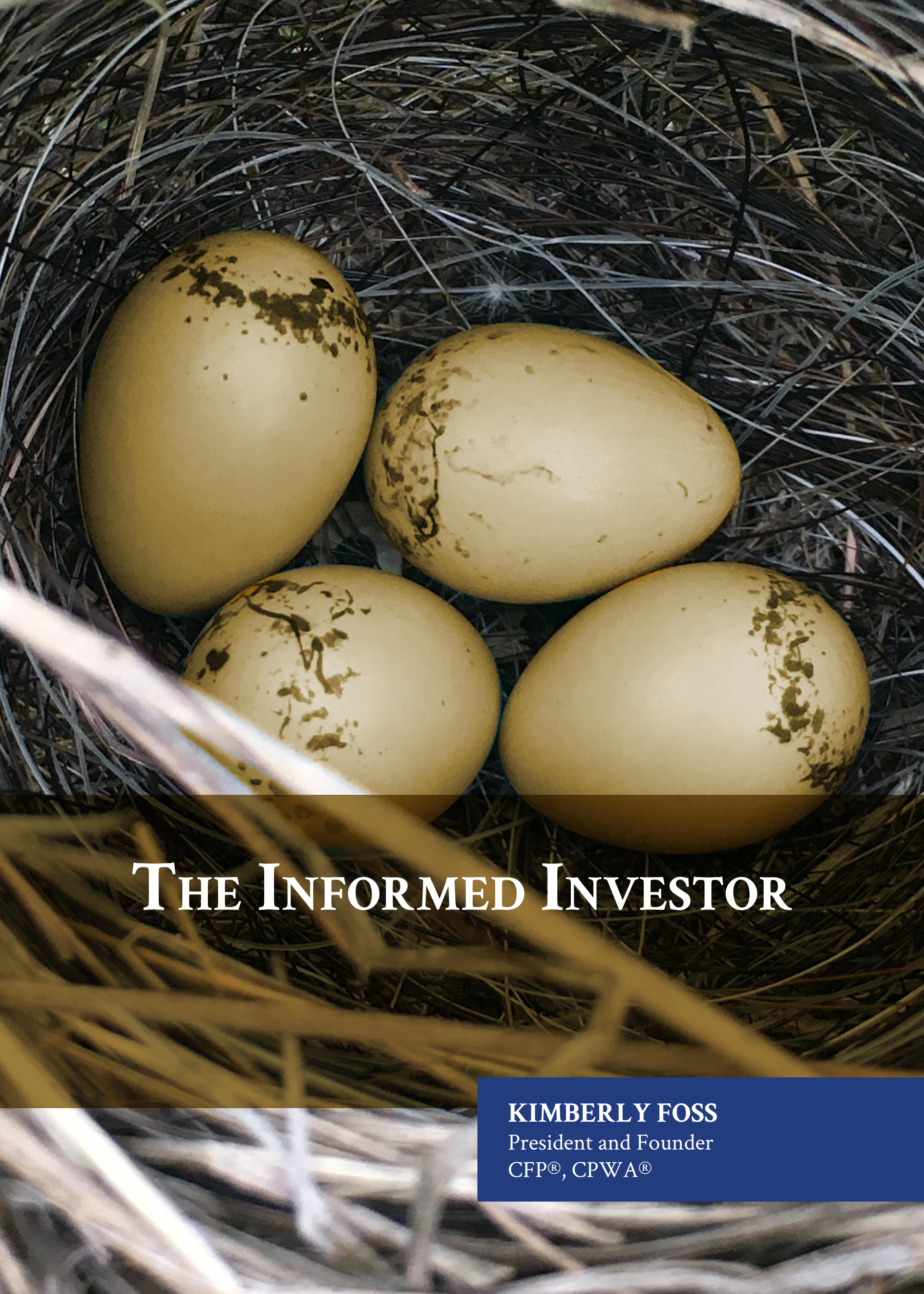


THE INFORMED INVESTOR

KIMBERLY FOSS
President and Founder
CFP®, CPWA®

There's an old joke about a farmer, talking to one of his neighbors at the local feed store. The neighbor asked how his cotton crop was doing, and the farmer replied, "I didn't plant cotton this year; I'm worried about the boll weevils." "Well," the neighbor replied, "then I guess you're about ready to start harvesting wheat." "No, I didn't plant wheat, either," the farmer said. "I'm worried about the army worms." A bit confused, the neighbor said, "Surely you've got your corn planted?" "Nope," the farmer said, "because I'm worried about a drought." Completely flummoxed, the neighbor said, "Aren't you going to make a crop of any kind, then?" The farmer said, "No, this year I decided to just play it safe."

