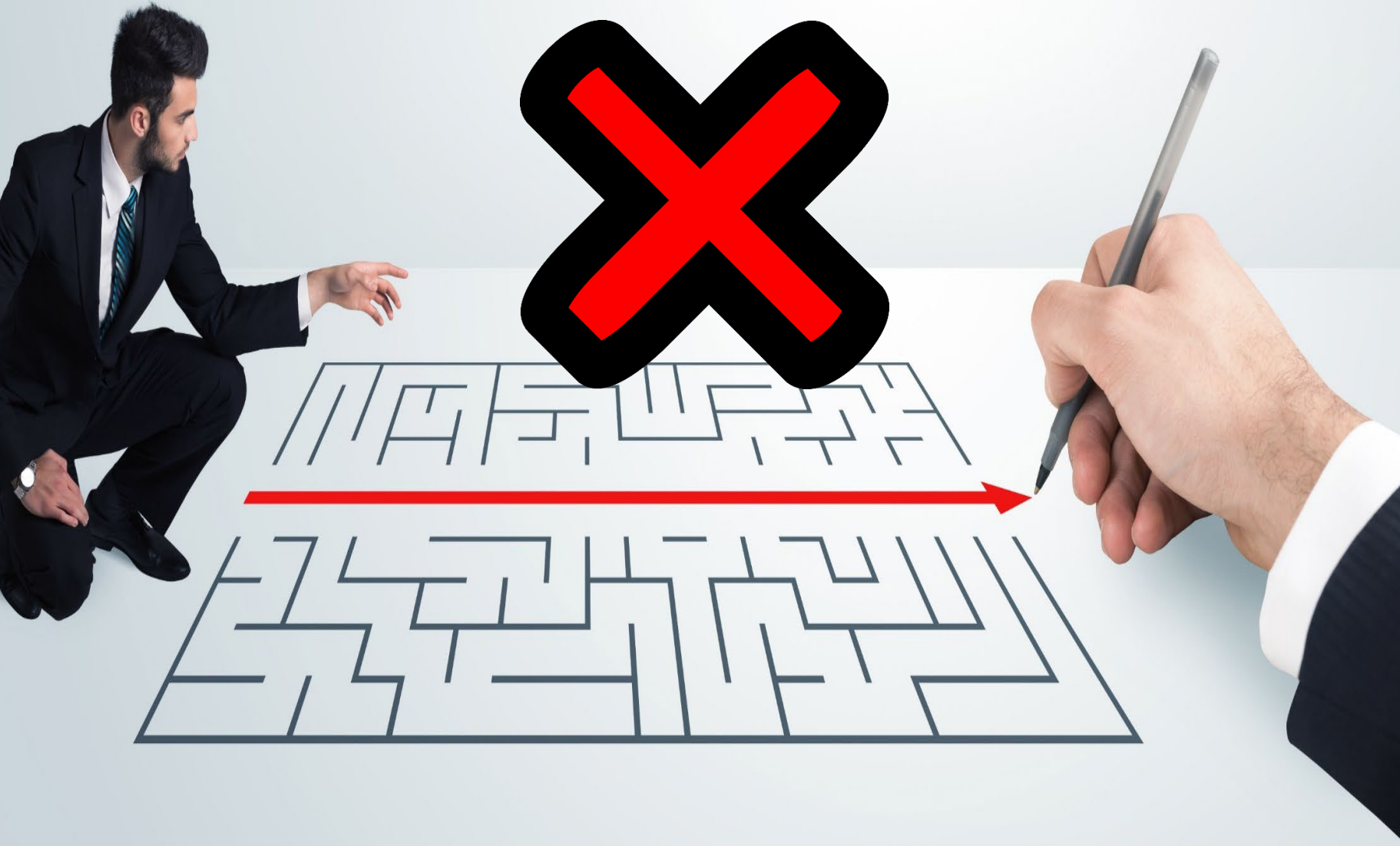


Allow others to complicate your investing



Sasin | School of Management

Andrew Stotz, PhD, CFA



Keep investing simple



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Learning outcomes

- Learn that success comes from reducing, not increasing information
- Learn why it is critical to create a simple financial plan

Learning outcomes

- Understand company and market risk
- Know the minimum number of stocks an investor should hold
- Clearly see and apply the biggest risk reducer when investing

Does more information improve decisions?

