TEN INVESTING MISTAKES TO AVOID

ADAM GROSSMAN, CFA

Dear Reader,

Thank you for your interest in *Ten Investing Mistakes to Avoid.*

Recently I heard someone cite a rule of thumb for building an investment portfolio: “Stocks should be equal to 100 minus your age. That way, at age 20 you have 80% of your money in stocks, and at age 80, you have just 20% in stocks.” It’s hard to argue with the logic of this simple idea. But, as you manage your finances, I think you’ll want to be careful with simple rules of thumb. In this ebook, I address ten mistakes commonly made by investors and provide a recommended solution for each.

I hope you find this information helpful, and please contact me at any time with questions.

Best regards,

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1. PAYING TOO MUCH

According to a survey by TD Bank, even when people know that they are paying *something* for their 401(k), often they're not sure where to find this information. My recommendation: Start by asking your human resources department and/or log on to your benefits website. Keep in mind that retirement plans often carry multiple layers of fees. Depending upon the plan, there might be administrative fees, investment fund fees, investment advisory fees, trustee fees, commissions and sales charges. But the most significant—and the one over which you have the most control—are the fees charged by the funds you select. The term you are looking for is "expense ratio." Ideally, you'll find funds that charge 0.1% or less. Even 0.5% is acceptable. If it's much more than that, I would be wary.

2. LETTING THE TAIL WAG THE DOG

Research has shown that asset allocation—the mix of stocks, bonds and other investments you hold—is the single most important factor driving results. For that reason, don't choose based on price alone. While fees are important, if you have to make a choice, it's usually better to overpay for an appropriate investment than to get a bargain on one that is not appropriate.

3. MAKING BIG BETS

In promoting index funds, the late Jack Bogle, founder of Vanguard, often talked about "the relentless rules of humble arithmetic." Indexing worked, he said, because it kept costs low. I completely agree with that, but that's not the only reason indexing has produced better results than active management. Another reason is that active managers can make risky, outsized bets in ways that index funds cannot. A case in point is former star fund manager Bill Miller, whose flagship fund once beat the S&P 500 for an astounding 15 years in a row. During the 2008 financial crisis, however, Miller badly miscalculated. He thought people were overreacting and that the crisis would soon pass. This led him to double down on the stocks of AIG, Bear Stearns and other financial firms that lost nearly all their value. His fund was decimated, and Miller was soon out of a job.

When you invest in a broadly-diversified index fund, you avoid that risk. While you do give up the opportunity to outperform the index, you are simultaneously buying yourself the peace of mind that you won't dramatically underperform when a fund manager's overconfidence gets the better of him.

4. ASSUMING TOMORROW WILL BE LIKE TODAY

As human beings, we have a limited ability to process data, and these limitations bias the way we think about things. Notably, a phenomenon called Recency Bias leads us to place disproportionate weight on recent events and to discount events that happened longer ago. The result is that we generally assume things will continue tomorrow the way they've been going today and don't consider the possibility of extreme change. This is a problem because, of course, things do change. This is where it's important to avoid being over-confident and why I always recommend considering, and planning for, a variety of scenarios other than the status quo. You can't prepare for everything, but as you formulate your financial plan, it's worth considering a tomorrow that looks a good bit different from today.

5. PUTTING TOO MUCH WEIGHT ON THE LAST WORD

The Internet today gives us access to thousands of economic statistics and market indicators. No one, however—including full-time investors—has the time to sift through all this data. As a result, we tend to rely on the information that is most readily available or that comes to mind most easily. While the information might be correct, the danger is that it might be incomplete. One day in 2018, for example, when the government announced that unemployment had hit a multi-decade low, the *New York Times* reported, "The current economic expansion is already one of the longest on record, and there is no sign that it is losing steam." CNN put it in these enthusiastic terms: "The last time the roaring American jobs market was this strong, astronauts were still going to the moon." That same day, however, the Tampa Bay Times ran an article titled, "As corporate debt rises, so do worries about it triggering the next recession," and cautioned that, "By some measures, companies have more debt than at any time in history…" Depending upon which of these stories happened to cross your desk, you might reach very different conclusions about the health of the economy. That is the Availability Bias.

6. BELIEVING PREDICTIONS

When considering financial risk, look beyond the recent past and the “consensus” view among Wall Street pundits.

In November 2008, in the depths of the financial crisis, Queen Elizabeth convened a group of economists and asked a simple question: Why didn’t anyone see this coming? One brave soul answered, “At every stage, someone was relying on somebody else and everyone thought they were doing the right thing.” In other words, no one was worried about a recession because *no one else* was worried about a recession.

The lesson: As you structure your finances, try to think beyond the groupthink. Just because something has never happened before, or hasn’t happened recently, or no one’s talking about it—that doesn’t mean that it can’t happen.

7. BEING TOO SURE

Have you ever struggled with a financial decision? If you’re like most people, I suspect that the math wasn’t the hard part. What makes financial decisions a challenge, more often than not, is the subjective element. Financial decisions involve lots of variables—your future income, interest rates, housing prices, tax rates, and more. We can make reasonable forecasts, but ultimately these decisions require judgment calls in the absence of complete information. No doubt, this can be unnerving. In her 2018 book, *Thinking in Bets*, retired poker champion Annie Duke offers these strategies to help make better decisions in situations like this:

As a poker player, Duke knows the importance of subtle cues. For that reason, she has a number of recommendations on how to communicate better. For example, whenever you're discussing a financial question—whether it's with your spouse, a business partner, a lawyer or a financial advisor—avoid asking the question, "Are you sure?" While that seems like an innocuous question, Duke suggests this alternative: "How sure are you?" This accomplishes two things. First, it acknowledges the reality that there are very few absolute truths when it comes to financial decisions. Second, it allows for a healthier exchange of ideas. The question "are you sure?" puts the other person on the defensive. It's a yes-or-no question and doesn't allow someone to express a less-than-certain level of confidence without feeling defeated. But the alternative formulation, "how sure are you?" allows for a more open discussion, and that, in turn, may lead to a more well thought out decision.

