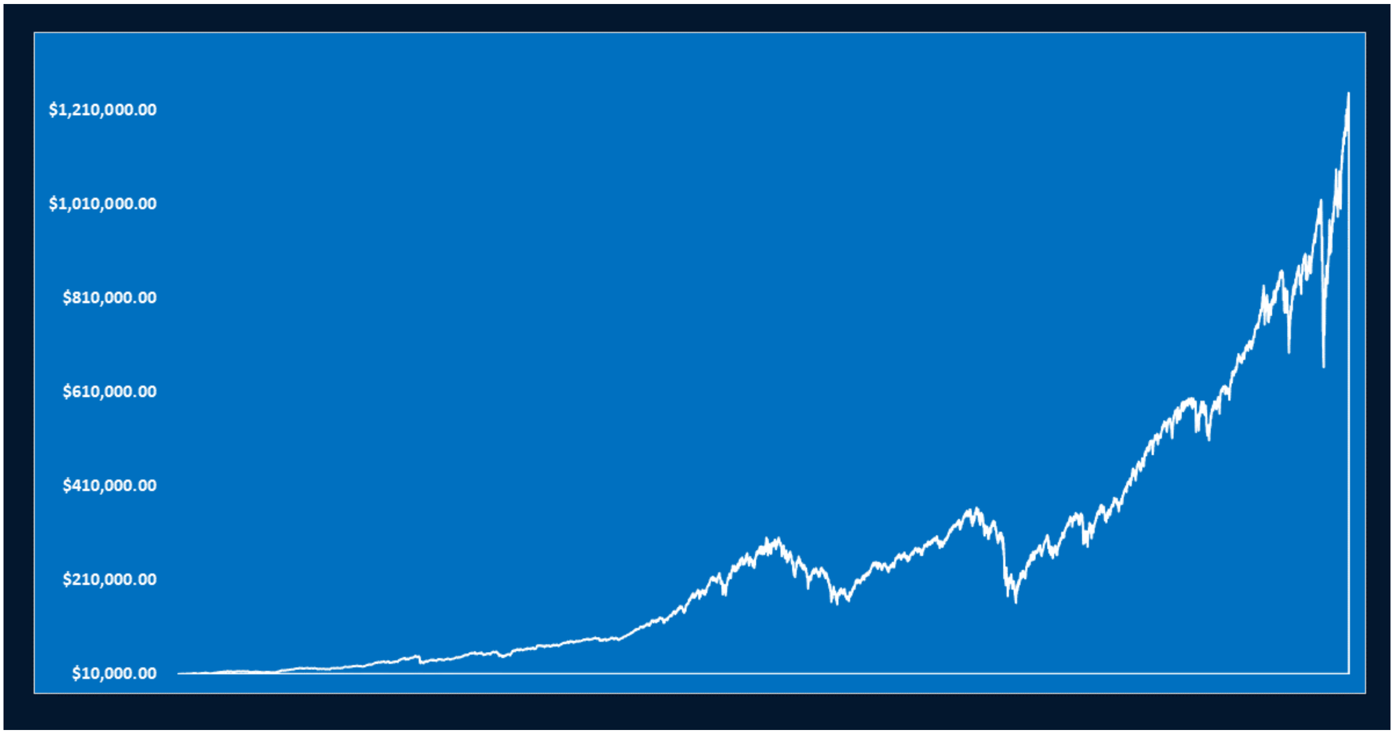
PRATO CAPITAL

Fear of Missing Out (FOMO)

March 2021

Media reports of investors making large profits from Bitcoin and stocks like Game Stop have created an illusion of easy money for investors now. These stories have left some investors with a fear of missing out on the profits generated with certain assets.



Hitting the “big one” is everyone's dream. Every investor would like to see the chart above represent their investments. This chart shows an investment of $10,000 growing to over $1.2 million. This chart will be discussed in greater depth later in this newsletter. The recent media reports leave some investors feeling they are missing out on returns like those in displayed in this chart. Unfortunately, this coverage from the media feeds a speculative side to investing that more closely resembles gambling.

