CHAPTER 17

HOW TO DO NOTHING

Approximately 99% of the time, the single most important thing investors should do is absolutely nothing.

—Jason Zweig, the *Wall Street Journal's Moneybeat* blog[124]

The advantages of buying and then simply *holding* your investments should by now be clear. You will earn better long-run returns than those who try to time the market, chase performance, or otherwise trade frequently. And the longer you remain fully invested in a well-diversified portfolio, the less likely it is that you will suffer a long-term loss of your principal or purchasing power.

There is one additional, very important advantage to the buy-and-hold approach. It is a strategy that requires no particular skill or knowledge and very little work on your part. It is tailor-made for amateur investors who have neither the time nor the inclination to devote significant effort to studying the markets. There is no need to try to guess which way stocks are headed or to figure out which particular investments you should buy or sell on any given day. You just decide on an asset allocation, buy a set of index funds or exchange-traded funds (ETFs) to implement that allocation, and then … do nothing. It is the perfect investment strategy for busy people, and for lazy people (like me).

You Will Be Tested

Well, at least it's perfect *most* of the time. But there will come a day when doing nothing will not be as easy as it sounds. In fact, when it comes to investing, doing nothing can be one of the most difficult things you will ever have to do.

Consider, for example, how difficult doing nothing would have been in 1999. In the preceding four years, the S&P 500's *worst* annual returns were 23.1 percent. And in 1999, the index was on track to beat 20 percent for the fifth year in a row. Yet the

best returns for the advanced moderate (60/40) portfolio over those same four years were 15.3 percent. In 1998, this portfolio yielded a pathetic 1.1 percent—27.5 percentage points less than the S&P 500 in that same year. Imagine being at a New Year's Eve party on December 31, 1999, listening to all your friends and neighbors talking about the killings they made on this or that dot-com stock. And imagine if this was the *fifth* New Year's Eve party in a row where you had to listen to pretty much this same conversation. Wouldn't you have been tempted to ditch your boring, underperforming diversified portfolio and go for the gold?

Or even worse, imagine it is October 2008. The market has been gyrating wildly, up and down (mostly down), 5 percent or more per *day*. The S&P 500 has already dropped 40 percent from its 2007 high, and there is no end in sight. Normally calm government officials are waving their arms in the air, warning of a financial calamity, and the media is full of predictions of a new Great Depression. There is fear in the air; it is palpable. Would you be able to hold your allocation to stocks in the face of this fear?

Desire and fear are the most powerful of emotions. We all have a bit of John Stockman and Joe Bondsman in us. When times are good and the market is posting new record highs every other day, your inner John Stockman will come to you. He will show up dressed to the nines, with a blonde flapper on his arm, and whisper in your ear, "Come with us to the big party over at the stock market. We're all going to get rich!" When times are bad and stocks are plummeting toward oblivion, your inner Joe Bondsman may come to the fore. Dressed in a gray business suit and looking grim, he yells, "Sell, sell! Quick, before we lose everything!"

You can be sure of two things. First, sooner or later in your investing career, you will face a test similar to 1999 or 2008. And second, when that test comes, if you let your emotions get the better of you, they will betray you. There may perhaps be certain situations in life where it is wiser to follow your heart than your head. But investing is absolutely not one of those situations. Imagine if you had decided to dump your bonds, gold, and PME funds and put all your money in tech stocks in 1999. Your nest egg would have been crushed when the tech bubble burst in 2000. Imagine if you had sold your stock funds in October 2008 after they had lost 40 percent of their value. You would likely have missed out on the 2009 rally, thereby turning a temporary loss into a permanent one.

Of course, it is much easier for me to tell you that you should ignore your emotions than for you to actually do it. When a new test like 1999 or 2008 comes, ignoring the temptations posed by your inner John Stockman or Joe Bondsman will be one of the hardest things you will ever have to do. You must prepare yourself in advance for this test. You must *learn* how to do nothing, and you must have a plan in place that will prevent you from doing *something*. In this chapter we tackle the task of developing, and then sticking to, a do-nothing plan. Because behavioral finance researchers have shown that the fear of financial loss (loss aversion) is a more powerful psychological motivator than the desire for financial gain, we are going to focus mainly on the challenge posed by bear markets. However, the do-nothing plan

we develop should also help you to control your emotions during bull markets and bubbles. Where necessary, we will tweak the plan a bit to deal more directly with the desire for gains that arise during the good times.

This chapter is the most important chapter in the entire book. Buying a well-diversified portfolio of index mutual funds and ETFs is easy. *Holding* that portfolio through good times and bad is the hard part. Many investors have started out fully intending to follow a buy-and-hold strategy, only to abandon the strategy after a few years or even months. Diversifying your portfolio using high-volatility and low-volatility hedges will smooth out some of the market volatility you experience, but it will not eliminate it. It will be up to *you* to ride out the volatility that cannot be diversified away. You may want to bookmark this chapter and reread it when your inner John Stockman or Joe Bondsman comes calling. Sooner or later, they *will* call. You *will* be tested.

Tigers, Bears, and Loose Rocks

But before we worry too much about the tests the stock market may have in store for us, let's count our blessings and keep things in perspective. The kinds of tests we modern folks face are *nothing* like those faced by our ancestors. Losing part of your savings in a bear market? Sorry, that doesn't begin to compare with losing your *life* to a real bear. Or a saber-toothed tiger. Like the one Bil the Caveman ran into one day, long, long ago.

It happened in the evening when Bil was commuting back to his cave after a long, hard day of hunting mastodons. He had with him his spear, his shield, and his trusty hunting dog, Dog. His commute took him up a mountain along a narrow ledge. As he rounded a bend, he noticed a spot where the ledge was starting to crumble. He carefully stepped over the spot and then made a mental note. This took him about five minutes of exhausting effort, but finally he had committed to memory an important warning to himself: "Me no fal down."

