(UBS)

May the force (of compounding) be with you, always

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In honor of Star Wars Day ("May the Fourth be with you!"), let's ignore Han Solo's request ("Never tell me the odds!") and explore why understanding the odds is actually crucial for investors.

For example, looking at the historical probability of gains and losses in the S&P 500 over different time horizons shows that the probability of seeing a loss on any given **day** is about 46%, but losses have been much less common for longer time horizons. Stocks have never experienced a loss over a 20-year period. Balanced, well-diversified portfolios' gains are even more consistent, especially over longer time frames.

This has two main consequences:

1. Short time horizons make investing feel riskier.
Unless you're a droid, it's likely that you suffer from a behavioral bias known as "**loss aversion**," which means that you will tend to feel the pain of losses about twice as strongly as the pleasure from gains.

The effect of loss aversion can be supercharged when it's combined with the fact that losses are much more common over short holding periods. This combined effect (which behavioral economists call "**myopic loss aversion**," referring to myopia/short-sightedness) means that you will experience more stress and fear when you look at returns more frequently and over shorter time frames.

2. Short-term investing requires a different approach.
Each dollar (or Imperial Credit) in your portfolio is earmarked for spending at some point in the future. It's likely that the bulk of your portfolio is earmarked for spending that's more than a decade away, in which case there is a very good

chance that you will be able to grow your investment considerably, and only a small chance that you will experience a loss—especially if you are invested in a balanced, well-diversified portfolio. If you do have cash flow needs from your portfolio in the next few years, focus your attention on protecting that part of your portfolio first and foremost.

Recommendations

Shortsightedness can skew your perception of risk and reward. The more often you check your portfolio, the more likely you are to encounter losses, which can trigger anxiety and lead to impulsive decisions—like selling in response to a temporary market decline instead of sticking with your long-term plan.

The good news is that we have some powerful tools to help us combat myopic loss aversion:

1. Focus on long-term returns. As we've discussed, short-term returns are chaotic, testing your patience and tempting you to overtrade your portfolio. Choosing to focus on long-term returns—and the context of your goals—can help you foster a healthier perspective of markets' risks and opportunities.
2. Use others' fear to your advantage. When we look at investor sentiment, we find a “pessimism paradox”: when investors are fearful or pessimistic, it tends to precede higher-than-average market returns.
3. Switch off your targeting computer. Rather than relying on forecasts to determine when you need to protect yourself against a potential bear market, we recommend building a portfolio that structurally protects you from the risk of poor short-term returns.
4. Give yourself credit for your progress. Loss aversion is one reason we don't generally become happier with our portfolios over time. If you are in a balanced, well-diversified portfolio, its long-term growth is likely to be far more durable than its short-term losses.
5. Embrace illiquidity. Consider adding illiquid investments to your portfolio—for example, private markets (equity, credit, infrastructure, real estate), hedge funds, and structured investments. These investments may help you to improve your return potential without increasing your anxiety.

Conclusion

Resisting the urge to focus on short-term market moves and embracing the long-term probabilities can help you become a more powerful investor than you can possibly imagine.

To paraphrase Master Yoda: “Fear is the path to underperformance. Fear leads to myopia, myopia leads to loss aversion, loss aversion leads to underperformance.”

To learn more about our solutions and recommendations, see the full report: **Fear is the path to underperformance**, 30 April 2025.

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