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What College Football Can Teach Us About Investing

It is often said that Florida has no change of seasons, but those of us who have lived here for a while know better. The year begins with tourist season, which by the end of May has quietly faded into an infernal summer season. Then, Labor Day marks the start of the most important season of the year: college football season.

College football is a tradition in Florida. It is an integral part of our social fabric and it ignites our primordial "us versus them" instincts on Saturday afternoons in the fall. It is an emotionally-charged event with many random outcomes, not unlike investing. And in thinking about college football and investing, we find that there are many analogies between the two. So, at the risk of tainting your love of college football, we are going to make a bold attempt to draw some comparisons.

> ***"That inability to pick the winners is probably the most compelling analogy we can draw here."***

Much like financial markets, college football is a very chaotic game, which makes the outcome of a football season very difficult to predict. In the 2014 preseason polls, Oklahoma and South Carolina were both ranked in the top-10, yet they both finished the year outside the top-25 with a combined 15-and-11 record. Ohio State, meanwhile, presumed dead after losing its first and second-string quarterbacks to injury, somehow managed to win the national championship.

College football poll rankings are determined by sports writers and coaches; individuals considered to be experts in the field who often make their predictions with the assistance of computers. They are heralded by the media as prescient oracles, they have extensive experience and access to technology and all relevant public information, yet their record of success in forecasting the outcome of a season is not much better than 50/50. It's a lot of fun to listen to the predictions, but unfortunately there is no consistent accuracy in the picks due to the random outcome of many of the games.

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That inability to pick the winners is probably the most compelling analogy we can draw here. The financial media promotes the predictions of professional market strategists as if they were a window into the future, yet, despite having access to the best technology and information, these strategists have a dismal record in forecasting the direction of the overall markets. These experts continue to make these hollow predictions for the same reason football strategists continue to make theirs: It gets the attention of customers and provides the media with entertainment content.

> *"Investors often behave like college football homers. They tend to buy stocks in companies that they like and that they are familiar with."*

That said, some college football outcomes are obvious. When a powerhouse like Alabama plays an obscure school in a tune-up game, the outcome is effectively predetermined. However, in order for this game to be profitable for anyone, Alabama must not simply win, *they must also beat the point spread.*

Profiting from individual stock picking is no different. Everyone knows which companies are the strongest and which companies are experiencing hard times; this "point spread" between the two companies is expressed in the current value of their stock prices. In order to profit from picking stocks, buying great companies is not the point; you need to buy companies that "beat the spread" by outperforming the market's expectations. The failure of professional stock pickers to outperform the overall market is evidence that picking stocks, like betting on football, is a difficult game to win.

The chaos of college football makes rational prediction of outcomes difficult, but for many fans, the emotional attachment to a team makes rational evaluation impossible. Every Floridian knows at least one person, and probably many more, whose emotional attachment to a college football team borders on madness. When the team wins, it is merely a confirmation of the obvious. When the team loses, it is the result of biased officiating or unforeseeable bad luck.

We see the same type of psychological justification in financial markets. Investors often behave like college football "homers." They tend to buy stocks in companies that they like and that they are familiar with. When an investment goes well, the success is attributed to the strength of the company and the brilliance of the investor's acumen. When an investment performs poorly, it is blamed on bad luck, unforeseeable events or an unreasonable market bias. This psychological tendency, known as familiarity bias, can make a person blind to the fact that his favorite stock (or his favorite football team) is not necessarily a winner.

College football is a media circus surrounding a game that is chaotic and fraught with emotion. Many of the teams that you expect to go far will get beaten early, and your own favorite team may not be the powerhouse you had hoped it would be. Financial markets also involve chaos, emotion and an omnipresent media. The short-term moves in the market are unpredictable and great companies are not necessarily great investments. The best investment strategy is to avoid making large bets based on bold predictions or emotional attachments. Instead, invest for the long-term and view the financial media in the same way we view college football: as pure entertainment.

The original version of this article was written by Heritage for the September 2014 edition of The Light, a local magazine serving Broward County, Florida.

Gravel Road Investing

Owners of all-purpose motor vehicles often appreciate their cars most when they leave smooth city freeways for rough gravel country roads. In the world of investing, highly diversified portfolios can provide similar reassurance.

In blue skies and open highways, flimsy city sedans might cruise along just as well as sturdier sports utility vehicles. But the real test occurs when the road and weather conditions deteriorate. That's why people who travel through different terrains often invest in a SUV that can accommodate a range of environments, but without sacrificing too much in fuel economy, efficiency, and performance.

Structuring an appropriate investment portfolio involves similar decisions. You need an allocation that can withstand a range of investment climates while being mindful of fees and taxes. When certain sectors or stocks are performing strongly, it can be tempting to chase returns in one area. But if the underlying conditions deteriorate, you can end up like a motorist with a flat on a desert road without a spare.

Likewise, when the market performs badly, the temptation might be to hunker down completely. But if the investment skies brighten and the roads improve, you can risk missing out on better returns elsewhere.

