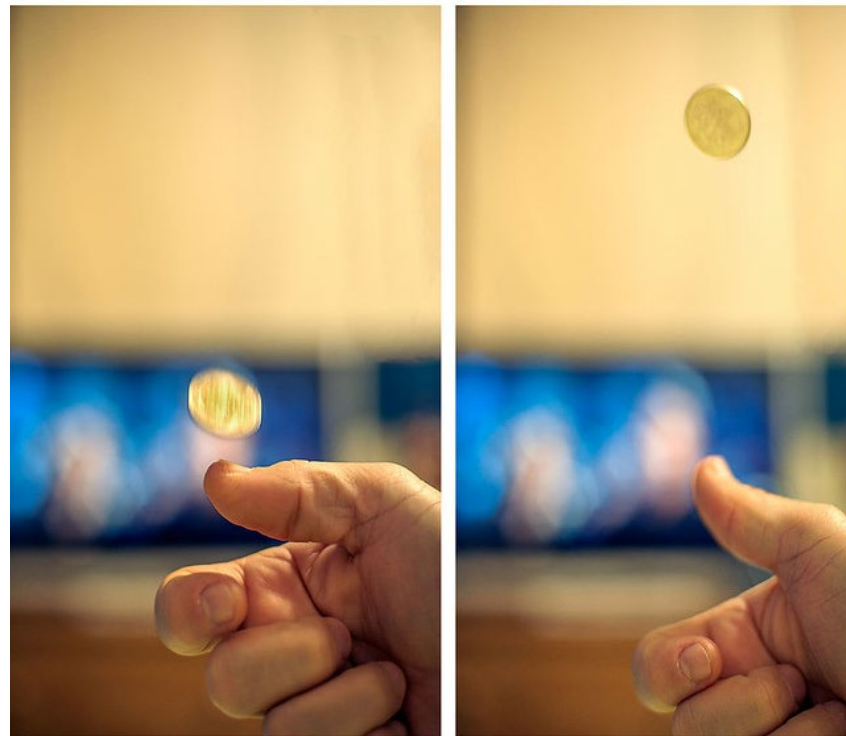
Loss Aversion

- Why investors value avoiding losses more than winning gains
 - Behavioral scientists have found that the pain of a loss is felt more strongly than the pleasure of an equivalent gain
 - Loss aversion can lead to portfolios that are too conservative.



Loss Aversion Poll Question

- Choose between losing \$900 guaranteed or a 90% chance of losing \$1,000.
 - Losing \$900
 - 90% chance of losing \$1,000



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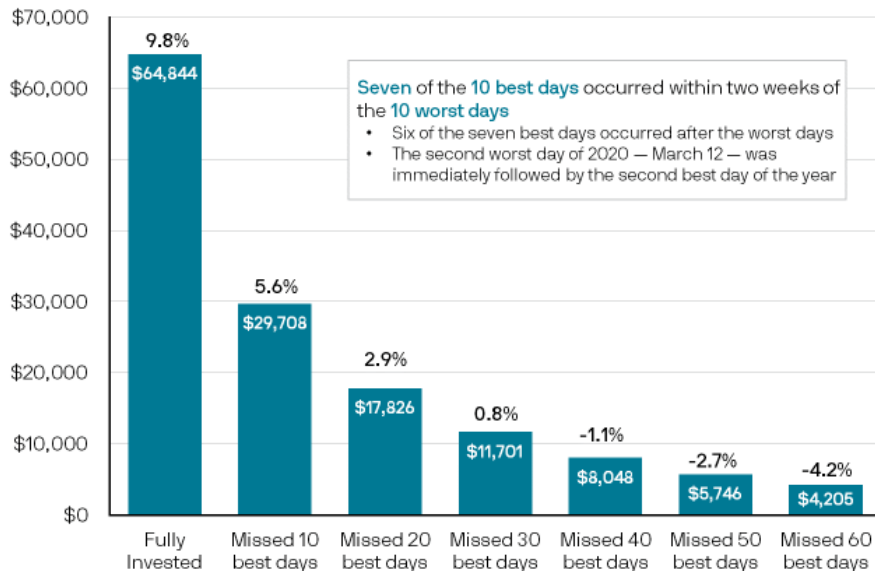
Loss Aversion Poll Question

- Choose between getting \$900 guaranteed or a 90% chance of getting \$1,000.
 - Getting \$900
 - 90% chance of getting \$1,000



Returns of the S&P 500

Performance of a \$10,000 investment between January 1, 2003 and December 30, 2022



Plan to stay invested

Losses hurt more than gains feel good. Market lows can result in emotional decision making.

