Special 250th Edition

April 2018

Mistakes that made us better investors

Introduction

"Regrets, I've had a few, But then again, Too few to mention,
I did what I had to do, And saw it through without exemption,
I planned each charted course, Each careful step along the byway,
And more, much more than this, I did it my way."

My Way, made famous by Frank Sinatra. © WARNER CHAPPELL MUSIC

Special Edition 250 includes over 30 market experts sharing a mistake that made them better investors.

Since Edition 1 of Cuffelinks, we have focussed on independent expert insights from high-profile finance professionals to deliver useful ideas to our community, now over 35,000 strong.

It's an important time to learn these lessons, as the 88-year-old founder of Vanguard, Jack Bogle, recently said in a CNBC interview:

"I have never seen a market this volatile to this extent in my career. Now that's only 66 years, so I shouldn't make too much of it."

We had a fantastic response from people we approached, but something new happened this time. Disappointingly, some fund managers were prevented from offering a response by their legal and compliance team. It's a sad state of affairs when a fund manager is unable to admit a mistake, as we're all supposed to learn from them. The question we asked was:

"What is an enduring investment lesson you learned from making a mistake?"

We also had responses asking what a 'mistake' really is, such as:

"What is a mistake in investing? Too often managers admit to mistakes (that reveals their deep humility) that weren't mistakes; rather the market went against them. As in bridge, you can make excellent decisions with rotten outcomes and rotten decisions with excellent outcomes."

One famous local fund manager wrote that **identifying a mistake can relieve stress**:

"Insights from past failures can help boost performance on a new task – and this study is the first, as far as I know, to explain why. The researchers report that writing critically about past setbacks leads to lower levels of the 'stress' hormone, cortisol, and more careful choices when faced with a new stressful task, resulting in improved performance. The study, published in the journal Frontiers in Behavioral Neuroscience, is the first demonstration that writing and thinking deeply about a past failure improves the body's response to stress and enhances performance on a new task."

Another was more skeptical:

"The harsh truth is that I don't believe any investor really learns from their mistakes in any meaningful way. By this I mean we can easily avoid investing in the same dud company, but that doesn't stop us investing in other dud companies. We can then develop personal heuristics that steer us away from all companies that have similar traits to the dud one we lost money on, only to find out that some of them turn out to be great investments. ***The problem of course is that history never exactly repeats.***

The reasons we make mistakes can usually find their roots in the human foibles we learn about in behavioural finance (anchoring, confirmation bias, recency bias, etc), and because we are human we keep making them. And the problem with the behavioural finance work is that it's a very good descriptor of why we have stuffed up in the past, but offers little by way of prescription for future success. I reckon the biggest mistakes we are likely to make comes from over-confidence."

Investors learn from previous experiences, whether or not they are considered mistakes at the time, and sharing the lessons from market professionals may help our readers.

Graham Hand

Managing Editor

Cuffelinks

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Anton Tagliaferro, Investors Mutual

As a young man in the 1980's, I was drawn to the stock market as it was always in the news. The Australian dollar had just been floated, the stock market was booming, and people like Alan Bond, Christopher Skase and Larry Adler were being idolised in the media as financial wizards. I became caught up in the hype of these 'hot' entrepreneurial stocks and believed that the stock market was an exciting and easy place to make money.

Everything changed in October 1987, when the market crashed by over 25% in one day. The lesson I learnt during this harsh introduction was to always buy good quality stocks that I understand. This lesson spawned the mantra that I have used throughout my investing career to always seek and buy companies with a competitive advantage, recurring earnings, run by capable management that can grow, at a reasonable price. This is my definition of quality and has served as the IML investment philosophy since 1998.

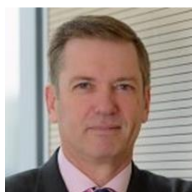
Buying and holding good quality companies that you understand means that in a stock market downturn you are less likely to panic and sell than those who hold poor quality, speculative stocks, or stocks they simply do not understand.

While almost every stock declines in a downturn, good quality companies will recover to fight another day, while speculative companies almost never recover and many end up trading at fractions of their boom prices.

As I have learnt and continue to preach: the stock market is an excellent place for the patient to make money slowly, or an even better place for the reckless to lose money quickly.

There is no recipe for success in the stock market but holding a portfolio of quality stocks removes many of the unwanted surprises that are part of investing in the stock market.

Paul Moore, PM Capital



The reality is that good ideas are hard to find, so if you come across a genuinely good idea, you want to keep it as long as possible.

