How can investors best maintain, gain through stock market ups, downs?

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- The author argues that published investment returns are not important for evaluating funds.
- It is nearly impossible to consistently "beat the market" over long periods of time.
- Maintaining investment discipline through market cycles is more crucial than comparing returns to an index.

Q: How important are published investment returns for the funds I invest in?

A: Not important at all! Let's start with an agreement. Let's agree that no one can "beat the market" over long periods of time. It's a fact, proven over and over and over. In the many thousands of funds run by professional investors, you can find a few with several year track records "beating" the index of stocks that they invest in. But if you wait long enough (or look earlier), you'll find that they are not long-term winners. So, it is vitally important to pick primarily low-cost index funds for your portfolio.

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Ok, let's add the next agreement. Picking specific time periods in which to view "performance" of index funds makes no sense at all. You seem skeptical — don't we see the regular use of one-year, five-year and 10-year performance everywhere we look? Are not even quarterly returns trumpeted by the financial press? Certainly, but it makes no sense. When different asset classes move up and down (say, U.S. stocks), they move over cycles of years. Sometimes a few years, sometimes many years. And we don't know the length or size of the cyclic move until it's done. No one does. Picking out a specific short time in the middle of a cycle not only doesn't make sense but is crazy.

Ok, one final agreement. Over periods of time measured in at least a few years, stocks do better than bonds, which do better than cash. Again, this isn't my opinion, it is history. We can also agree that we "pay" for stock returns by tolerating more volatility up and down than with bonds and cash. The goal is to match the market returns of both stocks and bonds with your investments.

These are the questions investors should ask, answer

Ok, let's put our agreements together. If we can't beat the market and we don't know the time period in which it is appropriate to measure how we are doing, what should we do? We should decide how long our investment period is, and also, how much of our portfolio should be in stocks vs. bonds vs. cash. For example, if we have more than a decade to invest (almost everyone) and can tolerate volatility reasonably well (you know if you can, you've been through it and you know how you reacted before), then you should have a large portion of your portfolio in stocks. Since no one is likely to beat the market long term (which is our time horizon, right?), it probably doesn't matter too much as to the specific vehicles we use to invest with.

You and your advisor should consider a low-cost way to invest in stock markets around the world in the agreed upon percentage and be complacent. It's fine to pick some "active" managers to hedge your bets if the fees are not too high. It's also fine to choose all low-cost index funds. The real returns will come over long periods of time, and you won't know which portfolio choices are better until after it is all over.

As to the rest of your portfolio, the agreed upon percentage should be in bonds and other fixed income-again consider global diversification at a reasonable cost and fill in the rest with cash equivalents. I’m not saying this is easy, as it is very difficult to avoid fear in falling markets and greed in bull markets. But the discipline is crucial to success.

Poof! No more worries about how you did last year. No more concerns about "five year returns vs. the S&P 500." You'll do about as well as the markets you invest in. If you are mostly in stocks, you'll do as most of the world stock markets did for any particular time (luckily for us, they go up most of the time).

Any more concern than this about performance over any period of time is a mistake. It will make you unhappy, and likely less wealthy in the long run.

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