Investing - Understanding its True Nature

Early in 2008 as the bear market got underway, I received this question from a reader:

I see from your portfolio disclosure page on your web site that you sold several stocks from 11 to 18 January 2008 on a downward slope of the ASX and several more on 23 January 2008, the day after the free fall. What was the strategy in your model that caused you to sell that late? To have confidence to follow your advice I need to understand why this loss happened and what can be done to minimize this result in the future.

This was my response to the reader:

My entire investment plan is in my book *Building Wealth in the Stock Market*. There are many parts to the plan and they are all logically interconnected. For you to understand my investment plan, you will need to read the book and work through the examples and case studies in the book.

According to my plan, my sales were not late, except that I avoided selling on the final panic day and sold into the ensuing rally.

When I turned 60, our share investments were worth a seven figure sum. I am now 64 and the worth of our investments is now double what it was four years ago. My returns on capital before tax since 2000 are as follows:

Year	My Return%	Market %	Diff
2000/01	9.69	8.85	0.84
2001/02	2.11	-4.50	6.61
2002/03	20.61	-1.08	21.69
2003/04	17.48	22.37	-4.89
2004/05	26.88	24.75	2.13
2005/06	33.62	24.20	9.42
2006/07	45.25	30.28	14.97
2007/08	-7.42	-11.38	3.96

The 2007/08 return is to 16.03.08.

Value of $100,000 invested 1 July 2000:

Year	Colin	Market
2000/01	109,690	108,845
2001/02	112,004	103,946

2002/03	135,089	102,818
2003/04	158,702	125,819
2004/05	201,361	156,955
2005/06	269,059	194,932
2006/07	390,808	253,961
2007/08	361,810	225,060

As you can see, 2002/03 is the only year since 2000 in which I did not beat the market.

So, I don't think I am looking at unusual losses as your question assumes. Nor were the sales in January especially late on my investment plan as you have suggested in your question. To explain this, there are three issues here which I think are important:

First, it is never useful to judge an investment plan by looking at individual investments. All investing involves investments, which do not work out. That is part of the nature of the art of investing. The aim is not to try to win on every investment, because that is totally unrealistic. Instead, we should focus on the return on capital over an accounting period (I use the Australian financial year). To make a positive return, this means that the total gains from successful investments must be larger than the total losses on unsuccessful investments.

Second, my investment plan is an aggressive one, in that I am attempting to time the market. This is not something which I recommend to inexperienced investors. I have been learning the craft for 40 years and it is only in the last five years that I have managed our entire portfolio. Prior to that, some part of it was with professional managers within the superannuation system. The returns shown above are for the capital which I was personally managing.

My recommendation to beginners is that they should start with only a small part of their assets under their own management. The rest should be with professionals. When we can show that we can match or beat the professional managers, then we can progressively take more assets away from the professionals and manage it ourselves. It could take a decade or more to develop the skills and experience. It took me longer. Many people will find they lack the time, energy, and temperament to learn a new profession, because that is what is involved. As explained in detail in my book The Aggressive Investor, I try to get fully into a bull market as early as possible and then scale out as we approach and pass the top. Reducing my exposure dramatically in the third phase of a bull market helps considerably, but since we never know when the top will be, only its proximity, there will always be some unsuccessful investments once the top is passed and sell signals are encountered.

Third, one of the most important aspects of investing is the management of risk. There are many parts to this, but one of the more important is the use of what is called money management to limit the risk on each investment as a proportion of the portfolio total. In the preamble to your question, you mention the stocks I have sold in January. These were:

- Retail Food Group (loss of 0.66% of portfolio)

- Cardno (loss of 0.63% of portfolio)
- Wesfarmers (loss of 0.33% of portfolio)
- Amalgamated Holdings (loss of 0.29% of portfolio)
- David Jones (loss of 0.34% of portfolio)
- Fosters Group (loss of 0.29% of portfolio)

I try to limit risk to 0.5% of the portfolio on any one investment. Allowing for some slippage in selling the first two, you can see that these sales were not out of the ordinary and did not involve big losses in terms of my investment plan.

I hope this helps you to understand the nature of the issues in learning to be a successful investor and maybe it will encourage you to look further into what I do as explained in my book *Building Wealth in the Stock Market* and further brought to light on the members website.

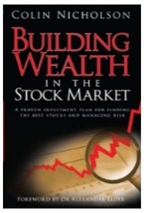
To read more of my work

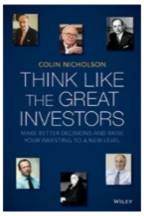
Previous Articles

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