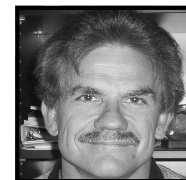
De Thomas Financial Corp

Editor: Tony De Thomasis, BSc, CFP, RFP
7620 Yonge St. # 200 Thornhill Ontario L4J 1V9

Contact; email invest@dethomasfinancial.com Tel 905 731 9800 Fax 905 731 9759



Avoiding The Four Major Investor Mistakes

The Four Biggest Mistakes

Go ahead...read the morning business newspaper, view CNN business channel every day, and read all the weekly business magazines that you want.

Unless you avoid these four major investment mistakes - plus understand the "herd instinct mentality," all this knowledge and information will not help you.

The Man Who Knows Too Much

Neurologist William Bernstein has some unorthodox ideas about what it takes to be a good investor. In 1990, Bernstein, a neurologist on the coast of Oregon, decided to cut his workload in half and devote his spare time to learning all he could about investing. The result is one of the great-do-it-yourself stories of personal finance.

According to Dr. William Bernstein, author of three books including the book "*The Four Pillars of Investing,"* most people will never make good investors. Dr. Bernstein established the advisory firm Efficient Frontier Advisors and today only accepts clients with assets of at least $10 million (he was also surprised to find *that when you write about finance, people ask you to manage their money,* he stated to CNNMoney staff writer Adiga).

How does Dr. Bernstein invest? Dr. Bernstein's firm makes up personal portfolios for clients, by building a portfolio to "fit" a client's risk-adjusted unique profile.

"Sounds simple enough but hardly," retorts Dr. Bernstein. In fact, this great-self taught investor doubts that most people will ever make good investors. Most investors lack the four skills that are absolutely essential for investment success.

First Skill Lacking: The Mathematics of Investing

The first mistake is that most will not admit that they don't understand that *"mathematics is the language of investing."*
For example; did you know that the odds an investment manager can beat the market over a 20 year period is documented to be less than 20%? The odds of your portfolio holding only top managers over a 20 year period are as follows:

- The odds of picking a top money manager is less than 20%.
- The odds of picking 2 top money managers is 4.0% (20% x 20%).
- The odds of picking 3 top money managers for your portfolio is less than one percent: 0.8% (20% x 20% x 20%).
- If you have a portfolio of 4 fund managers, the odds of having all four being a top money manager is only 0.16% (0.8% x 20%).

Read Warren Buffett's comments on this on page 4...

Second Skill: The History of Investing

The second mistake is not having a sense of investment history. Those that do not know the history of major financial events such as the Dutch Tulip craze of the 1660s, 1929 crash, rebuilding of Europe, 1973 oil crises, 1987 Black Monday, etc will crash and burn again, which is exactly what happened in the technology bubble of 2000.

Third Skill: Emotional Toughness

The third mistake is not sticking to a chosen strategy but jumping around with the "herd." The majority of people fail to execute the plan that they have chosen. The first sign of trouble, they panic and bail out of their strategy. We explain why we are hard-wired "to run" on page two.

Fourth: Independence

The final mistake is not realizing that investors are in a *"life and death struggle*" with the financial industry.

Brokers? Bernstein has written that they service clients "the same way Bonnie and Clyde serviced banks."

Mutual Fund Companies? Fund Marketing machines peddle whatever is hot: tech, oil-gas, income trusts, hedge funds, etc to attract as much in assets as they possibly can gather.

The business press? "There is a loose conspiracy between the financial media and the investment industry," he says. The business press only survives on investor's ignorance or their overconfidence that they can outsmart other investors (or the 45,000 professional money managers as of last count).

Conclusion

According to Dr. Bernstein, the chances of you having all four skills to succeed is less than 1%. Dr. Bernstein states that finance is a science, just like medicine. No doctor would ever dream of prescribing a drug without it first passing rigorous trials in such prestigious periodicals such as *The New England Journal of Medicine and Lancet.* Most physicians would not commence a treatment for so much as a cold without a good deal of statistical evidence to back it up.

Time Line of Investors

Are you like the majority of other investors frustrated by the inability to grasp key insights each day while reading/listening to the business news?
Here is some good news and some bad news.
The bad news is that you are not (in most probability), well designed to be a successful investor.

