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How to Build a Bomb-proof Investment Portfolio: Part 2 of 3: The 16 Truths About Investing

(excerpted from the book *The Science of Investing Made Simple*)

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Many people hold false ideas or myths about investing. Some even believe in a "magic formula" that can avoid risk and provide a high return, or that a conspiracy drives the market and fudges prices or that investing is a way to get rich. At the same time, there are a lot of true things about investing that many people don't know or don't believe.

Here are the truths:

1. In the 230 years that equity markets have existed in 16 countries, there has never been a 20-year period of time when they have shown a negative rate of return.

2. There have been only two periods when stocks underperformed bonds on the average for 30 years. Those periods were the time ending in 1865 (and including the American Civil War), and today.

3. On the other hand, the markets have shown negative returns quite frequently for shorter periods of time. For that reason, you should be investing in the market with a long timeframe in mind.

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4. When you invest, know your risk tolerance precisely. This means expressing it as a number, not just a phrase like "I am conservative" or "I am aggressive." By what percentage can you accept your portfolio declining during a year? Although you can reasonably expect the value of your portfolio to increase over time, fluctuations downward will happen and there will be periods when it will lose value. How much of this fluctuation are you willing to accept?

5. When you invest, you should have a clear idea for what you are investing. Is it to pay for college in 10 years? Are you on the brink of retirement and concerned with having enough income for the

next 30 years or more? Whatever it is, the purpose for which you invest will determine a lot of your decisions.

Know your risk tolerance precisely.

6. Inflation matters, even when it is low – as at present. It's never zero, and that means your income from investment needs to grow by at least enough to cover the loss in the value of money over the period you're investing.

7. Investing is not a do-it-yourself, instinctive, by-the-gut endeavor. Our instincts evolved to avoid danger in a primitive environment, and many sound investment decisions go against that mindset. A good investment manager can help with this, as that manager is one step removed from the emotional impact of shifts in the value of your investments. But many managers can fall into the same trap. Even more than portfolio products and construction, therefore, you need an evidence-based, rules-based system that is sophisticated in its simplicity.

8. You will not get rich in the stock market. You already may be rich. If not, you should not place your savings at risk of the price of fluctuations. Investing in the stock market is a good way to protect your assets from inflation and ensure long-term appreciation, but the prospect of turning modest means into great riches is a myth. It almost never happens.

9. It is impossible to predict exactly which company, manager, industry, geography, or asset class will outperform the market average. This is why it's important to diversity.

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10 Shares in small companies outperform shares in large ones, over time. At the same time, they fluctuate more in value and so many present greater risk (which goes along with their higher average return). How much small company ownership depends on your risk tolerance, your time horizon, and the purpose for which you are investing?

11. Disciplined, strategic indexing will provide you with a solid portfolio – the core. This should be at least 50% of your portfolio.

And it leads to the virtue of buying lower, while selling high.

12. Fees, taxes, and expenses count, and they count a lot. Saving a mere 1 or 2% in these costs can have a huge impact on the value of your portfolio over 20 to 30 years (the average retirement expectancy). For this reason, we want lower turnover in our portfolios. The less frequently you buy and sell company shares, the lower your transaction costs. If you are tempted to "micromanage" your portfolio so as to only hold shares in any particular company when they are increasing in value, keep this in mind. Every purchase or sale carries a cost, and those costs can easily outweigh any gains from time –hopping, particularly since that's unlikely to work well anyway.

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13. Opportunity costs also matter a lot. Expenses, taxes, and other lost funds count for more than their face value, because they also cost you what they could have earned you if they had not been lost in the first place.

14. Government intervention affects the economy more than it does your long-term investment. The same is true of major economic events such as a recession, even on the scale of the Great Recession. Such things may affect your portfolio's short-term values, and the panic that sometimes sets in among investors can affect it even more, but remember that you should be investing over a long time. Watch the world, not the West, and concentrate on the companies, not the countries.

15. Sequence of returns is not important while your assts are accumulating value, but it becomes critical when you reach the distribution phase of your investments. When you are receiving distributions from your investments, a short-term dip in value can have a major negative effect because you may still have to take the distributions in order to maintain your lifestyle. This puts further downward pressure on your account balances. Other strategies, in addition to investments, may be called for to offset this. While you are not actively taking distributions from the investment accounts, however, what the early or late returns are doesn't matter much. You are concerned mainly with the long-term trend and net investment return.

16. The best time to start investing is 20 years ago. The second-best time is now. Always keep your investments aligned with your long-term strategy, your risk tolerance, your time horizon, and your

goals – not someone else's or some arbitrary figure that may have been supplied by an "expert" who doesn't know your situation.

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There are other details to the science of investing, of course, but these 16 truths lie at the heart of an evidence-based, rules-based, disciplined system that can guide your investments. Those rules and that system are not intended to avoid risks or short-term losses (which is virtually impossible and certainly can't be made to happen), but will help you to safeguard your assets against inflation, provide you with an income for whatever purpose you need it for, and let you achieve a measure of financial security in retirement.

How to Build a bomb-proof Investment Portfolio:
Part 1: The 10 Myths that Cause Investors to Fail
Part 2: The 16 Truths About Investing
Part 3: The 7 Factor Focus

ABOUT THE AUTHOR

MITCH LEVIN, MD, CWPP, CAPP, *THE FINANCIAL PHYSICIAN*™ developed his interest in financial matters while working in the Harvard Graduate School, where he was instrumental in setting up, what may be the first and completely student-financed long-term endowment campaign through insurance and derivative products.

In the early 2000s, Dr. Levin retired from active practice of eye surgery to devote himself to philanthropic endeavors and to his family.

Ultimately, this led him to begin a new career in the field of wealth management and he became *"The Financial Physician*™ and the managing member of Summit Asset Protection Group, LLC.

Summit is a Florida registered insurance agency providing a wide array of insurance products and services to individuals, families, organizations, and institutions.

Dr. Levin is a two-time national best-selling author, trusted advisor and accomplished public speaker.

His published works include a multitude of professional articles and papers, as well as the books *Power Principles for Success; Goal!, The Financial Physician's Ultimate Survival Guide for the Professional Athlete; Shift Happens; Smart Choices for Serious Money;* and *Cover Your Assets: How to Build, Protect and Maintain Your Own Financial Fortress.*

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