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focus

Investing Fads: Hazardous to Your Wealth

US bank JPMorgan recently published data highlighting that the average US retail investor's portfolio was down -44% so far this year (with the value now sitting below the level it was at the beginning of 2020 before COVID hit). While it's undoubtedly been a tough year in US markets — the S&P500 index has fallen -21% year-to-date, while the tech-heavy NASDAQ is down -31% — the magnitude of retail investor losses are still surprising. Why have retail investors, on average, done so much worse than the market? We suspect it's due to retail investors' unfortunate and costly tendency to chase investment fads.

FORSYTH BARR

...Chasing investing fads can do significant damage to your long-term financial health....

Fads come and go

> *FAD: "an intense and widely shared enthusiasm for something, especially one that is short-lived; a craze"*

Fads come (and go) in all shapes and sizes. In toys, fashion, dances, and diets. Most are typically pretty harmless. When you look back at the photos of those acid washed jeans or that perm you might cringe a little, but the long-term impact is minimal (unless of course you're still sporting them!). Investing fads, however, are an exception. Chasing these can do significant damage to your long-term financial health.

Investing is a long-term pursuit

> *"All there is to investing is picking good stocks at good times and staying with them as long as they remain good companies."*

Warren Buffett

Good investing takes work and discipline to identify good companies and assets, to buy at reasonable prices, to manage emotions particularly through volatile periods, and not to be distracted by all the outside noise and influence.

> *"It's not supposed to be easy. Anyone who finds it easy is stupid."*

Charlie Munger, Vice Chairman Berkshire Hathaway, investing legend

Highly important in investing is understanding the value of what you're buying. You'd never agree to buy a car, house, or washing machine without first considering the reasonableness of the price. It should be the same when you make an investment.

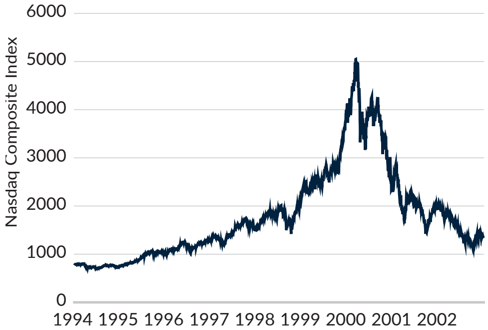
There is no such thing as a good investment regardless of the price. An investment in a great company but whose stock price assumes a wildly optimistic future will disappoint if it only delivers an okay result. Conversely, a stock that is pricing in grim prospects will perform well if the outcome proves to be unexceptional but better than expected.

Fads aplenty to trip up the unwary investor

When people jump into investment fads they neglect the disciplines of investing and take shortcuts. That's easy to do. Humans are hardwired to follow the crowd. It's easy to be excited by new industries or companies, the ones people hear about from friends and family, or on social media. If these investments have recently provided strong returns, FOMO (fear of missing out) can kick in and it can be even harder to stay away. Unfortunately this is typically when they become even more treacherous.

History is full of investment fads – Dutch tulips, the South Sea Company, canals, railways, the Nifty 50. The most noteworthy in most of our lifetimes was the dot.com bubble and crash of the late 1990s/early 2000s. The internet (like railways before it!) was clearly going to change the world and investors piled in … indiscriminately. Stock prices soared. Between 1994 and 2000 the NASDAQ climbed over 600%. But all because a company operates in an exciting new industry doesn't mean it's going to be a business success. Far from it. While a handful of these early internet companies, the likes of Amazon, went on to become giants, the vast majority did not. (Even for Amazon it took 16 years to recapture its 2000 highs.) From its peak in March 2000 the NASDAQ fell 78%, shedding most of its gains from the previous six years.

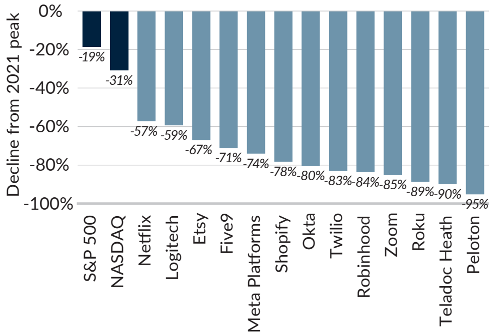
THE DOT.COM BUBBLE – THE BIGGEST INVESTING FAD OF THE 21ST CENTURY (SO FAR AT LEAST!)