Reports of Elon Musk and Mark Cuban investing in Bitcoin have helped push up prices of all cryptocurrencies. Reports of companies using cryptocurrencies as a substitute for cash have seen not only the price of that currency rise but have seen their stock price rise as well. The software company MicroStrategy (MSTR) has seen its share price rise by over 400% in one year while its Earnings per Share (EPS) have decreased from $3.33/share to a loss of $0.79/share in the same period. MicroStrategy has only announced minor updates to their products over the past year but they have purchased Bitcoin. These announcements have the (intended?) effect of increasing the price and overall value of their investment.

Investors need to differentiate between speculation and investing. Following the lead of a celebrity may or may not lead to a short-term gain, but it is certainly not a disciplined long-term investment strategy.

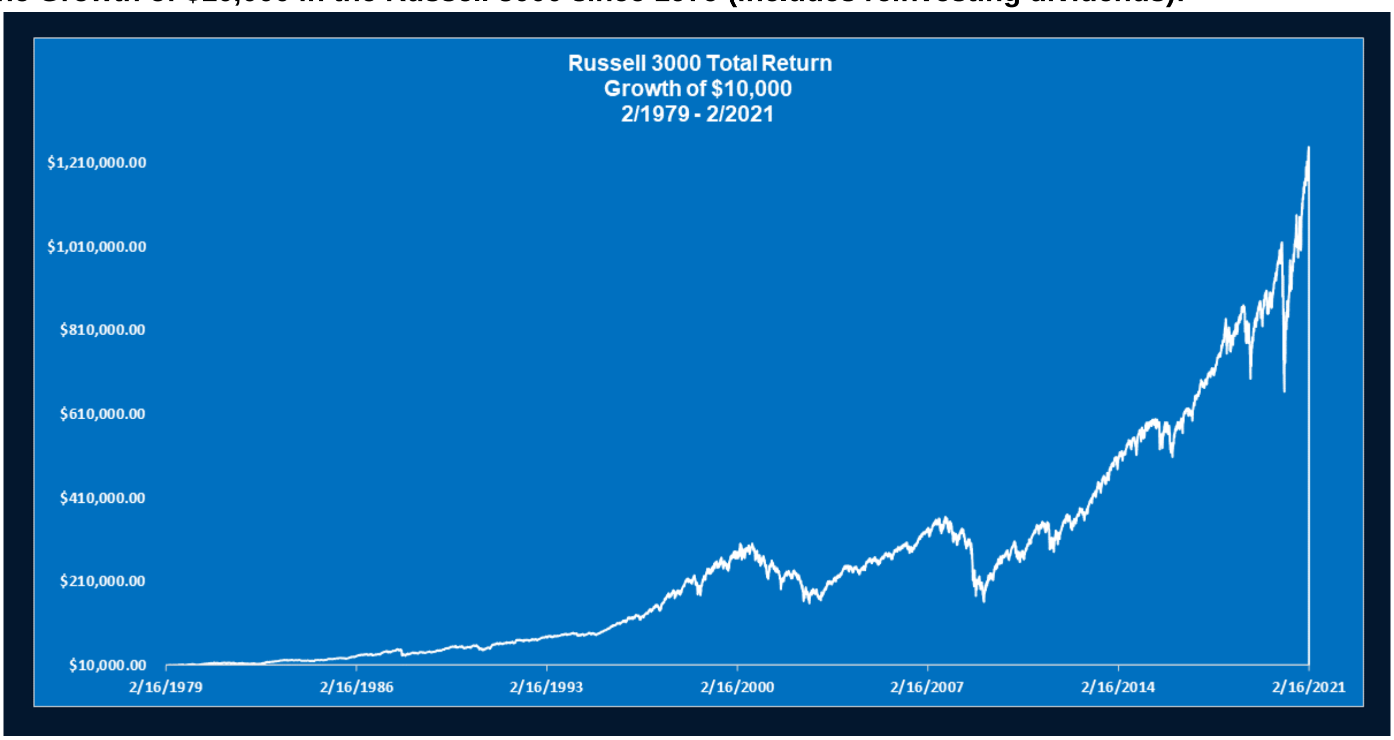
Academic research has shown over the long-term it is nearly impossible to consistently outperform the overall stock market. This includes trying to pick a hot stock, market timing, momentum trading, day trading ……. All of these short-term investment strategies add to trading costs, increase overall risk, and in the end, can be very costly for the investor.

