Feedback of the Worst Kind

When we make decisions as investors, we naturally seek an instantaneous affirmation that we've made the correct choices. At some point in our lives most of us have invested in a mutual fund or stock in pursuit of a long-term goal and then checked the price the following day only to be saddened that it had not increased in value. You might have asked yourself: Should I have bought that stock? Did I buy the right fund? Is this portfolio manager the best choice? Unfortunately, these are the questions that investors often ask themselves when they should be asking themselves if their assets in aggregate are properly aligned with their goals.

The financial services industry and the financial media are happy to oblige our thirst for instant feedback. With a few deft clicks of your mouse you can probably find how the value of your portfolio has changed over the past ten minutes. You can get five different analysts opinions of what your stock will do this morning and six other analysts opinions of what the market will do next week. You can easily find seven different ratings on the mutual fund manager of your favorite fund. Comically, if you're really tech savvy you can have your blackberry continuously scroll price updates on all your portfolio positions so that you always know at any moment "how much you have."

The reality is that none of that readily available feedback is even remotely useful as it applies to determining whether you made sound choices while pursing long-term goals. The fact that this feedback is available to you doesn't mean that you should observe it. The overwhelming obstacle that you face as an investor is that you are making investment decisions for financial goals spanning decades and you seek positive reinforcement five minutes after you've made the investments. In fact, if you are doing anything beyond reviewing your quarterly statements there's a significant likelihood that you are accepting the wrong feedback and putting yourself at risk to engage in bad investment behavior.

If we were seeking feedback on an investment decision we would be focusing on portfolio analytics, not individual positions. We would want to know how closely the portfolio positions are correlated and the nature of the impact of each position on the volatility of the aggregate portfolio. How tax efficient is the portfolio and how expensive is it compared to portfolios of similar composition? Is the portfolio optimized to harness the most risk-adjusted return? Of course, the answers to these questions are much less readily available than the quasi-mindless noise spewed out through seemingly innumerable financial media outlets.

Bear markets bring plenty of feedback from the purveyors of "gloom and doom" and discussions regarding loss of wealth. What we find interesting is that with all the debate about market issues, these losses of wealth are not market driven – they are behaviorally driven. This notion may seem like an oversimplification – but, for investment horizons appropriate for equity investors the global equity markets have historically risen. So how has loss of wealth occurred when markets have risen? The answer, of course, is bad behavior. That bad behavior is often facilitated by the preponderance of the wrong kind of feedback. Your success as an investor depends predominantly upon your behavior and the structure of your portfolio, not your well-timed moves based on short-term feedback or what's on the cover of Money Magazine.