You Need A Budget.

Invest Like a Pro

A 10-day Investing Course

Day 1: Who This Course is For

Introduction

You might already know me as "the guy that thinks everyone needs a budget." Or, "that really good-looking guy."

Just in case you don't yet know me, a brief introduction.

In 2003 I was newly-married and broke. My wife and I didn't own a car, or computer. I had three years of schooling left to obtain my Masters in Accountancy (yes, you can achieve a Master Level of education in things that boring).

I knew my wife and I needed a budget.

We set one up, I learned from some early mistakes, and about a year later realized that I was onto something. In September of 2004 I launched YouNeedABudget.com, where we teach *the best* way to to think about and manage your money (and we sell cool software to boot). We're now a household name (at my house). Even my neighbors have heard of it.

No, seriously, the YNAB movement has actually grown into something worldwide, with thousands upon thousands of users all over the world. We've experienced rapid growth, with a fantastic tribe of happy customers. As a team, we are spread all over the world, delivering superb customer service, and high-quality software and instruction to anyone that will let us tell them over and over again that they...need a budget.

I used to be a CPA, so I used to know what I was talking about ;) I'm passionate about personal finance because it affects *every other aspect of your life*. I have a wife (same one I mentioned above), and five children. If you have any ideas on how I could fill my spare time, I'd love to hear it, because man, I'm really struggling with that. Kidding. But when I do have spare time, I'm learning the piano, making divot-art on the golf course, gardening, and treating my body as a work of art, by doing some CrossFit.

Why an Investing course?

Because you think it's a lot harder than it actually is. Because investing scares you, and it shouldn't. Because you should be investing and you aren't. Because you're investing incorrectly and it's costing you a lot of money.

Because the average savings of a 50-year old is $43,000.

Because 80% of people ages 30-54 believe they will not have enough money to retire.

This Course is For You if:

You're a "YNABer."

I've created this course for you. I'm operating under the assumption that you subscribe to the "You Need A Budget" (YNAB) way of managing their money. In a word, you:

- Give every dollar a job. You spend intentionally, without guilt, and according to your values.
- Save for a rainy day. You look ahead and anticipate larger, less-frequent expenses. You break those up into smaller, manageable, monthly chunks. Holiday spending doesn't sneak up on you.
- Roll with the punches. You recognize that a budget isn't set in stone. You are flexible, and adjust your budget as needed (and wanted!) in order to reach your goals.
- Live on last month's income. Or you're working toward it.

If those four bullets describe you, or the aspirational you, then YOU are my target audience. You have the "budgeting thing" down, and you'd like to expand your financial knowledge to other aspects of the personal finance realm.

You want to invest correctly (and enough!), but have ZERO interest in the complex stuff.

This course is for you if you want to make sure you are investing enough, and investing correctly, but you have no desire whatsoever to delve into the complex stuff.

You and I are both on the same page then. If there's a topic that's getting a little hairy, I may even warn you beforehand, letting you know you can skip it. All in all though, I'm going to filter out all of the complex stuff. Complexity in the investing world serves one evil purpose: it paralyzes you. The complexity kills your momentum, suffocates your confidence, and adds no value whatsoever when it comes to the performance of your investments.

[Enter record-stopping screeching sound here.]

Did you catch that last sentence? Your level of investment knowledge, once beyond the levels we'll discuss in this course, will not help your investment performance. Warren Buffet, the greatest investor of all time, said it best:

"..the active investors will have their returns diminished by a far greater percentage than will their inactive brethren. That means that the passive group - **the 'know-nothings' - must win.**"

I'm a "know-nothing", and I want you to join me! When you discover the amount of time I spend managing my investing (a few hours *per year*), you'll want to be a know-nothing as well.

You're ready to take action.

This course is for you if you're ready to take action. *Action* in this case, means you'll have set up an investment account, and will have put it on autopilot.

Some of you aren't doing any investing at all, and we'll change that. You'll be *informed*, you'll understand *what* it is that you're doing, and you'll understand *why* you're doing it.

The rest of you are already doing some investing, but you want to make sure you're doing so correctly. You'll benefit from this course very much as well.

Day 2: Why Should You Invest?

We're going to spend eight more fun-filled days talking about the ins and outs of investing. Putting yourself through this course begs the question:

"Why should you invest?"

I mean, honestly, is it just because your dad, or uncle, told you that investing is the way to go? Is it because you're on the elliptical at the gym and your eyes meander over to your neighbor's TV where the talk is stocks, P/E ratios, markets, and ETFs...and you wonder if you're not missing something important (or sexy?!)

What you'll learn in this course won't impress anyone anyway. Imagine this conversation between you and your friend (that thinks investing is sexy and sophisticated):

Friend: "So, do you invest?"

You: "Yeah. I set up an account and have $125 auto-invested each month."

Friend: "Yeah!? What stocks are in your gameplan?"

You: "All of them."

Friend: "Yeah, yeah I get it. Diversify. Where do you think the market's headed?"

You: "I'm pretty sure the market will move either up or down."

Friend: "Ha! Yeah, totally... right... I read ya..."

At that point your friend will choose another topic of stimulating conversation.

The following are all reasons NOT to invest. If your primary reason is any of these, re-evaluate your reasoning. You should NOT invest if:

You want to make quick buck.

You think the market's going to "make a move."

Your uncle/aunt/dad/brother/neighbor has been talking up some opportunity that won't be around much longer.

You don't understand what you're investing in.

You don't have a clear goal, with a firm timeline.