The moral of this little story is perhaps obvious: For many aspects of life, deciding to do nothing can be the most dangerous decision of all. And yet, for so many individuals, the decision to take control of their finances and investments falls victim to the impulse to "play it safe," which often translates as either inaction or the maintenance of an unprofitable status quo. Most often, this indecision or lack of action stems from either fear or lack of knowledge: "The markets are risky, and I don't want to lose my money"; "I don't understand all that financial jargon"; "I don't trust investment salespeople."

The More You Know…

Most of us will do anything in our power to avoid making an important decision when we're unfamiliar with all the facts and possibilities. If you've ever left an auto mechanic feeling as if you might have paid too much for the repairs you were assured were "necessary," or if you've felt nervous about signing up for a new online service because you were afraid of your vital information leaking into the hands of an identity thief, you understand the apprehension that results from a lack of knowledge. Especially where our money is concerned, a lack of knowledge can easily lead to nervousness, anxiety, and a resulting avoidance of action—even when taking the right actions would put us on the path to meeting our financial goals.

The purpose of this white paper is to provide you with the important facts and principles that you need in order to be an informed investor. Informed investors know what they need to know about the financial markets and various investments. Rather than blindly trusting to promises made by a salesperson or refusing to take any action at all, informed investors carefully consider their alternatives, weighing them in light of current conditions and facts established by financial research. They understand their own situations and have formulated long-term strategies based on what is most important to them and those closest to them. When the facts are known and alternatives are presented, they make decisions informed by reliable data and in synch with their established strategy. And most important of all, they sleep well at night, knowing that whatever happens, their financial and investment plans are built to carry them past economic and market obstacles as well as capitalize on available opportunities.

Wouldn't you like to become an informed investor? To stop avoiding financial decisions and acquire the knowledge and habits of mind that will allow you to take charge instead of passively hoping for the best? To have greater peace of mind, knowing that you have a plan, a strategy, and the right pieces in place to win over the long term? If you answered "yes" to any of these questions, please keep reading. The journey to greater financial confidence starts with the first step, and it continues one principle at a time.

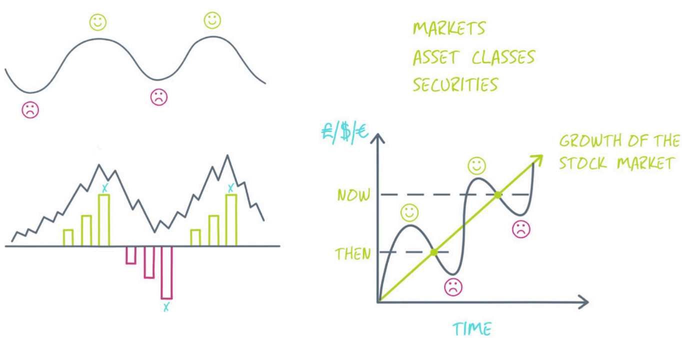
Understanding Your Emotions

One of the most foundational pieces of knowledge that you need to become an informed investor is self-understanding. As you enter the financial markets and the world of investing, that means having a grasp of your emotions and the part they play in your investing life.

Few topics arouse our emotions more quickly than our money. That makes sense, of course; money is crucial to almost everything we do. The proverb that says, "Money can't buy happiness" is true, but money can and does give us options that the lack of money cannot provide. And few things make us feel as helpless or vulnerable as not having enough money.

For this reason, as we learn about investing, we need to start by learning how emotions can affect our investing decisions. The following illustration will serve as a good place to start our discussion.

Managing the Emotions of Investing



SOURCE: Dimensional Fund Advisors, L.P.

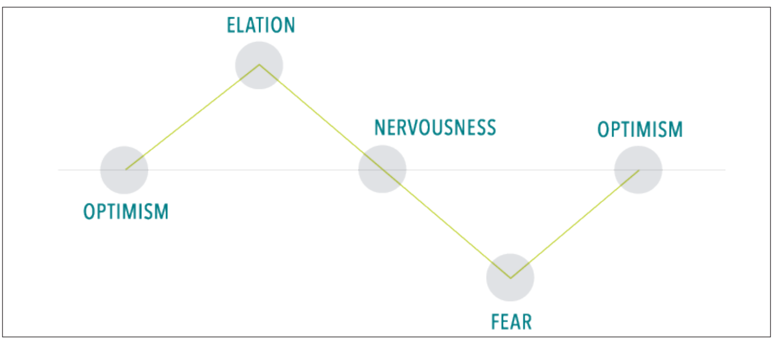
As the graphic illustrates, our emotions tend to follow a somewhat predictable cycle during the investment process. When prices are rising, investors tend to feel more positive emotions. If we buy a stock and its price goes up, we are pleased. But if the price falls for some reason, we begin to feel nervous or even apprehensive. This cycle of emotions makes up what is sometimes referred to as the "fear-greed cycle," and the associated feelings, if not the actual behavior, are familiar to anyone who has been involved in the stock market for any period of time.

