Mitch on the Markets

Here's Why Most Investors Underperform the Market

By Mitch Zacks
Portfolio Manager

Since January of 1986, the research firm DALBAR has been compiling data measuring how the average investor performs over time. The results are pretty harrowing, and they might surprise you.

Over long stretches of time, the average investor is *widely underperforming*. The table below underscores the magnitude of the underperformance for equity investors and fixed income investors alike:

For Equity Investors:

Investment Time Period	**Average Equity Investor**	S&P 500
30-year period	3.66%	10.35%
20-year period	4.67%	8.91%
10-year period	4.23%	7.31%

For Fixed Income Investors:

Investment Time Period	**Average Fixed Income Investor**	Barclays Aggregate Bond Index
30-year period	0.59%	6.73%
20-year period	0.51%	5.34%
10-year period	0.39%	4.51%

The figures listed above look at time periods fall within the range of January 1, 1986, to December 31, 2015. That means the study includes the crash of 1987 and the big bear markets of 2000 and 2008, but also the fierce bull market of the 1990's. The inclusion of these very significant market cycles and market swings perhaps best explain why the average investor is underperforming so badly: *there are too many temptations to try to time the market.*

It is clear that staying put in an equity or fixed income index would have generated much better results for the average investor. But, that's not how most investors behave. As emotional creatures of habit, investors tend to get too greedy during the good times and too fearful during the down times. The result is that investors move in-and-out of the market at the wrong times, leading to lackluster performance over time. In other words, investors "get in their own way" all too often.

Indeed, the primary reason investors tend to underperform, in my opinion, is simple: the average investor works without a disciplined system, and he/she allows emotions to drive investment decisions. Sometimes investors become overconfident and misjudge risk. Other times they latch onto a price target or think they've identified a pattern that isn't there. Whatever the case, the emotional decisions that result often lead to suboptimal investment outcomes. This is often referred to as the "behavior gap," which is the difference between the return on investment versus what an investor actually realizes.

This performance gap can be catastrophic to retirement planning. Compounded over 20 or 30 years, a percent or two in lost earnings can potentially amount to *hundreds of thousands of dollars of forgone earnings in an investment portfolio*. This opportunity cost is no small matter, especially for working year investors and retirees trying to grow and maintain a nest egg.

What to Do About This Underperformance

If the root of the problem is 'emotional decision-making' and the lack of a long-term disciplined approach, then a logical solution would be to hire a manager with a disciplined approach based on time-tested and research-driven methodologies. That is precisely what we bring to the table at Zacks Investment Management, and it's why we have a track record of strong results with among five of our strategies ranked in the top 7% of our respective investment strategy classes by Morningstar®. While we know we won't outperform the market every single quarter or year, we believe we have the patience and discipline to produce superior results over long stretches of time – and that's ultimately what matters most to investors.

Bottom Line for Investors

The performance of an investment portfolio, in my view, should be measured by how well it does over 10, 20, and 30-year periods – not over a quarter or a year. After all, it is the long-term results that are likely to matter most to your retirement and having your assets span generations, if that is your goal.

The average investor, as detailed by the study, has consistently fallen short of delivering the kind of results I believe are needed for long-term success. This is *not to say* that it cannot be done – of course, it can. But, the odds are stacked against many retail investors who lack the resources and *time* needed to consistently deliver results. That's why it makes good sense to partner with a professional.

-Mitch

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

Disclosure:

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