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Learning outcomes

- Be empowered to do less
- Learn why action leads to costs and mistakes
- Understand how action could cause you to lose half of your money

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Avoid trading the market

★ The stock market has constant ups and downs, it’s hard not to want to “play the market”

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Avoid trading the market

- ★ It is exciting when you own stocks, so it is natural to want to always be watching the market
- ★ This can cause you to trade far more than you should

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Avoid trading the market

★ When investing in the stock market, patience is key, trade as little as possible

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Active trading brings two problems

- First, there is a cost every time you buy or sell (called shareholder or transaction costs)
  - A broker or a fund manager somewhere must do something to make your trade happen, and the must be paid (There is no free lunch!)

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Active trading brings two problems

- Second, every time you trade, you run the risk of buying or selling at the wrong time, which can destroy the wealth you have built

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Actively trading is a losing long-term strategy

- Avoid telling yourself that you can get rich by actively trading stocks
- It is a losing strategy

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Trading increases fees and reduces returns

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- ★ You now know that you should start with the conservative expectation of about 8% return for the stock market

Trading increases fees and reduces returns

★ If you add in bonds, as you should, your long-term total portfolio return might go down to about 5.5%

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Trading increases fees and reduces returns

- ★ Most investors then pay fees to active manager's or others of about 1%, so their long-term return falls to 4.5%

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Building wealth comes from staying invested

- As we saw in previous chapters, building wealth in the stock market is not about trying to shoot for high returns

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Building wealth comes from staying invested

- ★ Rather it is about leaving your money in the market for a long time to get the benefit of compounding
- ★ Remember that the stock market is where you grow your wealth

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Building wealth comes from staying invested

- Success in the stock market comes from contributing as much money as possible, as early as possible

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Building wealth comes from staying invested

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- ★ Though most investors like to think that they are good at timing the stock market, over the long run they rarely succeed

Bad timing is another reason not to trade

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- One way to understand the damage bad timing can have on your investment performance is to calculate return in a way that considers the timing of when an investor puts money into a fund

Bad timing is another reason not to trade

- The main thing to understand about the result of this calculation is that over the long run bad timing is almost always damaging to your return
- How damaging? Well let’s see

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What can research teach us?

- One study estimated that the average investor loses over 1% of the market return due to their badly timed trading behavior
- Think about that for a moment

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Research

What can research teach us?

- The average mutual fund investor's timing is so bad that they lose at least 1% of the total stock market return that they could have had, just because they wanted to try to time the market

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Research

What can research teach us?

- ★ If they had just bought and held their stocks, they would not have had this problem

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Research

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Why most people lose in the stock market

- Over the long-run, at best, they probably earn about 8% per year
- If they know enough to reduce their risk by blending in bonds, that long-term annual return of 8% becomes about 5.5%

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How you can beat most investors

Assumptions	Others	You
Expected LT stock market return	8.0	8.0
Expected LT bond market return	3.0	3.0
50/50 Blend of stocks and bonds	**5.5**	**5.5**

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Why most people lose in the stock market

- ★ They lose at least 1% per year in fees to financial professionals
- ★ They lose about another 0.5% because of shareholder fees related to buying and selling

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How you can beat most investors

Assumptions	Others	You
Expected LT stock market return	8.0	8.0
Expected LT bond market return	3.0	3.0
50/50 Blend of stocks and bonds	**5.5**	**5.5**
Fund manager fees	(1.0)	(0.2)
Shareholder & transaction fees	(1.0)	(0.1)
Portfolio return after fees	**3.5**	**5.2**

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

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Why most people lose in the stock market

- ★ They lose about 1% because of their bad market timing
- ★ With all that buying and selling they end up paying taxes of about 1%

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How you can beat most investors

Assumptions	Others	You
Expected LT stock market return	8.0	8.0
Expected LT bond market return	3.0	3.0
50/50 Blend of stocks and bonds	**5.5**	**5.5**
Fund manager fees	(1.0)	(0.2)
Shareholder & transaction fees	(1.0)	(0.1)
Portfolio return after fees	**3.5**	**5.2**
Penalty or cost of bad timing	(1.0)	(0.2)
Tax costs	(1.0)	(0.1)
Portfolio return after all costs	**1.5**	**4.9**

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Why most people lose in the stock market

★ It is hard to believe, but these costs are real

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Why most people lose in the stock market

- If an investor does not know what they are doing, they may think they are earning 8% annually or more in the stock market, but over the long run they are earning much, much less

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Reducing fees increases your returns

- What you have learned so far is that by buying a passively managed index fund or ETF you can reduce the fees you pay a fund manager from 1% to about 0.2% (or less!)

