



# Fisher Funds

## Investor Education Centre

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### **Mechanical Investing**

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Some investors like to remove the emotional highs and lows associated with share market investing by using a trading system or a mechanical investment method. Mechanical investing involves buying or selling stocks according to a set of predetermined criteria. It can involve a trading system which regularly gives you trading recommendations, or it can simply involve a set of rules to adhere to, which highlight when purchases and sales should be made.

There are trading systems to suit all investors. If you want to trade hot stocks frequently, there are strategies that select the fastest-moving shares in the market and suggest which ones should be bought and sold. If you want to spend one day a month investing in the market, there is a system for that too.

Mechanical investing shifts the responsibility for decision-making from you to the computer. Essentially a trading system will look at historical price trends, establish patterns and then create rules that allow investors to position themselves appropriately when those patterns re-emerge. Good trading systems will back-test results over many years and many different share market scenarios.

Readers of this column will be unsurprised to learn that I am not a supporter of mechanical investing. I have said many times that investing is as much art as science, and I do not believe that a trading system or strategy exists that will guarantee good returns simply on the basis of historical information.

The problem is that history doesn't always repeat. A mechanical strategy that has worked well for the past three years, 10 years or 25 years won't necessarily continue working into the future. Sometimes it will be based on a statistical fluke. Share markets are dynamic, so your starting point can make a real difference to your outcome.

One example I've seen showed a trading strategy that began on December 28, 2000 which yielded a return of 53% in nine months, whereas when an investor began using the same strategy on December 31, 2000 he experienced a 30% loss over the same period.

The other flaw is that if lots of people are using the same set of rules to identify trading opportunities, those opportunities will quickly disappear as everybody starts buying or selling the same stocks. The only people benefiting in this scenario are the writers of the rules who could position their portfolios ahead of everyone else.

Supporters of mechanical investing say that it takes the emotion out of trading, and emotion is often the thing that gets investors in trouble. We often react inappropriately to share prices that are rising or falling, and logic disappears out the window when markets behave erratically.

While I completely understand the importance of having a disciplined strategy to remove emotion from investment decision-making, I don't think that investing should be completely devoid of human thought. To me, it is just plain wrong to buy shares in an unprofitable company, simply because its share price has followed the same pattern as another company in the past which subsequently performed well.

Humans are fallible, and when it comes to share investing, so are computers.

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