

How to be a Successful Investor Or: Stop Gambling and Speculating with Your Hard Earned Money

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Most people don't really know how to invest. Why is that true?

The answer is simple. It is not something we are ever taught. It's like parenting. We aren't taught how to parent, so we end up doing what our parents did, what our neighbors or friends have said worked for them, or what amounts to a trial-and-error approach with our children.

Well, isn't that what you do with your investments too? We tend to buy what sounds good in the moment and, through trial and error, we then hope for the best. Unfortunately, we won't know our results for several years.

Investing versus Speculating

What if I could just give you the keys to prudent investing based on more than 60 years of academic evidence? Yes, that's right evidence (peer-reviewed findings) on how to invest, which could provide you with the highest probability of success over time.

Wouldn't that be helpful? It's sad to say, most people have never heard of the scholars who have been awarded Nobel Prizes for their empirical research leading to the academic evidence available or the concepts of prudent investing.

Let's start with the Rules of Investing.

Oh, you didn't know there were rules? Interesting. So what are they?

1: Own equities, which are stocks or stock-based mutual funds.

2: Diversify globally.

3: Rebalance, which allows you to follow the Golden Rule of Investing (buying when prices are relatively low and selling when prices are relatively high in relationship to the overall percentages allocated to your globally allocated positions).

Isn't that what everyone would like to do? Well how do you do it?

Measure Twice, Cut Once

There are some things you need to know before you get started. Here are some of the questions you need to ask yourself:

How much risk should I be taking?

What are my goals and objectives?

Do I have a written plan to accomplish my goals and objectives, such as:

When do I want to retire?

How much can I save if I am not retired yet?

How much can I spend?

What are my expenses?

When do I want to access my investments for income/cash for other purposes?

What happens if I get sick or die?

How much income would my spouse need?

Do I want to leave anything to my children?

Do I have an estate tax issue?

How much income do I need to maintain my desired standard of living?

Yes, it goes on and on, with the biggest question being:

Will I run out of money?

Few people have ever sat down and discussed these critically important questions and the issues related to them. In fact, they tend to avoid them, because it's uncomfortable and it's hard work.

But someday, probably when you least expect it, you will have to address like every investor the problems, with or without the help of your spouse. Advance preparation makes better sense, for both of you.

Let There Be Evidence

Now that we have covered those concerns, let's get back to investing. Once you know the Rules of Investing and have answered the critical questions related to your individual circumstances, you need to understand the academic empirical evidence and the use of asset-class investing to help you build a better portfolio you can use for the rest of your life.

Here is that evidence in a nutshell:

1. Modern Portfolio Theory describes how to put your portfolio together so you can maximize your expected returns for any given level of risk you wish to take consistent with your goals and objectives. (See empirical research by Professor Harry Markowitz.)

2. The Three-Factor Model helps you understand which asset classes are expected to give you the highest returns over time (but also typically entail the highest market risks).

(See empirical research by professors Eugene Fama and Kenneth French.)

The three factors are: **equities** outperform fixed income over time, **small-company stocks** outperform large-company stocks over time and **value stocks** outperform growth stocks over time. By tilting your portfolio toward small-company and value holdings, you can pick up these additional expected returns. A portfolio allocated according to the Three-Factor Model will allow you to do this without taking more risk than you want to take.

(See empirical research by professors Eugene Fama and Kenneth French.)

3. Control your risk using asset classes with low correlation. Correlated assets go up and down together. You want low correlation, so you have some going up while some are going down, or at least not up (or down) as much.

4. Do not pick individual stocks. Do not chase star managers or try to time when you think you should get in or out of the market. These are all a loser's game.

(See Charles Ellis' book, "Winning the Loser's Game.")

5. Use only short-term and intermediate government fixed income instruments to control the risk in your portfolio.

6. Control your taxation by using low-turnover and low-cost index, exchange-traded and structured asset class funds. Avoid locking up your money in an annuity with high surrender penalties for several years.

