Major Investment Lessons

Editor's note: While sports metaphors may be clichÃ©s, as in this case, they often provide a laboratory for helpful life lessons. Whether you are a fan or not, I hope you will indulge this golf story as a vehicle for a few important investment (and life) lessons. I hope you'll read on regardless.

Heading into the final hole, Jean van de Velde held a seemingly insurmountable lead. All he had to do was score better than a triple-bogey seven, and he would be the champion of the 128th Open Championship. The victory would be the first major tournament win by a Frenchman in more than 90 years.

Despite holding a three-stroke lead on the final hole of a major tournament, van de Velde pulled out his driver. Fortunately, his tee shot ended on the 17th hole. He was fortunate because the shot was so far right that it carried the water bordering the 18th fairway. Following the errant tee shot, van de Velde could still play it safe and cruise to victory. However, he chose the more aggressive strategy, attempting to reach the green with his second shot. After ricocheting off a grandstand and bouncing off a rock in the Barry Burn, the second shot settled in an area of deep rough.

Van de Velde's challenges continued as his third shot landed in the water, followed by his fifth shot finding the deep greenside bunker. When the ball finally found the hole on his seventh shot, he had lost his insurmountable lead and, ultimately, lost the Open Championship in a playoff.

The events that led to van de Velde's collapse at the 1999 Open Championship are similar to the challenges investors frequently face, and the outcomes can, unfortunately, be the same. Many investors learn their major investment lessons the hard way.

Here are a few thoughts to expedite your learnings—or remind you of a few timeless lessons.

Know the Score

Many have questioned whether van de Velde actually knew he was three strokes ahead. Over the past 30 years, we have seen numerous examples of investors with seemingly large leads pull out their driver when all that is required to win is to keep the ball in the middle of the fairway. Typically, these investors have not paused to check their score and continue their strategies focused on building a lead.

Investing is a competition, but an investor's only opponent is the important financial goals he or she sets for the future. Unfortunately, there are no easy-to-observe scoreboards along the course, so investors rarely check their scores—or, potentially more harmful, they check the market's scorecard to determine if they are winning.

In the absence of knowing the score, the required decision must be to try for more.

It's about Time

Another important investing lesson surrounds time. Time is a uniquely critical variable in nearly every decision. Time can be a risk and a risk-reducer. Too much time is a potential risk, and too little time is a potential risk. Consequently, it is imperative to understand how time impacts a decision's risk profile.

The stock market has been incredible at healing itself. While individual companies have come and gone, with sufficient time, the market has always recovered. Historically, the simple formula for investment success has been: Protect the downside, and the upside has taken care of itself.

While the formula is simple, it's not easy. Protecting the downside does not mean attempting to avoid the downside; that's likely a formula for failure. Van de Velde would not have been in a position for victory if he had not taken calculated risks of loss along the way. Rather, protecting the downside is about never being forced to turn a potentially temporary decline into a permanent loss, which most often happens when time runs out.

Van de Velde's mistake was not triple bogeying a hole. Rather, it was triple bogeying the final hole when he had the most to lose and, more importantly, the least amount of time to recover. Saving for retirement requires emotional discipline, financial sacrifices, and adequate time to capture the full power of compounding.

An early mistake in the investing journey can be overcome; a late mistake, when the stakes are highest and time is shortest, can be catastrophic.

Probability, Not Magnitude

Napoleon Bonaparte said, “The greatest danger occurs at the moment of victory.” Unfortunately, many investors can’t even define what financial victory looks like, and for those that can, it’s terribly difficult to declare it. The thrill of winning is often more fun than acknowledging “I’ve won,” so they overconfidently continue to play the same game, focused on what can go right, and they never stop to question what can go wrong.

The decision to hit his driver on the final hole will forever be questioned. Not because of van de Velde’s abilities—his aggressiveness and execution on the 18th hole was one of the primary contributors to his large lead, having birdied the hole two out of three previous rounds—but because the risk far outweighed the reward. The reward for being right was to win by three (or more) strokes. The risk of being wrong was to not win at all.

Following the death of his dear friend Joseph Heller, *The New Yorker* published this classic poem written by Kurt Vonnegut:

Joe Heller

True story, Word of Honor:
Joseph Heller, an important and funny writer
now dead,
and I were at a party given by a billionaire
on Shelter Island.
I said “Joe, how does it make you feel
to know that our host only yesterday
may have made more money
than your novel â€˜Catch-22’
has earned in its entire history?”
And Joe said, “I’ve got something he can never have.”
And I said, “What on earth could that be, Joe?”
And Joe said, “The knowledge that I’ve got enough.”
Not bad! Rest in peace!

It is critical for investors to clearly define what success looks like to them, and if they are fortunate to be able to declare victory, stop the game and be thankful for having enough.

Comprehensive Financial Planning

An individual’s investment strategy is just one element of your comprehensive financial plan. The planning process helps you clearly define what victory means. It identifies the future financial goals that you are competing against and establishes a strategic spending-saving-investment game plan focused on maximizing the probability of success—not the magnitude of success! Finally, it provides the necessary context you need to accurately check your current financial scorecard and allows you to know how much longer you need to compete.