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Winning strategies

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"We are what we repeatedly do. Excellence, therefore, is not an act, but a habit."
- Aristotle, Greek critic, philosopher, physicist & zoologist (384BC – 322BC)

For an investor to be successful, they need to not only be able to achieve their financial goals but to have the confidence that they will. To do this, they need to adopt the right investment strategy, keep costs/fees low and develop winning habits.

Investing involves a process to put savings into in the different types of assets (cash, bonds, property and shares), capture the required income and growth returns, and have the savings returned when they are needed. To win this process and be successful an investor needs to appreciate and **understand the investment markets** and what might happen, how they can capture the positives and manage the negatives, and **understand who they are** - their beliefs and personality. It is best not to do something that goes against your beliefs and what comes natural to you.

Understanding the markets

The markets are impersonal. They do not know you or care who you are, how much money you have, what you do, or what you believe in. They are indifferent to your personal goals.

Successful investors therefore must take responsibility for their personal goals and outcomes, and must navigate the challenges of the markets. To do this it is good to adopt behaviours that demonstrate:

- an understanding of the long-term characteristics of the different types of assets, recognising that short-term they are unpredictable and may go against the long-term trend;
- an understanding of current affairs and their potential impact on the returns of different investments over the timeframe that is relevant to them personally.

These understandings help ensure that they do not react to temporary events. Also, an investor needs to demonstrate they can respond appropriately to new information and are willing to update (and change) their expectations and decisions.

It is also important for an investor to understand their goals and beliefs. As a general rule, people who do not know what they really want and what is important to them, make it harder for them to achieve success given the impersonal nature of the markets.

Understanding who you are

Each investor has individual needs and often reacts to the uncertainties differently. The basic questions you must continually ask yourself include:

- what are your assets and liabilities? The difference is what you are worth. It is good to know if it is increasing or reducing, and how it compares to your future (e.g. retirement) requirements?
- how much cash you need each month?
- whether you can cut your expenditure, or sell surplus assets?
- whether your goal is to be financially comfortable, or really rich?
- whether your investment goals are important so that you will make sacrifices today?
- how much risk are you willing to take to reach your goals? Risk in this context relates to the chance you will not achieve your goals and the financial consequences to you of this happening.

Once you have set your goals and you are comfortable with them, you should split your capital between investment capital and risk capital. The "risk" capital may often be nil and is limited to the money you can lose before your goals or future living standards would be compromised.

Successful investors

The winning habits of successful investors are such that they:

- **Don't react to news, but think about the implications**
  When news (good or bad) is on the front page of the paper or on TV, it is generally too late to profit from it. Most successful investors are therefore flexible, pragmatic and open minded. It is important to focus not on what is happening, but what the implications of what is happening are on the markets.
- **Respond to new information**
  When looking at new information, it is important to look at the trend and the impact on the investment markets. At times, this will require an immediate change and at other times patience. What is important is that you think about:
  - is the economy getting stronger or weaker?
  - are energy costs (e.g. oil prices) likely to rise or fall?
  - will the Reserve Bank meet its inflation targets, exceed them or fall short?
  - is the supply of money in the market expanding or reducing?
  - what is changing in the world that everyone takes for granted?

- **Understand the value of money**
  A key driver of investment returns is the value of money and the changes to this. The value of money is indicated by current interest rates, exchanges rates and inflation rates. These typically have a more immediate impact on the basic level of economic activity and therefore on short-term investment returns, than any other variables.

  The interest rate is the price of money to borrow it. The current interest rates also determine the present value of future income streams. If interest rates are rising, then the value of an investment is typically falling and vice versa. It is not as simple as this, as both interest rates and the value of an investment can rise at the same time, particularly if the economy is buoyant and the income generated by the investment is rising as a consequence.

- **Are willing to buy when others want to sell**
  Investing is partly psychological. Investors within the market move from optimism and enthusiasm to rampant despair. Generally, the best time to buy is when everyone else wants to sell. This is the best time to get assets at a low price because there is a little competition to buy.

- **Are patient and are willing to adopt a longer holding period before selling**
  One way to beat the ups and downs of the market is to adopt a longer term patient approach, when it comes to selling. The market is generally very short-term and very impersonal. The patient investor has an advantage over other market participants because they can set a time longer than the average of the market and choose when to sell.

Successful investors also think about what will be successful investments for them.

Successful investments

The requirement of a good investment is to let you sleep at night, knowing that you can achieve your financial goals. It also has to be consistent with your personality and beliefs. If the investment is inconsistent with who you are, there is greater risk that you will react to negative news and therefore buy/sell at the wrong time. This will occur for reasons other than investment considerations. Successful investments help you achieve your goals.

Here are five factors that an investor should understand with each investment.

1. **Liquidity.** An investor needs to understand how much cash they can get from an investment and when they will need the cash from the investment. Not all investments need to be liquid as long as some are, if you are likely to have some immediate expenditure.

2. **Nature.** An investor needs to understand whether the investment is real (property, business, commodities, etc.), or a paper based intangible asset (loans, financial investments, etc) and whether it is productive or unproductive.

If an investment is real and productive then, even if it cannot be sold, it can be used to generate a return. This is not always the same for intangible assets and unproductive assets.

3. **Yield.** The natural income level relative to the need, should be the main motivation for buying an investment. Income may be current (dividends, rent, interest) or future (through capital appreciation). The income through capital appreciation can only be realised when the investment is sold. Combining the actual cash income and the capital appreciation, gives the total yield on an investment. Both the total and the current yields are important relative to your cash flow needs.

4. **Potential.** Potential is also referred to as risk. For a conservative investor, an investment with a high potential may be unacceptable because of the equally high chances of a poor outcome, i.e. the potential not being realised. Potential is an estimate of a future uncertainty in the yield being either above or below the expected level.

5. **Control.** An investor needs to understand who controls the investment and whether their interests are consistent with theirs as an investor, or whether they will work against them.

To be a successful investment, the liquidity, nature, yield, potential and control, must meet the requirements of your investment needs for the income and the timing of that income.