



Investing: The Evidence

A documentary film for investors

“ On the topic of investing Robin Powell’s new documentary is the best 45 minutes you will ever spend. With the help of clear and compelling experts Robin lays out what everyone interested in the markets must know. It will be required viewing at Vanguard! ”

*William McNabb,
CEO of the Vanguard Group*

“ What is needed in the investment world is clarity and the long view. This film provides both. ”

*Keith Cuthbertson,
Professor of Finance,
Cass Business School*

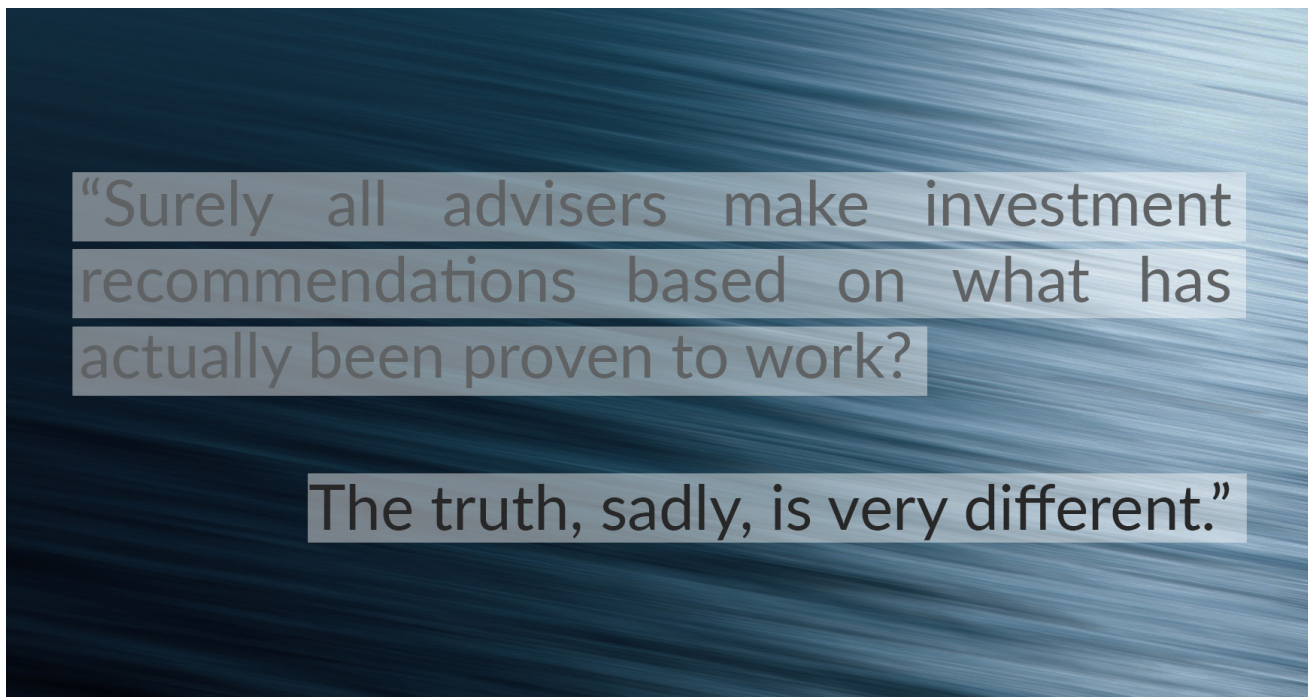
“ Every now and then you stumble across something that really helps you to see the truth. Investing: The Evidence sets out clearly and simply how you can capture your fair share of the returns from capitalism so you can achieve more with less. ”

*Jason Butler,
Personal finance writer*

Foreword

One of the things that makes RockWealth different to other financial planning firms is the fact that our investment philosophy is based entirely on evidence.

