

Most Important Question in Investing

Conversations between newly introduced investors and advisors follow a predictable pattern. The advisor will ask important questions about the investor's background, goals and objectives. The investor will ask the advisor about his or her experience and views on a variety of topics.

I usually kick off these introductory conversations with the rather direct question, "What brings you here today?" I figure that, if someone took the trouble to make an appointment, they have a pretty good idea of why they did so. I like to get that reason out on the table right up front so we don't have to dance around it for too long.

After that first question, I too follow the time-tested process of asking and answering questions. While all of the questions and answers are important, I am always seeking the answer to the single most important question about investing. This is the one issue that often drives all others. This one simple question is,

"When do you want the money back?"

If I were allowed to ask only one question, that is the one I would ask. From there, I have already narrowed the potential investment strategies from dozens to only a few. While the question is simple to ask, investors find it hard to answer.

For example, people saving for retirement want the money back in small annual amounts, starting some time in the future and ending way, way out in the future. But if I ask, "So when do you want the money back?" they lock up. They sort of mutter and think and look at me blankly. The usual answer is, "I want it back whenever I decide I want it back."

This investor will acknowledge that the money needs to come back sometime out in the future, but they are quite reluctant to commit it to an investment strategy that will only deliver satisfying results if the money is left alone for a while.

I have given investors hypothetical choices. For example, imagine an investor who is not retiring for another 15 years, and is thinking about how to invest his IRA. The first hypothetical choice would be to put the money into an investment that will pay a guaranteed rate equal to *inflation plus 7%* per year for 10 years. This is a fantastical rate of return that equals the highest rate earned on stocks for any ten-year period we can examine. Note – this is hypothetical of course. I know of no such actual investments!

The catch is that the investor cannot touch the money for 10 years. He has to stick with the program, and cannot draw the money out of the investment to move it to something else.

Alternatively, I can offer an investment strategy that might or might not make money. It will probably pay somewhere between zero and 8% annualized, but will vary wildly from year to year and will suffer badly if inflation spikes. The upside is that he can liquidate this portfolio at any time with a phone call or a mouse click. He is free to change investments and pull out of this strategy at any time and take his money somewhere else.

People invariably choose the second option (which you might recognize as a stock portfolio). They just cannot wrap their brains around the idea of committing to a true long-term strategy. It reminds of a roommate I had in college. We could never get him to come out to any parties with us because he was always terrified that if he went to one party, he would be missing a better one somewhere else. So he stayed in his room watching TV.

The risk-reward relationship with which we are all familiar is more correctly stated as a time-reward relationship. The sooner you want your money back, the less you should expect to earn on it. This includes long-term savings accounts invested in short-term strategies. What is a short-term strategy? Well, besides money market funds and certificates of deposit, it also includes the investor that owns stock funds but changes them all the time because of an obsession with never missing a better party.

I wrote a column about a year ago in which I discussed the findings of an 18-year study of mutual fund investors. While the collective universe of stock mutual funds paid an annual return of over 11%, the actual investors in those funds only earned 2.6% because they kept shifting from one fund to another. They got short-term investment results despite employing the tools of a long-term strategy. They would have been better off just sticking with a money market fund.

If you don't need the money back for a long time, invest accordingly. You can still invest as safely and prudently as you desire, but just make sure that you have honestly answered the most important question in investing.