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Important Information

PERSONAL FINANCE

What ‘Shark Week’ can teach investors about a money ‘survival instinct’

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KEY POINTS

“Shark Week” is an annual block of TV programming on Discovery. It runs July 23 to July 29 this year.

Perhaps the most famous shark — the fictional great white from the 1975 Steven Spielberg summer blockbuster “Jaws” — can teach investors an important lesson about behavioral bias.

“Recency bias” is the tendency to put too much emphasis on recent events like a stock market rout when making investment decisions.



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the ocean's apex predators. And perhaps the most famous of these fish — the fictional, man-eating great white from the 1975 thriller “Jaws” — can teach an important money-saving [behavioral lesson](#) to investors.

Specifically, investors have a tendency to get swept away by the fear or euphoria of the recent past. This is called “recency bias,” and it's often accompanied by [financial loss](#).

This bias leads investors to put too much emphasis on recent events — say, a stock-market rout, or the meteoric rise of bitcoin or a [meme stock](#) like GameStop.

“People need to understand that recency bias is normal, and it's hard-wired,” said Charlie Fitzgerald III, an Orlando, Florida-based certified financial planner. “It's a survival instinct.”

By Wildestanimal | Moment | Getty Images

Even so, allowing short-term emotion to guide long-term financial decisions is generally counter to investors' best interests, as is often the case when selling stocks in a panic.

Recency bias is akin to a common yet illogical human impulse, such as watching Steven Spielberg's classic summer blockbuster “Jaws” and then being afraid of the water.

“Would you want to go for a long ocean swim after watching ‘Jaws’? Probably not, even though the actual risk of being attacked by a shark is infinitesimally small,”



Fitzgerald equates the impulse to a bee sting.

“If I get stung by a bee once or twice, I’m not going to go there again,” said Fitzgerald, a principal and founding member of Moisand Fitzgerald Tamayo. “The recent experience can override all logic.”

Recency bias is largely associated with FOMO

Here’s a recent real-world illustration.

The financial services sector was among the top performers of the [S&P 500 Index](#) in 2019, when it yielded a 32% annual return. Investors who chased that performance and subsequently bought a bunch of financial services stocks “may have been disappointed” when the sector’s returns fell 2% in 2020, a year when the S&P 500 had a positive 18% return, Aguilar said.

Fans celebrate the June 14, 2005, release of the “Jaws” 30th Anniversary Edition DVD from Universal Studios Home Entertainment.

Christopher Polk | Filmmagic | Getty Images

Among other examples posed by financial experts: tilting a portfolio more heavily toward U.S. stocks after a string of underwhelming performance in international stocks, and overreliance on a mutual fund’s recent performance history to guide a buying decision.

“Short-term market moves caused by recency bias can sap long-term results, making it more difficult for clients to reach their financial goals,” Aguilar said.

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Acting on that impulse is akin to timing the investment markets, which is never a good idea. It often leads to buying high and selling low, he said.

Investors are most vulnerable to recency bias, he said, when on the precipice of a major life change such as retirement, when market gyrations may seem especially scary.

What’s in a well-diversified portfolio

Long-term investors with a well-diversified portfolio can feel confident about riding out a storm instead of panic selling, however.

Such a portfolio generally has broad exposure to the equity markets, via large-, mid- and small-cap stocks, as well as foreign stocks and maybe real estate, Fitzgerald said. It also holds short- and intermediate-term bonds, and maybe a sliver of cash, he added.

Investors can get this broad market exposure by buying various low-cost index mutual funds or exchange-traded funds that track these segments. Or, investors can buy an all-in-one fund, such as a target-date fund or balanced fund.

One’s asset allocation — the share of stock and bond holdings — is generally guided by principles such as investment horizon, tolerance for risk and ability to take risk, Fitzgerald said. For example, a young investor with three decades to retirement would likely hold at least 80% to 90% in stocks.

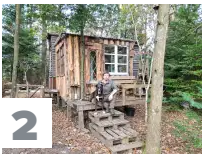


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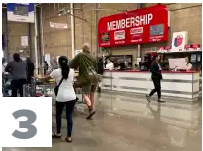
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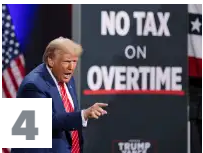
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