The good news, is that you share this trait with most every one else (but they won't admit to it). The investor time line chart below may help explain why the majority of investors are so frustrated with their investing skills.

Investor Time Line of Homo Sapiens

Event	When (years ago)	Time of Day
Homo sapiens appear	2,000,000	12:00 am
Mitochondial Eve	180,000	9:50 pm
Domesticated Homo Sapiens	20,000	11:46 pm
Hindu/Arabic numbering system	800	11:59.25 pm
Modern Finance Theory	40	11:59:58 pm

The *"time line"* shows that in terms of a 24 hour clock, Modern Finance Theory has only been around since 11.59:58 pm. What have you learned in the past two seconds of financial portfolio evolution? The point is clear; humans are not wired to rationally weigh investment risk and reward. The time line shows that the mind has been trained for "hunting and gathering" rather than the understanding of modern investment theories, which have only been around since 11.59.58.

You are still better suited to run like hell when you see a saber-toothed tiger than to weigh the risk and rewards as explained in modern finance theories that have been around the past 40 yrs. Changing our "human wired responses" takes more than two seconds. Can you now begin to understand the investor's problem?

The Herd Mentality Still Exists

Your mind is still strapped with the herd mentality thinking. Our ancestors (and the other mammals) realized that being part of the "herd" or of a "larger group" was a key to surviving. Think of the lone gazelle or the lone water bison vs a hungry lion - not good odds of survival is it? When investing, we still have the "herd thinking" as it is more comforting having company than being left alone to face the danger of the "investment world." The "herd" offers safety and confirmation that others are also doing it.

Remember your mother telling you *"if all your friends were to jump off a cliff would you follow?"* Unfortunately, in the investment world, the answer most often is yes.

Chances of Success

Do not confuse nature's "law of evolution" with "law of chance." By a fluke of evolution, someone will be the strongest or fastest in the country due to their unique genetic makeup. By chance, someone in the country will succeed with their investments or that someone in the country will win the lottery.

By evolution or by chance alone, there will always be a few people who are better suited to succeed in various enterprises based on their unique physical and/or mental makeup. This unique makeup allows a few to thrive in certain "endeavours." For example, the following people had certain unique attributes:

Name	Unique Endeavour
Wayne Gretzky	hockey
Babe Ruth	baseball
Pele	soccer
Galileo	science
Warren Buffet	investing

There is again good news and bad news. The good news is that while there are certain individuals that can excel in certain endeavours such as "investing," the bad news is that the skills needed are indeed unique and non-transferable.

You can read all of the business news and all of Berkshire Hathaway annual reports you want but you will not execute the ideas as successfully unless you had Mr. Buffet's "physical and mental" unique traits. You could no more be the next Warren Buffet than you could be the next great hockey player by reading Mr. Gretzky's memoirs and following his training techniques.

Your Dilemma:

Can you find the future Wayne Gretzky from today's crop of 45,000 world wide 10 year old hockey players?

Can you find the future Warren Buffet from today's crop of 45,000 world wide money managers?

We are sure that an investment genius does exist out there but the odds of finding that one person today is 1 in 45,000.

The Real Odds of Investment Success

According to documented data as far back a 1945, it is sad to report but less than 20% of money managers outperform their market average. Why? The professional money manager faces the same herd instinct as the rest of us do. After all, our brains are all wired the same way plus professional money managers run the risk of losing clients or worse, of getting fired if they do not follow the herd. Imagine a money manager making a bold statement that contradicts the majority and things do not go their way - their reputation would be in ruins and so would their career.

Most professional money managers take comfort in knowing that even if their picks miss out, most of the others in their peer group will too. So...they cannot be blamed for being a *"lone wolf."*

SUMMARY

IFA Canada uses science in their portfolios.

IFA Canada has developed twenty portfolios, and like Dr. Bernstein, IFA Canada treats investing like a science. In the 1960s, when computers finally had the ability to crunch huge amounts of research and numbers, data was complied that showed what returns and risk one could expect from various portfolios. Firms such as C.R.S.P. (Center for Research in Security Prices) were able to supply data from as far back as 1926. Professors such as Eugene Fama and Kenneth French started to study the data and came up with scientific studies and theories. Entrepreneurs like David Booth and Rex Sinquefield used the data and the scientific findings from these and other professors to create portfolios based on these scientific strategies.

