Your Wealth Bulletin

Dear David,

Welcome to the September edition of Your Wealth Bulletin.

"When we are sure that we are on the right road there is no need to plan our journey too far ahead. No need to burden ourselves with doubts and fears as to the obstacles that may bar our progress. We cannot take more than one step at a time." (Orison Marden)

Capturing Market Returns

Buying high, selling low. Sounds familiar huh.

Despite their claims to the contrary, the vast majority of investors do the opposite.

That's the conclusion of the 2010 study "Quantitative Analysis of Investor Behavior," produced by financial research firm Dalbar* in the USA.

They have found that there is a big difference between investment returns from the markets, and investor returns.

So how different are investor returns from investment returns?........Huge.

While the (USA) S&P 500 Stock Index returned an average of 8.2% per year during the 20-year period ending December 31, 2009.

The average investor who invested in stock mutual funds earned only 3.2% per year. That's a massive 61% less.

Video of the Month

Why do people succeed?

A short video presentation by Richard St.John

Money Links

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To add perspective, if you invested $100,000 and achieved 3.2% returns over 20 years, your money would be worth about $187,756.

Alternatively, if your capital achieved market returns of 8.2%, then the same $100,000 would be valued at $483,666. This represents more than 2.5 times the average investors returns with a difference of $295,910.

As Dalbar's data clearly illustrates, investors consistently buy investments when prices are relatively high, and they sell their investments when market prices are relatively low.

The sad result: Over the past 20 years, the average investor has earned only about one-third of the returns that the funds themselves produced!

Buying high and selling low is, of course, the exact opposite of what you're supposed to do.

As Dalbar shows, it's easy to obtain the full return that investments offer: You simply need to be invested throughout the entire time period.

The markets will reward you over time. Ignore the noise and temptation, stay disciplined and invested.

* This 2010 study was conducted by an independent third party, DALBAR, Inc, a research firm specializing in financial services.

Quick decisions are better?

For major purchases and decisions, we are taught to take our time and make an informed judgement.

A new study, published by Morningstar this month, questions this method.

"Consider the following experiment: Two groups of college students are instructed to taste identical jellybeans and rate the flavours.

Participants in one group are told to record their initial reactions. Those in the second group are told to think hard before rating the flavours and then to explain their choices in writing.

Forty minutes later, the experiment is repeated to see which group is likeliest to change their preferences. It makes sense that the students who put the most thought into their decisions will stand pat, right?

Instead, Loran F. Nordgren, an assistant professor of Management and Organizations, and Ap Dijksterhuis, a professor at Radbound University in the Netherlands, found just the opposite."

So it turns out, that too much analysis leads to inconsistent decisions.

Why does this happen?

The authors argue that deliberation distracts consumers from the most relevant information at hand. They say that someone asked to scrutinise jellybean flavors might prefer chocolate one time and lemon the next.

"Deliberation introduces noise into the decision-making process," Nordgren says. "Thinking too much somehow brings us away from our true preferences."

But what about big-ticket items that we expect to enjoy for months or years, like artwork or an apartment?

Those are exactly the sorts of acquisitions we are likeliest to deliberate about most - and, Nordgren argues, become dissatisfied with later.

Instant reactions are favoured

Nordgren says the best - and most consistent - decisions are made very quickly, by tapping into our intuition. "It is analysing why we like something that leads us astray," he observes.

They found that people who made quick decisions based on their gut feelings made more consistent choices.

To discover the impact of decision-making styles on accuracy, the authors asked subjects to view eight paintings.

Half were high-quality paintings from the Museum of Modern Art in New York, half were inferior works from the Museum of Bad Art in Boston.

Seventy-three subjects were divided into two groups, deliberators and non-deliberators, and asked to rate the

paintings twice. The authors found the two groups were equally capable of assessing the quality of the art, but that the non-deliberators made more consistent choices.

Trust your instincts

Nordgren and Dijksterhuis concluded that deliberation disrupts the natural weighting of information.

As information becomes more complex, deliberators weigh the information differently from one time to the next, leading to inconsistent decisions.

The message for consumers is to avoid over-thinking big, complex decisions, Nordgren suggests.

That does not mean, for example, that house-hunters should buy the first house they like.

But after narrowing their choices by critical decision rules, such as location and price, consumers should trust their first impressions.

Nordgren says his research should "relieve consumers of the burden to feel like important decisions can only be made after careful reflection."

The prescription for better decision-making, he says, "is not to deliberate."

Interesting thoughts indeed!

If you would like to discuss any of these issues further with us, please feel welcome to ring me on 9525 0777 or emailenquiries@reedfinancial.com.au

Warm Regards!

David Reed

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