CHAPTER 1

The Individual Investor versus the Institutional Investor

When "dumb" money acknowledges its limitations, it ceases to be dumb.

—Warren Buffett

I was fresh out of college and in the early days of my career in the money management industry, but I could tell this talk was a big deal. It was one of my first big industry conferences and it was standing room only. The room was packed with professional investors, portfolio managers, and consultants, all eagerly awaiting the message to be delivered by a well-known billionaire hedge fund manager. There was a buzz in the air. At every investment conference there is always one speech that every attendee circles on their agenda. This was that speech.

After taking the podium and making the customary break-the-ice joke, the headline speaker got right into his speech. It covered a wide variety of topics on the markets and the investment industry in general. It was very data driven, but interesting and even funny at times. You could tell that he had plenty of practice over the years speaking to large crowds such as this one. There were no note cards or PowerPoint slides. It was like you were having a one-on-one conversation with a business associate. Everyone around me was frantically scribbling away in their notebooks so they could look back on his words of wisdom in the future. Once the bulk of the current market outlook was through he decided to spend some time going over the big changes he foresaw in the investment management industry in the coming years.

He made the claim that many of the best, academically tested, evidence-based investment strategies from the past—once only reserved for the wealthy elite at a very high cost—would soon become available to all investors through low-cost exchange-traded funds (ETFs) and mutual funds that could be instituted on a systematic, quantitative basis. At the time ETFs were still a relatively new product, so this was somewhat of a bold call that not many were making at the time. He was predicting a sea change in the industry.

In way of background on ETFs, the industry has experienced explosive growth in assets under management in the past decade and a half. ETFs in all financial asset classes carried only $70 billion in assets in the year 2000. By the end of 2014, that number was closer to $2 trillion, an unbelievable growth trajectory.[1] For the uninitiated, an ETF is very much like a mutual fund in that it allows you to hold a number of different securities under a single fund structure. This allows investors to buy a diversified pool of securities so you don't have to buy them each individually. The biggest difference is that ETFs trade on the stock exchanges throughout the day, just like individual stocks, whereas mutual funds transactions only happen at the market close. ETFs are also structured in a way that that makes them very tax and cost efficient, so they're cheaper, on average, than mutual funds. ETFs have better transparency of their holdings than mutual funds, as you can view ETF holdings on a daily basis. They aren't nearly as affected by forced buying and selling as mutual funds can be.[2] ETFs are allowing enterprising fund companies to slice and dice risk factors, sectors, regions, and asset classes in a number of interesting ways. This should only continue in the future, as these strategies will become more and more specialized. ETFs are worth paying attention to as they will only carve out an ever-larger market share of investor dollars over time.

Back to the investment conference: I found myself nodding in agreement with this fund manager as he surgically laid out the reasoning behind the potential shift to make better investment strategies available at a lower cost to more and more investors—increased competition, availability of information, a dearth of academic studies on back-tested strategies, and the fact that most professional portfolio managers came from similar schools of thought. This was making it harder and harder for portfolio managers to justify their claims of superior investment processes at a much higher cost to the individual investor. The line of thinking was that these newer products wouldn't offer the possibility for enormous outsized gains, but at a reduced cost to the investor, would give similar returns on a net basis after costs, the only thing that really matters in the end.

When the speech was over, there was a Q&A session that gave the professional investors in the room a chance to follow up with this hedge fund manager about his speech. Participants quickly hurried to the microphones to ask this famous investor a question. The first audience member, looking a little flustered, didn't waste any time as he asked, "How are we ever supposed to sell these lower cost funds to our clients? Won't this be an admission that we're buying sub-par funds?" As I looked around the room I noticed nearly every other investor nodding their head in agreement. One by one they all took their turn asking similar questions.

"How can we justify the use of inferior funds?"

"Don't you understand that you get what you pay for?"

"How do we prove our value-add when selecting these types of funds?"

