7 Simple Things Most Investors Don't Do

Tadas Viskanta from Abnormal Returns made a great point in a recent post:

In the financial blogosphere and financial media we are often confronted with debates about issues that really are important only the margin. Of late discussions about active vs. passive, smart beta vs. dumb beta *and* alternative assets *have been at the front and center. The problem is that issues like these are really peripheral to the big problems facing most average investors.*

Most investors can safely ignore the debates investment professionals have amongst themselves.

This is something that's easy to forget when you deal with this stuff on a daily basis. It's interesting to us that work in the world of finance, but it's fairly trivial to the average investor. In the spirit of focusing on the big picture, here are seven simple things most average investors don't do that can make a big difference:

(1) Look at everything from an overall portfolio perspective. While it can make sense to think about a bucket approach for certain future liabilities, you still have to consider everything within the context of an overall portfolio. This means aggregating all retirement funds, brokerage accounts and emergency savings vehicles into one place. This helps determine how liquid you are, what your true performance numbers look like, how diversified your portfolio is and what your entire asset allocation is.

It's very difficult to make informed decisions if you're not thinking about your next move in terms of your overall portfolio.

(2) Understand the importance of asset allocation. Asset allocation is the nerve center of the portfolio. Everything -- risk tolerance, performance, expected gains and losses, volatility -- really comes down to selecting the correct mix of asset classes. Get this one decision right and it gives you a pretty good margin of safety in other areas of portfolio construction as you look to find your way as an investor.

Stock picking is sexier, but asset allocation is far more important for 95% of investors.

(3) Calculate investment performance. This one seems obvious, but it’s something that most investors don't do. One study showed that investors overestimate both their absolute and relative performance to the market by an average of 5% a year, so it's a good way to keep your ego in check. Calculating performance numbers allows you to see how much of your change in market value is driven by investment performance versus how much is due to the money you save.

Comparing your portfolio performance to some very simple benchmarks (such as total market or balanced funds) in relation to your asset allocation over longer time frames can also help make sure the work you're putting in is worth the time and effort.

Once a year should suffice.

(4) Define a time horizon when making a purchase. Buying an investment is easy. Managing risk after the fact is where things get difficult for most investors. Without an upfront definition of your expected holding period or when you will sell/rebalance an investment, it's impossible to make rational decisions.

We only become more irrational after making a purchase, so taking the emotions out of your sell decisions by making systematic if/then rules helps a great deal.

(5) Save more every year. Tweaking your portfolio between asset classes or finding cheaper or better funds might make you feel like your doing something to increase your performance, but these are usually marginal improvements at best. The easiest way to grow your wealth will always be to save more money.

Saving just 1% more a year can have a large impact on your ending balance over many decades of compounding. Every 1% you increase your savings rate could translate into the equivalent of 0.4% in annual investment gains. So a 5% increase in your savings rate could add up to 1.5-2.0% a year to your bottom line.

(6) Focus only on what you control. Investors are constantly stressing about where the market is going to go next. Not only does no one really know which way the market is heading, but it's something that's completely out of anyone's control. The factors that most often stress people out about the markets are the things that they have absolutely no control over.

(7) Delay gratification. The entire process of investing is about delaying current consumption for future consumption. A solid investment strategy should do the same. To make money you have to be willing trade comfort now for comfort later.

Here's one of my favorite Buffett quotes from Guy Spier's Education of a Value Investor when Spier sat down with Buffett for a charity lunch:

"Charlie [Munger] and I always knew we would become very wealthy," he told us, "but we weren't in a hurry." After all, he said, "If you're even a slightly above average investor who spends less than you earn, over a lifetime you cannot help but get very wealthy -- if you're patient."

Source:
The starting is the hardest part: the case for robo-advisors (Abnormal Returns)

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