When we explain our philosophy to new clients they often, understandably, express surprise that being evidence-based is a distinguishing feature at all. Surely all advisers make investment recommendations based on what has actually been proven to work? The truth, sadly, is very different. Many advisers still rely on hunches and guesswork, and most continue to recommend just the sort of products that have failed investors for decades.



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To explain our evidence-based approach to investing, we commissioned Robin Powell and his team at Ember Regis Group to produce an online documentary about it, called Investing: The Evidence. You can choose to watch the full 45-minute film in one go, or else work through its six separate parts at your own pace. Either way, this could be the most important investment in your future financial security that you will ever make.

This booklet is designed to accompany the documentary. You'll also find more information about evidence-based investing on the RockWealth website. But please, if there's anything that you're unsure about and would like to discuss further, please don't hesitate to get in touch with us.

By Tim Horrocks, Managing Partner, RockWealth LLP

Preface

A little knowledge, they say, is a dangerous thing. It certainly was for me when it came to investing. I read the money sections in the weekend papers, I watched financial television, and I kept a regular check on how the global stock markets were doing. I knew I wasn't an expert, but I considered myself at least a bit sophisticated.

But then, in 2011, after a long career in mainstream journalism, I started to research how investing really works. I read books and academic articles, and I travelled far and wide meeting men and women who've spent decades studying this subject, including three winners of the Nobel Prize in Economics.

What amazed throughout this process, and indeed still does today, is that there is a vast amount of academic literature out there which most investors – and even, astonishingly enough, many financial professionals – are not even aware of. What does it say? Well, there's a remarkably broad academic consensus on what investors should be doing; basically, they should be keeping costs low, diversifying widely, taking a long-term view and trading as little as possible. Yet very, very few people actually do all of those things, and many do none.



What's even more worrying is that investors are actively encouraged by the investing industry and the financial media to act in ways which usually lead to worse outcomes.

This aside, just the sheer volume of information available can make it difficult to obtain a clear understanding of what works. But the truth is, to quote William Bernstein in his book *The Four Pillars of Investing*, "the body of knowledge that the individual investor, or even the professional, needs to master is pitifully small".

By watching this documentary you will be arming yourself with all the information you really need to know in order to have a successful investment experience.

By Robin Powell, Writer and Presenter, Investing: The Evidence

One documentary, six separate parts

For those who don't want to watch the full 45-minute version of Investing: The Evidence in one sitting, we've broken it down into six separate parts. Here is a brief synopsis:

Active investing

Active investors try to beat the market through a combination of stock selection and market timing. The vast majority of investors give their money to professional stockpickers who actively manage it for them.

The idea of beating the market is appealing to investors, but active investing is fraught with problems. First and foremost, it's extremely difficult to outperform over the long term, especially when costs are factored in; according to research* by the Pensions Institute in London, only around 1% of actively managed funds succeed in doing so, and spotting those very few winners in advance is all but impossible.

*New evidence on mutual fund performance: a comparison of alternative bootstrap methods by David Blake, Tristan Caulfield, Christos Ioannidis and Ian Tonks (2017)

"99% of fund managers deliver negative value added for their consumers once you take into account the fees."

David Blake



Passive investing

Instead of trying to beat the market, passive investors simply aim to capture market returns by using funds that track an index. The two main advantages of using index funds are that, as long as you stay invested, you are guaranteed to achieve, near enough, the market return, and also that they're very much cheaper to invest in than actively managed funds.

One of the biggest advocates of passive investing is, ironically, the most famous active investor of all, Warren Buffett. In his 2017 letter to Berkshire Hathaway shareholders, Buffett said this: "Both large and small investors should stick with low-cost index funds."

"Passive investing has been growing at a pace far outstripping traditional actively managed funds."