I learnt that from a stock that provided me with a significant return. In 1998, I found a US-based semiconductor company called Analog Devices. Within six months, I'd made 100%. I thought I was a genius, but I also thought it had run hard, so I sold it.

Unfortunately, I wasn't such a genius as it then went up another 400%, so it was one of my biggest mistakes. The crux of the matter comes down to your original investment thesis and why you want to own that stock over time. I was distracted by a short-term gain and probably because of shortcuts in my background research. There is always a temptation to rotate your capital into the next new idea, but as long as it's providing a satisfactory return, you should continue to hold it.

Justin Wood, Vinva Investment Management

On 25 May 1988, it was announced that superannuation funds would become subject to tax. The value of franking credits to this group of investors went from zero to something approaching cash dividends. Share prices rose 10% that month with NAB, ANZ, and WBC averaging 19% gains. On 13 March 2018, Bill Shorten announced that if Labor won government, excess franking credits would not be refunded to some investors. The value of franking credits to them would fall to zero.

I reasoned that this should have a smaller and almost immediate negative impact on high yield stocks and purchased some short dated put options. *When making my own investment decisions I often underestimate unexpected factors or noise*.

The share prices of the big four banks fell only 0.3% the day of the tax announcement. Fortuitously (for me), bad news from the Banking Royal Commission over the next seven days resulted in further 2.2% fall by the expiry of the options and then a global market sell down over the next two days resulted in another 2.9% fall! Looking back, I was lucky on this occasion other factors enhanced, not reversed, my predictions, but it's easy to be fooled by randomness. But luck evens out over time.

The lesson for me is to be aware of complexity and randomness. Multi-factor strategies or multiple-manager strategies will generally offer higher performance consistency.

Warren Bird, Uniting Financial Services

At the end of one of the most successful years of my career, 1997, I made an investment decision that was the beginning of my passion for diversification of risk.

We put 5% of the active risk of our fund into a security that seemed like a great deal. Rated BBB, at an attractive yield, it was our largest single corporate bond exposure. It tracked fine in early 1998, but then corporate bonds started coming under pressure. We assessed that our security was less sound than we'd originally thought and decided to sell it.

Just as well. A few weeks later, this security had sold off enough that on its own it would have wiped out the value added by all other decisions over the previous year. Even when corporate bonds generally started to recover, this asset remained 'on the nose' in the market.

I determined that no one security would ever put my portfolios at risk to that extent again. That lesson proved invaluable when, 10 years later, the GFC put much greater pressure on corporate bonds. We had some troubled assets, but none threatened to undermine our whole portfolio the way that earlier purchase had done.

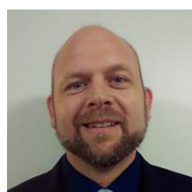
Phil Ruthven, IBISWorld

My most important and 'near-death' experience was in 1987 when I was in the midst of an unlisted IPO for my company. We had been promised nearly $12 million for a $10 million float, and had consequently committed over $8 million of that to the acquisition of new businesses, staff, and equipment. The sudden collapse of the stock market in October, which ironically I thought would happen early in 1988, saw us raise only $4.5 million.

We struggled for two years and were saved by a new investor making up the shortfall equity. The lesson indelibly stamped on my brain since, has been "don't count your chickens until they are hatched"! A very old adage.

As luck would have it, a recession in 1991 saw our major equity holder needing to sell out, and I was able to fully privatise the company with funding from the ANZ. That company, IBISWorld, is now the world's largest online marketing and industry information provider, operating in 10 nations including the USA, China, UK, Germany, and others.

Tony Hansen, EGP Capital

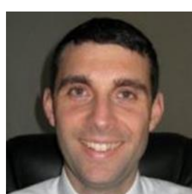


Two mistakes I think others might benefit from are:

1. The most dangerous thing for a business is leverage. Debt falling due at an inopportune time is the one thing that can devastate an otherwise sound business. An example that caused some havoc for EGP a few years ago was NRW Holdings (ASX:NWH), which, alongside a general decline in mining services, got into a major contract dispute while carrying a lot of debt. The shares fell from around $1 to around 5c in pretty short order. The experience is etched into our consciousness.

2. Don't borrow someone else's conviction about an investment. Fortunately, we made this mistake more often when our capital base was smaller. We are now incredibly pedantic about ensuring that no matter how much we are impressed by a smart investor and their ideas, we buy a stock because we've developed our own conviction based on our own research and due diligence.