Visit www.ifacanada.ca
IFA Canada, using data from C.R.S.P. studies (1926 - 2006), research and scientific conclusions from economic Nobel prize winning professors, strategies such as those created by Booth and Sinquefield, and in conjunction with www.ifa.com, has structured "twenty scientific portfolios" for Canadian investors.

Portfolios
IFA Canada portfolio strategies are the natural evolution of investing based on scientific research. For comparison purposes, we have selected three portfolios from the twenty portfolios built by IFA Canada to illustrate various investor risk-adjusted profiles. Compare the portfolios return-risk (std deviation) data to your current portfolio.

Returns to Dec 2006	Portfolio A	Your Portfolio
1 yr return	6.46%	
1 yr std dev.	2.72%	
3 yr return	5.40%	
3 yr std dev.	2.62%	
5 yr return	4.64%	
5 yr std dev.	2.55%	
10 yr return	4.85%	
10 yr std dev.	2.85%	
20 yr return	6.90%	
20 yr std dev.	3.28%	

Portfolio A
30% equity - 70% fixed income/real estate

Returns to Dec 2006	Portfolio B	Your Portfolio
1 yr return	11.58%	
1 yr std dev.	5.91%	
3 yr return	9.36%	
3 yr std dev.	5.32%	
5 yr return	6.75%	
5 yr std dev.	5.82%	
10 yr return	6.52%	
10 yr std dev.	6.28%	
20 yr return	8.21%	
20 yr std dev.	6.71%	

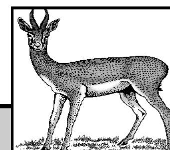
Portfolio B
50% equity - 50% fixed income/real estate

Returns to Dec 2006	Portfolio C	Your Portfolio
1 yr return	19.85%	
1 yr std dev.	11.73%	
3 yr return	16.52%	
3 yr std dev.	10.27%	
5 yr return	10.77%	
5 yr std dev.	11.83%	
10 yr return	8.65%	
10 yr std dev.	12.63%	
20 yr return	11.22%	
20 yr std dev.	12.55%	

Portfolio C
90% equity - 10% fixed income/real estate

Scary not being part of the herd, isn't it?

This chart compares the typical investment strategy used by the "herd' to the investment strategy based on the science of "Modern Investment Theories."



Choose Your Investment Strategy

	THE HERD INVESTMENT STRATEGY	THE SCIENTIFIC INVESTMENT STRATEGY
Objective	To beat other investors - either by luck or with skill.	To obtain return on a portfolio as selected by risk profiling.
Strategy	To read the papers, trade, seek out the best money managers, change style with the news.	Pure and consistent asset class diversification: the portfolio is based solely on risk profile of the investor.
Results	According to Dalbar research, the average investor return for the 20 yr period to Dec 2004 was 7.8%	Using DFA portfolios, the average return for the 20 year period to Dec 2004 was 13.3% (ifa.com data)
State of Mind	**Stressed, nervous, fearful, angry, depressed.**	**Relaxed.**
Taxes&Turnover	Both Extremely High	Both Extremely Low
The Herd	Currently about 90% use this strategy.	Currently about 10% use this strategy.
Proponents	Virtually all brokerage firms, mutual fund companies, financial press, and stock exchanges.	Nobel prize winners in finance, IFA, Warren Buffet, Dr. Bernstein, and Benjamin Graham (father of investing).
Investment Alternatives	RBC, CIBC, TD, Scotia, B2B, Chou, Sprott, Hirsch, Mackenzie, Quadrus, Sun Life, Manulife, Standard Life, London Life, Canada Life, Sceptre, Cundill, Fidelity, Templeton, Dynamic, AGF, CIG, AIC, AIM, ING, Acuity, Trimark, Putnam, AMBRO, SEI, Brandes, Empire, Trans, Northwest, Dynamic ...plus 4,500 other alternatives!	• Canadian large cap and small cap index • US large cap and small cap index • International large cap and small cap index • Emerging markets index • Fixed income / bond asset class index • Real estate, REITS asset class index • Portfolios tilted to value and small cap index

The various asset classes are all from independent third parties (such as banks, mutual fund companies, etc).

