Stay focused when news breaks

Learn how news headlines can influence investors and contribute to emotional decision making.

Investors today have an abundance of information at their fingertips. News of significant market events arrives in real time—24 hours a day, seven days a week, easily accessible with a few clicks of a mouse or the swipe of a thumb.

Despite the prevalence and access to investment information, individual investors still struggle to find success in the financial markets. The average investor continues to underperform broad market indexes—a trend that has been in place for many years and continues to this day. (See right.) While there are many causes for this underperformance, frequent trading (often at inopportune times) is the primary culprit. Much of the frequent trading happens as individual investors react to news headlines.

In this white paper, we examine the role of news headlines in driving emotional reactions and investment decisions. We’ll discuss the consequences of headline-driven emotional investing and share ideas to help investors tune out the noise from the financial media and focus on the basics of long-term investing.

Key highlights

- News headlines can lead investors to make irrational and emotional decisions, often due to the hard wiring of the human brain.
- The average investor has underperformed the market due to frequent trading and short holding periods in efforts to time changes in performance trends.
- Investors can seek to avoid reacting to news headlines by sticking to investment basics, seeking opportunities to buy when others sell and working with a financial professional.

Average equity fund investor vs. the broad stock market, 1992-2021

<table>
<thead>
<tr>
<th></th>
<th>Average annualized return</th>
<th>Growth of $100,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average equity fund investor</td>
<td>7.1%</td>
<td>$789,465</td>
</tr>
<tr>
<td>S&amp;P 500® Index</td>
<td>10.7%</td>
<td>$2,082,296</td>
</tr>
</tbody>
</table>

Source for chart data: Dalbar Quantitative Analysis of Investor Behavior (QAIB) 2022 Report
Too much of a good thing

We are currently living in an age of information abundance. For an investor, that can be a blessing; anyone with enough curiosity and a few seconds to spare can unearth knowledge on any asset class, industry sector or company under the sun. Turn this information into intelligence and it can become a powerful resource for making informed investment decisions.

But information abundance can also become a curse when it turns into a glut. These days, it can be said investors have too much information at their fingertips. While some of it is valuable, a lot is simply “clickbait” that distracts people’s attention or sensationalism that provokes emotional reactions. The information glut did not appear overnight—it has accumulated over the last four decades. A confluence of forces has brought us to this point of saturation, from the rise of round-the-clock news, to the broad adoption of technology among consumers, to the spread of interconnectivity through the Internet.

Also significantly, the growth of the information glut has occurred alongside the democratization of the financial markets. Starting in the 1980s with the introduction of 401(k) plans and individual retirement accounts (IRAs), investors have assumed greater responsibility for preparing for their financial futures and making their own investment decisions. Investors must rely on their judgment to sort through the information glut and extract the good data from the bad. That can be a challenge as news headlines demonstrate strong emotional influences over the ability to make rational investment decisions.

A zettabyte is 1,000,000,000,000,000,000,000 bytes of data

44 zettabytes of data at the beginning of 2020.¹

175 zettabytes of data estimated by 2025.²

Sources of news, 2013-2022

<table>
<thead>
<tr>
<th>Year</th>
<th>Television</th>
<th>Print</th>
<th>Social media</th>
<th>Online (incl. social media)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>72%</td>
<td>47%</td>
<td>47%</td>
<td>72%</td>
</tr>
<tr>
<td>2018</td>
<td>75%</td>
<td>48%</td>
<td>47%</td>
<td>75%</td>
</tr>
<tr>
<td>2022</td>
<td>67%</td>
<td>42%</td>
<td>47%</td>
<td>67%</td>
</tr>
</tbody>
</table>

¹ World Economic Forum
² Seagate U.K.
Bad news is good business

In the information glut, attention and diversion are more valuable than knowledge and intelligence. For the most part, broadcasters and publishers of financial news strive not to inform investors but to attract them. Their profits are driven by ratings, likes, retweets and click-throughs—the more traffic from viewers or subscribers they have, the more attractive their media platforms are to advertisers. And nothing attracts individual investors more than bad news.

