



## **When Is A Good Time To Come Back Into The Stock Market?**

Did you know that the pain of losing money in your investments is twice as bad as the pleasure you get from making it?

Studies show that we require at least a 2-to-1 ratio of gain to loss, and that the trauma of losing money is two times greater than our euphoria from winning an equal amount!

### Loss Aversion

In the investment world, this slightly complex human reaction to losing versus winning is called Loss Aversion... not loss minimization – which is something else. Minimizing your losses is good. Basing your investment decisions on emotion and *loss aversion* is not good. I have been talking a lot about loss aversion these days because I've noticed that a lot of folks are still wary of re-entering the stock market.

### Net Outflows

In fact, not only are people wary of re-entering the market, they've actually been pulling their money out since 2008. Here's some data:

2008: \$152 billion withdrawn from the stock market

2009: \$39 billion withdrawn

2010: \$97 billion withdrawn

2011: \$18 billion added (through March 2011)

After three years of outflows, the first quarter of 2011 saw a net inflow into the market, but at a very slow pace. We're perhaps seeing this inflow in 2011 because those who pulled their money out in 2009 and 2010 saw the market rise 26.5% and 15% in those two years and want to make up for past follies.

So why is the average investor still staying away from the stock market? I have a theory, but first, let's take a quick survey.

### That Sinking Feeling

How many of you recall how you felt at year-end 2008 when you saw that your 401(k) and stock assets were down nearly 40%? The anxiety and that sinking feeling in the pit

of your stomach when you thought that your financial future was at dire risk... that you would never be financially comfortable again?

Fast forward to February 2011 when the market hit a near-time high that was almost double its low in March 2009! Do you remember how you felt in Feb 2009? Probably not too much! I am almost certain that the emotions from nearly doubling your money were not as pleasurable or lasting as the pain when you thought your money was lost. Your reactions above reflect *loss aversion* – a concept derived from Behavioral Finance which studies how we react to certain investment situations and allow our emotions to derail our logical way of thinking.

To be fair, the market truly was collapsing in 2008 - we were in the midst of a real recessionary crisis, so your sinking-stomach feeling back then was fully justified. So let's look at how investors react, not to recessions, but to more routine and frequent events like market corrections.

Mar 3, 2011 to Mar 16, 2011: the Dow dropped 5.3% from 12,258 to 11,613. If you are in the *loss aversion* camp, this 5.3% drop probably hurt - and you probably did not care that the Dow actually rose 5% from the beginning of the year through Mar 3, 2011. But please always remember that even though the market dropped 5.3% within two weeks, those losses are not realized until you sell your shares.

Also know that *loss aversion* equally applies to your non-stock investments. For example, real estate investors go through similar emotions when home prices fall, relative to when they rise.

### Wall of Worry

With stocks, many individual investors are still waiting on the sidelines - trying to pinpoint the optimal time to enter the market, when it feels safe. From my 30 years of investing experience, I can tell you that by the time most investors feel comfortable, the market has already reached close to its top.

I know what I am about to say will sound unfair, but... **You have to invest when you feel uncomfortable. You have to “climb a wall of worry”.**

When investors are unsure about whether the market may rise or fall, stock prices may be still reasonable. By the time you feel that conditions are safe, prices could be significantly higher causing you the risk of joining a bubble near its peak. Don't let that happen to you.

The fear of losing should not be your driver for making investment decisions. If you have this fear... read a few books on investor psychology so you can master your fear and become a Zen investor. If you don't have the time, then hire someone who has... a qualified advisor who can objectively invest your money without the baggage of *loss aversion*.