INVESTING

‘The greatest predictor of success in markets,’ and how to take advantage, from a financial advisor

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KEY POINTS

- Compound interest calculations reveal that starting investing even a few years earlier can add hundreds of thousands of dollars to your portfolio.
- Paying attention to diversification and fund fees can help boost your long-term returns, too, investing experts say.

As an investor, you have to accept that certain things are out of your control. Your collection of sensible, well-researched investments could be humming along before interest rate worries or inflation fears or foreign wars or housing bubbles or a series of bad tweets or a meteor strike comes along and sends your portfolio plummeting.

That makes it all the more important that optimize what you can control to give yourself the best chance to build long-term wealth. The earlier you realize that, the better, says Craig Ferrantino, president of Craig James Financial Services in Melville, New York.

As a young person, “you have something that older investors don’t have: time,” he told Grow. “Time is the greatest predictor of success in markets.”

That doesn’t mean you can buy any old stock, mutual fund, or ETF, sit back, and watch your millions accumulate. Time in the market, though very important, is just one factor that you’d be wise to focus on if you seek investing success.

Markets are unpredictable, but over long periods, you can up your odds of odds of achieving good results by following a few important maxims, investing experts say. Here’s what they say are the most important things to pay attention to.

Time: Your ‘greatest money-making asset’

The idea that the earlier you begin investing, the better is predicated on the assumption that markets will rise throughout your lifetime as an investor.

There is no guarantee that this will be the case, but it’s been a relatively safe bet so far: The S&P 500 has returned somewhere in the neighborhood of 10% per year, on average, over the course of the last several decades.

From there, the advantage you have from starting early comes down to math.

Consider: A 21-year-old invests $1,000 in a portfolio that earns 7% annually, and contributes $100 per month thereafter. By the time she is 66 and ready to retire, she’d have more than $404,000, according to Grow’s compound interest calculator.

Had she started just five years later, at age 26, she'd end up with about $280,000, despite earning the same return on her investments.

Diversification: 'The most important thing for an investor'

For the above example to work, an investor would have to achieve steady, market-like returns over a long period, which is why Ferrantino excluded investors who hold narrow stock portfolios.

Devoting big chunks of your portfolio to just a few investments can come with huge swings in performance if those investments fare well or do poorly. Such swings can influence investors to try to buy or sell their investments in an attempt to time the market, which can lead to subpar results.

"You're trying to build an all-weather portfolio," Lauren Hunt, a certified financial planner and senior advisor at the Monetta Group, told Grow. "Having something you can stick with through thick and thin is going to be the most important thing for an investor."

That's where diversification comes in. By investing across a broad range of asset classes, you plan that different parts of your portfolio will behave in different ways under different market conditions. Diversified portfolios can offer a "smoothing" effect on your returns, which makes it less likely that sharp drawdowns will tempt you into panicking and selling.

"Research has shown that those portfolios will get you a higher risk-adjusted return over time," Hunt adds.

Cost: The only 'reliable' way of predicting future success

There are plenty of ways to gain access to a broad array of investments, the most popular of which are buying mutual funds and exchange-traded funds. These funds, which may hold pools of stocks, bonds, and other investments, come in two main varieties: passive and active.

Passively managed funds seek to replicate the performance of a particular index, such as the S&P 500. Because these funds require little work on the part of those who manage them, fees investors pay are often next to nothing.

Active funds are helmed by managers who buy and sell investments in the portfolio in an attempt, typically, to beat the long-term returns of a particular benchmark index. Those managers make big bucks, which is why these funds come with higher expense ratios.

While fund companies have come up with seemingly hundreds of ways to outperform markets, one data point reigns supreme when it comes to predicting investors' results: cost. "The only data point we've found that is in any way reliable in predicting future fund success is fees," Ben Johnson, director of global ETF research at Morningstar, told Grow.

That's because higher annual fees eat into the compounding returns of your investments over time. Take our 21-year-old investor from before. This time, instead of investing regularly, she plunks $10,000 into a mutual fund earning 7% per year. If the mutual fund charged an expense ratio of 0.12% — the average among passive funds, according to the latest data from Morningstar — she'd have about $199,000 by the time she reached 66, having paid about $3,500 in total fees, according to calculations from Bankrate.

If she paid the average expense ratio among active funds, 0.62%, she'd have about $159,000 at retirement after forking over nearly $16,000 in fees.