- ★ Studies have shown that when you give people more information before they make a decision, something interesting happens

Research



Does more information improve decisions?

- ★ Their confidence level rises
- ★ But
- ★ Their decision-making does not improve

Research



More information does not always help us

- ★ The financial world is full of information
- ★ Newspapers, magazines, TV, and online content bombard us every day
- ★ Ever feel overwhelmed?



More information does not always help us

- ★ Imagine you want to cross the street
- ★ Even this simple task throws a lot of information at you
- ★ You see the billboard across the road

Steps 1 **2** 3 4 5 6 7 8 9 10 11 12

More information does not always help us

- ★ Your friend is talking to you
- ★ Your phone rings
- ★ Another friend is on the other side of the road calling out to you

More information does not always help us

- ★ But what is the only information that really matters?
- ★ Whether you are about to step in front of a bus!



A simple financial plan is easy to follow

- ★ If your financial plan is too complicated, you won't follow it
- ★ More information does not mean better decisions
- ★ So keep your plan simple

Don't be impressed by complex plans

- ★ Financial institutions and advisors often create lengthy financial plans

Don't be impressed by complex plans

- ★ That plan may seem impressive, but its complexity usually means you need assistance to follow it
- ★ Let's make a plan that is simple enough for you to follow it on your own

Three general stock investing options

- ★ Own one stock,
- ★ Own all stocks,
- ★ Own some number of stocks between these two extremes

Buying one stock is highly risky

- ★ By owning one stock, you expose yourself to the risk that the company you are investing in goes bankrupt and its share price collapses, leaving you with nothing

Buying one stock is highly risky

- ★ Share price collapse happen more often than you might think
- ★ I have known some people who made the decision to buy one stock at the recommendation of a friend, and then...

Buying one stock is highly risky

- ★ ...lost almost all their money when that stock collapsed
 - They then often say “I will never invest in the stock market again”

Buying one stock is highly risky

- ★ But, when they bought only one stock they took on unnecessary risk
- ★ Of course, they thought that stock would be a winner

Buying one stock is highly risky

- ★ And they risked all their money on it
- ★ But it turned out to be a loser
- ★ It is likely that people who buy only one stock did not know how much risk they were taking on

Buying one stock is highly risky

- ★ But unfortunately, the world does not care when people don't know they are taking on excessive company-specific risk



What is the risk of owning all stocks?

- ★ If you owned all stocks in the stock market, this company-specific risk would not affect you because...
 - ...when one stock crashes, another rises

What is the risk of owning all stocks?

- ★ Of course, you would still be exposed to the ups and downs of the stock market

What is the risk of owning all stocks?

- ★ If you own all stocks and the stock market crashed, you will lose some value in your portfolio, but not all the value

What is the risk of owning all stocks?

- ★ This is different from if you owned only one stock of a company that went bankrupt

What is the risk of owning all stocks?

- ★ Of course, if you owned all stocks, you would miss the big gains that can come from owning one great stock

What is the risk of owning all stocks?

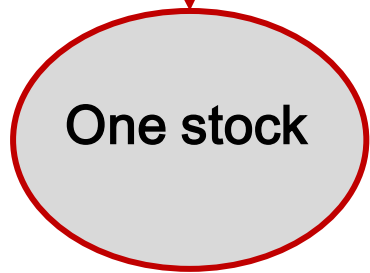
- ★ The trade-off is that your portfolio would never collapse completely

Understanding the two main risks

- ★ Company specific risk
- ★ Market risk

Understanding the two main risks

Company risk
+
Market risk



Risk that the company's
share price collapses

Company risk
+
Market risk



Risk that the overall
stock market collapses



How many stocks should you own?

