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McDONOUGH SCHOOL of BUSINESS

A Letter to a Young Investor

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Dear Aspiring Investor,

Recent market volatility driven by renewed tariff tensions has once again tested investors' resolve. Concerns over trade restrictions, supply chain disruptions, and their potential impact on global growth have led to sharp market swings and unsettling headlines. For long-term investors, these moments of uncertainty can feel overwhelming, but they are far from unprecedented.

History reminds us that markets have weathered trade wars, inflation shocks, recessions, and geopolitical events, only to recover and reach new highs. The short-term reaction to tariffs may create noise, but it does not alter the long-term trajectory of well-diversified portfolios grounded in sound strategy. Headlines around trade negotiations by President Trump, such as shifting rhetoric or unexpected policy reversals, have sparked extreme intraday movements, creating the perception of new buying or selling opportunities. Constant back-and-forth by the Trump Administration has created significant noise and volatility in recent days.

While each individual needs to be mindful of their tolerance for risk, their own personal investment goals and how to achieve them, panic-selling in response to headlines often leads to missed opportunities. Instead, lean on time-tested principles: maintain a long-term perspective, stay diversified, control costs, and invest regularly. Volatility is not always a signal to exit the market–it can be a reminder to stay focused on your financial goals, even when the path ahead feels uncertain.

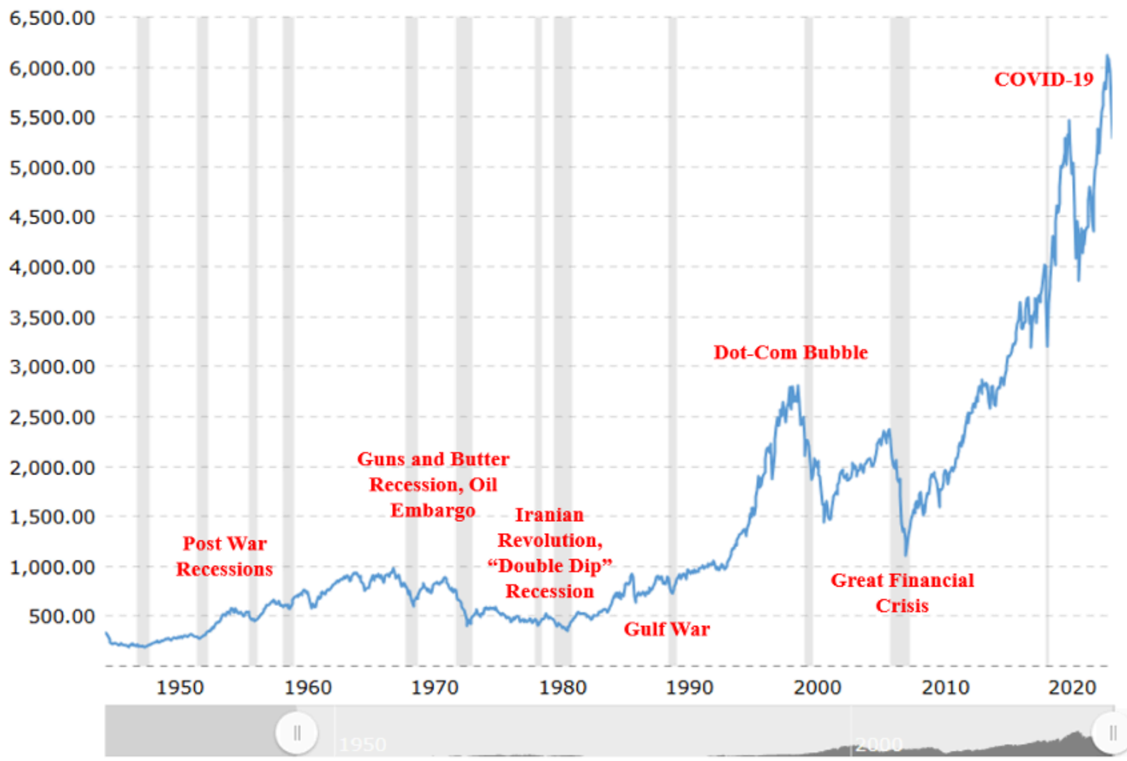
1. Focus on the Long Term

The stock market's daily fluctuations can trigger emotional responses that lead to poor decision-making. Research consistently shows that investors who maintain a long-term perspective outperform those who frequently trade in response to market news or volatility. Ultimately, the stock market keeps reaching long-term heights despite short-term volatility. Markets may bottom out during the middle or end of a recession but they do find a way to recover. More important than timing the market: time in the market.