"How could we ever sell the fact that we're not buying the best of breed funds at the highest cost? We might as well admit we don't know what we're doing!"

At first, this reaction by my fellow, more experienced investors, made absolutely no sense to me. Why wouldn't they be thrilled about the fact that certain strategies would now be much more accessible at a lower cost in a more shareholder-friendly investment vehicle? Wasn't the investment industry becoming flatter and more cost-effective a good thing for advisors, consultants, and investors alike?

Then I started to realize my naiveté. I was still a rookie in the field of finance. Not everything works in black and white when it comes to products and investment choices in the financial services industry. All of the pros in the room were thinking about the same thing—signaling. If they were using inferior products at a lower cost, they would be signaling to their clients that they weren't doing their job to uncover the best investment products available in the marketplace. These investors and allocators of capital were worried about becoming marginalized. If they couldn't offer access to only *the best funds*, then how would that look to current and potential clients? If you have your name on the list at the best nightclub in the city, you're in exclusive company. But if that velvet rope is open to everyone that wants to get in, suddenly the shine comes off just a bit and you don't feel so special anymore. Also, you get what you pay for is an expensive theory, but one that all too many still believe in. It's more or less a sales tactic, but one with a narrative that's difficult to shake for many both inside and outside the industry.

It was far too counterintuitive for these investors to accept the fact that they could earn above average returns at a lower cost while giving up the opportunity for extraordinary performance at a much higher cost. The extraordinary performance was much harder to get and there was no way that all of them were going to be able to succeed in finding it, but how could they admit this fact and not even try? These are very competitive people. They all went to top colleges and universities. Most attended the top business schools, obtained the prestigious CFA designation, or both. Everyone in the room was intelligent and extremely qualified. Investing can be a cutthroat business. Everyone wants to be the best investor by making the most money possible in the shortest amount of time. Unfortunately, it's just not possible for every single professional investor to be in the top echelon of the performance rankings. This can be a difficult realization to come to.

The look on the speaker's face was priceless after he finished answering the final round of angry questions from the audience. He had a smirk on his face. It was almost like he knew what was coming for many of these investors based on their reactions. He knew it was only a matter of time before market participants came around to his line of thinking. But breaking established viewpoints on the markets can be difficult for intelligent people. It's not easy to admit that there might be another way of doing things, a simpler approach.

Luckily, individual investors don't have to worry about entrenched positions from the investment industry. You don't have to try to impress anyone. You don't have to invest in the Rolls Royce of portfolios to reach your goals. A more economical, fuel-efficient model will do the trick as long as you're not worried about impressing anyone else (which you should not be). It's about getting from point A to point B, not how you get there. There are no style points when investing. There's no bonus for degree of difficulty. You don't have to signal that you invest only in the best, most exclusive strategies. No one is there to judge you or your portfolio and you don't have to compete against your peers. The most important thing is that you increase your probability for success. That's all.

Coming to this realization can be a huge weight lifted off your shoulders because, as you'll see in the next section, being in the upper echelon of investors is nearly impossible for even the professionals that do this for a living.

Institutional versus Individual Investors

Professional investors now control the markets, but it wasn't always like this. Fifty years ago, the little guy controlled the stock market, as individuals made up more than 90 percent of trading volume on the New York Stock Exchange. Today those roles are reversed, as institutions handle more than 95 percent of all trades in listed stocks while trading almost 100 percent of all other investable securities. Institutional investors such as pension funds, endowments, foundations, sovereign wealth funds, and wealthy family offices have trillions of dollars at their disposal to invest.[3]

Warren Buffett is probably the most well-known investor to the average guy or gal on the street. Not as many individual investors know who David Swensen is. Swensen is Warren Buffett in the world of institutional money management. He's one of the greatest institutional investors of all time. Swensen literally wrote the book on the institutional investment model, called *Pioneering Portfolio Management*. They even call his style of portfolio management, which has been imitated by hundreds and hundreds of investment funds around the globe, the Yale Model, because he is the chief investment officer for the Yale University endowment fund. Swensen has earned Yale nearly 14 percent per year in gains since the mid-1990s, an unbelievable run of performance over two decades.

