
Facts an Astute Investor Must Know

Diversify, have a plan, rebalance annually, and more

By Bill Bender, CPA, PFS, MS

When I finished graduate school in 1974, I had very little knowledge of the stock market. When I got married in June 1975, my wife owned four stocks given to her by her grandfather, Ben.

Around this time, we had our first oil embargo and the cost of a gallon of gas shot up to 50 cents. Ben said people would travel again. He bought GM, Ford, Howard Johnsons and Holiday Inn. They all recovered. He never sold. He eventually gave 100 shares of Howard Johnsons (HJ) to each of his seven great grandchildren, two of which were our children. In time, HJ was bought out by a British company. GM is bankrupt. Ford is in trouble. As for Holiday Inn, I do not know who owns it, but it is certainly not the hotel of choice that it was for families and business people that it was 30+ years ago.

What can we learn from Ben's stock picking?

First of all, diversify. Where was the diversification in Ben's portfolio? All he bought was large U.S. companies. Studies show that the more choices we face in life, the more likely we are to simply do nothing. If Ben sold GM and Ford as their market share dwindled, he would have had to decide where to invest the proceeds. Buying four mutual funds instead of four stocks would have provided much more diversification with less risk.

Second, marry your holdings. A study by Terrance Odean on the faculty at the University of California Davis, showed that stocks investors sold outperformed stocks they held on to by 3.4% over the next 12 months. This was consistent among thousands of investors studied. We tend to sell winners too soon and hold on to the losers too long hoping for a comeback. Do not try to time the market. Marry your holdings unless circumstances change. As Toyota and Honda became power houses, it became time to sell GM and Ford.

Third, do not confuse familiarity with knowledge. In Ben's portfolio, only U.S. companies were purchased. Many investors buy local companies. People in Atlanta own a disproportionate amount of Coca Cola. People in Rochester, N.Y., own a disproportionate amount of Eastman Kodak. U.S. investors need to think outside the U.S. for investments.

Fourth, have a plan and stick to it. This can be as simple as writing that for the next 10 years you will not let your portfolio



vary by more than five percentage points from this allocation: Stocks __%, Bonds __%, Cash __%. Once you have a plan, review and rebalance at least annually to keep things on track.

Fifth, do not believe that bigger is better. Small cap stocks are nothing to fear. Studies have shown that small companies tend to outperform large ones, particularly toward the end of a recession. Historically, they have clobbered blue chips by 11 percent in the first year after a recession ends.

So, to conclude this article, diversify your holdings. Stick to your investor policy statement and rebalance at least annually to make sure your plan stays on target. Do not confuse familiarity with knowledge. Buy mutual funds (preferably passive asset class funds) with the bulk of your money instead of individual stocks. In addition, if you own individual stocks and the reason(s) you bought the stock no longer exist, sell the stock(s).



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