You are afraid (this course will help that).

Those are all reasons NOT to invest. But what is a great reason TO invest?

In the end, there's only one reason to invest: to build wealth.

You can cut it any way you like. You can say that you want to invest to support socially-responsible companies, or to fund your children's education, or just to be able to retire and not worry about money. But the root of the idea, the *real* goal of investing, is to build wealth.

You greedy Rich-Dad-Poor-Dad-Reading, Scrooge-McDuck-Swimming-in-Money, Daddy Warbucks wanna-be!

Nah, I'm just sort of kidding. The type of wealthy person I'm talking about, and I'm sure the type of wealthy person *you and I* aspire to be, is the one that lives next door. The one that goes about living their life, and being an excellent steward of their many blessings.

But understand that wealthy people, *by definition*, are investors. There are no exceptions to that rule. If you want to be wealthy, you need to be investing. (*Where* the wealthy invest is another topic entirely, but not because it's secret, only because it's so diverse. Their wealth is doing *something*, and that *something* is their investment. Every time.)

Speaking of wealthy people living next door, in Thomas Stanley's *The Millionaire Next Door*, he writes that the average millionaire invests almost 20% of their income. What percentage of your income are you investing? That number is pretty important (though it's not the *most* important, as we'll find out.)

The critical element to building wealth is leverage.

But not the leverage you may be thinking about. Heavens no.

A lever "amplifies an input force to provide a greater output force." (Thank you Wikipedia.) I can't lift a piano for very long if I just squat down and give it the ol' heave-ho, but if I lift it using a lever, I expend a lot less energy, and get the exact same output. The lever is a simple machine that makes your life easier.

In the traditional sense, leverage means that you're borrowing money, investing that money, and earning a return on your investment greater than the cost of borrowing. That's not at all how I operate, and you won't hear another word about "other people's money" for the rest of this course, unless I see an opportunity to mock it.

Most of you are familiar with Rule One of the YNAB Method: Give Every Dollar a Job. Some of those dollars go off and buy groceries, some feed your hobby of artistic blacksmithing, and some... some of those dollars are your levers.

When you invest, you're leveraging your money. Your money basically goes out and does work for you. It's beautiful. They're the easiest employees to manage. They never talk back. They always stay on task. And they recruit other employees to keep doing the same thing. When you build wealth, you are leveraging your money. Period. There's no other way around it.

The end goal is to have so many little dollars out there, recruiting other dollars, that you just sit around in your underwear watching your soaps. Or something else. But at least you have the option. ;)

Wealth is a super-boring motivator.

I mean, snooze alert.

Normal Person: "Hey, what drives you? What gets you up in the morning?"

Boring Person: "Money."

Normal Person: "I see..." [looks off and to the left, suddenly remembering something very important that must be taken care of this instant.]

I think I used to be motivated purely by money. I would plan, scheme, and project how I could retire before I turn 45. It was all about the nest egg.

That was all fine and good until my first child. The lesson was reinforced with the subsequent four children thereafter.

Wealth just doesn't bring joy. Beyond the levels necessary to survive, and live comfortably (I recognize the wide definitional chasm that word introduces, but choose to pass...), wealth is not directly correlated to happiness. In fact, researchers at Princeton studied just that. While the "comfort level" was dependent on the survey respondent's location, when it all shook out, it turns out that beyond about $75,000 we just don't find much more happiness.

I don't say this to drive you completely away from using raw wealth as your motivator--only to perhaps give you some food for thought.

What could your wealth *do*? That is an exciting question.

What could you DO with your wealth?

Retirement

The obvious one is that you could retire. Make sure you define your retirement beyond a simple amount, or an age. You'll want to retire with *purpose*, and that purpose will be realized because you're independently wealthy.

Just this morning I was reading job applications for a Quality Assurance position on the YNAB Team. One of our standard interview questions is to ask, "What do you want to learn next? And what do you want to learn after that?"

Reading these job applications is quite time-consuming, because I'm constantly sent off on informational treasure-hunting tangents. "Wait, what is that they want to learn? I want to learn that!" This happens to me again, and again. We have aspiring woodworkers, linguists, mechanics, blacksmiths, gardeners, musicians...

One of the reasons I invest for my future is so I can have more time to pursue my own educational endeavors. I find that motivating.

The same researchers at Princeton that settled on the $75,000 "happiness number", recommended that we spend less on material items (which don't increase our happiness), and more on experiences, which do. What experiences could you have, or share, with your wealth? I find that question motivating.

Education

One very common reason to invest, is to help your children pay the (skyrocketing) cost of higher education. Education often falls under the "investing" umbrella because the timeline is long (18 years until your child heads off to college), and probably because there are lots of fancy acronyms and cryptic numbers (ESA... 529...) you need to decode in order to feel like you can even get going in this regard.

I personally am not completely sold on the idea of helping my kids with their education. I'm not against it...I'm on the fence. (I recognize that if I'm going to help them, I should start sooner rather than later, so this is a bit of a quandary for me personally.) At the moment, Julie and I are more focused on providing them a very solid K-12 education, and teaching them how to work. Again, I have no philosophical reasons behind this, but I thought I would just let you know where I personally stand. Your mileage may vary greatly from mine. Cool.

Weddings

Say what? That's right. Weddings cost a small fortune. So you need to have a small fortune saved.

My friend, Ramit Sethi, in his book *I Will Teach You To Be Rich*, makes me want my daughters to elope:

"The average American wedding costs almost $28,000, which *The Wall Street Journal* notes, is 'well over half the median annual income in U.S. households.'"

