

RATIONAL REFLECTIONS

April 2021

When Everyone Seems Crazy

- When investors have different objectives, motivations, and time horizons, asset prices that look crazy to one investor can make perfect sense to another.
- Markets reflect the collective behavior of millions of investors, all of whom are acting rational from their own point of view.
- Where investors get themselves into trouble is when they are naïvely persuaded by others who are playing a different game.
- From my perspective, successful investing is less about knowing the next great investment opportunity and more about knowing yourself—controlling your emotions and staying in the lanes of your own game.
- With an understanding of who you are, what you believe, and what you want to achieve with your money, you can start making investments intentionally.



Rob Edwards
 Managing Director - Investments
 Senior PIM Portfolio Manager

✉ rob.edwards@wfadvisors.com

in [linkedin.com/in/rob-edwards-naples](https://www.linkedin.com/in/rob-edwards-naples)

It's human nature to resist the things outside our control and that we do not understand.

Over the past year, while we were all cooped up with COVID-19 lockdowns, there were a series of investments that captured the attentions and imaginations of speculators—social media hype stocks, digital artwork, and, in more than just a few parts of America, housing. For those who are buying these assets, the price run-ups seem completely justified. And for those on the sidelines, it seems like these buyers and the prices they are paying are *crazy*.

Sure, without picking sides, many people do some crazy things with money. And rapidly rising asset prices have a way of blurring the lines between investors, speculators, and gamblers. However, in my experience, I've found that few investors are truly crazy. Those who do not fully understand the decision-making framework of others thus may be inclined to label their investment behavior *irrational*.

When investors have different objectives, motivations, and time horizons, asset prices that look crazy to one investor can make perfect sense to another.

Should you buy the stock of a left-for-dead, brick-and-mortar retailer at a knowingly stratospheric valuation? It seems crazy to me. But I don't share the same investment philosophy as a short-term trader.

Should you buy a multi-million dollar piece of artwork that exists merely in a computer network? It seems crazy to me. But I don't have the vision to see how the digital medium is a generational change to the way collectors around the world view and value art.

Should you pay well above the asking price on a beachfront condo in Naples that just hit the market? It seems crazy to me. But I don't have to shovel a driveway each time there is a snowstorm.

Investment and Insurance Products: NOT FDIC Insured / NO Bank Guarantee / MAY Lose Value

Markets reflect the collective behavior of millions of investors, all of whom are acting rational from their own point of view.

Each of us has our own framework to make sense of our individual realities, shaped by lifetime experiences: when and where we were born, how we were raised, and what kind of luck we enjoyed or lacked along the way. Consequently, what may appear to be entirely rational to one person may seem entirely nuts to someone else.

Take, for example, someone who was born and raised during the Great Depression. Given the sharp collapse of the stock market and intense resource scarcity that prevailed during the 1930s, this person is likely pretty risk averse and frugal. On the other hand, someone who grew up during the 1970s, when inflation was raging, likely remembers gas lines and prefers to consume today rather than save for tomorrow. And, today's generation of investors, emboldened by a decade-long bull market in stocks, has never seen a market dip it didn't want to buy. Here are three generations of people with widely divergent views of the world and how it can affect their money.

Where investors get themselves into trouble is when they are naïvely persuaded by others who are playing a different game.

Let's face it: the world is hard. As social creatures, we generally try to remain open minded as we navigate a complex, sometimes irrational world. Many devout PhD's in the world of academic finance have proposed hypotheses as to how markets and investors should optimally operate. But, we do not live our lives in a mathematical model or a spreadsheet. Further, it's impossible to accurately assess how our emotions—fear, guilt, greed, shame, and envy—may impact our investment decisions.

James Grant, a well-respected financial writer and publisher, sums it up well: *"To suppose that the value of a common stock is determined purely by a corporation's earnings discounted by the relevant interest rate and adjusted for the marginal tax rate is to forget that people have burned witches, gone to war on a whim, risen to the defense of Joseph Stalin, and believed Orson Welles when he told them over the radio that the Martians had landed."*

From my perspective, successful investing is less about knowing the next great investment opportunity and more about knowing yourself—controlling your emotions and staying in the lanes of your own game.

In order to help our clients avoid potentially costly mistakes, we guide them to be very clear about what is truly important to them. With an understanding of who you are, what you believe, and what you want to achieve with your money, you can start making investments intentionally. That is, with a sense of purpose. Our team utilizes a planning process that is designed to provide for more intentional and thoughtful investment decision-making. We work with our clients to keep them focused on their long-term objectives—the things that matter most—and not on the market's ups and downs, as crazy as they may seem.

All investing involves some degree of risk, whether it is associated with market volatility, purchasing power or a specific security, including the possible loss of principal.

Wells Fargo Advisors did not assist in the preparation of this report, and its accuracy and completeness are not guaranteed. The opinions expressed in this report are those of the author(s) and are not necessarily those of Wells Fargo Advisors or its affiliates. The material has been prepared or is distributed solely for information purposes and is not a solicitation or an offer to buy any security or instrument or to participate in any trading strategy. Additional information is available upon request.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC, Member SIPC, a registered broker-dealer and non-bank affiliate of Wells Fargo & Company. 0421-00461