WEEKLY

Strategy Perspectives

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Efficient Markets and Rational Investors: Fact or Fiction?

"Nothing so undermines your financial judgement as the sight of your neighbor getting rich."

— J. Pierpont Morgan, financier, banker, industrialist during the Gilded Age

THE THROUGH LINE: Capital markets have been on a wild ride, leaving many investors' psyches (and stomachs) churning. Are fundamentals truly changing as markedly as the gyrations imply (spoiler alert: no)? We parse the situation through the lens of behavioral finance, highlighting nuggets to help anchor a more measured perspective.

Reaction versus reflection

Scientists have discovered that crows respond to visual cues at twice the speed of humans and other primates.[i] Thankfully we don't let them trade stocks – the velocity of twists and turns in markets over the last two weeks has already been enough to give investors whiplash. But who said speed is the be-all and end-all anyway? In financial decisions, haste can actually prove detrimental to long-term outcomes.

The rapidly shifting headlines we've been inundated with have triggered an almost irresistible urge to act – even if we know we should ignore the noise. Why? Blame it on the oldest, most primitive parts of our brain. We like to think we are deliberative and careful decision makers, yet we are habitually more influenced by innate hardwiring than we care to admit. Case in point: what happens when I ask you to visualize slicing into a fat, juicy, bright yellow lemon?

Our irksome lizard brains: thinking fast and slow

Nobel history was made in 2002 when half of the *economics* prize was awarded to *psychologist* Daniel Kahneman, who later wrote the best-seller *Thinking, Fast and Slow*. Until that time, **traditional economics had presumed humans (homo economicus, the perfectly rational decision-maker) behaved logically**, carefully weighing risk/return tradeoffs – a simplistic model on which many economic models still rest.

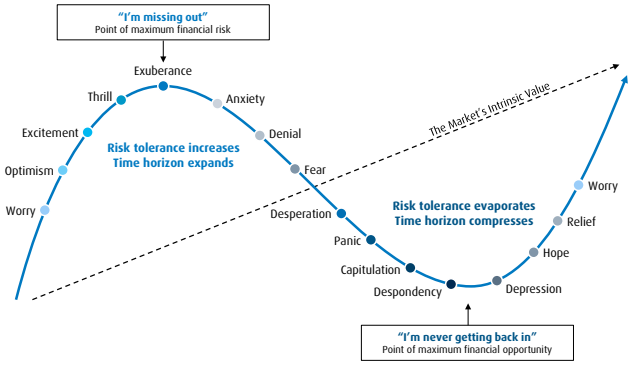
Dr. Kahneman (and collaborator Amos Tversky, who died in 1996 and was thus ineligible to share the Nobel prize) showed otherwise. The Nobel win was based on their work integrating psychological research into economic science. **Behavioral economics presumes we frequently make flawed or biased choices** influenced by observable mental shortcuts (termed heuristics). These tendencies are typically rooted in primitive wiring that overrides logic, particularly when we're stressed. Studies by Dr. Kahneman and Dr. Tversky identified two primary decision-making systems:

- **Fast:** primitive wiring causing us to fight, flee or freeze in response to unexpected stimuli. This is also the rote/routine way we handle the thousands of decisions we make each day as we operate from habit and embedded (comfortable) routines.
- **Slow:** a more deliberative and analytic state that often requires specific, effortful intention to operate from.

A few core tenets of behavioral finance

Investor behavior continuously swings between **greed** and **fear**. Back and forth, forth and back, over time markets are pushed to extremes before they exhaust excess and migrate back toward equilibrium. We can see from the chart below how emotions play a substantial role in the market cycle.