The cycle begins with hopeful or optimistic feelings, as would-be investors learn about a particular investment opportunity and decide to buy in. Often, this initial decision has been reached as a result of favorable publicity in the financial media, or sometimes it is because the investment is being touted by a trusted friend or acquaintance. For whatever reason, the investor's fear of missing out on the opportunity (i.e., "greed") becomes stronger than the desire to avoid losing money (i.e., "fear"), and they purchase the asset.

If the price of the asset continues to rise, the investor begins to feel stronger positive emotions, peaking with elation at having made such a wise choice at "just the right time." By the time this happens, some amount of time has passed, and it may even be that many other individuals have made a similar buying decision.

But for every investment in the financial markets, the day will inevitably come when the price stops rising and even begins to fall. This is a normal part of the long-term cycle of markets and investments, but when less experienced investors begin to see this happen, they typically begin to experience emotions of nervousness. As the price of the asset sinks closer to the price that they initially paid for it, the nervousness increases, and when the price falls below their buy-in point, their emotions often begin to move from nervousness toward fear. If the feelings of fear become strong enough, investors will sell their investment, even at a loss, to halt their worries of losing even more money.

Too often, the point at which the novice investor's fear causes them to press the panic button and sell is just before the point at which the normal market cycle resumes its upward trajectory, lifting the price of the investment to or even beyond the investor's original purchase price. At some point, the investor may notice this and, motivated by fresh emotions of optimism, buy in again. And so, the cycle continues.



The Fear-Greed Cycle, or Reactive Investing.

SOURCE: Dimensional Fund Advisors, L.P.

As you can probably tell, investing decisions made on the basis of the fear-greed cycle often lead to a pattern of buying high and selling low—the opposite of successful investing. Over time, making investment decisions driven by emotional reactions to information—whether news in the financial media, a "hot tip" from a friend, or some other source—will usually prove harmful to long-term investment outcomes.

Filtering Out the Noise, Looking beyond the Headlines

To the detriment of less-informed investors, the financial media and other widespread sources of information are driven by creating headlines designed to capture your attention—and your emotions.

SOURCE: Dimensional Fund Advisors L.P.

Daily market news and commentary can challenge your emotional and investment discipline. Some messages stir anxiety about the future, while others tempt you to chase the latest investment fad. The point is that the job of headlines like these is not to educate or inform; instead, it is to provoke you to read the article (and, usually, to notice the accompanying advertisements). Making an investment decision driven by the emotions you experience from reading the headlines or their accompanying articles is typically not a sound method for building wealth. In fact, there's an old stock market saying: "By the time everybody knows it, it's too late." In other words, information that is widely enough known to be featured in the financial media—or on Facebook and Twitter—has probably already been factored into the prices of the assets that would be affected by it, and any decision made due to such information is based on relatively "old news." This is because modern, computer-driven markets are highly efficient at digesting and incorporating relevant information—a topic we will return to a bit later in this white paper.

The point is that when headlines unsettle you—either by exciting you at the prospect of the Next New Thing or dismaying you with news of the next market meltdown—consider the source and maintain a long term perspective. There's absolutely nothing wrong with reading the financial media in order to stay informed about the general condition of the markets and to notice the opinions of others, but using the latest news as a basis for day-to-day investment decisions will not typically lead to long-term success. Instead, it's better to filter out the noise and instead focus on investment principles that have been empirically tested and found reliable through peer-reviewed research.

But where can you find that kind of information? That is the next topic of our discussion.

Putting Financial Research to Work for You

Over the years, thousands of studies have been done on financial markets and investments; hundreds of thousands of words have been written about those studies. Financial theorists and analysts have read, argued over, and crunched the numbers over and over again. Given all that, what can the average investor hope to learn that is useful for answering the big question: "How can I invest in the markets with a reasonable hope of success?"

The good news is that there is a way to put financial research to work for you, and it doesn't require getting an advanced degree in accounting or investing. What it does require is heeding the advice and guidance of serious economic research backed by decades of study and review. This research and the investment philosophy formed around can be captured by only a few basic principles.