Bil turned to continue on his way, but after a couple more steps, suddenly something jumped onto the path ahead. It was a saber-toothed tiger! Bil froze in place. His pulse quickened; his muscles tightened; his pupils dilated to help him see the tiger in the fading light. His mind was filled with a single thought: "Me no cat fud." Unfortunately, this one thought crowded out all the other thoughts—including his recently completed mental note. He turned, took two steps, hit the loose rocks, and fell to his death. Life really was nasty, brutish, and short in those days.

As strange and tragic as Bil's death seems to us today, safe as we are from wild animals, there are some important parallels between Bil's experience and our own experiences with bear markets. First, bear markets are aptly named. Like real bears and saber-toothed tigers, you don't want to run into a bear market. They are scary.

Second, like Bil, when you do encounter a bear market, you basically have two choices. In Bil's case, the choices were to fight or run. In our case, the choices are "hold" (fight) or "sell" (run).[125]

Third, that second option—sell in our case, run in Bil's—*seems* the safer choice. But in fact, it comes with its own dangers—loose rocks in Bil's case, the difficulties of finding a market reentry point in ours. These dangers are nowhere near as scary as a saber-toothed tiger, or a growling bear market, but they can be just as great a threat to your portfolio.

And finally, like Bil, when confronted with a bear market, many of us are more likely to panic and flee the market rather than *think* before we act. Had Bil *thought* about his predicament before acting, he might have reached a different decision. First, instead of forgetting everything, except the tiger in front of him, he might have remembered his mental note and realized that escape back down the ledge was a treacherous option. And second, he would have realized that standing his ground wouldn't necessarily have led to his becoming cat food. He had his spear, his shield, and Dog (who was actually closer to a wolf than a modern dog and a pretty good match for saber-toothed tigers). Staying and fighting couldn't have turned out any *worse* than his decision to flee.

Panicking is a natural reaction to saber-toothed tigers—and to bear markets. The scientific term for the panic Bil felt is the fight-or-flight response. When it is triggered, the stress hormones adrenaline and noradrenaline are released, the heart beats faster, muscles tense in preparation for either fighting or fleeing, and, most importantly, the brain shifts its focus from all other tasks to the perceived source of danger. Back in Bil's time, when humans regularly faced the prospect of winding up as cat food, the fight-or-flight response usually worked to keep our ancestors alive. But Bil faced *two* dangers: a saber-toothed tiger in front and loose rocks behind. Only one of these dangers was scary enough to trigger the fight-or-flight response, and once it was triggered in Bil's rather small brain, his total focus on the tiger caused him to forget all about the danger behind. In the *complex* situation Bil encountered, the fight-or-flight response betrayed him.

Today, when the danger posed by wild animals has been replaced by the danger of tight deadlines, rush-hour traffic, and market crashes, the fight-or-flight response often does us more harm than good. It raises our stress level, clouds our thinking, and causes us to make snap decisions we later regret. Our modern environment is often too *complex* for our ancient instinctual responses. What we need to make the right choices in the face of this complexity is cool, calm, rational analysis, not panicky split-second decisions.

This is especially true in the complex environment of the securities markets. Like Bil, investors often face dangers both in front and in back. And like the saber-toothed tiger, the danger in front is often scarier, but the danger behind is usually worse. During a bear market, a decision to hold will likely result in a major, but *temporary*, loss. A decision to sell may reduce the size of the loss, but it will also likely make the loss *permanent*. This is especially true if the sell decision arises out of fear or the outright panic felt during the fight-or-flight response. To understand why, we need to review some of what we learned about market timing in the last chapter.

"Rational" Market Timing versus Panicking

We have already seen that market timing doesn't work. As practiced by active mutual fund managers, it might improve short-run returns, but it results in lower returns over the long run. Still, for fund managers and other professional traders, market timing may be a perfectly *rational* strategy. The pros are often judged primarily by their short-term results. Hence they may be more than willing to sacrifice long-term profits for short-term gains. Furthermore, fund managers and other pros have less reason to panic during a bear market than you or I, for one simple reason: it's not *their* money that's at risk. It is therefore reasonable to assume that the market timing decisions made by at least some professional traders are based on reason, not emotion. Let's refer to these decisions as *rational market timing*—not because they produce superior long-run returns (they don't) but because they are based on reason.

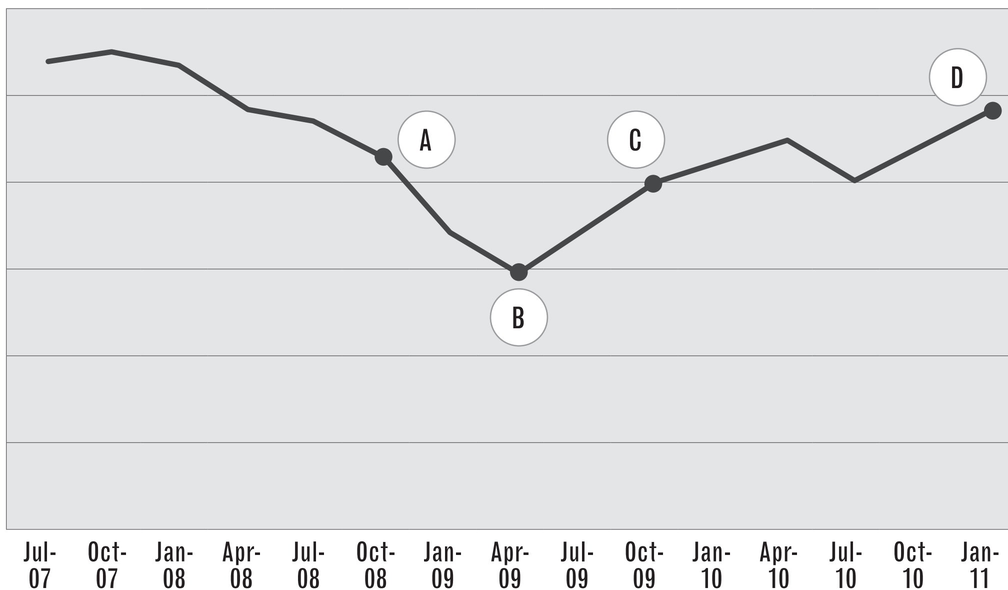
In contrast to the rational market timing practiced by at least some professionals, many amateurs sell during market downturns out of fear. In some cases, the sell decision may be an immediate outcome of the fight-or-flight response. In other cases, the investor may be able to suppress his fears for a period of time and continue to hold, until finally succumbing to his emotions. But in either case, fear rather than reason is driving the investor's decision to sell. To contrast this kind of market timing from the kind practiced by the professionals, we will refer to it simply as *panicking*.