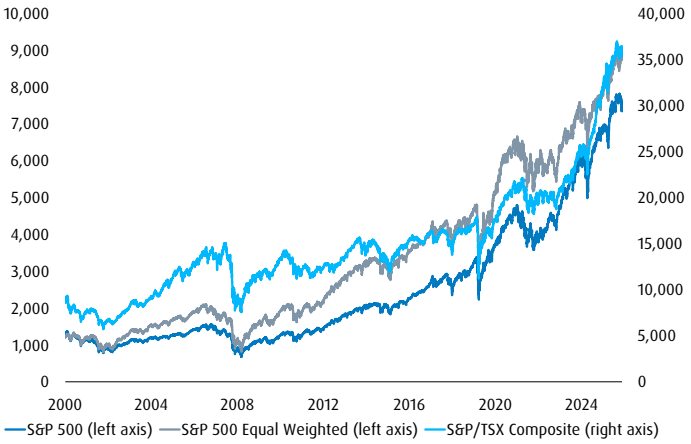
The Cycle of Investor Emotions



Source: BMO Wealth Management

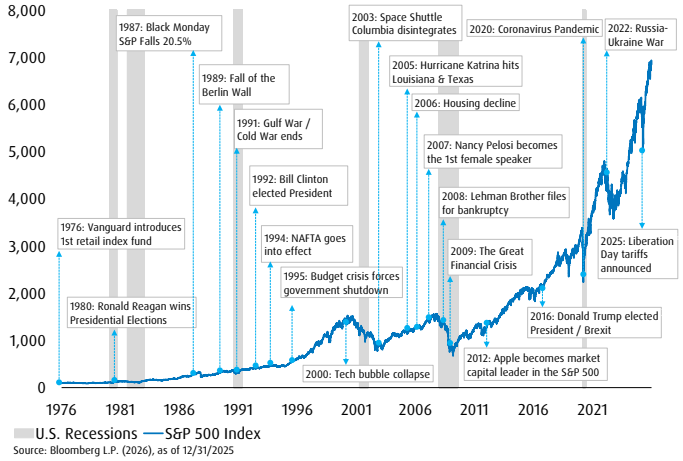
What routinely gets overlooked is that those pendulum swings happen around a trend line that tends to climb up and to the right over the long haul, regardless of the barrage of concerning news stories blasted at us along the way. The first chart below shows the S&P 500 Composite, S&P 500 Equal Weight and S&P/TSX Composite Indexes since 12/31/2000 (the year the dotcom bubble peaked). The second chart shows some pretty high profile headlines that hit along an even longer stretch of market advance.

Equity Index Price Since 2000



Source: Bloomberg L.P. (2026), as of 11/18/2026

50 Years of the S&P 500 Index

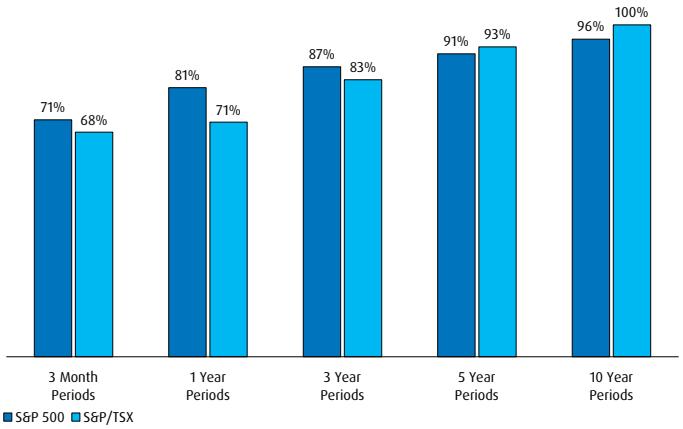


Source: Bloomberg L.P. (2026), as of 12/31/2025

Emotional swings can be chalked up to some of the biases that behavioral finance exposed:

- **Herd behavior.** Our brains are literally wired to fear ostracization, which in early civilizations could be a death sentence. Despite how advanced we like to think we are, our brain's hardwiring hasn't caught up. Today, being the last one picked for the dodgeball team (or excluded from the hottest new investment club) still triggers ancient brain chemicals that come from the very same place that that sends out physical pain messages. **Market FOMO (fear of missing out) is very real according to our brain chemistry.** We are also born story tellers – imparting life-saving information to the pack about which plants are poisonous or where the saber-tooth tiger was last seen (or helping amplify market trends via our social media feeds).
- **Loss aversion.** Numerous studies show we are twice as distressed by losses as we are thrilled by similar-sized gains. A perfect illustration of this emotional reaction is the drumbeat of panic headlines asking whether we're in a bubble – especially if the markets have been enjoying a good run. Nevertheless, markets spend most of their time trending upward and by design capture the best and brightest of a country's economic endeavor.