Not Missing Out

The long-term investor has one major advantage over Wall Street professionals, the gift of time. Most professional money managers are judged on their short-term performance, quarterly or annually percentages, and compared to benchmark indices like the S&P 500. For many money managers having to focus on the short-term, they lose the benefit of compounding over time.

A long-term investment strategy rewards 'time in the market' not 'timing the market.' Over time the compounding effect, where dividends can generate additional earnings and more dividends, can add up substantially for the long-term investor. As an example of the power of compounding, an initial investment with a 10% return would double about every 7 years. This means an initial investment of $10,000 should double in about 7 years to $20,000 and double again in another 7 years. Since 1926, the S&P 500 has averaged 10.26% annual returns.

The Growth of $10,000 in the Russell 3000 since 1979 (includes reinvesting dividends):



The chart above is the same chart previously shown but with some more detail. It shows the growth of $10,000 invested in the Russell 3000, an index that represents 3000 of the largest companies in the US and is often thought of as a benchmark for the total US stock market. Since 1979, when all dividends are reinvested, this index grew at an annual rate of 12.13% and a $10,000 investment grew to over $1.2 million. This is without any additional funds added. This figure could have grown even more with modest regular contributions. Without reinvesting the dividends in the example above, that $10,000 investment grew to less than $414,000[1].

As part of a long-term investment strategy, the power of compounding can make for remarkable growth in a portfolio. An initial investment of $10,000 can grow to become quite the nest egg over time and with regular contributions it will grow even more. Imagine giving a new child or grandchild a gift of $10,000 in a Roth IRA and letting it grow for their retirement. There are no certainties when investing but with time and the power of compounding, this comes very close. This is not missing out.

Not Worrying About Missing Out

We often speak of the benefit of a written financial plan and the benefits it can provide to everyone. Our newsletter last month discussed how the planning process accounts for portfolio growth by having a long-term disciplined investing strategy and not speculating.

A Financial Life Plan (FLP), a more detailed version of a standard financial plan, can provide a sense of security when looking to the future. The FLP answers the questions about saving enough for the future. It can remove the doubts and fears of running out of money in retirement or how to pay for college. It helps tune out the noise of the financial media and leads to investments working for your plan and financial goals. The focus becomes the future and not reacting to short-term volatility. When a disciplined investment process that captures the advantages of time and compounding is combined with an individualized Financial Life Plan, it can be a very powerful tool for anyone. Many of those with a FLP do not worry about missing out on the next hyped asset, they just look forward to their future.

Conclusion

A sound financial strategy starts with a Financial Life Plan. Investors that start with a valid FLP will have a portfolio that works for them and their plan. This will be a long-term strategy that takes advantage of time and the power of compounding and it leads to confidence that they are not ‘missing out’ on the next investment hyped on social media or in the financial press. Knowing what their financial goals are, having confidence in the strategy to reach them with a FLP, and using a disciplined approach to investing is less stressful and allows them to reach those goals now and in the future.

“Planning is bringing the future into the present so that you can do something about it now.”

— Alan Lakein, author

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[1] Data for the Russell 3000 from YCharts. The Russell 3000 is a stock index and does not accept direct investments