Investing - Twelve Key Lessons

Here is a summary of twelve key lessons I have learned in over fifty years of investing:

Lesson One: It takes ten years of full-time study to become a good investor

The point here is that there is a two-stage process. First we learn the basic knowledge. This is the easy part. Then we learn how to apply the knowledge from experience. This is the tough part. Notice that I said ten years of **full-**time study. It took me longer because I had a day job and my study was part-time, as a hobby. What I have learned is that the key aim in the ten years is to try not to lose too much while we are learning. This leads into lesson two.

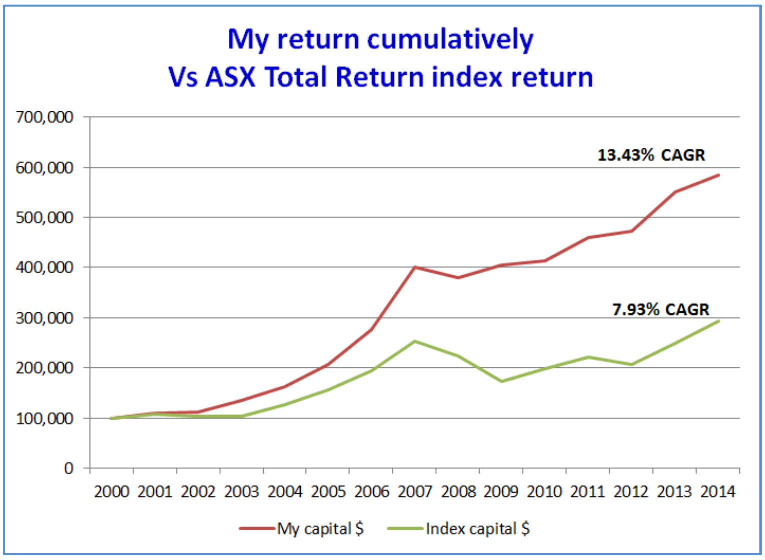
Lesson Two: Over 90% of investors are better in index funds, LICs* or managed funds

Lesson one suggests that most people do not wish to make the time and expend the effort to become good investors, which basically involves learning a new profession. However, they need not despair. My formula is that if they still want to try to improve their skills and maybe become a good investor one day, it is best to start managing no more than 10% of their investment capital. The rest should be invested in the above instruments. Then, if they are able to beat the index fund, gradually take more of their investment capital under their own control.

* LICs are Listed Investment Companies. Note that they do not all have the same cost structure, so check this, which will bias you towards the bigger and longer-established LICs.

Lesson Three: Market timing is possible, but not simple

Market timing is what I do and teach. It took me a lot longer than ten years to learn, because I did it while earning my crust in a day job. It was my hobby. It was a very rewarding journey. Market timing is far more difficult than passive investing. It takes great skill and experience. It requires a lot of time and effort. My investing record over the last couple of cycles is evidence of what can be done:



I update this chart each year on my website at About Colin/Investment Returns.

Lesson Four: Investing without a plan is like flying on a wing and a prayer

The origin of this expression comes from the First World War, when a pilot landed a plane with only one undamaged wing. He confessed to praying all the way in and a wag coined the expression on the spot.

My experience teaches me that a successful investor is more than likely to have a **written** investment plan. It will be **complete**. It will have been **tested**. It will always be a work-in-progress, but fewer changes are made over time as it is honed to the required level and begins to **fit closely to the investor's personality**.

Lesson Five: Fundamental analysis and technical analysis are best used in combination

I use both, but those who use only one and think the other is useless all regard me as a heretic. The reason I use both is that they are different tools and they are best used for what they do well:

Fundamental analysis gives us great insights into relative value. I use it in stock selection to ensure that the stocks I buy have a margin of safety. It gives few useful insights into timing.

Technical analysis gives us great insights into timing. I use it to decide when to buy, where to situate sell stops, when to build positions, when to take profits and when to sell. It gives few useful insights into relative value.

Lesson Six: The price paid for a stock is irrelevant after you have bought it

This is the one that I rate very highly as being a turning point in my journey to being a good investor. It is something that many beginners never get past and begin to think like good investors. The price of a stock is what you can sell it for. If it was bought much more cheaply in the past, we cannot go back and buy more at that price. We have to assess whether to buy it at the current price. Likewise, if the stock was bought at much higher prices, we cannot go back and sell at those prices. We have to assess whether to sell it at the current price. This leads into lesson seven.

Lesson Seven: If our stock falls in price there are three options

Best option

Sell it and buy a better prospect - think of "switching" rather than "selling" or "taking a loss", if it helps your psychology.