How to apply this principle to your finances: When you're making a financial decision, acknowledge that you can't be 100% certain how something will turn out. Try to think in terms of a range of possible outcomes. Ask yourself what could go wrong, and try to quantify what that would mean to you. For example, if you expect an investment to return about 10%, ask yourself what would happen if instead it lost 10%, or more. Would that change your decision? Or might you take additional steps to protect yourself from that outcome? To be sure, you can't protect yourself against every extreme scenario—a Great Depression-style 90% market crash, for example. But it's reasonable, I think, to imagine a repeat of relatively recent events, such as the 10% inflation we saw in the 1970s or the 50% market declines we've seen twice in the past twenty years.

8. RESULTING

Among poker players, there is a phenomenon known as "resulting." This occurs when players mistakenly assess their strategy in a game based on the outcome. For example, if a player wins, he might conclude that he played his hand well. While that seems logical, it's a mistake because it overlooks the potential role of luck. It also overlooks the fact that other players might have played poorly. In other words, just because something turns out well doesn't necessarily mean that you were following a good strategy. And just because something turns out poorly doesn't necessarily mean you were following a bad strategy.

How to apply this principle to your finances: To avoid resulting when evaluating past decisions, keep a journal in which you document all of your major financial decisions. It doesn't need to be fancy; just note the basic facts and your reasoning so you have it for future reference. This will enable you to review the results of your decisions without rewriting the facts in your mind to fit the outcome.

You should also be careful of resulting when evaluating others' decisions. If an investment manager delivers great results, don't ascribe their success to skill alone. Instead, evaluate their strategy and ask how much was luck and how much was skill.

9. ALPHABETICITY

In the world of personal finance, researchers have long understood that behavioral biases negatively impact investors. Examples include recency bias, hindsight bias, confirmation bias, and many others. These are all well documented. But recently, a group of researchers uncovered yet another investor bias: This one is called "alphabeticity bias."

Alphabeticity, as you might guess, refers to the bias that can occur when choices are presented in alphabetical order. This bias, the researchers note, is found in a number of domains: In elections, candidates at the top of the ballot often win more votes. In fundraising, solicitors call people with A names more frequently (and, as a result, they give more). And consumers do this too, which is why companies favor names like Acme.

In this case, researchers wanted to find out whether alphabeticity also impacts the way people make investment decisions. They examined this question by looking at corporate 401(k) accounts, where workers typically choose from a fixed list of 10 or 20 mutual funds.

The result: Alphabeticity strikes again. Even when it's a short list, the data shows that workers disproportionately choose funds that appear near the top of the list. On the surface, this is unfortunate because a fund's position on a list shouldn't tell you anything about the quality of the fund. But it's doubly unfortunate for this reason: Two companies with expensive funds—American Funds and American Century—land at the top of most lists, while low-cost leader Vanguard usually falls near the bottom.

10. TIMING THE MARKET

Virtually all academic studies agree that market timing is a bad idea. That's because it's impossible to predict the myriad of political or economic events that can impact the market. But if you're feeling stuck because you don't know which way the market is going, there are lots of strategies you can employ.

One is dollar-cost averaging. Suppose you want to buy $10,000 of stocks. With a dollar-cost averaging approach, you might buy $1,000 each month for ten months. This doesn't guarantee a better financial result, but it certainly can help minimize regret and may be better than waiting on the sidelines.

Another approach is to use decision rules. For example, you might decide to buy more stocks only if the market drops below a specific level. Or, if you have stock options, you might decide to sell a specific number of additional shares only when the price reaches a certain level. These kinds of rules are great because they replace emotion with a mechanical process, ensuring that you follow through.

A third approach, if you can't ignore your gut feel about the market, is to split the difference and do a small amount of timing. Cliff Asness, a well regarded fund manager, refers to this as "sinning a little." If you time the market with a slice of your portfolio, it might help or it might hurt, but the important point is that it need not be an all-or-nothing decision.

NEXT STEPS

- **Looking to learn more?** Visit Mayport's website to download other ebooks in this series.

- **To discuss how these principles apply to your own portfolio,** you can schedule a call with Mayport principal Adam Grossman.

- **For a complimentary analysis of your portfolio,** please get in touch.

ABOUT THE AUTHOR

ADAM M. GROSSMAN, CFA

Adam Grossman is the founder of Mayport Wealth Management. Adam founded Mayport with the goal of providing comprehensive service at a fair price. Specifically, this means that Mayport charges simple, fixed fees, rather than the typical 1%-of-assets fees that most firms charge.

Adam is a graduate of Williams College and holds an MBA from the Sloan School at MIT. He is a Chartered Financial Analyst and a member of the CFA Institute. Adam has several years of experience working with high net worth individual and families to help plan for a safe and secure financial future.

If you would like to discuss your individual needs, please contact Adam at adam.grossman@mayport.com or schedule a call at your convenience.