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ALTERNATIVE PERSPECTIVES

Macro Strategy & Research

4 Wall Street Myths That Hurt Investors

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Navigating Wall Street can be confusing for the average investor. It can be scary, confusing and is shrouded in myths. Often times, what you think is in your best interests is nothing more than a product or service designed to service an investment firm or its shareholders as opposed to the client's needs FIRST. Understanding these myths is crucial to navigating your way to financial success.

Myth #1— You Get What You Pay For

Most investors outsource their portfolio to professional money managers who supposedly perform better because, well, they're "professionals"! But the money management business is just like any other competitive business. Not everyone can be great at it. And research shows that over 80% of professional mutual fund and hedge fund managers underperform a correlating index. The reality on Wall Street is that most professional money managers cannot outperform an index and add very little value over buying a simple index fund. Those extra fees you're paying are often times a sunk cost. More expensive doesn't mean better performance.

"Risk comes from not knowing what you're doing." - Warren Buffett

Myth #2— Money Managers and Advisors Have Their Interests Aligned With Yours.

Many investors assume that their financial advisor or money manager has their interests aligned with those of the investor. But the reality is that most Wall Street firms are designed around the best interests of their shareholders and the firm. Most advisors and managers get paid regardless of their performance and have adopted an asset accumulation approach that maximizes recurring fees. Charging you higher fees is how most financial firms maximize profits. Most managers don't care how your portfolio performs in absolute terms just so long as they continue to sell the idea that they can "beat the market".

Most importantly, the majority of money managers view the concept of "risk" differently than their clients do. Investors perceive risk as the likelihood of not meeting their financial goals. In the markets this generally involves the risk of purchasing power loss and the risk of permanent loss. Most investors don't need to "beat the market" and would take too much risk in trying to do so. But this is how most money managers perceive risk. If they can't "beat the market" then they underperform their benchmark which creates career risk. This misaligns the client's perception of risk with the way the money manager perceives risk.

"We are all active investors. Proper portfolio construction isn't about being "active" or "passive". It's about understanding your risk tolerance and establishing a low fee, efficient portfolio that helps you achieve your financial goals."

Myth #3— Buy and Hold or "Passive" Investing s the Best Approach

Many investors think they can just put a portfolio on auto-pilot and that they're "passively" investing in the market. But the devil is in the details. Proper portfolio construction is a process that involves a dynamic market and your personally dynamic financial goals. We don't live in a static financial world. Portfolio construction requires maintenance, rebalancing, risk adjusted dollar cost averaging and proper monitoring of the portfolio over the long-term.

Additionally, we have to accept that we're all "active" to some degree and no one can buy and hold an index without ever having to engage in the portfolio over its lifetime. Most importantly, anyone who is making a directional market bet of any type (index based or not) is indeed making macro forecasts. There is no such thing as "forecast free" investing. When we construct portfolios we need to understand these macro perspectives and embrace a certain degree of activity and forecasting within any portfolio. But most importantly, we need to construct that portfolio so that it is low fee, tax efficient, diversified and aligned with our personal financial goals. Don't be so dogmatic about the idea of "passive investing" that it actually works to your own detriment.

Myth #4— You Have to "Beat the Market"

Many investors believe the stock market returns 10-12% per year and that they need to outperform even this lofty figure. The reality is that the stock market's real, real return is about 6% per year and that's an index of the very best companies in the world (for instance the S&P 500 is arguably the 500 greatest companies in the world out of millions). The stock market's real, real returns are not only lower than we often think, but more difficult to achieve than widely thought.

More importantly, this mentality of becoming the next Warren Buffett or "beating the market" puts the cart before the horse. An investment portfolio is what economists call a stock which flows from your income. Your primary source of output (your day job) is how you get "rich". Your portfolio is simply a repository where you protect your wealth from the risk of permanent loss and loss of purchasing power. It is, for all practical purposes, your savings. And your savings shouldn't be thrown entirely into the stock market rollercoaster. It should generally be viewed as a balanced portfolio that helps create stability and predictability in your life so you can plan for life's big events. Trying to "beat the market" could be dangerous for your wealth as it involves a higher level of risk than most people think.

At Orcam we use the "Total Portfolio" approach which emphasizes this understanding of "savings" and "investment" and places the role of your portfolio in the proper context. Anyone who can create a portfolio that beats inflation without creating unnecessary risk of permanent loss will substantially increase the probability of meeting their financial goals.

For more information on avoiding the pitfalls of Wall Street and securing a more objective and prudent view on investing please contact Orcam Financial Group, LLC at (858) 220-5383 or by email at info@orcamgroup.com

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