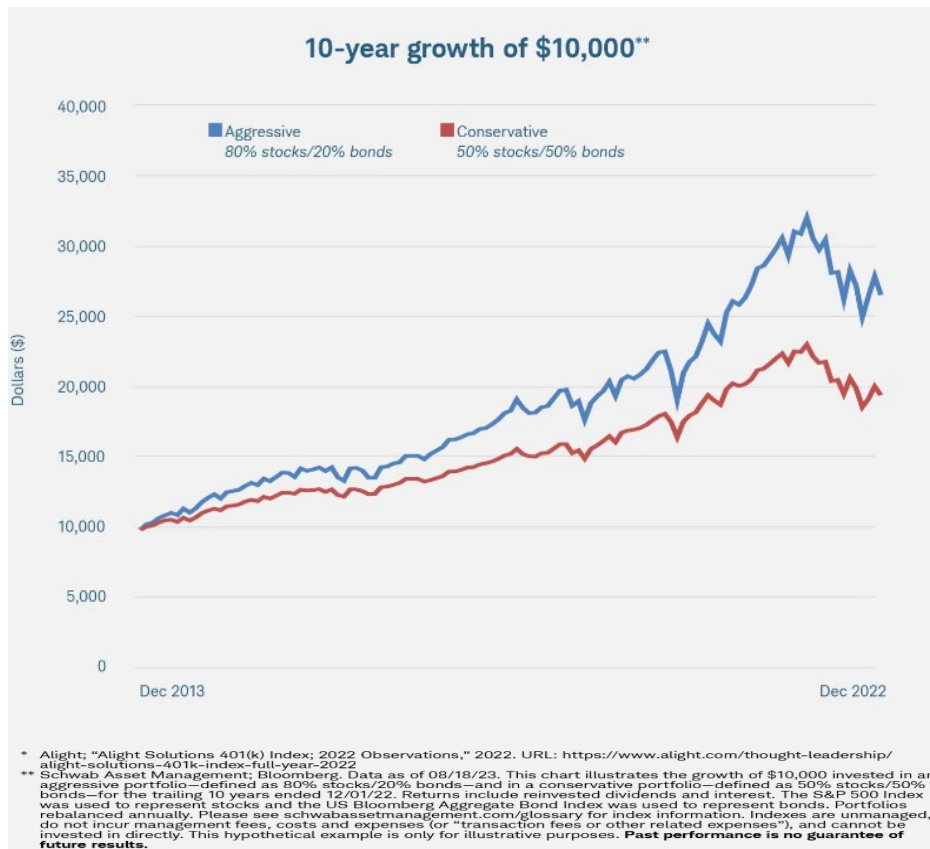
Taking “control” by selling out of the market after the worst days is likely to result in missing the best days that follow. Investing for the long term in a well-diversified portfolio can result in a better retirement outcome.

Source: J.P. Morgan Asset Management analysis using data from Bloomberg. Returns are based on the S&P 500 Total Return Index, an unmanaged, capitalization-weighted index that measures the performance of 500 large capitalization domestic stocks representing all major industries. Indices do not include fees or operating expenses and are not available for actual investment. The hypothetical performance calculations are shown for illustrative purposes only and are not meant to be representative of actual results while investing over the time periods shown. The hypothetical performance calculations are shown gross of fees. If fees were included, returns would be lower. Hypothetical performance returns reflect the reinvestment of all dividends. The hypothetical performance results have certain inherent limitations. Unlike an actual performance record, they do not reflect actual trading, liquidity constraints, fees and other costs. Also, since the trades have not actually been executed, the results may have under- or overcompensated for the impact of certain market factors such as lack of liquidity. Simulated trading programs in general are also subject to the fact that they are designed with the benefit of hindsight. Returns will fluctuate and an investment upon redemption may be worth more or less than its original value. Past performance is not indicative of future returns. An individual cannot invest directly in an index. Data as of December 31, 2022.

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Loss Aversion



Loss Aversion

At a glance: Loss aversion bias

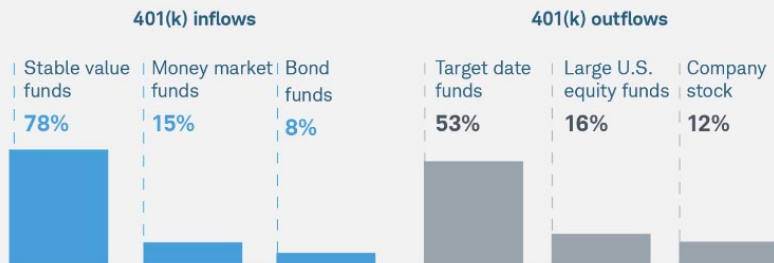


Head or Heart?

Loss aversion is an emotional bias. It describes the tendency to prioritize avoiding losses over earning gains.

Loss aversion can make investors overly conservative:

During the down year of 2022, many 401(k) participants put new money into assets they presumed to be safer while pulling money out of equities.*



The big problem

The short-term protection of a conservative portfolio may sacrifice the growth potential investors need to reach their long-term goals.

Source: www.schwabassetmanagement.com



Principals of Investing: Four Pillars

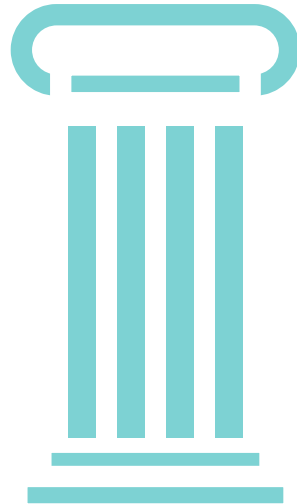
Liquidity

Maintaining cash reserves for short, medium, & long term needs



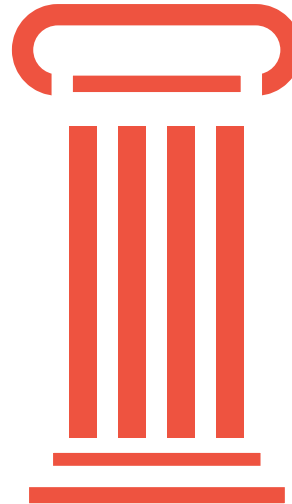
Diversity

Spreading investments across different asset classes, industries, and regions



Risk Management

Maintaining an appropriate asset allocation, and properly rebalancing



Cognitive Biases

Systematic behavioral patterns that influence our decision making



Thank you!

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