- ★ If you were picking your own stocks, what would be the right number of stocks to own in a portfolio?

Research



How many stocks should you own?

- ★ My research and my experience show that to eliminate unnecessary risk, you should hold at least 10 stocks

Research



How many stocks should you own?

- ★ Ten is a large enough number of stocks to partially protect your portfolio from being damaged by any one stock collapsing

Research



How many stocks should you own?

- ★ But not so large that your portfolio is just following the market
- ★ Owning 10 stocks reduces the majority of unnecessary company-specific risk

Research



Story time...

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Imagine an alien arrives on earth from Mars

- ★ He stands at the side of a road
- ★ And upon seeing a car approaching, flags down the driver and asks him



Imagine an alien arrives on earth from Mars

- ★ “Hey, can I drive your car?”
- ★ The driver agrees, quickly explains how the gas, brakes, and steering wheel work and the Martian speeds away



Imagine an alien arrives on earth from Mars

- ★ The Martian drives as fast as the car can go, loses control, and hits a tree and flies through the windshield and dies



Imagine an alien arrives on earth from Mars

- ★ The Martian did not know what that strap that goes over your shoulder and buckles you into the seat was



Imagine an alien arrives on earth from Mars

- ★ He did not know that a seatbelt could protect him while driving
- ★ He paid the price for his ignorance with his life



Imagine an alien arrives on earth from Mars

- ★ You wear a seatbelt in a car because you understand how it can reduce the risk of injury in case of an accident



Imagine an alien arrives on earth from Mars

- ★ But, because he was an alien from Mars, he had no idea what it was or why he should wear it



Imagine an alien arrives on earth from Mars

- ★ Did the world care that he did not know what a seatbelt was?
- ★ Of course not!
- ★ The lesson is that you are not rewarded for taking on unnecessary risks



So what 10 stocks should you buy?

- ★ How would you find the best 10 stocks?
- ★ How would you track them?
- ★ How would you know when to sell them?

So what 10 stocks should you buy?

- ★ You would have to keep a close eye on company-specific news and watch quarterly profit announcements for each of those ten stocks

So what 10 stocks should you buy?

- ★ You would end up doing the job of a professional fund manager!
 - Of course if you like that job and you have time then enjoy!

So what 10 stocks should you buy?

- ★ Do you want to pick stocks with your time?
- ★ Don't worry, there are other options we will get to later

Risk reducer #1: Own no less than 10 stocks

- ★ Consider this like your seatbelt in a car



What can research teach us?

- ★ In 2008, two professors reviewed a survey of many US investors
- ★ In their research, they had asked how many stocks those investors held in their portfolios

Research



How many stocks do people own?

- ★ Now you know that a person who picks stocks should own about 10 stocks in their portfolio to reduce most of their company-specific risk

Research



How many stocks do people own?

- ★ How many stocks do you think the investors had?
- ★ Take a guess!
- ★ But, wait, before you guess

Research



What can research teach us?

- ★ Remember, there is decades of free academic research on how many stocks you should hold
- ★ Now, what's your answer?

Research



What can research teach us?

- ★ The results of the study showed that 75% of the investors surveyed owned five or fewer stocks
- ★ Fifty percent owned only one or two stocks!

Research



What can research teach us?

- ★ Most people take on much more risk in the stock market than they are rewarded for

Research



What can research teach us?

- ★ They do not wear their seatbelts
- ★ And remember, these are the sophisticated investors who actually own stocks

