Five key tips for DIY investing

Money Matters

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If you're planning to be the next Allan Gray, then this article should be of interest to you, with five tips for successful do-it-yourself investing.

Tip 1: Read articles on behavioural finance and study the various biases, which wreak havoc with rational investing; like loss aversion, anchoring, confirmation and hindsight bias. Adam Smith said: "If you don't know who you are, the stock market is an expensive place to find out."

Tip 2: Understand and define the meaning of risk for yourself. The financial services industry defines risk as volatility of return. The fact that the stock market has historically fallen by as much as minus-50% classifies share investing as high-risk. However, all past market crashes have been temporary and recovered to surpass earlier highs. The risk is not the temporary market correction, but how you react to the fall in prices. A panic decision to sell crystallises the temporary loss making it permanent. A better definition of risk is permanent loss of capital, which happens when you over-pay or a business goes bankrupt, and of course a Ponzi scheme.

Tip 3: Think long-term for a competitive edge above the herd. Investment analysts spend an inordinate amount of time and energy in trying to forecast company earnings for the next 12 to 24 months, which drives their decision to buy or sell a share, despite empirical evidence that their forecasts are mostly wrong. This short-term focus leads them to selling good businesses with a poor earnings outlook, which the long-term investor can exploit. Warren Buffet has openly criticised Wall Street for this irrational behaviour, believing that when you invest in any company you should have 10-plus year view.

Tip 4: Diversification is the only free "lunch" when it comes to investing. Whether you are diversifying between asset classes in a multi-asset class portfolio or between a portfolio of 20 to 50 shares, investing is a game of probability; there is no certainty and for this reason diversification is essential. So, don't put all your eggs in one basket.

Tip 5: Patience – the nemesis of most investors. Markets can misprice assets driven by irrational investors for longer than most can endure. Holding a contrarian view and looking like a fool is not easy. It is far easier to cave-in to herd pressure than risk being wrong on your own. Revisit your investment case and only change if the facts have changed. Accept that most promising investment decisions will always feel uncomfortable. – *www.mwwealth.co.za*