Percent of Time with Positive Return 1970-2026*



*Represents total returns over rolling monthly periods from 1/30/1970 - 10/31/2026

Source: Bloomberg L.P. (2026)

- **Anchoring.** We instinctively anchor to prior prices. Basically, we rely too heavily on some initial reference point when making estimates or defining options and adjust too little when confronted by new information that warrants an upward shift. **This decade's affordability agita is arguably tied to pre-pandemic price levels – not to the rate of inflation itself.** However, we would not want the type of economic damage it would take to force prices back to those levels. Similarly, housing pain partly reflects anchoring to loan interest rates that prevailed during the unusual period when interest rates were at or near zero. This era was actually an anachronism from a historical perspective: current rates are closer to long-term normal levels.
- **Recency bias.** What happened last week is more memorable than what happened last year. Remember the Sturm und Drang over DOGE? Liberation Day? Deep Seek? Such anguish now pales relative to headlines surrounding rogue AI, datacenters, newly elected policymakers and rolling technology outages. We suspect that a year from now we will be stressing over a whole new list of concerns. We also suspect markets will find a way to claw their way through the list of worries – provided that fundamentals continue to spool constructively, which we expect they will do.
- **Confirmation bias.** Pack animals that we are, we place greater emphasis on opinions, articles and insights that confirm our beliefs versus those that challenge them. Social media and the algorithms that fill our personalized feeds amp this tendency to the nth degree.
- **Familiarity bias.** We gravitate toward things we know or experience ourselves. This tendency is what makes predication markets so compelling to many. It explains why we are drawn to investing in goods or services we personally like – regardless of the company/industry's underlying valuation or growth prospects.

- **Self-attribution.** This bias refers to the human tendency to take credit for wins while blaming the markets or external factors for investing losses. Friends and acquaintances will eagerly tell you about the latest investment where they made a "killing." They are much less forthcoming when the numbers go south.
- **Mental accounting/bucketing.** We segment financial decisions into discrete buckets. Although asset location (pre-tax versus after-tax accounts as one example) is important, it's also imperative to periodically review the whole picture. Stepping back allows you to see where specific industries, assets or risks are weightier versus looking at each account separately.

The long-term efficiency of capital markets

Capital markets exist to match buyers and sellers. Those who have extra capital to invest are matched with those looking to obtain funds to support their activities or growth plans. **Technically there is a clearing price for every asset on any given day – it just depends upon how badly each party wants (needs) to get in or out.** Finding a mutually agreeable price typically depends upon underlying fundamentals, investor appetite and the prevailing economic environment – though when volume, emotions and/or sentiment are running high, those same emotional extremes of greed and fear can take hold. Thus, perception can play a role, particularly in the very short term. We saw this in technicolor last week after the indexes' rapid upmove on Wednesday, followed by Thursday's sharp reversal. We're pretty sure 1) fundamentals didn't shift that rapidly and 2) there was a fair amount of systemic and algorithmic trading that was reset/triggered in barely 48 hours to exacerbate the moves – bullwhip effect, anyone?

This year, we have written frequently about how discriminating investors have been in their treatment of AI-related names. Far from behaving with the bubble-like ebullience that many feared (especially early in the year), entire segments of the market (think chips and software) have seen share prices swing by 30, 40, 50% or more. This is despite the fact that earnings, revenues, margins and backlogs continue to build. Bond investors have steadily absorbed record levels of issuance (particularly from tech companies) and simultaneously demanded higher yields for the longer-dated maturities of the most levered companies. Yes, some share prices (particularly in tech) have been pummeled recently; however, SpaceX's record IPO was readily absorbed this summer as was Anthropic PBC's IPO just this week which saw demand for shares more than seven times greater than the number on offer.

New technologies and investment innovations (e.g., levered exchange-traded funds that amplify the up and down moves of highly volatile names/indexes, prediction markets, tokenized securities) are rapidly changing the nature of price discovery. And we best get prepped for more: just this week the first AI agent-to-agent Treasury trade was conducted between Microsoft and Bank New York. Humans ultimately pulled the trigger, but the haggling to find the transaction price happened entirely between two autonomous AI agents.[ii]

Growth story intact despite short-term turbulence

The dramatic market swings and shifting headlines of the last few weeks have masked an entire suite of constructive fundamentals. Here's a short list of things going right:

- The U.S. and Canada are both finishing up robust reporting seasons (WSP: Q3 Earnings Recap: Passing the Baton). The S&P 500, for example, now shows 14% topline and 32% bottom-line growth with 95% of results tallied. This marks the third consecutive quarter of 25% or better earnings growth; all 11 sectors showed gains.
- In the face of all this good news, investors continue to punish stocks overall, meaning valuations are lower this week than they were last week (ironic that stocks are one of the only goods we can think of where sale prices seem repellant versus compelling).
- U.S. economic numbers – GDP, productivity and manufacturing activity – show few/no signs of deterioration.
- Canada Strong programs are taking root; investment interest is queuing up substantial potential infrastructure spend for the first time in years.
- Oil prices are down double digits from earlier in the year, setting the stage for stabilizing (falling?) inflation in months/quarters to come.
- Consumers are employed and spending (at least in the top tiers that move the aggregate economic/market numbers).
- AI demand continues unabated – illustrated by backlogs, anticipated chip spending and corporate earnings reports. While moderation of the datacenter build will likely happen thanks to the election results, we expect it to be a slowing – not cessation. Additionally, we expect the grid and infrastructure build needed to support rapidly increasing energy needs will continue to roll along (WSP: The Muddy Middle).
- **Market pullbacks are the rule, not the exception – a feature, not a bug.** Much of the market pressure has come in the largest names, primarily the narrow list of technology names that propelled much of the market advance over the last few years. That said, the broadening in participation that we have been watching for is showing green shoots of activity amid the recent gyrations. The Equal-Weight S&P 500 is up 1% in the last month versus a decline of 6% for the standard market cap-weight version.

Implications for investors: tips for outwitting our hardwiring

When markets move sharply, keeping our cool can be difficult – the most reptilian areas of our brains are hardwired for action. A few tactics can help short-circuit this innate tendency:

- **When surprising news hits – pause.** We are one of the few species with the ability to *put a space between stimulus and response*. Use it to slow down, breathe, educate yourself and evaluate.

- **Acknowledge the media will use incendiary words to generate clicks** – it's what their business models are predicated upon. Words like "plunged, vaulted, soared" are meant to appeal to emotions and trigger a response – don't rise to the bait.
- **Set up systems** – such as dollar-cost averaging (in or out) and regular rebalancing to tamp down the urge to react in the moment. Plan your goals during calm market times – and write them down.
- **Own different asset classes** – understand the purpose each serves in your portfolio (e.g., volatility dampener, growth, income).
- **Use bucketing to your advantage** – consider segmenting assets into different accounts to serve specific needs. For example, you might need cash for your offspring's next few years of college tuition; fixed income to generate a set level of living or retirement expenses; a stash of mad money; or a pool to fund legacy objectives.
- **Avoid anchoring to a specific price** – especially when pruning overweights or cutting losses and moving on. *Recognize that nobody cares what you paid.*
- **Focus on what you have some control over** – turnover, taxes, timing, some costs.
- **Keep everything in perspective** – remember money is a tool that allows you to do things. Think of it as leverage that affords you choice and resilience.

Next week in North America

A smorgasbord of key reads in the U.S. despite a holiday-shortened week. Three different PMI surveys will be served on Monday. The Conference Board's consumer confidence readings drop on Tuesday. The bulk of the eco-data feast is served Wednesday when we'll get the Personal Consumption Expenditures price index (PCE), the Fed's preferred inflation measure; GDP; durable goods orders; and the Fed's Beige Book.

Monday 11/23	**U.S.** S&P Global Manufacturing, Services and Composite PMIs **Canada** Bloomberg Nanos confidence
Tuesday 11/24	**U.S.** Conference Board Consumer Confidence, Industrial Production **Canada** None scheduled
Wednesday 11/25	**U.S.** PCE, GDP, Initial Jobless Claims, Durable goods orders, New home sales, Fed's Beige Book **Canada** None scheduled
Thursday 11/26	**U.S.** Thanksgiving holiday, stock and bond markets closed **Canada** Payroll employment change
Friday 11/27	**U.S.** Trade balances, Wholesale and Retail Inventories **Canada** Current account balance

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Benchmark data does not reflect actual investment performance but reflects benchmark results of the underlying indices referenced. You cannot invest directly in an index.

[i] 'Birdbrain' Is a Misnomer. Crows Make Decisions Faster Than We Can - The New York Times
[ii] AI Agents in Bond Market Arrive With a Stealthy Microsoft Trade - Bloomberg