1. The financial markets price investments efficiently and almost instantaneously.

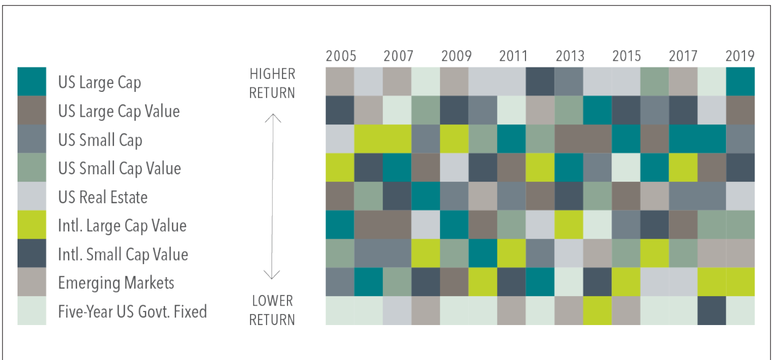
Think of it this way: if I set a jar of marbles on the counter and offer a prize for the person who can get closest to guessing the number of marbles in the jar, I might get a hundred or so guesses. One of those will be closest to the correct number. Several will be way off, either on the low side or the high side. But if I average all hundred guesses together, I will get a result that is far more likely to be close to the answer than any single guess.

The financial markets work in a similar way, but on a vastly larger and faster scale. As investments come to the markets, thousands of investors are making offers to buy, and thousands of others, at the same time, are making offers to sell. All of the buyers and sellers have access to the same information, and the collective result of all those buying and selling decisions is the market price of that investment.

A problem results if an investor tries to "outguess" the market. Or, as one financial researcher has said,

> *Many studies highlight the challenges and costs for investors looking for "mistakes" in prices. Academics have long documented that there's no compelling evidence to suggest that trying to find mistakes in markets has yielded better investment outcomes. This supports our belief that market prices are the best model we have for understanding expected returns (SOURCE: Dimensional Fund Advisors, L.P., "Implementing the Great Ideas in Finance," March 5, 2020).*

To understand the impossibility of outguessing the market, consider the following chart of annual returns from various markets, both US and international, over the past 15 years:



SOURCE: Dimensional Fund Advisors L.P.

This chart represents segments of both the US and international stock and bond markets, 2005–2019. Each color block represents a different market, and the blocks are arranged vertically for each year, with the best-performing market on top and the worst at the bottom.

As you can see, in 2005, the best-performing market in the world was the equities of emerging markets—stocks of companies in countries like India, Vietnam, or Russia. How likely is that any investor, at the beginning of 2005, would have been able to predict that this group of stocks would have been the star performers for that year? Probably not very likely. The next year, the US real estate market outperformed all other markets in the world. The year after, first place went to emerging markets again. And so on, for each year until 2019.

Viewed in this way, it becomes easier to understand how difficult it is for any individual investor to accurately pick the stock or even group of stocks that will have the highest returns in any given year. This fact is why investors should never get in the business of trying to outguess the markets, either by chasing a "hot stock" or by making assumptions about overall market direction during any particular period of time.

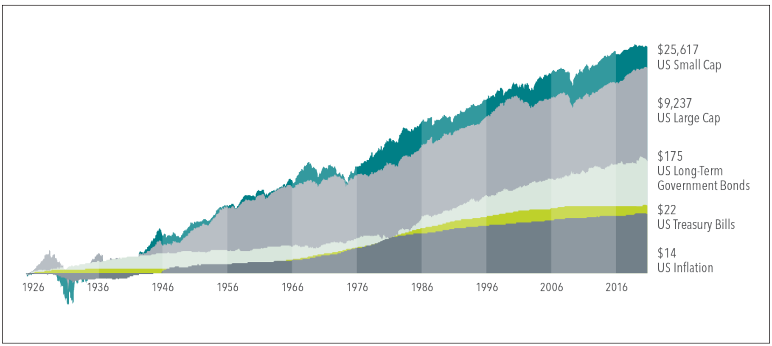
In other words, the first fundamental principle of informed investing is: Trust the markets to set the price, and don't try to outguess them.

2.Let the markets work for you; don't try to work against them.

If the markets are the most efficient pricing mechanism for investments, then you should put that efficiency to work for you. How? By allowing them to create wealth for you over the long term, as they have done for decades.

Most people look to the financial markets as their main investment avenue—and the good news is that the capital markets have rewarded long-term investors. The markets represent capitalism at work in the economy—and historically, free markets have provided a long-term return that has offset inflation.

This is documented in the growth of wealth graph, which shows monthly performance of various indices and inflation since 1926.



The financial markets have historically rewarded long-term investors.

SOURCE: Dimensional Fund Advisors LP.

Past performance is no guarantee of future results.

