First Quarter 2021

Plan to be a Survivor

"You cannot predict, but you can prepare."
Howard Marks

The biggest game in town in January isn't football. It's forecasting the year ahead, particularly the financial market's direction and the best investments to hold in 2021. There's just one problem. No one really knows. Financial markets have a habit of confounding the best models, tripping up "experts," and reacting contrary to all expectations. And that's without black swans, those rare and unpredictable events that seem to be increasingly probable.

When it comes to surviving down markets or bad investments, there's a lot to learn from how and why some people survive major disasters while others perish. Every crisis – *whether a financial or physical disaster* - produces two types of people - survivors and victims. The difference can be a matter of luck, but more often imagination and preparation play a role.

In a crisis, we are thrown into a stressful, unfamiliar environment, where determining what we need to do to survive requires a lot more conscious effort than primitive fight or flight reactions. In the emotional overload of emergencies, people often fail to do things that under normal circumstances would seem obvious.

According to researchers who have studied disasters, people typically go through a three-stage process when in mortal peril: denial, deliberation and the "decisive moment."

All too often, **denial** takes the form of delay. Interviews with survivors who worked in the twin towers on September 11, 2001 found that fewer than 10% fled as soon as the alarm was raised. The vast majority, more than 90%, stayed behind waiting for information or carrying out at least one additional task. Even in the face of obvious impending disaster, some people just won't move. Others become highly emotional or passive, believing they are going to die and are unable to prevent it.

In a disaster, we know something is terribly wrong, but we are in unfamiliar territory. Nothing is normal. Fear takes away normal thought processes. At heightened levels of fear, a person makes mistakes. He or she reacts too fast, panics, or may act in dysfunctional ways.

Deliberation – deciding the best response – requires tapping down emotion and quickly considering a range of response choices. Humor (although probably rather dark humor) has proven to help people feel more in control of the situation. There's no time for getting upset about what has been lost or things going badly – the focus is on how to survive.

The **decisive moment** that follows is often surprising. The more cynical might assume it is every man and/or woman for himself or herself. But often survival is a result of how the group functions. Survivors tend to extend their coping skills and commitment to live to those around them to keep both themselves and others alive.

The best survivors are not the best educated, smartest or most athletic. What they do tend to have is curiosity about how things work and the flexibility to innovate to succeed. A sense of humor helps, as does having overcome adversity in the past, learning from their mistakes and being willing to try different approaches. One survivor of an airline disaster explained that he had made a habit of locating exit doors before he takes his seat. Having imagined what he should do in an emergency, when one occurred he reacted quickly to open the closest exit door, saving not only his family but also surrounding passengers.

How does this apply to investing? The biggest failing of investors in market crashes is denial. They cling too long to past beliefs, fail to accept that something is terribly wrong and are unable to make decisions that could save their portfolios.

Deciding the best response to a declining market (deliberation) – requires the same reactions as a physical disaster. Tapping down emotional reactions, quickly evaluating a wide range of responses and possible outcomes, humor, accepting that you might be wrong, and then taking action to survive to invest another day are classic survivor traits.

It also helps if your curiosity as to how things work has led you to study past market cycles and understand how fortunes have been made and lost in the markets. Ideally, you have asked yourself how you would have reacted during prior bear markets to preserve your capital and have put plans in place to survive should a similar situation arise. You need the confidence gained from facing or at least considering difficult financial situations in the past to make a decision, and, if your action appears incorrect for the current circumstances, the flexibility to change directions.

Many people assume their financial advisor or mutual fund has a plan to protect their portfolio in a major market downturn. That's a risky assumption. Ronald Reagan had it right when he said, "Trust. But verify." Ask your financial advisor what his or her plan is in the event of market decline. Read your fund documents to know how the managers will try to protect the portfolio from adverse markets. If the plan is simply to buy and hold and wait for the market to recover, you need to know how much you can afford to lose and weight your investment accordingly. If the manager seems to assume markets will always go up, start interviewing new advisors or finding alternative mutual funds. Don't assume the unthinkable can't happen.

Financial markets have destroyed lives just as effectively as forest fires and hurricanes. This isn't a safe game. Successful investors need to approach the markets with a survivor's mentality.

One of the ultimate survival stories is that of Ernest Shackleton and his crew. The British expedition ship, HMS Endurance, left South Georgia on December 5, 1914 for Antarctica with a crew of 27 and the goal of establishing a base on Antarctica's Weddell Sea Coast, from which to cross the continent. Before the ship was able to reach Antarctica, it was trapped in ice. It would be 20 months of surviving impossible odds before every one of the Endurance crew reached the coast of Chile, alive and safe.

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