FAHNESTOCK ASSET MANAGEMENT
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Dear Client,

The Efficient Market Hypothesis is an economic theory which posits that the trading price of an investment fully reflects all available public information. Market participants – buyers and sellers – form opinions on how much an investment is worth by assessing its financial prospects and the macroeconomic climate. This aggregate action of all participants sets a price that reflects their collective knowledge. In theory, the Efficient Market Hypothesis describes an investment's intrinsic value. **But in practice it assumes everyone is rational and ignores the impulses of human emotion.**

Emotion can cloud one's ability to accurately interpret facts. When making any decision, we tend to consult how recent similar experiences made us feel. If something was euphoric, we tend to repeat the behavior and if it was miserable, fear has us avoid it. The stronger the emotion, the more powerful the reaction.

Money can be especially emotionally charged because it impacts one's ability to live the life they want to live. We work to earn money, we delay gratification by saving and investing it for the future, and we rely on it to be there to fund our wants and needs. If an investor overreacts to the ups and downs of the markets, it is usually because they are imagining a scenario where they will meet their goals faster than projected, or a scenario where they are unable to meet all of their goals.

When investments experience above average price increases, an investor might begin to feel that investing is simple and the ascent will continue forever and buy more to reach their goals even faster. Euphoria can lead to a sense of invincibility and overconfidence about the future prospects for an investment. **Euphoria can motivate investors to focus on the potential near term returns and dismiss the potential risks of an investment causing it to trade in excess of its intrinsic value.**

When investments experience above average price decreases, an investor might begin to feel that the game is rigged, that the declines will continue unabated and conclude they should cut their losses and sell while they still can. **Fear can motivate investors to ignore the long term potential returns and emphasize the potential risks of an investment causing it to trade below its intrinsic value.** In an emotionally driven self-reinforcing feedback loop, higher prices can beget higher prices and vice versa regardless of the change in intrinsic value.

The internet and the 24 hour news cycle has been a double edged sword for the efficient pricing of investments. On the one hand, mass communication allows for the universal and instantaneous dissemination of facts which enhances market efficiency. On the other hand, with so many mediums of communication – social networks, blogs, TV, newspapers – people can easily curate the type of information they wish to consume and surround themselves with likeminded peers. Everyone has biases learned from their parents and life experiences and it is human nature to seek out confirmation of those subjective truths. Unfortunately, most news outlets are for-profit organizations that cater to their bottom

line instead of the facts and hook viewers in for longer with evocative reporting. The irony of such wide access to information is that it can actually narrow one's exposure to facts and differing points of view.

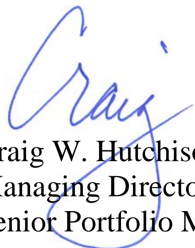
Emotion manifests in the market in the form of volatility and volatility has picked up recently. For every seemingly negative headline, there is also a positive one. There is angst from escalating trade wars and tariffs, the executive branch attempting to influence an independent central bank, political polarization drifting even further to the fringes, the increasing stratification of wealth, and higher correlations thanks to index funds and ETFs. Negative headlines tend to be more powerful over the short term but are buoyed over the long term by exciting positives such as low interest rates, record low unemployment and life changing technological advances once the domain of science fiction.

It is remarkable how effective a good night of sleep can be at quelling elevated emotions and this holds true for markets, though it might take longer than eight hours. Emotions abate as investors dissect and process new information and shift their focus from kneejerk reactions to the fundamentals. **Emotions are fleeting, but the consequences to acting on them are not and we avoid this pitfall by accepting near term volatility and uncertainty as an inherent part of long term investing.**

We proactively design your portfolio to reflect a level of risk commensurate with your financial circumstances and your emotional makeup and stick to it through market gyrations. We strive to strike an appropriate balance between stocks and bonds and include shock absorbers such as precious metals that tend to outperform in volatile markets. It is our task to keep our finger on the pulse of the market and buy/sell investments where prices have experienced drastic, emotionally driven divergences from their intrinsic values. Despite the ever present near term hurdles, we continue to believe that **TIME** is an investor's biggest asset and in the long run it is the optimist who wins.

With summer winding down, we look forward to our favorite season of the year. As always, if you have any questions at all regarding your finances or your investments, please don't hesitate to reach out (through your preferred method of communication of course!!!).

Best Regards,



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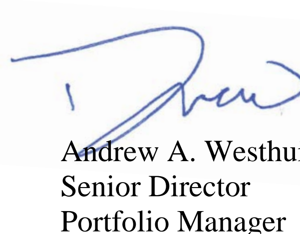

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