Weddings are NEVER considered a viable investing goal, which is too bad, considering the time horizon for weddings is (hopefully) 40 years or so. I'm kidding. Eh, not really. Dang. I'm not sure on this one. I have two daughters. One is five, going on fifteen. I'll bite the bullet and assume they'll marry when they're 25. That gives me 20 years to save $56,000. And I'm ignoring inflation. I grabbed my TI-30XA just now (it sits on my 'strong side', like a trusty sidearm) and calculated that I'll need to save $233 per month. Not happening.

However, if I treat the wedding savings as an investment, and follow the principles learned in this course, I need to save $108 per month. Doable. But still ludicrous. Can we please move on? Yes, let's.

Cars

Unless you're Jay Leno, a car is not an investment. However, if you start following some sound investing principles, you'll be paying cash for cars for the rest of your life. (I'll mention some terms in here, like time horizon and return on investment, that we'll delve into later.) It goes like this:

You purchase a clunker for $2,000. Spend $100 on repairs each month (on average), and "invest" a $200 car payment that you make to yourself. Since clunkers don't really depreciate, at the end of two years, you trade in your clunker for $2,000 and add the $4,800 you saved, and trade up to a $6,800 vehicle.

You're now driving a $6,800 vehicle. You spend $70 on repairs each month (on average), and "invest" a $230 car payment ($200 you were already paying, plus the $30 of repairs you don't have to make because your car is more reliable) that you make to yourself. At the end of two years, you trade in your car for $6,000 and add the $5,520 you saved, and trade up to a $11,520 vehicle.

Things are looking pretty good. Notice that I haven't mentioned an investing time horizon, or a return on investment. The reason being that since you were only saving that money for two years, investing it probably wouldn't have been the wisest move.

BUT, now you have a five-year horizon because you have a pretty nice, reliable car to drive. You end up with $50 of car repairs on average each month, and you invest the $250 exactly the way I teach in this course (you take into account your time horizon, you diversify, etc.). Where did the $250 come from? You're saving $50 per month in car repairs, and funneling that money over to your car investment. So how does this shake out? At the end of five years, you trade in your vehicle for $10,000 (there was some depreciation), and add the $17,400 invested, and trade up to a $27,000 vehicle.

With cash.

The key in all this, is to purchase that clunker in the beginning, and start treating yourself like the lender-dutifully making payments to yourself. The magic happens when you turn $15,000 of payments into $17,400, by way of a six percent return on investment.

Investing should be goal-driven.

What the previous examples illustrate is that your investing should be goal-driven. You should *not* be investing for any other reason, except to reach a specific, wealth-building goal.

When it comes to investing, you need concrete goals. We'll get into this in more depth as we discuss "Winning the Investment Game", but with concrete goals, you want to focus on what you control concretely-the amount you invest.

Remember learning about SMART goals in that time management seminar you were late to? SMART goals are:

- **S**pecific
- **M**easurable
- **A**ttainable
- **R**elevant
- **T**ime-Specific

Follow those guidelines as you set your investing goals. For instance:

I will invest $125 (SM) each month (A) into my investment account so I can purchase a new car (R) in five years (T).

I will double (SM) the percentage I'm investing for retirement within 36 months (AT), so I can take greater advantage of my company's 401k match (R).

On my first daughter's 18th birthday (T), I will destroy all copies (M) of My Bride and ban the viewing of Wedding Makeover (S), so I can prevent 50% of wedding costs, and more readily manage expectations (R). I'm the dad (A).

In the end, just like your day feels wasted if you don't have clear tasks to accomplish, your investments can easily be wasted if there's no specific target to reach. If you don't have a specific investment goal in mind, you likely 1) won't get started, 2) won't invest enough and 3) won't continue. You'll be an In 'n Out investor, and while the burgers are good (and shakes even better), you can't do that and win in the investment game over the long haul.

Day 3: Investment Growth

We've discussed the *Why* behind investing (to become obscenely wealthy-kidding!), so today we're going discuss exactly HOW that happens.

I'm still not going to mention stocks, ETFs, mutual funds, or expense ratios. We'll save that for NEVER. Well, almost.

You invest to grow your wealth.

"Jesse, we know! You beat that dead horse all yesterday!"

It's true, I did. We talked a lot about wealth, and why you might want a modest amount of it. Today, we'll talk about the other major part of that statement: *growing* that wealth.

I have this tall grass in a portion of my front yard. When we first put the stuff in, it grew modestly. The diameter of the grass was probably about eight inches in any one spot. The grass has now had four years to grow, and it's killing the other bushes. It's twice as tall, and about four times the diameter that it once was.

And the kicker is that its *rate* of growth is increasing. You may say that my grass is compounding.

For those of you that aren't familiar with the concept of compound growth, I give you a very popular tale (hat tip: Wikipedia):

When the creator of the game of chess showed his invention to the ruler of the country, the ruler was so pleased that he gave the inventor the right to name his prize for the invention. The man, who was very wise, asked the king this: that for the first square of the chessboard, he would receive one grain of rice, two for the second one, four on the third one, and so forth, doubling the amount each time. The ruler, arithmetically unaware, quickly accepted the inventor's offer, even getting offended by his perceived notion that the inventor was asking for such a low price, and ordered the treasurer to count and hand over the rice to the inventor. However, when the treasurer took more than a week to calculate the amount of rice, the ruler asked him for a reason for his tardiness. The treasurer *then gave him the result of the calculation, and explained that it would take more than all the assets of the kingdom to give the inventor the reward. The story ends with the inventor becoming the new king.*

(A bit more digging in Wikipedia yielded the fact that the inventor should have been given about 461 BILLION metric tons of rice. A heap of rice larger than Mount Everest, and 1,000 times more than the world's 2010 rice production.)