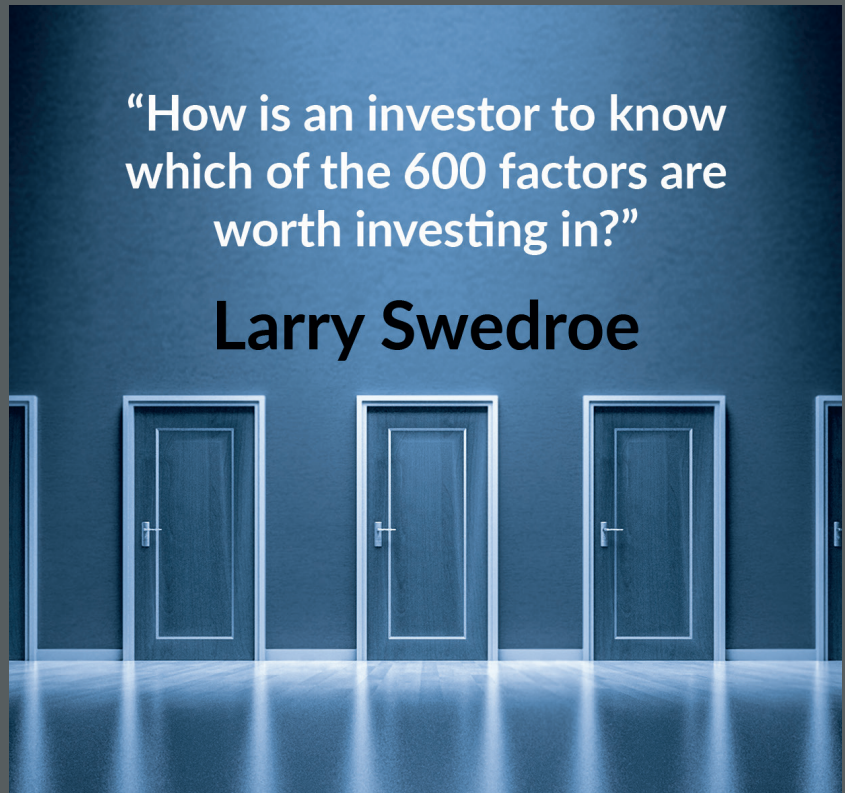
Ben Johnson



Factor investing

Sometimes referred to as smart, strategic or alternative beta, factor investing is based on the multi-factor model developed by two American academics, Eugene Fama and Kenneth French.

Fama and French have identified a number of different risk factors which, over time, are expected to produce higher returns than the market. However, factor investing is not a panacea; it does, for example, entail greater risk than passive investing, and it comes at a slightly higher cost.



“How is an investor to know which of the 600 factors are worth investing in?”

Larry Swedroe

Risk

The returns you receive are a reward for the risk you take. That doesn't mean that taking risk guarantees a positive return, but you can't expect your money to grow unless you're prepared to accept the possibility that your portfolio could significantly fall in value, at least in the short term.

How much risk you take is a very personal matter; no one should take on more risk than they need to take, can afford to take or are comfortable taking, and whatever your own capacity for risk, you should always ensure your portfolio is well diversified.



“The main risk for most people is failure to achieve their desired lifestyle and other important goals.”

