Sleaze and Fees

A prominent Hollywood actor found himself unable to spend a lot of time with his wife because of the demands of his job. Realizing that he was not adequately meeting her emotional needs, he asked his best friend to start spending some time with her. As all of us non-Hollywood people would have guessed, she ended up ditching her husband and running off with his best friend.

What seems obvious to most of us when it comes to relationships is often missed when it comes to finances. If you wouldn't hand over your wife or husband for someone else to "nurture," why would you do this with your money? Putting all of your savings into the hands of a trusted money manager is a really bad idea. He will either "run off with it" or start "dipping into it" by charging you fees.

If you don't have the time or the inclination to meet the emotional needs of your spouse, you shouldn't get married. If you don't have the time or the inclination to manage your savings, then you should either give them away or lock them away and forget about them. The first option might be a bit radical for those of us who don't aspire to sainthood. However, the second option is actually quite reasonable and relatively simple to do.

A lot of people feel that it is somehow irresponsible not to make high returns on their invested money. They should realize, however, that savings (which become investment capital when they are deployed into stocks or bonds) are only a catalyst for economic activity, rather than actual economic activity itself.

The management of your wealth, regardless of the amount, is a task that cannot be delegated to someone else any more than the management of your fitness can be delegated to someone else. Everyone can and should learn about saving and investing—and take charge of all the decision-making. Rather than handing over your assets to a hedge fund manager or financial planner, you should develop and implement your own conservative investment strategy. Managing your money well does not require a lot of time or an advanced degree in finance, just adherence to some basic, common sense principles.

Many people give up a significant portion of their investment returns in the form of fees paid to professionals to manage their money for them. Few of these professionals ever generate returns greater than that of a simple index fund. In fact, eighty percent of professional managers fail to beat the aggregate returns of all the stocks in the market, which an index fund replicates for a very low fee. Worse, they can lose a significant portion of your investment portfolio if they make the wrong calls; and if they are dishonest, they may take everything. The financial industry has succeeded in convincing a lot of hard-working successful people that they are incompetent to manage their own savings—that they should rely instead on the professionals trained by the financial industry. The reality is that most of the training these professionals receive is in marketing.

The analysts among them continually make predictions about whether or not the price of a stock will go up or down—something no one could possibly know. When some of them get it right—this always happens when people take different sides in a bet—investors eagerly hand over their funds to the winners in the belief that they are shrewd and insightful. Usually, they are just lucky. If their luck persists for a few years, they can often sucker in a large number of investors and continue betting with even bigger sums of money. At some point, though, almost all of them will end up losing, taking down their investors with them.

Why take such a risk with your hard-earned savings? Instead, you can simply put your funds into a few conventional investment vehicles, such as an index fund or bond fund at a large, well-established investment firm. Later, you can diversify into the stocks of a few solid, blue-chip companies that are profitable and pay a high dividend. Then you can (and should) forget about the markets and move on with your life. Periodically, you can check on things and possibly re-allocate some of your funds, but this will only rarely be necessary. Most people lose money when they try to predict what the economy, markets, and stock prices are going to do. This is, in fact, why hedge fund managers lose so much money—playing this game is their full-time job. The bottom line is that such predictions cannot be made reliably.

Therefore, it's better not to try. Instead of buying and selling all the time and stressing yourself out about whether or not you made the right decisions (and most of the time you won't), just invest in things that will steadily grow in value regardless of what happens in the markets. Yes, you will probably miss out on the higher returns being made by a few lucky winners—and these winners (whether they are prominent hedge fund managers or your colleagues at work) will be quite vocal about their recent good fortune. But for most of them, the good times will only be temporary and they will eventually start to experience losses—sometimes catastrophic losses. It is far better to stick to a sound investment plan that will generate moderate returns over the long run and that requires minimal oversight.