

# 6 PRINCIPLES OF LONG-TERM INVESTING



## INTRODUCTION

We believe that increasing your wealth over time is about more than making the right stock picks or always buying low and selling high. Too often, we see intelligent investors hamstringing their potential for success by making fundamental errors in their investing strategy.

Over the years, we have observed the effects of fear, greed, lack of discipline, groupthink, and many other pitfalls that investors experience. Accordingly, we have compiled this list of six principles of long-term investing. These principles are by no means exhaustive, nor will they guarantee investment success, but we hope that you will find them useful in helping you make investment decisions.

## 1. DON'T CHASE THE CROWD

“NEVER FOLLOW THE CROWD.”

BERNARD BARUCH

ECONOMIC ADVISER TO PRESIDENTS WOODROW WILSON & F.D. ROOSEVELT

No one knows with any certainty which direction markets will go in the future. However, a good axiom to remember is that it is usually wise to avoid following the herd. By the time your friends, family, neighbors and newspaper columnists are all investing in a particular sector or security, it's often too late to benefit because hype has already inflated the price. Whenever investment dollars charge in, prices soar and savvy investors usually move on. By the time the mass of average investors has caught on to a new fad, prices are often too high and investments are overvalued, making them a poor choice for investors who are seeking value.

We don't necessarily advise becoming contrarian investors, i.e. those who believe that crowds are always wrong and look for opportunities to invest against the prevailing trend. Instead, we strongly encourage an investment strategy that is based on objective research using the best information available, calculated choices, a realistic assessment of risk, and a determination to avoid emotional decision-making.

Emotional investing is a well-documented pitfall among investors and it can have striking consequences for investment performance. A recent study found that while the S&P 500 returned 9.9 percent between 1995 and 2014, the average investor fared much worse, seeing only a 2.5 percent return during the same period. Much of the difference can be attributed to jumping in and out of markets during downturns. Letting emotion take over and following the crowd can be extremely costly to your long-term performance.

## 2. REMAIN FLEXIBLE AND DIVERSIFIED

“DIVERSIFY. IN STOCKS AND BONDS, AS IN MUCH ELSE, THERE IS SAFETY IN NUMBERS.”

SIR JOHN TEMPLETON

STOCK INVESTOR & PHILANTHROPIST

In today's volatile markets a successful long-term investment strategy can often benefit from flexibility and proper diversification. Diversification is one of the pillars of modern investment theory and can be a powerful tool to reduce certain types of risk in your portfolio. We believe it's important that your overall portfolio contains a variety of quality investment types, including stocks, bonds, international securities, and a few alternative investments if your risk profile and investment goals support them.

That's not to say that diversification can guarantee success. No matter how careful or prudent you are, you cannot predict or control future market movements. Much of the market volatility of the last few years has been driven by economic events that are outside any investor's control. Global economic events, natural disasters, and government activities can all cause large-scale market movements. While we can't diversify away all forms of risk, a flexible strategy can help you find investment opportunities in many market conditions.

On the level of individual companies, any number of unforeseen factors can affect a stock's price: Natural disasters, supply line disruptions, unexpected technological advances by a competitor, or the loss of a major partner can all cost a company millions of dollars in losses and affect its value to your portfolio. Since it's impossible to predict these events, we believe it's important to implement an investment strategy that diversifies by industry, by risk level, by country, by investment type, and other factors. While diversification can't always protect your assets in times of widespread market declines, by spreading investment risk among a wide variety of securities, we hope that what affects one part of a portfolio doesn't bring down the value of the whole.

It's important to remember that there is no single kind of investment that is always best. There are times when it may be best to purchase corporate bonds, Treasuries, blue chip stocks, small-cap stocks, internationals and so on. And there are times when it may be best to keep enough cash on hand to take advantage of investment opportunities that present themselves.

## 3. BUY VALUE, NOT MARKET TRENDS OR THE ECONOMIC OUTLOOK

“IN MY OPINION, THERE ARE TWO KEY CONCEPTS INVESTORS MUST MASTER: VALUE AND CYCLES.”

HOWARD MARKS

INVESTOR & WRITER

We believe wise investors focus on value when evaluating investment options. Too many investors focus on buying market trends and economic outlook, not realizing that trends can be deceiving and markets often perform very differently from the economy. Individual stocks can easily surprise you – rising in a down market, and falling during a rally – making it important for long-term investors to focus on buying quality investments with good fundamentals.