Making your investment grow.

There are three components to investment growth. I don't care how fancy anyone wants to make investing seem, it all boils down to these three components, in all their glory:

- The amount of money you're investing.
- The length of time your money will be invested.
- The rate your investment is growing (often called an investment's "return").

Let's dissect all three. The first two aren't too crazy. The third gets a bit trickier. They're all important, so hang with me!

Investment AMOUNT

This is really, really obvious when it comes to lump-sum investing. If you have two identical investments, and in one, you put $1,000 and in the other you put $2,000--well, the one with the $2,000 initially invested will have more money.

Thank you.

And, of course, if you're investing over a period of time, the more money you invest, the bigger your investment will be--all else equal.

I fear this day will be full of similarly obvious statements.

Of course, you control how much you invest, and understanding *what you control* in the investment game is actually a really big deal. We'll get into that in a serious way with Day Six.

TIME for the Investment to Grow

Back to my yard care woes, if I let the weeds go unattended for a week, it's not too big of a deal. If I let them go for a month, I have Weedageddon on my hands, and would rather uproot the family and move into a new home. (With investing, I suppose you *want* this Weedageddon, for yard care, not so much.)

When it comes to investing, time is your best friend, and your worst enemy.

Let's start with an investment goal: You want to have $500,000 saved by the time you're 65:

Age	30	40	50
Years until 65	35	25	15
Growth rate	8%	8%	8%
Req. Monthly Payment	**$218**	**$526**	**$1,445**

Starting when you're 30, you'll need to put away $218 per month. Wait 10 years, until you're 40, and your required monthly investment more than doubles, to $526. Or maybe you don't start at 40, and you wait until you're 50... your payment almost *triples* if you wait another ten years.

Let's look at this another way. You're 30 years old, and you decide to invest $200 each month. Your investment returns 8% per year. You stop investing any additional money when you turn 50 (you went through a midlife crisis and ended up with a $200 car payment for a Chrysler LeBaron--hey, don't ask me, you did it).

Your buddy mocked you when you were 30 years old, because you were investing to win, and opted not to see *Titanic* nine times in the theater. In other words, you watched your pennies. Well, your buddy turns 50 as well and hasn't invested a dime. He sees you in your sweet Chrysler, (falsely) assumes you're rolling in dough, and decides he better catch up. So he *triples* your monthly contribution and starts saving $600 every month, like a crazy man. He no longer plays golf, eats out, or goes to the movies. Same eight percent return.

Fifteen years later, you still (surprisingly) have the LeBaron, and a retirement nest egg of almost $400,000. Your buddy, who hasn't seen a movie in 15 years, has a nest egg of just over $200,000.

That is the power of time. And that is also the last time I'll mention *Titanic*, or Chrysler LeBarons.

Time is something you will never get back. I want you to feel some serious urgency here. Time is your greatest ally with investing! If you're 40, and you haven't set aside a penny, then guess what? Let's get **started!** Do NOT throw up your hands and tell me you've missed your investing window. That's complete and utter nonsense, and I won't have you thinking that way.

You may have missed yesterday's investing window. But you haven't yet missed today's. Don't harbor the attitude that you've missed out, because in five years, you will have missed out on *five* years of growth.

(I was about to say that you'd be exactly where you started if, five years from now, you still had decided not to begin investing earnestly. That's wrong though. If you wait five *more* years, then you're even *further* behind than you are now.)

You are on a treadmill where the speed increases on a regular basis. The only way to slow it down is to start running.

We have six days left in this course. Day Seven is where I discuss STARTING. Be ready to start.

Your Investment GROWTH (rate of return)

There is no shortage of writing when it comes to the rate of return on your investments. I know we've hit on it a little bit with the above examples, but just to make sure we're all super clear on it: Your investment rate of return is the rate at which your investment is returned to you (usually expressed annually).

I warned you earlier that I may throw out some pretty obvious stuff today.

So when someone says they're "earning 10% with some super mutual fund," what they're really saying is that for every dollar they put in, in one year it gives them back 10 cents ($1.00 * 10%).

You may be thinking that it would take ten years to earn back your entire investment, if your rate of return is 10 percent. Nope, because the investment compounds. Remember, every dollar your investments recruit also recruit new dollars.

(Note: a quick way to figure out how long it would take to double your invested money, is to divide 72 by the rate of return you're getting. It's not totally accurate, but it's good enough to give you a ballpark to work with. If my rate of return is 8%, my money will double in (72 / 8 = 9) nine years.)

Understanding your rate of return is critical when determining your investment goals. Unfortunately, the rate of return is a bit elusive. It's best to understand the underlying components of your rate of return, so you can focus in on what you can *control more easily*.

Growth (positive)

This is not the place to get into the reasons why investments become inherently more valuable, but let's just boil it down to this: Your investment rate of return goes up if the value of your investment goes up. Cool? So you buy a house worth $200,000 and then you have it appraised and it's worth $220,000. You had a rate of return of 10% ($20,000 growth / $200,000 investment).

It makes sense that growth plays a role in your investment's rate of return :) As a matter of fact, growth is the only potential *positive* for your rate of return. The rest of the factors can only be zero, at best.