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Reducing fees increases your returns

- In addition, you would have almost no shareholder fees, such as front-end fees, because you are not using a financial advisor

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Reducing mistakes increases your returns

- ★ Finally you can reduce the penalty you pay for bad timing and taxes by not trading in and out of stocks or funds at all

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Reducing mistakes increases your returns

- As I told my nieces
  - When you are implementing this system, think of it this way, “Never sell – Let it grow!”

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The average return you should expect

- Of course, the situation will be different for each person, but my best estimates in the previous table shows what potential return you can expect over the long term

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Do not trade too much

★ Be patient with the market, and do not stress out about what your portfolio is doing

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Do not trade too much

★ Those people who leave their money in the market are generally better off because

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Do not trade too much

- ★ They reduce stress
- ★ They reduce risk
- ★ They lower costs
- ★ They increase returns!

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Do not trade too much

- ★ This leaves you with much more wealth than if you try to play the market

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What you have learned

- Most people trade a lot, make mistakes, and invest in expensive products

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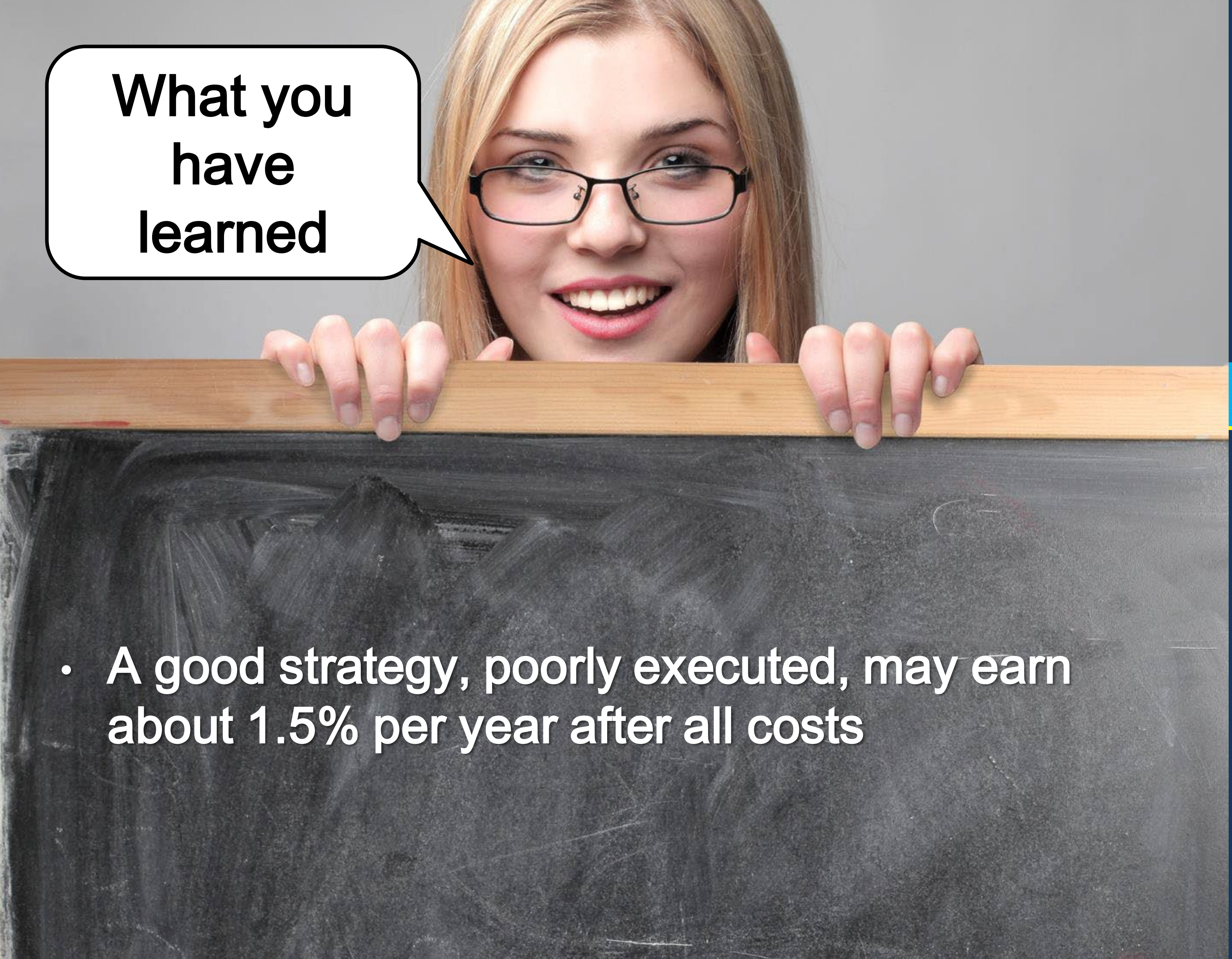
What you have learned