Yale's portfolio is currently valued at over $20 billion. For those wishing to replicate Swensen's success, it's worth noting the structure of Yale's endowment fund. The school brings in hundreds of millions of dollars a year in charitable donations and grants. Ivy leaguers love giving back to their alma maters. Yale has a staff of 26 fulltime investment professionals who specialize in particular areas of expertise for the portfolio. Plus, Yale is a tax-exempt organization, meaning they don't have to worry about tax implications when it comes to their portfolio decisions. They also have a time horizon of forever, more or less, as the endowment is a perpetuity to the school. Large institutions, such as Yale, have access to certain funds that most average investors can't invest in because the minimums are far too large. There are deals that the largest players in the industry are involved in that would never become available to individual investors. Large pools of capital get a foot in the door simply for having such so much money at their disposal. The scale of these funds allows them to pay less in fees as a percentage of assets through negotiations because the absolute amounts can be so large.

While it's important to distinguish between individual and institutional investors, Swensen is quick to point out that even within the rank of professional investors there is a hierarchy. In the Yale Investment Office's 2013 annual report, Swensen offered the following advice to both institutional and individual investors alike (emphasis mine):

> The most important distinction in the investment world does not separate individuals and institutions; the most important distinction divides those investors that have the ability to make high-quality active management decisions from those investors without active management expertise. Few institutions and even fewer individuals exhibit the ability and commit the resources to produce risk-adjusted excess returns.
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> The correct strategies for investors with active management expertise fall on the opposite end of the spectrum from the appropriate approaches for investors without active management abilities. Aside from the obvious fact that skilled active managers face the opportunity to generate market-beating returns in traditional asset classes of domestic and foreign equity, skilled active managers enjoy the more important opportunity to create lower-risk, higher returning portfolios with the alternative asset classes, and private equity. Only those investors with active management ability sensibly pursue market-beating strategies in traditional asset classes and portfolio allocation to nontraditional asset classes.
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> *No middle ground exists. Low-cost passive strategies suit the overwhelming number of individual and institutional investors without the time, resources, and ability to make high-quality decisions.* The framework of the Yale model applies to only a small number of

> investors with the resources and temperament to pursue the grail of risk-adjusted excess returns.[4]

One of the biggest problems for individual investors just starting out is that they try to pursue the grail of earning higher returns with lower risks without the proper understanding of how hard it truly is to obtain. They assume that they need to use the most sophisticated investment strategies to succeed in the markets. On the flipside of that coin, those that are at the top of their game and have used the most complex approaches always seem to offer simple solutions to individual investors. In essence, they are saying, "Do as I say, not as I do." In a way, it takes an understanding of complexity to see the beauty in simplicity. This is a painful lesson for individuals to learn on their own, which is why it's preferable to let someone else pay the tuition for you. Learn from them and try not to make the same mistakes or understand why they advise you to think and act a certain way when investing.

The middle ground that Swensen describes is a place that many investors often find themselves stuck in. They want to try to beat the market by using sophisticated strategies, but they don't have the resources or knowhow to do it. In this case, trying to be above-average leads to below-average performance. Trying too hard becomes a weight around your neck. There's no shame in admitting that truly extraordinary market performance, such as Swensen's, is difficult to achieve. What hurts most investors is trying to be extraordinary in the markets, without the correct understanding that it's a game suited for a small number of investors.

