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Can Regular Investors Beat The Market?

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We all invest with the hope that one day we won't have to work, but will have enough money to live off our investments. The question remains, can a regular investor really beat the market? Do we have what it takes to win over the middlemen and institutions that have millions, or even billions, invested in the market? According to Terrance Odean, a finance professor at the University of California, Berkley's Haas School of Business, "Many of the mistakes investors make come from a lack of any understanding of the innate disadvantages they face." In this article, we bring you some of the takes about beating the markets from experts in the field.

KEY TAKEAWAYS

- Figuring out whether you can beat the market is not easy one, but the answers generally vary depending on who you ask.
- The average investor may not have a very good chance of beating the market.
- Regular investors may be able to achieve better risk-adjusted returns by focusing on losing less.
- Consider using low-cost platforms, creating a portfolio with a purpose, and beware of headline risk.

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David and Goliath

Can you beat the market? The answer to this question is not an easy one, and the answers generally vary depending on who you ask. By beating the market we're talking about everyday working Americans who invest to try to get greater capital gains and more returns than the S&P 500. According to one expert, investors may have to give up something in return for higher returns.

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"We all have some larceny in us. We buy securities because we think we know someone or something others don't. I don't think anyone can consistently outperform the S&P 500 without assuming greater than market risk," according to David E. Y. Sarna, author of "History Of Greed."

Don't Model Yourself After the Professionals

While some of us have the tools—and connections—required to make knowledgeable decisions that will lead us to a portfolio with higher returns, others like stockbrokers, bankers, and big corporations most likely have an advantage, right?

Sure, these people in the financial industry have insider information which they cannot legally trade on. But they also possess the necessary financial statement analysis skills to develop a greater insight about a given company. [1]

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> **Important:** Don't model yourself after financial professionals who have a history of analytical skills.

Beating the Market: Probabilities

"The reality is there will always be a lure to try and beat the market, especially since those who have beat it consistently are revered so highly (Bill Miller, Peter Lynch) and/or are compensated well (hedge fund managers). I think the market can be beaten, but even a broken clock is right twice a day. Best way to describe it: It's possible but not probable," says Robert Laura, author of "Naked Retirement: A

Stimulating Guide to a More Meaningful Retirement" and president of SYNERGOS Financial Group.

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According to Laura, the average individual investor has little chance of beating the market. He says the common investor uses mutual funds, is stuck in 401(k) plans which essentially track the broader index, and pays higher fees as compared to stock, index funds, or ETFs. Also, many mutual fund-type investments don't use stop loss order to protect gains and thus do not always provide the type of protection individualized portfolios can perform. As he puts it, "investors are set-up to fail from the get-go."

Investing in 401(k)s is no better. "Most 401(k)s aren't benchmarked and most companies don't have a good investment policy for selecting funds within the program. You can't even get some asset classes in many and most advisors are sales people, not fiduciaries and just taught how to sell funds," adds Laura.

The good thing is many more investors are taking responsibility and interest in their investments. They are taking the initiative to learn how their investments work and are less intimidated. Laura says investors are learning that individual stocks aren't as scary as everyone suggests and there is valuable information available to everyone if they know where to find it and how to apply it.

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"The advent of ETFs and index investing allow people to mimic the market, instead of trying to beat it, which is a better, less expensive perspective to have," Laura adds.

A Lost Cause?

"All the evidence supports the disappointing fact that regular investors as a whole underperform the market. As long as they try to 'beat the market' they actually underperform," said Todd R. Tresidder, founder of FinancialMentor.com, in 2010.

According to Tresidder, the best way for regular investors to achieve better risk-adjusted returns is by focusing not on out performance, but by losing less. In other words, regular investors have one competitive advantage - liquidity.

"Big investors are the market but the little guy is nimble and can buy or sell without affecting the market - something the big guy can't do. Systematic risk management can work to provide regular investors with similar or slightly improved investment performance relative to the market at substantially less risk," he says.

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Helping the Odds

What can an investor do to increase their chances of beating the market? Laura says there are several things you can do.

Save Money

Use low-cost funds and/or a low-cost platform for trades. There really is no sense of trying to increase your chance of getting higher returns if you're going to spend a lot of money investing your money. Look for opportunities to try to cut down on your costs if you're managing your own portfolio. Remember: The best way to make money is to save money.

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You Need Discipline

Regardless of what your goals and intentions are, you need to have a plan. And once you have a plan, you need to stick to it, no matter what the circumstances. Establish and follow a discipline which translates into just doing what you said you are going to do.

Portfolio With a Purpose

Give every investment in your portfolio a buy price, hold price, and sell price along with one or two reasons to buy, hold, or sell at that value. This gives you specific criteria to act and provides your portfolio with purpose and specific direction.

Headline Risk

Watch for headline risk. This term refers to the shock of news that may affect a company's stock, industry, or sector. Set up email alerts for your investments so as new information comes out about them, you become aware of it in the early stages to consider changes.[2] Mark your calendar for things to watch like earnings dates, intellectual property timelines, and industry reports like Federal Reserve meetings, unemployment numbers, new housing starts, and other information that will affect the specific sector or security.[3] [4]

Sarna suggests investing in what you know and understand such as solid, profitable small-caps, and even microcaps in niches you can monitor and understand. These can appreciate much more rapidly than equivalently-priced large caps.

The only way to get above market returns is to develop a competitive advantage. "It is either developed through knowledge and information flow, or it is developed through extensive research resulting in an investment strategy that exploits irregular market behavior," says Tresidder.

According to Tresidder, the only way to outperform the markets is to develop a competitive advantage that exceeds transaction costs and passive market return.

The Bottom Line

The debate of whether an individual investor can beat the market is as old as the stock market itself. Those who have found fortune investing will often preach that they possess superior analytical skills which allowed them to predict the market. Those investors who suffer losses will tell a much different tale.

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