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This is a fantastic time to be a long-term investor.

Capitalism is not dead. Capitalism promises to allocate resources to their most productive uses. For capitalism to function properly, companies need a free market system that enables them to take in resources – natural resources, human capital, intellectual capital, financial capital – and produce and sell something of greater value than the individual parts. Investors provide the financial capital, and are thus due their fair share of what capitalism creates.

An integral, and necessary, component of capitalism is that risk and return are related. For example, pretend you're a bank... Walmart and K-mart walk in and ask for a loan – Walmart wants \$100 to wipe out the next mom-and-pop store in some Midwest town; K-mart wants \$100 to pay its employees and keep the lights on. Who pays the higher rate on the loan? K-mart; that loan is a riskier proposition, and thus must offer a higher expected return for the bank. The stock market works the same way; stocks are riskier than T-bills, and thus must offer a higher expected return to attract investors' financial capital.

Is there a specific time-table that guarantees stock market investors a higher return than risk free Treasuries? Of course not. If there was, we wouldn't be able to expect anything greater than the returns on long-term T-bonds. That's the nature of risk; risk is not finite.

The shrewdest investors realize that down markets present a great buying opportunity; stocks are on sale. If there was a positive expected return on capital a year ago for a properly diversified portfolio, it's much greater today. As Warren Buffet said in a recent NY Times article, "...bad news is an investor's best friend. It lets you buy a slice of America's future at a marked-down price." It's unintuitive, but equity risk premiums are higher in poor economic times; they have to be in order to attract investment. Who knows what the market will do tomorrow, but I'm confident that a diversified portfolio will produce higher returns than T-bills over the next 10 years... boring, huh?

A rubric for successful investors:

Understand that “systematic” risk and return are related. Leverage Nobel prize-winning financial economists to understand the sources of risk that are **not** diversifiable (rather, are ‘systematic’ in nature) and result in higher expected returns. Playing roulette is risky; is there a positive return on your betting capital? No. Investing in individual stocks, industries, or countries exposes investors to risks that are not much different – risks that are diversifiable do not carry with them the promise of higher expected returns.

Diversify away any risks that you can diversify away from. Diversification is more or less free when investing in public equities. Investors that have a concentrated investment portfolio are exposed to risks that they don't need to bear; those specific risks (risks related to specific companies, industries, etc.) do not offer investors an expected reward.

The recent market events have provided a great case for diversification. Fannie Mae (dated example now) had, for a long time, been considered the most bullet proof stock to hold in a portfolio; a perpetual cash flow kind that had the implicit guarantee of the US gov't. Investors that bought into that story, and overexposed themselves to Fannie, have lost their shirt.

Don't let the state of the economy or market pundits inform long-term investment decisions. Investors have historically been abysmal at capturing market rates of return, let alone picking the next hot stock or fund manager that can produce returns over and above the market return. The data are shocking on this front. One major reason is that investors buy in when the economy and/or the market is doing well, and sell when the market is down. They chase returns; buying the hot stock, sector or fund manager, and cash out of the poorer performing segments of the market. This systematic behavior of buying high and selling low has hurt average investor returns considerably throughout time.

The equity markets promise a higher return than T-bills over time for investors that live by this rule set. Sure, there are speculative opportunities that can create (and destroy) massive wealth. It is important to understand the difference between "speculation" and "investing" in order to have a successful investment experience.

Many investors dismiss index investing with the reason or rationale that the investor is guaranteed to be average. That's wrong; index investors who stick with a sensible investment strategy are guaranteed to capture market rates of return, more or less, which is far better than average investor returns. Average investment returns have fared far better than average investor returns.

A quick side note on Jim Cramer; he's recently been saying that investors who had short-term needs for cash should not be in the stock market. Duh!!! That's the smartest thing I've ever heard him say. This from a guy who perpetuates the common investor confusion between 'speculation' and 'investing'; who, two weeks before the Bear Stearns collapse pleaded with callers to "stay with Bear Stearns."