Jonathan Rochford, Narrow Road Capital



My worst investment mistake was buying shares in a mining services company many years ago. It had a good strategic position, but I replaced thorough due diligence with assumptions about how it would perform. It was also outside of my area of expertise. As Mark Twain said: *"It ain't what you don't know that gets you into trouble. It's what you know for sure that just ain't so."*

We live in a world where management and general expertise is increasingly valued more than technical expertise. In managing money, a little knowledge when combined with hubris, is far more dangerous than no expertise. The funds management industry is finally recognising this reality. Boutiques that deliver outperformance at a reasonable cost are doing well. Passive funds with no expertise but very low fees are doing well. Generalists that deliver no outperformance and charge high fees are dying.

Peter Thornhill, Motivated Money

How painful to open old wounds! The fact that it wasn't one mistake but many merely increases the pain.

It stemmed from mindless comments about 'investing' that were repeated over and over. "You don't make a profit until you sell" would top the list. The fact that buying and selling has nothing to do with investing should have provided the first warning to ignore this.

Add to this the constant reminder from your online broker that you are overweight particular holdings, then add a touch of human emotion, and the trap is set.

The fear for most is that the share you buy goes bust and you lose your money. However, without fail, the greatest mistakes have been my sell decisions. There is a thing called opportunity cost.

For various reasons I have sold some, or occasionally, all my holdings in Cochlear, Commonwealth Serum Laboratories, Credit Corp, etc. The invitation to participate in this 250th Special Edition has both encouraged me to go back and do the sums, and the results scared me.

Let me quantify it: The total amount lost because of sales made over 20 years is $2.7 million. To add insult to injury, the dividends lost because of the sales would increase that amount substantially. The only mitigating factor was that the cash was recycled into further investments.

Don Ezra, Retirement expert and author

I was lucky. My lesson caused shame rather than a loss.

I hadn't calculated my 'personal funded ratio' for many years, as the last time (right after I retired) it was embarrassingly well below 100%. I was shamed into recalibration by the need to write a piece for the London FT, who asked their columnists about the most important thing they had left undone.

To my astonishment, the ratio now exceeded 100%. How on earth? The explanation had never occurred to me. I had moved from the US to Canada, but had left my assets (a global equity index fund) in US dollars. The collapse of the Canadian dollar (which often mirrors the Australian dollar) meant that, relative to C$ spending needs, my assets suddenly supported much more.

I did the usual regret minimisation and promptly hedged half the exposure, essentially locking in half the gain. Thank goodness. Without the shaming, I'd never have guessed – or taken action.

A more severe lesson from a friend. After the GFC, he cashed in his equities. The time has never felt exactly right to go back in. He's still in cash. Satisfice, don't seek perfection.

(Editor note: A 'personal funded ratio' calculates progress towards a goal. For example, it is a fraction where the current value of assets is divided by the goal).

Daniel Reyes, Vanguard

I learned one of the greatest investment lessons early in my career.

As a 20-year-old intern, I worked hard to save up a modest sum of money to invest. Doing what countless others do when considering financial matters, I sought the advice of a trusted family member who suggested investing in a tech stock they believed would provide a great return for me.

So that's what I did, every cent I owned (which admittedly wasn't much) went into that one share as I dreamed of doubling, tripling my money, or more …

I subsequently lost all of my investment when the stock tanked, and boy did I learn my lesson the hard way. But in the end, it was a really valuable exercise and I feel very fortunate I gained that knowledge then rather than gambling my retirement fund or a more substantial sum later on.

It may not always seem intuitive, and may not be what your family or friends like to discuss at the BBQ, but balance and diversification are the most powerful tools you can employ to protect your portfolio against volatility and the inevitable ups and downs of the share market.

We spend a lot of time at Vanguard trying to ensure investors are well informed about the importance of good asset allocation - it's a cliché, but you really can't put all your eggs in one basket and expect to just get lucky.

Shane Oliver, AMP Capital

My biggest mistake as an investor was in a global technology fund at the peak of the technology bubble in early 2000, thinking IT would revolutionise the way we live, that tech stocks were the best way to take advantage of it, and that their excessive valuations would be irrelevant in the face of the revolution just around the corner. Heard it all before and will hear it all again - Bitcoin anyone?

Tech stocks plunged 80% or so over the next 2.5 years, and so did the value of my investment.

IT did revolutionise the world in even more ways that many envisaged back then. But by 2000, too many investors had jumped on board and the benefits it would provide had been more than factored into share prices.

