Money Myth: Why Past Performance Doesn't Guarantee Future Results

Description

It's the first thing you probably look at as an investor. How has this company performed in the past? And before I go too far, this is an excellent starting point when you're looking at what to add to your watch list.

After all, if a stock has been around for decades and is on a steady track upwards, it would be hard to say that this stock will suddenly plummet in the next few decades.

Unfortunately, that *can* happen. While past performance can tell you a lot about a company, what you need to be digging is what the company is doing *now* to keep you as an investor happy, which means diving into how the company is moving its business forward.

The problem is that many investors tend to look at what's hot *right now* when deciding where their money will be invested. Take tech stocks for example. Rather than keep your money in those safe and steady stocks you've seen grow for the last few years, you decide to sell them so that you can put money on this new hot market.

But how hot is it? How long can that last? How are those companies going to keep themselves ahead of the pack? This new hot market also means you're probably buying at the worst possible time, which that you're probably one of those who will sell at the worst possible time as well.

I don't mean to be harsh, but the numbers don't lie.

One study found that funds that should have been compounded at between 9% and 11% were actually giving investors between 2% and 4% because those investors were buying and selling at the wrong times. That's due to those same investors letting their emotions guide their choices rather than taking a long-term approach to investing.

Think about it. What’s the number one fear you likely have as an investor? Missing the boat. You want to have the bragging rights to say that you bought such and such a stock when it was so far down that your returns are enormous. But you can still have those bragging rights by doing your research ahead of picking strong stocks.

So here are some questions you should consider beyond past performance.

- Beyond present earnings, what is the company doing to push those earnings even higher in the future from where they are now?
- What risks is the company taking that I should take into consideration?
- What could cause this company to under or over-perform?
- Is the industry that this company is in experience a growth spurt? Or even the stock itself? Or is that growth going to continue for much longer?
- Has management experienced a lot of turnover in the last few years that could be a red flag?
- What expenses is this company going to incur now and in the future that could bring affect its future earnings?

These are just some of the things you should look at when deciding to purchase shares in a new investment, but these questions aren’t everything you should consider.

The main driver behind your purchases should be your own goals — and deciding whether your stock choices suit your goals should always be top of mind.

Some things to consider would be the type of portfolio you have, such as a TFSA or RRSP as this could also be a major factor in your stock decision, especially if you’re considering foreign investments.

Before making any purchasing decisions, I always recommend meeting with your financial advisor to come up with a strategy.

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