

Five Investing Mistakes to Avoid

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Glenn has written the following article primarily with 401(k) investments in mind. We believe the principles stated apply broadly to investors.

MISTAKE #1: You don't know what your money is doing.

In other words, you're investing your money with or through a service that denies you true transparency.

With typical mutual fund investments, for example, investors don't know what's happening day-to-day or in real-time. Instead, the fund might send a letter detailing all holdings 30 to 45 days after the end of the quarter. This lack of transparency can have numerous implications. You may not clearly understand how all fees are being assessed and/or charged, or you may not see serious conflicts of interest (where investment advisors steer clients into a small group of funds based on "pay to play" agreements with those companies).

Unfortunately, transparency best practices are lagging, according to a 2017 survey by Northern Trust, whose respondents named transparency as the #1 "very important" consideration for investments both traditional (63%) and alternative (62%).ⁱ If you don't know what's happening with your investments, how do you know if they can meet your needs?

MISTAKE #2: Your investments aren't right for you.

Put simply, you must have the ability to customize your account to meet your unique situation. Many, many investments (e.g., mutual funds) don't account for factors like age or time until retirement. That's because mutual funds manage a single portfolio that treats every investor the same in terms of time horizon, risk tolerance, etc. Indeed, investment portfolios should be designed with some attention to individual needs rather than institutional practices. They should complement any other assets you have, support the kind of lifestyle you want to live, and otherwise incorporate all of your needs and where you are in your lifecycle.

This mistake is an ironic one. When you leave an employer, and you can roll your 401(k) into another investment vehicle, you go overnight from something highly restrictive to something highly flexible. That's a huge opportunity! Yet many investors choose something just as restrictive, or even let their 401(k) stand. Worse, they choose an investment vehicle that's set on autopilot, with zero corporate accountability on how publicly traded companies are being allocated. Mutual funds are especially guilty because they own hundreds of companies and generally don't have the resources to adequately vet every company in the portfolio.

MISTAKE #3: You're too impatient.

I'd estimate that fewer than 5% of market participants think beyond next quarter, let alone next year. It's no surprise: the entire system is built around a short-term, action-oriented

approach to investing. From the minute you wake up, information flows nonstop across the computer and device screens in front of you. Prices are changing constantly, and you can buy and sell at any time.

Long-term thinking is key to successful investing, however.

In fact, patience is perhaps the single most important variable for success over time. The stocks you own will dip from time to time. Short-term under-performance flows into long-term over-performance, and vice versa; you cannot have one without the other.

In other words, while we all want our investments to do well 100% of the time, it's more important to do well over a long period of time, and what works well over time doesn't necessarily work all the time. Short-term dips must and should be endured, as long as the investment has been carefully studied and understood to possess the underlying investment characteristics that distinguish good value from bad.

MISTAKE #4: Your investment strategy isn't value-driven.

Most investors act as though the market is perfectly efficient with information, instantly and accurately incorporating all information about a company and its market into price. Unfortunately, this unspoken assumption means that most investment vehicles are founded on buy-high, sell-low strategies.

That's because stock prices discount the future; these ratios tell you more about the past. So, the investor's job is to make judgments about the future that the market is discounting, while looking for things that are happening behind the scenes that the market hasn't fully appreciated.

The market's inefficiency with information can compound on itself. Most passive funds weight the indexes based on size. So, if a company gets bigger over time, the impact they have on the index goes up. If a company gets smaller, they have less of an impact. At its core, this is a momentum-based strategy, which penalizes the investor for past success rather than rewarding you for future success. The reality is that most of your best ideas do not come from companies that have done well from a price perspective.

Remember, there are just two kinds of companies: those that have problems, and those that will have problems. That's business. No one will ride above everything all the time.

The key is to identify and deeply understand companies that are well-situated from a value perspective. It helps to spend a lot of time talking to management, going to presentations, reading filings, talking to people in the industry, discovering who's gaining or losing share, etc. Then, once you've spotted a business you want to invest in, but you think it's only worth X while it's selling at 2X, you wait (see Mistake #3 again). Eventually, if you have enough of those companies that you're patiently watching, that situation will reverse, and you'll have an opportunity to pay X to get 2X value. You just need to have self-control. This is the essence of value investing: do the fundamental analysis today, with the expectation that the company can be bought at a discounted price sometime in the future.

MISTAKE #5: Your investments are too diversified.

Diversification has been overmarketed and overhyped. It's important across asset classes but not within asset classes. Owning more and more equity mutual funds (which is very common) won't protect you in a bear market (like what happened in 2008). In fact, it's very easy to

trick yourself into believing you've diversified when all you've done is concentrate.

The Wall Street Journal puts it perfectly: "In fact, regardless of the number of holdings, most traditionally allocated portfolios are saturated with equity risk. Over-diversification can create a false sense of confidence whereby we believe we are well diversified, but in reality, a large number of investments actually share a common risk."ⁱⁱ

On any given day, the market just doesn't present dozens and dozens of great investment opportunities, unfortunately. If you want to own 50 positions, the only way to do so is to lower your standards until you're putting money into lower-value options. Instead, look for 15 to 20 different or uncorrelated positions. Owning such a number allows us to concentrate on our very best ideas without compromising the benefits of diversification.