The middle ground isn't reserved just for individual investors either. It's also littered with institutional investors that don't have the same resources or expertise as Yale. Table 1.1 shows the

Table 1.1 Endowment Fund Annual Performance Comparison

	5 Years	10 years	15 Years	20 Years	25 Years
Yale University Endowment	3.30%	11.00%	11.80%	13.50%	13.20%
Harvard University Endowment	1.70%	9.40%	9.60%	11.90%	11.50%
All Endowments	3.80%	6.80%	5.60%	7.70%	8.40%
60% Stocks, 40% Bonds	5.90%	7.40%	5.70%	7.60%	8.30%

Source: Vanguard.

performance numbers over varying time horizons for Yale's Endowment Fund along with the numbers for one of their peers, Harvard, and the record for all endowment funds set against a simple 60/40 stock/bond benchmark. These numbers show how extraordinary Swensen's long-term results have been over a multidecade time horizon—phenomenal, in fact. Harvard, one of Yale's biggest rivals, has also shown the ability to deliver above average long-term returns, as well. Now look at the results of all endowment funds in this institutional investment universe. When compared to a 60/40 portfolio made up of two simple index funds the results look nearly identical. They basically matched a balanced fund's performance over every period, not something most novice investors would expect.[5]

Not only is it difficult for the average individual investor to come close to matching David Swensen's return figures, but even his peers in the institutional investment community have a hard time coming anywhere near his performance. In fact, most have a hard time beating one of the simplest portfolios you can create for nearly nothing in fees today. Swensen himself is an advocate for passive funds; as he says, "Certainly, the game of active management entices players to enter, offering the often false hope of excess returns. Perhaps those few smart enough to recognize that passive strategies provide a superior alternative believe themselves to be smart enough to beat the market. In any event, deviations from benchmark returns represent an important source of portfolio risk."[6] This comes from a guy who has beat the market handily over the past two and a half decades. Sometimes it takes the perspective from someone that utilizes a complex approach to portfolio management to recognize the beauty of simplicity for everyone else without the same resources at their disposal.

Yale is definitely the Michael Jordan of the institutional investing world. (I guess that makes Harvard the Kobe Bryant?) It's a pipe dream to think individual investors can match their success. But look at the results of the rest of these multimillion- and billion-dollar portfolios: A simple 60/40 mix of stock and bond index funds that merely matches the returns of the market is right there over every single time frame. It's not out of the realm of possibilities for the average investor to hang with professional investment offices, assuming they have the required patience, discipline, and long-term perspective.

To match or even beat the performance of institutional investors, the individual has to think differently. You can't try to beat Wall Street at its own game. In this case, a very simple portfolio pulled in nearly the same performance with much less work involved and a far simpler strategy. Obviously, not all institutional investors can outperform the market. There will always be winners and losers.

Yet just think about all the work that goes into the returns for the institutional investors. Each large fund has a fulltime staff that can range in size from a few trained professionals to more than a couple thousand at the largest pension funds. There are also third-party consultants and back-office employees. The fulltime staffs that run these funds are constantly researching and analyzing the markets for investment opportunities. Although information access is becoming more widespread, annual budgets allow institutional investors to pay top dollar for the best research and market-data providers.

On the flipside, individual investors are on their own more often than not. If you don't work in the industry, you probably have a full-time job or family to worry about. You can't track the markets or perform research on a daily basis. Even though your investments are extremely important to your future well-being, you have to live your life and likely don't have the time or interest to follow the markets as closely as the pros. As individuals, we are much more emotionally invested in our portfolios because it's our money. It's not other people's money that we're managing. No one's ever going to care more about your money that you. Your investment portfolio really contains your goals and desires.

We're All Human

One of the biggest mistakes investors make is letting their emotions get in the way of making intelligent investment decisions. Research shows individuals sell winning stocks and hold on to losing stocks. They chase past performance and make decisions with the herd, buying more stocks after a huge run-up in price and selling after a market crash.[7] These errors cost investors a lot of money when compounded over very long time horizons.

