For individual investors, risk-free investment money is fantasy money

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*Summary: Investments with low risk and high returns are just fantasies. No "risk-free" investment money is consistently and reliably available to individuals. Luck dominates skill in the securities markets. Clever investment selection is vastly over-hyped, and only the promoters tend to benefit. On average over long periods, investors get paid risk premiums, because they put their money at risk. If they control their costs, they get to keep most of these risk premiums.*Securities markets pay risk premiums and nothing more. While risk premiums that have been paid historically on asset classes have been highly variable and unpredictable, long-term averages demonstrate their existence. (See: What have average investment asset class risk premiums been over long periods? and How stable have common stock equity risk premiums been over time?)In general, you should expect compensation only for some of the investment risks that you might bear. An optimal investment strategy is one that attempts to capture market risk premiums and to avoid the unnecessary and unproductive investment risks associated with individual securities. Someone will capture the risk premiums that the securities markets will pay. It might as well be you. (See: Asset class investment risk premiums -- your reward for taking investment risk)Suboptimal strategies are more likely to give these market risk premiums to someone else. Variations in returns surrounding the market return are largely a matter of luck. The more active an investment strategy is, then the wider the expected performance variation will tend to be. Competitive securities markets are real-time auction markets that make many smart people just average, and luck dominates skill. (See: Introduction to investment valuation and securities risk)To believe that the securities markets will pay you more means that the securities markets will pay less to someone else. There is no magic money. Every ‘beat-the-market’ notion requires a patsy. Are you really likely to win consistently over the long term, because of a clever security selection method, a hot sector rotation strategy, or buying companies reported prominently in the media? How can you consistently win in these securities auction markets, when future asset values are fundamentally unknowable and your strategies duplicate those of so many others?When luck overwhelms skill in investing, each individual needs to assess realistically whether he is likely to be among that very small minority who might possibly have superior investment management skill. Recall the saying from gambling: “If you look around the poker table, and you cannot identify the sucker, then it is you.” If there is such a thing as easy investment money, it is the money that naive individual investors keep giving and giving to more sophisticated professional investors through excessive investment fees and expenses. Many investors continually squander a significant portion of their returns by naively overpaying to those who promise superior returns, but who will not deliver. (See: Excessive investment costs are a huge problem for individual investors) The more active an investment strategy is, then the higher the associated investment costs tend to be. Higher variability of outcomes and higher costs are a recipe for both missing and under-achieving your goals. In addition, because of the higher taxes associated with more active strategies, your net performance is likely to be even lower.

Is it time for you to get off your personal investment hamster wheel and think more clearly about your lifetime investment strategy? If so, sign up to our RSS link in the side column and stay tuned for more rational information about personal financial planning and investing.

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