Source: Refinitiv, Forsyth Barr analysis

More recently during the pandemic we had the rush into "stay-at-home stocks". The likes of Zoom, Peloton, and Netflix were seen as beneficiaries of COVID and the resulting lockdowns. Their share prices soared but returned to earth once it became apparent people weren't going to stay in lockdown forever.

STAY-AT-HOME STOCKS HAVE CRASHED



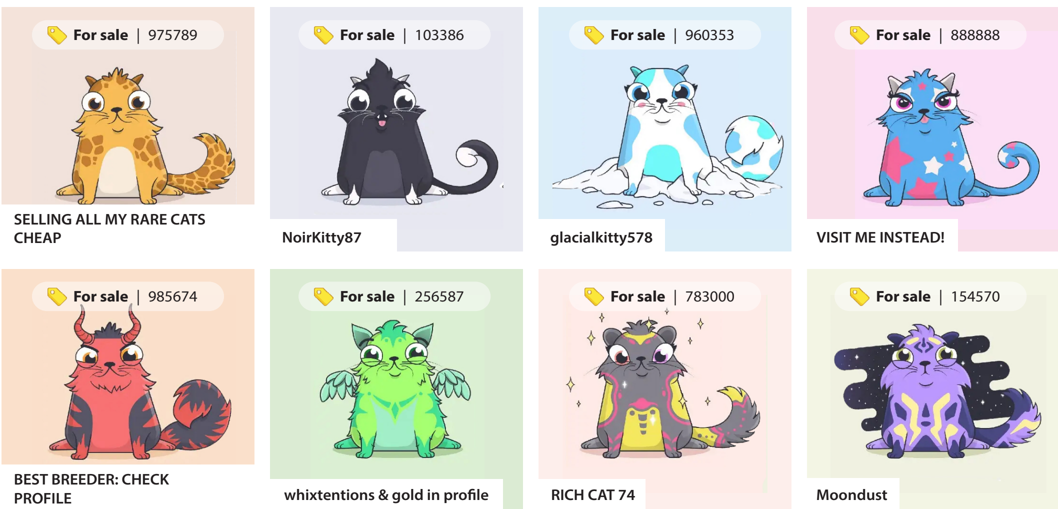
Source: Refinitiv, Forsyth Barr analysis

For recent fads it's hard to leave out crypto. There are a lot of examples. CryptoKitties – a game on the Ethereum blockchain – which allows players to buy, collect, breed, and sell virtual cats launched in November 2017. It went viral. Sales surged and a month later many CryptoKitties were selling for hundreds or even thousands of dollars. The most expensive CryptoKitty ever was an angry looking cat called Dragon which sold for US$170,000. The fad didn't last long. Sales peaked in December 2017. CryptoKitties are still around today but typically trade at less than US$10.

(As an aside, if you're wondering, do people learn? Bored Ape non-fungible tokens (NFTs) – this time digital cartoon monkeys – launched in April 2021, again on the Etheremum blockchain. History is repeating.)

While speculating on the price of a cartoon cat (or monkey) will sound absurd to many, it's not hugely different than speculating on a wildly overpriced fad stock. The price paid has no connection to the asset's underlying intrinsic value. The only way you make money is if you sell it to someone who's willing to pay an even

CRYPTOKITTIES



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higher price. (This is known as the "Greater Fool Theory" — a fool can sometimes make money on buying an overpriced asset if they can find an even greater fool to pay an even higher price.)

Best to stay away

Avoiding investing fads is beneficial to your long-term financial health. But that is sometimes easier said than done.

Many investing fads are connected with a positive underlying trend, e.g. the growth of the internet. That's the reason why they become hyped in the first place. If an investment is en vogue and popular you should approach it with a higher level of caution. If everyone "knows" it's a good investment then it's very likely an overly optimistic outlook is already priced in.

Ask yourself, am I buying this stock because it sounds exciting, or do I think this is a good company valued at a reasonable price that's well positioned to grow shareholder value over the long-term? Make sure you undertake in-depth research, or at least work with people who do.

Maintain a diversified portfolio. Investing across a range of assets, sectors, and geographies reduces the impact if one segment runs into trouble.

These don't mean you'll get it right every time — you won't — but it will reduce the number of mistakes. And avoiding the big declines that come when investing fads ultimately bust will add much to your portfolio's long-term health.

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If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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