Even with all of the advantages outlined in the previous section, professional investors are not immune from making these same exact mistakes. Researchers looked at a dataset of more than 80,000 annual observations of institutional accounts from 1984 through 2007. These funds collectively managed trillions of dollars in assets. The study looked at the buy and sell decisions among stocks, bonds, and externally hired investment managers. The researchers found that the investments that were sold far outperformed the investments that were purchased. Instead of systematically buying low and selling high, these professional pools of money bought high and sold low. We often hear of individual investors buying and selling mutual funds at the wrong times (we'll get to that later), but this study shows that professional investors practice this same type of money-destroying behavior. In fact, the authors of the study figured that these poor decisions caused this group of investors to lose more than $170 billion.[8]

Another study looked at large pension plans. These funds had an average size of $10 billion each, but they also made the mistake of chasing past performance. Nearly 600 funds were studied from 1990 to 2011. The authors of the study found that these sophisticated funds allowed their stock allocation to drift higher when the markets were rising in the bull market of the late 1990s, making them overweight to their target asset allocation percentages. So when the market crashed they held more stocks than their policies and risk controls suggested. And following the financial crisis in 2008, these funds were far underweight in their target equity allocations and kept them low. These pension funds didn't factor in reversion to the mean. All they did was extrapolate the recent past into their current decisions. They didn't rebalance by buying low and selling high. To stay within their stated objectives they should have been trimming stocks in the late 1990s as they ran up higher and buying stocks after the crash in 2008, but that's not what happened at all. Instead they were fighting the last war and investing through the rearview mirror instead of sticking to their investment policy guidelines. Risk management was secondary to chasing returns.[9]

Why does this type of behavior exist, from professionals down to the individual? In the classic movie *Wall Street*, Michael Douglas's character Gordon Gekko famously said, "Greed, for a lack of a better word, is good."[10] And while greed is said to be a driving factor in most financial decisions, envy can actually dissuade us from reaching our goals as well. In one study, Harvard researchers asked subjects if they would rather live in a place where they had income of $50,000, but the average person had an income of $25,000 or one where they have an income of $100,000 in a place where the average income was $200,000—assuming prices were constant in both examples. In the end 52 percent of the respondents preferred the $50K salary, half as much money in absolute terms as the other option but twice as much as their neighbors.[11]

Envy finds its way into the world of institutional money management as well. One of the reasons for this is the fact that people are the ones investing these portfolios. Professional investors, although much more used to the ups and downs in the markets, can succumb to human nature just as easily as anyone else. And because of all of the advantages listed above, professional investors are expected to beat the market and their own benchmarks on a consistent basis. Even though it shouldn't matter, professional investors are constantly comparing themselves to their peers in the industry. The one-upmanship can be fierce when the annual return numbers are made public. While competition can be healthy in many aspects of life, when comparing portfolios with different goals, objectives, risk profiles, and time horizons, this type of behavior can lead to unforced errors when trying to beat your fellow investors.

Speaking of relative performance—institutional investors not only benchmark themselves against peers in the industry, but also against custom or index-based internal benchmarks. Benchmarking can be helpful in some ways for individuals (more on this later in the book), but the only benchmarks that really matter are your own personal goals. If your portfolio is able to meet those goals, who cares if you beat the market or not? You don't have to judge yourself on any particular timeframe against a set index or market. Investing doesn't have to be about beating others or beating the market. It's about not beating yourself.

These different goals are the reason investors shouldn't worry about how the professionals invest or even what type of performance numbers they're putting up on an annual basis. They say if you want to win against a team with superior talent in sports, you don't try to beat them at their own game. You level the playing field by exploiting their weaknesses and utilizing your strengths. That means trying to get involved in the increasingly competitive world of professional money management is not the game individuals should be trying to play. You're at a competitive disadvantage.

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Extra Zeroes

When you work with large institutional portfolios, it can be a bit overwhelming at first. It takes some time to get used to working with market values and investments with a few extra zeroes. But after a while you realize that's all they really are, a few extra zeroes. Yes, there can be more pressure involved when you're investing multimillion- or billion-dollar portfolios. But the same basic investment principles apply to even the largest portfolios. Every investment plan and portfolio is going to be different because every individual or organization has unique circumstances and cash flow needs. But at the end of the day, those extra zeroes have to follow the same basic principles whether you're managing $10,000,000 or $10,000. There's an old saying that people don't go to church on Sundays expecting to hear an eleventh commandment. They go to reinforce the ten that are already in place. Every investor, both big and small, is forced to deal with erratic markets and an uncertain future. There's no reason to try to reinvent the wheel and come up with some exotic strategy that no one else has figured out to try to change this fact.