What is particularly striking is that a small number of days often account for the majority of annual market returns. Studies have demonstrated that missing even the three best trading days in a given year can significantly diminish overall performance. Between 2003 and 2023, investors who missed the ten best market days saw their returns reduced by nearly half, compared to those who remained fully invested.[1] This highlights the importance of maintaining consistent market exposure, as it is nearly impossible to predict which few days will drive the bulk of long-term gains.

[1] Konish, L. (April 7 2025). *Selling out during the market's worst days can hurt you, research shows — here's how much you could lose*. CNBC. https://www.cnbc.com/2025/04/07/selling-out-during-the-markets-worst-days-can-hurt-you-research.html

S&P 500 Benchmark Past 90 Years (Recessions Shaded in Gray)[2]



Remember that market volatility is normal. Since 1980, the S&P 500 has experienced an average intra-year decline of 14%, yet finished with positive returns in 32 of those 44 years. Today's increase in volatility is still a blip in the long run.

2. Tune Out the Headlines

In today's 24/7 news cycle and social media environment, investors are bombarded with financial headlines designed to capture attention rather than provide a balanced perspective. Media outlets consistently emphasize market corrections, economic concerns, and potential crises over steady growth or positive developments. This phenomenon is driven by what psychologists call "negativity bias" – our tendency to pay more attention to negative information than positive. A study found that negative news about the economy receives significantly more coverage than positive news of equivalent magnitude.[3] This disproportionate coverage of market declines can trigger emotional responses that lead to impulsive investment decisions.

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[2] S&P 500 Index - 90 Year Historical Chart. *Macrotrends.* https://www.macrotrends.net/2324/sp-500-historical-chart-data

[3] Chahrour, R., Nimark, K., & Pitchner, S. (2021). *Sectoral Media Focus and Aggregate Fluctuations*. American Economic Review 2021, 111(12): 3872–3922 https://doi.org/10.1257/aer.20191895

For the long-term investor, consistency is key. While it is essential to stay informed, reacting impulsively to short-term developments can lead to suboptimal outcomes. The ability to distinguish meaningful trends from temporary noise is a skill worth cultivating. At times, this may mean adopting a contrarian mindset–resisting the urge to follow the crowd, especially during periods of widespread pessimism. Remaining disciplined, patient, and focused on long-term objectives is not always easy, but over time, it often proves to be the most rewarding approach.

3. Diversification as a Safety Net

While the U.S. maintained high earnings over the last decade, the future remains uncertain. Amidst other underperforming regions and significant devaluation of the heavily weighted technology sector, diversification remains critical to balance exposure and steady growth.

The remarkable performance of the "Magnificent 7" tech giants–Apple, Microsoft, Alphabet, Amazon, Nvidia, Meta, and Tesla–has dominated market returns in recent years, making it extraordinarily difficult for active investors to beat broad market indices. These seven companies alone have accounted for an outsized portion of S&P 500 returns, creating a market environment where concentration risk has increased dramatically.

However, history suggests that market leadership doesn't last forever. Small-cap stocks, which have lagged significantly behind their larger counterparts, often shine during different economic cycles and can provide valuable diversification benefits. Their current relative undervaluation compared to large caps presents a potential opportunity for long-term investors willing to weather short-term volatility.

Diversification–spreading investments across different asset classes, sectors, and geographical regions–remains one of the most effective risk management strategies. Modern Portfolio Theory, developed by Harry Markowitz in 1952, demonstrates mathematically that diversification can reduce portfolio volatility without necessarily reducing expected returns.[4]

It is hard to predict the next big investment. A famous Wall Street Journal experiment is a testament to this, as a blindfolded monkey was able to outperform professional stock picks.[5] By spreading money across different types of investments, industries, and regions, a portfolio can be protected from unnecessarily large losses due to idiosyncratic risk. Each diversification strategy is different and dependent on your long-term goals and risk tolerance.

