Quarterly Commentary
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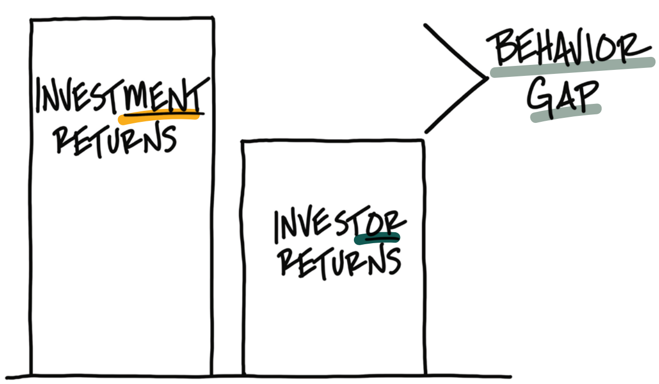
Emotional Intelligence: Why can it make you a better investor?

For more than 100 years, IQ tests and scores have represented a familiar gauge of "book smarts," with a 140 IQ as the generally accepted mark of a genius. We now know that there are many different kinds of intelligence, including one that's the subject of one of our favorite books, non-investing division. It's called "Emotional Intelligence: Why It Can Matter More Than IQ," The author, psychologist Daniel Goleman, says he was introduced to the concept of emotional intelligence (EQ) in an obscure academic journal article by two university professors, Peter Salovey (now Yale's President) and John Mayer (University of New Hampshire), who defined EQ as "the ability to perceive emotions, integrate emotions to facilitate thought, understand emotions and to regulate emotions to promote personal growth." From an investing perspective, we'd simply change the ending a bit: "to help drive long-term investment growth." We'd also argue, along with Buffett and Carlson, that when it comes to the market, EQ>IQ.

All investing is emotional, with fear and greed often as drivers of financial markets. At NewSquare Capital, we often cite the annual investor study from Massachusetts-based financial services firm DALBAR[1]. Every year, its numbers splash across the media landscape, showing how **the average equity fund investor lags the general equity market,** often significantly, decade after decade. The average equity fund investor also lags a more conservative bond index over those periods of time. Why? A big reason is emotional investment decisions, such as when fearful investors sell during market downturns, or greed drives excessive risk-taking during market upswings.



BEHAVIOR GAP

"Intelligence doesn't guarantee investment success. Warren Buffett once wrote, 'Investing is not a game where the guy with the 160 IQ [or Intelligence Quotient] beats the guy with the 130 IQ. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing.' . . . Emotional intelligence is the true sign of investment smarts."

—Ben Carlson, CFA, Director of Institutional Asset Management at Ritholtz Wealth Management, March 2024

We know that managing your emotions is a major key to being a successful investor. It's also one of every investor's biggest challenges, and, based on the evidence, is a test that people consistently fail. They don't have to—if they understand and develop EQ.

EQ can help make you a better investor (and financial advisor).

Truth is, IQ and EQ both have value when it comes to being successful in the market. IQ allows you understand and analyze asset classes, sectors, funds, stocks or what have you. EQ provides the rest: patience, discipline, perspective, and the ability to avoid rash decisions and potentially costly mistakes.

In his book, Goleman breaks EQ into five core components:

- **Self-Awareness** – the ability to understand your own moods, and how that affects others around you
- **Self-Regulation** – the ability to control certain impulses and moods
- **Internal Motivation** – the vision to pursue goals with energy and creativity
- **Empathy** – the ability to understand what others are feeling and thinking, as well as their emotions
- **Social Skills** – the ability to manage relationships and build rapport

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At least three of those are hugely important for investors *and* financial advisors. Self-awareness helps us recognize the emotions and biases we all feel, and the impact they can have on our investment decisions. We can then regulate them and make them work for us, rather than allowing them to unduly influence us. When the market, or the noise surrounding it, tries to throw us off track, internal motivation allows us to manage emotions and keep pursuing our investing goals in a disciplined way. Empathy and social skills also come into play, because understanding other investors' sentiment and emotions, together with staying informed about trends and macroeconomic factors, can help us make better decisions.

We believe the best advisors in the business have high EQ, *and* they help clients develop theirs, by recognizing when emotions may be getting in the way, reminding them of what their well-thought-out investment plan is, providing guidance and support, and driving rational choices.

