SHARPER GRANITE LLC

White Paper

Pursuing a Better Investing Experience

The U.S stock market has been an engine for wealth creation throughout the past century. This is especially true when investors are mindful of how markets work, what strategies deliver success, and what to ignore. So, how exactly do successful investors approach the markets? Here, we highlight ten ways any investor can create a better investing experience and generate consistent returns over time.[1]

1. Embrace Market Pricing

The market is an effective information-processing machine. Millions of participants, including company insiders and analysts whose job is to know everything about a company, buy and sell securities every day. The real-time information they bring sets prices, instantly and accurately. Individuals buying stocks should ask themselves if they know more than all of these insiders and analysts combined, because their combined knowledge is embedded in the price.

World Equity Trading in 2022

	Number of Trades	Dollar Volume
Daily Average	> 60 million	$675.8 billion

2. Don’t Try to Outguess the Market

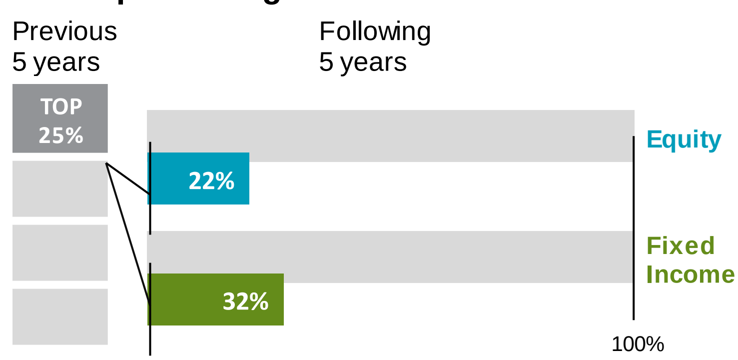
The market's pricing power works against mutual fund managers and individuals who try to outsmart other participants through stock picking or market timing. As evidence, over the past 20 years only 17% of active U.S. equity mutual funds have outperformed their benchmarks, and 56% of these funds do not even exist anymore. William Sharpe received a Nobel Prize in 1990 for proving mathematically what fund data shows us each year -- most actively managed money must trail the indexes due to frictional trading costs.

US Equity Mutual Fund Performance 2003 - 2022

3. Resist Chasing Past Performance

Some investors select mutual funds based on past returns; however, past performance is a poor indicator of future results. Most funds do not continue to outperform. From 2012 – 2022, only 22% of equity mutual funds in the top quartile of five-year returns maintained a top 25% ranking in the following five years. Even Morningstar, which produces the popular fund “star ratings,” cautions against using ratings for investment selection. Studies show that 4- and 5- star funds have no better chance of future outperformance than 1- and 2-star funds.[2, 3]

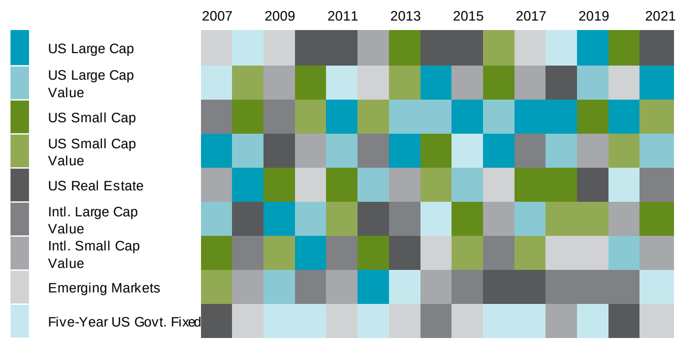
Do Outperforming Mutual Funds Persist?



4. Avoid Market Timing

It is impossible to know which sectors will perform best year-to-year. Even if you could skillfully interpret future corporate earnings or the world economy, you would need to do so better than the *combined* abilities of other sophisticated investors. No one has ever proven the ability to repeatedly profit by market timing. Holders of a well-diversified portfolio over time are positioned to capture returns wherever they occur.

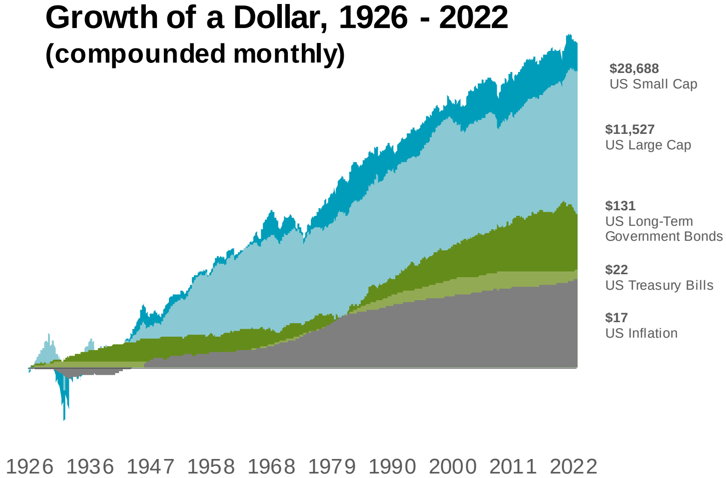
Year-to-year Sector Return Rankings



5. Let Markets Work for You

The financial markets have rewarded long-term investors. Investors expect positive returns on the capital they provide, and historically, equity and bond markets have provided asset growth that has more than offset inflation. Equities have proven to be the best-returning asset class over long time periods.

