AMP CAPITAL

The perils for investors of too much information in the app age

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Key points

> The more we are exposed to information about how our investments are performing, the greater the risk that we will be disappointed and at risk of making poor short term investment decisions.

> The greater access to information around short term investment performance and the ever present worry list around investing via traditional media and increasingly from apps on our phones is likely accentuating this risk.

> The key is to turn down the volume on financial news and find ways to filter it such that it doesn't distort investment decisions.

Introduction

A decade or so ago a large Australian fund manager ran a campaign urging Australians' to pay more attention to their superannuation (pension) savings. This initially struck me as good advice – after the family home for most of us it will end up being our biggest pot of savings so it makes sense to keep a close eye on it. And surely the closer we look at it the better the outcome? But over the years I have come to the view that we need to be careful here. In fact the avalanche of information around investing if not properly managed may be making us worse, not better, investors: more fearful, more jittery and more focussed on the short term than ever. I have looked at this theme before and the more I look into it the more convinced I have become that investors need to try and turn down the noise around investing. (See "The end is nigh, or is it? Try to turn down the noise," Oliver's Insights, November 2014.)

The permanent worry list

The technology revolution has made it easier and easier to track our investments. And with this has come easier and easier access to information and views around the outlook for investment markets. Some of this is balanced, but a lot of it is not. For the last few years it seems there has been a constant worry list with a range of things about to drag us down into the next financial crisis: budget deficits, debt, money printing, the Euro, Greece (every six months!), hyperinflation, deflation, taxes, welfare spending, banks, retiring baby boomers, the government, peak oil, low oil, pollution, global warming, the Middle East, terrorism, Russia, a pandemic, China, the South China Sea, emerging markets and of course the current fascination being the Fed (will she or won't she?). And of course the perennial worry in Australia relates to the residential property market.

Big picture macro concerns have always been around. And I find it very hard to believe that things are any worse today than they were 100 years ago (when Europe had entered World War 1, living standards and life expectancy were a fraction of today's and pandemics were a regular phenomenon). But the communication revolution means that such concerns are now regularly in our face. I cannot google something without links popping up to new disasters. The fascination with financial news has exploded – with several financial TV channels with 24/7 finance updates interspersed with constant debate about what it all means. And this is now all accessible via apps we can have at our fingertips on smart phones.

Loss myopia

In a way this is all fun. But there are several risks. Human nature is naturally cautious because our brains evolved at a time when we had to be on the lookout for physical threats. As a result bad news always attracts more interest and so "bad news sells". Of course, this also applies to financial news.

But it also feeds into a common behavioural trait called "myopic loss aversion." And here lies the threat to our long term financial health. Oddly enough I was reminded of this by a great Wall Street Journal article I saw recently – "Keep Stock-Market Apps Off Your Phone", by Dr Shlomo Benartzi – that I actually found on a stock market app on my phone! It's long been observed that a loss in financial wealth is felt much more distastefully by investors than the beneficial impact of the same sized gain and in the world of behavioural economists – who study how people behave in relation to economic and finance considerations – this has come to be known as "myopic loss aversion".

When the value of an investment falls it makes sense that unless something has fundamentally gone wrong investors should be thinking about increasing their allocation to it to take advantage of it now being cheaper and better value and therefore offering better return prospects. The reality though is that many are motivated to do the opposite as the distaste for loss combines with another well-known behavioural trait called "recency bias" that causes investors to give more weight to recent events than they should so they project recent news of falls in their investment into the future.

