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The Turkey Fallacy and Investing

As we get closer to Thanksgiving Day, we're sure everybody has something or someone that they're incredibly thankful for. Food, home, shelter, family and friends are the more obvious things that come to mind. We're also thankful for the wonderful bounty that the markets have provided over the past 10-years or so. Since March of 2009, investors have been fortunate to receive near-uninterrupted gains from stock and bonds. We'll raise a turkey leg and cider to that! But, while we give thanks, we won't lose sight of the fact that investing is an exercise in managing risk…and this long period of market calm brings to mind an anecdote from one of our favorite books about risk, *The Black Swan*, by Nassim Taleb.

For those who are wondering, a Black Swan is an event that is so remote that it's completely unforeseen. The best example that Taleb uses to describe this phenomenon just happens to be the Thanksgiving Turkey. As Taleb best tells it:

"Consider a turkey that is fed every day. Every single feeding will firm up the bird's belief that it's the general rule of life to be fed every day by a friendly member of the human race 'looking out for its best interests' as a politician would say." Then after 1,000 days of the good life, "On the afternoon on the Wednesday before Thanksgiving, something unexpected will happen to the turkey. It will incur a revision in belief."

Can you can guess why the turkey's view of the world will change? The turkey's "well-being" increased without interruption for 1,000 days, and then on day 1,001…the turkey's "well-being" drops straight to zero. Taleb neatly sums up the anecdote by stating something incredibly poignant, ***"Consider that (the turkey's) feeling of safety reached its maximum when the risk was at its highest!"***

The Turkey Fallacy has a valuable lesson for today's investors. Outside of a few market blips here and there, markets have been getting fat and happy for nearly 3,900 days…or 2,900 more than that poor Thanksgiving turkey. Like the turkey, who became more and more comfortable each day, investors can often be lulled into the same false sense of security. ***The truth is that as market prices go higher and our feeling of safety increases, risk is typically increasing as well.*** Remember, ever-higher prices on stocks and bonds generally imputes to lower investment returns in the future. And now, the Federal Reserve, has once again gone back to "feeding" markets with ever-cheaper money, to provide additional comfort to market participants.

We're not implying that a market crash is ahead. Maybe the good times continue to roll. But, our conclusion for investors as we approach Thanksgiving is simple - heed the lesson of the turkey. Don't be complacent, be prepared. After the market feast of the last 10-years, markets will likely need to go on a diet at some point given the normal ebb and flow of market cycles. If we mentally prepare ourselves for this likelihood of more risk and less reward, and do the little things necessary to potentially benefit from such an environment, like diversification, rebalancing, tax-loss harvesting and, importantly, *identifying what our own "comfort zone" for market risk and reward looks like*, it will be easier to remain invested and stay on course as the process unfolds. If we do, our financial plans and investment portfolios will be very thankful that we did.

If you have any questions regarding this report, please contact us at info@atwob.com or 914.302.3233

Point B Planning, LLC d/b/a AtwoB | 23 Parkway, 2nd Floor Katonah, NY 10536 | www.atwob.com