MCLEAN CAPITAL
GESTION DE PORTEFEUILLE | PORTFOLIO MANAGEMENT

10 Important Lessons about Investing

1. **Volatility is normal.**

   Volatility is an inherent and unavoidable aspect of financial markets, not an anomaly. Volatility should be understood as a normal part of investing in stocks and other securities, reflecting the constant fluctuation of prices in response to new information, investor sentiment, and broader economic factors. Understanding, accepting, and even *welcoming* market volatility is crucial for investors.

   Rather than being feared, volatility can offer opportunities to buy quality assets at lower prices during downturns. The greatest opportunities for investment gains can arise during periods of heightened market uncertainty when others are overly pessimistic.

   Trying to time the market based on short-term volatility is often counterproductive and can lead to missed opportunities. A long-term investment strategy, executed in a way that helps the investor stay invested through market ups and downs, can ultimately lead to superior returns.

   The investor's focus should move from short-term market movements to the fundamental value of assets. This perspective encourages investors to look beyond temporary market disturbances and focus on their long-term financial goals.

   The fact that volatility creates short-term noise makes it important to look at performance over periods of 5 years or more. Over a 5-year period, one excellent year can more than make up for 2 negative years and completely

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change the annualized return over that 5-year period. Investors should always be careful when looking at performance over periods under 5 years.

2. **Remember that large upside returns are historically frequent.**

For the S&P 500 (US stock market), the 13 bull markets between 1932 and 2009 have lasted almost 5 years on and obtained 21% annualized returns on average.

Why is this important to remember? Because it can help you stay the course even after a difficult bear market or a large drop in market prices.

The most frequent annual return occurrence in history: more than 20%.

38% of years between 1925 and 2010 obtained a return above 20%.

Again, this can help you stay the course after a difficult bear market or a large drop in market prices when you know very large positive returns should come again, most likely soon.

3. **Stocks can be safer than bonds.**

If you take the returns over all the 20-year periods between 1926 and 1993 (1926-1946, 1927-1947, ..., 1993-2013) for the S&P 500, stocks beat bonds 97% of the time.

Over those 20-year periods, stocks beat bonds by an almost 4-to-1 margin. The 3% of periods when bonds beat stocks, it was by a 1.1-to-1 margin on average.

Over every one of those periods, the S&P 500 20-year return has never been negative.

Another important lesson to remember is that bonds can go down a lot when interest rates go up. It is false to assume bonds can never go down.

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4. **It is normal that stocks have continuously gone up a lot over time.**

Some people have a hard time understanding that stocks have always gone up and by enormous amounts over long periods of time.

Compounding is the first important lesson to better understand this fact. If something goes up at a rate of 7% per year, it will have doubled in 10 years. Now realize this: for the next 10 years, you will now have twice the amount you had 10 years ago working for you. If you double again, you will have *quadrupled* over 20 years. $10,000 at 7% a year becomes $8.7 million after 100 years.

We often hear people say things like: "I paid my house $80,000 in 1986 and it is now worth $450,000." People think this is an abnormally high return when it actually comes out to a 4.8% annual return. Not as much as you would expect. That is compounding at work.

Human inventiveness is the second important lesson to better understand the fact that stocks have continuously gone up a lot over time.

How can we explain this historical 10% average return for the S&P 500 (US stock market)?

Is it air? Is it purely more and more investor demand for stocks? Not at all. It comes from the fact that companies have increased their profits by 7% per year and they have managed to do this while paying investors a 3% dividend on average. Therefore, the value of investors' stocks has gone up 7% per year and they got an income stream of 3% per year paid out from their annual profits.

Ok. So how did these companies get 7% annual growth in profits?

Here is the breakdown.

1. Inflation has been 3-4% on average. Therefore, the dollar value of companies (the S&P 500) has gone up at least 3-4% a year since companies have risen their prices on average 3-4% a year historically.

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Ok. We got another 3-4% to explain.

2. Demographics. The population has gone up about 1% per year. More people means more goods and services produced and sold by these companies.

