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Mitigating extreme investment strategies.

The Star (7 January 2017)

***By:** Ismitz Matthew De Alwis*

LIVING on the edge is often perceived as a sheer act of stupidity by people with low risk appetites. But for thrill-seekers, i.e. stuntmen, rock climbers or gamblers, such lifestyles promise excitement and fulfilment – something that cannot be quantified by mere dollars and cents.

The same logic applies to investing – at one extreme are those play-it-safe investors who are overly prudent or risk-adverse in parting with their hard-earned money, while the other extreme features those who would happily throw their money around, spurred by the belief that their good fortune is ripening.

Hence, it can be baffling to learn how a university professor who specialises in the subject of economics and finance can suddenly fall prey to scammers who operate get-rich-quick schemes. This surely has to do with the universal concept of greed. The Salt Lake Tribune in a recent editorial entitled "Gambling-averse Utahans take wild investment bets", questioned why Utahans – who are always speaking up against the evils of gambling – so often fall into the pitches of con men who promise outrageously high returns with obvious significant risk.

Isn't an investment that promises a return of 600% per annum (or more) a form of gambling too?

Closer to home, as of July 12 last year, Bank Negara has identified 272 companies comprising illegal foreign exchange trading (forex) and gold investment firms that wooed Malaysians with tempting prospects of becoming overnight millionaires. Obviously, the operators of these "unauthorised and unapproved" schemes are able to use money received from subsequent depositors to pay high returns or to re-pay the principal amount to the earlier depositors.

However, such schemes are bound to fail eventually once the pipeline of new deposits have slowed or are altogether exhausted, leading to their collapse. Money certainly does not grow on trees but that does not mean that we are unable to grow our very own “money tree”. Unlike martial art movies, we need not be a disciple to an investment guru to master the art of investing.

In fact, investing is all about common sense albeit with a little effort in researching the products, knowing our monetary limits, having the ability to pre-empt the various pitfalls and continuously expanding our learning curve. Obviously, every investor has the right to decide how he/she wishes to strategise his/her investment portfolio but if one is unsure which route to take, it’s best to avoid putting all of one’s eggs in a single basket.

Legendary investor Warren Buffett’s (pic) recommendation of dumping 90% of one’s nest egg in a stock index fund and 10% in short-term government bonds has raised many eyebrows but the Berkshire Hathaway tycoon has not entirely erred in his opinion. While dumping all of one’s savings in stocks-related investments may not be an ideal strategy for retirees, it may be more suited for youthful and high-flying investors who are capable of amassing substantial income.

Invest in equity funds

In other words, instead of “burning” their money incessantly through lavish lifestyles – something which is characteristic of the younger generation of investors – Buffett’s advice can be tweaked as a call to invest in equity funds which are highly volatile but promises probable high returns. The fine print here is that the trading of stocks based on instinct and gut feel is likely to backfire unless the decision is backed by ample research (i.e. positive outlook from the technical and fundamental analyses viewpoint).

On the same note, observe that Buffet proposes “a stock index fund (which he specifically identified as a very low-cost S&P 500 index fund)” as opposed to an individual stock for he has obviously considered the risk factors in the event that the single stock fails to live up to its expectations. Moreover, a mutual fund which invests in securities such as stocks, bonds, money market instruments and similar assets boasts diversification, convenience and lower costs.

Watching your favourite stock nose-diving or investment value shrinking can be a traumatic experience. A severe and prolonged market setback can wreak havoc not only on your wealth but affect your family, health and happiness. Even with steely nerves, how long is one able to bear seeing the paper gains wiped out in the blink of an eye or profits swiftly dwindling (or translating into losses) as the stock portfolio begins to hit rock bottom?

It is during such dark hours that investors should understand the concept of capitulation (as opposed to capitalisation) as even the most gung-ho of investors give up the hope of a rebound and would willingly exit the stock market no matter how low the price is. Hence, instead of pursuing an extreme investing strategy, it makes better sense to embark on a less risky approach – probably a strategy that tallies with your age and career aspirations, income, savings, spending power and financial commitments, among others.

All-in, the level of risk depends on how long you can afford to tie up your money and how much you can afford to lose. If the plan is to invest for 10 years or more, then you may be able to take relatively more risk in exchange for the possibility of higher returns over a longer period.

Unfortunately, it's not easy to make a precise assessment of risk. Markets are inherently unpredictable. Sectors that look unhealthy may start performing strongly and steadily – or companies that look dominant – may suddenly get blown away by the revelation of a corporate scandal overnight.

Finding the middle path in investment is as important as in life. Siddhartha Gautama (Founder of Buddhism) said it best, "Neither a life of self-indulgence, nor one of self-mortification can bring happiness. Only a middle path – avoiding these two extremes – leads to peace of mind, wisdom, and complete liberation from the dissatisfactions of life."

Ismitz Matthew De Alwis is the executive director and CEO of Kenanga Investors Bhd and the current president of the Financial Planning Association of Malaysia (FPAM). Matthew is a Certified Financial Planner and holds a Capital Market Services Representative's Licence from the Securities Commission for fund management and investment advice. He is a staunch believer that financial literacy will empower Malaysians to invest wisely in the financial markets.

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BY ISMITZ MATTHEW DE ALWIS

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Obviously, the operators of these "unauthorised and unapproved" schemes are able to use money received from subsequent depositors to pay high returns or to re-pay the principal amount to the earlier depositors.

However, such schemes are bound to fail eventually once the pipeline of new deposits have slowed or are altogether exhausted, leading to their collapse. Money certainly does not grow on trees but that does not mean that we are unable to grow our very own "money tree". Unlike martial art movies, we need not be a disciple to an investment guru to master the art of investing.

In fact, investing is all about common sense albeit with a little effort in researching the products, knowing our monetary limits, having the ability to pre-empt the various pitfalls and continuously expanding our learning curve.

Obviously, every investor has the right to decide how he/she wishes to strategise his/her investment portfolio but if one is unsure which route to take, it's best to avoid putting all of one's eggs in a single basket.

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On the same note, observe that Buffet proposes "a stock index fund (which he specifically identified as a very low-cost S&P 500 index fund)" as opposed to an individual stock for he has obviously considered the risk factors in the event that the single stock fails to live up to its expectations. Moreover, a mutual fund which invests in securities such as stocks, bonds, money market instruments and similar assets boasts diversification, convenience and lower costs.

Watching your favourite stock nose-diving or investment value shrinking can be a traumatic experience. A severe and prolonged market setback can wreak havoc not only on your wealth but affect your family, health and happiness.

Even with steely nerves, how long is one able to bear seeing the paper gains wiped out in the blink of an eye or profits swiftly dwindling (or translating into losses) as the stock portfolio begins to hit rock bottom?

It is during such dark hours that investors should understand the concept of capitulation (as opposed to capitalisation) as even the most gung-ho of investors give up the hope of a rebound and would willingly exit the stock market no matter how low the price is.

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