It may be surprising to you what other factors in your investment's rate of return also play fairly significant roles!

Taxes (negative)
Don't get me started.

The tax situation changes like the weather. Taxes are your life's single biggest expense. Don't take them lightly. Minimize them as much as possible, just as you'd try and minimize what you pay for a gallon of milk, or your next car. (Except big wins with tax minimization strategies are much bigger than big wins purchasing milk.)

We can't predict the future, so predicting future tax rates on your investments is a guessing game, at best. Tomorrow we'll discuss various investment vehicles (don't worry if you don't know what I'm talking about) and some tax strategies that come along with them, but for now, let's just leave it at this:

Taxes negatively affect your investment's rate of return. If you predict your investment will return 10%, but your state and federal governments tax you at a combined 30%, then that means you get to keep 70% of your return (100% - 30% in taxes). So your rate of return will be 7% (10% * 70% = 7%).

Inflation (negative)
My grandpa loves to tell the story (again...and again...) of how he would take a quarter, ride the bus downtown, buy two candy bars, see a movie, and ride the bus back home. For a quarter!

A quarter doesn't buy much at all these days. That's inflation.

"A dollar just doesn't buy what it used to."

It's just the purchasing power of the dollar going down over time. That's inflation.

So in 30 years, when your investments are all just spilling out of your pockets, you'll want to make sure you have enough of those investments at the *future* dollar's value.

The easiest way to figure inflation into a rate of return is to subtract it. Inflation since 1900 has averaged about 3 percent. That's right, if your cash is in a savings account earning 1 percent, you're being taxed on that 1 percent *and then* inflation is ravaging it. You're actually losing money :(

With that 10 percent return we've been using, 3 percent went to taxes, and 3 percent to inflation. We're down to 4 percent. Woah.

Transaction Fees (negative)

It takes money to make money, and Wall Street likes to take your money in order to make their money. When you hop over to a broker to purchase a stock, they'll charge you a transaction fee. When you sell that stock they'll charge you a transaction fee.

Let's say you want to invest $500 to get started. If you purchase it through a normal online broker, such as Scottrade, they'll charge you $7. Factor that $7 into your first year's rate of return, and you start in the hole by 1.4 percent ($7 fee / $500 initial investment).

Then sell that initial investment for $600 and you pay another $7, or 1.2 percent ($7 fee / $600 investment sold).

If you are stuck in a situation where you *have* to pay transaction fees, it's best if your investment amounts are larger.

Most brokers will charge you a transaction fee, but there are ways to avoid them (we'll talk more about that when we talk about STARTING).

Investing Fees

We covered fees that you may incur as you *transact* (buy or sell), but there are also fees you incur ongoing. These are often called expense ratios. If the fund you've invested in has $1 billion in assets, and $10 million in expenses (paying managers, paying transaction fees, paying for stamps, etc.), the expense ratio would be one percent.

Expense ratios tend to be more expensive as the underlying investments become more extravagant. I personally avoid mutual funds all together and invest where the expenses are even lower (about .10 percent, or 10 percent of a percent).

Financial Advisor Fees (negative, with a caveat)

Don't confuse financial advisor fees with the expense ratio that is partially used to pay managers of a mutual fund. Many financial advisors will charge what's call an

"Assets Under Management" (AUM) fee that is tacked on top of their client's investments.

If you've invested $100,000 with your neighbor's uncle's brother, and he has an AUM fee of 2%, then he'll charge you $2,000 the first year under management. If he manages to grow your investments, he grows his fee. Many advisors like this arrangement because it aligns the advisor's interest with their client's. Sort of.

If your advisor invests on your behalf, and your $100,000 investment drops to $80,000, your advisor would still be paid $1,600; not the $2,000 he would have made, but certainly a good chunk of change nonetheless. This is often why financial advisors seek out wealthier clients. They dramatically increase the assets they have under management if their clients have assets to invest in the first place!

My favorite investing option, Betterment (this is the one I use personally, except for our company 401k) also charges a management fee of anywhere from .15 to .35 percent. That fee is dramatically less (about one tenth) than what a financial advisor would charge you, but Betterment is able to charge less to the individual because they can serve more people.

Now, I do believe there is a place for financial advisors and their management fee. If an advisor can talk their client out of doing something irrational ("the sky is falling!") and keep them steady on their course, then perhaps that AUM fee isn't too bad after all, since the alternative would be much worse (the client would, perhaps, underperform when left to his or her own devices).

401k Fees (negative, and mysterious)
These are the most nefarious of fees, because they're so darn hard to understand, if you can even get access to something that makes sense. When I set up our company's 401k, I did my best to make sure that there were no administrative fees levied against our team member's investment accounts, and that the business paid those fees directly.

However, not every company is as cool as YNAB, let's just be honest (we're always hiring). And, since we're being honest, I still don't have total clarity on the fees associated with our 401k anyway. It's just a black box. You look at your retirement balance, and you hope it goes up. When it doesn't, you don't have enough information to diagnose what the cause was anyway (market movements, or fees?)

We're making progress, as a whole, on 401k fee transparency, and that's encouraging. I'd just like to see it addressed sooner rather than later.

One "fee" you pay with a 401k is that a lot of the time, you're very limited in the funds you can select, and those funds are more expensive than what you could buy on the open market anyway. So while the administrative fees may be low, if you're forced to use fund A, with an expense ratio of 2.2 percent, and you could get fund VerySimilarToA on the open market with an expense ratio of .85 percent...you're paying dearly for that 401k.

