Diary of a Private Investor General Colm Fagan 17 January 2016

"Are you beating the professionals?" It's a question I am regularly asked at this time of year, when the financial sections of the newspapers publish tables showing the past performance of various fund managers. My answer is that I am doing well, but I won't claim any expertise until l have survived a severe downturn. Like most investors, I suffered badly in 2008; I don't want to suffer a similar fate in the next recession.

Guaranteeing no repeat of 2008 carries a hefty price tag. The most I can earn from genuinely risk-free investments is around 2% a year- if I'm lucky. I need to earn more than three times for a reasonable income in retirement: 6% per annum plus inflation is my target. For that reason, bonds and deposits don't feature in my portfolio other than for short-term cash needs and the unexpected rainy day.

I have put my faith in ordinary shares for around 90% of my portfolio, believing that they will deliver the required return in the long-term. Over the last seven years, returns have been comfortably ahead of target, but that has been a good period for stock markets; I don't expect the good times to last forever. Indeed, recent market falls portend that the good times could end much sooner than we thought just a few short weeks ago.

Temporary price dips don't worry me: on the contrary, I see them as buying opportunities if the fundamentals of the business are unchanged. Temporary price dips would be a concern if investments had to be redeemed when prices were down but up to now dividend income and normal turnover of investments have been sufficient to meet voluntary and compulsory cash withdrawals. (Because of my age, Irish pension regulations compel me to take some money from my investments every year, whether I want to or not.)

Permanent loss of value is a different matter. I try to reduce that risk by investing in companies that are strong enough to weather a severe recession. Often, that means choosing companies with little or no debt, even though that can be a drag on performance in good times: just as someone who borrows to invest in property can earn a higher return than one who risks only what they can afford, the same is true for companies that borrow to expand or to acquire other businesses. The danger with such companies is that, in a downturn, all the profits could be eaten up by borrowing costs; worse, if loan covenants are breached, shareholders could be wiped out. I am prepared to pay the price of lower returns in the good times in order to reduce that risk.

Some of my worst investment decisions have come from buying shares recommended by others. As a consequence, I now only buy shares that I have studied myself. I don't have much time for research, which means that there are only a small number of companies in my portfolio. That doesn't worry me unduly. It results in concentration risk, but I believe that less than a dozen companies gives sufficient diversification, provided they are financially and strategically resilient and if there is little overlap between them in terms of risk exposures – a tall order, I know.

Nevertheless, I recognise that I am running extra risks with a concentrated portfolio and one of my New Year resolutions is to increase the spread of companies in which I am invested. That means disposing of some of my current holdings to make room for the new arrivals. In mulling over which stocks to sell, I discovered that I have a condition that psychologists and behavioural economists call

the endowment effect. People with this condition ascribe more value to things merely because they own them. I recognise myself in that description: I am prone to believing that the stocks I own are worth more than others I could buy for the same price. Now that I know I have the condition, however, I hope to be better able to counter it.

A significant proportion of my investments are in UK companies, probably because the Financial Times is my investment bible. In the last two years, UK exposure has delivered windfall profits: sterling rose by over 7% against the euro in 2014 and by over 5% in 2015. In mid-2015, partly in anticipation of Brexit risk, I decided to hedge some of my sterling exposure. I have locked in a fixed euro/ sterling exchange rate until mid-2016 and the present intention is to renew the lock when the current one expires. I have not hedged my exposure to UK companies that have significant international operations, on the grounds that the underlying businesses are already multicurrency.

I discovered the hard way that I know very little about commodities: I incurred significant losses on Tullow Oil and Barrick Gold (a Canadian mining company), believing about two years ago – wrongly as it transpired – that oil and gold had hit rock bottom. I cut my losses on both stocks in 2015. I have resolved to stick to stock-picking in future and not try to predict macro trends, whether in commodities, currencies, or in the overall level of the market.

As we enter a new year, I look forward to continuing to share with you the ups and downs of life as a private investor. I also hope that 2016 will not be the year that will test the quality of my defences against another 2008-style collapse.