AKADVISORY PARTNERS LLC
Unlocking Real Value

Protecting Clients From Themselves

" The investor's chief problem – and even his worst enemy – is likely to be himself."
- Benjamin Graham, The Intelligent Investor

After an unexpectedly strong showing in 2014, the bull market in stocks continues unabated and without the long-expected 10% - 20% correction. Market watchers are expecting more normal returns this year; flat to slightly higher would probably be a good expectation, and don't be surprised if there is that long-expected correction – which would be a healthy thing.

2015 is also setting up to be a more volatile one, as geopolitical uncertainty remains in Russia and the Middle East, lower oil prices threaten economic growth in Europe and many of the developing economies and the U.S. Federal Reserve (Fed) is set to raise interest rates at some point during the year.

Amidst all of this uncertainty, many investors are wondering if they should exit the market, or at least reduce their exposure. But what market history has shown us is that individual investors tend to do the wrong thing at exactly the wrong time. They panic when uncertainty increases, selling into down markets, and then reenter too late, only after the market has recovered.

An example was early October of last year, when stocks sold off during the first two weeks of the month because of the Ebola threat. As those fears eased, the market recovered, actually ending the month in the red. Investors who sold into the panic likely missed the rebound, once again victims of their own emotions.

It's important to ask prospects and clients the simple question "Are you a good investor?" Because if they say that they aren't, they're not alone. The reality is that investments do well and many investors do not. According to the latest analysis of investor behavior by Dalbar Inc., stock fund investors underperformed the S&P 500 over the 3, 5 10 and 20 year periods ending December 31, 2012 by an average of 4% per year over the full period.

Let's look at the most common errors investors make and why they make them, explain what it takes to be a good investor and illustrate how working with an experienced advisor – tapping into their experience and discipline - can help increase the odds that investors will meet their long-term goals and objectives.

Common Investing Pitfalls

The key to successful investing is discipline – having a sound strategy and sticking to it. Unfortunately, the odds are stacked against most investors when it comes to their ability to be disciplined when it comes to investing their own money. Investment decisions are heavily influenced by emotions. And emotions tend to lead investors into mistakes – ones they will often repeat.

The science of Behavioral Economics explains how individuals are less rational in their decision-making than economic theory assumes. Reasons for this include:

- Loss aversion – the pain of losing money outweighs the pleasure of making it;
- Confirmation bias – ingrained thoughts and tendencies are hard to change;
- Herd mentality – the tendency to follow the crowd; and
- Availability bias – we tend to treat more recent events as more relevant.

Emotions lead investors to a number of common mistakes that are detrimental to investing success. Let's take a closer look at two of them: buying last year's winners (also referred to as chasing the hot dot or investing in the rearview mirror) and trying to time the market.

Dimensional Fund Advisors (DFA) conducted a study that looked at how funds that had outperformed in the 3, 5 and 7 year periods ending in December 2009 performed in the subsequent three years. The results are summarized in the table below for both equity and fixed income funds. The vast majority of equity funds – almost 75% - underperformed; while the results for the fixed income funds was slightly better, there were far fewer funds in the sample.

Do Winners Keep Winning?
Outperforming Funds: 2010-2013

	Equity Funds	Sample Size	Fixed Income Funds	Sample size
3-year Winners	26.4%	1189	43.2%	118
5-year Winners	26.1%	918	45.7%	105
7-year Winners	23.6%	597	52.1%	94

Data provided by the CRSP Mutual Fund Database. Source: CRSP data provided by the Center for Research in Security Prices, University of Chicago. Past performance is no guarantee of future results.

As to trying to time the market, the chart on the next page clearly illustrates why trying to do so is futile.