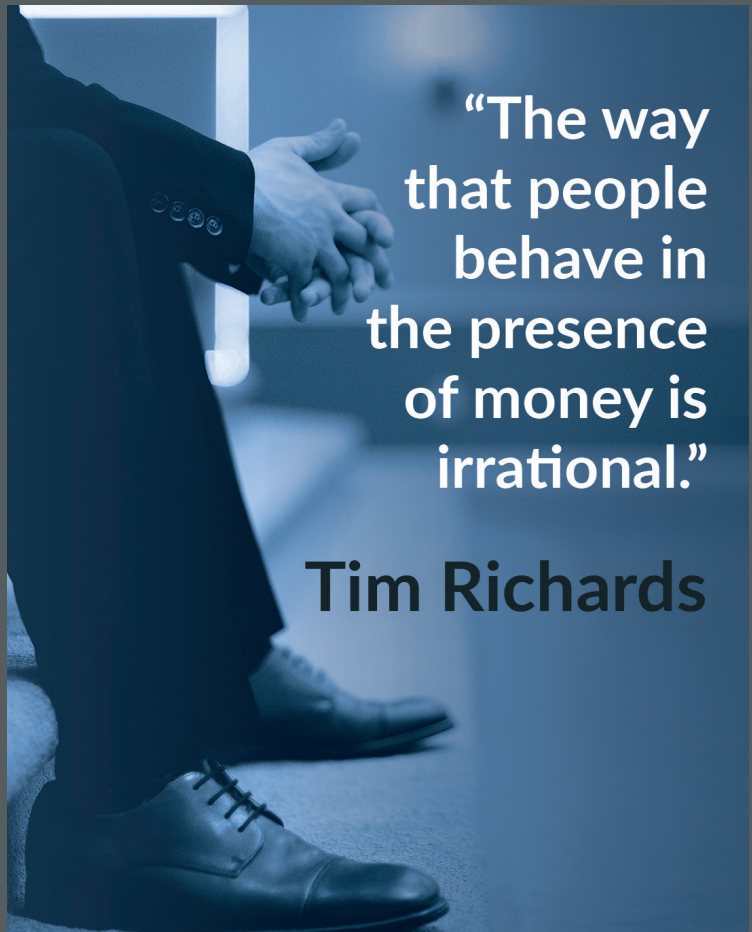
Jason Butler

Behaviour

Unfortunately, human beings are not cut out to be good investors. Evolution has taught us to focus on what we perceive as immediate threats. So, for example, when stock markets tumble, our brain's amygdala floods our bloodstream with corticosterone, fear kicks in and we're overwhelmed by the urge to sell.

Another problem is that investors are prone to a range of behavioural biases. For example, we attach far more importance than we should to recent events, forgetting what market history teaches us.

To succeed at investing, we need to be aware of these biases and control our emotions, always looking to the longer term.



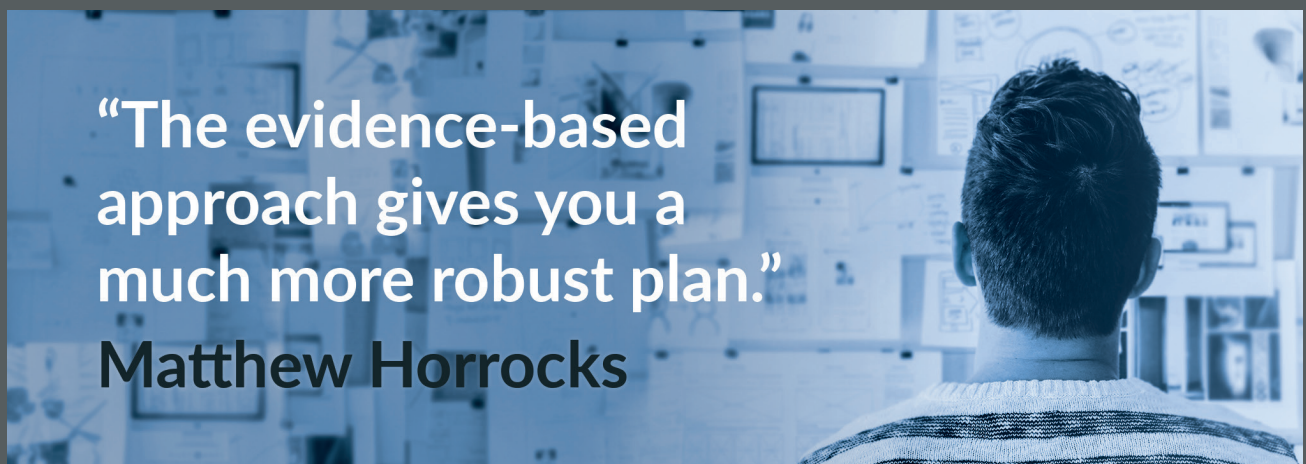
“The way that people behave in the presence of money is irrational.”