Granted, there is deferred taxation, however, an annuity converts favorable lower taxed capital gains income into higher-taxed ordinary income. Your taxation may still be low since your principal is returned to you tax free unless it is in a qualified plan.

Annuities can be a valuable financial instrument when properly implemented, and to learn more, see my article, "Always Buy the Right Annuity for You." (See Page 5)

7. Determine the amount of risk you are able, willing, and needing to take in order to accomplish your goals. When you take more risk than you need to take to reach your goals, you have to ask yourself three questions:

How will it affect my life if I am right?

What are the consequences if I am wrong?

Have I ever been wrong before?

8. Keep in mind, your asset allocation will play the biggest role in determining your investment performance, "not stock picking, manager picking or market timing."

(See professors Brinson, Hood and Beebower studies.)

9. Start thinking in terms of total return when you come to retirement rather than assuming you will need to change everything to income-producing assets. Notice today how the only way you can get higher income from your bond holdings is by taking greater risk through increased duration and lower-quality junk bonds.

This is not what you should be doing. It usually involves more risk than you realize or have been led to believe until it is too late to do anything about it.

10. Caveat: Work only with a fiduciary investment advisor, who is required to make recommendations that are in your best interest, period. Brokerage relationships are not held to that standard of care. However, rules are changing with the new best interest regulations being imposed.

Concluding Thought

There you have it.

Everything you need to know to be a more successful investor without stock picking, manager picking or market timing, which are all forms of gambling and speculating with your money.

Keep in mind two things when it comes to investing:

1: Instincts and emotions are your enemies.

2: You cannot gamble and speculate with your money and prudently invest at the same time.

If you would like to know more, I would be happy to send you two of my articles:

“Income Allocation Plus Asset Allocation,” and

“Always Buy the Right Annuity for You.”

Just email me at rfh@hoffmanwm.com or call me on my direct line; (805) 648-5306 with no obligation of course.

In the meantime, be well and stay well.

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Ross F. Hoffman is President and Chief Executive Officer of Hoffman & Associates, Estate & Financial Advisors, Inc. He has over 40 years of professional experience in financial, estate, and investment advising. Ross believes everyone should have the opportunity, the freedom and the best information to decide what estate, retirement, and business transition plans work best for them. He has also written articles on these topics.

Ross has earned the most respected professional designations, including Accredited Wealth Management Advisor (AWMA), Accredited Investment Fiduciary (AIF®), Certified Financial Planner (CFP), Chartered Financial Consultant (ChFC), and Chartered Life Underwriter (CLU). He earned his undergraduate degree from UCLA, attended the U.S. Army School of Finance, and the Center of Fiduciary Studies at the University of Pittsburgh.

Ross is an accomplished speaker. He has lectured on Family Wealth Counseling, Evidence Based Investing, Exit Planning, creative uses of life insurance, charitable estate planning to professional groups including the Ventura County Bar Association and the Santa Barbara CPA/Law Society; and has taught estate and gift tax planning.

He is a former co-host of the weekly internet radio show “Conscious Investing,” and was in “Navigating the Fog of Investing,” a documentary film on the investment industry.

Ross is a prior member of Vistage (formerly TEC), an organization for CEOs, for over 25 years. They presented him the “Widest Range of Knowledge Award” as a Vistage member.

His community involvement has included Vice Chairman and Cabinet member of the Ventura County United Way, Technical Advisory Committee member for the Ventura County Community Foundation, Deferred Giving Board member for the Ventura County Medical Center, Board member of the American Lung Association, Board member of the Ventura County Planned Giving Council, Deferred Giving Committee member for the Boy Scouts of America and a past member of the Estate Planning Council. Ross was on the Board of Segue, a nonprofit, dedicated to keeping kids in school and helping them develop career paths.

Ross’s outside interests include golf, daily workouts and time with his family. He also wrote **Back And Better, 37 Rapid Recovery Exercises I Use When Injured or Bedridden.**

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