Picking Individual Stocks Is A Loser’s Game

*[Editor’s Note: This **Tuesday Classic** post originally ran in 2016. I was pleased that see that it was pretty much completely evergreen and needed no updates whatsoever to be run again. Picking stocks was just as dumb in 2016 as it is in 2019.]*

Long-time readers and avowed Bogleheads will not be surprised to see the title of this post, however, they may be surprised by the data presented. Way back in 2011 – two months after this blog started – I told you not to take uncompensated risk by buying individual stocks. Here is yet more data that supports that recommendation.

JP Morgan took a look at how difficult it was to pick individual stocks. They looked at data from 1980 to 2014 using the stocks in the Russell 3000 (98% of the US market.) What they found was the following:

Individual Stocks Have a High Risk of Permanent Impairment

40% of stocks would, at some point, suffer a "catastrophic decline." This decline represents a 70%+ decline in value from which the stock price DID NOT recover. At all. 40%. This isn't like buying the entire market where you wait out the bear market. The company just goes out of business. 40% of companies over a 35 year time period. The percentage was higher than 40% in the Telecom, Biotech, and Energy sectors.

Individual Stocks Underperform, On Average

67% of stocks would underperform the Russell 3000. The index returns (and thus those of a mutual fund tracking the index) heavily depend on the relatively few winners for their gains. By only owning one or a few stocks, your risk of missing out on those winners is quite high. Even actively managed mutual funds do better than 67% underperformance in a given year (although it is even worse over the long term.)

Helping baby sea turtles reach the sea is way more interesting than investing

Lower Returns AND Worse Risk Control?

Wait, it gets worse. It turns out when you start looking at the volatility of the stock prices of individual stocks, that things get even worse. On a risk-adjusted basis, it turns out that 75% of the "concentrated stockholders" they looked at would benefit from additional diversification. I'm surprised the number was that low. So even those who buy a whole bunch of individual stocks, still lack adequate diversification.

Good Investing is Boring Investing

I often run into people who list "investing" among their hobbies. I can't help but think about what a stupid hobby that is. Don't get me wrong. I think many of the financial concepts behind investing are interesting. But the actual activity? You've got to be kidding me. If you're enjoying this, you're doing it all wrong.

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I mean, let's think about what I do when I "invest." I log into my 401(k) and see there's a chunk of money sitting there that has been taken out of my paycheck. I open my spreadsheet and see that I'm a little low on US stocks. So I go back to the 401(k) and place an order to buy as many shares of VTI as that chunk of cash will buy using a limit order at something close to the current price. A few minutes later, I see my order was filled. I update my spreadsheet a few weeks later when I get around to it. What's fun about that? Nothing. It's one of the most boring things I do all week.

So if you're enjoying investing (researching, buying, selling, discussing etc), at least in the stock market, chances are good you're spending a great deal of time and effort engaging in an activity that is actually decreasing your returns. Do yourself a favor and get a hobby that makes money, a free hobby, or at least one that costs you less than stock picking. You know, like boating.

What do you think? Do you buy individual stocks? Why or why not? What percentage of your serious money do you have in individual stocks? Comment below!