Track Record Investing

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"If you don't know where you are going, you might end up someplace else."
- Yogi Berra

Most people think that the markets (stock & bond) are something that can make their assets go up. They are wrong; instead, they are merely vehicles through which you can accomplish your investment goals. Unfortunately, many people who have realistic goals, and even create a proper strategy, go off course once it comes time to implement their plan. In essence, the problem tends to be that most people drive their investment plan while looking through the rear-view mirror, thinking that what worked well yesterday will do well tomorrow. And if you steer your portfolio based on assumptions that turn out to be wrong, then you can go off course.

Such was the case in the late 1990's when people were reassured by past performance that recent outperforming funds were the best place to put their money. For instance, Janus Twenty, one of the best performing funds during the 90's, including a 65% increase in 1999, experienced massive inflows of money during/after that performance; based on its past track record, investors obviously assumed this fund was a great place to invest their money for the future. Unfortunately, Janus Twenty plunged 69% from 2000-2002 and experienced massive outflows of money - investors bought high and sold low based on track record investing. ("Janus Rebuilt", Bob Frick, Kiplinger, 06/29/2007)

The 1990's is not a rare example; in fact, history has a way of repetitively teaching us lessons we never seem to fully grasp. During the 1970's, the 44 Wall Street Fund was the top-performing diversified U.S. stock fund of the decade, yet it was also the worst-performing fund of the 1980's ("Don't Fall For It", Paul Merriman, MarketWatch, 04/13/2004), and then disappeared in 1993 (this "disappearance" is part of a "survivorship bias", a dirty little secret in our mind, whereby results of funds that survived a certain time period may have been bolstered by the underperformers that either merged with others or simply discontinued operations).

The trick is to understand that there is a "random" component in the markets – such that even though we may be able to try and forecast the future based on past events, the markets will inevitably prove some of these forecasts wrong and take a turn for the unexpected. Also remember that we humans have the inherent ability to easily, and unknowingly, make conclusions and then find data to support those conclusions. In fact, if you are predisposed to one of the two basic investment emotions (fear/greed), then you may inevitably use past performance to justify your thoughts about future markets. So, false confidence could breed failure if the assumptions or conclusion turn out to be wrong.

This is why, though we admittedly have a bias, we recommend that people work with an advisor who may help reduce the influence your emotions can have on your portfolio's direction, as well as help eliminate the noise (from the media, the industry, etc) that may impinge upon your judgment. A good advisor will be one that guides you to success based on sound financial principles, without being overly influenced by the past, and try to proactively hedge against unforeseen and/or random events that try to steer you off course periodically. He or she should also utilize timeless financial principles, many of which are based on common sense, and try to control the controllable variables.

Regardless of whether or not you use an advisor, we believe the key here is the difference between knowledge and use. You see, although most of what I have discussed here is not necessarily earth-shattering (some might call it mind-numbing instead!), there frequently is a disconnect between knowing what I have said is true, and actually using it for the benefit of your situation. This could explain why the most disseminated phrase in this industry, "past performance is no guarantee of future results", also seems to be the most widely disregarded phrase as well. When trying to choose the correct investment vehicles to implement their investment plans, many people make the mistake of forgetting that what happens yesterday can be quite meaningless in the big picture for two simple reasons: first, although history *may* repeat itself, we never know if it *will* actually repeat itself, much less when. Second, one day/week/month/year does not a long-term success make.

Remember, the primary goal should be to proactively steer your investments toward your goals without letting the past steer you. Make sure you always keep your eyes on the road ahead, glancing in the rear-view mirror only periodically for reference and research, and never try to guess what lies behind the next turn. Because I promise you this: sometimes what is behind the next turn will be expected based on past events, and sometimes it will be completely unexpected. And if you allow your version of past events to guide you through the future, the road ahead may be bumpier than you anticipate. This is why we believe history is important but no indication of future results, and if you invest solely on an historical track record then you may end up somewhere other than where you really wanted to go.

Last, we want to take a moment to thank you. Many of you have graciously forwarded our newsletters on to other potential clients. As always, we really appreciate your trust and promise to handle any referral with integrity and hard work. Speaking of the future, I hope you have a great end to your summer; ignore the markets as much as possible and enjoy time with friends and family!

R. Timothy Curran, JD, CFP®

tcurran@lpl.com 704.499-9703