

OUTSIDE THE FLAGS

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MAY 2015

The Write Stuff

Everyone knows that reaching a long-term goal appears less daunting if you break the bigger task down into smaller steps. Approaching investment in a similar way makes a lot of sense.

A typical novel contains anywhere from 60,000 to 100,000 words. If a writer were to sit at his desk and contemplate the task involved in pumping out that much material, he might feel overwhelmed by the challenge.

Instead, many writers of long-form fiction break down what appears to be a monumental job into smaller chunks. They may aim to write a thousand words a day or a chapter a week. And they may grant themselves a day off every week.

Ostensibly, someone working on that schedule could knock out a novel in 10 weeks. Of course, there'll be days when the inspiration doesn't flow or when there are unavoidable distractions. But there'll also be days when the writer is hugely inspired and productive, so that he exceeds his target.

What matters to the writer is that he's making progress toward a long-term goal made up of a lot of little wins (and the occasional loss). The long-form piece of fiction becomes in reality a lot of smaller stories and incidents.

An investor should think about returns in the same way. The long-term goal may be to secure the 8% or so annual return that the equity market has historically offered on average. The challenge is accepting that that return is not delivered every time.

There will be years where the risk of owning stocks shows up. Take 2008, for instance, when the Australian share market, as measured by the S&P/ASX 300 accumulation index, delivered a negative return of nearly 39%.

But there will also be years when the market delivers double-digit positive returns, as in 2004-07 and 2012-13.

Because no-one knows for sure when the market premium will show up, the investor, needs to stay in his seat. Like the writer, the smart investor is not focused on the daily, monthly or even yearly returns, but on his own long-term goal.

Dimensional's **Matrix Book** shows how historical context can provide perspective for the investor distracted by short-term returns. In 1980, for instance, the S&P/ASX 300 delivered a return of nearly 50%. The following year, it fell by nearly 13% and by a similar amount again in 1982. In 1983, it snapped back by nearly 67%. Over the full 25-year period from 1980-2014, the market delivered an annualised return of 11.6%.

It's the same story with other premiums such as from low relative price and small company stocks. The Matrix Book shows Dimensional's Australia Core Equity index, which tilts to those dimensions, had negative returns in seven years of the 33-year period from 1982-2014. Over the whole period, though, it delivered a total annualised return of 12.5%.

Of course, an investor confronted with another year like 2008 might be tempted to get out of the market completely. But timing one's exit point is tough. And even if you manage to get that right, you have to work out when to get back in again.

So an investor who quit the Australian Core Equity index in 2008 (when it fell 41.6%) may also have missed the rebound of 46.2% the following year.

A writer succeeds by maintaining discipline and working slowly and steadily with the end goal of the novel in mind, accepting that there will be setbacks on the way. An investor succeeds in exactly the same way.

Call it the Write Stuff.



"Outside the Flags" began as a weekly web column on Dimensional Fund Advisors' website in 2006. The articles are designed to help advisors communicate with their clients about the principles of good investment—working with markets, understanding risk and return, broadly diversifying and focusing on elements within the investor's control—including portfolio structure, fees, taxes, and discipline. Jim's flags metaphor has been taken up and recognised by Australia's corporate regulator in its own investor education program.

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