Growth of a Dollar, 1926 - 2022 (compounded monthly)



6. Consider the Drivers of Returns

Academic research from Eugene Fama (Nobel 2013), Harry Markowitz (Nobel 1990), and William Sharpe (Nobel 1990), has identified the following stock (equity) and bond (fixed income) factors which are predictors of expected returns. These factors are pervasive around the world and persistent over time. Exposure to these factors predict over 90% of diversified portfolio returns. Sharper Granite strives to cost-effectively capture these factors in portfolios.

EQUITIES

- Company Size (Market Capitalization, Small vs. Large)
- Relative Price (Value vs. Growth Companies)
- Profitability (High vs. Low Profitability Companies)

FIXED INCOME

- Term (Sensitivity to Interest Rates)
- Credit (Credit Quality of Issuer)
- Currency (Currency of Issuance)

7. Practice Smart Diversification

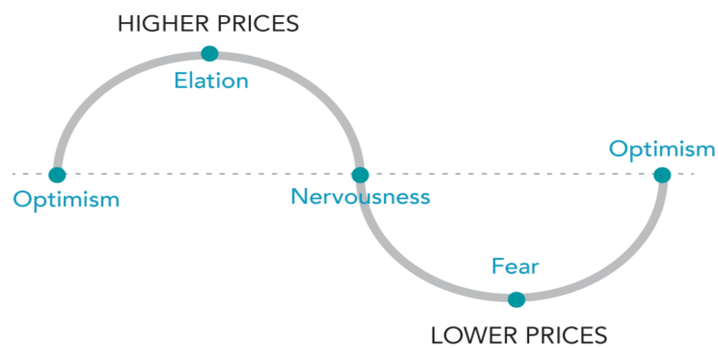
Diversification helps reduce risks that have no expected return. For example, investors are not compensated for company-specific risk when they hold individual stocks. Diversification is critical and diversifying within the U.S. is not enough. Global diversification broadens the investment universe.

8. Manage Your Emotions

Warren Buffett says, "Be fearful when others are greedy, and be greedy when others are fearful." But this is difficult for most. While the S&P 500 index 10-year annualized return was 16.6% (from 2012 – 2021), the average investor in those funds has earned only 8.7%, primarily because of bad investing behavior.[4]

Human brains are wired such that they will struggle to separate emotions from investing, according to Daniel Khaneman (Nobel 2002).[5] Markets go up and down. Reacting to current market conditions may lead to making poor investment decisions at the worst times.

Reactive Investing in a Market Cycle

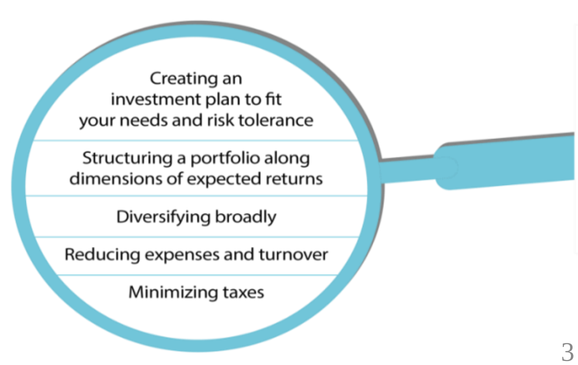


9. Look Beyond the Headlines

Daily market news and commentary can challenge investment discipline. Some messages stir anxiety about the future while others tempt you to chase the latest investment fad. When reading, consider the source and whether there may be an agenda behind the message. Maintain a long-term perspective. If the experts are wrong most of the time (see #2), then what advantage is likely to be gained by reacting to media stories which all can see?

10. Focus on What You Can Control

Your financial advisor can create a plan tailored to your personal financial needs while helping you focus on actions that add value. This can lead to better investment results and less anxiety about reaching your goals and objectives.



Notes and Acknowledgements:

1. "Pursuing a Better Investing Experience" is written with input from Dimensional Fund Advisors. All data not footnoted is referenced to Dimensional Fund Advisors, May 2023
2. From 1992 – 2009 for the three years following their 5-star rating, 39% of the 5-star funds beat their bench-marks, while 46% of the 1-star funds did so, "Higher ratings in no way ensure that an investor will increase the odds of outperforming a benchmark in subsequent year. 5-star funds actually show the lowest probability of maintaining their rating." Chris Phillips, Francis Kinnery Jr, Vanguard, 2009.
3. "To be fair, I don't think that you'd want to pay much attention to Morningstar's star ratings either." John Rekenthatler, Morningstar, 2000
4. JP Morgan Asset Management, Guide to the Markets, data as of December 31, 2022.
5. *Thinking Fast and Slow*, Daniel Khaneman, 2005

Questions?
Contact us at:
questions@sharpergranite.com