Conclusion

We have covered a *ton* of information here with Day Three!

However, you've learned a lot. You've learned that the sole reason to invest is to have your wealth work for you (instead of you working for every single dollar you ever bring in). You've also learned that there are three components to growth: the time an investment has to grow, the amount you're investing, and the rate of investment growth. Finally, you learned about the individual components that make up your investment growth rate. Those are: intrinsic growth, inflation, taxes, transaction fees, investment fees, management fees, and 401k fees. Man, there are a lot of fees!

(In Day Six we'll distill all of those investing components down to what you can control, and I promise you that you'll feel much more in control as you implement what it takes to win at the investing game.)

Tomorrow, we'll discuss investment types (stocks, bonds, index funds, ETFs). You'll know exactly what they mean, what to avoid, and what to embrace.

Day 4: How to Win the Investment Game

There are is no shortage of books on investing. To be honest, it's pretty overwhelming. You can go from investing for the long haul, to technical trading, to cocoa bean futures. (If you don't know what futures are, don't worry about it. It'll likely be the last time I mention them.)

What many CNBC pundits don't want to tell you, because this never sells ratings, is that investing to *win* is actually...really boring.

So boring, that if you were to try and have me talk for a half hour each weekday on some financial show, I'd run out of stuff to talk about in oh, about 20 minutes. Investing the right way just doesn't sell seats to the show. There's no emotion, there's no panic. It's just slow and steady progress over time.

There are some key principles that you must follow in order to win at the investment game. Today, we'll discuss those principles. They are:

- Starting now.
- Choosing to be boring.
- Understanding risk & reward.
- Understanding allocation.
- Diversifying (appropriately).
- Buying Low and selling high, on autopilot.
- Focusing on what you can control. (Discussed on its own tomorrow.)

Starting Now

This whole discussion is moot if you don't start investing.

The other day I was having lunch with a good friend and we got on the subject of money.

Dear reader, you don't understand, folks confess their money "sins" to me all the time. I wish they knew I wasn't judging them. Really, I'm not :)

He mentions that he's in his thirties and doesn't have a penny put away for retirement. So I told him to start. He says, "Start how?" So I told him to sign up with Betterment (as far as starting goes, and not intimidating people, Betterment wins hands down). I committed him to $100 per month, set up on autopilot.

A few days later I asked him if he had set it up. He had.

Do you realize that if he now just *maintains* the status quo, of investing $100 per month, that he'll have a nest egg of $150,000 when he's sixty? All because he now has to do nothing but maintain. Maybe to some of you that's not a huge amount, but as my dad says, it's better than a kick in the teeth.

The point isn't the nest egg amount 30 years later. The point is that he's now **started**. He won't feel the $100 go out. He won't have to worry about it. It's not even on his radar.

If my friend can start, so can you. **START**.

Choose to Be Boring

Your investments will not be the talk of the party.

"Wow, the market's been really [up/down/crazy/insane] ever since [whatever] happened."

Your witty response: "Yep."

"So, what are you going to do?"

Your second witty response: "I think it's a great time to keep investing."

And those conversations usually die off fairly quickly. Talk football or something. Another friend of mine has a great way of changing the subject of conversations. Just pipe up with:

"So, I'm thinking of getting a jet boat."

And then go wherever that takes you.

The key to winning the investment game is to be BORING. Set it and forget it. Impress people with how many pushups you can do, not with your stock-picking prowess.

Have you ever noticed how people don't talk about their "investments" in their online savings accounts? That's because those are predictable, boring, stable, insured conversation-killers. That's how your investing should be. As boring as an online savings account.

Risk & Reward

I hold in my hand a coin. I'll flip it, and if it's heads, you have to give me a dollar. If it's tails, you get to keep your dollar.

Would you take that bet? Absolutely not. There's only risk, and no reward. At best, you don't lose something.

Alright, if it's tails then, you get one of my dollars. Would you do it? Maybe. Some of you like to live on the edge, some of you don't. What if you could win two of my dollars? Or three? Or four?

As the potential reward increases, you're willing to accept the risk.

With investing, the risk is that you'll lose your money. Really. It could go to zero. So you weigh that risk with the potential reward of your money growing, outpacing inflation, being able to fund whatever your goals are, etc.

We'll get into investment types tomorrow, but for the sake of a risk vs. reward discussion, just understand that some investment types offer greater risk and greater reward. Other investment types carry much less risk, and much less potential reward.

For back-of-the-napkin discussion here, you can assume that investment types are listed here from least- to most-risky:

- Cash
- Bonds
- Stocks

Within bonds and stocks you have varying degrees of risk and reward, but we'll get into that tomorrow.

What's important to realize is that *how* you're invested in these various assets has a huge impact on your risk and reward. The mix of these assets is called your asset allocation. That's an important principle there, because it's totally controllable (by you), and has a massive impact on your investment returns.

What we want to do is make sure your asset allocation matches your desired risk and reward. You can mix cash, bonds, and stocks in the right way to get to virtually any risk/reward profile.

Consider the 20-something that has forty to fifty years until they'll retire. They can have a portfolio that is subject to a lot of risk, because they don't need that money for decades!

So if our 20-something's portfolio drops by 25%, will they be in trouble? Not at all. They can ride out the dips in their investment, keep investing with their head down, and not miss a beat.

But 40 years later, our 20-something is now sixty-something. They want to retire next year. Can they tolerate their portfolio dropping 25% in a single year? No! They need that money to stick around now, because they're going to want to start using it!