Having more capital to invest shouldn't shield large pools of capital from creating a comprehensive investment plan and having the discipline to follow that plan by the rules and guidelines set out by the investment policy statement. There are no short cuts.

You most likely don't have the time, experience, or expertise, to try to be an extraordinary investor on the same level as David Swensen at Yale. But it's okay to admit this fact. Those who don't are the ones who get themselves into trouble. The competition for the very best investment ideas is now higher than it's ever been. That competition is only going to get fiercer over time. Professional investors are constantly on the lookout for ways to improve their portfolios by looking at different securities, industries, markets, asset classes, geographies, investment managers, and fund structures.

Individuals have to understand that no matter what innovations we see in the financial industry, patience will always be the great equalizer in the financial markets. There's no way to arbitrage good behavior over a long time horizon. In fact, one of the biggest advantages individuals have over the pros is the ability to be patient. You don't have to answer to a committee or a group of clients. No one is judging you against your peers or a custom-made benchmark. There's no one to impress. It's not that all of the professional investors don't think for the long term; it's just much more difficult to pull off for some because of the culture of comparisons and benchmarking. You can trade as little as you want and no one will be there to question your results in the short term. You can extend your time horizon for as long as your circumstances dictate and allow the magic of compound interest to do the heavy lifting for you. There's no need to worry about the next week, month, quarter, or year with your long-term capital. Individuals have the luxury of thinking—and hopefully acting—in terms of decades, an unheard of time frame on Wall Street. The ability to be patient and disciplined while extending your time horizon can be a huge advantage.

You don't have to worry about beating the market or Harvard or Yale. You just have to worry about doing enough to reach your goals. That's your true benchmark. You can focus on yourself and your own portfolio.

Long-Term Thinking

A number of years ago, in one of my first due diligence meetings on a potential investment manager, I was listening to a marketing pitch given by a portfolio manager and what he said still stands out to me to this day. As he was giving the general outline of the firm's strategy he talked about the possible alternatives to the way that they invested in stocks. The average holding period for stocks in the fund was eighteen months and they used various market-timing indicators to try to improve performance.

In the marketing material, there was a page listing the different ways in which you can outperform as a stock investor. Number one was trading opportunistically over the very short term. Number two was to find the intermediate-term trends in sectors and industries and ride them before the rest of the market discovered them. Finally, number three was to be a buy and hold investor for the very long-term.

What was interesting about this presentation was that he discussed the buy and hold strategy as if it were a mythical creature that could only be seen in a fairy tale. He flippantly said, "Sure, you could do very well with a buy and hold strategy but what portfolio manager has the leeway to be able to pull that off in today's environment? No investors have that kind of patience." This was crazy to me, but for the majority of investors that this portfolio manager pitched his strategy to, it was probably true. He was basically saying that none of his clients or prospective clients would give the fund a wide enough berth to pull off a buy and hold strategy because there would of course be periods where it wouldn't work. And his fund gave the apparent illusion of increasing the odds of improving upon this—even though it was probably just that, an illusion.

This isn't to say that buy and hold is a perfect strategy by any means. It's not. No strategy is perfect. But the way that this professional money manager dismissed a long-term approach simply because of impatient investors was difficult to grasp. Just because something is hard doesn't mean you shouldn't do it. The problem with a buy and hold strategy is that for it to work the way it's supposed to, you have to do both the buying and the holding during a market crash. It's much easier to both buy and hold when markets are rising. Get this right and you can be wrong in many other aspects of the investment process and still succeed. It just requires intestinal fortitude not seen in many people because we're used to running from burning buildings, not towards them.

