INDEX INVESTOR

Couch potato with a side order of stocks

Why are so many Couch Potatoes unable to resist dabbling in active investing? Maybe it's because they're human

BY DAN BORTOLOTTI

It's a lot easier to admit you're a Couch Potato these days. Index investing was a fringe idea not so long ago, but today more and more individual investors and their advisers are using passive strategies. But even if index investing has entered the mainstream, hardly anyone seems to embrace it completely.

I have no data to support this—maybe Stats Can should add the question to the next census—but I can count on my fingers and toes the number of people I know whose portfolios are 100% indexed. The majority of people who call themselves Couch Potatoes can't resist doing a little freelancing on the side. Maybe they bought Apple when it was trading at $200 and can't bear to sell it. Perhaps they hold other investments with an active adviser because "she's done well for me lately." Then there's the type who makes tactical shifts like overweighting emerging markets or underweighting bonds based on forecasts.

> Index investing forces us to fight our inner Cro-Magnon because it runs up against human flaws

I'm not trying to be judgmental: I'm just curious about this kind of investor psychology. Using index funds suggests you understand their basic principles—namely that stock picking, sector plays and market timing are unlikely to improve performance. But if you know that, why not follow through and index your whole portfolio?

Blame your brain. "I have spent many years trying to figure out why people have the misconceptions they do," says Chris Turnbull, portfolio manager with The Index House, an Edmonton wealth management firm that uses passive strategies with clients. "My sense is people don't really get it. It seems like a simple concept to just combine index funds to get an asset mix appropriate for you. But people still want to know where the market's going, or what you think about this or that stock."

It's hardly surprising investors think this way. "The industry is a large sales force and what they're selling is generally products and predictions," says Turnbull, author of *Your Portfolio is Broken: Who's to Blame and How to Fix It*. When you're constantly told the key to successful investing is the ability to analyze stocks and forecast the economy, it takes a long time to be de-programmed, even if you accept the principles of indexing on an intellectual level.

Evolution did not shape humans to be long-term investors: the characteristics that helped us survive on the savannah don't help us manage our RRSPs. And index investing forces us to fight back even harder against our inner Cro-Magnon, because it runs up against a host of human flaws. We love predictability, we're overconfident in our abilities, and we fall prey to the illusion of control—all of which make it difficult to trust an index fund.

Does it matter? All this leads to an important question. Can you be a successful Couch Potato investor if you pick stocks on the side or make tactical shifts based on the economy?

It's hard to argue with an indexer who also holds a handful of blue-chip dividend-payers because they give her the confidence to stay invested in a bear market. Whether those stocks can outperform the index isn't the issue here: the potential benefit is behavioural.

I'm more concerned about ostensible Couch Potatoes who shift their asset allocation according to market conditions. That kind of behaviour almost never occurs in a disciplined, thoughtful manner, and with an eye toward the long term. Almost always it's based on a combination of fear and performance chasing. How do you think that will work out over the long run?

Love the one you're with. I asked Chris Turnbull whether he's willing to indulge clients who wish to dabble in active investing. I was surprised to hear the question hardly comes up anymore. "I've had this conversation before," he says, "but many of my clients have already been through the system: they've bought stocks on their own, bought mutual funds and tried this and that. Now they're at the point where they realize indexing just makes sense."

That's the key insight. To be a successful Couch Potato investor, you have to be in the same headspace as Turnbull's clients. At some point—and this won't happen the day you buy your first ETF—you need to stop wondering whether you should buy more Enbridge or trim your bond holdings because someone on TV is urging you to. You won't need to fight against those urges, because you no longer even *get* the urges. Advisers like Turnbull say it often takes a year or two before investors truly appreciate that buying individual stocks and making tactical moves not only adds no value, it undermines the whole process.

Indexing isn't for everyone. Above all, it's not suited to investors who hold index funds but are constantly nagged by the idea there's something better out there. Whether you're a staunch indexer or an active investor, we can all agree the best strategy is the one you truly believe in, because that's the only way you will stick with it over the long haul. M

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