Morgan Stanley

How to Think About Investing

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One of Many Approaches

Investing is a huge topic, so big I will only scratch the surface to get to a few basic principles. Having been in the business for over 33 years, advising large institutional clients and billion dollar families, I have seen almost everything. There are dozens of smart ways to invest, but I will focus on a few strategies tailored to taxpaying individuals, trusts and partnerships.

Most investors do poorly. The reason why most people don't do that well investing money is usually a combination of: 1) poor timing and 2) the inability to maintain the strategy during down periods.[i] If you start with a good approach and stick with it, odds are really high you will do fine, maybe even well.

A few last words before we jump in to investing. In my opinion, the road to accumulating wealth is first to budget thoughtfully. Plan to spend less than you earn – every year. The second is to invest systematically – every paycheck, every month, and if you can, reinvest the dividends. Finally, diversify your investments. Have some cash, bonds and stocks – and at least a few different types of stock investments.

Investing in the Stock Market

I believe the most important thing to establish is your time horizon. If you need some money in three years, more money in ten years and do not need the rest for 25 years, you should establish three different accounts and manage each accordingly. Most people get derailed because they invest with a long-term horizon and find they need the money sooner – often after a market correction. This article will focus on investment strategies that are appropriate for ten years and longer.

Have an Investment Philosophy

Be among the few investors who have an investment philosophy who writes it down[ii]. Know what is likely to happen during market corrections and when your "style" of investing is temporarily unpopular. Even brilliant strategies wax and wane in and out of favor, often lasting three to four years. Avoid chasing the next fad.

If one is just starting out, it may be best to buy a couple of low cost index funds. It is simpler and cost effective. However, if you have a fair amount of money and a longer time horizon, the strategies I will describe that follow may be appealing.

Market Volatility

In any given calendar year, it is "normal" for the stock market to fall 15-20%, and sometimes the fall is 30%-40%.[iii] When the market eventually rebounded, it historically reclaimed the losses and advanced to new highs. Sometimes the recovery is rapid and happens within a few months; sometimes it takes years. Of course there are no guarantees, but this volatility is normal, and as you will find, can be very useful for wealth accumulation.

For individual companies, it is "normal" for a stock to be down nearly 40% from its peak price in a given year.[iv] Sometimes it follows after a rapid ascent, sometimes after an earnings disappointment, and sometimes for no apparent reason at all. Whether you own a mutual fund, an ETF, an index fund or individual stock, this will happen to your investments. Plan on it.

Investment Policy Statement

An Investment Policy Statement (IPS) is a brief set of rules you establish for yourself to follow. You should write your IPS before you invest when there is no emotional strain of euphoria or despair, and you should review your IPS each time before you look at your investments to assess how you are doing. If you are following your own process, and things are not going well, it is almost always a sign to stick with it. A sample investment policy statement is available for the asking.

Three Investment Approaches: Growth, Value and Indexing[vvi]

Each of these approaches has subcategories, most of which are just as valid as what I am describing.

1. **Growth:** When you invest with a "growth" style you hope that the companies have the ability to earn above average earnings over long periods of time and therefore the dividends and stock price will also increase.
2. **Value:** When you use a "value" style of investing you for look companies with lower earnings growth prospects and a lower relative cost. It is assumed that value investing will have less volatility during market corrections, but there is certainly no assurance that it will occur.
3. **Indexing:** Index investing is a way to let someone else, often a committee at Standard & Poors Corporation, determine what stocks you will own. Generally, the costs of owning an index fund are lower, usually substantially lower.[vii] However, there are many ways to employ an "index" investment approach.

The avalanches of money pouring into "capitalization-weighted" funds and ETFs over the last 25 years make this an interesting time to consider other methods.[viii] In another article I point out one way that may make more sense over longer periods of time, especially for taxable investors with larger investable amounts.

Keep it Simple

Remember: Have a sensible plan with enough cash available when you might need it and, stick with your plan, especially in times of turbulence.

Most people benefit from having a co-pilot during times of trouble. So while you are thinking about investing, also think about engaging a seasoned financial advisor to help.

Is this all there is?

These findings apply to most situations, but not to all. A body of knowledge has been gathered through thousands of interactions. Further detail is reserved for clients.

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Any type of continuous or periodic investment plan does not assure a profit and does not protect against loss in declining markets. Since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his financial ability to continue his purchases through periods of low price levels.

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Companies paying dividends can reduce or cut payouts at any time.

Growth investing does not guarantee a profit or eliminate risk. The stocks of these companies can have relatively high valuations. Because of these high valuations, an investment in a growth stock can be more risky than an investment in a company with more modest growth expectations.

Value investing involves the risk that the market may not recognize that securities are undervalued and they may not appreciate as anticipated.

An investment cannot be made directly in a market index.

Investors should carefully consider the investment objectives and risks as well as charges and expenses of mutual funds and exchange traded funds (ETFs) before investing. To obtain a prospectus, contact your Financial Advisor or visit the fund company's website. The prospectus contains this and other important information about the mutual funds and ETFs. Read the prospectus carefully before investing.

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[i] "DALBAR Study Shows Trump Rally Left Average Investor Behind" April 2017
[ii] Aswath Damodaran, *"An Introduction to Portfolio Management"* New York University Stern School of Business, January 5, 2017
[iii] "Volatility In Perspective" , Ed Easterling, January 2017
[iv] "Volatility of Single Stocks", Morningstar, 2015
v "Growth vs. Value: Two Approaches to Stock Investing" Standard & Poors, 2017
vi Investopedia "Index Investing"
[vii] "Mutual Funds: The Costs" Adam Hayes, Investopedia March 2017
[viii] Credit Suisse Research, *"Fund Flows Into Active and Passive Funds and ETFs, US Domestic Equity, 1990-2016*", January 4, 2017, Page 13