Tim Richards

Advice

Although it's not essential to have a financial adviser, you are far more likely to achieve your goals if you do. The important thing to remember is that investment advice is only part of what a financial adviser should be providing. His or her first priority is to work out what's important to you and what you want to achieve, and, on the basis of that, to produce a financial plan. Then, and only then, is the adviser in a position to build a portfolio that's appropriate to your personal capacity for risk.

The focus should be on sticking to your plan, not the particular funds in your portfolio. You should therefore look for someone who really takes the trouble to get to know you and provide coaching to help you stay the course.



“The evidence-based approach gives you a much more robust plan.”

Matthew Horrocks

What do we mean by evidence?

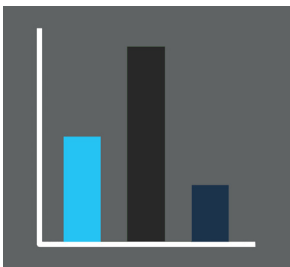
Most investment professionals would claim to base their methodology on some form of evidence. So then, what sort of evidence can investors rely on? Generally speaking, reliable evidence has four main characteristics.

It's independent

Too often, reports are produced, or else commissioned and paid for, by companies with a commercial interest in publicising the outcome. Most academics, by contrast, are independent. They don't have an agenda or a point to prove; instead they leave it to financial practitioners to act on their findings or not.

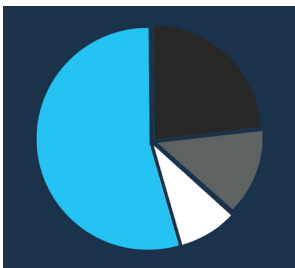
It's based on robust data analysis

We all know the old adage about lies, damned lies and statistics. Often findings are based on too short a time period or a sample that's too small. Sometimes the fund industry ignores biases in the data, other times it compares returns to the wrong benchmark, or it quotes performance figures before the full impact of fees and charges.



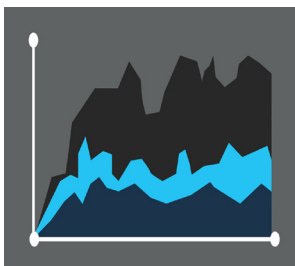
It's been peer-reviewed

Publishing research in academic journals gives other academics the chance to analyse the methodology, outcomes and conclusions of a study and provide their own review as to the reliability of the study. Caution is required – there are journals that are less credible than others – but evidence that has been properly peer-reviewed should carry far more weight with investors.



The results have been reproduced

The fourth and final characteristic of findings you can depend on is that they've been tested across multiple environments and timeframes. There needs to be a strong element of repeatability to demonstrate that the findings of a particular study weren't just down to random luck.



The lesson, then, is to be very cautious about anyone claiming that a particular investment strategy is evidence-based. Even if it fails just one of these four important tests, it's probably worth ignoring.

About RockWealth



Financial planning sits at the heart of what we do for and with our clients and we really enjoy working with interesting people who understand that life is not a rehearsal. You will find us refreshingly down to earth and easy to work with.

We have strong beliefs about how a financial planning business should operate and care for its clients. We imprint these beliefs on everything we do. We believe our clients should know the truth about their money and what it will or will not allow them to do. We can then help them to make the choices that are right for them.

This means we place great significance on long-term relationships and doing the right thing.

By Mark Vail, Partner, RockWealth LLP

About Robin Powell

Robin Powell is an award-winning journalist, blogger and content marketing consultant, based in the UK, with specialist expertise in the investing industry.

He also campaigns for better investor education and for greater transparency in global asset management. He runs Ember Regis Group, a content marketing company working primarily with disruptive companies in the financial sector, and he blogs as The Evidence-Based Investor at evidenceinvestor.co.uk

