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A sloth's guide to surviving a week of market volatility
By Tim Harford
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What happened in the markets this week? That depends on how often you were looking. It was a brutal Monday — the S&P 500 was down more than 4 per cent, the worst day on the market for more than six years.

Tuesday continued the rout — at least at first. But anyone who had paused for a leisurely coffee on the way to the office might have wondered what all the fuss was about: by 9.25am on Tuesday morning, New York time, the S&P 500 was up 2 per cent from the opening plunge. After various adventures, Tuesday ended up the best day in more than a year.

Twenty-five minutes for coffee is a very long time in the life of a high-frequency trading algorithm, with trades timestamped with an accuracy of one-ten-thousandth of a second. A casual investor, though, can blink and miss it.

A few months ago, my wife asked me for advice about where to invest some money on behalf of her family. I was concerned that stocks seemed rather expensive and advised caution. My words of warning rang true this week, when it has felt like a time to be cautious — but the truth is that over a six-month timescale my advice cost her money.

Most investors should operate closer to that six-month timescale than to the frenetic fast-twitch world in which a coffee break lasts an eternity. Given the choice between investing fast or slow, the slower the better.

This is partly for the sake of sanity. The concept of "loss aversion" was developed by two founding figures in behavioural economics, Daniel Kahneman and Amos Tversky. Their experiments showed that we tend to find a modest loss roughly twice as painful as an equivalent gain. (Ponder the annoyance of losing £10 against the pleasure of finding £10 and you may agree.)

If you check the market every day, you will find it is down very nearly as often as it is up, and the pain of the downs will tend to outweigh the joy of the ups. But if you check less frequently you will have more reason to smile: unlike good days, good years are almost three times more likely than bad ones. Slow investing feels better.

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Slow investing may also be more lucrative, at least for those of us who lack the technology to compete at the microsecond level. One laboratory study — by Mr Kahneman, Tversky, Alan Schwartz and last year's Nobel laureate economist Richard Thaler — invited participants to make investment allocation decisions over 200 "turns", each meant to simulate a few weeks of real investment. Some were allowed to reallocate every turn after observing what had just happened. Others had to wait and decide whether to reallocate after seeing the accumulated return over either eight or 40 turns, simulating months or years without peeking at the portfolio.

Those who were forced to evaluate and decide at a slow pace were — like real investors — less likely to witness losses. As a result, they were not intimidated by short-term fluctuations. They chose less conservative investments and could expect bigger profits.

Research into the behaviour of real-world investors has reached similar conclusions. One study, by Brad Barber and Terrance Odean, looked at the investments of 65,000 ordinary retail investors in the early 1990s, a time of sharply rising markets. Messrs Barber and Odean found that the less retail investors traded, the better able they were to keep up with the market as a whole. Active traders underperformed by six percentage points a year because trading costs eroded their profits. Lazy investors made more money.

There may be a broader lesson in this. Sometimes we have a clearer view of the world when we stand back from it. In 1965, two Norwegian sociologists, Johan Galtung and Mari Holmboe Ruge, pointed out that the speed of the news cycle affects what we see as news: "To single out one murder during a battle where there is one person killed every minute would make little sense."

A newspaper that was published once every 50 years — an idea proposed by Max Roser, an economist at Oxford university — might give us a much clearer perspective of what has gone right and wrong since 1968 than a stack of daily papers. The latest headlines: the world population growth rate has roughly halved and continues to fall. In 1968, nearly one in five children died before their fifth birthday; the rate is now lower than one in 20. Annual carbon-dioxide emissions have nearly tripled. Meanwhile the financial page reports that, over the past 50 years, the S&P 500 has delivered a total post-inflation return averaging almost 6 per cent per year — a 17-fold gain.

Perhaps we slow investors should adopt a mascot. I suggest the sloth. Hanging upside-down, moving at a few metres a minute, is much like trading infrequently: it saves the costs of doing things more quickly. Sloths take almost two months fully to digest each meal — which is handy, given that they eat mildly toxic leaves that would poison them if absorbed too quickly.

Investors are reminded, all too often, that the financial world is lush with toxic get-rich quick products. A slower approach to finance makes market movements a great deal more digestible.

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