4 PRACTICAL PRINCIPLES TO INVESTMENT SUCCESS

By Paddy Delaney, QFA, RPA
Founder of Informed Decisions

www.informeddecisions.ie | help@informeddecisions.ie | @idecisionsfp

Foreword

Successful investing is usually based on a core investment plan, and at Informed Decisions we believe this to be absolutely true. There are so many confusing strategies that you will hear about when you dig deep on this topic, however we believe that a common theme runs through all of this 'stuff' – a need to focus on the things you can control.

Many of us, when we investigate it, are bombarded by information about the markets, the economy, manager ratings, investment strategies, past performance of a fund or strategy. This can result in us overlooking the fundamental and practical principles which give you the best chance of success with your savings, retirement planning and investing.

The 4 principles in this short eBook are nothing overly new or radical, they are simple and applicable by all of us. They have been shaped over my near 20 years in helping others achieve investment success, and from learning from those that have been here before us.

These principles represent both the past and the future – enduring principles that can enable you on the road to investment success.

I hope this short and simple guide helps.

Paddy Delaney
QFA RPA APA Qualified Coach

Founder & Director @ Informed Decisions

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The 4 Practical Principles Of Investment Success

GOALS

Identify & create your own investment goals – not the goals of an advisor or product producer

DIVERSIFICATION

Identify where to invest in order to ensure stability – minimise over-exposure and reduce likelihood of permanent capital loss

COSTS

Keep costs as low as you possibly can – learn the impact of fees and charges on your long term returns, the same fees that too often line the pockets of everyone apart from the investor

PERSISTANCE

Remain invested for the long term – benefit from the probability of success that is offered for investors that have stayed the course and are persistent in the of volatility

1 Goals

Identify & Create Your Own Investment Goals – or as I too-often state 'begin with the end in mind'!

They say that an appropriate goal should be specific, measurable, attainable and time-bound. Success should not depend on outsized investment returns, nor upon impractical saving levels or spending restraints.

Defining goals clearly and being realistic about ways to achieve them can help protect investors from common mistakes that derail progress. Check out our interview with Dr. Daniel Crosby, Behavioural Finance Expert & New York Times Best-Seller, on how we can avoid letting our emotions take over our money decisions… **Part 1** & **Part 2**.

A basic plan will include specific, attainable outcomes you seek with your investments. I believe everyone can consider and arrive at 'their number'. You may or may not need some help in doing so. Either way, having that clarity can improve your probability of long term success.

Discouraging results often come from chasing unrealistic returns, or from being ill-informed at the outset. An unsound and daunting strategy can result in panic in investors. The importance of having a well-grounded plan and investment goal cannot be over-stated.

Without a plan, investors can be tempted to build a portfolio or invest in a fund based on factors such as recent fund performance – something that can amount to a 'buy high, sell low' strategy. Don't let yourself fall into this costly trap that impacts so many investors.

HOW TO BUILD A PLAN?

A sound investment plan begins by outlining your objective. Defining this is essential because the plan needs to fit you, not the other way around. Picking a product without a plan is where most go wrong. Indeed copying other people's actions can and does prove unwise.

Because most objectives and financial goals are long-term, the plan should ideally be designed to endure through changing market and personal circumstances. It should also be flexible enough to adjust for unexpected events along the way – life is rarely as we expect!. If you have multiple goals (for example, maintaining a large investment pot or passing funds to your kids or grandchildren) you will be best served accounting for and planning for both as opposed to picking one over the other. Once the plan is in you should evaluate it at regular intervals but not so regular that it becomes a chore or a concern. If you are using one, set a reminder to check-in with your advisor.

2 Diversification

Identify Where You Need to Invest in Order To Ensure Stability.

A sensible investment strategy starts with an asset allocation suitable for the your objective. The allocation should be built upon realistic expectations for volatility and returns needed. Diversification either within or across appropriate assets can help avoid exposure to unnecessary risks. Risks, in this instance refers to total loss of capital, which is very different from volatility.

Both asset allocation and diversification are ultimately about balance and keeping things on an even keel to some degree. Because all investments which provide opportunity for growth involve volatility, you really should aim to get a balance between volatility and potential return through the sensible selection of assets. For example, it is probably fair to say that most of us have left behind the idea that investing all our money into property funds is a route to consistent and steady growth.