So the sixty-something's risk tolerance is much lower, their reward is much lower (which is fine, because they've amassed their wealth and are more concerned with preservation than growth), and their asset allocation should reflect that.

Asset allocation is a way to spread across many asset classes, in order to not be taken for a wild ride by any single class. Luckily, in this day and age, being properly allocated is as easy as clicking a few buttons. You just need to know what buttons to click :)

Diversify

You don't want to invest in a single stock, or bond. You want to be invested in many stocks, and many bonds. That way, if one stock tanks, there will be 2,000 others that might climb (literally, you *can* own every single stock available on every market).

What you're doing when you diversify is placing a small bet on every company. Some companies will fail, others will thrive, some will just kind of sputter along. That's okay! If you believe that, in total, companies and economies will grow, then you should happily take part in the entire process.

One problem people run into, actually, is that they *think* they're diversified because they're invested in multiple mutual funds (which hold many stocks). Upon closer examination of those mutual funds, you realize that many of them are holding the same stocks!

Diversifying your portfolio is very simple, and I'll show you how when we talk about actually STARTING in a few days.

Buy Low, Sell High (of course...)

You hear the mantra to buy low, and sell high. Did you know that most investors do the exact opposite? Investors see that their investment is going up and they think, "Yeah! This investment is going great! Me wants more!" And that is right before the investment takes a nosedive.

And with a nose-diving investment, the inclination is not to think, "Yeah, I want to put my money in that plummeting investment!" You think the opposite: "I gotta get out!" So right at the bottom, you sell your investment, having eaten all of the losses.

This has been proven in academic circles again and again. Investors do exactly the opposite of what they should do.

So, how does one buy low, and sell high *automatically*? You'll be very happy to hear how easy it is. It's all in your asset allocation. There's a certain mix of assets that you want to hit with your investing (given your risk tolerance). Let's work with just two simple assets, recognizing that these represent diversified investment types -- not single stocks or bonds.

Based on your risk preference and time horizon, you decide you need to be 50% invested in stocks, and 50% invested in bonds. Let's say that portfolio is $20,000 where $10,000 is in stocks and $10,000 in bonds.

Then stocks go on a tear! They're up 30% on the year. Bonds, meanwhile have take a 10% dip. Your overall portfolio is up 10% on the year, valued at $22,000 and you're feeling really good about things.

However, your mix is now off. Stocks grew from $10,000 to $13,000 ($10,000 + 30% growth) and bonds dropped from $10,000 to $9,000 ($10,000 - 10% decline). Your new asset allocation is not 50/50, it's 59% stocks ($13,000 / $22,000) and 41% bonds ($9,000 / $22,000).

You want a 50/50 split. Your target mix is $11,000 in stocks, and $11,000 in bonds, because your $22,000 is divided equally between the two investment types.

So you sell $2,000 of your stocks, and purchase $2,000 of bonds. You've now sold stocks when they were high, and bought bonds when they were low. It's very true that stocks may still continue to rise, and bonds may continue to fall, but as you hold your ground on this principle over the long haul, and as long as the market rises over the long-term, you will end up buying low, and selling high. Its fancy name is dollar-cost averaging.

Did you notice how much math we did right there? Or did you just skim over all of those numbers? Well, good news. There are a few services that now do it for you. You just invest the $100 (or whatever) and the purchase will be made based on your desired allocation. It takes no brains, no stress, and no time. Which is why I like it, and you should too.

The fallacy of trying to time the highs and lows

Trying to time the highs and lows of the market is a fool's game. It can't be done with any reliability, and you shouldn't waste your time trying.

What usually happens is that people get wrapped up in the emotion of their investment and buy high, then sell low. In fact, waiting for the perfect time to get back into the market can have a disastrous effect on your returns!

Conclusion

We've covered a good bit of ground here! You now recognize how important it is to start *now*. You know that boring is better. You understand that when you take more risk, there is a higher potential reward. We talked about the importance of proper asset allocation, diversifying, and buying low and selling high.

Since today was pretty epic, we'll wait until tomorrow to discuss one final principle to win at the investment game: You have to become a control freak.

See you tomorrow!

Day 5: Become a Control Freak

Yesterday we discussed some key principles to winning the investment game (starting now, balancing risk & reward, proper asset allocation, diversification, and *not* trying to time the market.)

Today we'll discuss one final principle of winning the investment game, and that is to *focus only on what you can control.* Yes, I want you to become a control freak.

Focus on what you can control

Here are the various aspects of investing, listed from what you MOST control, to what you LEAST control:

- Time (when you start investing)
- Allocation (how you're investing, based on your risk)
- Amount (how much you're investing)
- Your return on investment

You control with 100% certainty, WHEN you start investing.

So decide to start today. Some of you will say that you don't have enough money to begin investing, and I would say that you haven't looked hard enough. Others of you would tell me that you're first focusing on your debt pay down, and I would tell you that THAT is investing (your return is the interest you're AVOIDING).

You control when you start investing. Start today.

You control with 100% certainty, HOW you will invest.

If you take a look at your investment time horizon (are you 25, with 40 years to invest, or 50, with 15 years to invest?), you can determine the proper asset allocation and choose that allocation with absolute certainty. William Bernstein, author of *The Four Pillars of Investing*, says it best:

"Since you cannot successfully time the market or select individual stocks, asset allocation should be the major focus of your investment strategy, because it is the only factor affecting your investment risk and return that you can control."

