



Ugly Sisters and Uglier Investment Mistakes

Dear Reader,

Hi again, and not much to write about this month, apart from the Eurozone debt crisis, concern over a slowdown in China and fears of a possible double dip recession in the West.

The past month has been turbulent to say the least. In fact, the bad news flow is largely responsible for the worst May for the S&P500 index since 1962.

The question on everybody's lips is will the sell-off continue throughout June.

Yet, typical of this recovery to date, the mix of news is good and bad. We've seen encouraging macroeconomic data this week, with stronger-than-expected US home and auto sales and a positive market reaction in the US and Europe.

US non-farm payroll numbers will be released on Friday and estimates point to an increase in employment by a slam-dunking 500,000 extra US jobs! If the forecasts are accurate this may well be a significant turning point.

Closer to home, the upside is that a weakening Euro will help the Eurozone become more competitive, making exports cheaper and imports more expensive.

It's also possible that the Eurozone debt crisis has seen markets oversold, so my advice is to hold off hitting the sell button and to wait and see how the situation pans out.

Cinderella and her ugly sisters

You know when things are looking grim when even the blighted greenback starts to look good. Traders refer to this as the 'Ugly Sister' effect, and to be sure, the US Dollar has been rising simply as there are very few attractive alternatives out there. The Euro, Yen and Sterling all look like bad ports in this particular financial storm.

But instead of dancing with the Ugly Sisters, we should always remember that there are some potential Cinderellas out there. Gold is one such shining light. It's always a healthy hedge and in times of economic uncertainty, high sovereign debt and inflation, gold can act as your portfolio insurance.

If inflation gets out of hand (caused by printing too much money) gold is the place to be. And if the global recovery continues, demand for industrial metals and energy, especially black gold (oil) will continue to increase.

However, I'm not advocating simply converting your assets into gold or oil and waiting for the deluge to pass.

Industrialization of China and India is not about to come to a halt, thus demand for natural resources will keep rising

Rather, I believe investing in funds that invest in precious and industrial metals and energy covers all bases. Interim market turbulence aside, as I will state again and again in these e-letters, the mass industrialization of China and India is not about to come to a grinding halt any time soon. And as discussed previously, this means continual rising demand for natural resources.

To that end, we must look at funds that invest in, say, gold and silver mining or oil services companies rather than directly buying lumps of shiny stuff or barrels of sticky black liquid.



"Risk comes from not knowing what you're doing"

Warren Buffet

The lone wolf and other common investment mistakes

One of the best things about my job is that I get to talk to a lot of people about their investments, past, future and present. And, sadly, I keep hearing about the same mistakes being made over and over again. After literally 100s of real-life interviews with real people from all walks of life I can say that these investors fall into three main groups.

The first two are DIY enthusiasts.

Before we look at the specific mistakes they seem doomed to repeat, let me ask a question.

When did you last fit a new exhaust to your car, install a central heating system in your home, replace the he circuit board on your TV, or change a filling in your teeth?

Why do so many people think they can actively manage a complex portfolio of stock and fund investments whilst going to work or running a home?

Maybe you did one of those things recently. Maybe you really are a dentist with a penchant for cars and you did two. But I'm guessing you did none. Instead you called a professional and paid them to do it and were happy to do so.

That as a given, then why do so many people think they can actively manage a complex portfolio of stock and fund investments whilst also going to work or running a household?

So, why the Lone Wolf investor? It might sound edgy and exciting, but it's usually the most tragic. Out on his or her own, this amateur investor is very isolated and very vulnerable. Wolves hunt in packs and do not thrive alone. The same is true of investors. Without the protection of the pack, the lone investor is stuck out in the frozen wilderness, scrabbling around for food and the target of bigger, dangerous predators.

It is not an enviable existence, so why choose to go down this lonely route. Give yourself a chance of survival instead.

Yes, some people are hobby investors - they play with a small fixed amount of capital that they can afford to lose, and this, while not particularly smart, is at least not dangerous. But sadly I meet many people that are out on their own, trying to self-manage a large portion, if not all, their net worth. This is madness.

I also speak to many people who want to "do it themselves" saying that they like to feel they have control over their assets.

Again, this seems a strange and irrational notion to me, for if your money is invested in a portfolio of shares you have very little control over the global economy or disasters such as the recent BP oil slick.

The only control investors have is deciding when and what to buy and when to sell. And wherever you decide - on your own - to park your capital there are significant risks.

These range from inflation to bank collapse. Even that supposedly safe 'bricks and mortar' investment is risky, as the spectacular bursting of the house price bubble has illustrated.

Without expert advice to help manage the risks involved in investing the lone wolf position is practically mission impossible.

Don't try to out analyse the analysts!

Even an informed amateur stock investor is also at a huge disadvantage. Stock markets are the most analyzed markets by far. Let's focus on just one participant in the stock market, the Fund manager, and realise the vast resources he has at his fingertips: access to thousands of analysts who devour every piece of news and information to the nth degree as they search for that one undervalued company to invest in.

Research tells us that to reduce stock market investment risk we need a portfolio spread across around 30 companies, from a diverse range of sectors such as, insurance, telecoms, retail, etc.

The amateur investor has little to no chance of beating the professional Fund Manager and his army of tools.

The amateur stock investor has little to no chance of beating the professional Fund Manager and his army of tools in this search for undervalued shares. The single amateur has even less chance of actively managing a wider portfolio of investments.

A little knowledge can also be deadly...

The amateur that does better than the lone wolf or the semi-informed stock investor is the one that understands how crucial diversification is and admits that he has neither the time nor expertise to manage a diversified portfolio on

his own.

This investor buys funds. This is progress, but most often mistakes are still being made.

Let's take an example. Our amateur investor has decided to get into funds. He finds a well-known fund website, sees something attractive and buys in. Coincidentally, the business cycle is heading into slowdown phase, the phase before recession.

Now, there is not a fund management group in the world that will not take your money even if they know the market is about to tank.

So, our investor has just plunged a significant part of his net worth into a fund on the basis of its past performance and a nice chart on the internet. He has received no advice, nor will he get any going forward. Sure enough, the economy heads into recession and our man is looking at a 30% loss.

This type of investor is always in trouble, as they know little about risk management nor do they have the skill or experience to manage risk by diversifying across asset classes, i.e. equities, bonds, property, and alternatives such as commodities and hedge funds.

Moreover, he does not understand his own risk profile and often ends up taking too much or too little risk and, almost always, does not understand tactical asset allocation.

Tactical asset allocation is when switches are made from one asset class to another depending on the prevailing economic condition. Being defensive in the slow down phase and recession phase and being more adventurous in the recession (markets start to rally whilst still in recession) and boom phase.

This is particularly true of those that invest in actively managed pure equity funds or index tracking equity funds. These are great if the FT 100 is rising, less so when it is

not, simply as these fund are obliged to remain invested - most often between 90% - 100% in the very asset class that is falling in value.
Then there is a final group of investors I come across.

These are the ones whose returns consistently outperform the amateurs and the ones that spend little to no time managing their investments.

Who are they? These are the ones that are protected by a good Independent Financial Advisor or Wealth manager.

I am UK qualified financial advisor. If you have any questions please contact me on +361 354 0010 or e-mail me to r.holmes@gerrardsinternational.com

All the best,
Richard Holmes



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