Exencial
Wealth Advisors

A Small Minded Approach

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The perception that small investors can no longer profit in financial markets has grown in recent years. People who once regarded stock market exposure as necessary to their retirement saving plans now watch from the sidelines because they are shell-shocked and distrustful after being burned. Many have chosen to wait for a better entry point without defining what it will look like once it arrives.

The facts, however, suggest that disciplined small investors may actually have an advantage over the big banks, computer trading platforms and professional traders that are responsible for the majority of stocks bought and sold every day. But the small investor's edge cannot be put to work playing their game.

What do small investors have that financial entities lack? Time.

We measure success on a multi-year timeline while banks and their traders are judged quarterly, if not monthly.

What can we do with that time? Sit on our hands.

We tend to make decisions based on emotional responses, which can be disastrous when managing investments. Time and again, small investors show up late to stock market rallies after the risk-return tradeoff has skewed away from their favor. We also get the overwhelming urge to sell stocks only after taking significant losses when, at that point, future potential returns make staying put the best choice.

If small investors can practice patience, rebalance periodically and avoid panicking, they will outlast the professionals. For proof, consider that small U.S. investors who remained invested and rebalanced periodically from the peak of 2007 through the bottom of 2009 and back up to today's levels would have retained *all* of their savings today. Discipline can ensure our portfolios stay intact despite some of the worst market environments in history.

The patient small investor looks even more successful when we consider how the competition fared.

Our winners, which we can define as those financial institutions that made it out of the financial crisis, have only recovered a fraction of their pre-crash value. Goldman Sachs stands out as the clear leader, trading today around 48 percent of its peak price in 2007. Morgan Stanley trades under 23 percent of its peak price, Bank of America around 16 percent and AIG at just over 2 percent!

What about Merrill Lynch, Bear Stearns, Countrywide, Wachovia and Lehman Brothers? Well, the reckless management of these companies ultimately delivered their shareholder equity to the dustbin of history.

At least the survivors learned the importance of discipline and prudence, right? Not exactly.

Banks began relying heavily on professional traders for easy profits as other sources of revenue evaporated in the wake of the financial crisis. This has resulted in a string of high profile disasters in which rogue traders have lost tens of billions for their banks. But the losses to their shareholders have been even greater as investors pulled their money from institutions they could no longer consider responsible stewards of their capital.

There is no free lunch. Investors, small and large, must understand the only reliable path to wealth takes discipline and a long-term commitment. Those of us who have taken this approach still have our savings, while the competition has a long way to go.

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