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Portfolio *Confidential*

Barbara Stewart

Do you have questions about your own investment portfolio? *I have recently set up The Rich Thinking® Financial Advice Hotline. This will be a win/win: you get a free 30-minute confidential Zoom chat offering an independent, unbiased perspective on your financial situation with no sales pitch! In exchange, I get to use the anonymized data that will come from these conversations to make my Rich Thinking research even better. Email me to book your Zoom discussion:* ***barbara@barbarastewart.ca***

My brother is an active retail investor, and he tells me that he consistently beats the index. Is that possible?.

I'd say it is highly unlikely! Given all the data that shows that PROFESSIONAL investors (on average) don't and can't beat the index and underperform by quite a lot…why do so many RETAIL investors think they can do it? The answer is that (based on the ones I've talked to over the years) most retail investors who try to pick stocks honestly believe that they are beating the index. Sometimes they are right, but they are usually wrong. There are some structural reasons why they are mistaken.

1. Some retail investors don't do a proper assessment of performance at all and rely on their memory of their various trades.

The problem with this is that our memory is selective, and we tend to remember winning trades, forget losing trades, get weightings wrong, and we are largely unaware of stocks that we don't follow closely. A Canadian example of that would be someone who owned Royal Bank over Bank of Montreal (which was a good decision) but doesn't know that Shopify outperformed both massively. Or someone who made 100% on a $10,000 Bitcoin investment…but lost 20% on a $50,000 gold investment. Net-net they are at zero, but that's not how they remember it.

2. Some retail investors are more quantitative but make a big mistake.

"I started investing 10 years ago with $100K, and now have $300K according to my investment statement right here. In the same time frame, the TSX has doubled, so I am beating the TSX!"

"Have you taken any money out of your investing account?"

"Nope"

"Have you put any money in since you started?"

"Nope."

"Are you sure? Right here on your investment statement it shows you've been adding $800 every month?"

"Oh right. I forgot about that. I set that up years ago…it's an automatic deduction from my pay that goes into my account. But I'm still beating the index, right?"

"Nope. You've put in a total of $200K over the years, and are now at $300K, which means you almost certainly are lagging the TSX by a lot."

(It is more complicated than that. You need software to calculate what is called a time-weighted rate of return, that includes transfers in and out, and when they occur. The average retail investor almost never does that and forgets about additional contributions they have been making. The software isn't rocket science, but it is complex.)

3. Some retail investors make another big source of error by ignoring currency.

"My portfolio of stocks is up 30%, and the TSX is up 25%, over the last year. I haven't put any money in or taken it out, so I am beating the index!"

"Which stocks do you own?"

"U.S. bank B, U.S. retailer R, and U.S. tech stocks X, Y and Z."

"But the USD is up 10% for the year. In Canadian dollars, your portfolio is up 30%, but currency adjusted you're actually up less than the TSX."

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