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Trying to Beat the Market? Consider These Steps Instead

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I'm often asked about modifying an investment portfolio to "be more aggressive" and/or "try to beat the market." I wish it were possible, but know it is not. If I buy investment vehicles that as a group outperform any particular index they are compared to, it is just for a while.

If we are talking about selecting individual stocks and industries that might outperform the index they reside in to "beat the market," this effort is extremely unlikely to succeed for very long (if at all). Study after study clearly reveals that only a very small percentage of full time investing professionals can get returns that exceed the broad market return of the assets they use. Knowing which of those rare individuals will succeed in advance is impossible. Beating the experts yourself over the long term is also unlikely. (For related reading, see: Seeking a Financial Advisor? You Probably Need a CFP)

However, there are many things you can do to improve your long-term chance of financial success (and almost certainly "beat" the returns of most of your neighbors and friends).

Asset Allocation

First, choose your asset allocation decisions based on your individual goals and situation. One example might be avoiding stock-based real estate investments for a family that owns a significant amount of real estate. Another example might be avoiding putting stock from an individual's employer in their pension plan.

Additionally, you should make your asset allocation decisions based on specific family goals for investment returns. A primary goal here is to match investments to goals, not to "returns." A simple example is keeping funds that are needed in the short term in safe low-yielding bank CDs rather than exposing them to stock market volatility.

Conversely, long-term retirement savings should often be invested primarily in equities. On the other hand, if you have more than enough saved for retirement security, you may adopt an investment strategy that just keeps up with inflation and taxes and has a reduced exposure to volatility. (For more, see: How Inflation Impacts Your Financial Planning.)

Reducing Taxes

There are many strategies that can be considered to both increase long-term income and reduce taxes. These include retirement fund withdrawal strategies and timing of Social Security benefits. There are "tax efficient" methods of both investing and taking investment withdrawals. On the investing side, using municipal bonds if you are in a high tax bracket may be wise. Another strategy involves keeping investments for more than one year to allow lower capital gains taxation rates to apply.

Another method of increasing long-term returns is known as "filling the bracket." Doing so means that you take taxable withdrawals from pre-tax accounts up to the level that keeps you in a lower bracket on a year by year basis. Also, during the years that you take withdrawals from a retirement portfolio, knowing how to mix money from pre and post-tax accounts can make a large difference in your tax bill.

All of the above methods are far more likely to lead to success than trying to "beat" the market.

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