The enduring lessons to me were threefold. First, valuations matter a lot, even when something revolutionary is underway. Second, the crowd is a poor guide to what makes a good investment and in fact, it's best to do the opposite to what the crowd is raving on about. I should have been buying resources shares back then! Third, just because a big theme is underway supporting a sector, it does not necessarily mean that it will be the current high-flying firms in that sector which will benefit. Amazon figured highly in the tech boom but the other big tech stocks of today - Facebook, Apple, Netscape, and Google - did not.

Alex Denham, Focus Wealth Advisers

I made the mistake once of trusting an adviser too much (I won't mention which profession, it's not relevant to the story). It wasn't my area of expertise and that was why I had an adviser. I asked the relevant questions regarding their advice, and they had answers - long, detailed, technical answers – which made me believe they knew what they were talking about.

They were wrong, and I paid dearly for it for years afterwards. I found out later that there was an ongoing history of their advice being incorrect.

The enduring lesson being: Don't blindly trust someone because they sound like an expert. Check them out – a simple google search would have revealed some background on this person that would have saved me a lot of heartache.

David Bell, Mine Super

During the great quant equity meltdown of August 2007, I was managing a 'fund of hedge funds' portfolio and we allocated heavily to quant equity managers (with labels such as 'market neutral' and 'statistical arbitrage'). The logic was that these managers had reasonably low correlations to each other, and because they held many stocks in their portfolios, we felt we had a good handle on their risk profile. A huge amount of industry capital flowed into these strategies, and it was common for the managers to use leverage.

From 6 to 10 August 2007, all of the quant equity managers in our portfolio lost about 25%! What happened? First, the managers had a degree of overlap in stock holdings and style (favouring relatively cheap, good quality companies and shorting the opposite). In a sell-off, they would all likely experience underperformance at the same time. Heading into the early stages of the GFC, one major investment bank savagely sold down their huge leveraged portfolio. This proved the catalyst, triggering a cascade of managers exiting positions to reduce leverage and manage risk. Each transaction triggered further pressure to exit as the sell-off fed itself for five days.

While there are multiple lessons, the most important one is: consider the strategy universe that a manager is part of, and the associated systemic threats to the strategy, particularly leverage, capital flows and common risk models.

Liz Moran, FIIG Securities

The global financial crisis showed me the worst of markets but also some of the best opportunities. A number of financial institutions in both the domestic and international markets were teetering on the verge of collapse. We breathed a sigh of relief when the US government stepped in to save Bear Stearns, the worst US financial institution.

I presumed that it would again step in and rescue Lehman Brothers, but I was wrong. The havoc it wreaked on markets was a lifetime lesson. The US then stepped in to guarantee bank debt as did the Australian government. The deposit guarantee continues 10 years after the event.

I'm now extra cautious when assessing companies that rely on sovereign favour either in the regulations that govern them, or assumptions made in their support.

Interestingly, international credit rating agencies still presume the Australian government would support our major banks if needed. I'm wary of that commitment.

Hugh Dive, Atlas Funds Management

An enduring lesson is that it is not enough to buy a company trading at a discount to its net tangible assets (NTA). A company needs strong and stable cash flow to weather the inevitable storms.

Some companies have a large asset backing, often with a NTA per share (assets minus liabilities and non-cash intangible assets such as goodwill and patents) higher than its market value. In theory, investors can often buy $1 in cash for 80c by liquidating the company's assets and paying back its liabilities. This is the basis of the investing approach espoused by the father of value investing, Benjamin Graham, in his seminal investing tome from 1934, *Security Analysis.* This approach has led value investors into asset-rich industrial companies such as Arrium that traded for extended periods below its NTA before going into administration.

Whilst avoiding Arrium, I was involved in making an investment in timber company Gunns, seduced by the 250,000 hectares of land containing $500 million worth of trees. Ultimately, this vast land bank counted for little when a rising AUD dramatically reduced woodchip sales to Japan and the company's debt load became unsustainable. Gunns became an asset rich and cash flow poor company that was unable to control its own destiny, as they were unable to sell off assets quickly enough to pay current liabilities during stressful market conditions.

Lesson: You can't eat assets, cash flow is king.

Neil Rogan, Centuria

Some years ago, my partner and I created an education account for our two children. We invested $10,000 to open a high-interest online savings account and selected one we could add to regularly, but which wasn't easily accessible lest we be tempted.

