AGGREGATE ASSET MANAGEMENT

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Own 100 stocks — be massively diversified

THE idea that to do well in investing one must focus one's bet on something that one knows inside out is a brain virus that must be terminated. It is responsible for the deaths of many portfolios.

The two famous investors who preach this mantra are Warren Buffett and Peter Lynch. They are advocators of the focused approach to investing and have brought untold misery to many naïve investors.

Buffett advises that, imagine in your lifetime, you can choose only 10 stocks. So, pick only the best. Pick only what you know thoroughly and hold it forever. Pick the businesses with long-term competitive advantages and a defensible moat. "Diversification is protection against ignorance; it makes little sense if you know what you are doing," he says.

Lynch, in his book *One Up on Wall Street*, suggests that we should buy what we use, like and observe. So, if you like Starbucks coffee, then buy Starbucks stock. If your child shops at Abercrombie, then buy its stock. (To be fair, Lynch advises checking the financial statements and valuations, but people do not do that nor bother to remember that.)

Advocators of the focused approach suggest that you spend time at your local Starbucks and count the number of coffees that people buy. Then, use that information to form your revenue forecasting model and arrive at your stock valuation decision.

Please do not do that. It will not work. After having sat there for consecutive weekends counting coffee cups, it is hard for you not to buy the stock. You have invested too much emotionally. I would say you have fallen in love with your stock.

Mistakes made in investing are psychological. Treat your stocks like chickens. Imagine you are a chicken farmer. You keep and feed chickens to make them grow fat and then take them to the market for slaughter. You do not name your chickens, such as calling them "Chirpy". If Chirpy is fat and healthy, you make chicken rice. No hard feelings. The point is, your stocks are here to serve you, pay you dividends and perhaps some capital gains — they are not for you to fall in love with and defend when they have fallen 20%.

Buffett and Lynch are well-meaning and try to give good advice. But if you are an average Joe, it is not going to work for you. Their advice is suitable only for people who are completely detached of emotions, smart and can spend more than 24 hours a day in isolation reading books. If you feel like grabbing a beer halfway, you are not going to make it.

We are average. We are normal. We have children, a career and a life outside work. So, we do something simpler and that is still effective.

Here is the recipe. Buy 100 stocks. Buy them in various countries, industries and currencies. Do not buy only Singapore stocks. Buy South Korea, Malaysia, Taiwan, Japan, Indonesia, China, Hong Kong and so on. Buy only value small caps (see previous article on our website).

Buying 100 stocks yourself is like making your own exchange-traded fund, but you will do better than the ETFs because you are invested in only value small caps.

Owning 100 stocks gives you a psychological advantage and overcomes many emotional biases. As each position is about 1% of your portfolio, you can make decisions in buying, trimming and taking profit in a rational and detached manner. If a mistake is made, only 1% of your portfolio is damaged, hardly anything to lose sleep over. Another advantage is that you can deploy huge sums of money into the stock market — as how can 100 stocks in different countries and industries be completely wiped out?

How do you choose the 100 stocks? Learn to use a stock screener. If you are a beginner investor, stick to low price-to-earnings, high-dividend-yield and low price-to-NTA stocks. Learn to read the financial statements. Understand how the balance sheet changes over time. Examine the cash flows. It is not hard, it just requires some practice and cutting out some TV/internet time. — *www.aggregate.com.sg*