# Don’t Make These Investment Mistakes!

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The investment world is a confusing, opinionated and noisy place. Here are 2 classic investment mistakes that are very common: 1) trying to time markets and 2) stock-picking your way to investment success.

**Mistake One: Thinking You Can Time Markets (And Do Better Than the Average Investor)**

Markets are notoriously changeable, just like the weather. There are hundreds of *types* of investments (asset classes) that move somewhat independently of other asset classes. These movements cannot necessarily be predicted. Sometimes there is no logical trigger that makes (example) US mid-cap stocks appreciate more than many other asset classes (or decline less than other asset classes in bad markets).

The random nature of asset class movements works to your advantage if you have exposure to as many different asset classes as possible. Examples of asset classes include US large cap value stocks, corporate bonds and US small cap stocks. While you can’t control markets, you (or your investment advisor) *can* decide how much to overweight or underweight each asset class. This is important *in order to create the best portfolio that gives you the best chance of having a strong financial outcome.*

To return to random movements of asset classes, imagine that each asset class is assigned a color . Let’s assign the color pink to US large cap value companies, dark blue for corporate bonds, red for international developed etc. This is the so-called “periodic table of investments” showing the  relative performance of different asset classes each year. Looking at this “periodic table of investments” highlights how the randomness of asset class movements. are. For example, international developed (pink) may have done relatively poorly 2 or 3 years in a row but it suddenly outperforms the next year. (Go to this website to see this colorful phenomenon: https://www.callan.com/periodic-table/).

An asset class that outperforms 2-3 years is ripe for a “regression to the mean” (a fancy way of saying it has a higher risk of underperforming other asset classes in the future because it’s had it’s  “day in the sun”. Even so, we can’t predict if it will underperform the following year because movements are random.

So what can you do about this? Learn to tolerate some underperforming asset classes and be patient. You can control how overweight (overexposed) or underweight (underexposed) you are to various asset classes but you can’t control markets or anticipate them by “market timing”. A well diversified portfolio means you’ll hit some of the notes some of the time but not all of the notes all of the time. If you’re hitting most of the notes right now, this is a temporary situation and you’re vulnerable to a downdraft.

**Mistake Two: Thinking You Can Pick Stocks Better Than the Average Investor**

Just as I don’t believe the average investor can “time markets” and do better than other investors, I don’t believe the average investor can pick enough outperforming stocks to meaningfully outperform markets in general over the long time. Sure, some people get very lucky and spot winners early (buying Amazon or Starbucks decades back) but stock pickers rarely talk about the stocks that bombed or went nowhere for years (so they massively underperformed a diversified portfolio).

Perhaps a better way to think about stocks is to approach it like a venture capitalist approaches budding companies. The venture capitalist will invest in 10 companies, expect 9 to fail and hope that 1 shines and enough to make up for the other 9. In the investment world the emergence of index funds makes it very easy to pick hundreds or thousands of investments and to be satisfied with a decent, diversified return without having to resort to “stock picking.” For example, the average return of the S&P 500 over decades is +10% per year, including dividends. The average investor, however, has earned far less because he/she jumped in and out of positions (market timing) and perhaps he/she bypassed the S&P 500 altogether in favor of stock picking.  Other stock-picking hazards include concentrating too much I one position and becoming sentimentally attached to a holding. Again, randomness works in your favor if you avoid the stock picking equivalent in the mutual fund world, meaning “actively managed funds”.

A better approach is to embrace randomness and invest across indexes or use an investment approach developed by specialists that filter for traits that lead to outperformance over time. A good example of screening techniques that filter for attributes that lead to outperformance by asset classes (*not individual stocks)* can be found at [www.dfaus.com](http://www.dfaus.com) Dimensional Fund Advisors.

In this confusing and noisy world the best approach to investing is to locate a prudent advisor who invests on your behalf in a diversified, low cost manner and does *not* engage in market timing. And the best investment advisor is someone who doesn’t sell products or split commissions – someone who puts your interests before his/her own: a Fee-Only advisor.