If Investing is so Easy, Why Aren't More People Rich?

Christopher F. Poch, *Private Wealth Advisor*

After thirty-five years working with investors, I believe we face a societal problem. Over the long term, the savings of a typical family do not grow as much as they should. A recent survey found that 42% of Americans will retire broke.[1]

Why aren't people rich?

There are many culprits; low savings, consumption, taxes and inflation. A lesser understood culprit, however, is poor investing. Even those who had a sizable amount of money decades ago couldn't hold onto it. Let me explain.

If you had $1mm invested passively in the US stock market in 1935, with no withdrawals, it would have grown to about $5.4B today.[2] That was a lot of money back then, but records indicate we had between 5,000 -10,000 millionaire families in the US, even during the depression. Let's just say 5000 to keep it simple.

Where did it all go?

If each family had two children, today we would have 30 families (four people) for each one living back in 1935. That means if there were 5000 families, they would have spawned 150,000 billionaire families living today (actually $5B but who's counting) if only their investments had been able to match the returns of a passive investment in the US stock market.

According to a recent study we have about 560 billionaire families in the US[3] and virtually none of them derived their money from their ancestors living in 1935. What happened to the other 99.6% of them?

Was it so hard to match the returns of a passive investment in the US stock market?

Evidently it was.
What makes it so difficult?

Besides consumption and taxes, we face two major investment related enemies that oppose the successful growth of our savings. We all know the financial industry takes a toll through fees, commissions and spreads. That is a large fraction. However the second, and even bigger problem, is: Ourselves.

> It turns out it is incredibly challenging to capture even the passive returns offered by the market.

Yes, it may come as a surprise that when it comes to investing, we are our own worst enemy. Lots of research has been done over the last 30 years on cognitive sciences. And there have been many experiments that prove we humans carry enormous baggage from evolution past which is a hindrance to the 21st century financial environment.[4]

Good then, bad now

These instincts may have saved us from being eaten thousands of years ago, but today it makes us sitting ducks. One well known study was by Barber and Odean, who authored a study "Trading is Hazardous to Your Wealth"[5]. In their study they analyzed over 60,000 households of active, non-professional investors. They found that on average they lost 6% per year in the stock market. Wow!

What can we do to stop us from being fleeced or fleecing ourselves? It turns out there has been an effective solution available for more than 60 years known as Modern Portfolio Theory (MPT). This was invented by Harry Markowitz who won the Nobel Prize, and also kick started the $13T passive investment industry.[6]

The idea behind Modern Portfolio Theory is to seek efficient diversification by investing across the entire market. Investing this way minimizes fees and taxes, requires almost no thought, and restrains us from ourselves. The savings problem would be much less acute had people only followed this passive investing approach all along. **There is only one problem**. Most people can't accept this approach. And even those who try generally can't stick with it.

Cognitive bias at work again

Part of the problem is we don't like to see ourselves as passive or static. It goes against our human nature. We like to feel in control and proactive. Our bias towards action hurts us.

Secondly, most believe that bubbles do occasionally occur. The tyranny of passive index investing, and this is a real problem, is that not only does it prevent us from avoiding investing in these bubbles, passive investing has the perverse tendency to makes us invest more heavily at the height of valuations.

Passive isn't perfect

To illustrate this point, take the Japanese stock market bubble in 1989. Those who mindlessly allocated assets to a global equity index paid a price. An example of how "everything Japan" was so expensive, it was purported that the one square mile under the Imperial Palace in Tokyo was worth more than all of California.[7] Wow! At that time, a passively managed, cap-weighted portfolio would have been 43% invested Japanese equities. Then the price of Japanese equities collapsed. 29 years later, Japanese equities are still 40% below their peak.[8]

We need a better solution

We need a solution that both resonates and keeps us safe from our worst instincts. An investment approach is needed to keep us invested, that is sufficiently diversified, understandable and offered at a low enough price that all will accept it. We need a new way of investing that combines the benefits of passive investing with what is good in active investing.

What about inactive investing?

What if you could combine Warren Buffet value investing approach with Charlie Munger's common sense? No set of rules will capture all of the genius. Yet, if you could thoughtfully and systematically invest in a low cost, easy to understand manner, we would be more likely to stay the course. What if we were able to avoid chasing markets and selling out in despondence near market bottoms? What if we combine a few simple principles and common sense?

Not passive but not active

When someone introduces a simple way of low cost, easy to understand method of long term investing, for those who adopted it, wealth accumulation would be a lot easier and odds are good a lot more people would be rich.

Does the approach already exist?

Many providers have programs and packages that claim to do just that: Think robo advisors. The key is not the product; the key is finding someone who can help you start and stick with the program. Someone who can help you get it done - correctly.

Look for someone who knows how to be an "inactive" investor - then ask for help.

Christopher F. Poch is a Private Wealth Advisor and the author of numerous articles and publications on investing. He has managed international private banking units, advised billionaires and heads of state, has been the chief executive of a trust company, and founded the industry leading UHNW platform.

Mr. Poch advises private clients and family offices.

christopher.f.poch@morganstanleypwm.com
1747 Pennsylvania Ave. NW
Washington, DC 20006
w. 202-292-5495 | m. 202-557-8801

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[3] Over 1,500 Billionaires Worldwide, Business Insider, Tanza Loudenback, Oct 2017
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[6] Passive investing continues to captivate global audience, Trilbe Wynne, Pensions and Investment Age Oct 2018
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[8] Nikkei 225 Index - 67 Year Historical Chart, Macro Trends, 2018