Your Money Matters
TIMELY ADVICE FOR CLIENTS OF GOLD KEY FINANCIAL

Investing wit and wisdom from the Oracle of Omaha

Born in Omaha, Nebraska, Warren Buffet turned 75 years old last month. Widely regarded as one of the most successful investors of all time, his wealth has been created solely from investing in stocks. The Oracle of Omaha has amassed a fortune that's second only to Bill Gates of Microsoft.

Buffet's approach is simple and followed by thousands of investors the world over. Invest with discipline, patience and a constant eye for value. His company, Berkshire Hathaway, holds stocks such as Coca-Cola, American Express, Gillette and The Washington Post. Not the most exciting names, but his results are irrefutable.

A $10,000 investment in Berkshire Hathaway in 1965, the year Buffet took control, would today be worth over $50 million. By comparison, the same investment in the S&P 500 would have grown to only $500,000.

In his search for undervalued companies, Buffet ignores both macroeconomic predictions and Wall Street trends. He refused to get caught up in the tech / dot com frenzy of late 1990s, stating that he wouldn't invest in companies that he couldn't visualize 10 years down the road.

What Warren Buffet has to say on diversification. "Wide diversification is only required when investors do not understand what they are doing."

You've heard the cliché not to put all your eggs in one basket. This applies to your retirement savings, but only to an extent. Proper diversification means holding a suitable mix of investments that, when combined, serve to both reduce risk and provide the potential for increased returns. Diversification at its most basic could be holding a Canadian equity fund and a global equity fund in your portfolio.

However, there's a fine line to be drawn. Too many investors suffer from what I call di***worse***ification. Their money is spread amongst so many holdings that they're no longer investing; they're collecting.

Their account statement reads like a history of the mutual fund. Every year's favourite makes an appearance. Because their money is spread so widely, appreciation in any one holding barely impacts the value of the overall portfolio.

On risk, Buffet has to say, "Risk comes from not knowing what you're doing."

I recall a gentleman who came to our firm in late 2002, distraught over the recent losses in his portfolio. The advisor with whom he was working at the time had recommended a number of different mutual funds, all with different managers and different fund companies.

Upon closer examination, everything he owned was invested to a great extent in the U.S. market. His statement read Global Equity, U.S. Large Cap, U.S. Value, American Growth and Income and so on.

That he was diversified was undeniable. He owned 10 different funds. That all of his investments moved in lockstep, which at the

time was down, had only just become painfully apparent. He'd been sold a well balanced diet consisting of white bread, whole grain bread, bagels and a pita.

What Warren Buffet has to say on staying invested. "Only buy something that you'd be perfectly happy to hold if the market shut down for 10 years."

In 2001, Dalbar, a U.S. financial services research firm published its study Quantitative Analysis of Investor Behaviour. The study examined the returns earned by actual U.S. investors in equity, fixed income and money market mutual funds, during the period January 1984 to December 2000. The findings were surprising.

Over the 17 year period measured, the average equity-fund investor earned an annualized return of 5.3%. At the same time, the S & P 500 Index returned an average of 16.3%. Fixed income investors fared similarly. Their average return was 6.1%, while the Government Bond Index returned 11.8%.

Why do investors trail passive, unmanaged indexes by such a margin?

The simple truth is that all too often, investors can be their own worst enemies. Think of the equity markets as a man walking up a hill playing with a yo-yo. In the short term, investor's focus is drawn to the yo-yo. It may be the constant up and down, or possibly the spinning, that has one mesmerized. Step back and let your gaze return to the hill. The market's direction over the course of your lifetime is abundantly clear.

Trying to time the market and guess which sector or asset class is most promising leads to irrational decisions and second guessing. Chasing the current trend isn't likely to win out over a buy and hold approach, and can be seriously detrimental to your financial health.

And finally, some Buffet wit to accompany the wisdom. "It's only when the tide goes out that you learn who's been swimming naked."

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