viewpoint

MARSHALL & SULLIVAN

Marshall & Sullivan, Inc. / Registered Investment Advisor

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Investor Misbehavior

We recently came across an article written by behavioral finance expert, Daniel Crosby. In the article, the author outlined 12 rules that he believes account for a bulk of investor misbehavior. The article reinforces one of the greatest values of an investment advisor - keeping client from making impulsive decisions. We would like to take that one step further and say that it is equally important for advisors to have strong disciplines in order to avoid letting emotion - instead of fundamentals – drive their investment decisions.

Those of you who work with Marshall & Sullivan know just how disciplined we are in our approach to investing. In this newsletter we thought we would take a look at a handful of Mr. Crosby's rules that dovetail nicely with our own investment philosophy. If you would like to read the article in its entirety, go to http://feelincontrol.org/wp-content/uploads/2012/12/12-rules-that-govern-all-investor-behavior.pdf

- **Your life is your benchmark:** Benchmarking to your own goals instead of arbitrary external ones has myriad benefits. First off, it personalizes the whole endeavor and makes investing about doing what you love instead of outperforming others. Research also shows that goals-based investors are more likely to stay the course during tough times and even save at higher rates, since what they are chasing is so personal.
- **Forecasting is for** weathermen: Famed contrarian David Dreman found that from 1973 to 1993, of the 78,695 estimates he looked at, there was a 1 in 170 chance that analyst projections would fall within plus or minus 5% of the actual number. The smartest people in the world don't bother with the crystal ball. Said JP Morgan of the market's future trajectory, "It will fluctuate."
- **Diversified doesn't mean never going down:** Diversification is not a panacea nor does it prevent your portfolio from falling, even dramatically at times. What it does is protect you from idiosyncratic risk and losing your shirt on a concentrated bet. Buying a car with an airbag is not a bad idea, even if you never get in a wreck. Diversifying your portfolio is wise, even if the benefits may not always be apparent.
- **This time isn't different (and neither are you):** Robert Shiller is fond of saying that "This time it's different" is the most dangerous phrase in investing. While mania can carry a market for a time, the truth about what works long-term on Wall Street is pretty boring (think paying a fair price for a profitable company) and is unlikely to fundamentally change.
- **Excess is never permanent:** John Neff astutely noted that, "Every trend goes on forever, until it ends." It has been said that nature abhors a vacuum and an investment corollary is that markets abhor excess. While short term trends and emotionally fueled investors can push a stock up or down for a time, things tend to come back to Earth eventually. Betting that something will rise or fall in perpetuity is a risky bet.
- **Risk is a permanent loss of capital:** Risk is not a paper loss. Risk is not underperforming your golf buddy. Risk is not even underperforming the benchmark. Real risk is the probability of you permanently losing your money. Viewed thusly, those with a long time horizon and diversified portfolios are taking on very little risk indeed.

These principals are embraced within our own investment philosophy. And, as mentioned in last quarter's newsletter, we strongly adhere to a well-defined fundamental approach combined with prudent asset allocation. In the long run, we believe this strategy is more likely than not to remove emotion from our investing decisions and provide meaningful, positive value to our long-term portfolio results.

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