Individual Asset Class Performances to Dec 2006	2004	2005	2006	Since 2003
Canadian Core Index (only six mths in'04)	9.4%	21.1%	13.4%	19.0%
International Small Cap Index	18.6%	18.3%	15.4%	21.1%
International Large Value Index	15.5%	9.9%	23.7%	20.2%
US Small Cap Index	7.1%	0.6%	11.1%	8.0%
US Large Value Index	9.6%	7.3%	12.2%	13.6%
Mackenzie World Real Estate/REITs	24.1%	4.7%	34.8%	24.6%
Emerging Market Index	14.8%	30.2%	31.8%	26.8%
Premium Savings	2.90%	3.30%	3.8%	3.4%

Individual Sample Portfolios Equity / Fixed Income/Real Estate	2006	3 yrs	5 yrs	10 yrs	20 yrs
30 - 70 Risk Adjusted	6.46%	5.40%	4.64%	4.85%	6.90%
40 - 60 Risk Adjusted	9.87%	8.04%	6.06%	5.97%	7.79%
50 - 50 Risk Adjusted	11.58%	9.36%	6.75%	6.52%	8.21%
60 - 40 Risk Adjusted	13.28%	10.67%	7.43%	7.06%	8.63%
70 - 30 Risk Adjusted	15.84%	12.64%	8.45%	7.87%	9.22%
80 - 20 Risk Adjusted	17.55%	13.96%	9.11%	8.40%	9.61%
100 - 0 Risk Adjusted	19.86%	16.80%	10.96%	8.54%	11.49%

Commissions, trailing commissions, management fees and expenses all may be associated with mutual funds. Please read the prospectus before investing. The indicated rates of return are the historical annual compounded total returns including changes in (share or unit) value and reinvestment of all (dividends or distributions) and does (do) not take into account sales, redemption, distribution or optional charges or income taxes payable by any security holder that would have reduced returns. Mutual funds are not guaranteed, their values change frequently and past performance may not be repeated.

...continued from page one

"Investor disappointment is growing. Each investor has hired a professional but they are not getting any richer. What should they do? Of course hire more help. This help arrives in the form of Banker-Helpers and Advisor-Helpers. The befuddled investor welcomes this new type of advisor. By now, the investor realizes that they cannot pick the right stock nor the right professional stock picker. Why, might one ask, should they expect success in picking the right advisor? But this thought does not occur to the investor and the Helper is not going to suggest it to them. Investors now support three classes of expensive helpers, but they find their returns are getting worse and not better. "

Warren Buffett

C.R.S.P.

The Center for Research in Security Prices (CRSP), located in the center of the Chicago financial district, is an integral part of the University of Chicago's Graduate School of Business (GSB).

Founded in 1894, the GSB became an important resource for other academic institutions and corporations. Industry leaders often partnered with the school to explore and develop new ideas. One of these was Louis Engel, vice president at the firm then known as Merrill Lynch, Pierce, Fenner & Smith. In 1959, he inquired of Professor James H. Lorie as to whether investment performance in the stock market relative to other types of investments had been analyzed.
The answer was it had never been!

Professor Lorie proposed that Merrill Lynch provide funds for a project with the purpose of constructing the stock database. The work would involve gathering the prices and rates of return of all stocks listed and trading on the NYSE since 1926. The work would also include calculating rates of returns for those same stocks.
Thus with a grant of $300,000 from Merrill Lynch, the Center for Research in Security Prices (CRSP) was established in 1960.

The new capabilities offered by computers allowed the maintenance of accurate securities information over time, once the original set of data had been collected manually. Researchers could conduct analyses pertinent to their projects with a complete and accurate database.

Professors Lorie and Lawrence Fisher (former Associate Professor of Finance, Associate Director of CRSP and the originator of the structure of the CRSP Master File) collaborated on collecting and researching the accuracy of each piece of stock data. The stock market database, was completed in 1964.

Although the project didn't answer Mr. Engel's original question, it did allow for the *average rate of return to be measured for the first time*. Professors Lorie and Fisher subsequently published an article in the *Journal of Business* that stated the average rate of return on common stocks listed on the NYSE. Eighty percent (80%) of academic research in stock market and investment analysis uses CRSP data as a source due to the completeness and accuracy of the information.

Quote: Rex A. Sinquefield, chief investment officer and co-chair of Dimensional Fund Advisors Inc: "The entire field of finance has been changed and developed through that database."