These indices represent different areas of the US financial markets, such as stocks and bonds. The data illustrates the beneficial role of stocks in creating real wealth over time. T-bills have barely covered inflation, while longer-term bonds have provided higher returns over inflation. US stock returns have far exceeded inflation and significantly outperformed bonds.

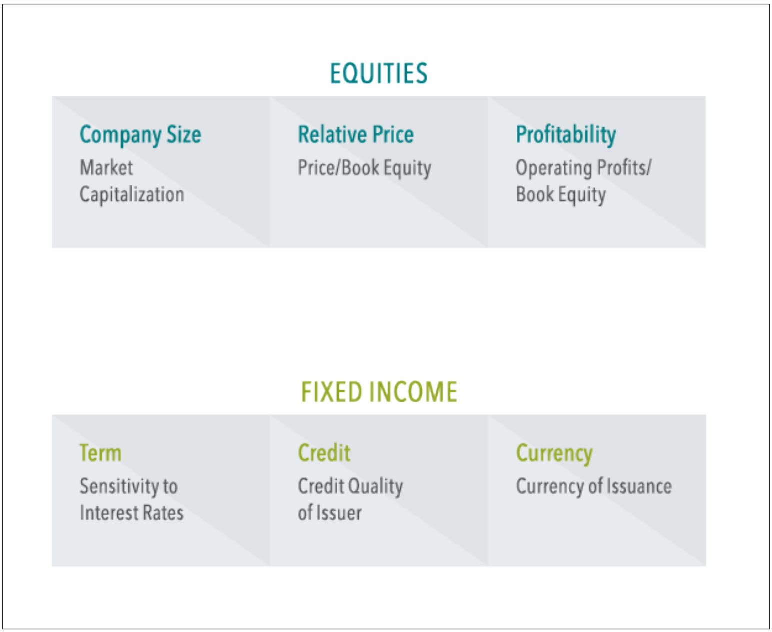
Keep in mind that there's risk and uncertainty in the markets. Historical results may not be repeated in the future. Nevertheless, as mentioned previously, the market is constantly pricing securities to reflect a positive expected return going forward. Otherwise, people would not invest their capital.

Informed investors, therefore, recognize this key principle: the financial markets tend to reward investors who are patient and have a long-term strategy.

3. Understand the dimensions that drive investment returns.

Rather than viewing the market universe in terms of individual stocks and bonds, informed investors think of markets along the dimensions of expected returns to identify broader areas or groups that have similar relevant characteristics.

This approach relies on academic research and internal testing to identify these dimensions, which point to differences in expected returns.



SOURCE: Dimensional Fund Advisors, L.P.

In the equity (stock) market, the dimensions are size (small capitalization or smaller companies vs. large capitalization or larger companies), relative price (value stocks that are inexpensive relative to the company's net worth vs. growth companies that are attractive because of how fast their revenues are increasing), and profitability (high vs. low). In the fixed income market, these dimensions are term (length of time to maturity), credit (highly creditworthy vs. less creditworthy), and currency (the country in which the debt was issued). The return differences between stocks and bonds can be considerably large, as can the return differences among a group of stocks or bonds.

To be considered a dimension, a factor must be sensible, backed by data over time and across markets, and cost-effective to capture in diversified portfolios. In a dimensions-based approach, capturing returns does not involve predicting which stocks, bonds, or market areas are going to outperform in the future. Rather, the goal is to hold well-diversified portfolios that emphasize dimensions of higher expected returns, control costs, and have low turnover.

By understanding and applying these dimensional drivers of investment returns, informed investors can position themselves to benefit from a broader range of market circumstances as assets spread across the various dimensions are impacted by the millions of daily individual pricing decisions made by buyers and sellers.

4. Diversification is your friend.

As we saw in the previous chart, it is impossible for anyone to consistently pick the best- or worst-performing investments during any given period. For this reason, informed investors practice smart diversification: they own assets in a broad array of different categories and with differing characteristics, knowing that at any given time one asset type may outperform the others.

For example, many equity investors concentrate their investments in their home stock market. They might consider their portfolio diversified when they choose a large group of US stocks or US mutual funds. In some cases, they may hold a small group of US securities.

SOURCE: Dimensional Fund Advisors L.P.

Yet, from a global perspective, limiting one's investment universe to a handful of stocks, or even one stock market, is a concentrated strategy with possible risk and return implications. Figure 7 offers a conceptual comparison of investing only in the US market, as represented by the S&P 500 Index, and structuring a globally diversified portfolio that holds assets in markets around the world, as represented by the MSCI All Country World Index (IMI). For the global portfolio, holding thousands of stocks across the world's developed and emerging market countries broadens one's investment universe.

