

WEALTH MANAGEMENT

Disciplined investment approach always beats emotion

The Dow Jones Industrial Average recently crossed the 11,000 level, marking another milestone in what has been one of the strongest stock-market rebounds in history.

From its closing level on March 9, 2009, the DJIA has climbed more than 68 percent, and other market averages have delivered even more impressive gains.

Too many investors, however, have not participated fully in the markets' rise. Why? Because rather than maintaining their stock positions through the depths of the market meltdown, most investors — both individual and institutional — fled stocks in favor of the short-term comfort of cash and bonds.

According to the Investment Company Institute, investors yanked nearly \$250 billion from stock mutual funds during the year ended February 2009, making that annual net outflow from stock funds one of the largest ever.

Even after the market began its recovery, investors were still plowing their money into bond funds. For the 12 months ended February 2010, bond funds experienced net inflows of \$420 billion while stock funds garnered just \$25 billion, a mere fraction of the \$250 billion pulled out in the year prior.

Ouch. Talk about watching the train leave the station without your money in it.

If these moves into and out of stocks sound all too familiar, they should. Investors have long demonstrated an uncanny ability to load up on stocks near market peaks and bail out near the bottoms. In stark contrast to the "buy low, sell high" ideal, the reality of investors' timing decisions exacts a stiff toll on their wealth:

- In a study of investors' moves into, out of and between stock and bond funds from 1980 to 2005, Vanguard's John Bogle found that investors' decisions cost them 2.7 percent per year. Even during this remarkable 25-year run for stocks, investors managed to earn just a little more than 75 percent of the return that was simply there for the taking.

- Dalbar Inc.'s study of investor behavior found that over the 20 years ended in Decem-



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ber 2008, investors in U.S. stock funds earned less than 2 percent per year, while the broad U.S. stock market delivered nearly 9 percent. On a \$1 million portfolio starting value, such underperformance represents the chasm between ending up with \$1.5 million or \$5.4 million.

This staggering price of emotion is not paid by retail investors alone. Large institutional investors and prominent money managers — supposed to be the

sharpest among us — make similar mistakes.

A recent review of pension plan sponsors (the trustees who direct endowment and pension portfolios) found that their collective decisions to hire and fire money managers cost them more than 1 percent per year. Over the 1984 to 2007 period under study, a lost 1 percent per year amounts to a staggering \$170 billion.

If you think the failure of the so-called "smart money" to beat the market means the "little guy" has absolutely no chance to have a successful investment experience, think again. In fact, success in investing requires neither sophisticated market knowledge nor a stratospheric I.Q.

To paraphrase investing legend Warren Buffett, all that is needed is the temperament to control the urges that so frequently get other people into trouble. Very simply, don't let your emotions guide your investment decisions.

Easier said than done, you say? No question.

On March 10, 2009, the day after the DJIA closed at 6,549, the Wall Street Journal ran a cover story in which Buffet himself was quoted as saying the "economy has fallen off a cliff." Who would have thought at the time that it was the best day to buy stocks in nearly 30 years?

Maintaining an investment strategy in the face of such extreme market pessimism requires uncommon discipline, detachment or some blend of both. Very few have the right temperament. But, the world recently learned of an investor who possessed such characteristics, and in her

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story may lie a lesson for the rest of us:

Grace Groner, of Lake Forest, Illinois, passed away recently at the age of 100, leaving \$7 million to her alma mater, Lake Forest College. Despite the fact that she was orphaned at age 12, never owned a car, and lived in a small one-bedroom house amidst the mansions more typical of this tiny suburb of Chicago, Ms. Groner had the "right stuff" from an investment point of view.

As reported in the Chicago Sun-Times, she purchased three shares of Abbott Laboratories stock in 1935 for \$60 each. Ms. Groner, who worked as a secretary at Abbott for 43 years, always reinvested the dividends and never sold her shares. Over the subsequent 75 years, those initial three shares multiplied into more than 100,000, meaning her \$180 initial investment grew more than 38,000-fold to approximately \$7 million.

During those 75 years, both Ms. Groner's Abbott shares and the broad market went through multiple periods of upheaval. Just two short years after her initial purchase, Abbott shares lost one-third of their value in the bear market of 1937 and didn't recover in price until 1944.

Surely, she had ample reason to question the wisdom of her investment. She held on, however, and continued to do so despite plunging stock prices in 1962, 1970, 1974, 1982, 1987, 1990, 2002, and 2008.

And therein lies the lesson: Call her "strategy" disciplined, disinterested or worse. Whatever you call it, you have to admit it sure beats the price of emotion.

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