BUSINESS INSIDER

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September 26, 2020

Billionaire David Booth says focusing on this long-term investing strategy will help you get the returns you're expecting — and the ones you're not

David Booth

- David Booth is the founder and executive chairman of Dimensional Fund Advisors and a trustee of the Univeristy of Chicago, whose Booth School of Business is named after him.
- If you want returns on your investments, Booth says the best strategy is to stick around for long-term, lucrative growth.
- Expect the unexpected – the volatility of the market makes it's difficult to predict, which is why so many experts and researchers devote their lives to understand it.
- For now, Booth suggests focusing on factors you can control, such as pursuing expected returns, managing costs, and accumulating compound interests in a broadly diversified portfolio.

DAVID BOOTH

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I wake up every morning expecting the stock market to go up a little bit. But I'm not surprised when it doesn't. That's because I don't obsess over the short-term ups and downs of the market. I want to make sure I stick around to capture the long-term ups.

Honestly, it's a pretty simple philosophy rooted in decades of academic research.

But with so many distractions and apparent shortcuts, I know it can be hard to stick to your plan. The growth of trading platforms like Robinhood is proof that you›re not alone.

One crucial piece to staying a long-term investor is to understand the difference between expected and unexpected returns.

Over about the last century, the stock market has gone up around 10% per year. That's what I call the expected return. And it makes sense to me.

What would it take for you to risk putting money into the stock market? It's not 100% a year. It's not 0% per year. Ten percent seems sensible. When that amount is divided up into all 250 trading days of the year, I expect the market to go up every day … a little bit.

But we all know the market almost never goes up 10% a year.

Last year, the S&P 500 was up about 25%. The year before, it was down about 6%. It's been like that my whole life.

So what happens when the market doesn't give that historical average?

Those are what I call unexpected returns – the result of what people didn't see coming. From day to day and week to week, the market may go up a lot or down a lot because of pandemics, trade wars, interest rates, and everything else no one saw coming.

That's why, on most days, returns are unexpected.

When folks on TV talk about what the markets did today, they are trying to explain unexpected returns.

Personally, I find these developments very interesting. I have spent a lot of my career talking about them. But I don't find them useful in my choices for how to invest tomorrow. That's because I think the market has taken all the day's information and processed it.

Think of a giant computer made up of millions of different people on each side of a trade – buyers and sellers – who only make a transaction if they think they are getting a good deal. What happened today may not inform what happens tomorrow.

So that's the struggle for both the new investor who just signed up for an online account and the experienced investor with lots of computers and data and degrees.

There are short-term unexpected returns and long-term expected returns.

My colleagues Gene Fama and Ken French have spent their whole careers combing through the data to explain those expected returns. Thanks to them, you don't have to. I believe their research suggests timeless strategies that give you the greatest chance of capturing the long-term expected returns relative to your risk tolerance. And it reinforces the benefits of working with a fee-only financial advisor, because this is the sort of thing to talk out with a professional who has your best interests in mind.

Lately, our firm has been having conversations with clients about why growth stocks have been outperforming value stocks.

You've read about what is happening: a bunch of high-tech companies – Facebook, Amazon, Apple, Netflix, and Google among them – have seen extraordinary returns. They are doing better than anyone anticipated.

To me, this is evidence that everything broke their way. In other words, I see it as probably lower-than-average expected return and then a huge amount of good luck in terms of cash flow and future expectations of cash flow.

The good news is, even when unexpected events lead to high levels of unexpected returns, you still get the expected returns … as long as you stay in your seat.

Staying in your seat is the one part of investing you can always control.

I often say that the market has no memory, which is another way of saying that unexpected returns don't repeat.

So, instead of getting distracted by them, pay attention to the small things that can make a big difference over the long haul.

Pursue expected returns, manage costs, and accumulate compound interest.

How do you do this?

One of the simplest ways to increase your exposure to expected returns is to invest in a broadly diversified portfolio.

The next time you hear a story about an investor picking a few good stocks on a trading app, remind yourself that success stories are often outweighed by less-newsworthy failures.

Your chances of picking a few good stocks and realizing a quick return are very low. Your chances of starting with the market and capturing expected returns are much higher.

Keep your eyes on the total costs of investing. There's no quicker way to erode future expected returns than by paying excessive fees.

Finally, embrace the power of compounding returns. One of the best tools you have as an investor is time.

We develop solutions to help clients achieve long-term expected returns. Day to day, you're more likely to experience unexpected returns.

Sweating the small stuff has been the secret to our success for the last 40 years. And I believe it's the secret to your success for the next 40 years, too.

Disclosure: *David Booth is founder and executive chairman of Dimensional Fund Advisors. There is no guarantee strategies will be successful.*

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