A diversified portfolio should be structured to hold multiple asset classes that represent different market areas across the world. In the words of the experts at Dimensional Fund Advisors,

> *Over long periods of time, investors may benefit from consistent exposure in their portfolios to both US and non-US equities. While both asset classes offer the potential to earn positive expected returns in the long run, they may perform quite differently over short periods. While the performance of different countries and asset classes will vary over time, there is no reliable evidence that this performance can be predicted. An approach to equity investing that uses the global opportunity set available to investors can provide diversification benefits as well as potentially higher expected returns (SOURCE: Dimensional Fund Advisors L.P., "Why Should You Diversify?" April 1, 2020).*

The bottom line: Informed investors understand the value of diversification and put it work in their portfolios.

5. Focus on What You Can Control

This may be the most important principle of all for the informed investor. After all, there are so many events that can cause market prices to drop and rise that are beyond anyone's control: legislation, the outbreak of war, natural disasters, elections, and—as we now know all too well—pandemics. Any of these can cause gyrations in the financial markets, both positive and negative, and the only way an investor could prevent them from affecting the portfolio would involve the ability to see into the future.

Though most of us would never claim the gift of prophecy, too many investors attempt to use the crystal-ball approach: they think they can see what is about to happen, and they make investment decisions in an attempt to either chase windfall profits or to avoid financial disaster. Both attempts are usually counterproductive over the long term.

Here's what the researchers at Dimensional Fund Advisors L.P. have to say about trying to anticipate market movements:

> *History has shown there's no compelling or dependable way to forecast stock and bond movements… Rather than basing investment decisions on predictions of which way debt or equity markets are headed, a wiser strategy may be to hold a range of investments that focus on systematic and robust drivers of potential returns… Last year, this year, next year—that approach is a timeless one (SOURCE: Dimensional Fund Advisors L.P., "Hindsight Is 20/20: Foresight Isn't," December 2, 2019).*

Focus on What You Can Control

- Create an investment plan to fit your needs and risk tolerance.
- Structure a portfolio along the dimensions of expected returns.
- Diversify globally.
- Manage expenses, turnover, and taxes.
- Stay disciplined through market dips and swings.

SOURCE: Dimensional Fund Advisors L.P.

In other words, instead of trying to guess what's about to happen—whether the stock market is about to drop or go higher; whether it's better to invest in the computer industry or airlines; whether interest rates are about to go higher or lower—an informed investor will recognize the value of holding a portfolio of well-diversified assets that are distributed in a way that will benefit from the various dimensions of returns and are designed to align with the investor's tolerance for risk and stage of life. When investors concentrate on what they can control—having the right mix of assets, aligning their holdings with their risk preference, and maintaining a long-term strategy built on their most important goals and priorities—they can relax and allow their investments to do what they're supposed to do: benefit over the long term from the efficiency of the markets. Rather than anxiously following each day's headlines and trying to puzzle out the possible effects on their investments, informed investors build diversified portfolios of quality holdings that match their investment style, and they permit them to function as they were intended.

Becoming an Informed Investor

Investment executive Jim Parker compares launching a financial plan to setting out on a voyage:

> *Embarking on a financial plan is like sailing around the world. The voyage won't always go to plan, and there'll be rough seas. But the odds of reaching your destination increase greatly if you are prepared, flexible, patient, and well-advised.*
>
> *A mistake many inexperienced sailors make is not having a plan at all. They embark without a clear sense of their destination. And once they do decide, they often find themselves lost at sea in the wrong boat with inadequate provisions.*
>
> *Likewise, in planning an investment journey, you need to decide on your goal. A first step might be to consider whether the goal is realistic and achievable. For instance, while you may long to retire in the south of France, you may not be prepared to sacrifice your needs today to satisfy that distant desire.*
> *Once you are set on a realistic destination, you*

> *need to ensure you have the right portfolio to get you there. Have you planned for multiple contingencies? What degree of "bad weather" can your plan withstand along the way?*
>
> *Key to a successful voyage is a good navigator. A trusted advisor is like that, regularly taking coordinates and making adjustments, if necessary. If your circumstances change, the advisor may suggest you replot your course.*
>
> *As with the weather at sea, markets can be unpredictable. A sudden squall can whip up waves of volatility, tides can shift, and strong currents can threaten to blow you off course. Like a seasoned sailor, an experienced advisor will work with the conditions (SOURCE: Jim Parker, "Sailing with the Tides," Dimensional Fund Advisors L.P., March 2018).*

Along with foundational steps like matching your plan with your long-term goals and utilizing appropriate diversification, Parker's image suggests the importance of working with a professional, certified financial advisor—a seasoned "navigator" who can help you keep your financial vessel trimmed properly and running before the favorable breezes. Indeed, finding the right advisor is a crucial step for anyone who aspires to become an informed investor.