- A good strategy, poorly executed, may earn about 1.5% per year after all costs

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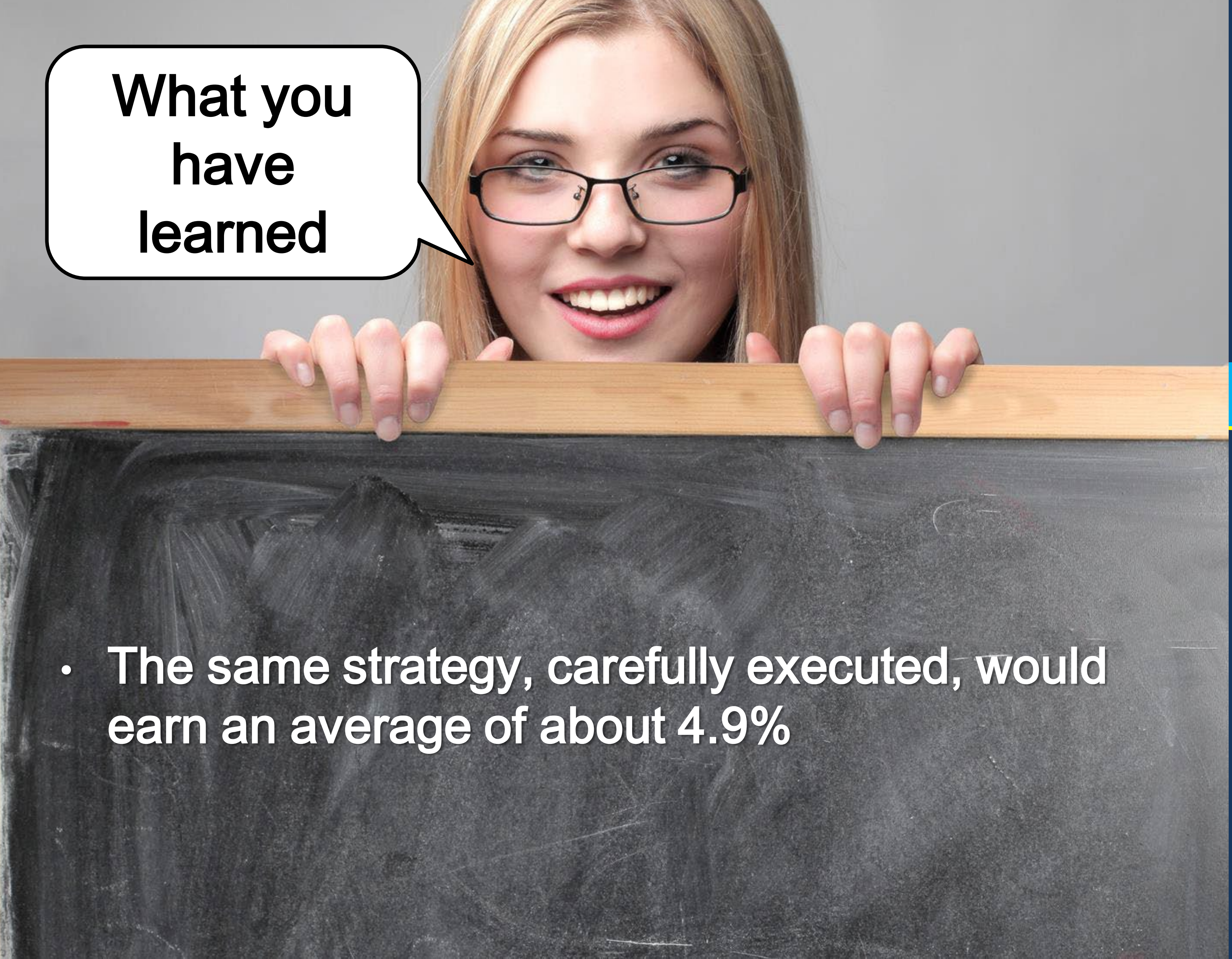

What you have learned

- The same strategy, carefully executed, would earn an average of about 4.9%

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Trade too much

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