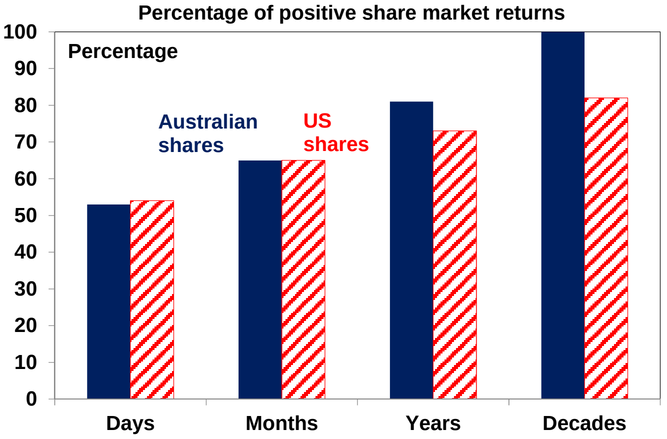
The information overload we are now seeing is likely to be reinforcing this because it is increasing our exposure to news about our investments. And this constant feedback is likely adding to "myopic loss aversion". (Hopefully this is not getting too technical!)

The shorter the horizon the worse shares look

In a family discussion about shares versus bank term deposits a relative once observed to me that there is no point investing in shares as they just go down about as much as they go up. I thought this odd as my experience has been a lot more positive. But then it occurred to me that for many people their perception of what shares do likely comes from daily updates – from the media or increasingly via an app. And this can lead to a very jaundiced experience.

For example, if you track the daily movements in the Australian All Ordinaries share price index, measured over the last twenty years it has been down almost as much as it has been up with falls 47% of the time and gains 53% of the time. It's little different for the US S&P 500 share index which has seen falls 46% of the time on a daily basis versus gains 54% of the time. So from day to day it's pretty much a coin toss with bad news nearly half the time.

By contrast if you only look at how the share market has gone each month and allow for dividends the historical experience tells us you will only get bad news (ie a loss) 35% of the time in Australia and the US. Looking only on a calendar year basis, data back to 1900 indicates that the probability of bad news in the form of a loss slides further to just 19% for Australian shares and 27% for US shares. And if you can stretch it out to once a decade, again since 1900, positive returns have been seen 100% of the time for Australian shares and 82% of the time for US shares. See the next chart.



Daily and monthly data from 1995, data for years and decades from 1900. Source: Global Financial Data, AMP Capital

The point is that the less frequently you look the less you will be disappointed and so the lower the chance that a bout of "myopic loss aversion" will be triggered which causes you to adopt an investment strategy which is too cautious to meet your goals or leads you to sell at precisely the wrong time.

But is there any evidence backing this up? Yes there is. As the Wall Street Journal article sited above noted, a 1997 study by US behavioural economists Richard Thaler, Amos Tversky, Daniel Kahneman and Alan Schwartz showed that providing investors in an experiment "with frequent feedback about their [investment] outcome is likely to encourage their worst tendencies...More is not always better. The subjects with the most data did the worst in terms of money earned." Basically what's happening here is that investors tend to go for the safer lower returning investment options when more frequent feedback on their investment performance is provided.

Of course, the greater access to financial information we are now seeing in the media and via mobile devices is having the effect of encouraging us to look at our investments more frequently not less – via daily and even more frequent updates. And around this is an avalanche of news and other information that is often out of context, often irrelevant and often in the bad news category. This has the effect of exposing us to more frequent news of loss from our investments and reinforcing that news. Which in turn risks encouraging bad investment decisions. In particular a focus away from investments like shares that can grow wealth over time towards assets that may be safe in the short term but will lead to much lower wealth levels over the long term.

What can investors do to avoid this?

The key I think is to find ways to turn down the volume on financial news because if you are exposed to it less frequently you are less likely to make decisions that are contrary to your long term investment goals. Try to avoid looking at market updates so regularly and even consider removing related apps from your smart phones, tablets and watches. Or at the very least find a way to filter such news in a way that it doesn't distort your investment decisions.

The traditional approach of adopting a long term investment strategy and sticking to it is arguably now more important than ever. Yes we are now in an environment of more constrained and volatile investment returns which has increased the importance of active asset allocation – but this is best left to experts who can put the time in to filter the noise from fundamental signals and avoid allowing "myopic loss aversion" from getting control.

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