While economic trends can exert a powerful effect on market movements, the stock market and the economy do not move with perfect correlation and there are many occasions in which markets rally in spite of poor economic fundamentals or declining corporate earnings. This is not to say that economic outlook is unimportant. Over the long term, market movements often foreshadow economic trends as investors attempt to “price in” how they expect the economy to affect stock prices. A smart investor keeps an eye on the economy and factors economic outlook into investment decisions, but ultimately seeks out high-quality individual investments.



#### 4. TAKE THE RIGHT AMOUNT OF RISK

Experience and research has taught us that investors do best when they take on the right amount of risk for their individual goals and tolerance. We see that too many investors focus strictly on generating returns while ignoring the importance of managing risk properly. Although there are many different types of risk, when discussing portfolios, we generally are referring to systematic risk: risk that affects markets as a whole, such as recessions and wars; or unsystematic risk: risk that is specific to individual stocks and securities that can be addressed through diversification.

Too much risk can leave your nest egg vulnerable to market swings with too little time to recover before you must start withdrawing money and locking in the losses. Too little risk in your portfolio will reduce your potential for capital appreciation and allow inflation to eat away at the long-term value of your investments.

The challenge is in ascertaining how much risk is right for you and your portfolio. Determining risk tolerance and the appropriate amount of risk for your investment goals is one of the most important things we help our clients with.

Obviously, no one wants to see their portfolio lose money at any point, but it's important to understand that, generally, one must take on more risk in order to achieve higher long-term returns. It's vital to be honest about your ability to withstand short-term swings in value and take investment losses in the pursuit of returns.

Another essential question that you must answer is how much risk you need to take on in order to meet your investment goals. The right risk allocation for a portfolio will depend on a number of factors, including your expectations for return, investment objectives, time horizon, and appetite for risk.

Many popular asset allocation tools focus on age – or time until retirement – as the primary driver of an allocation strategy. While this can be useful, we believe that age is only one factor in determining a proper asset allocation strategy; other factors include liquidity needs, net worth, and investing priorities. Unfortunately, many simple age-based allocations fail to adequately account for longer lifespans and the effects of inflation, putting investors at risk of running out of money later in life.

Today's markets can be unforgiving of the wrong risk management strategy. Ultimately, holding the wrong amount of risk means that you may not realize the investment gains that you expect or that you may experience wider swings in portfolio value than you can stomach. If you are unsure about how much risk you are taking or have questions about managing risk in volatile markets, please give us a call. We can help you understand your options.

## 5. LEARN FROM YOUR MISTAKES

“THE GAME OF LIFE IS THE GAME OF EVERLASTING LEARNING. AT LEAST IT IS IF YOU WANT TO WIN.”

CHARLIE MUNGER  
INVESTOR & PHILANTHROPIST

The words “this time is different” are among the most costly words in the history of investing. We’ve found that one of the key differences between successful long-term investors and those who are not, is that successful people learn from their own mistakes and commit to never making the same mistakes twice. Even when a mistake results in a large loss, take a step back to review the actions that led to the loss. We caution against compounding the errors by taking bigger risks in an effort to recover your money. Determine where you went astray and take steps to ensure that you avoid the same mistake in the future.

Many common investing mistakes can be attributed to emotional decision-making. Whenever you make financial or investment decisions, you will confront the challenges of overcoming fear and greed. Fear can cause you to run for the exits when markets decline or your portfolio takes losses. Greed can encourage you to chase fads and take on too much risk in the pursuit of a big score. However, by recognizing your emotional triggers and engaging your rational mind, you can overcome your impulses and cultivate discipline.

Working with a financial professional can help avoid emotional decision-making and many other pitfalls commonly encountered by amateur investors. It’s our job to remain focused on the long-term strategy and act as a voice of reason when emotions run high. In today’s world of high-tech investing, major financial decisions are only a click away and investors pay a high price for short-term thinking. Professional financial representatives can be invaluable for their ability to answer questions, provide reassurance, and keep financial strategies on track despite volatile conditions.