Research



Seatbelt reduces risk related to owning stocks

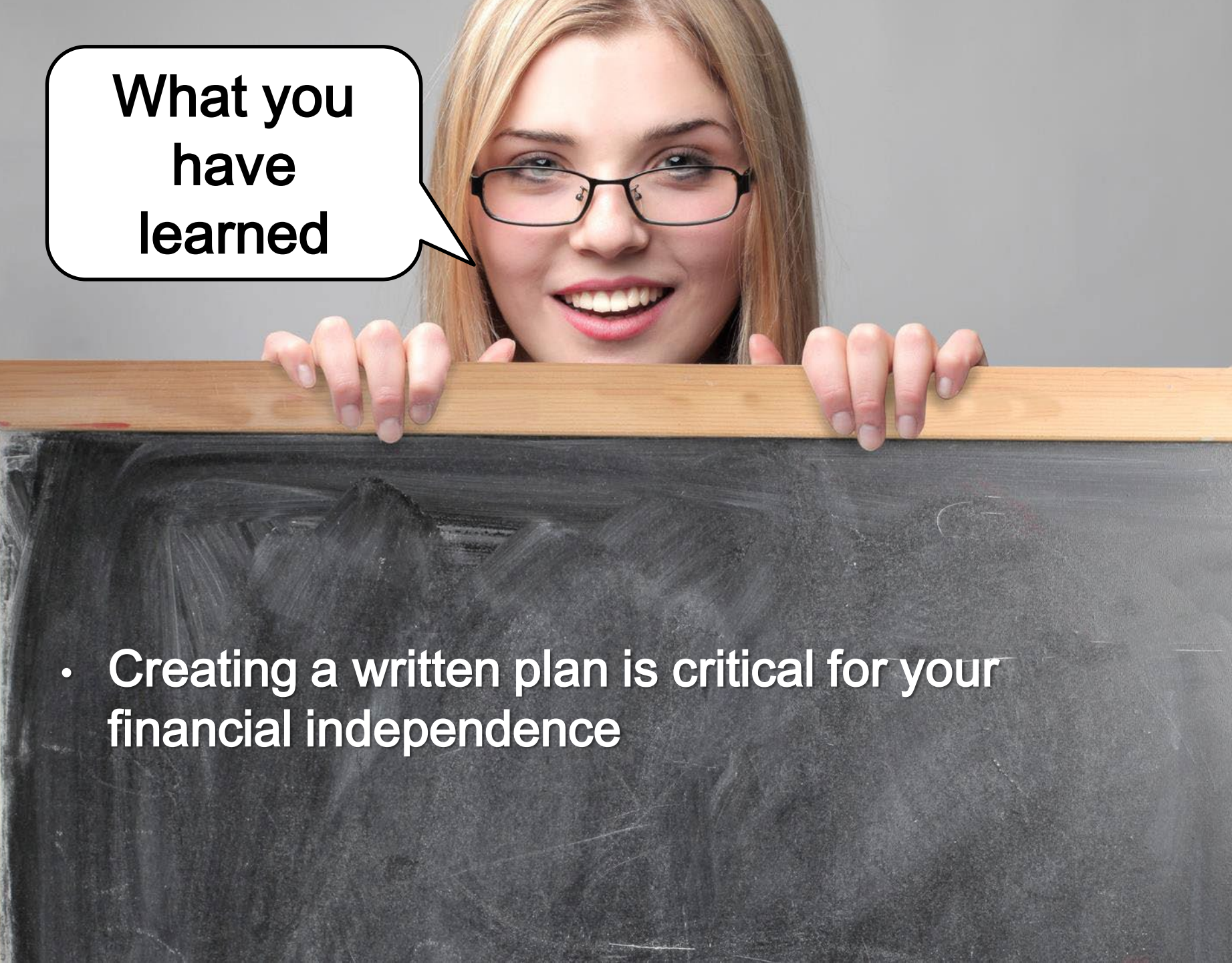
Seatbelt reduces risk related to owning stocks

Types of investment risks	Risk	Owning fewer stocks	Owning more stocks
Company-specific risk	One company's stock price falls	Increases	Decreases

Seatbelt reduces risk related to owning stocks

Seatbelt reduces risk related to owning stocks

Types of investment risks	Risk	Owning fewer stocks	Owning more stocks
Company-specific risk	One company's stock price falls	Increases	Decreases
Market risk	The whole market falls	No impact	No impact




What you
have
learned

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- Keep it simple – only pay attention to the information that is most important

