Invest like an Institution: Stop Trying to Beat the Market

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The following is adapted from Navigate the Investment Jungle.

Time and time again, when I ask investors about their goals, they tell me they want to beat the market. My response to these investors is always the same: "Why would you want to do that?"

Beating the market has become accepted as the standard benchmark for investing, but trying to beat the market is a dangerous, slippery slope. It pushes you into a short-term mindset and distracts you from your true goals. Do you really want to beat the market, or do you want to build long-term wealth?

If your goal is long-term wealth accumulation, there's much you can learn from how institutions invest. Institutions have long lifespans, so they aren't trying to get great returns for a few years; they're looking to build a significant endowment over decades, even centuries, and their investment strategies reflect this.

If you want to invest pragmatically to secure your future, you need to stop trying to beat the market and begin investing like an institution. I know this advice may be controversial to some, so let's start by exploring why trying to beat the market is such a poor strategy, and then I'll show you how you can invest like an institution instead.

You Can't Beat the Market Forever

It is entirely possible for you to beat the market—for a while. Like casinos, however, the house always wins in the end. At some point, the market will turn in a way you don't expect, and you will start to lose. Your gains from one year will be wiped out and balanced by the next.

Nobody can beat the market forever. The bottom line is that volatility is a normal part of investing. We'd all like the market to go up every day, but we'd also like a goose that lays golden eggs. Unfortunately, the nature of markets is such that it's not going to happen.

If you want proof of this, look no further than the 2008 financial crisis and the recent stock market volatility due to COVID-19. In both instances, countless investors who had previously been beating the market on a regular basis had the bottom drop out from under their portfolios.

The problem with trying to beat the market is that it forces you to take on an unacceptable level of risk. To beat the market, you'll need to have 100 percent of your money in stocks, and the stock market is one of the riskiest investment arenas. Sure, some stocks appreciate rapidly, but many others drop just as fast. There are few safeguards, so there's almost no limit to how much the unwary investor can lose.

Additionally, you never know for sure when those losses will come. In some instances, when the market hits a rough patch, you can hold on in the hope that things will get better. But what if the crash happens right before you're set to retire? Suddenly your true financial goal—a comfortable retirement—has been sacrificed in the name of trying to beat the markets.

Beating the market consistently over decades is extremely difficult, and it's not a stable strategy to rely on when planning your retirement. Fortunately, there's a better way.

Investing like an Institution: The Power of Diversification

By investing like an institution, you can set up your portfolio in a way that reduces risk and limits the severity of your losses in bad times, while delivering solid returns in good times.

The key to investing like an institution is diversification. You might think, *My portfolio is already diversified!* However, the way institutions approach diversification is very different from how individual investors traditionally approach it.

Chances are, the advice you've heard or read about asset allocation recommends investing approximately 60 percent of your funds in the stock market and 40 percent in lower-risk, lower-return investments, such as bonds. With 60 percent of investable assets in stocks, the potential for volatility is still huge. This can lead to big wins. It can also lead to crushing defeats.

Institutional investors significantly reduce the percentage of assets invested in stocks. For example, an institutional investor might put 20 to 30 percent of the assets under their management into stocks, with 40 percent in bonds, and the remaining 30 to 40 percent in commodities, real estate, gold, and other alternative investments.

Because they have a variety of different assets, institutional investors can protect themselves from deep losses. They build their portfolios so that some of their positions are negatively correlated to one other, meaning that when one goes down, another goes up. The result is decreased risk.

Most people associate low risk with low returns, but that's not the case for institutional investing. Ray Dalio, the founder of Bridgewater, the largest hedge fund in the world, employs the institutional model, and over many years, he has consistently delivered returns of up to 21 percent before fees. He even achieved positive returns during the market collapse of 2008.

That's the power of institutional investing: steady wealth accumulation while hedging against market volatility.

What Do You Want to Achieve?

The key question you must ask yourself is: What do you want to achieve? Unless you're a thrill seeker, your authentic financial goals probably involve setting up a comfortable retirement.

How much money do you need to accomplish that goal? How much risk can you comfortably absorb? These are far more important considerations than whether you can beat the market.

If you want to set up a comfortable retirement, you don't need to beat the market. You need to protect and grow your investments, and you do that by investing like an institution.

For more advice on the institutional model of investing, you can find [Navigate the Investment Jungle] on Amazon.

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