

Fear and Greed

The Impact of Human Emotion on Investor Behavior

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In 2016, the national news buzzed as the Powerball reached epic heights. The surreal jackpot soared to an estimated \$1.56 billion, making it the largest lottery winnings in world history. People from all over the country lined up days before the drawing to buy tickets in hopes of winning the grand prize. It was nearly impossible not to get caught up in this hysteria.

As the greed slowly took over their subconscious, hopeful winners started asking questions like “what will you do with the money if you win?” Debates about the best way to spend and plan for a billion dollars sparked all over the United States. Once the winning numbers were revealed, all but three families found themselves in the same financial position as before the lottery began (less the price for lottery tickets). Plans of living the easy life fizzled instantly when everyone else realized they didn’t have the winning combination of numbers.

The Cycle of Fear and Greed

After such a monumental financial event, it is worthwhile to examine the human pattern of fear and greed with money. The lottery provides a near term illustration of this cycle. There is the fear of not buying a lottery ticket with such a small investment that could lead to a limitless fortune. Then, there is the greed of buying a large stash of tickets even though a disproportionate amount of tickets doesn’t improve your chance of winning a great deal (statistically speaking). The Powerball subplot mirrors similar emotions that stay within investors on Wall Street. Professional institutions and normal retail clients can get dizzy trying to grow their money over the long-term during certain intervals where dreams of prosperity overtake the reality of consistent, stable growth. The euphoric dream of swimming the backstroke amidst a pile of loose hundred dollar bills can overpower low mathematical realities and encourage behavior that is both out of character and fundamentally flawed.

Fear, Greed and Investing

Investor psychology takes over when the market makes moves higher and lower. A relatively new tool that tracks this sentiment can be found on the [CNN website](#). If you go to the site, what you will find is a speedometer that attempts to measure the relative excitement or anxiety of the stock market. The symbol will vary and on June 6, it looked like this:

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Fear & Greed Index beta

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What emotion is driving the market now?



Previous Close	Extreme Greed	77
1 Week Ago	Extreme Greed	77
1 Month Ago	Greed	60
1 Year Ago	Fear	40

Last updated Jun 6 at 12:55pm

Seven Fear & Greed Indicators

 How we calculate the index [More »](#)

Put and Call Options

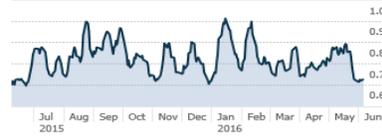
Extreme Greed

During the last five trading days, volume in put options has lagged volume in call options by 37.35% as investors make bullish bets in their portfolios. This is among the lowest levels of put buying seen during the last two years, indicating extreme greed on the part of investors.

Last changed May 24 from a Neutral rating

Updated Jun 6 at 12:54pm

CBOE 5-Day Average Put/Call Ratio



In essence, this chart represents how investors are feeling about the stock market in comparison to historical averages. On a daily basis this index attempts to measure stock prices, stock volume, option trading, junk bonds and the demand for ultra safe investments. Although no one benchmark or chart is perfect, this CNN index provides a nice snapshot to ascertain the levels of relative fear and greed in the marketplace.

Market Events and Investor Behavior

Yet, that is certainly not how things really work as the stock market undulates. Economists know that humans make investment mistakes and choices that cannot be explained with logic. So, as much as we want to believe that when a company makes more money for its shareholders the stock will rise in value steadily and evenly as profits rise, reality dictates that this is not always the case, which defies common logic. Behavioral finance plays a large role in investor sentiment and the critical drivers behind stock prices. Moreover, we need to understand that investor inclinations and psychological emotions play a vital role in helping the motivations behind the stock market undulations. A shrewd investor or adviser can stay disciplined, unemotional and use those psychological breakdowns to take advantage of market

overreactions and invest in the market, while others incorrectly overreact and run away. A review of some of the worst market events in our history help shed a light into investor behavior:

- **Black Monday in 1987:** Billions of dollars melted away in one trading day. On that day, the U.S. Market fell 22.61%, Hong Kong shed 45.8% of its value, the UK lost 26.4% and New Zealand folded with a massive 60% drop. It was a heck of a day. Some blame early computer program trades for the rapid descent, while others look back and blame an overvalued stock market, or even market psychology. By doing nothing but holding the stocks in your portfolio, the Dow Jones recovered from the crash by the end of 1990.
- **Dot Com Bubble of 1999-2000:** This event saw the technology sector of the market drop more than 70% in a matter of months. Investors bid up the prices of startup companies like Webvan, Pets.com, Global Crossing and JDS Uniphase with little revenue and no profits. Many of these technology companies subsequently came back down to reality with their stocks plummeting. Many failed to exist altogether. Prices surged on investor optimism with reckless speculation on a new reality with technology companies. Share prices collapsed in investor panic and the realization that technology stocks were far overvalued and needed to sink down to the real world. Many stocks never recovered in the tech wreck of 1999. Yet, the broad market of the S&P 500 recovered and made new highs by the fall of 2006.
- **Stories of the Great Recession of 2008:** These make for award winning movies and bestselling novels depicting the story of the economic collapse spawned by the financial system and an overvalued residential housing market. Overextended consumers and higher unemployment pushed our economic growth into a downward spiral and the market fell 54% from top to bottom. Investor panic ruled the airwaves and confusion loomed large as investments were liquidated to provide safety. Yet by the spring of 2012, the S&P 500 recovered the losses of 2008 and for the patient investors, they reaped the rewards by not panicking.

In each case, investor psychology took over beyond the news and reality, leading to spiraling market downturns. Market cycles will happen. Economic turmoil rears its ugly head in the boom and bust cycles every few years. Investment trends become dominant and money floods into them with reckless abandon until such a point as values become unsustainable and eventually go down.

The Big Picture

There are two big pictures:

1. Be a prudent investor. Understand the cyclicity of the stock market.

2. Be disciplined. If you see an opportunity to invest in the market, don't try to buy into the absolute bottom.

Early in 2016, the stock market fell by 12%+/- . Now looking back, it was a good time to invest to make a nice profit. We don't know if every 10%+ correction will lead to a quick turnaround. Nor do we know that the market recovery in March will be sustained. Yet, we do promote the discipline of being forward thinking, not panicking and investing wisely at a discount when the opportunities arise.

Right now, we face a host of anxiety creating events:

- Election uncertainty and the direction of the economy – Who will win and what will the candidates' economic policies do to help or hurt the economy?
- China debt – Is the massive amount of Chinese debt the ultimate signal that will send their economy spiraling downward, and will we go with it?
- Are we in a commercial real estate bubble? – Asset prices on certain areas of commercial real estate have hit highs not seen since the premarket crisis. Is it sustainable, or does this low interest rate environment we are in necessitate a larger than normal demand for income producing investments for years to come?
- Will the recent oil market stability bring greater peace and harmony for the oil producing nations so badly hurt by the lower commodity price?

No matter what, we will always face economic hurdles and uncertainty. Stay diversified. Be sure to review your portfolio for diversification and risk. If you need help, reach out to an adviser you trust. Otherwise, try not to play into the fear and greed cycle of the stock market. Just know that market events will happen. Those that stay cool and don't panic while things get crazy stand positioned to perform the best when the economic environment reverses course.

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