

June 29, 2009

Dear friends,

The other day I was reading a book on investing that wasn't particularly scintillating or much of a captivating read until I happened upon one idea that struck a chord. The author spent some time discussing the difference between possibility and probability. As pertains to constructing and maintaining smart long-term investment portfolios this is a really important distinction and one that merits attention.

Catastrophic investment mistakes are made all the time by those who construct and maintain portfolios based on what could possibly happen as opposed to what is very likely to happen. In today's difficult and challenging economic times it might seem like these mistakes are solely the domain of the pessimists and doomsayers among us but in better times optimists are every bit as likely to err. Let's look at two common examples of how these stories play out:

The devastating bear market behavior

"I can't believe stocks have fallen 40% over the last six months (say September 2008 into March 2009, for example). The experts on TV say things are going to get much worse before they get any better so I must look to preserve what's left of my battered life savings and just park it on the sidelines for now until things get better..."

The roaring bull market behavior

"The stocks in my investment portfolio have more than doubled in just the last three years alone (say 1997 thru 1999, for example). Even at half this growth rate, if I alter my stodgy bond and cash investments and put more into some carefully selected stocks and growth funds I'll be able to retire much earlier, or spend much more, than I planned on..."

Do either of these scenarios sound or read a bit familiar? Too many people just can't help themselves and ultimately acquiesce to the constant drum beat of the media that insists on presciently pontificating that either the bad times are only going to get worse or the good times just never looked so good (my apologies to Neil Diamond and his hit "Sweet Caroline").

Let me get back to the idea of differentiating between what is possible versus what is probable vis-à-vis your investment choices. Sure it is possible that our global financial infrastructure could collapse and bring decades of despair and ruin to savvy, thoughtful, and responsible investors like us. Is it probable? Not hardly. A far more likely scenario is that markets will recover from troubled times, as they always have, and deliver solid returns to those who persevere. Or conversely, is it possible that you could load up and get in on the ground floor of the next Fidelity Magellan Fund and turn \$100,000 into \$3,500,000 in fourteen years (say 1977 thru 1990, for example). Sure, it is possible but again highly improbable. The reality is what is far more probable in the rosy scenario is exactly what is far more probable in the dire example. Over time, markets will deliver good solid results, just not the lottery winning type, to those who demonstrate the requisite patience and self-discipline to succeed.

Sometimes when people ask me what I do for a living I tell them I'm in the risk/return business. But when you get right down to it, one way or another, aren't we all?

Be well,

