Investing When No One Really Knows What to Do

> "Risk control is the best route to loss avoidance. Risk avoidance, on the other hand, is likely to lead to return avoidance as well." - Howard Marks

Here's a conversation that has likely occurred in some form or another -- either as an inner monologue, between a financial professional and client or among investors -- in the past few years when thinking about how to approach today's markets:

I'm getting extremely nervous about U.S. stocks. They're expensive and this bull market is getting long in the tooth.

Why don't you invest some of your portfolio overseas in foreign stocks?

Well, the U.S. economy seems to be the best shirt in the laundry hamper. Foreign stocks are cheaper for a reason. Europe is a mess and those economies are growing much slower than the U.S.

Why don't you think about allocating some funds to emerging market stocks?

No way. Emerging market stocks and economies are far too volatile for my taste. I know they've underperformed for a number of years now but those markets are also cheaper for a reason.

All right, invest more money in bonds if you're so worried about stocks.

Are you nuts?! Interest rates are way too low and if they rise meaningfully fixed income is going to lose money.

Okay, shorten your bond duration.

But that means I'm excepting a much smaller yield to protect myself from bond losses.

How about holding some cash reserves in an ultra-safe savings account?

Cash loses to money inflation over time.

Diversify your bond holdings?

That could mean taking more risk in certain areas.

So diversify among different investment strategies, asset classes or investment styles. It's never *been easier to diversify a portfolio with time-tested investment ideas.*

What happens when my strategies underperform? And how will I know when they're just out of favor or when they've stopped working?

Eventually, you have to take a leap of faith and learn to live with the inevitable uncertainty of investing in risk assets...

You could continue this routine all day long by talking yourself out of investments, markets, asset classes, and strategies. Investments that have done relatively well can make you feel like you missed the boat while investments that have done relatively poorly can feel like you're about to catch a falling knife.

Investing is hard. Diversification is hard. Following a single strategy is hard. Nothing works all the time. It can be emotionally exhausting to put your money to work when you consider all of the variables involved along with the fact that you're dealing with your life savings. Investing is a scary proposition.

Those who have missed most or all of the bull market are frightened to jump in right now while those who stayed invested are worried about giving back some or all of their gains. It seems like very few investors know what to do right now. Here are some thoughts on how to think about investing when it seems like no one really knows what to do:

- **Avoid extreme all-in or all-out stances.** Since mid-February of last year, the S&P 500 is up almost 30%. Small-cap value stocks are up around 20% since early-November. You can miss out on a few year's worth of gains if you try to get tricky with your timing in the markets (this works the same way on the downside as well). Risk-on or risk-off stances in the markets can turn into addictions. Holding 100% of your portfolio in any single asset class is mentally draining. Investing doesn't have to be black or white. Allow yourself room to be breath and a margin of safety if you're wrong.

- **Don't allow armchair quarterbacks judge your decisions.** This is an odd bull market. Every type of investor seems to assume every other type of investor must be out of their mind because of the way they're positioned. With all of the different communication channels available to share and receive opinions these days, it's never been easier to judge or be judged by others. Obsessing about how other people choose to invest or worrying what others think about your investment strategy is a waste of time. It's hard enough sticking to your own strategy. Don't let others talk you out of a good process just because they don't have similar ideas on how to invest. There's no one right way to do this.

- **Minimize your regret.** I like to say that investing in inherently a form of regret minimization, a process that's full of trade-offs. Long-term returns are the only ones that really matter but you have to figure out how to survive the bad times enough to ensure a good process can see you through to make it to the long-term. A balanced portfolio approach won't always put you in a comfortable position but it's a great way to avoid blowing up your portfolio. There's a lot to be said for giving up on the dream of hitting home runs to avoid striking out and instead, accepting singles and doubles.

- **Learn to accept volatility.** In a low-interest rate environment, you have to accept *some* form of volatility to earn a decent return on your capital. It's unfortunate this is the case but this is the hand we've been dealt. If you have to take risks in the markets the goal is to figure out which risks you're paid to take and which ones are unnecessary or avoidable. Investors have to understand their risk exposures and how those risks can be expected to translate into a potential range of outcomes in the future. Obviously, this is not always that easy but neither is investing.
- **Have a plan, even if it's a bad one.** A bad plan is better than no plan at all.

Further Reading:
The Psychology of Sitting in Cash