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[4] Investopedia. (August 29, 2023). Modern Portfolio Theory: What MPT Is and How Investors Use It. *Investopedia*. https://www.investopedia.com/terms/m/modernportfoliotheory.asp

[5] Kueppers, A. (June 5 2001). Blindfolded Monkey Beats Humans With Stock Picks. The Wall Street Journal. https://www.wsj.com/articles/SB991681622136214659

4. Cost Management Matters

Many young investors overlook investment fees, assuming a small percentage won't make much of a difference. But over time, those fees quietly eat away at your returns–and the effect compounds dramatically. Simply put, keeping fees low is one of the most reliable ways to boost long-term performance.

The numbers are striking. A report by the U.S. Securities and Exchange Commission found that a seemingly modest 1% increase in annual fees could reduce your portfolio's final value by nearly 28% over 40 years.[6] This could make a difference between retiring comfortably and falling short of financial goals.

Fortunately, you have more tools than ever to minimize costs. Low-cost index funds and ETFs–many with expense ratios below 0.10%–offer broad diversification and competitive returns without the hefty price tag. Platforms like Vanguard, Fidelity, and Charles Schwab have embraced this low-fee model, making it easy to build a cost-effective portfolio.

As John Bogle, the founder of Vanguard, famously said: "In investing, you get what you don't pay for."[7] By being fee-conscious now, you give your money more room to grow–and that's a habit that will serve you for decades to come.

5. Regular, Systematic Investing

Dollar-cost averaging (DCA)–investing a fixed amount at regular intervals–can be a powerful tool for long-term investors. By committing to invest consistently, regardless of market conditions, you reduce the pressure to time the market and naturally buy more shares when prices are low and fewer when prices are high. This approach can smooth out the effects of market volatility and help avoid emotional decision-making.

Research from the Schwab Center for Financial Research shows that even investors with poor timing who invest immediately tend to outperform those who wait on the sidelines for the "perfect" moment.[8] In other words, time in the market beats timing the market.

This principle becomes even more powerful when we consider that historically, just three trading days often determine a major share of annual returns. Missing these critical days–which are impossible to predict in advance–can devastate long-term performance. By maintaining

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[6] Office of Investo Education and Advocacy. Mutual Fund Fees and Expenses. Securities and Exchange Commission. https://www.sec.gov/investor/alerts/ib_fees_expenses.pdf
[7] Tsang, A. (January 17 2019). 5 Pieces of Advice from John Bogle. *The New York Times.* https://www.nytimes.com/2019/01/17/business/mutfund/john-bogle-vanguard-investment-advice.html
[8] Center for Financial Research. (September 13 2023). Does Market Timing Work? *Charles Schwab.* https://www.schwab.com/learn/story/does-market-timing-work

consistent exposure through regular investments, you ensure you're in the market during these crucial but unpredictable periods of exceptional performance.

Beyond performance, dollar-cost averaging helps counteract behavioral pitfalls like loss aversion and recency bias. FINRA reports that those who follow automatic investment plans are significantly more likely to stay the course and meet their financial goals.[9]

Consistency builds momentum–and over time, that discipline pays off.

6. Conclusion

While these principles may seem simple, their consistent application differentiates successful investors from the crowd. During periods of market turmoil, such as now, these fundamentals become even more important, providing the discipline needed to avoid costly mistakes.

Remember that financial markets have endured countless crises throughout history–from the Great Depression, 2008 Great Financial Crisis, COVID-19 Recessions, to the current incredible volatility–yet have ultimately rewarded patient, disciplined investors who stayed the course.

By maintaining focus on these fundamental approaches rather than reacting to short-term market movements, you position yourself for long-term investment success.

[9] Investor Insights. (July 18 2022). National Study by FINRA Foundation Finds U.S. Adults' Financial Capability Has Generally Grown Despite Pandemic Disruption. *Financial Industry Regulatory Authority.* https://www.finra.org/investors/insights/finra-foundation-national-financial-capability-study