INVESTOR IQ SERIES

Why Yesterday is a Terrible Strategy.

How Recency Bias Creates Blind Spots in Market Cycles.

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There's an old saying generals are always preparing to fight the last war. Investors have a remarkably similar habit.

When stocks have been climbing for months, we begin to believe the good times are here to stay. When markets fall sharply, we start wondering whether the decline will ever end. And when one particular investment has been outperforming everything else, suddenly everyone wants to own it.

Welcome to **recency bias**—our very human tendency to assume that whatever happened most recently is probably what will happen next. It's understandable. It's also one of the more subtle ways investors can undermine an otherwise thoughtful investment strategy.

The Rearview Mirror Problem

Imagine driving down a winding mountain road while spending most of your time looking in the rearview mirror. You'd have an excellent understanding of where you've been. Where you're going? Not so much. Yet investors routinely make decisions using precisely this approach.

Last year's winning sector becomes this year's must-have investment. Yesterday's disappointing asset class becomes something to avoid. And the investment that has delivered several years of exceptional returns begins to feel less like an opportunity and more like a certainty. The problem isn't that recent performance tells us nothing. It's that **recent performance rarely tells us everything.**

Markets Have Short Memories. History Doesn't.

Consider how dramatically the investment landscape can change. Technology stocks dominated the late 1990s before the dot-com collapse. Financial stocks enjoyed years of enthusiasm before the 2008 financial crisis. The pandemic created extraordinary demand for certain businesses, only for some of those expectations to reverse as the economy reopened.

Each period had its own compelling narrative. And each narrative felt remarkably convincing while it was happening. That's the tricky part about market cycles. They don't announce themselves with a calendar invitation.

Economic growth accelerates and slows. Interest rates rise and fall. Investor enthusiasm expands and contracts. Leadership rotates between industries, investment styles and asset classes. These changes don't follow a predictable schedule, and yesterday's laggards don't automatically become tomorrow's winners.

But they remind us of something important: **Markets change their minds far more often than investors change their expectations.**



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When Confidence Becomes a Liability

Recency bias can be especially dangerous because it often disguises itself as informed decision-making. An investor sees a strong three-year performance record and concludes that a strategy has demonstrated its superiority.

Perhaps it has. Or perhaps the strategy benefited from economic conditions that won't persist.

A period of falling interest rates, expanding valuations or unusually strong demand can make certain investments look exceptionally attractive. But when those conditions change, the same characteristics that contributed to strong performance may become sources of risk.

This is why understanding *what drove returns* can matter as much as understanding the returns themselves. Performance deserves examination, not extrapolation.

The Discipline to Look Forward

So how can investors keep yesterday from making tomorrow's decisions?

Start by separating investment fundamentals from recent price movements. Review whether an investment still serves its intended purpose. Consider valuation, diversification, risk exposure and how changing economic conditions might affect the portfolio.

Revisit your assumptions, particularly when an investment has performed exceptionally well—or poorly. And recognize that adjusting a portfolio isn't necessarily an admission that the original decision was wrong. Sometimes circumstances change. Sometimes objectives change. Sometimes the risks simply look different.

A disciplined investment process allows room for those realities without requiring investors to predict the next market cycle. Importantly, diversification and risk-management strategies cannot eliminate losses, and even a well-constructed portfolio can experience extended periods of disappointing performance.

The objective is not certainty. It's making decisions with a clearer understanding of uncertainty.

Investor IQ Takeaway:

The past is an invaluable teacher.

It's just a questionable financial advisor.

Historical performance can help us understand how investments have behaved under different conditions. But it cannot reliably tell us what happens next.

The smartest investment question isn't "What's been working?" It's "What assumptions am I making about what happens next?"



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