ALL OF THE EVIDENCE SUGGESTS:

1) A diversified portfolio's proportions in equities, bonds and other investment types determine most of its return as well as its volatility (likelihood of ups & downs). If you have lots of equity you will likely have lots of volatility. This has also historically delivered optimum levels of average long term growth

2) Attempting to escape volatility and short term losses by minimising equity investments can expose investors to other types of risk, including the risks of failing to get a return in excess of inflation or falling short of your investment goals

3) Realistic return assumptions and empirical data – not hopes or empty promises – are essential in choosing a long term strategy

THE IMPORTANCE OF ASSET ALLOCATION:

When building a portfolio to meet a specific objective, it is critical to select a combination of assets that offers the best chance for meeting your objective. Assuming you chose a well-diversified approach to picking funds and assets, the mixture of those assets will determine both the returns and the variability of returns for your investment.

AREN'T EQUITIES VOLATILE?

Equities are and will most likely continue to be volatile, however if you are investing for the long term then so is avoiding them!

Equities are absolutely more volatile than investments such as bonds or cash deposits, that is their nature, and what has delivered significant returns over the past 10 decades. Equities are often held and purchased on the promise of future performance of that group of companies. Investors therefore must be willing to participate in the company's uncertain future. The 'carrot' that entices them is the potential price inflation to be had over time, plus dividends. The owners of business have achieved on average double the return that loaners (Bond holders) have achieved over the long term.

Speaking of returns, what is a realistic expectation for returns in equities? Using long-term historical data is often utilised as a guide in setting this expectation but you must keep in mind that markets are extremely volatile always, and returns will differ dramatically over different periods of time.

For example, since 1925, a Global Equity Index has returned an average in the region of 10.8% annually while bonds have delivered in the region of 5.5%, based on certain benchmarks. Over this same period, a portfolio with 50% equities and 50% bonds, rebalanced every year has delivered 7% per year on average. These are simple examples of the power of very simple index investing. Low fees and high transparency have been very effective for committed investors.

As noted above however if you take a look at shorter time-frames say from the year in which Informed Decisions Founder Paddy Delaney was born, 1980, through to 2015! In that period equities returned an average of 12% per annum.

In this case an investment with 50% equity and 50% bonds, rebalanced each year, would have generated annual returns of 11%! Before you sign up and celebrate your riches however look at the period from 2000 to 2015, when equities delivered annual returns of just under 4% and bonds provided almost 6%, which if split and balanced each year gave 5% per annum. Likewise, 2008 saw temporary declines of 40% or more in some indices, again, those who stuck to the plan were rewarded in the following years.

Moral of the story is to ensure that whatever we are doing, be that eating, exercising or investing, we should really aim to have balance, to ensure that balance is appropriate to you, your plan and that it is in line with your investment objectives.

If we are tempted to not diversify, to concentrate our investments in single stocks or shares we are unnecessarily exposing ourselves to risk, and permanent capital loss. Most of us don’t want to expose ourselves to this sort of risk.

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THE TEN BEST AND WORST EQUITIES IN THE FTSE ALL SHARE INDEX (UK SHARES) IN THE NASTY YEAR OF 2008

WORST		BEST	
Medcom Group	-97.9%	Telecom Plus	73.0%
Pendragon	-94.8%	Randgold Resources	60.0%
Johnston Press	-93.7%	BTG	50.5%
Taylor Wimpey	-92.7%	Jardine Lloyd Thompson	38.6%
Quintain Estates & Development	-92.5%	Lancashire Holdings	37.9%
Punch Taverns	-92.2%	AstraZeneca	35.6%
Lonrho	-90.1%	Amlin	27.3%
Hogg Robinson Group	-90.0%	Barr	24.7%
Inchcape	-89.8%	Hiscox	24.7%
Norcros	-89.8%	Ruffer	23.0

3 Costs

You can't control the markets, but you can try control the price you pay to access the markets. The lower your investment costs, the greater your share of an investment's return, assuming it is positive. A recent study in The United States indicated that 93% of individuals had no idea what costs they were paying on their investment plans. Based on my own experience with investors the same can broadly be said here in Ireland.

To show why it is essential to consider cost when choosing investments, all common sense and evidence proves:

- Higher costs can significantly reduce a portfolio's growth over long periods
- Higher costs create a large gap between what markets return and what the investor receives
- Lower-cost passive/indexed investments have tended to perform better than others over the long term

WHY COST MATTERS:

Controlling cost is a critical part of your investment strategy. When it comes to investing there is no reason to assume that you get more in value if you pay more in fees. Instead, every euro paid for management fees is 1 less euro earning and working for you.

