Fear of Missing Out

The *Fear of Missing Out (FOMO)* is a terrible, debilitating, mind-altering feeling that makes even the strongest succumb to bad decision making. I've seen some of the best strategies and plans get completely dismissed when emotions take over and logic gets thrown out the door. The *Fear of Missing Out* is defined in Wikipedia as "a pervasive apprehension that others might be having rewarding experiences from which one is absent." *FOMO* is often tied to the mobile revolution. Just about everyone totes around a smartphone these days, which allows them to instantaneously be connected to the world. People have become so reliant on and addicted to the need to be connected at all times that many people will panic if they are separated or even have thoughts of being separated from this device. Suddenly, fear grips their body as thoughts of missing out on what is happening or, better yet, what could be happening take over. It is at this point that many individuals will do whatever it takes, regardless of the consequences, to be able to hit the refresh button and instantly be "in the know."

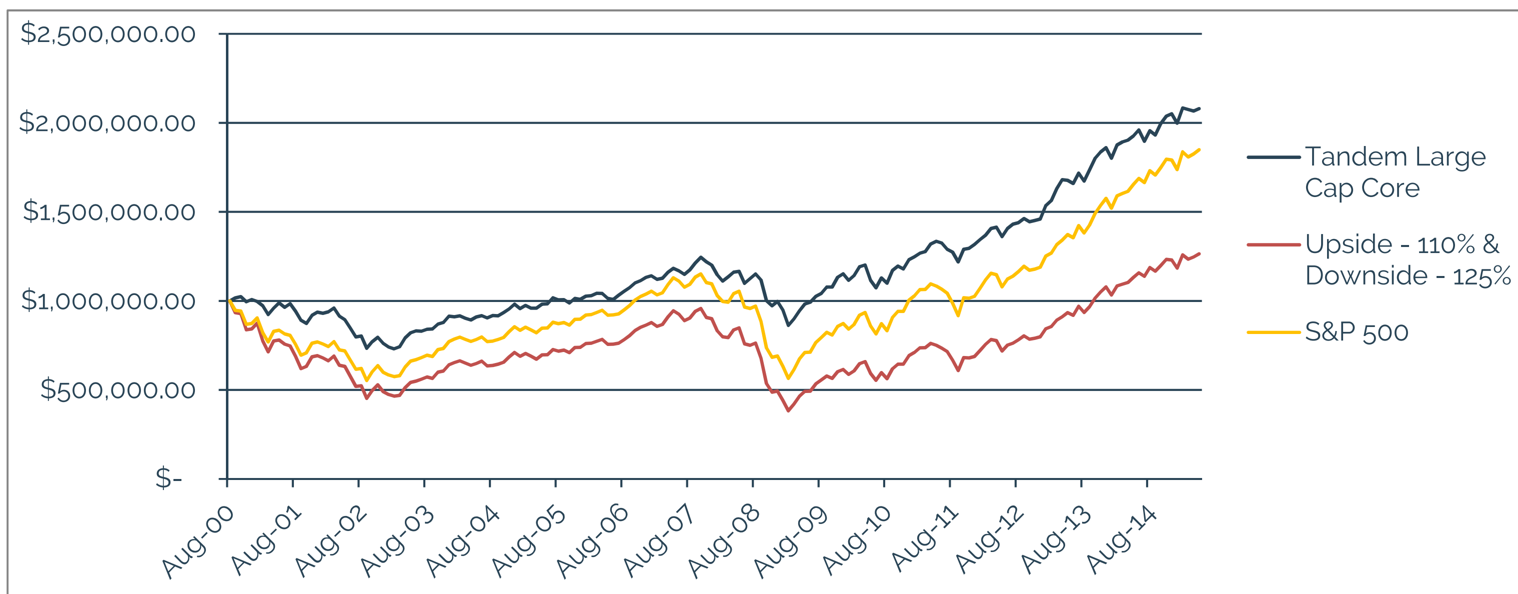
By now, you are probably wondering where I am going with all of this. Investing is an emotional roller coaster. The highs can be very high and the lows can be very low. The truth of it is, neither the highest highs or lowest lows exist in perpetuity. However, when emotions are running wild, it is very difficult to look beyond the current trend. It is for this reason why investors tend to ditch even the most successful, well thought out strategies to chase euphoria or liquidate out of fear.

