Are You Living a Financial Groundhog Day?

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Do you remember the 1993 movie, "Groundhog Day" where Bill Murray's character "Phil" got trapped in a time warp and was doomed to relive the same day over-and-over again until he finally "got it right"? What's the connection?

Although we don't really have any groundhogs here in La Canada (we do have coyotes) and Hollywood is just over the hill… I started thinking about that movie and how I seem to have the same or similar conversations with new clients and prospects about the same subjects so much so that sometimes I have felt like Phil; doomed to repeat the same meetings over-and-over.

What gives me hope that I may be able to break out of my Groundhog Day? Sky Sprowles recently asked me to write this monthly column for LCFN and I accepted his invitation. Just like being the financial advisor for the families that TFRG serves, writing this monthly column is both an honor and a privilege that also comes with a significant responsibility.

What is that responsibility you ask? I want to provide you with a fresh perspective on things. To challenge those often incorrect but widely held "myths" about finances that are mindlessly repeated over-and-over by the financial media. In a nutshell… I want to make sure not one of our LCFN readers begins to feel like Phil after reading one of my columns. Yes, I would like to share my thoughts, but equally, I would like to give our readers a chance to get their questions answered anonymously. If you have a question that you'd love to ask me, please send them in to us at LCFN and I'll address them in a future column using only your first name. So with that… what is one of the top "groundhog" conversations I seem to have over-and-over?

I'm often asked why so many investments never seem to deliver the average annual returns that they advertise? Interestingly, many people are surprised to learn that you can NEVER get the average annual return from your investments as it's not mathematically possible!

An easier way to explain this is to provide an example. If you had an investment that went up 100% in year one and then lost 50% in year two, you wouldn't say you "averaged" 25% per year because your actual return is zero. You ended up with the same amount of money that you started with. So how would the fund industry report this? This would be a two-year average return of 25%. How does that work? 100% + (-50%) = 50% divided by 2 years equals 25%. In this example, the 25% used by the fund industry is the simple average, or "arithmetic mean" and the 0% return that you really get as an investor is the "geometric mean", also called the "annualized return", or the Compound Annual Growth Rate (or CAGR).

It is interesting that with volatile investments including mutual funds, returns are frequently stated in terms of the simple average rather than the CAGR that investors actually receive. The bad news is that the CAGR is always lower.

You must ask yourself… did you or your financial advisor focus on the average annual returns for the investments that were selected for your portfolio? If so, I guess you might want to potentially re-evaluate your expected returns and possibly make some adjustments.

It's your money, I trust this new insight will help and I look forward to hearing from you.

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