The Department of Social Protection conducted an extensive study of pension charges in Ireland and in 2012 released the monstrous '**Report on Pension Charges in Ireland**'. It took these guys a 290 page report to outline all there is to know about the impact of fees, but here are the main ones that apply to traditional insurance-based pension contracts here in Ireland:

- Annual Management Charge
- Bid/Offer Spread
- Implicit Charges
- Transaction Charges
- Stamp Duty

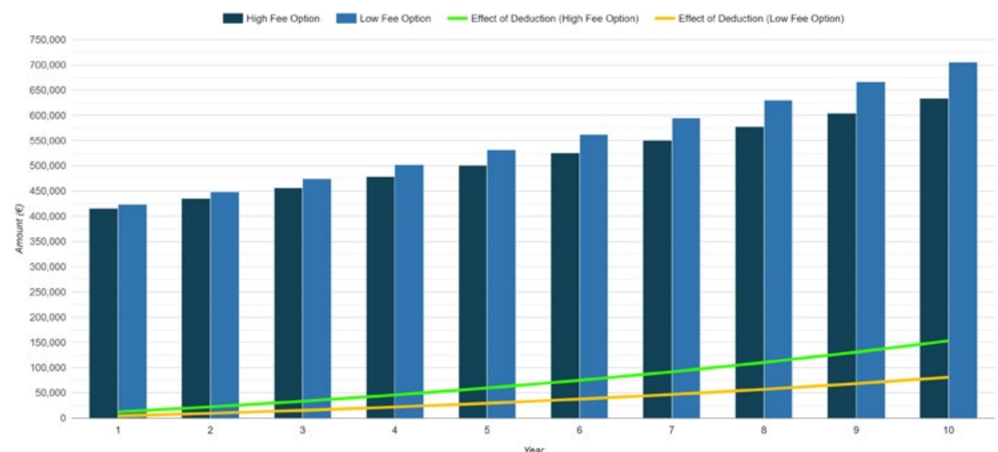
Interestingly, the analysis, which is obviously from 2012, showed that the fees for insured schemes were on average 40% dearer than those of non-insured schemes. However, for individual investors it only analysed 'insured-schemes', as there were no non-insured schemes really available to individual investors back in 2012 (there are now!).

Anyway, the heel of the hunt is that, despite what might be printed on the tin, the average all-in fees on a pension stood at 2.1%! This tallies with my own experiences, seeing all-in fees on insured schemes totaling from 1.7% to 3% generally.

One example we can draw on to show how strongly costs can affect long-term portfolio values of a lump-sum investment. For this example assume a 10-year time horizon in which a portfolio has a starting value of €400,000. This fund grows an average of 7% annually. In the low-cost scenario, the investor is paying a charge of 1.1% of assets every year, whereas in the high-cost scenario the investor is paying 2.1%. On the face of it this appears to be a marginal 1% difference in fees per year.

