

# Investor Behavior

Market returns generally have been favorable over the past two years. As in most periods, favorable outcomes have resulted from irregular uptrends. Each period presents investors with an array of challenges and opportunities. This period has included higher than normal political and geopolitical uncertainties. Such uncertainties can lower confidence across the policy spectrum - fiscal, monetary, trade, foreign affairs. Higher uncertainty and lower confidence usually are not friendly to economic growth and investor risk-taking. So far, growth has remained positive and risk-taking has been rewarded. A review of investor behavior can provide a sense of preferences and outcomes.

## PERSPECTIVE

Net flows for open-end mutual funds and exchange-traded funds (“ETFs”) provide reasonable indications of investor preferences. **Chart I** shows monthly flows over the past two years for all stock mutual funds and ETFs traded in the U.S. Investors reduced their stock investments in aggregate and in 18 of the past 24 months. **Chart I** also shows the cumulative return of the U.S. stock market (Wilshire 5000 Index) which reached +20.5% for the full period. The outflow has been particularly notable since the U.S. stock market reached a two-year low last December and recorded a +22.1% recovery. Reducing stock investments throughout this period has been a suboptimal portfolio strategy.

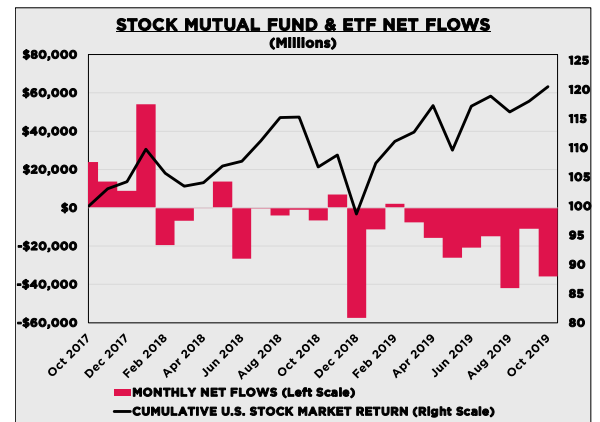
A quite different pattern occurred with bond investments as shown in **Chart II**. Investors have increased their bond investments in aggregate and in 21 of the past 24 months. **Chart II** also shows the cumulative return of the U.S. taxable bond market (Bloomberg Barclays U.S. Aggregate Index) which reached +9.2% for the full period. During the first twelve months, reducing bond investments was timely as a -2.2% loss was experienced. However, net bond investments occurred in 11 of the 12 months with reductions only coming in the twelfth month. Reductions continued into the subsequent two months but by this time the bond market was on its way to a +11.5% recovery. Net bond fund inflows have occurred in each of 2019’s first ten months.

The American Association of Individual Investors (“AAII”) has surveyed asset allocation preferences for over thirty years. **Chart III** shows average asset allocations for individual investors surveyed over the past two years. The drifts in average allocations - stocks from 68% to 65% and bonds from 17% to 18% - are consistent with the net fund flow data. The current money markets allocation of 17% may seem high but is below the long-term survey median of 21%. This relatively high level suggests that individuals may be including more than longer term investments, i.e., liquidity reserves, in their allocation responses.

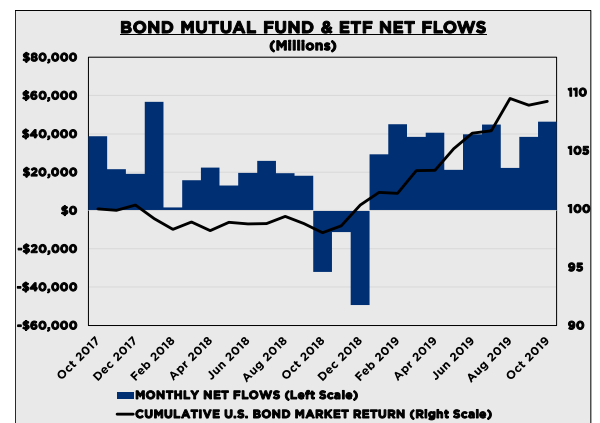
## INVESTMENT IMPLICATIONS

Aggregate investor behavior is of interest in that it provides a sense of overall preferences which could influence prospective market returns. Certainly if all investors decided simultaneously to sell or buy all their stock or bond investments, market returns would respond accordingly. The outcomes of the past two years, however, suggest that such influence may be quite unpredictable over shorter periods. Diversifying portfolios among asset classes is a proven risk-management tool. Equally important is matching goals, horizons and risk tolerance to allocations appropriate over market cycles.

**CHART I**



**CHART II**



**CHART III**

