



Wise Wealth Management

The Wise Investor

The Egg Whites and French Fries Portfolio

For some of us, it's hard to give up on the idea that investing should be exciting. Picking stocks can be fun, after all, and there's nothing like getting your timing right and bragging about it later with friends.

For all the accumulated wisdom about asset allocation, risk, diversification, and discipline, some people seem bound to see investing as an end in itself rather than a means to an end. For these folks, picking stocks is a hobby. They follow the gurus and soak up the financial media. Despite evidence to the contrary, they're convinced they can build a consistently winning strategy by exploiting perceived mistakes in market prices.

Part of the reason is the human tendency toward overconfidence. For instance, we all like to think of ourselves as above-average drivers, when that's simply not possible. Likewise in investing, many of us believe we have powers of foresight not evident in the wider population.

A Duke University study of corporate executives published in 2010 found a dismal record of prediction among a group you might think would do well. Indeed, of 11,600 forecasts for the S&P 500 over nine years, the survey found executives' estimates of future returns and actual outcomes were negatively correlated.¹ (This is a technical way of saying the executives were hopeless forecasters).

Research also suggests the tendency to trade a lot and make confident forecasts about stocks has a gender bias. Whether it's a testosterone-driven instinct among men to boast or something else, study after study shows men find it harder to accept that they are unlikely to "beat" the market.²

For these red-meat eaters, an investment approach that advocates working with the market, diversifying around risks related to an expected return, trading efficiently, exercising discipline, and watching fees and taxes is going to sound like the financial equivalent of a broccoli and walnut salad: healthy but boring.

Surely the point of investing is to try hard and, Don Quixote-like, to charge at those market windmills? Are we not men?

There are a couple of ways of confronting this mindset. One is to hope for a change in human nature and persuade each would-be master of the universe to separate his urge for ego gratification from his need to build wealth patiently and efficiently.

This is not impossible, of course. But one suspects it would take some time and would require a lot of face saving.

A second approach is to separate the investment nest egg from the play money. If someone really wants to speculate, he can be allowed to do that with the proviso that long-term retirement money be invested the boring way.

This way, the investor can buy some (expensive) entertainment and accumulate a few war stories to share at his next golf game without compromising the asset allocation painstakingly designed for him and his family.

It's understandable that investing is a kind of a hobby for some people. After all, this is what keeps much of the financial services industry and media in business.

But in separating the concepts of speculation and investing, you can still enjoy the occasional treat while maintaining a balanced diet.

Call it the egg whites and french fries portfolio.

1. Ben-David, Itzhak, John R. Graham, and Campbell R. Harvey, "Managerial Miscalibration," Duke University (2010).

2. Barber, B.M., and T. Odean, "Boys Will Be Boys: Gender, Overconfidence and Common Stock Investment," *Quarterly Journal of Economics* 116 (2001).

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