Investors Are Usually Wrong. I’m One of Them.

By Jeff Sommer

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Forget about getting everything right. Most people are so consistently wrong that merely avoiding major errors is enough to set you apart from the pack.

That is the message in the latest data from Dalbar, a Massachusetts research firm that has been studying the behavior of mutual fund investors for 25 years.

Over the past year and for periods of five, 10, 20 and 30 years, the average mutual fund investor has underperformed the markets for both stocks and bonds, according to Dalbar. Bond investors have generally failed to even keep up with inflation.

In the 30 years through December 2018, for example, the average bond mutual fund investor earned 0.26 percent, annualized, compared with annual inflation of 2.49 percent, Dalbar found. Over the course of an entire generation, bond investors’ money shrank more than 2 percentage points a year in real terms.

This miserable record isn’t the bond market’s fault: The benchmark Bloomberg-Barclays Aggregate Bond Index returned 6.1 percent, annualized, over those 30 years. If you had held an index fund that simply tracked the bond market — Vanguard started such a fund in 1986 — you would have earned about 6 percent a year, fees included.

But very few people did that. I certainly didn’t pay much attention to bond index funds until about a decade ago, when I realized that I was suffering from a common malaise: I had accepted the imperfect choices and high fees imposed by so-called active mutual funds, and I had compounded those liabilities by buying and selling at the wrong times.

The Dalbar data leads to the inescapable conclusion that most investors, this one included, are bunglers: We panic and exult at the wrong moments, impairing our chances of success.

As Richard Bernstein, a former chief investment strategist at Merrill Lynch who now runs his own firm, told me, “What’s shocking is that simply by investing, most people actually made themselves poorer.” He added, “They’re just shooting themselves in the foot, over and over.”

The Dalbar results for 2018 are especially painful to contemplate. The inflation rate was 1.93 percent, so investors would have had to earn that just to tread water. Instead, the

average stock fund investor lost 9.42 percent, for a gap of more than 11 percentage points.

Bond fund investors did a bit better, though they had little to brag about. Their average investments declined "only" 2.84 percent, so they lagged inflation by more than 4.7 percentage points.

Consider a few more dismal data points for stock mutual fund investors. Compared with the S&P 500, through Dec. 31, they underperformed by:

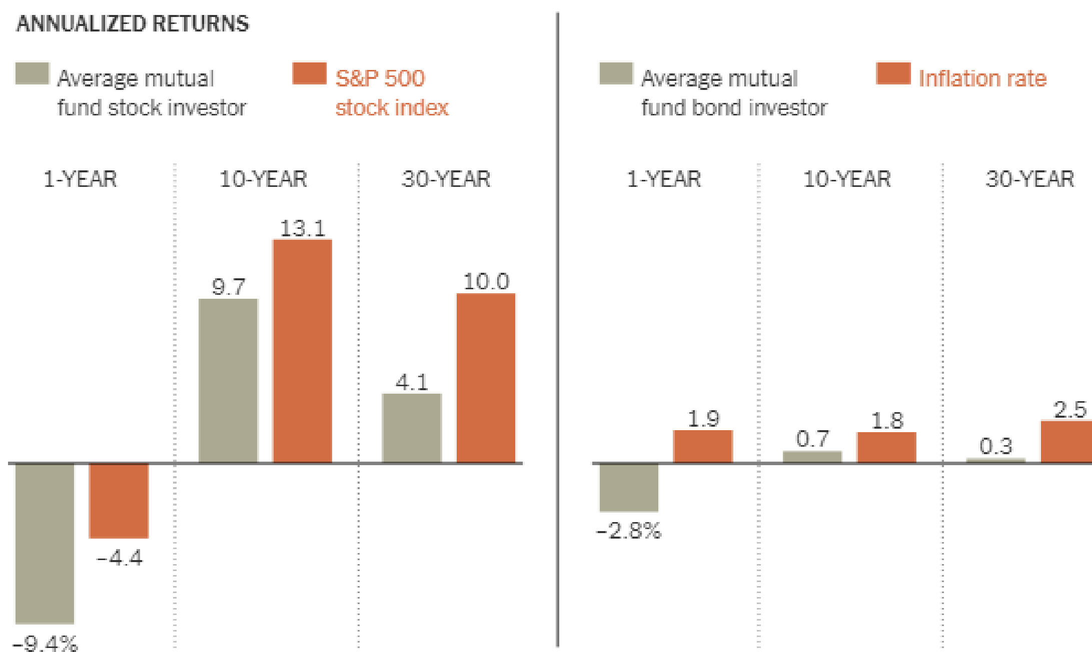
- 5.88 percentage points, annualized, over 30 years;

- 3.46 percentage points, annualized, over 10 years;

- 4.35 percentage points, annualized over five years.

Losing Ground

The average stock mutual fund investor has lagged behind the stock market, while investors in bond mutual funds haven't kept up with inflation.



By The New York Times | Source: Dalbar

Most people, including me, would be better off if we gave up on being smart and stuck with a simple approach: long-term holdings of diversified, low-cost index funds, using only money we can afford to tie up for years.

“If you are going to need money soon, for retirement or to finance education or to buy a house, you shouldn’t take risks with it,” said Louis S. Harvey, Dalbar’s president. “Keep that money safe and separate. But for the rest of your money, the long-term money, stay invested in the market. Don’t do anything fancy with it, and just keep it there.”

If people are going to successfully hold investments for the long haul, they need a high degree of discipline, according to Mr. Bernstein. “You really need to put the money in a lockbox, of some sort,” he said, “and not give in to the temptation to do something that you think is smart — and that will probably turn out to be stupid.”

Bizarrely, a separate Dalbar report suggested that such a lockbox exists, and that it has had a beneficial effect. A form of investment known as a variable annuity — a blend of mutual funds and insurance — performed the lockbox function, Mr. Harvey said. Counterintuitively, Dalbar found, investors in variable annuities outperformed those who bought mutual funds, even though the annuities had much higher fees.

“I was shocked,” Mr. Harvey said. “I never would have expected that.”

Variable annuities generally impose “surrender charges” that investors must pay if they want to sell their funds before a set period of, say, 10 years. These charges and various other fees have made variable annuities the subject of repeated warnings by experts, including those at the [Securities and Exchange Commission].

“Variable annuities are not suitable for meeting short-term goals because substantial taxes and insurance company charges may apply if you withdraw your money early,” the commission says. “Variable annuities also involve investment risks, just as mutual funds do.”

Yet despite the extra fees and penalties — perversely, it seems, because of them — investors in variable annuities outperformed those in mutual funds over 12 months, as well as over three, five, 10, 15 and 19 years, Dalbar found.

The secret to the annuities’ success appears to be the surrender charges, Mr. Harvey said. Unless you really need the money urgently, a charge of, say, 7 percent, is likely to deter you from going ahead with a sale during a market downturn, he said. Assuming your investment is diversified, sticking with it over a long period may be a better strategy.

This isn’t an endorsement of variable annuities. Because of the fees and constraints, I don’t plan on owning one. But the discipline they impose is worth having.

In a word, I’d call it humility. Clearly, it’s time to recognize that I’m unable to predict the future.

Anticipating rough times this year, for example, I lightened the risk in my portfolio, shifting some of my stock and bond holdings into stable money market funds.

But I did not expect the stock market to rise more than 20 percent or the bond market to rally or the Federal Reserve to prepare to cut interest rates. And so I've missed some of the rich returns that stocks and bonds have delivered this year.

What should I have done? Absolutely nothing. Remind me the next time I try to outsmart the markets.

For a direct link to the NYT article, please click here.