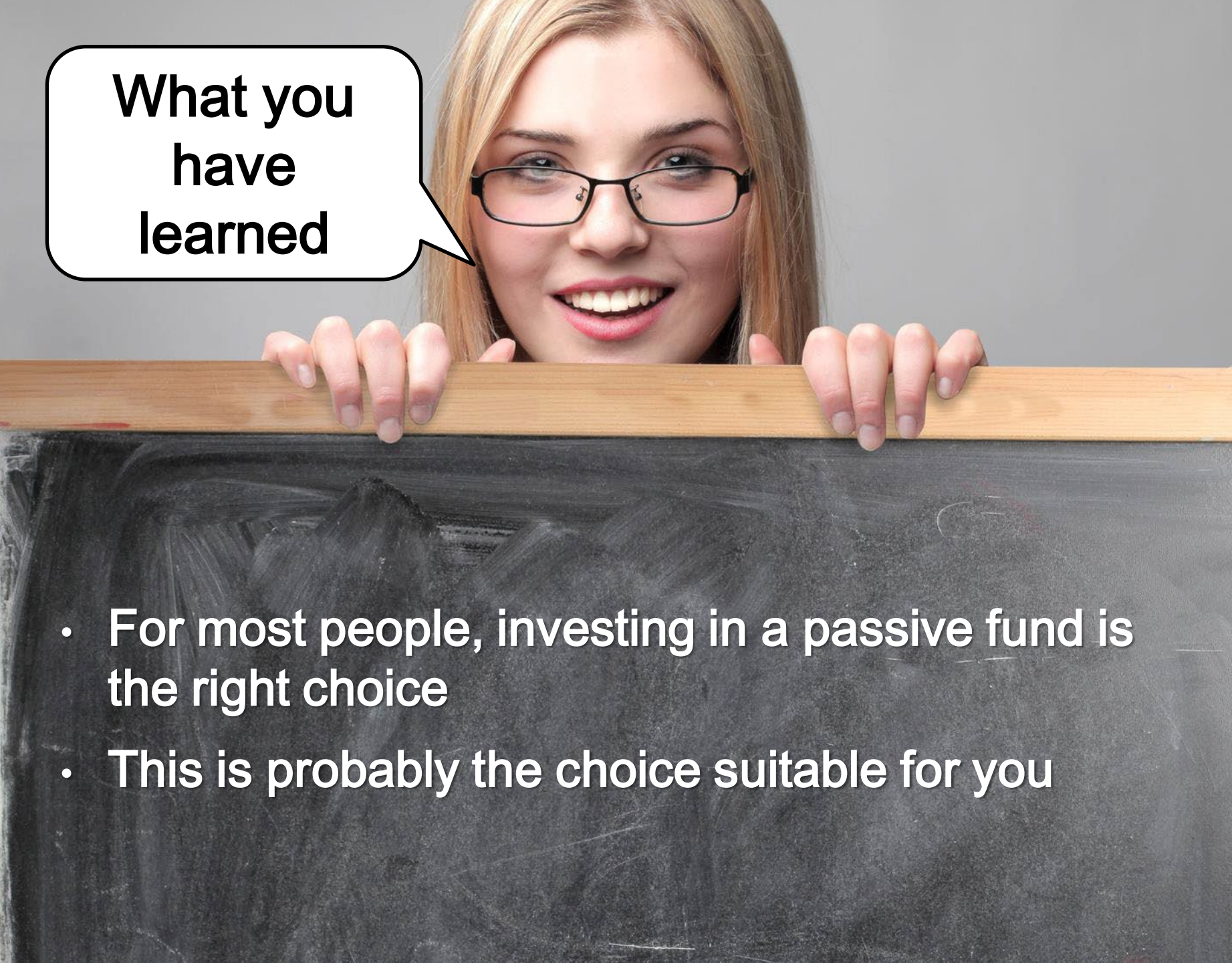


What you
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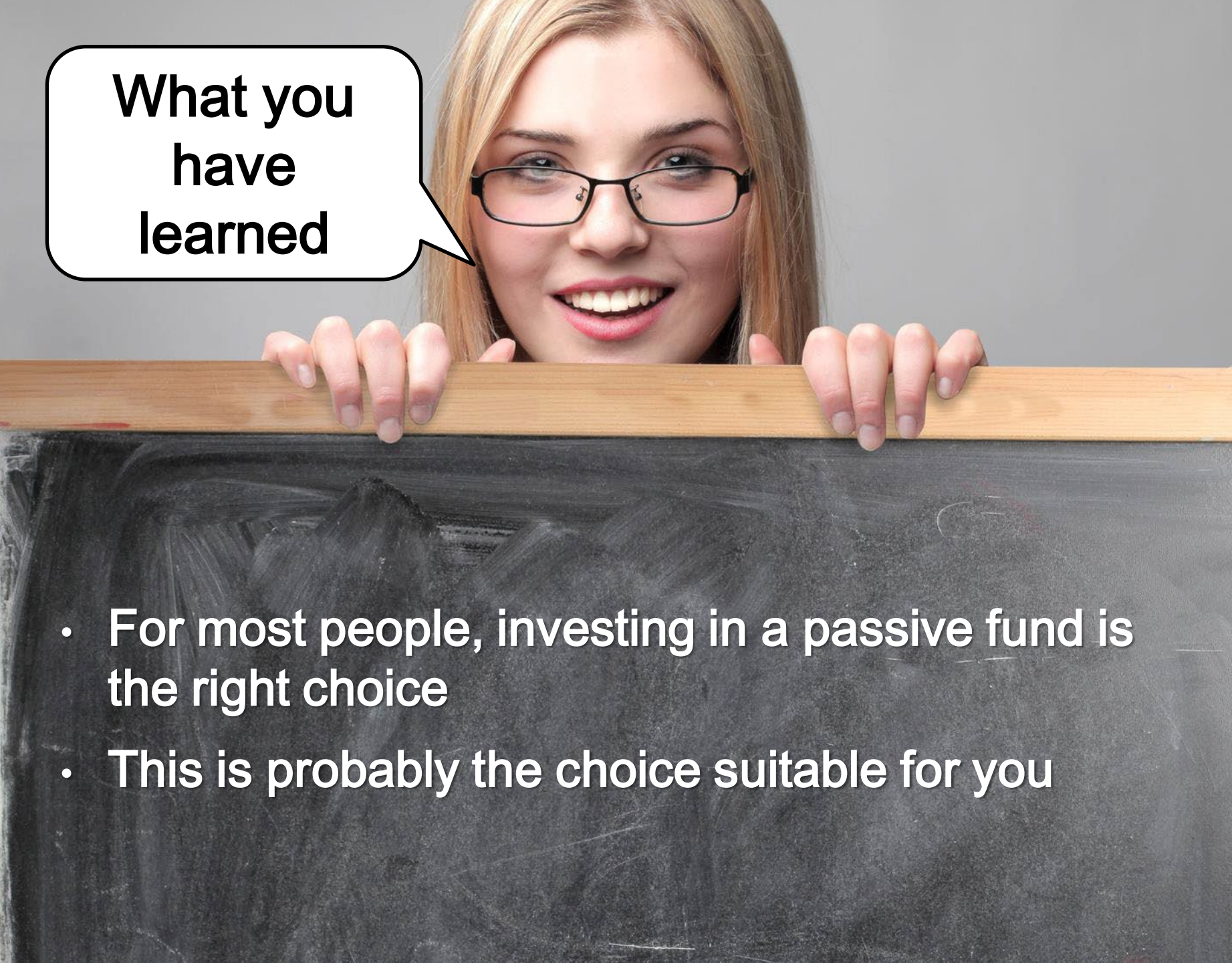
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- Owning stocks exposes you to company-specific and market risk