The Right Advisor

A certified, fiduciary financial planner is duty-bound to place the client's interest foremost in all interactions. That means that they will not offer you investment advice based on the size of a commission or some other benefit to the advisor. Instead, you should expect professional, dependable advice offered in the context of a relationship where all fees or other costs are fully disclosed in writing and in advance. You should expect that all advice or suggested courses of action will be undertaken for your best interest, and you should expect that the advisor gives you personalized attention and clear, jargon-free answers to any questions you may have. The right advisor will spend much of their time listening to you in order to help you create a financial plan built on a strategy that is designed around your unique preferences, plans, and goals. The advisor will work with you to create a plan that:

- Fits your needs and risk tolerance;
- Structures a portfolio along the dimensions of expected returns;
- Diversifies globally where possible;
- Efficiently manages expenses, asset turnover, and taxes;
- Stays disciplined through market dips and swings.

Working with your advisor, you can prepare yourself to move into the world of investing by asking yourself the "big questions" that all informed investors must answer for themselves:

- What are my long-term goals?
- Am I prepared for retirement?
- How much risk am I prepared to tolerate?
- What is most important to me?
- What impact will my financial plan have on my family?

As you reflect on the major themes of your life and future, you may develop additional questions for reflection. Your advisor can assist you in working through these questions and their implications for your long-term financial plan and strategy. From that point on, every recommendation made by your advisor will be directed at supporting the answers to your questions, moving you forward toward a more prosperous and worry-free financial future.

Asking the Right Questions

As you move farther along the path to being an informed investor, you will no doubt face other questions. In closing this discussion, let's look at a few of these and consider some answers that could prove helpful in your ongoing financial education.

1. What sort of competition do I face as an investor?

The market is an effective information-processing machine. As we have already noted, millions of market participants buy and sell securities every day, and the real-time information they bring helps set prices. This means competition is stiff, and trying to outguess market prices is difficult for anyone, even professional money managers. This is good news for investors, though. Rather than basing an investment strategy on trying to find securities that are priced "incorrectly," investors can instead rely on the information in market prices to help build their portfolios.

2. What are my chances of picking an investment fund that survives and outperforms?

Flip a coin, and your odds of getting heads or tails are 50/50. Historically, the odds of selecting an investment fund that was still around 20 years later are about the same. Regarding outperformance, the odds are worse. The market's pricing power works against fund managers who try to outperform through stock picking or market timing. One needn't look further than real-world results to see this. Based on research, only 22% of US equity mutual funds and 10% of fixed income funds have survived and outperformed their benchmarks over the past 20 years

(SOURCE: Mutual Fund Landscape 2020, Dimensional Fund Advisors L.P. Past performance is no guarantee of future results).

3. If I choose a fund because of strong past performance, does that mean it will do well in the future?

Some investors select mutual funds based on past returns. However, research shows that most funds in the top quartile of previous five-year returns did not maintain a top-quartile ranking in the following five years. In other words, past performance offers little insight into a fund's future returns.

4. Do I have to outsmart the market to be a successful investor?

Financial markets have rewarded long-term investors. People expect a positive return on the capital they invest, and historically, the equity and bond markets have provided growth of wealth that has more than offset inflation. Instead of fighting markets, let them work for you.

5. So, what should I be doing?

Work closely with a financial advisor who can offer expertise and guidance to help you focus on actions that add value. Focusing on what you can control can lead to a better investment experience.

Conclusion

Though the world of financial markets and investing can seem intimidating to the newcomer, history has shown again and again that a disciplined, structured approach can provide the best opportunity for building a secure future. Rather than avoiding what seems complicated or unfamiliar, you can choose to learn, grow, and develop the understandings that will make you an informed investor: someone who has decided to take greater control over their financial destiny.

To be sure, the financial markets can be a source of unexpected events, both good and bad. But over time, those who have remained patient, disciplined, and committed to a long-term strategy have generally benefited greatly.

Having the right advisor can make all the difference. A professional, certified, fiduciary financial planner can become your traveling companion: a dependable guide on the journey toward becoming an informed investor.

