the EDUCATED INVESTOR FEATURE ARTICLE

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# It's Important To Be Educated

**Overview:** If the majority of investors understood the true benefits of a buy-and-hold strategy, some of the thousands of trades placed each day would likely not be made. Likewise, some of the products that thrive on being complex would see a not-surprising decline in popularity — if investors knew about their many disadvantages. The following are some key investing principles that investors should know.

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## The Importance of Education

It is our desire and intent to educate clients about how capital markets work and to provide them with the information necessary for their financial well-being.

The advice to invest in passively managed funds is significantly different from the advice of most investment advisor firms, and it also is different from the strategy followed by the typical individual investor. Therefore, we feel it is extremely important to be aware of the academic research demonstrating that markets are generally highly efficient.

Studies have shown that it is highly unlikely investors will be able to exploit market inefficiencies after accounting for the expenses of the effort. It is essential to know how a well-diversified portfolio can help manage risk, a message that often bears repeating as asset classes come in and out of favor over time. The same sentiment applies to understanding how attempts to time the market — either in terms of individual securities or asset classes — typically lead to realizing lower returns than those available from a buy, hold and rebalance strategy.

Because our investment approach is different from the average investment advisor, it is crucial for you to understand why we recommend it. Put simply, knowledge is the key to discipline. For example, in the late 1990s, when the growth asset class outperformed the value asset class, it became tempting to pour everything into that single asset class. Those who do not possess a basic understanding of passive investing are more likely to quickly become dissatisfied when their portfolio underperforms the latest hot asset class.

## Essential Investment Education

What is the minimum basic knowledge needed to remain a disciplined passive investor? We believe the following five concepts form a strong foundation from which to build.

**Point 1: Markets Are Efficient**
Public information is of little fundamental value. New information is so quickly incorporated into asset prices that use of this knowledge cannot be expected to consistently yield superior risk-adjusted returns. Information that is not public is also of no value, since it is illegal to trade on it.

**Point 2: Risk and Expected Reward Are Related**
Investors who expect or need to achieve higher returns must accept the associated risk. The benefits of diversification are the only "free lunch" of investing. Restated, equity-like returns do not come without commensurate risks.

**Point 3: Diversification Works**
Global diversification across a variety of imperfectly correlated asset classes is the most effective way to reduce risk. (Correlation is how similarly different investments perform. The higher the correlation, the more similar the performance and thus the lower the diversification.)

Diversification is always working, whether we're pleased with the immediate results. Diversification should be thought of as the equivalent of buying insurance against having all of one's investment eggs in the wrong basket. From 2000 through 2002, those who had placed all of their eggs in the large-cap growth basket learned a painful lesson about the value of diversification.

**Point 4: Markets Are Unpredictable in the Short Run and Even in the Long Run**
In the short (or even long) run, anything is possible. In the long run, we expect that equity markets will rise more than fall. Individuals who correctly predict short-term market movements should likely attribute their results to luck rather than skill.

**Point 5: Discipline Is Key to Successful Investing**
For far too many investors, the variable that ultimately determines the results of their portfolio is not investment returns but investor behavior. Emotions can lead investors to make poor decisions at the wrong times. It is easy to remain disciplined during bull markets. However, it is far more important to do so in bear markets to avoid the far-too-human propensity to sell at market bottoms. Thus, the role that emotion plays in the success of an investment strategy cannot be overemphasized. Education is key to ignoring one's emotional reactions and staying the course.

## Summary
If you understand the above concepts, you will be well ahead of the majority of the investing public. No matter where your plan goes, we will continue to place importance on evaluating risk tolerance, building a globally diversified portfolio and implementing regular, disciplined rebalancing techniques. Having such knowledge changes the way you approach investing.

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