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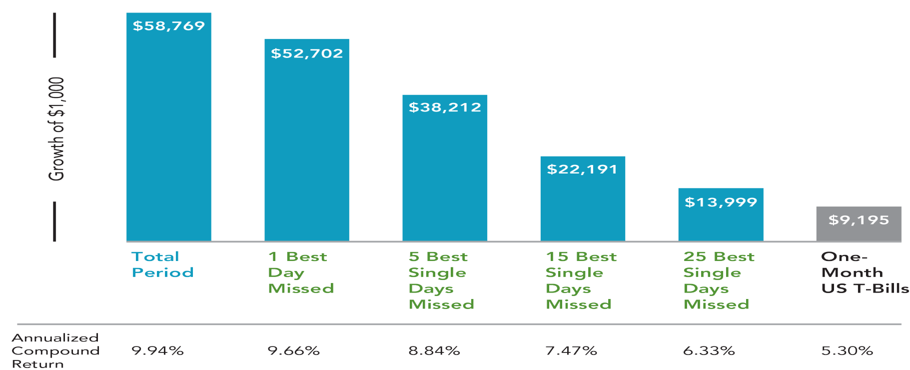
Had you missed the 25 best trading days over a 42-year period, your total return would have been reduced by about 33%. Missing only a few days of strong performance can drastically impact your results.

Studies have also found that investors tend to lack diversification, trade too much, have a reluctance to sell their losers and are unduly influenced by the media and market noise.

Market Timing Does Not Work
(Performance of the S&P 500 Index, 1970-2012)



In US dollars. Indices are not available for direct investment. Their performance does not reflect the expenses associated with the management of an actual portfolio. Past performance is not a guarantee of future results. Performance data for January 1970–August 2008 provided by CRSP; performance data for September 2008–December 2012 provided by Bloomberg. S&P data provided by Standard & Poor's Index Services Group. US bonds and bills data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

What Makes a Successful Investor?

There are a number of keys to being a successful investor, including:

- Having a long-term investment philosophy which takes your individual preferences – goals, risk tolerance levels, etc. – into account;
- Creating an investment plan that follows this philosophy, one which includes a prudent asset allocation and is maintained through all market conditions, unless individual circumstances change;
- Researching and monitoring the appropriate investments and asset classes to include in your portfolio; and
- Having a system in place to track your progress and make adjustments along the way.

The issue that faces most investors, however, is that they don't have the expertise to do these things. Couple this with emotions and it's not hard to see why investments do better than many investors. The markets have historically rewarded those investors with the discipline to stay in the market.

But discipline is not enough. Even if investors think that they can remove their emotions from the equation, they still have to have the skill set to develop a sensible plan, choose the proper investments among dozens of asset classes and thousands of investments and have the requisite time to dedicate to the endeavor. Compare and contrast this to an advisor who dedicates 100% of his/her time, resources and expertise to designing and managing portfolios for clients.

While many people enjoy investing themselves, prudence dictates that for many investors the right move is to work with someone who will help remove ego and emotion from the investment process.

Working With A Qualified Advisor

In general, advisors provide objective, disciplined and trustworthy advice that is designed to help clients meet their long-term goals and objectives. They understand that there are things they can't control – like the ups and downs in the market – and things that they can control – for example ensuring that client portfolios are diversified and managed with an eye on costs and taxes.

Advisors also help clients understand what they do and don't know about the markets and help protect them from acting against their own long-term interests. The more informed and comfortable clients are, the greater the odds that they will stick with their investment plan and resist the temptation to do it themselves.

For prospects, advisors have the dual task of first making the case for hiring someone as opposed to having the investors do it themselves (as outlined here), and then describing their value-added proposition – what makes them different and better than the competition. Whether it is their level of experience, the investment process, client service model, or all of the above, prospects must believe that you can help them and be a true long-term prospect.

For clients, it's always good to remind them of your value added. Re-educating clients from time to time on not only your unique qualifications, but also why they shouldn't go it alone, will help solidify and grow the relationship and ensure that clients don't either panic when the markets are bumpy, or be tempted to leave you for another advisor.