How To Invest. Investing For Idiots. And Smart People.

For most people, a simple investment strategy is best. Complex investment strategies with ambitious objectives, whether they are loss reduction, returns enhancement, volatility targeting, alpha generation, et al, are luxuries with associated cost. Here are some simple rules that investors of all levels of sophistication should follow.

1. Invest early and keep it simple. Take more risk when young and reduce your risk with age.

2. Diversify over time. Apply dollar cost averaging to reduce the impact of market volatility. Diversify over assets. Don’t have all your eggs in one basket.

3. Manage your costs which include both transaction as well as ongoing fees. Don’t trade often as it is expensive and does not add to performance in the long run.

4. Learn about economics, politics and finance but not so much that you feel you can break rules 1 to 3 above.

When you are young and just earning an income, say in your early twenties, set some income aside and invest it all in equities. A diversified ETFs is the most efficient way to invest. As you get older, put some portion away in bonds. Again one or two diversified ETFs or a single diversified mutual fund is best. At age 70, or 90, or whatever the retirement age has become by then, have no equities and should only have low risk, high quality bonds. In between, just do a straight line pro ration to figure out how much you need in bonds and how much in equities for any given age you are.

Exchange traded funds (ETFs) and mutual funds are useful investment vehicles. They give the investor instant diversification and reduce the investment amounts to manageable sizes for those who don’t have a lot to invest.

Stock picking is a difficult thing to do. Too much concentration in a single stock is risky, and too little exposure per stock means that the time and effort spent identifying that stock is diluted. Have a diversified portfolio.

Market timing is difficult to do. The best of professional traders fail at market timing, an amateur should not even try. Nor should they delegate market timing even to professionals. Apply dollar cost averaging, spreading investments over time to smooth the impact of market volatility.

Fund picking can be easy or difficult. Don’t make it difficult by trying to identify so-called alpha generating fund managers. Alpha is hard to find and can be variable. Often an ETF is the most effective investment instrument. When selecting an ETF, check that it indeed gives you the exposure you seek, check that you are comfortable with the cost (total expense ratio, not just management fees), and with the liquidity in case you need to cash out.

Sometimes, ETFs are not available for the investment you are trying to make. This is rare if you are keeping it simple, but some investors are a bit more sophisticated than others. In this case, a mutual fund could be the answer. Again, check that the fund gives you the intended exposure at a reasonable cost and liquidity.

Find a cost effective execution and custody platform. Most banks offer all of the investment solutions you seek but can be expensive. If all you seek is execution and safekeeping of assets, you should be acutely cost sensitive and risk conscious.

If you have lots of money, many financial institutions will try to advise you. If you have little or less money, fewer people will be willing to advise you. You should be clear what advice you need or want and seek it.

If advice comes looking for you, it is likely to be expensive. It is generally expensive to provide investment advice and so that advice comes at a price. Financial advisors have to find you. This is expensive as they have to spend money on advertisements or hire salespeople to seek you out. These costs are borne by you directly or indirectly, they are not borne by the financial advisor. Investment advice is expensive to deliver. The financial advisor has certain duties and responsibilities which raise their costs. They have to get to know you, your financial circumstances and objectives. The collection and maintenance of data is expensive. They have to provide suitable advice. This process involves finding the right products and selling them to you in a proper way, meaning that apart from telling you the benefits, they have to tell you the risks, and the costs. Financial firms have people who check that their salespeople are behaving properly and following procedure. They have investment professionals seeking out suitable products and doing research for you. All this costs money, and of course has to be paid for by you.

Small investors pay the highest fees because they do not have bargaining power and yet are not very profitable to the firm as their investment amounts are too small. To make servicing small investors profitable, costs have to be cut. Automation and other systematic asset allocation models are a potentially efficient solution.

Big investors are very price sensitive and often haggle over fees and shop around. To make servicing big investors profitable, service levels have to be raised, often raising costs further. The provision of increasingly sophisticated investment advice and products can be like an arms race, but the cost often rises to meet the benefit.