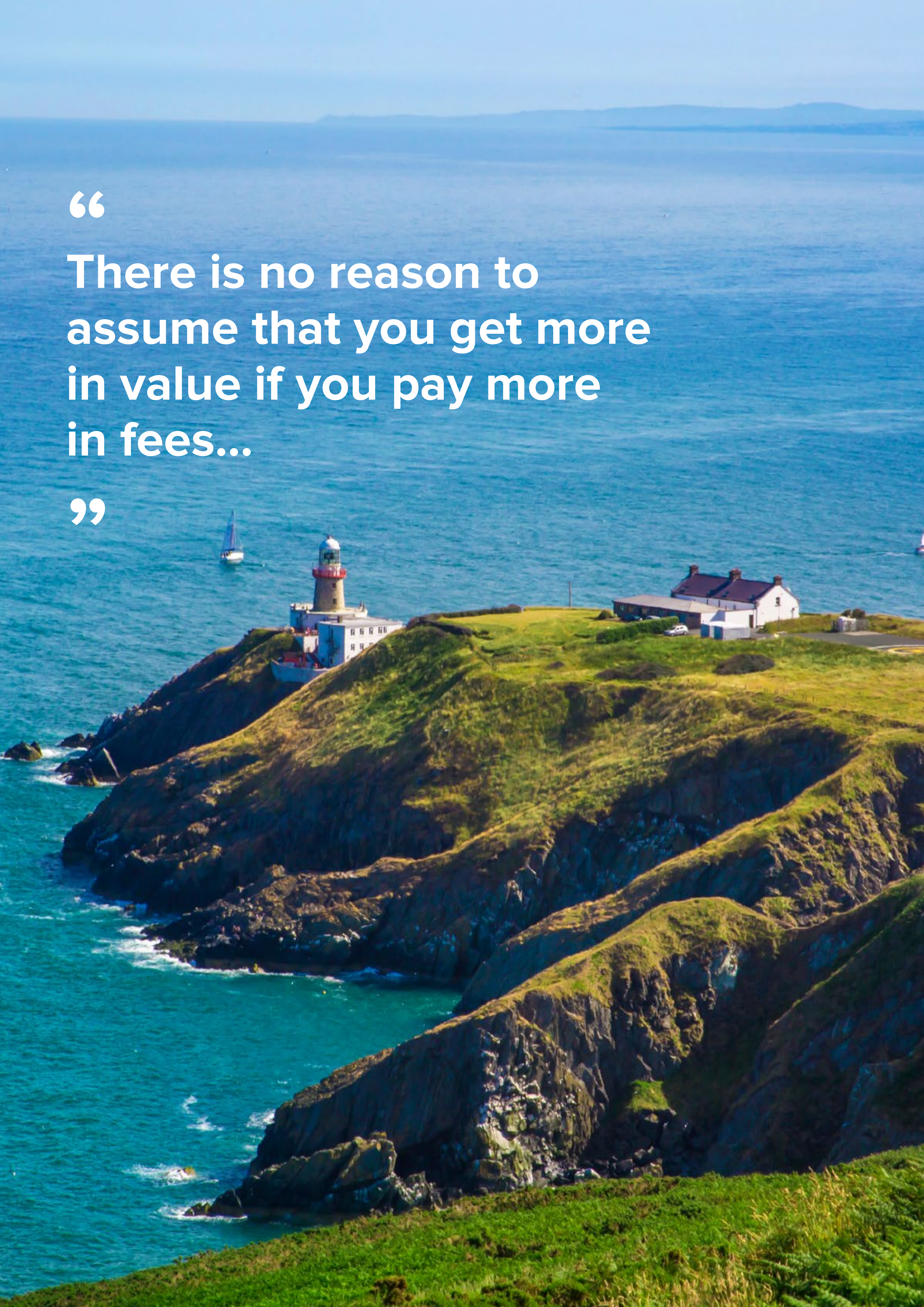
When considered over time the impact is far from marginal...

With the lower-fee option you get to keep an additional €72,210 of growth. That equates to over €7,000 per year, or €600 per month in growth.



BOTTOM LINE:

Fees & Costs matter and have a significant impact on your growth over the long term. Clients deserve better, deserve to know the truth, and deserve more for their money.


“
There is no reason to assume that you get more in value if you pay more in fees…
”

4 Persist

Keep your head and a long-term discipline in order to achieve your goals.

Investing can provoke strong emotions, particularly when things get shaky. That is perfectly normal, we all suffer them. In the face of market turmoil and media speculation some investors will make impulsive and short-term-focused decisions. These decisions result in them not achieving their goals.

Discipline and perspective are the qualities that can help investors remain committed to their long-term investment programmes through periods of market uncertainty. As New York Times Best-Seller, Dr. Daniel Crosby outlined for us in Podcast **Episode 28** & **29**, it is in these times that investors can really benefit from having the guiding hand of an advisor/coach to help them avoid these decisions.

Over the long term a disciplined approach to your investing can pay dividends (literally & figuratively!) while the costs of allowing emotional impulse to undermine that discipline can be corrosive on your investment success. There is lots of research which suggests that:

- Knee-jerk moves out of your asset allocation can be irreparably costly
- Attempts to predict the markets rarely if ever result in success
- Chasing the ‘next big stock’ more often than not disappoints and proves costly

If you are into it you can check out Eugene Fama and Kenneth French’s 22-year study from 2010 where they outlined that if an investor keeps at least a 15 year time-horizon they should be able to overcome most short term volatility and achieve success.

Because investing evokes emotion, even sophisticated the most sophisticated investors among us should arm themselves with a long-term perspective and a disciplined approach. Abandoning a planned investment strategy can be costly, and research has shown that when it comes to investing we are our own worst enemy, not the markets!

Thanks for reading, I really do hope it was of some value to you.

If you would like to get in touch about any aspect of this please **drop me a mail here**.

help@informeddecisions.ie

Paddy Delaney

Qualified Financial Advisor | Qualified Retirement Planning Advisor | Qualified Executive Coach

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Informed
Decisions

Informed Decisions
Golf Links Road, Bettystown, Co. Meath

www.informeddecisions.ie
help@informeddecisions.ie
@idecisionsfp

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