About the Author

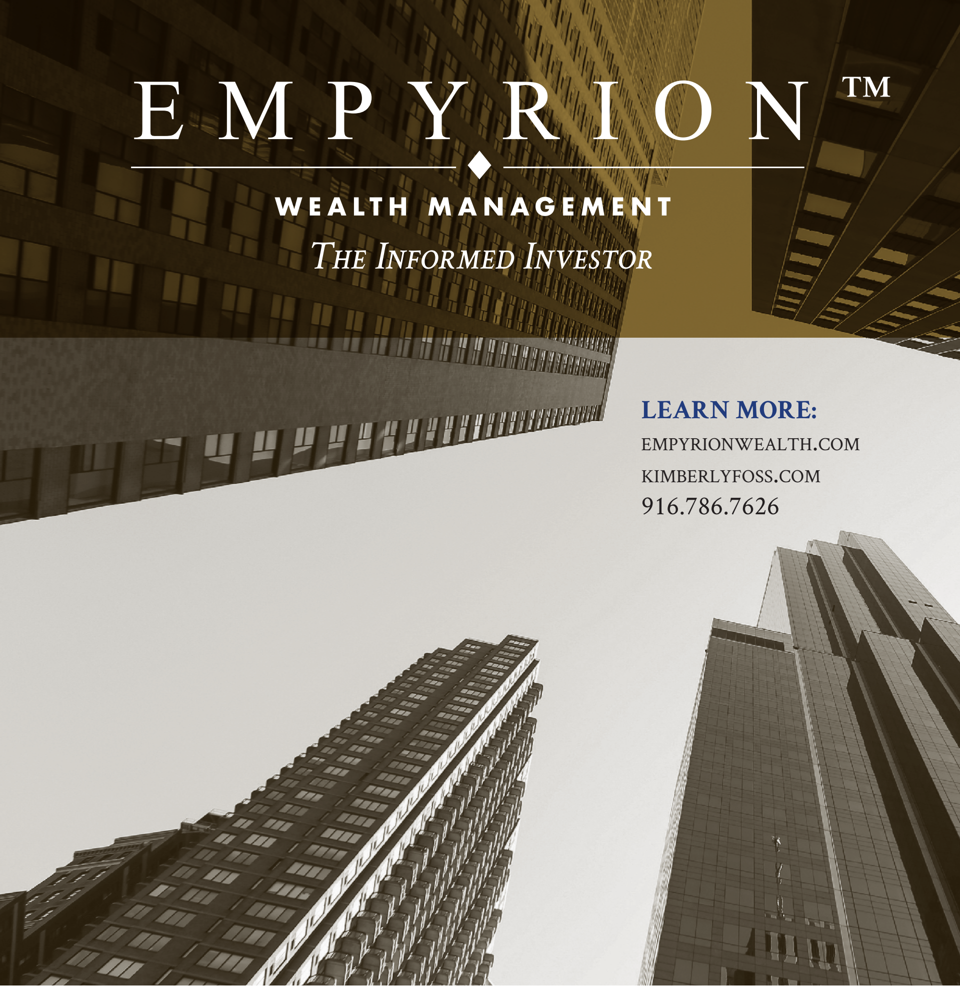
I was born and raised in Auburn, California, a town founded in 1849 during the gold rush. One of Auburn's original settlers was my great-great-grandfather, Daniel Austin Rice, the first Wells Fargo agent in the greater Sacramento Valley. A career in finance always seemed to be written in the stars for me.

But it was a dream that was hard to come by. I grew up the youngest of six children from humble means. We didn't have much, but one of the things my parents gave me in abundance was the ability to dream.

In order to achieve my dreams, I learned how to believe in myself. That belief landed me a job at Merrill Lynch post-college, where I was the youngest female account executive at the time. It drove me to leave the commission-driven environment of a stock brokerage firm to establish Empyrion Wealth Management. And it led me to write my book, "Wealthy by Design: A 5-Step Plan for Financial Security," which made it to #7 on The New York Times Bestsellers List.

It all comes down to the power of choice — and my life's work is to give that power to my clients, which include affluent family stewards, women in transition, and thriving retirees. As a fiduciary, I strongly believe in putting people over profit and service above self. My sole priority is to provide my clients with the independent advice, tools, and analysis they need to make the best financial decisions for themselves and their families. Backed by a research-driven, disciplined, and diversified investment philosophy, I'm committed to guiding my clients to new levels of financial abundance and security, so they can soar farther in life than they ever dreamed possible.

In addition to my work as a financial advisor, I'm also proud to be one of the industry's leading personal financial experts and thought leaders. I frequently share my expertise on the markets, financial planning, and investing with some of the nation's most reputable media outlets, including The Today Show, Good Morning America, CNBC, Forbes, The Wall Street Journal, Fox News, Fox Business, MSN Money, Investor's Business Daily, and U.S. News & World Report.



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