When applied during a bear market, both rational market timing and panicking have one key feature in common: both result in a decision to *sell low*. There are only two ways this can work to the benefit of a long-term investor. First, if it takes *decades* for the stock market to return to the point at which the investor sold, then he will have avoided a loss from which he may never live to recover. But as we learned back in Chapter 8, in all of the major bear markets of the past 84 years, the U.S. stock market has recovered in a matter of years, not decades. In fact, across the globe, there are very few examples of developed-market countries that have experienced down markets lasting longer than a decade. It *is* true that the Japanese stock market has as yet failed to recover from a downturn that began in 1990, but the Japanese experience is the exception, not the rule. And as long as an investor holds a globally diversified portfolio of U.S., developed-market, and emerging-market stocks, it would take simultaneous, decades-long downturns in multiple countries to keep the investor's portfolio from recovering in fewer than ten years. This is not likely, and if it *does* happen, it may be the result of some catastrophe far worse than an economic downturn, such as a global military conflict or environmental disaster. In the event of such a catastrophe, the money saved by timing the market may prove worthless, and we will have much bigger things to worry about than retirement.

Assuming a normal recovery time, the only way a market timer who sells low during a bear market has a chance of benefitting from this move is by subsequently buying even lower. This is illustrated in Figure 17.1, which is a graph of the S&P 500's total returns from July 2007 to January 2011 (with the numbers removed for

simplicity). Let's imagine an investor with an S&P 500 index fund who sticks with a buy-and-hold strategy through the early months of the 2007–9 bear market, only to panic and sell her fund at the beginning of October 2008 (point A in the figure). If she then waits to buy back her fund until the market has risen above point A—say, to point D—then she will have *permanently* lost the returns yielded by the market as it moved first down but then up from point A to point D. True, by selling, she would have avoided the additional losses incurred by the market between points A and B. But these losses were temporary. By selling at point A and buying at point D, she has permanently locked in a large portion of her losses.

Figure 17.1. Market Timing during the 2007–9 Bear Market



Of course, if instead of buying back her index fund at point D, our hypothetical investor instead bought it back at point C, then she will have sold low but bought even lower. In this case, not only would she have avoided the temporary losses the market experienced as it moved from point A to point B but she would actually have *gained* the returns the market yielded as it climbed from point C back to the same price level as point A.

There's only one problem. Any investor who would have panicked and sold her stocks at point A is highly unlikely to have bought back at point C, or at any other point below point A. Rather, she would have waited until the market climbed back to point D or to some other point above point A—and by waiting, she would have permanently locked in her losses. How can I be so sure of this? The stock market is a mechanism for pricing expectations about the future. At points B, C, and all other points below point A, the market has priced the S&P 500 below its point A price. A lower price means that the millions of investors comprising the market have looked

into the future and found it to be *bleaker* than it appeared at point A. If the market was worried about the future at point A, then it was even more concerned at point B. The market's increasing worries as we moved from point A to point B were reflected in a slew of bleak predictions of recession and even depression, published not only by the financial media but also the mainstream media between autumn 2008 and spring 2009. Even after the price rise between point B and point C, the market still had not reached the point A price level. And in fact, as we moved up from point B to point C, the media was filled with predictions of a double-dip recession. Many media reports predicted that the second leg down would be worse than the first.

If an investor, at point A, found the future to be so scary and bleak she abandoned buy and hold and sold her stocks, how likely is it that she would have bought them back at point B, C, or some other point below point A, when the future appeared even worse? Investors who succumb to the fight-or-flight response and sell in a panic are faced with an agonizing decision: *when* is it safe to buy stocks again? Such investors usually wait until the future looks much brighter and the market has risen well above the point at which they sold. This is certainly what we saw in the wake of the 2007–9 financial crisis. Far from repurchasing their stock funds while prices remained low, investors were *still* fleeing from equities in 2012—three years into the subsequent bull market. Between 2008 and 2012, investors in the world's ten largest economies sold $1.1 trillion worth of stock mutual funds, while adding $1.3 trillion to bond mutual funds.[126] Investors who sold their stocks in 2008 and waited until 2013 or later to repurchase them missed out on the 129 percent returns produced by the S&P 500 between the market bottom on March 9, 2009, and December 31, 2012. The retirees among these latecomers wound up increasing, rather than reducing, their risk of bankruptcy.