   Ok. What about the last 2-3%.

3. Human inventiveness. Innovation. Since humans have been humans, we invent. We look for improvements everywhere and try to make things more efficient all the time. When we invented the wheel, we were able to move around faster, and this made us more productive in countless ways.

   When Henry Ford and Ransom E. Olds established the assembly line, and the auto industry implemented the use of interchangeable parts, the automobile industry was revolutionized. We were now able to produce cars on a large scale and at a much lower cost than was previously possible. This, in turn, made automobiles more affordable for the average person, which greatly contributed to the growth of the automobile industry and had a significant impact on the economy and society.

   As long as you believe in human beings wanting to make things more efficient and better, you can trust the value of companies will increase.

   I don't think innovation is an accident. I think it is a feature of who we are.

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5. **You can't time the market.**

Surprisingly, a lot of people think investing is about knowing when to buy and when to sell.

Actually, it's about knowing what and how to buy. Over *actual* investment time horizons, when you bought becomes less and less important over time.

Thinking you can time the market can be very costly. Even when people get out at the beginning of a bear market and think they made a smart move, they usually get back into the market long after the bull market has started again and end up with a lower net return as a result.

Even when people are correct to think stocks are overpriced, the market may go up another 40% before falling 30%.

Don't assume you can predict short term market fluctuations and focus on the long term.

6. **Know the difference between speculating and investing.**

When you buy something for emotional reasons (greed, fear of missing out, a "gut" feeling, impulsivity, etc.) without doing your homework, you are probably speculating.

When you do your homework and based on an objective evaluation you assess whether a certain investment should yield a satisfactory return over time without taking too much risk, you are investing.

A 40% return on a mediocre business because its stock went from trading at 25X earnings to 35X earnings, purely based on popularity with no fundamental change in its business prospects, is a speculative return.

A 150% return on a diamond-type business because its stock went from trading at 10X earnings to 20X earnings, and its profits went up 25%, is an investment-type return.

It is hard to be disciplined and patient when it comes to speculating. It becomes possible to do when you are investing.

7. Be careful when others tell you "This time is different."

"The four most dangerous words in investing are: 'this time it's different.'"

- Sir John Templeton

Even though some things have changed, human nature doesn't seem to change. Or it changes very slowly. Therefore, regardless of how unpredictable some outcomes may be, we can expect to see humans reacting in similar ways to emotional situations in the future.

Next time there is a bear market, remember human nature will overreact because of fear and create opportunities.

Next time there is a euphoric bull market, remember human nature will overreact because of greed and fear of missing out. Even though someone tells you this time is different, remember human nature probably didn't change.

8. Your investment horizon is probably longer than you think.

When people approach retirement, they tend to grossly miscalculate their investment horizon.

In a typical scenario, most people only need a tiny percentage of their portfolio every year starting at retirement. Some people need none of it and it will all be for an inheritance.

If you are withdrawing 3% of your portfolio every year, it is false to assume you cannot handle much volatility. It may come down to your own personal comfort zone (and that's ok) but rationally, you should be able to handle the volatility of stocks.

9. **Don't assume geopolitics and macroeconomic factors are predictable and always bad for stocks.**

    Geopolitical problems and macroeconomic uncertainty are unfortunately frequent to the point of being expected by stock markets.

    They are also extremely hard to predict, at least in the short to medium term, and they tend to have little to no impact on stocks, even over relatively short time periods. Markets are used to them.

    It is usually best to focus on which investments you purchase and at what price then to try and predict the impact geopolitics and macroeconomic factors may or may not have on markets at any given time.

10. **Try to reduce the fees you pay.**

    Most people pay high fees to get a portfolio that is more or less a replica of everybody else's portfolio: a super-diversified mix of stock and bond mutual funds, stocks, bonds, preferred shares and private funds (like mutual funds with higher fees and less liquidity).

    Most don't realize they pay fees to the mutual funds they own on top of the fees they pay to their advisor.

    There are alternatives so you can pay much lower and more transparent fees.

    How much fees you pay can have a large impact on your long term returns.

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