Chapter One

The Opposite of What You're Aiming For

In our earliest years most of us learn that if you want to be successful you have to make an effort. Whether it's good exam results at high school, winning a game of football, or perhaps losing weight, we have to work to achieve it. And most of the time, this sound principle of 'sowing the seeds to reap the rewards' holds true.

But how much effort do you really need to put in to reap those rewards? Many people believe there is a positive relationship between the amount of effort you put into something and the likelihood that you will succeed. The more effort you put in, the more likely you are to succeed. But is this true?

It is not. There is something known as the law of diminishing returns. Let me clarify by applying this law to sports. You need to train if you play professional football or want to run a marathon. You really need to kick a ball or put on your running shoes a few times a week in order to develop some muscle strength. But the first 100 hours of training will have more effect than the next 100 hours and so on. Perhaps you recognize this effect, as it also might explain why it is often fun to learn new things. The learning curve is quite steep at the beginning and then it starts to gradually level off. It's the theory of diminishing returns put into practice.

Moreover, once you have put a certain amount of effort into something, any additional extra effort can paradoxically result in the opposite of what you were aiming to achieve. For example, if you train too much and fail to rest at regular intervals, it can even be damaging. The opposite of what you were aiming for (finishing that marathon) might occur: an injury might even prevent you from showing up at the start of the game or the race in the first place. Too much of something, even a good thing, can have a negative effect.

Take the amount of salt you use when preparing a dish. A little bit of salt can add flavor to the food; too much might spoil it. Vitamins are healthy, but become toxic when consumed in large quantities. And some advice for bachelors who are desperately looking for a spouse: yes, you should make the first move to approach someone you like, but too much attention might have the opposite effect and scare her (or him!) off. Losing weight? Might sound like a good plan if you need to shed a few extra pounds, but not when too much dieting results in anorexia. Studying really hard just before your exams and then showing up completely exhausted before the test itself is another example.[1] Needless to say, a good night's sleep before an exam will serve you better than studying all night long. Too much of something often causes more harm than good.

In life you should try to find the optimum between too little and too much. You need practical wisdom to determine where this

[1] I've witnessed this counterproductive behavior at universities in the US, Sweden, and the Netherlands.

'golden mean' is. Aristotle, a Greek philosopher, wrote extensively about the golden mean. This is the desirable middle between two extremes, one of excess and one of deficiency. The golden mean is *not* the exact middle, as this will vary according to the situation. It requires practical wisdom to find it. The Chinese philosopher Confucius also taught the doctrine of the middle way, while references to the golden mean can also be found in Buddhism, Judaism, Christianity, and in Islam.

So why this golden mean? Why am I bringing up these old philosophers? Why this focus on the fact that too much of something can result in the opposite effect to the one desired? Well, I wanted to make you familiar with the concept of a paradox. A paradox is anything that is apparently – in itself – contradictory in nature. Chances are that you are already familiar with the word, as we use it in everyday communication to express astonishment or disbelief about something that is unusual or unexpected. Paradoxes also exist in the world of investing. In fact, as a student I hit upon perhaps the biggest paradox in the investment world: low-risk stocks deliver high returns while high-risk stocks deliver low returns. Quite a surprising and remarkable finding.

Let me explain why this is remarkable. Think about the following common 'investment wisdom': the more risk you take, the better your returns will be. Most equity investors, whether they are professional money managers, such as investment advisors or hedge fund managers, or 'do-it-yourself' private investors, believe that concept of more risk, more return. But is this really true?

A lot of these investors 'aim for the moon' when it comes to managing money for their investment portfolios. They try to find the next potential Apple, Google, or Tesla. Investing in these kinds of exciting stocks is risky, as you might lose your initial investment if your potential 'super stock' turns out to be not quite so super, and perhaps even files for bankruptcy.

But what if you were to succeed in finding the next Google or Tesla in time and the stock quadrupled in price? Oh yes, then you would be laughing all the way to the bank, knowing that you'd won the jackpot and reached the moon! And what about the less exciting stocks? Well, according to many investors, boring stocks won't get you very far in life. After all, doesn't low risk equal low return? Do you know anybody who got rich quickly by investing in a slow-moving low-risk stock?

So if I tell you that low-risk stocks can make you rich while high-risk stocks can make you poor, I completely understand that your initial response might be something like: *"What has the guy who came up with that statement been smoking?"* I can't blame you for having those thoughts. After all, I was born and raised in the Netherlands and still live here. This statement is counterintuitive to anyone familiar with the general investment wisdom 'more risk equals more return'. So if you buy a book about investing and read in the first chapter the exact opposite to this widely accepted premise, you would be justified in questioning the author's credibility.

And, to be honest I was a bit puzzled as well when I first read about this investment paradox. Back in the days when I was an undergraduate student, I stumbled upon an academic article that described this risk–return paradox for the first time. Afterwards, as a PhD student I had plenty of time to reread and digest this fascinating study published in the early 1970s. As a result of doing this, something I will describe briefly in the following chapters, I was able to find more data to confirm that low-risk stocks beat high-risk stocks. After I received my doctorate degree I decided it was about time to put this well-tested theory into practice. Would an investment strategy based on this paradox also play out in the real world?

Well, it did! After my university years I joined an international investment management company, which manages money for institutional investors (like insurance companies, endowments, and pension funds) and private investors. Robeco is a prudent investment firm that employs many smart researchers and has a research heritage going back to the 1920s. Although it was not my original intention to start a new fund, we started a low-risk equity fund in 2006, two years after I joined the firm.

What struck me during my first months at Robeco was how the concept of risk was turned upside down in the investment industry. I had studied risk for many years at university, but in the industry, risk was not defined as losing money, but as underperforming a benchmark. I started to realize that this perspective on risk is wrong, but that it could also explain the investment paradox. I also felt that we had to do something about this and convince our existing and potential clients about this misperception of risk. And of course we also explained how they could profit from it. We managed to convince a lot of investors and the once-small fund became a strategy with over USD 15 billion worth of assets which we manage for investors from all over the world.

You might wonder why I decided to share this investment paradox with you. Because, after all, I could just focus on managing the funds and playing golf in my spare time. Well, first of all, I wanted to reach out to those who are not experts in finance. I have written many articles in several journals; I know that reading an academic paper is not something a lot of investors like to do in their spare time. So writing this easy-to-read book gives me the opportunity to explain some fascinating academic results to a broader audience. Second, I enjoy trying to explain something complex in a simple way. Simplifying is quite difficult; it's much easier to make things complicated. Third, I like to link ancient wisdom and classical virtues to the modern world of investing. Throughout my life I have discovered that moral philosophy, which teaches us how to live a good life, can be surprisingly useful when it comes to investing.

A book is a much better medium for telling this story than an academic article. The final reason why I took this challenge is because this book will save me time. When people ask about my job and what a fund manager does, I can simply refer them to this book. So, for all these reasons I want to spread the word, to show that, in order to make a good investment return, you can simply buy low-risk stocks and stay away from high-risk stocks. Oh, and I don't play golf either…

I am assuming that I haven't convinced you yet. In fact, I would be quite surprised if, at this stage, you already believed that low-risk stocks will give you high returns. A skeptical attitude helps to increase knowledge on any topic, and you need a doubting mind to challenge conventional wisdom. Bertrand Russell, a British philosopher, noted that the main problem in the world is that fools and fanatics are always so sure of themselves, while wise men are full of doubts. Therefore, I will give you plenty of evidence in this book for the existence of this investment paradox. And don't worry, it will be an easy read. In the next chapter, I'll start by sharing my first experience of the stock market with you.