And just in case you don't quite believe that panicking and selling in a bear market is the financial equivalent of Bil's short trip over the cliff, consider this question. If fund managers and other professional traders lose money in the long run by practicing *rational* market timing, how in the world could you possibly avoid losing money with an *irrational, fear-driven* approach to market timing? When it comes to investing, decisions based on fear, or greed, are deadly. You must learn to suppress your emotions, your primitive fight-or-flight response, and act (or, more correctly, *not* act) based on reason and *the courage of your convictions*.

The Pledge

I hope at this point you have no doubt that market timing, whether based on fear or greed, is a losing proposition. If you are not *convinced* of this point, you should not even attempt to implement a buy-and-hold strategy. Make no mistake, buy and hold will test your nerves during bear markets and your patience during bull markets. You must be absolutely convinced that holding rather than selling is the *logical* thing to do or you *will* abandon buy and hold at the worst possible time.

But even if you are completely convinced of the logic behind buy and hold, unless you have ice water running through your veins, that won't be enough to protect you from yourself when the market goes into a tailspin. Our instinct is to protect our savings as we would our lives. In fact, for a few, money is more precious than life itself—as evidenced by those who committed suicide when they lost their life savings in the 1929 Crash. According to AARP, most people fear running out of money in retirement more than they fear death.[127] Reason is no match for the dread of losing everything. Like Bil the Caveman up on the cliff, we forget all about the danger behind us when the stock market bear rears up in front of us.

But let's consider a modification to Bil's story. Let's suppose that instead of being alone, Bil's wife and children were in front of him on the ledge, and the tiger was about to pounce. Would Bil still have turned and run, or would he have decided to fight to save his family? And let's also suppose Bil's entire tribe stood behind him, encouraging and pressuring him to fight. Would that have made a difference in his decision?

Your chances of facing down a bear market alone are poor. Conviction that holding is the rational, logical thing to do isn't enough. To face your fears, you need the *courage* of your conviction. And one way to bolster courage is to seek the support of your family and your peers. Let's now consider how this can be accomplished.

Seeking the Support of Your Family

Chances are you aren't the only one who has a lot riding on your investment decisions. If you are married, both you and your spouse face the retirement risk together. If you have children, it is they who may need to step in and provide for you if you outlive your money. This may in turn compromise their ability to provide for their own children or to save for their own retirements. I don't think many people retire with the goal of becoming a financial burden on their families. On the contrary, you would probably like to remain financially independent for the rest of your days, and maybe even leave a legacy to your heirs.

Given that your family members have a significant stake in the success of your retirement, you have a *responsibility* to them to try to hold true to your investment convictions. Making a promise to them, in writing, may help you to meet this responsibility. What I am suggesting is that you prepare and sign a written statement, pledging to your family to do your best to avoid making investment decisions based on emotion. If you are married, both you and your spouse could sign the pledge. The pledge might also be witnessed and signed by those of your family members old enough to understand the promise you are making.

Such a written pledge may give you the strength you will need to stand up to your fears during raging bear markets and to prevent greed from clouding your judgment during bull markets. Exhibit 17.1 provides an example of a "Rational Decision-Making Pledge" for a retired married couple. Let's go over some of the features of this pledge.

The first two sentences set forth the couple's reasons for making the pledge. Like this example, your pledge should also include an explicit statement of the risks of failing to adhere to a buy-and-hold strategy, not only to yourself but to the rest of your family. You will need to reread your pledge when you're tempted to break it, so having a reminder of why, and for whom, the pledge was made is very important.

Exhibit 17.1. Example of a Rational Decision-Making Pledge for a Retired Married Couple

RATIONAL DECISION-MAKING PLEDGE

We understand that when it comes to investing, decisions based on emotion may cause us to abandon buy and hold in favor of market timing or performance chasing. Market timing and performance chasing reduce returns in the long run, increase the chances of bankruptcy, and put not only our own retirements but the financial well-being of our children and grandchildren at risk. We, (your name here) and (your spouse's name here), hereby pledge to each other, to our children (child's name here) and (child's name here), and to our grandchildren (grandchild's name here), (grandchild's name here) and (grandchild's name here), that we will strive, to the best of our ability, to avoid emotionally-based decisions and instead follow a rational investment decision process at all times. To help us in this endeavor, we also promise that, whenever we are tempted by fear or greed to abandon our buy and hold approach to investing, we will follow the 6-Step Process described in Chapter 17 of *The Death of Buy and Hold*. To confirm that we have completed the 6-Step Process we will fill out and sign the checklist presented in Exhibit 17.2 of that same book. We will complete the 6-Step Process and checklist however often may be necessary to avoid the temptation of emotional decision making.

Signed:

(Signature)	(Date)
(Signature)	(Date)

And witnessed by our adult children:

(Signature)	(Date)
(Signature)	(Date)

Notice that the pledge does *not* actually commit the couple to following the buy-and-hold approach. Rather, it commits them to trying to avoid the kind of emotional decision making that often results in the abandonment of buy and hold. This is an important distinction. There are certain situations where you may in fact have to deviate from buy and hold, temporarily, to protect either the health of your portfolio or you or your spouse's physical and mental health. But these situations can and should be identified and acted upon based on reason, not emotion. The Rational Decision-Making Pledge commits you not to buy and hold per se, but to a rational decision process to determine if and when you should deviate from buy and hold.

Finally, the pledge commits the couple to following a "Six-Step Process" and to filling out a checklist confirming completion of this process. We will learn all about the Six-Step Process and accompanying checklist later in this chapter. For now, all you need know is that the Six-Step Process is intended to help you make rational investment decisions and to calm yourself so that you can more easily maintain your commitment to buy and hold if you decide against selling.