While additional contributions grew the capital base, we watched the income steadily decline. The cash rate fell from 7.25% when we commenced our 10-year plan in 2008, down to today's 1.5%. Once tax was paid on the income (at the highest marginal rate) and we accounted for inflation … well, the growth was negligible.

We should have considered alternative investment options, such as:

1. Invest in a portfolio of fully franked, dividend-paying stocks, where we could have reinvested the dividends, paid less tax, and regularly purchased additional shares.
2. Invest in a balanced or Australian equity managed fund with a regular savings program – capital growth plus some tax effective (franked) income.
3. Buy an investment bond where investment proceeds are distributed tax-free after 10 years.

The lesson? Consider all options and when saving for the longer term, consider the impact of tax on your investments.

Melanie Dunn, Accurium/Challenger

In my twenties as I started to accumulate savings while studying finance, I decided to buy some shares. It looked easy, and the ability to purchase a starter pack of diversified shares was promoted through my bank. And then I chose more ...

Fast-forward and a more experienced me realises just how hard it can be to make informed decisions about when to buy or sell shares. I didn't have the time to research each company I owned. I didn't have expertise in each of the industries I invested in, and I was swayed by the latest media coverage, particularly with a fear of losses.

The more I learn about markets, behavioural finance and investing the more I realise that I don't have the time, knowledge or resources of the investment professionals to manage my own money. In hindsight, I should have put my savings in the hands of experts via managed funds and ETFs who are aligned with my philosophy of investing.

My mistake was thinking I had the knowledge to pick appropriate shares and maintain my investments over time, the enduring investment lesson is to 'know what you don't know'.

Brett Murray, Mine Super Financial Advice

Time is a great educator, and while we can draw on life experience as we get older, there are some occasions where the heart rules the mind. When making investments, the heart often proves a poor judge.

Five years ago, one of my recently-married children wanted to buy a home. He and his partner were happy together and had secure jobs, but minimal savings. Getting an initial deposit proved difficultr, and they turned to us as parents for assistance. This was the moment that my heart ruled despite warnings from the mind.

Five years have passed, and the scenario is not great. The marriage is now finished and there have been no repayments of the money. The house is being sold and although there are assurances we'll get repaid, the ex-spouse is not so amiable. It's now that I realise a contract should have been drawn up and security taken over the property, so that as a secured investor I would be repaid prior to any profit being split between two parties.

A lesson learnt that even as a professional you should still get professional advice when making significant financial decisions.

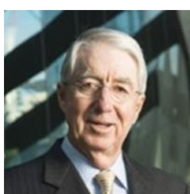
Jonas Palmqvist, Alphinity Investment Management

The attraction of buying cheap turn around stocks is obvious, but you can find yourself owning too many value traps instead of undervalued opportunities. Timing a company's turnaround is challenging. In 1994, I bought Rottneros, a Scandinavian paper pulp company. It was an interesting value case trading at a single digit P/E. I owned it for 4-5 years patiently waiting for the company to turnaround and the price to rise. I ended up selling out around the same price as I bought it, completely missing a great bull market in many other stocks over that period. I learnt that without a clear path to higher earnings to drive that revaluation, it might never eventuate.

From this insight 20 years ago and other similar missteps along the way, I have evolved my investment process to wait for evidence of a turnaround and to look for companies whose earnings are improving. I am unlikely to buy at the bottom but there is still a large and more reliable upside as the market starts to realise the company's fundamental earnings potential. The subsequent combination of earnings upgrades and multiple expansion is a powerful compounder of investment returns.

Some lessons you need to be frequently reminded of, and of course, I still regularly end up misjudging or mistiming a company's earnings cycle. However, actively searching for that underappreciated earnings potential, rather than identifying which knives are about to bounce, has narrowed my investment focus, tuned down market 'noise', and improved my hit rate. Rottneros was the first stock to teach me this lesson, and it continues to be a good reminder - the stock today trades around the same price as in 1994.

Noel Whittaker, Author, presenter and adviser



In the early 1980's I met a bloke who had suffered a succession of bad relationships with women, which together with some bad property deals, had left him penniless. He was keen to get back on the road to financial independence and saw me as the way to do it.

In a whispered yet excited tone he told me he had been visiting an island just outside Brisbane and had found "the deal of a lifetime". As he had no money himself, he was prepared to give me half the profits if I would go into the transaction with him. If only I had heeded the words of Edmund Burke: "Those who have much to hope and nothing to lose will always be dangerous".