FOMO is very real among the investment community. In fact, I believe it is a major contributor to the boom and bust cycles among retail investors. When the stock market is only going in one direction, it is very hard for an individual to not want to follow the trend. It is a lot easier for someone to go along with the crowd than it is to explain and accept the consequences, both good and bad, from independent decision making. *FOMO* is present mostly in a rising stock market. It's a tough pill to swallow when you're not making money or not making as much money as everyone else. However, it's also during this time that one of the most important rules of investing gets ignored for the hope of realizing significant profits. The protection of capital is just as important, if not more important, than the appreciation of capital. Many investors fail to realize that when a portfolio goes down a certain percentage, you need to go up by an even greater percentage to get back to even. Let's take the example of a hypothetical $1,000,000 portfolio over a period of 4 years alternating up and down 10%.

Hypothetical $1,000,000 Portfolio		
Year	**Hypothetical Return**	**Portfolio Value**
1	+10%	$1,100,000
2	-10%	$990,000
3	+10%	$1,089,000
4	-10%	$980,100

Theoretically, you would think you'd be in the same place after going up 10% and back down 10%. As you can see, this is not the case. In fact, when you go down 10%, you must go up 11.11% to get back to even. Similarly, if you go down 25%, you must go back up 33.33% to return to your previous capital level. Lastly, if you go down 50%, all you need is a 100% return to recoup your losses. This example is proof that the more success you have at limiting your losses, the less risk you need to take to make it back and eventually come out ahead. Unfortunately, it is *FOMO* which causes investors to chase the upside and overstay their welcome on the downside leading to consistently underperforming portfolios.

The holy grail of investing for many individuals and professional money managers is to beat the "market." Everyone tends to focus on the upside potential and to lose sight of the underlying risks being taken on to achieve this goal. It is these risks that can devastate a portfolio in a down market. Professional money managers are often hired or fired based on the amount of upside that is or isn't captured with their specific strategy. In reality, investors should focus less on the upside potential and more on the manager's ability to successfully navigate significant drawdowns, which in turn reduces the downside capture. More times than not, the time period money managers are being evaluated on is way too short to come to a meaningful conclusion. To successfully evaluate a manager's strategy, an investor should study their strategy over a full market cycle or couple of market cycles (measured from a top to a top or trough to a trough). It is only through a market cycle where you can really evaluate the skill of a manager in both a bull and bear market. Below is a graph depicting the growth of a hypothetical $1,000,000 portfolio since the S&P 500 Total Return peaked in August 2000. This time period encompasses two bull markets and two bear markets. The first data series is the Tandem Large Cap Core Institutional Composite*, which has an upside and downside capture vs. the S&P 500 of 70.5% and 60.4%, respectively since August 2000. The second data series shows a hypothetical portfolio that outperforms the S&P 500 on the upside and underperforms on the downside with an upside capture of 110% and downside capture of 125%. The third data series is the S&P 500.



There are a few important takeaways from this graph. First, you do not have to outperform the market on the upside to "beat" it over time, as long as your downside capture is less than your upside. Second, even though a portfolio might "beat" the market on the upside, you can significantly underperform over the long run if your downside capture is greater than your upside capture. The portfolio with less upside and downside capture is the one that removes emotion from the investing process and sticks to a well disciplined strategy. The individual invested in this portfolio is likely to stick with the strategy, because the volatility is much less and emotions can be held in check. The portfolio with more upside and downside capture is the one who throws all logic to the wind and invests solely on emotion. This is the investor who consistently suffers from *FOMO*. They may likely outperform over short periods of time, but since all decision making is emotionally driven with no consistent process to abide by, the investor fails to ever realize their gains.

The lesson here is to remove the emotional bias from your investment process. There is no need to chase and feel like you're missing out on an opportunity. When a specific stock, or the market in general, seems to continuously advance higher in the face of logic, sit back, take a deep breath, and turn off your smartphone to disconnect from the world. It is only then you can assess the situation in a rational manner to determine the right course of action. Remember, capital preservation and loss avoidance have a much more meaningful impact on a portfolio in the long run than the benefits of chasing an asset higher. By sticking to and not wavering from a disciplined strategy you will be able to sleep better knowing that even if you are selling while your neighbor is buying or vice versa, you will never succumb to the consequences related with the *Fear of Missing Out*.

--Billy Little, CFA

"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it." ~ Ralph Waldo Emerson

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