Canaccord Genuity Wealth Management

MANN TEAM

September 18, 2020

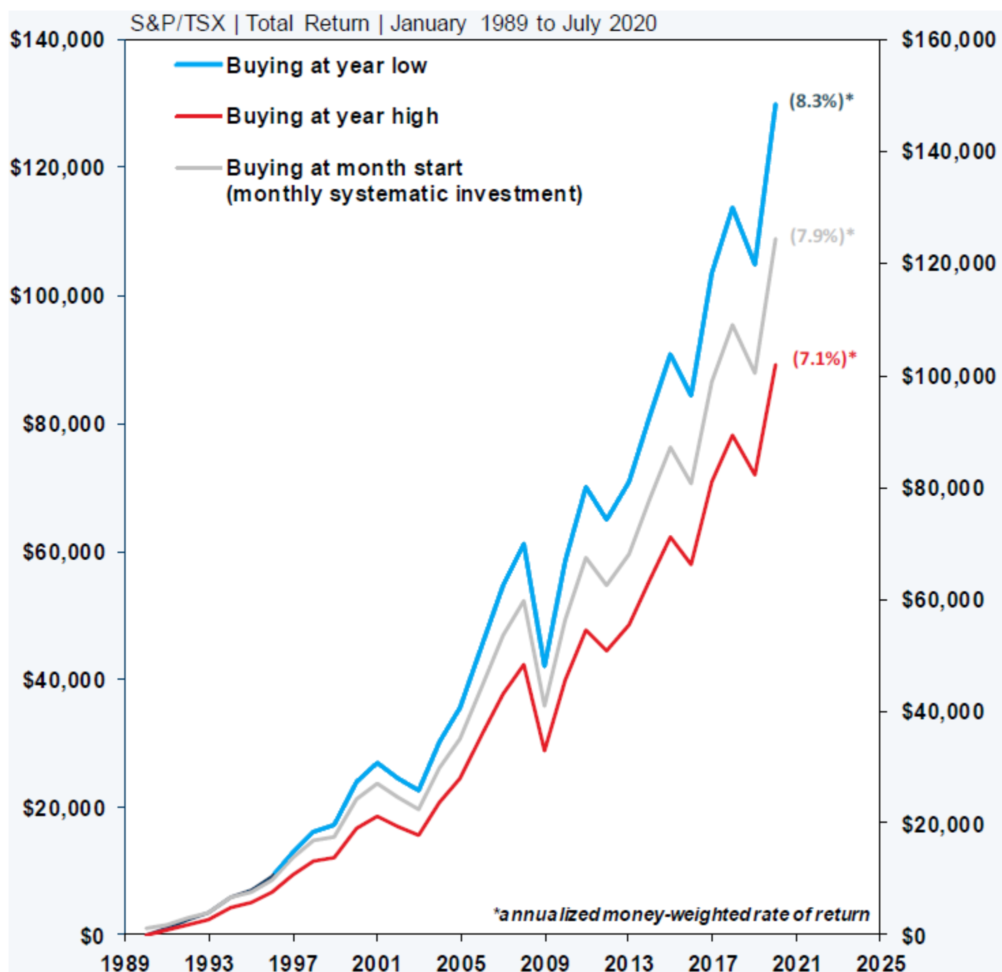
Common Investing Myths Busted

Stock markets are one of the greatest wealth creation engines of all time. Despite this, a lot of people are still quite wary of investing in stock markets. This is due at least in part to a number of myths and erroneous information that surrounds investing. Misinformed investors may feel that the safest place to keep money is "under one's mattress" or that "real estate is the most lucrative investment". Being able to tell the difference between myth and reality could help investors avoid costly mistakes.

Myth: *Timing one's investments perfectly is the most important factor of long-term investment success.*

While successfully timing your investments does make a small difference in the long run, it is not the critical factor many believe it to be. In fact, success is determined less by *what* days you are in the market and more by *how many* days you are in the market. What truly matters is the frequency of savings and passage of time, not market timing. The chart below helps illustrate the difference between the results attained by an investor blessed with perfect market timing (blue line) compared with another investor cursed with worst market timing (red line). In the long run the first year's return means rather little, and the timing champion's results are higher by a mere 1.2% per annum[1].