On the island, he showed me a half-finished house on a steep block on the hill looking over the water. The asking price was $39,000, it could be finished for "$12,000 at most" and would be worth "at least $80,000" on completion. He had been assured by the agent that there was a massive shortage of properties in the area. The numbers might seems trivial now but remember, this was nearly 30 years ago.

I paid the deposit and borrowed money from a finance company. The builder my 'partner' engaged believed that $12,000 was needed, but it took over $20,000 to complete the house. The house now owed us over $60,000 with interest accruing at around $1,000 a month.

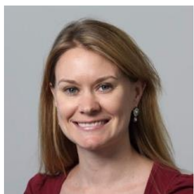
The house on completion could best be described as a good ‘advertiser’ – four bedrooms, two bathrooms and panoramic views. But it didn’t look quite right, and we were stuck with a lemon!

My ‘partner’ quickly lost interest and left me to sell it and to fund the interest payments. The agent was hopeless so I advertised the property myself and discovered another problem – logistics. It was a whole day out of one’s life, plus a $42 barge ride, just to take any prospective purchaser to the house.

Finally, I received a cash offer of $58,000. I couldn’t sign the contract fast enough. The final sting in the tail came when the tax department allowed me to claim only half the loss on the property despite the fact that I had personally funded the entire project.

There are many lessons in this story but if you go into partnership with a person with no money they get half the profits if it succeeds, but you pay all the losses if it loses. That’s odds on punting.

Emily Martin, Balance Impact



In July 2008, I was visiting Lehman Brothers in their London office. Whilst taking a walk around their trading floor, there was a notable absence of noise and activity and many empty desks. Prior to Lehman’s collapse, banks were nationalised or forced to merge, but none were left to fail, and the general consensus was that closure would never happen to a mainstream business like Lehman.

In September 2008, I was still entering into swaps with Lehman, despite the warning signs I should have read, including visiting their office. After their collapse, these swaps were worthless.

From this trading loss has come the enduring lesson to focus on facts not opinions. Most crises don’t happen overnight, they are months or years in the making. It is possible to avoid the worst of these crises by paying attention, and betting against the guy whose says “It’ll never happen.”

Roger Montgomery, Montgomery Investment Management

I suspect many other contributions to Edition 250 will refer to lessons already learned and mistakes made long ago. The reality however is one should continue to make mistakes through entire lives because one learns from errors.

Right now, the markets are showing us (again) that investor irrationality knows no bounds and that the investment commentariat has the memory of a goldfish.

We have held large amounts of cash believing markets to be irrationally overpriced. The CAPE Shiller ratio for the S&P500 is at levels previously seen only once since 1870. A narrow band of tech names are responsible for a material slice of the market’s gains, yet many of their business models are unprofitable. The expectations for some Australian companies are higher than any business has achieved and yet overpricing has persisted. The fear of missing out can usurp the fear of loss but when that happens, we believe the mistake committed is more punitive.

Calendar 2017 recorded the sixth consecutive year of positive real total returns from all major asset classes for Australian investors. It was the first time that everything has gone up for six straight years. As interest rates normalise – US 10-year bond rates rose from 1.36% in mid-2016 to 2.92% recently – and as perceptions of a regulatory backlash against the tech companies gains traction, along with a widening of corporate bond spreads, value investing will emerge as the rational, logical and sensible approach to investing it has always been.

Jordan Eliseo, ABC Bullion

My first real 'lesson' in investment markets came about at the end of the NASDAQ boom in the early 2000s. Like many speculators (I wouldn't dare call what was going on at the time 'investing'), I'd been fortunate to make what for me were significant gains as the bubble built.

However, it largely came to nothing as, lacking any framework for what was a reasonable price to sell at, or even what kind of profit I'd be happy with, I held most of my investments as the market took back its previous gains.

I was lucky to come out marginally ahead, and to this day it remains the hardest skill for me to personally master: the discipline to first set out an appropriate exit strategy and to follow it through no matter how exuberant you feel when an investment is going the right way.

Greg Cooper, Schroders Australia

"There is no point being right if you have no money left to be right with." This is a modern take on Keynes', "*Markets can remain irrational longer than you can remain solvent.*" We have a duty of care to look after the assets of our clients, and that duty extends to doing our best to ensure the clients stay and see through the investment decisions that have been taken on their part. This means that even though we may think markets are wrong, and may ultimately be able to show that markets are wrong, if clients have walked before that opportunity has been seen through, then we haven't done our job properly.