Second best option

Sell it and sit in cash awaiting a better opportunity. Sometimes there is no obvious better prospect. Cash earns interest, so is better than sitting in a stock which is trending down – death by a thousand cuts.

Worst option

Keep holding it, hope and pray. Good luck. You still have much to learn.

Lesson Eight: If you cannot understand both sides of a trade don't do it

We cannot make sound decisions unless we can first see both the pros and the cons of a situation. We are most vulnerable as investors when we can only see one side. Ask: if our buy is a certainty, why would there be a seller? The way out of this hole is to do whatever it takes to get an opposite view – more research or find someone who can act as a devil's advocate and show us the contrary view. Then we can weigh it all up and reach a much better decision.

Many investors do the exact opposite. They seek views that reinforce their unfounded certainty. This is fatal in my experience. The best friends we have are those who suggest there are things to ponder that we have not thought of or of which we were unaware. Of course, this makes the whole job harder in that every decision means more work and the decisions can seem more difficult. This, however, is good – welcome to the real world of the good investors.

Lesson Nine: It is the losses that destroy portfolio return

This is an expression of one of the most durable of Wall Street sayings – let your profits run and cut your losses short. It is usually dismissed as being the bleeding obvious. Yet most beginners and many quite good investors still do the opposite and at times grab small profits quickly, but let losses run and build until they are so deep in the psychological mire that they are frozen into inaction. This is when I hear the excuse: "it is now worth so little, it is not worth selling". This is translated into the language of good investors: these investors still cannot bring themselves to understand and act on lessons six and seven.

Lesson Ten: Start investing when you are young

Survey after survey in western countries comes up with the conclusion that most people do not understand compound interest and therefore the whole idea of compounding returns. What comes out of a good understanding of compounding is that it is very difficult to make up for lost time and beyond a certain point it is probably impossible unless we win Lotto. The key to investing is: Right from when we earn our first pay packet, we should spend less than we earn, also known as saving; My wife and I lived off one income and saved the other through our whole working life. Then invest the savings progressively through our working life. Through our life and into retirement we will have created the means of living a rich life in which we have more freedom than 99% of the population. While we cannot make up for lost time, it is never too late to start.

Lesson Eleven: It is never different this time

Of course the details change. However, the basic drivers do not. The best way to learn this is to read the rich history of markets, investing, speculation, bubbles and crashes. My mantra is that when someone makes the claim that "it is different this time", I automatically translate it to "we are in a market bubble".

Lesson Twelve: Trying to predict the future is futile and useless

Book after book has been written that shows how poor all human beings are at predicting what will happen in any part of their lives. Of course, the near term is easier to get right sometimes than the more distant future. Even so, it should be obvious to anyone who thinks about it that predicting the future is very difficult if not impossible. This is especially true in economics and investment.

It is also true that most beginners think that the answer to their investing problems is to just find someone who can accurately and consistently tell them what is ahead. In my experience this is an unsound belief that is not supported by the evidence. What evidence that is trotted out will tend to be the odd occasion when someone does predict what will happen. However, what is absent in these cases is any details on how many predictions were made by that person compared to the one which was correct. Afterwards, they only talk about the correct predictions.

There is a better way, which I have found in my experience really works far better. However, it does require, as many of these twelve lessons do, that we change the way we think away from the thinking patterns of beginners and towards the thinking patterns of good investors. This is the secret:

- Assess what is happening in the market
- Design a strategy to take advantage of the situation
- Carry out that strategy (the difficult part)
- If what is happening changes, start the process over again.

My book *Building Wealth in the Stock Market* sets out my investment plan. This idea runs right through it. It has worked well for me over many years and cycles. It is endlessly adaptable.

I hope readers find these twelve lessons of value.

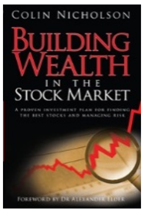
To read more of my work

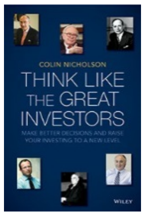
Previous Articles

All my previous articles for the free website are now on the *Educational Articles* page on the Free Resources menu. They are now listed alphabetically by title with a brief description of their contents.

Books

I have written two books, both of which are available for purchase from the ***Buy Books*** menu:





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Members Website

Follow my thinking on my own investments, disclosure of my portfolio as I go, weekly market scans, weekly market charts and analysis plus many more articles about investing and analysis

I am one of the very few investors who publishes their investment results each year, which I have done since 2000 – see the Investment Returns page on the About Colin menu on the website

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