

## **Avoid “hot thinking” when it comes to your investments**

*The markets have plunged in the face of COVID-19. The temptation to disinvest and wait on the side-lines for things to improve is real. But is this a form of “hot thinking” that is best avoided? Nomi Bodlani head of strategic markets at Allan Gray discusses.*

**7 May 2020:** It is human nature to make decisions that are influenced by our emotions. However, when it comes to investing, acting too quickly on our emotions can have a devastating long-term impact on our portfolios.

The key to being a long-term investor is learning the art of blocking out the short-term market noise that can distract you from achieving your long-term investment goals. This can be difficult to achieve when you’re watching the market downturn negatively impacting your investments. The disappointment, fear and perceived loss may make you feel compelled to act. Although this is a natural reaction, it may not be the best course of action. There is another way of thinking through your options to decide your next best action – if any at all.

Behavioural scientists refer to a certain type of thinking that happens under stress as “hot thinking”, and it is this inclination that leads us to react defensively. While hot thinking can help us act swiftly and automatically when we are in real and imminent danger, or performing routine tasks, it can lead to biased judgement and irrational decision-making outside of these circumstances.

When it comes to your investment portfolio, hot thinking is not a useful strategy. As counter-intuitive as it may seem, and as painful as it may feel, it is during times of crisis that the right decisions can enhance long-term returns.

Morgan Housel, a partner at the US venture capital firm Collaborative Fund, summed it up succinctly at the Allan Gray Investment Summit a few years ago, saying: “Volatility is not the biggest risk in investing. The biggest risk is the action that you take in response to that volatility. You think it is going to make you safe, but it actually injects substantially more risk into your investment portfolio.”

### **What to do with disappointment, fear and perceived loss?**

Slow down and reduce the heat. In sharp contrast to hot thinking, behavioural scientists refer to a second important system for processing information as “cold thinking”, or “slow thinking”. This is our ability to think and act in a deliberate, considered and controlled manner, i.e. to make decisions under circumstances of cool, level or moderate emotions. There are useful strategies you can apply to help you handle feverish thoughts and carefully consider what actions to take – if any. By first understanding some of the features and responses of hot thinking, we may be able to think through our decisions more deliberately and ensure a better long-term outcome, as shown in Table 1.

**Table 1: Hot vs cool responses to investment uncertainty**

Decision-making inputs	Hot-thinking responses to your investment uncertainty	Cooler thoughts and questions in response to your investment uncertainty
Belief	The financial markets have suffered a fundamental blow from which they cannot recover, therefore I must exit.	Yes, the global economic shutdown is extraordinary, but have the financial markets changed in ways that can't be reversed? Have factories, markets, workshops, commercial centres and people changed fundamentally? Have people's desires for the same products and services changed because of COVID-19?
Time	If I sell my assets now, at least I'll save something before the market really hits rock bottom. If I wait, I end up with nothing.	There was a before and there will be an after. Just a few weeks ago, the lead story on News24 was about the Budget Speech and our inevitable ratings downgrade. Remember that panic? Has the pandemic changed anything in your personal investment timeline? Are you trapped in the now, when the plan was for years in the future?
Stress	I'm worried about my children at home, my parents who are at risk, my income, my job and many other things. I must do something.	Have you given yourself the space to think critically and holistically, i.e. not reactively? Things are difficult and we should respond accordingly, but big decisions need space to breathe.
Emotion	I am panicked and angry and my emotions need an outlet. Selling is something I can do to soothe me. Taking drastic action at least gives me the illusion of control in a situation I am swept along in.	Suppressing emotions and pretending them away make them worse. The better solution is to ask: How can I soothe the emotions I have in a way that is not harmful in the long run? It may be that you need a news and digital detox so that you can stop absorbing the panic in the air, or perhaps you need to talk to someone you trust, like your independent financial adviser.
Group behaviour	Clearly everyone else is doing it. They must know something that I don't know. It's safer to follow the herd.	The wisdom of the crowd is wise if the crowd is informed. What are the beliefs driving market movements? Are they rational, well-thought-through arguments, or whispers of half-baked ideas and emotions?

Each of these thoughts and feelings may be easy to ignore in calmer times, but together – and with the frequency at which we see negative news – they make a compelling case for quick and reactive decision-making. Coupled with all the alone time we currently have to stare at screens and consume this panic, withdrawing from our investments may seem to make sense. But will this serve us over the long term? Distancing yourself from the very real emotions of disappointment, fear and perceived loss, and allowing yourself time to consider reliable sources of data, will help you answer this question.

### Where to from here?

No one knows what will happen next. As the pandemic spreads and a fever of panic and hot thinking follows, it's perhaps smart to remember that while our current feelings of disappointment and fear are real, we have within us the capacity for cooler thinking: to take a step back, evaluate reliable data and conclude with certainty that this, too, shall pass.

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