Raewyn Williams, Parametric Australia

My unusual pathway from being a tax lawyer to the investment profession has produced missteps and lessons along the way. One early mistake was to advocate for higher-yielding stocks and specific strategies that targeted extra franking credits. I thought the large super funds I influenced would find the opportunity to convert $1 of fully franked dividends to as much as $1.43 irresistible.

What I missed was a sense of the wider portfolio risks introduced by pursuing higher franking outcomes, such as the much higher exposure to the financial sector, large cap stocks and

momentum styles. I now work with after-tax focused funds to explicitly identify and contain the risks that come with seeking better returns. Funds should never pursue higher returns without thinking about the risks involved – what looks like a free lunch can in fact cause indigestion!

Jack Gray, Brookvine

In many routine, repetitive tasks such as calculating an average, chicken sexing, or passing a ball, mistakes are both observable and measurable. In complex ambiguous tasks like investing and surgery, mistakes lurk behind a veil and defy measurability.

BT's decision around 1987 to insure equities via a put offers an acid test of what constitutes an 'investment mistake'. The cost of insurance dragged BT's relative performance down so much that decision-makers were close to removing the put … before the '87 crash. Had they done so their business would have suffered. Would that decision have been a mistake?

As a fund CIO in 2005, I considered buying a deep out-of-the-money put on equities. The cost would probably drag the fund's performance from first to third quartile. That, combined with the Board's fear of derivatives, led me to not even mention the possibility to the Board - definitely a mistake of omission. (Had I mentioned it and had the Board agreed and stuck to the strategy for four long years, by end 2008 the fund would have saved substantial money, leapt into the top decile and lived off the story for a decade.)

All investors struggle to admit mistakes, a behavioural pattern that inhibits learning - one of the hallmarks of professionals. Can we change that pattern? Can we operationalise the acknowledgement of 'mistakes' as a step in that direction?

Chris Neesom, Mine Super Financial Advice

As a finance professional, I know the importance of separating emotions from investment decisions. However, on a personal level I have learned this the hard way. Just after the GFC, I took a view that mining stocks had been oversold and were providing good value. After undertaking considerable research, I believed I had identified a high return/high risk opportunity and was comfortable with the profile of the trade and the size of my exposure.

However, I let myself down at the trade implementation. I purchased shares in a coal mine company that had been heavily sold off. Sadly, within a matter of weeks, the company went into a trading halt, and the shares were heavily diluted to the point of being essentially worthless after a capital raising. Upon reflection, I had taken a considerable time forming my macro view, but then rushed in with too much enthusiasm, failing to maintain my implementation discipline of searching for quality sold-off companies. I had lost sight of my original goal of buying quality companies at a cheap price.

Lessons learned from a mistake that won't be repeated!

Reece Birtles, Martin Currie Australia

As a long-term investor that targets undervalued stocks, I'm used to potential investments that involve controversy. Whether it's cyclically-low earnings, structural change, technological disruption, heightened competition or macro factors, undervalued stocks are cheap for a reason. Determining which undervalued stocks have the potential to be strong long-term performers is what value investing is all about. Take Billabong and JB Hi-Fi in 2012. Whilst both retailers appeared to be undervalued for similar reasons - heightened competition, structural disruption, and macro consumer concerns - JB Hi-Fi achieved a successful corporate turnaround whilst Billabong did not.

The key reason for these different outcomes was the level of *debt*. Experience has taught me that when you combine controversy with high levels of debt, it significantly increases the investment risk and it rarely works out in favour of minority shareholders. High debt levels force boards to change their priorities, focusing heavily on the short term at the expense of long-term solutions. Value investors need to adequately adjust for debt levels in their analysis and portfolio exposure decisions. No matter how high your conviction level in the stock, the higher the debt, the higher the investment risk, hence the smaller the position should be in your portfolio.

David Bassanese, BetaShares

As I'm sure was the case with many investors, the global financial crisis was a testing time for what I had considered a disciplined investment strategy. I had owned bank shares and never truly believed they were at risk of insolvency despite the fears that were swirling in 2008. Nonetheless, banks did fall hard and I respected my stop losses and sold out when these were triggered, even though I thought banks were cheap. My biggest lesson, however, was not necessarily allowing perceived fundamentals to override my risk management process, but rather failing to be attentive enough to get back into the market when banks appeared to have finally bottomed and were technically starting to trend higher.

My lesson: if you are going to get out of the market rather than ride out a downturn, you need to remain attentive enough so you're not too late getting back in.