You can use Exhibit 17.1 as a starting point for writing your own pledge. Note that even if you are single and childless, you can still make a written promise to yourself like that shown in the exhibit. However, if you do not have a family to fall back on for support—and even if you *do* have a family—you may want to seek the support of your peers. Bil the Caveman would have felt braver facing off against the tiger if his tribe had had his back. You might similarly feel more courageous facing down bear markets with your "tribe" behind you.

Seeking Peer Support

The example pledge shown in Exhibit 17.1 can be easily modified to accommodate a group of friends or like-minded investors. You might, for example, form a buy-and-hold investment club for the express purpose of providing peer support and encouragement to club members during trying times. Each member of the club could sign a club pledge to strive to avoid emotionally based investment decisions. Regular club meetings would provide the group with an opportunity to help and encourage each member to stay true to the pledge. Members could share their own techniques for reducing stress during market routs, tuning out the financial media, avoiding the temptations of performance chasing and market timing, and staying the course.

The Six-Step Process

Making a written pledge to yourself, your significant other, your children, your friends, or your fellow investment club members is a positive step you can and should take when the market is calm and you are thinking clearly and rationally. But making

a pledge to follow a rational investment decision process isn't enough. You also need some way to help you *uphold* your pledge when a raging bull market or terrifying bear market comes along and you *can't* think straight for greed or fear. In this section, we will learn the Six-Step Process that you should promise to try to follow as a part of your pledge. The purpose of this process is to give you the inner calm and strength you will need to (1) avoid emotional decision making and (2) continue to follow the buy-and-hold approach whenever a rational analysis of the risks to your portfolio and your health warrant that approach. The six steps are simple to remember and can be summarized in just a few words, as follows:

1. **Stop!** (and calm yourself)
2. **Check Your Portfolio's Health** (Decision Point 1)
3. **Motivate Yourself**
4. **Seek (and Give) Useful Support**
5. **Tune Out Harmful Noise**
6. **Check Your Health** (Decision Point 2)

Let's now go over each of these steps.

Step 1: Stop!

You should *never, ever* buy or sell investments on an emotional whim. As soon as you feel yourself panicking during a market sell-off, or getting excited when the market's being irrationally exuberant, *do not act on your feelings*! Instead stop, take a deep breath, and calm yourself down. Meditate, take a long walk, go fishing, hit a bucket of golf balls—do whatever helps you to calm down.

Step 2: Check Your Portfolio's Health (Decision Point 1)

Once you've calmed down, the next step is to think through, rationally, what you should do. If you are in the midst of a bull market and are sorely tempted to dump your underperforming investments so you can chase performance, remind yourself of the dangers inherent in the greater fool theory of investing. (If you don't remember, go back and reread Chapter 16.) Consider what will happen if you sell your bonds and high-volatility hedges and the market suddenly turns and takes a dive. Consider

what *did* happen to the many investors who got caught up in the irrational exuberance of the tech bubble, only to see their savings vanish when the market crashed in 2000. Remember that mean reversion is one of the most powerful forces at work in the market, and whatever high-flying stock, fund, or sector you jump on *will* reverse and fall back to earth. Finally, understand that what matters to your financial safety is *not* what the market's doing but how *your portfolio* is holding up. As long as you are not losing massive amounts of money (a highly unlikely situation in a bull market), you must come to the only rational conclusion you can and stick with buy and hold.

If instead of a bull you are face-to-face with a raging bear, step 2 is a little more complicated. There *are* situations in which it may possibly be better to act rather than to do nothing, to avoid a potential catastrophic loss. To determine whether you face such a dangerous situation, you will need to take the temperature of your portfolio. We will learn how to do this in Chapter 18. But briefly, you take your portfolio's temperature by calculating your current withdrawal rate and comparing it with a low-risk withdrawal rate you will select from the tables in Chapter 18. If your current withdrawal rate falls below the selected maximum actionable withdrawal rate (MAWR), then you should do nothing.

Note a key implication of this approach. If you are not yet retired or fewer than five years from retirement, your withdrawal rate should be zero. A zero withdrawal rate will always fall below your MAWR. Hence your portfolio should be able to recover from its losses *and you should do nothing*. Only those investors who are already retired or near retirement *may* encounter a situation in which it might possibly be better to take action than hold. (Investors within five years of retirement should calculate their current withdrawal rate using an estimate of their expected living expenses in the first year of retirement.)

If you are retired or nearing retirement and your current withdrawal rate rises to your MAWR, then there is a hierarchy of actions you should follow to protect your nest egg. Before abandoning buy and hold, you would first take steps to reduce your withdrawal rate. Such steps might, for example, include reducing your expenses or taking a part-time job until the bear market ends and the danger subsides.

If, after taking all possible steps to reduce your withdrawal rate, the market decline continues and your withdrawal rate once again rises to your MAWR, you will need to sell your stock investments. However, in this situation, you will be making the sell decision based on a rational analysis of the dangers facing your portfolio rather than an irrational response to fear. Furthermore, using the approach outlined in Chapter 19, you will have a decent chance (though not a guarantee) of timing your reentry into the market in such a way as to improve your portfolio's odds of survival.

If, after taking your portfolio's temperature, you find that your current withdrawal rate is less than your MAWR, then the rational decision is to hold. Understand,

though, that this decision is by no means irrevocable. You can and should retake your portfolio's temperature frequently during a bear market. Each time you make a decision to hold rather than sell, that decision applies only until the next time you test your portfolio's temperature. You are committing yourself on a contingent basis to holding. If the temperature of your portfolio continues to rise, you will have many opportunities to reconsider your decision.

It is hoped that each time you calculate your portfolio's current withdrawal rate and find that it remains outside the danger zone, this knowledge will have a calming effect on you. And when you decide, based on this knowledge, to continue holding, then the understanding that you may revisit this decision as often as you like should help you to live with the decision. A revocable decision should be much easier and less stressful to make than an irrevocable one.