Look at the financial markets to see the effect that news headlines can have on investors. It is often said investors climb a “wall of worry” as market cycles reach their final stages, either at the bottoms of bear markets or near the peaks of bull markets. The worries that build this wall are usually economic, but political or international events can also sway investor sentiment as well. Eventually, investors overcome these worries and market cycles transition from growth to consolidation (or vice versa). But getting through those transitions takes time. Meanwhile, the drumbeat of news headlines drives the wall of worry higher. This is when investors are most vulnerable to making emotional and irrational decisions.

A neurological view

The same part of the brain that regulates emotion—the amygdala—is also used for decision making. In stressful situations, emotions can take over the amygdala and influence decision-making processes. This leads to behaviors that are less rational and more impulsive.

“Wall of Worry”: When the news influenced the S&P 500 Index (1986-June 2022)
**Turn on, tune in, drop out**

Many individual investors get caught in this vicious cycle: news headlines drive investor emotions, which may drive individuals to make irrational investment decisions. What comes next is poor performance. Over the 30-year period from 1992 to the end of 2021, individual stock investors have underperformed the broad equity market. (See chart on Page 1.)

Market timing has much to do with this poor performance. Individual investors tend to trade frequently and hold investments for short-term periods, shorter than the length of the average market cycle. They buy high and sell low—the exact opposite of what they should do according to basic investment principles.

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**Average holding period for U.S. stocks**

\[ 5 \frac{1}{2} \text{ months} \]

**Average length of a U.S. stock market cycle**

\[ 88 \text{ months} \]

3. Reuters analysis of New York Stock Exchange data as of June 2020


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A lot of this activity is driven by emotion, and many times these emotions are triggered by market events and headlines from the financial media. All of this movement in and out of the market means investors will often miss the best days in the market. Missing those days can significantly reduce the returns investors achieve, and ultimately cost real money relative to the outcomes investors who remain fully invested would achieve.

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**Growth of $10,000 in the S&P 500 © Index**

Based on daily price return, August 2002 to August 2022

<table>
<thead>
<tr>
<th>Missed x Best Days</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fully Invested</td>
<td>$46,018</td>
</tr>
<tr>
<td>Missed 10 best</td>
<td>$21,105</td>
</tr>
<tr>
<td>Missed 20 best</td>
<td>$12,767</td>
</tr>
<tr>
<td>Missed 30 best</td>
<td>$8,369</td>
</tr>
<tr>
<td>Missed 40 best</td>
<td>$5,711</td>
</tr>
<tr>
<td>Missed 50 best</td>
<td>$4,050</td>
</tr>
</tbody>
</table>

Source: Factset Data Systems, August 2022
Countering the lure of news headlines

The solution for countering the influence and effects of headline-driven emotional investing lies within the individual. By understanding the true role of the financial media and recognizing how sensational reports of market events can push our emotional buttons, individual investors can tap their own willpower to avoid making emotionally charged decisions and stick to the investment plan they established with their financial advisor. Historical results from the financial markets can also show investors the value of maintaining a long-term perspective and help them downplay the influence of short-term performance.

Looking at returns for the S&P 500 Index back to 1929 shows how the probability of positive returns increases with the length of the period. Negative returns are more likely for shorter periods—nearly every other day in the market is a down day, according to historical S&P 500 data. Even on an annual basis, one in every three years is negative. But over longer periods, 10 years and beyond, the probability of negative returns declines dramatically.

Probability of Negative Returns for the S&P
Based on historical returns from January 1929 through August 2022

Maintain a disciplined approach to investing

Perhaps most important of all, investors should become their own best advocates to help regulate their emotions when facing news headlines and dramatic events in the financial markets. By avoiding emotional decisions and maintaining a disciplined approach to investing, investors can seek to keep more of the money they save and earn and be positioned for opportunities to buy when prices are low.

Review these basic principles of investing with clients to help them manage the onslaught of financial news headlines:

- **Stick with investments for the long-term** to help achieve long-term goals.
- **Tune out the noise from the financial news media**, and don’t take any action in response to news events without first consulting a financial advisor.
- **Maintain a diversified portfolio** that’s suitable for your investment goals and risk tolerance to help lessen the impact of market fluctuations.
- **Take advantage of opportunities to invest** when other investors display emotional behaviors, buying when they are selling in falling markets.
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