Gemma Dale, nabtrade

Upon leaving university, I took the time-worn path and moved to London, to, as comedian Danny Bhoy describes it, live in a cupboard with 12 other Australians. I had saved a meaningful sum over four years of part-time jobs and holiday work, but opened a new bank account when I moved to the UK and kept my hard-earned savings in Australia to pay for future travels. With this UK bank account, I was given a 'Switch' card (similar to a Visa debit card, but transfers occurred over 24-48 hours rather than instantaneously), and an overdraft facility, neither of which I was familiar with.

After a brutal English winter, I took off for a glorious summer in Europe, and was pleasantly surprised to find that the meagre earnings from my few months of working in London never ran out. In every new country, the ATM would happily give me new (pre Euro) currency, despite my vague awareness that my savings were probably not enough to cover the withdrawals.

Three months later I returned to my old flat to find a large pile of red-framed letters and the threat of legal action from my bank. Apparently, my withdrawals were eating into my overdraft, which was only offered on the basis that I was getting paid into the same account. Several hundred pounds worth of fees and interest later, I had learned a healthy lesson – don't accept or invest in any product you don't understand.

Chris Stott, Wilson Asset Management

At age 16, I had two passions – playing AFL for the St Ives Saints and the stock market. At the time, my mum worked for Douglass Hanly Moir Pathology, a subsidiary of Sonic Healthcare (ASX: SHL). I invested $500 of my savings earnt from working at McDonald's into SHL shares at $3 per share. I soon sold them at $3.50 thinking I had secured a solid gain on my first foray into stock picking. While the experience had me hooked on the equity market, I sold far too early. 20 years on, SHL shares trade at $23. The investment lesson was to take a longer term view and resist the urge to take sell too soon – something I still do.

Vinay Kolhatkar, Cuffelinks

I have four, related lessons of the fallout from the GFC.

When prices are forcibly raised or lowered, the supply/demand equilibrium is thrown out of balance. This is basic economics, however:

(1) When the term structure of interest rates (the price of credit) is manipulated for long periods in a big way, the true economic aftereffects lag, but can show up abruptly. Central banks, supposedly in charge of controlling inflation, still measure themselves with the wrong metric – consumer price baskets.

(2) Inflation triggered by central banks manifests in asset prices. In the 1990s, the Clinton Administration revived legislation that was designed to encourage banks to issue home loans to minorities. Far more capital was diverted into real estate than was justifiable. Eventually there was glut of construction in the US, and real estate prices collapsed. Thus …

(3) Economic actors can be induced to act in ways that are not in their best interest. Then the economic virus spread rapidly like a deadly contagion. So …

(4) Markets were more deeply interconnected across asset classes and geography than I had realised.

Leisa Bell, Cuffelinks

I learnt that it should be me looking for and choosing an adviser, not the other way around. In my mid-20s, I was approached by a financial adviser to give this whole financial advice thing a go. I thought it sounded like the right thing to do – get my finances on the right track early in life.

I immediately felt a disconnect with the advisor, but I was there for a consultation, so I hung in there. Yes, a risk assessment was done, but the adviser couldn't comprehend why I was reluctant to buy into a wonderful, rent-guaranteed, 95% financed, yet to be built, property development, and kickstart my real estate portfolio straight away! Why waste time when I have an early retirement to think of? Here's the paperwork, ready to sign.

Mmm. Somehow, despite my doubts, I still managed to walk out of there having rolled over into a different superannuation fund which I soon realised wasn't for me. So when I started a new job, I took the opportunity to ditch it and severed all ties.

I may have 'missed' my chance of becoming a property tycoon by 30, but my financial equilibrium was back in balance. Phew.

Graham Hand, Cuffelinks

To answer this question, I checked my investment portfolio for the red numbers, although I already knew what it would tell me.

I don't mind the small losses on the gold and silver ETFs, as I consider them a hedge for a black swan event. I'm not overly bothered by the losses on the LICs trading at a discount to NTA, as I'm prepared to wait.

The most irritating are the small cap stocks bought in modest amounts because someone shared a hot tip with me. It's a classic FOMO, a personal failing. I could not face meeting the person again and hearing the story of how the stock is now a five-bagger and "Did you get aboard?".

I buy so little of these that even a five-bagger would have negligible impact on my entire portfolio. Those numbers with their incriminating and annoying 'redness' point to my inability to bear the smug pleasure of another person.

So why don't I sell these baggers and clean out the red? Well, they're even cheaper at these levels, aren't they? And who knows when I'll run into the tipster.

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