1(Source: Data sourced from Refinitiv via NBI)



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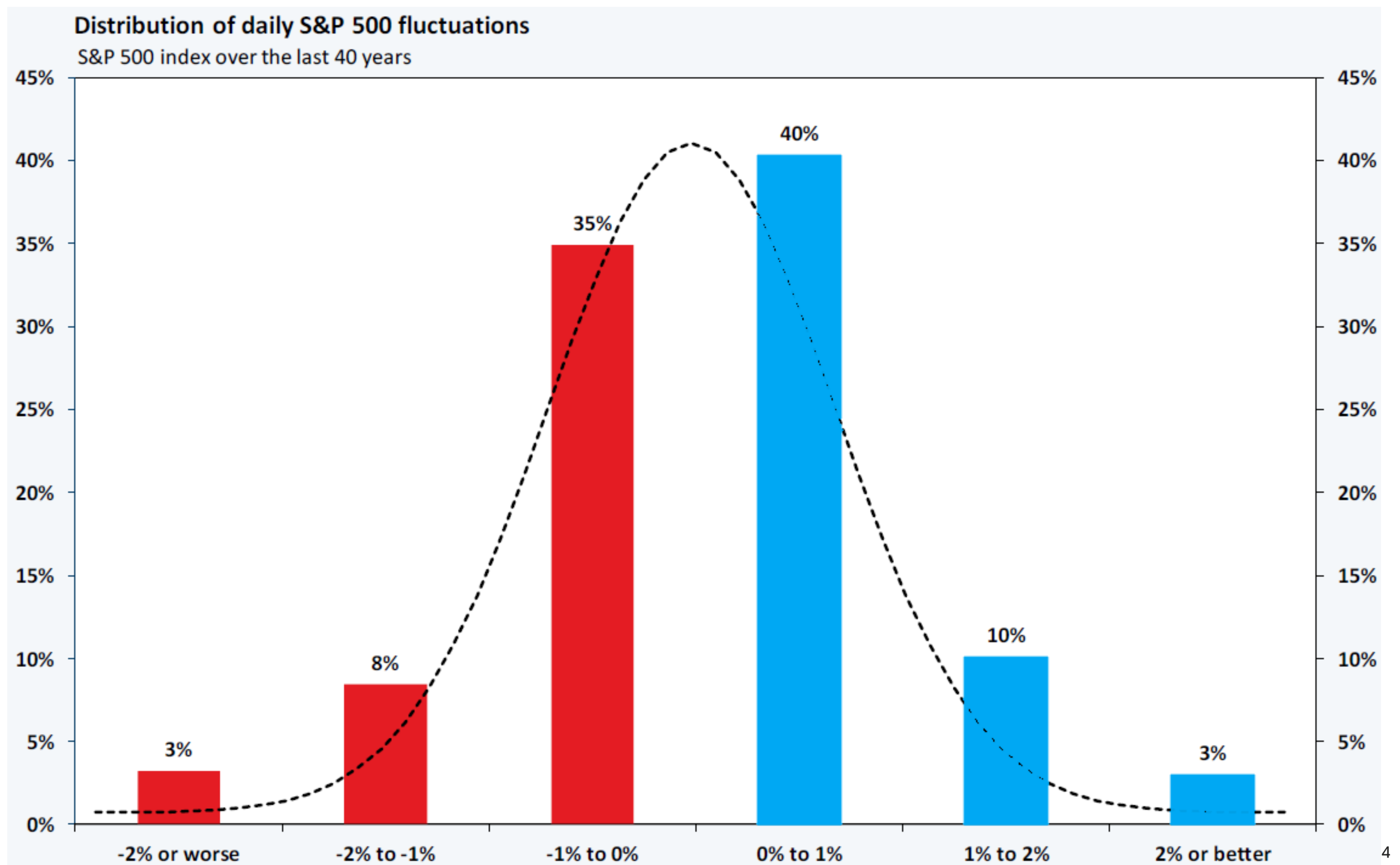
2(Source: Data sourced from Refinitiv via NBI)

Myth: *Financial markets are inherently volatile and involve an unacceptable amount of risk for the average investor.*

Market fluctuations are normal on a day to day basis. While extreme days of market movements show up on the evening news, what really matters is the accumulation of 0%-1% days, or average up days invested in the market. These days are responsible for much of the 12% S&P500 annualized total returns over the last 40 years[3].