Step 3: Motivate Yourself

Assuming that you have completed Step 2, and that your current withdrawal rate remains below your MAWR, you now know that you are not inside the danger zone. This knowledge, however, is unlikely to completely quiet your fears. Therefore you must take action to screw up your courage—to motivate yourself to stick with the buy-and-hold approach. The place to begin this motivational effort is with your written pledge. Take your pledge out and carefully reread it. Think about each of the people—your significant other, each of your kids, each of your grandchildren—to whom you made the pledge. Realize that each of them is depending on you to do the right thing, the rational thing, the responsible thing—which in step 2 you have determined to be hold, not sell. Think about what might be the impact on each of them if you *fail* to hold. You may permanently lock in your losses, thereby increasing your risk of becoming a financial burden to them. This may in turn affect your children's ability to provide for their own families, to fund their kids' education, and to save for their own retirements. If it helps to motivate you, think of the bear market as a saber-toothed tiger, and imagine that you are up on Bil's ledge with your family in front of you. Then ask yourself, should you flee and leave your family to the tiger, or should you stand your ground and protect your loved ones?

Do not be afraid to get emotional in step 3. Step 3 is all about calling on the *right* emotions to overpower the *wrong* emotions. If reason alone were enough to counteract the strong emotions elicited by market crashes and market bubbles, there'd be no need for any steps beyond step 2. But for many people, reason is *not* enough. You must counteract the greed or fear triggered by the market with the similarly strong emotions you feel toward your loved ones. Remember, it is your responsibility to *protect* them as well as yourself from the financial mistakes you will be sorely tempted to make.

Step 4: Seek (and Give) Useful Support

Military commanders have known from time immemorial that a soldier's courage will be enhanced if he is part of a tight unit and can count on the morale-building support, and peer pressure, of his comrades in arms. Similarly, you can bolster your courage by seeking the support of family, friends, and peers. If you are married, you can look first to your spouse, who (should have) signed the same Rational Decision-Making Pledge you signed. Confide in and support each other.

If you are a member of an investment club committed to the buy-and-hold approach, seek out the support of your fellow club members whenever you feel yourself wavering in your own commitment. Providing support during both bull and bear markets should be the number one purpose of such clubs.

If forming or joining such a club is not an option for you in your area, there is good news. A group of like-minded investors already exists on the Internet. You will find them at the Bogleheads investment forum. The Bogleheads are so named in honor of John Bogle, the founder of the Vanguard Group and longtime champion of index investing. Bogle launched the Vanguard 500 fund (VFINX), the first successful index fund, back in the 1970s and has written extensively on the advantages of buying and holding a simple portfolio of low-cost index funds.[128] The Bogleheads take their inspiration from Bogle's teachings and provide investing and other financial advice for all those who post questions on their website.[129] They boast among their members a number of finance professionals, and their investment advice consistently exhibits to a high degree the same deep financial knowledge, savvy, and common sense that characterizes Bogle's own advice.

Most importantly, the Bogleheads as a group are committed to the buy-and-hold approach and to encouraging each other to "stay the course" during tough times. Indeed, the Bogleheads' existence is proof that buy-and-hold is *not* dead. You must be a member of the website to post questions and replies, but membership is free and it's easy to sign up. Once a member, you will have an online support group that will address your every fear and concern about the market with insight and wisdom, while challenging, encouraging, persuading, and admonishing you to stick with buy and hold through thick and thin. I encourage you to check out their website and sign up.

While seeking support from your spouse, your friends, fellow club members, or others, don't neglect to give support as well. Not only will you be helping others to stay the buy-and-hold course but *you too* can gain courage and inner calm from your own words of strength and wisdom.

Step 5: Tune Out Harmful Noise

"STOCK SHOCK FELT ROUND THE WORLD.
Gets 'nasty' as Lehman tanks, Merrill vanishes, AIG wobbles"[130]

"Depression Coming? Boil Some Beans; Ladies Who Quilt Give Tips on Surviving Tough Times"[131]

"'Great Depression' closer than U.S. admits, report finds"[132]

"Will Bush become the new Hoover?"[133]

"Depression seen possible"[134]

"Behind Closed Doors, Warnings of Calamity"[135]

These are just a few of the dire headlines that greeted us from newsstands and websites during the dark days of September 2008. What better way to grab your attention, and sell you a newspaper, than with dire warnings of impending doom printed in big, bold letters? But while newspapers and magazines with these kinds of headlines may make you *want* to buy them, do you really *need* to buy them? Most of these headlines don't even convey actual facts. Rather, they are merely speculating on *possible* futures. Instead of useful news, what the media is often selling is at best useless noise. Of course, we now know that a depression was *not* in the offing, Bush did *not* become a new Hoover, and the quilting ladies were probably not reduced to a diet of beans. Given that none of these terrible things actually came to pass, would reading about them back in 2008 have made you any wiser? Or would it just have scared you into overreacting and doing something dumb?

If you are a buy-and-hold investor, *none* of the economic news, forecasts, and tips you read about in magazines, or hear on CNBC, will help you decide what you should or should not do during a market crash. The *only* factors that should matter in your decision process are how *your portfolio* and *your health* are holding up. If in step 2 you determine that your current withdrawal rate is still inside your safe zone, then the rational decision is to continue to hold—no matter how many stock market gurus on CNBC are predicting the end of civilization as we know it. If in step 4 your investment club, or the Bogleheads, have responded to all your concerns and calmed your nerves to the point where you can continue to hold, what will be gained by reading an article in your local paper that reawakens all the anxieties you worked so hard to quell?