## 6. AGGRESSIVELY MONITOR YOUR INVESTMENTS, OR PAY SOMEONE SKILLED TO DO IT

When markets are rising and amateur investors are doing very well, it’s easy to forget that protecting your assets during declining markets requires skill, discipline and constant attention. Investors need to expect and be prepared to react to fast-moving markets. No market rally is permanent and no decline lasts forever, meaning that there are no investments that you can buy and forget about. The pace of change of today’s markets is too great for investors to be complacent. For example, the 30 companies that make up the Dow Jones Industrials, which are some of the largest publicly traded companies in the U.S., have changed numerous times since the Dow’s inception in 1896. These companies were removed as they declined, were acquired, went private, or simply went bankrupt.

Investing with long-term assets is not child’s play since most investors can ill-afford to lose their nest egg. Today’s markets are no place for dabblers without the time, patience, discipline, and diligence needed to do a proper job. If you aren’t completely sure that you have what it takes to manage your investments well, it may be time to find a professional financial representative with the skills and experience to do it for you.

## CONCLUSION

Achieving long-term investing success is challenging and requires discipline, time, and skill. While it's not possible to predict future returns or market movements, it is possible to develop strategies that mitigate risk and place us in the best position to achieve reasonable returns. No strategy is perfect, but our experience has shown that when used with prudence, these guiding principles can help investors achieve financial success over the long term. We hope you've found these rules useful and that they will help you in your financial journey.

---

### Footnotes, Disclosures, and Sources

CTS Financial Planning, Inc. ("CTS") is an SEC registered investment adviser with its principal place of business in the State of Illinois. Registration does not imply a certain level of skill or training. For information pertaining to the registration of CTS, please contact CTS or refer to the Investment Adviser Public Disclosure web site ([www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov)). For additional information about CTS, including its fees and services, please send us a written request for our disclosure brochure. This newsletter is provided for informational purposes only. The information contained herein should not be construed as the provision of personalized investment advice. Information contained herein is subject to change without notice and should not be considered as a solicitation to buy or sell any security. Past performance is no guarantee of future results. Investing in the stock market involves the risk of loss, including loss of principal invested, and may not be suitable for all investors.

An index is a portfolio of specific securities whose performance is often used as a benchmark in measuring the performance of a specific asset class. Any references to a benchmark index are included for informational purposes only as it is not possible to directly invest in an index. The historical performance results of each index do not reflect the deduction of transaction and custodial charges, nor the deduction of an investment management fee, the incurrence of which would have the effect of decreasing indicated historical performance results. It should not be assumed that your account performance or the volatility of any securities held in your account will correspond directly to any comparative benchmark index.

This letter contains certain forward-looking statements which indicate future possibilities. Actual results may differ materially from the expectations portrayed in such forward-looking statements. As such, there is no guarantee that any views and opinions expressed in this letter will come to pass. Additionally, this letter contains information derived from third party sources. Although we believe these sources to be reliable, we make no representations as to the accuracy of any information prepared by any unaffiliated third party incorporated herein, and take no responsibility therefore. For information about your particular account holdings, please review the statements you receive directly from the custodian of your accounts or contact us. All expressions of opinion reflect the judgment of the authors as of the date of publication and are subject to change without prior notice.

CPI-U (1913-2014). Federal Reserve Economic Data. Source: <https://research.stlouisfed.org/fred2/series/CPIAUCNS#>. [Accessed 19 November 2015]

Bureau of Labor Statistics. Inflation Calculator. Source: [http://www.bls.gov/data/inflation\\_calculator.htm](http://www.bls.gov/data/inflation_calculator.htm). [Accessed 19 November 2015]

Annual Returns on Stock, T.Bonds and T.Bills: 1928 – Current. Aswath Damodaran. Source: <http://www.stern.nyu.edu/~adamodar/pc/datasets/histretSP.xls>. [Accessed 19 November 2015]

Dalbar Inc., J.P. Morgan Asset Management. The S&P 500 Index is a broad-based, unmanaged index not available for direct investment. Results reflect the reinvestment of dividends. Average asset-allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total returns where applicable) and represent the 20-year period ending 12/31/14 to match Dalbar's most recent analysis. Data are as of September 30, 2015. Source: [https://www.jpmorganfunds.com/blobcontentheader/202/900/1158474868049\\_jp-littlebook.pdf](https://www.jpmorganfunds.com/blobcontentheader/202/900/1158474868049_jp-littlebook.pdf). [Accessed 19 November 2015]