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UPSIDE | By Morgan Housel

Sweet 16: Rules for Investors

U.S. stocks are hitting all-time highs. And doesn't it feel good?

It has been three years since the S&P 500 has declined 10% or more from a recent high. Including dividends, the index has more than doubled in the past five years. The Dow Jones Industrial Average has 34 record highs this year alone. Even the Nasdaq is less than 6% away from its dot-com bubble peak.

But high returns breed complacency and create a false impression of how easy investing can be.

That makes it a great time to review some fundamental—if overlooked—investing truths. Here are 16 important ones I've learned.

◆ *All past market crashes are viewed as opportunities, but all future market crashes are viewed as risks.*

If you can recognize the silliness in this, you are on your way to becoming a better long-term investor.

◆ *Most bubbles begin with a rational idea that gets taken to an irrational extreme.*

Dot-com companies did change the world, land is limited and precious metals can hedge against inflation. But none of these stories justified paying outlandish prices for stocks, houses or gold. Bubbles are so easy to fall for precisely because, at least in part, they are based on solid logic.

◆ *"I don't know" are three of the most underused words in investing.*

I don't know what the market will do next month. I don't know when interest rates will rise. I don't know how low oil prices will go. Nobody does. Listening to people who say they do will cost you a lot of money. Alas, you can't charge a consulting fee for humility.

◆ *Short-term thinking is at the root of most investing problems.*

If you can focus on the next five years while the average investor is focused on the next five months, you have a powerful edge. Markets reward patience more than any other skill.

◆ *Investing is overwhelmingly a game of psychology.*

Success has less to do with your math skills—or your relationships with in-the-know investors—and more to do with your ability to resist the emotional urge to buy high and sell low.

◆ *Things change quickly—and more drastically than many think.*

Fourteen years ago, Enron was on Fortune magazine's list of the world's most-admired companies, Apple was a struggling niche company, Greece's economy was booming, and the Congressional Budget Office predicted the federal government would be effectively debt-free by 2009. There is a tendency to extrapolate the recent past, but 10 years from now the business world will look absolutely nothing like it does today.

◆ *Three of the most important variables to consider are the valuations of stocks when you buy them, the length of time you can stay invested, and the fees you pay to brokers and money managers.*

These three items alone will have a major impact on how you perform as an investor.

◆ *There are no points awarded for difficulty.*

Nobody cares how much effort you put into researching a stock, how detailed your spreadsheet is or how complicated your options strategy is. For many people, a diversified buy-and-hold strategy is the most reasonable way to invest. Some find it boring, but the purpose of investing isn't to reduce boredom; it is to increase wealth.

◆ *A couple of times per decade, investors forget that recessions happen a couple of times per decade.*

When recessions come, stocks tend to plunge. This is an unfortunate, but perfectly normal, part of the process—like a Florida hurricane. You should get used to it. If you are unable to stomach declines, consider another investment.

◆ *Don't check your brokerage account once a day and your blood pressure only once a year.*

Constant updates make investing more emotional than it needs to be. Check your brokerage account as infrequently as necessary to prevent you from becoming emotional about market moves.

◆ *You should pay the most attention to the investor who talks about his or her mistakes.*

Avoid those investors who don't—their mistakes are likely to be worse.

◆ *Change your mind when the facts change.*

Admit when you are wrong. Learn from your mistakes. Ignore those who refuse to do the same. This will save you untold investing misery.

◆ *Read past stock-market predictions, and you will take current predictions less seriously.*

Markets are complicated, and human emotions are unpredictable. Unless you have illegal insider information, predicting what stocks will do in the short run is unimaginably difficult.

◆ *There is no such thing as a normal economy, or a normal stock market.*

Investors have a tendency to want to "wait for things to get back to normal," but markets and economies are almost constantly in some state of absurdity, booming or busting at rates that seem (and are) unsustainable.

◆ *It can be difficult to tell the difference between luck and skill in investing.*

There are millions of investors around the world. Randomness guarantees that some will be wildly successful by pure chance. But you will rarely find an investor who attributes his success to luck. When you combine a market system that generates randomness with a belief that your actions reflect your intelligence, you get some misleading results.

◆ *You are only diversified if some of your investments are performing worse than others.*

Losing money on even a portion of your portfolio is hard for some people to swallow, so they gravitate toward what is performing well at the moment, often at their own expense.

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