Michael Batnick, Managing Partner at Ritzholz Wealth Management, is one who recognizes the importance of EQ for investors. "One thing that investors can do, and I'd guess less than 1 percent actually do this, is have a written plan before they make any investment. Having an exit plan on the way up and on the way down beforehand is a good way to minimize emotional involvement," he says.[2]

This insight into how investors' emotions can get in the way is nothing new. See what famed investor Benjamin Graham wrote in "The Intelligent Investor" as far back as in 1949[3]: "We have seen much more money made and *kept* by "ordinary people" who were temperamentally well suited for the investment process than by those who lacked this quality, even though they had an extensive knowledge of finance, accounting, and stock market lore."

The good news is, EQ isn't static. You can develop this kind of intelligence and learn how to make emotions work in your favor. Focus on understanding your emotions and recognizing when your emotions flare. Think about some decisions you've made in the past. We've all made mistakes along the way, after all. Identify the role emotions played in getting you to that point. If you need to make a financial decision, assess your emotional state, keep calm, and make the most rational decision, combining IQ and EQ. Next time, you'll likely be in a better position to embrace uncertainty as a part of investing, navigate the market's swings, assess, and manage risk, and maintain your discipline and long-term perspective.

To learn more about emotional intelligence, we recommend reading Daniel Goleman's bestselling book.

Market Review

Equities rallied in the first quarter of 2024, with the S&P 500® up 10.5%. Dow Jones Industrial Average and Nasdaq Composite finished the quarter near all-time highs. A stronger-than-expected earnings season and higher forward estimates bolstered investor sentiment, along with the continuing resilience of the consumer. While inflation data was mixed at times, the U.S. Federal Reserve continued to signal multiple forthcoming interest rate cuts, although investors repeatedly pushed back the timetable for policy easing. Large-cap and growth stocks continued to lead the rally, as did the communication services and information technology sectors. That said, we continue to see signs of broadening, with strong gains for energy—as oil prices advanced by double-digits, leading a modest upward move for the commodity complex—and financials. Ten of the 11 S&P sectors posted gains, with real estate as the lone exception. The Fed and other key global central banks left rates unchanged in March, and by quarter end, market expectations seemed to be coalescing around rate reductions in June, in both the U.S. and Europe. Global economic growth forecasts shifted higher, especially in the U.S., leading to yet another dip in recessionary expectations.

Turning to fixed income, the Bloomberg US Aggregate Bond Index finished with a return of -.8%, after a sharp rally to close out 2023, amid concerns about elevated valuations across broad swaths of the market. The yield on the 10-year U.S. Treasury bond, which reached a 15-plus-year high above 5% in October 2023, briefly dropped below 4% in late January before generally rising to close the quarter at 4.20%, as expectations for interest rate cuts faded further into 2024. High yield bonds broadly managed to post a positive return,

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while investment grade paper broadly declined but outpaced the Treasury market. Elsewhere, gold prices continued their 2023 rally and reached record highs in March, fueled in part by geopolitical uncertainty and hopes for interest rate cuts. Cryptocurrencies also rose sharply, less than 18 months after the FTX exchange collapsed, lifted in part by the launch and SEC approval of spot Bitcoin exchange-traded funds.

[1] Study source: DALBAR QAIB 2023 study, Morningstar, Inc.

[2] US News and World Report, December 13, 2016: "For Investors, Emotional Intelligence Is as Important as IQ"

[3] Benjamin Graham, 1949: "The Intelligent Investor"

Indexes referenced:

The Dow Jones Industrial Average (DJIA) is one of the best-known stock market indexes in the United States that measures the daily price movements of 30 large American companies on the Nasdaq and the New York Stock Exchange. It is widely viewed as a proxy for general market conditions and the U.S. economy as a whole.

The Russell 1000 Index is a stock market index used as a benchmark by investors. It is a subset of the larger Russell 3000 Index and represents the 1000 top companies by market capitalization in the United States.

The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and covers approximately 80% of available market capitalization. The S&P 500® Equal Weight Index (EWI) is the equal-weight version of the widely-used S&P 500®. The index includes the same constituents as the capitalization weighted S&P 500®, but each company in the S&P 500® EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

The Nasdaq-100® is a stock market index made up of 102 equity securities issued by 101 of the largest non-financial companies listed on the Nasdaq stock exchange.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index.

The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related corporate securities, mortgage-backed securities, (MBS) (agency fixed-rate pass-throughs), asset-backed securities (ABS), and commercial mortgage-backed securities (CMBS) (agency and non-agency).

Additional statistical data sourced from: Bloomberg Finance, LPL Research., Morningstar, and NewSquare Capital, LLC.

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