3(Source: Data sourced from Refinitiv via NBI)



4(Source: Data sourced from Refinitiv via NBI)

Myth: *Investing is one-size-fits-all.*

Just because what your friend is doing is working for them, doesn't mean the same strategy will work for you. Chances are you have different objectives, timelines, expenses, and income levels. All that means is that your investment strategy won't be exactly the same as anyone else's.

Myth: *Since the long-term historical average annual return on the stock market is ~10%, investors should expect to see annual returns near 10% on their stocks.*

Quite the contrary, it is likely that investors will only rarely see a calendar year where equity returns are close to their long-term historical averages. One likely reason for this myth is the common misconception that *average* is synonymous with *typical*. However, there is no such thing as a typical year in the stock market. As a result, investors should expect a wide range of possible outcomes in any given year. Over time the accumulated annualized stock returns will near the market's long-term average.

Myth: *Real estate is a better investment than owning stocks.*

Real estate has no guarantee of growth. It is subject to market volatility and price fluctuations like all other assets. Real estate also has many ongoing costs, such as property taxes, maintenance, insurance and/or strata fees. One also needs to consider the headache of being landlord to poor tenants. There's nothing inherently wrong with wanting to own your own home. However, it is important to understand that one's home is not an investment but an asset with liabilities. Unless you are generating positive free cashflow from the property, it is a liability that requires cashflow.

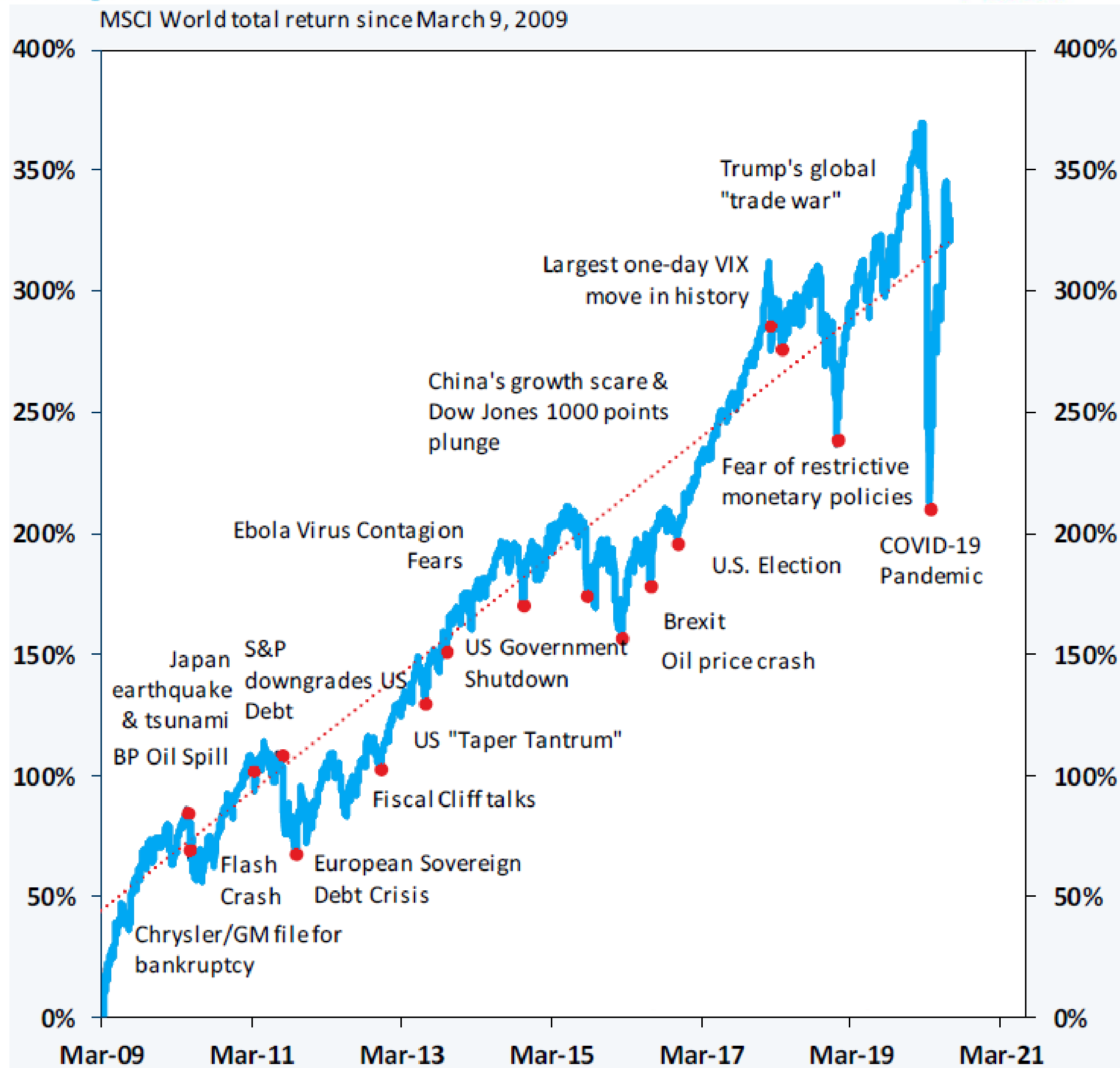
Myth: *Investing in the stock market is too risky for the average person and is akin to gambling at a casino.*

