Funds do Fine, Investors Don't

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Do you think investments have done poorly over the past three years? Look in the mirror, you have probably done worse.

Fundmonitor.com has released some of their findings with respect to mutual fund investing. The conclusion is simple; funds do fine but investors don't.

The reason is that investors either buy high, sell after a sharp downturn or worse both. The only way to participate in good long-term returns is to invest and stay invested for the long-term.

We know from stock market patterns that have occurred over the past 200 years that investments are volatile. Some years they go up and other years they go down.

Allowing investor emotions to get involved often leads to poor investment decisions. Only 6% of those invested in Canada's largest funds managed to match or outperform the fund's 10-year rate of return as of September 2002.

Fundmonitor.com gives an extreme example of the very popular and widely held AGF International Value Fund. The fund gained 13.5% per year over ten years however the investors surveyed only managed to get returns of 4.9%.

The fund posted huge gains during the 1990's. Due to these gains new money flooded in over the past few years but the last two years have been disappointing.

Investor's poor performance has little to do with the fact that we are in the worst investment period since the 1930's and the Great Depression.

Fundmonitor's survey is just the most recent example of research that validates the "buy and hold" investment approach. Similar results have come from US based research done during the 1990's and Duff Young, who is the principal of Fundmonitor.com, has released similar findings for Canada on previous occasions.

So the question is how to ensure we do not mismanage our portfolio? The key is time.

Time can be your ally and it also can be the enemy.

Over the last two centuries there has never been a time that the stock market has not recovered all of its previous losses and gone on to record new highs.

You should be fine if you have the time to wait out downturns and most investors do have the time since few will need all of their money in the near future.

One solution is to divide your investments into three time categories based on when you need the funds; short-term for needs within three years, medium term from three to seven years and long-term for anything longer than seven years.

Short term funds should not be risked in a stock market decline as there is often not enough time to recoup your losses and therefore should be invested in guaranteed investments.

Long-term needs should be funded by long-term investments, which normally require this part of your portfolio to be largely equity based.

The intermediate portion of your portfolio should be a combination of guaranteed investments and equities based on your financial objectives and risk tolerance.

If you are successful at managing the time element of investing, you have a better chance of being a successful investor.