A study performed by the Federal Reserve shows how the simplicity of a buy and hold strategy can pay dividends over the alternatives. They looked at mutual fund inflows and outflows over nearly 30 years from 1984 to 2012. Predictably, they found that most investors poured money into the markets after large gains and pulled money out after sustaining losses—a buy high, sell low debacle of a strategy. They then compared these return-chasing fund flows to a simple buy and hold strategy over seven year windows throughout the period. They found that the buy and hold strategy outperformed the return-chasing strategy by up to 5 percent per year. That means in the seven-year time frames they studied, the total return difference was as high as 40 percent in all.[12] Again, buy and hold has its flaws. Nothing works all the time or shields investors from losses. But when compared against typical investor behavior, it's not even a contest.

Another simple, yet effective way for individual investors to diversify investment decisions is through the process of dollar cost averaging (DCA) by making periodic purchases over time. This strategy ends up buying more shares at lower prices and fewer shares at higher prices. The point of dollar cost averaging isn't to perfectly time the market, but to admit that you don't have the ability or emotional control to try to time the market. Plus, rarely is it the case that investors are putting a lump sum into the market all at once. Remember, a portfolio is simply a place where you allocate your savings. Most people save a percentage of their income, making a dollar cost average strategy the most convenient way to invest, especially since the process can be automated through a workplace retirement plan. But even this strategy can be difficult to implement without the correct perspective, as Benjamin Graham pointed out when asked about DCA in the 1960s. "Such a policy will pay off ultimately, regardless of when it is begun, *provided* that it is adhered to conscientiously and courageously under all intervening conditions." But for this strategy to work out an investor must, "be a different sort of person from the rest of us . . . not subject to the alternations of exhilaration and deep gloom that have accompanied the gyrations of the stock market for generations past." Graham's conclusion, "This, I greatly doubt," says a lot about his knowledge on the emotions of investors.[13]

These are just two very basic investment ideas that are simple, but not easy, in practice. Both can work for the majority of investors as a good baseline assumption before doing a deeper dive into your own circumstances, risk profile, time horizon, and investment skills.

Also, there's a big difference between buy and hold and your personal holding period. It's impossible to have a portfolio where you never make any changes. There needs to be a balance between controlling for risk and staying out of your own way, from being overly active and mistiming the market. A patient, disciplined, long-term strategy isn't easy because most of the time it requires you, the investor, to basically sit on your hands and do nothing. This may sound easy, but for many doing something, *anything*, is much easier because it gives you the feeling of control. When you make constant changes to your portfolio that activity makes you feel as if you are having an impact by not sitting still and doing nothing by following your plan.

In most areas of our lives, trying harder is great advice. But trying harder does not mean doing better in the financial markets. In fact, trying harder is probably one of the easiest ways to achieve below average performance. Reaching for superior performance over every single shortened time frame will most likely lead to worse results than accepting what the market gives you, keeping your costs low, and trying to behave. It's easy to assume that the most skilled will become the best performers in various professions. This is generally how it works out in professional sports. But it is not only the most skilled; it is also those who work the hardest. The best people should do well year after year and this is exactly how many think that the financial markets should work. Somehow this never works out in reality. There's a constant stream of intelligent people making huge mistakes in the financial markets. In the next chapter we'll look at ways to reduce these mistakes and how to improve your performance by learning from some of the greatest investors of all time.

Key Takeaways from Chapter 1

- Don't try to beat the professionals at their own game. You're at a competitive disadvantage. The greatest equalizer in the markets will always be patience. You can't arbitrage good, long-term behavior.
- Envy is perhaps the worst emotion that you can feel as an investor. It can only lead to problems. There's no logical reason to compare yourself to other investors—institutional or individual. Focus on your own situation.
- The basic investment principles apply to all investors, regardless of the size of their portfolio. The hard part is following them when those around you cannot.

Notes

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