We are all tempted to slow down and look when we pass a highway accident, but if you do, you'll at best just make the traffic jam worse, and you probably won't be able to see anything anyway. In the worst case, you *will* see something—and be sorry you did. The smarter move is to keep your eyes on the road ahead and speed away. So it is when it comes to the financial, and even mainstream, media during market crashes. Instead of tuning in to the latest dire predictions or advice about how to boil beans, the wiser move is to *tune out* all so-called news that is likely to cause anxiety and make it harder for you to stay the buy-and-hold course. When the market goes into a nosedive, or turns into a bubbly froth, cancel your subscription to *Forbes,*

turn off CNBC, and walk rapidly past the corner newsstand with its headlines warning of Armageddon or promising Utopia. Instead of the newspaper, read a good book—it's more enjoyable, and you'll probably learn a lot more, too. Don't worry about being out of "the know" for a little while. You can catch up on the latest economic and financial news after the danger has passed and calm is restored to the markets.

Step 6: Check Your Health (Decision Point 2)

The Six-Step Process has two goals: (1) to give you a way to make a *rational* decision about whether to continue holding and, (2) *if* your decision is to hold in step 2, to reduce your stress level to the point where you will be able to safely follow through with this decision. In steps 2–5, the knowledge you gain that your withdrawal rate remains in the safe zone; the support of your family, friends, and fellow investors; and the avoidance of anxiety-inducing noise from the media should all combine to help ensure that the stress-reducing goal of the 6-Step Process is met.

However, it is possible that you will reach a decision to hold in step 2 but will *not*, despite your best stress-reducing efforts, be able to live with this decision without putting your health at risk. If you find yourself (or your significant other) in this situation, you *must* sell your stocks. Your health always comes before your money. You will not be doing yourself, or your family, any favors by giving yourself a heart attack. For that matter, you will not be doing your nest egg any good if you wind up with a big bill for an extended hospital stay. Allowing your anxiety to skyrocket to dangerous levels in an attempt to protect your savings is self-defeating behavior. It is for this reason that the Rational Decision-Making Pledge commits you only to completing the 6-Step Process, *not* to sticking with buy and hold if it endangers your health. If you complete the process in good faith and to the best of your ability, you have kept your promise to yourself and your family. If at the end of step 5 your stress level remains too elevated to allow you to safely continue holding, this is not a failure on your part but rather an indication that your portfolio's asset allocation is too aggressive for your personality. As is made clear back in Chapter 11, finding the right stock/bond mix to fit your risk tolerance level may take more than one try. It's OK if you find out, during a market crash, that you allocated too much of your nest egg to stocks, as long as you learn from this mistake and reduce your stock allocation going forward.

The last step of the 6-Step Process commits you to checking your stress level and making a *rational* decision as to whether you must abandon buy and hold, temporarily, for the sake of your (or your significant other's) health. It might seem that in step 6 you are making a decision based on emotion rather than reason, but this is not the case. Rather your goal is to make a decision based on a *rational* analysis of your *emotional* state and the implications for your health. Of course, there will be a good deal of judgment involved in evaluating your anxiety level and your ability to handle that anxiety. If you are unsure about what to do, a visit to your family doctor may

help you decide. If you are still in doubt even after consulting with your physician, you should err on the side of caution and choose to sell rather than continue holding.

The Checklist

In addition to following the Six-Step Process, your Rational Decision-Making Pledge should commit you to *documenting* the specific actions you've taken, and the decisions you've made, at each step along the way. Exhibit 17.2 is an example of a checklist you (and your significant other) can use to document your actions and decisions. To check off a particular step, you must be able to document at least one concrete action you've taken to meet that step's goals. The checklist is intended to keep you honest and eliminate any wiggle room you might otherwise have to avoid the work required by the Six-Step Process. With the checklist as part of your pledge, you can't simply tell yourself that you've finished one of the steps if you cannot describe, in writing, what you've actually done.

Use the Six-Step Process (and Accompanying Checklist) as Often as Necessary

When you encounter a major bull or bear market, you may want to make *multiple* copies of the checklist in Exhibit 17.2. During a long bull market, you will likely face the temptation to deviate from your buy-and-hold strategy more than once. During a lengthy bear market, fear may often tempt you to sell. Your pledge should commit you to completing the Six-Step Process *each time* you are tempted to deviate from your buy-and-hold strategy; you should complete the accompanying checklist every time you complete the Six-Step Process. The Six-Step Process and accompanying checklist should help you control and reduce your anxiety each time you use them.

The Play Account

The Rational Decision-Making Pledge, 6-Step Process, and accompanying checklist should help you navigate the temptations posed by rising as well as declining markets. That said, our discussion has focused more on controlling the fear that arises during bear markets. This focus reflects the findings of behavioral finance, which indicate that loss aversion is a more powerful motivator than the desire for gain. But that is not to say that greed is not a powerful, difficult-to-control emotion in its own right. When the stock market is going gangbusters, fear wanes, our inner John Stockman comes to the fore, and we are tempted by visions of striking it rich. So before we leave the subject of how to do nothing, let's touch on one last technique that is geared more toward staving off our inner John Stockman than our Joe Bondsman.

Exhibit 17.2. Example Checklist for the Six-Step Process

6-STEP PROCESS CHECKLIST

Instructions: Place a check next to each step as you complete it. For Steps 1, 3, 4, and 5, document the specific actions you have taken to complete each step. For Steps 2 and 6, document the decisions that you made.