One common solution is to shift strategies according to the climate. But the unpredictability of markets makes this a tough, and potentially costly, challenge. An alternative is to build a single diversified portfolio. That means spreading risk in a way that helps your portfolio capture what the global markets have to offer while reducing unnecessary risks. In any one period, some parts of the portfolio will do well and others will do poorly. You cannot predict which. But that is the point of diversification.

> *"By contrast, owning a diversified portfolio is like having an all-weather, all-road, fuel-efficient vehicle in your garage."*

It is important to remember that you can never completely remove risk in any investment. Even a well-diversified portfolio is not bulletproof. We saw that in 2008 when there were broad losses in markets.

But you can still work to minimize risks you do not need to take. These include unduly exposing your portfolio to the influences of individual stocks, sectors, or countries; or relying on the luck of the draw. An example is those people who made big bets on technology stocks in the late 1990s. These concentrated bets might pay off for a little while, but it is hard to build a consistent strategy out of them. And those fads are not free. It is hard to get your timing right, and it can be costly if you're buying and selling in a hurry.

By contrast, owning a diversified portfolio is like having an all-weather, all-road, fuel-efficient vehicle in your garage. This way you are smoothing out some of the bumps in the road and taking out the guesswork. Because you can never be sure which markets will outperform from year to year, diversification can help increase the consistency of the outcomes and help you capture what the global markets have to offer. Add discipline and efficient implementation to the mix, and you will get a structured low-cost, tax-efficient solution.

Just as expert engineers can design fuel-efficient vehicles for all conditions, astute financial advisors know how to construct globally diversified portfolios to help you capture what the markets offer in an efficient way while reducing the influence of random forces. There will be rough roads ahead, for sure. But with the right investment vehicle, the ride can be a more comfortable one.

Timeless Tips on Tax-Wise Investing

While most Americans would rather not think about taxes at all, the IRS tax filing deadline on April 15th focuses our minds on taxes for several weeks during the first part of the year. Although the phrase "tax season" may imply that there is an optimal time to think about your income taxes, the best way to minimize that April tax bill is to engage in tax-wise investing all year long. Here are a few best practices to consider.

Have a plan … and follow it

Investing according to a plan, preferably in the form of a written asset allocation strategy, makes everything else we are about to describe easier to accomplish. By clearly defining and documenting what you plan to achieve with your investments and how you plan to achieve it, you and your financial team are best positioned to ignore the inevitable, often tax-generating distractions along the way. An investment plan also serves as your reliable guide for resolving any conflicting priorities when balancing tax efficiency versus other considerations within your overall wealth management.

Avoid hyperactive trading

The more trading you do in your taxable accounts, the more "opportunities" you create for the government to tax you on the proceeds. The fewer trades that are required to accomplish your investment plan, the better off you are likely to be when taxes come due.

Make good use of tax-sheltered accounts

It stands to reason, the more assets you can hold in tax-sheltered or tax-free accounts such as IRAs, Roth IRAs, 401(k)s or 529 college saving plans, the more opportunities you have to avoid or at least postpone the tax ramifications otherwise inherent in building capital wealth.

Not all mutual funds are created equal

Just as you should minimize your own hyperactive trading, your fund managers should do the same by heeding the academic evidence on how markets operate. Most managers try to "beat" the market by actively picking individual stocks or forecasting when to be in or out of the market. Instead, you should look for managers who are seeking to build lasting wealth by patiently participating in the long-term growth expected from the global markets. This type of "rules-based" investing is not only a more sensible overall approach, it also is typically more tax-efficient.

You should also avoid hyperactive mutual fund shareholders. Undisciplined investors may force a fund manager to liquidate appreciated holdings as they panic sell during difficult markets. This may generate distributed capital gains that you, as a fellow shareholder, must pay even though you sold none of your own shares.

Not all advisors are created equal

Beyond tax-wise management within the individual funds in which you are invested, your advisor should be engaging in tax-wise management of the overall portfolio. A tax-wise advisor will employ such tax strategies as harvesting capital losses against capital gains, trading tax-optimized share lots, donating appreciated shares to charity, implementing a step-up in basis, optimizing cash flows, and efficiently balancing assets between taxable and tax-qualified accounts, among other considerations.

Foster communication between your advisors

It is important to manage your investments in a tax-efficient way. But what about when it comes time to transfer your wealth to your heirs or a charitable cause? And what about your tax filings themselves? Is your accountant aware of what your investment manager is up to, and are both of them informed of pertinent details related to your estate planning?

In short, the key members of your financial team (your estate planning attorney, investment advisor, tax professional and others) should act in a coordinated effort to minimize your tax burden. Even if each is seeking to best manage tax-related events within his or her specialized area of expertise, if there is little or no coordination among their activities, unnecessary taxable gaps or overlaps may occur when key communications break down.

The tax-wise wealth manager

Tax-efficient investing can add considerably to the net wealth that you and your family get to keep after taxes and expenses have taken their toll. A good advisor will organize the many moving parts and players involved, keep an eye on it all over time, and help you and your specialized team members make adjustments when appropriate. The tax savings achieved can have a profoundly positive impact on the financial comfort of your family and your heirs.

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