It is true that daily market fluctuations resemble a coin toss, as markets can be up one day and down the next. Nevertheless, two fundamental reasons make investing completely different from gambling.

Unlike the world of gambling, investing in the stock market is not a zero-sum game, as evidenced by the positive median annualized return. In the long run, equity returns come from companies' ability to grow their earnings, not from investors' misfortune. While gambling remains just as uncertain no matter how long you play, the opposite occurs within equity markets. The longer one remains invested, the greater the chances are of converging towards the premium investors earn for bearing equity risk.

Myth: *Selling in times of heightened uncertainty can protect investments from heavy losses.*

Selling in times of heightened uncertainty is generally the best way to *ensure* heavy losses, as it usually entails selling low and missing the rebound. More importantly, one should keep in mind that the only certainty is that there will always be uncertainty, as it is the price to pay for capital appreciation in the long run. Media does an excellent job of stoking fear and pessimism, rather than report the latest news with nuance and historical perspective. Letting emotions take over is a good recipe for short-term gain, but long-term pain. As illustrated by the chart below, global equities continue their persistent march upward through all the turmoil brought on by the multitude of newsworthy events.



5(Source: Data sourced from Refinitiv via NBI)

Myth: *Investors contemplating investing a large sum (an inheritance, or property sale) are better off spreading their entry over time (dollar cost averaging) rather than committing the full amount immediately (lump sum).*

To some degree this does depend on the luck of market timing (for example, investing right before or right after a market correction). However, since 1980, you would have been better off investing the full amount right away 84% of the time, while the decision to split the investment evenly over twelve months would have cost an average of 3.8% in lost returns[6].

6(Source: Data sourced from Refinitiv via NBI)

Myth: *Investors that have a "home country bias" feel that it is more prudent to invest primarily in familiar companies domiciled at home, instead of taking on foreign exposure and currency risk.*

While predominantly investing in domestic equities might seem sufficient and feel comforting, such a portfolio is often suboptimal. Do not confuse familiarity with safety. Canada's stock market is highly concentrated in some of the most cyclical sectors, and its relative lack of growth-oriented companies poses a risk that can result in unpleasant surprises if left undiversified. Canadian stocks represent a mere 3% of the global investment universe – far less than the ~59% they account for in Canadians' portfolios[7].

7(Source: Global index weight reflected by country's weight in the MSCI All Country World Index as of May 31, 2019. Investor holdings in domestic market sourced from the IMF, as of December 2014.)

Myth: *Investors should be fearful of recessions as they entail heavy financial losses.*

It is true that the most turbulent periods for markets are generally associated with recessions. As a result, investors who closely follow the daily market movements in times of economic downturn are likely to experience a great deal of fear.

However, if we step back from market fluctuations and look instead at the historical performance of a basic balanced portfolio (60% stocks, 40% bonds) during the last six recessions, we see that the average return was actually zero. Mind you, this is not something to celebrate, but far from the financial catastrophe many seem to believe - especially when we consider returns in the previous and following years. It is also important to note that recessions are relatively rare events, comprising a mere 14% of the last 50 years. Therefore, it is not the recession that investors should fear, but fear itself… or rather the risk of locking in heavy losses at an untimely moment, while being swayed by emotion.

There will always be circumstances that cause market turmoil. These events are hardly predictable and mostly unavoidable. Investors are rewarded for sticking to a disciplined investment approach and minimizing costly mistakes, instead of trying to outsmart the market. We pursue a successful long-term strategy of owning high quality assets, while taking advantage of market volatility for new investment opportunities.

Sincerely,

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