❒ **Step 1: Stop! (and calm yourself)**

Describe the specific actions you took to calm yourself that helped you to continue holding: ______________________________

❒ **Step 2: Check Your Portfolio's Health**

Check the Step 2 decision you reached on the list below, and the reason(s) for that decision:

- ❒ Continue to hold, since my (our) portfolio did not experience any investment losses (bull market)
- ❒ Continue to hold, since I am (we are) not yet retired or near retirement (hence my/our withdrawal rate is zero and safe)
- ❒ Continue to hold, since my (our) current withdrawal rate of ___% is less than my (our) Maximum Actionable Withdrawal Rate (MAWR) of ___% specified in my (our) Investment Plan
- ❒ Continue to hold, because although my (our) current withdrawal rate of ___% has risen to the MAWR of ___%, I (we) have taken steps to reduce my (our) withdrawal rate by reducing expenses or increasing non-investment income
- ❒ Sell my (our) stock mutual funds and ETFs because my (our) current withdrawal rate of ___% has risen to the MAWR of ___%
- ❒ Other (explain): ______________________________

❒ **Step 3: Motivate Yourself**

Describe the actions you've taken to complete Step 3:

- ❒ Re-read my (our) Rational Decision-Making Pledge
- ❒ Thought through potential impacts to family members of failing to hold
- ❒ Other (describe): ______________________________

Exhibit 17.2. Example Checklist for the Six-Step Process (continued)

❒ **Step 4: Seek (and Give) Useful Support**

List those fellow buy-and-hold investors to whom you turned to for support, or gave support to:

❒ Spouse
❒ Other family members (Provide names): ____________________
❒ Friends/Peers (Provide names): ____________________
❒ Investment club members
❒ Bogleheads online forum
❒ Others (Provide Names): ____________________

❒ **Step 5: Tune Out Harmful Noise**

Describe the specific actions you took to tune out noise:

❒ Stopped watching (or continued to stop watching) the financial news networks
❒ Stopped reading (or continued to stop reading) news about the stock market
❒ Other (describe): ____________________

❒ **Step 6: Check Your Health**

Check the decision you reached on the list below:

❒ Continue to hold, because I (we) judge that my (and my spouse's) current stress level does not put my (and/or my spouse's) health at risk
❒ Sell all stock mutual funds and ETFs, because I (we) judge that my (and my spouse's) current stress level puts my (and/or my spouse's) health at risk
❒ Other (explain): ____________________

If you find yourself frequently tempted to roll the dice by chasing performance, timing the market, or trying to discover the next Microsoft or Apple, then allow yourself to indulge these desires—within strict limits. Set up a brokerage account separate from your other accounts and funded with a *small* percentage of your nest egg. This will be your play account, which you can use to pursue any short-term trading strategy, hot stock tip, or get-rich-quick scheme that grabs your fancy. Use your play account to let off steam, have fun, and play the stock market, while you follow a strict buy-and-hold approach in your main retirement accounts. If your play account makes you rich, fantastic! If not, it will at least give you the chance to get your wilder ideas and strategies out of your system.

There are a few rules you need to follow if you do decide to set up a play account. First, you must limit the funds you deposit in the account to an amount you can afford to lose. One to 2 percent of your retirement nest egg is a reasonable amount, and certainly no more than 5 percent. Second, you must limit all experimentation, short-term trading, and stock picking to your play account, while following a strict well-diversified, buy-and-hold strategy in your main accounts. Third, you cannot count money in your play account as part of your retirement nest egg, because you are essentially gambling with this money, and it may not be there when you need it. Should you eventually decide to close your play account, you can then add any money remaining in the account to your retirement nest egg. Fourth and finally, you must not add any additional money to the play account after you open it with your initial funds. *This last rule is very important.* If you start adding funds to your play account, you run the risk of slowly (or quickly) draining your retirement savings on a series of long-shot gambles. If you happen to lose all the money in your play account, you must close the account—once your play money is gone, it's gone for good.

While a play account should prove particularly effective in helping you to deal with the desires that arise during bull markets and bubbles, it may also help you control your fears. Remember, you can do anything you want with the money in your play account, and that includes using trading strategies and derivatives to hedge your main accounts. If, for example, you are worried that the stock market will crash, you can sell the stocks in your play account and use the proceeds to short the market or buy put options.[136] If your hedging trades pay off, you can then transfer the profits from these trades to your main retirement accounts to offset your losses. (Although you should not add more money to your play account once it has been funded, you can always *withdraw* money from this account.) In this way, your play account gives you an opportunity to time the market, without doing damage to your main retirement accounts.

A Brief Word on Rebalancing

Doing nothing in the midst of a market crash or raging bull market is one of the hardest things you will ever have to do. But there is one thing that is even harder: rebalancing. Yes, rebalancing gives you an opportunity to buy low and sell high. But this is precisely why it is so hard to do. During a bull market, it just *feels wrong* to pull money out of high-flying investments, only to put the money back into laggards. And it can be scary, in the extreme, to sell your safe bonds and rebalance into stocks during a bear market.

What, then, should you do if it is time to rebalance but you are already having a lot of emotional difficulty just holding? In this situation, concentrate on holding, and postpone rebalancing until the markets—and you—calm down. Chasing performance during a bull market or panicking and selling your stock funds during a bear market are big mistakes. But failing to rebalance on time is more a missed opportunity than a major mistake. If your emotions are under control and you are able to hold with little difficulty, then by all means try to rebalance your portfolio. If need be, use the 6-Step Process to help calm your nerves as you take on the rebalancing effort. But if you are already struggling with the stress of holding, do not add to that stress by attempting to rebalance. Instead, give yourself a break.

However, if you are a retiree and the stock market is crashing, you *should* rebalance on the go by taking your withdrawals from your bond portfolio rather than your stock portfolio. When the market has weakened your stock portfolio, it is very important to avoid selling shares of your stock funds. This will only further weaken your financial situation and make recovery that much longer and more difficult.