Investment Truths, Part 1

Every once in a while, it can be helpful to remember the basic truths of investing. We often get so caught up in the issues of the moment that we lose focus on what matters. Here are the first 10 fundamental investment tenants. We will review the rest in our next column.

1. **Over long periods, stocks will have greater total returns than bonds.**
   There is ample evidence to demonstrate that, over time, stocks perform better than bonds. It is an economic principal that increased risk must offer increased return, or no one would willingly take the risk. The premium is the excess return (compared with the less risk alternative) that investors receive in return for accepting the risk.

2. **Over long periods, bonds will have greater total return than money market investments.**
   This can be violated when the yield curve is inverted, but under normal economic circumstances, the individual willing to lend his funds for long periods receives a premium for the risk taken.

3. **Over long periods, money market returns will slightly exceed inflation.**
   This is important to realize if your only goal is to keep pace with inflation. This is assuming that you have more than adequate money to live the life you want. Most individuals do not, which is why they must take on some sort of increased risk.

4. **On average, stocks are much riskier than bonds.**
   This seems obvious for professionals, and most others would agree. The problem is that a person's perception of risk may be very different from the risk he or she will experience. Most people's experience is based on recent investment history, so they have never gone through an extended downturn in stock prices. In any given year there is roughly a 30% chance that the broad-based stock market will be down rather than up.

5. **On average, bonds are riskier than money markets.**
   Bond risk is normally not well understood. People feel that if a bond price goes down, they can hold on until it matures. The reality is that

bond total returns are negative almost as frequently as stock returns. They do not lose the same value as stocks, however. Since the value of a bond is the sum total of all of its future coupons and maturity value, discounted by some interest factor then adjusted for the potential of default, it is obvious why bonds would frequently decline when stocks decline. In fact, the two have a surprisingly high correlation when it comes to losing value.

6. **Money markets are, for the most part, safe.**
   Most investors do not question the safety of money markets. Using money markets in a portfolio is a way to reduce the volatility of the overall portfolio value.

7. **You will make investments that go down immediately after you buy.**
   What more can be said?

8. **You will sell investments that continue to go up after you are out.**
   It is virtually impossible to pick a top. It is good advice to not watch an investment after you have sold it, but many people do – it's human nature – and some, unfortunately, will use it as an evaluation tool.

9. **You will stay in some holdings too long.**
   This is similar to not knowing exactly when to sell. If things go well, you will find and buy investments that go up. Securities tend to be driven to emotional extremes around a central value. So you will almost inevitably own something that will reach a price peak, decline, and then you will decide to sell. Some investors (again, unfortunately) will view selling a security below its high as lost money, even if they purchased it at a much lower price.

10. **The value of the opportunities you miss will far exceed those you take.**
    This is subtle, but it exists with almost all investors. For example, if investors had only invested in Microsoft when it first went public, before it became the large company it is today, then they would all be rich. The investment that they passed on has almost always made much more than the one they are in.

James D Hallett, Investment Advisor Representative, offering advisory services through Hallett & Associates, P.S., a Registered Investment Advisor. Registered Representative, securities offered

through Cambridge Investment Research, a Broker/Dealer (Member FINRA/SiPC) Cambridge and Hallett & Associates, P.S. are not affiliated.

This column is for informational purposes only and should not be used as the primary basis for an investment decision. Consult an advisor for your personal situation.