What you
have
learned

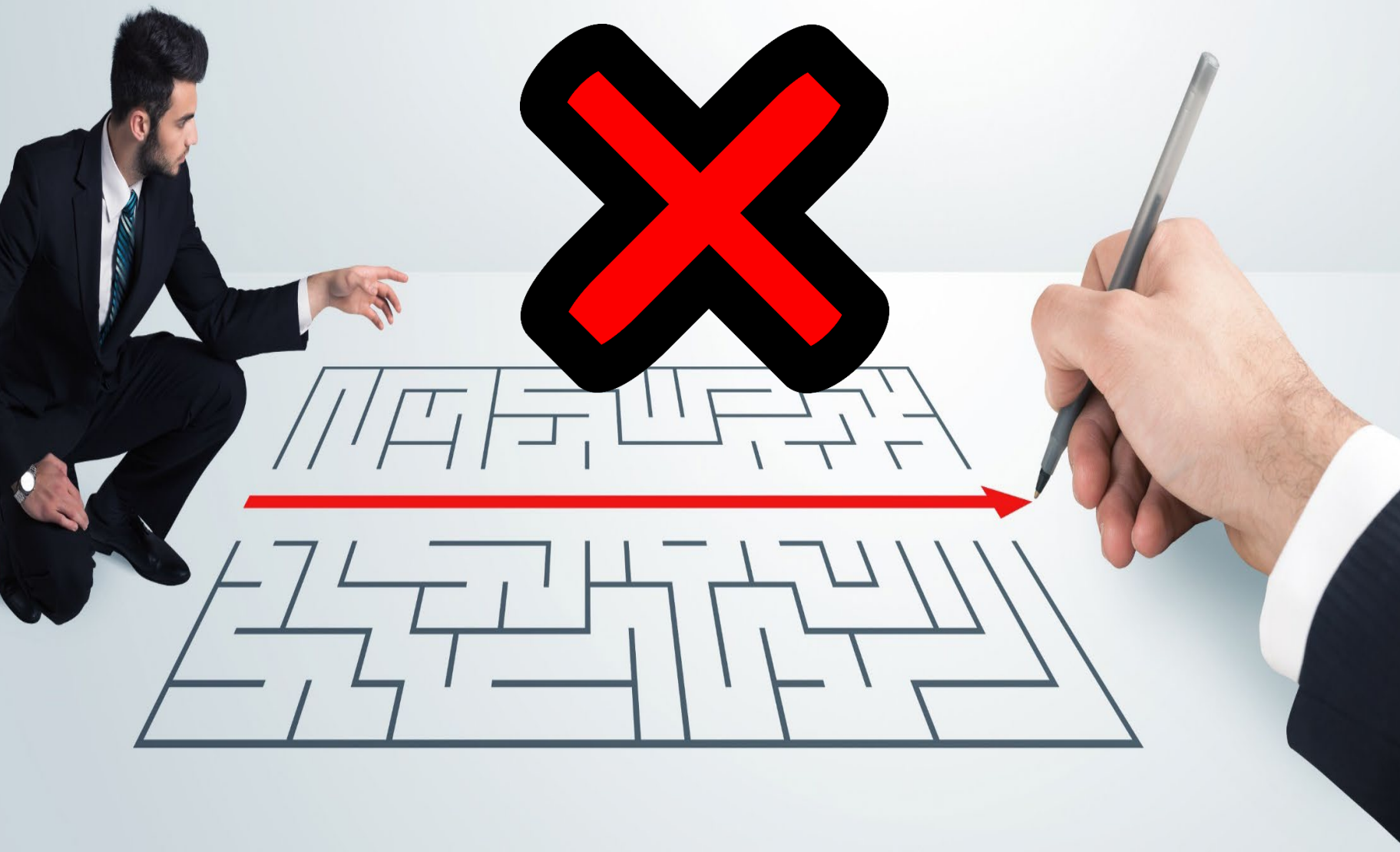
- To eliminate unnecessary company-specific risk, hold at least 10 stocks
- This diversification is like wearing your seatbelt in a car



What you
have
learned

- Most people are probably not suited for or interested in buying individual stocks
- Later chapters will introduce other options

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