You can control, with limitations, how much you invest

I'm a budgeter. I understand zero-based budgeting, and I get that money doesn't grow on trees. The amount you can invest is dictated, a lot of times, by what other expenses you're already dealing with.

However, I would encourage you to prioritize your investing *first*, and then give a critical look at your expenses. Let your need to invest drive the discussion, and not your need to consume, or maintain the status quo of your expenses.

If you're waiting for some "extra money" before you begin investing, I believe you'll be waiting for a long time. Scrutinize your expenses, find that money, and begin investing for the long term.

To give you just one more little something to chew on, consider this:

John invests $100 per month for 30 years, earns an 8 percent return, and ends up with a little nest egg of $149,000.

Steve steps it up just *slightly* and opts to eat out *one less time* per month, so he invests $150 each month. Same return. Same thirty years. Steve's nest egg is $223,000--$74,000 more for eating out one less time each month.

(Oh, and in case you're wondering, Steve invested an extra $18,000 over the thirty years. That $18,000 generated the additional $56,000 which he can turn around and use to eat at restaurants, I suppose. They'll probably just be nicer restaurants.)

Remember what a difference 10, 20, 50, or another 100 dollars can do you for your investments. They are game-changers over the long haul. Could you save $20 per month somewhere, and have that automatically invested? I know it seems small, but it will grow to be substantial!

With your investment return, control what you can, and don't worry about the rest. Your investment return, as discussed earlier in this course, is made up of your:

- investment cost (often called your expense ratio)
- asset allocation
- taxes (taxes are under your control to a certain extent. We'll get into it in a few days.)
- market performance

Investment Cost

You control this. Yes, there are costs that can't be avoided, but you can just as easily avoid an investment with a one percent expense ratio, and find something that charges you a tenth of that.

Some financial advisors/gurus will claim that they can pick mutual funds that outperform their peers, even with larger expense ratios. You'll hear it touted, "I'll gladly pay an extra percentage point if my return with that fund gains me an extra two percent!"

Well, of course you would. But you can't very well pick those funds (just like you can't pick individual stocks with any reliable accuracy), so it's best to focus on what you CAN control (the cost), and diversify like crazy.

Asset Allocation

We discussed asset allocation yesterday already. It's a big deal. It makes up a large part of your return. You need to make sure your allocation is appropriate to your risk tolerance, and time horizon. I'll probably say that twenty more times. In fact, I'll say it again now.

Asset allocation is in your control, and it's important.

Taxes

At this moment, taxes are totally up in the air for investors. We are never sure what Congress will do, so we're always in a bit of a holding pattern. You can't very well control what happens with the tax code. You *can* however, do some things to help you minimize your tax bill.

Understanding how you're taxed, and doing your best to minimize those taxes, is completely in your control. Avoiding funds that buy and sell frequently, usually the appropriate tax-sheltered vehicles (covered later), and selling your holdings very infrequently will all help you minimize your tax bill and increase your return on investment.

Market Performance

You are at the mercy of the Market Gods at this point. You have NO CONTROL over market performance. Just get used to it, get over it, and find a way to invest another $100 each month :) While it's true that, over time, investments track earnings, in the short-term, investment performance follows the market sentiment for investing. That market sentiment is an unpredictable, emotional roller coaster, and **I'd rather play with my kids than agonize over market movements, P/E ratios, and what the Dow did today.**

Be Lazy

In the end, when it comes to investing, I want you to be lazy. Put things on autopilot, set it, and forget it.

The great thing about technology these days, is that you can follow every single one of these principles of investing automatically, without changing anything, for...ever.

I'm reminded of the Japanese soldier that was sent into the jungle of a small island in the Philippines. He was told to conduct guerrilla warfare until he received other orders.

Seven months later, the war ended, and he didn't get the news. He ended up staying in the jungle for 30 years conducting reconnaissance, avoiding enemy search parties (these were legitimate search parties looking for him), and doing his duty.

Think about that! He was given a job, and he executed on it for 30 years. THAT is how I want you to be with your investments. Send them off with instructions, and then leave them alone.

Be lazy with your investing.

Conclusion

Tomorrow we'll dive into the specific investment types. It'll be informative and fun. Well, it'll be informative.

Day 6: Investment Types

I'm going to call today's topic a "necessary evil." Evil because it may get a smidge dry (that was just said by a *former* CPA, so use your relative scale and consider yourself forewarned), and necessary because I want you to understand, on a fundamental level, what you're investing in.

Today, we'll discuss the various types of investments, and then tomorrow, we'll get to investment *vehicles*. Investment vehicles are what the investments ride around in. They're completely different things, but I see people often confusing the two.

What We'll Cover

I'm just going to throw this list out here to let you know what's coming, and then, when you understand every single one of these things in twenty minutes, you'll feel really good about the day.

We're going to cover:

Stocks

- Mutual Funds
- Index Funds
- ETFs
- How to value a stock (Correction: How people *try* and value a stock.)

Bonds

- Government
- Corporate
- Junk… (really, they're called junk bonds).

Cash (we all get this one!)

There are other alternative investments but we won't talk about any of these, and thank heavens for that.

Stocks

When you invest in a stock, you're purchasing a share, or piece, of a corporation.

You're then an owner. If the company does well, the value of the stock goes up, and if the company does poorly, the value of the stock goes down. Stocks are traded on exchanges. To purchase a stock, you buy it through a broker.

Think about that though. You can own a little bit of General Electric, Apple, Microsoft, Google, Wal-Mart, or my favorite, and then one where I doubled my money in two months while I was in college, Singing Machines.

It's a longer story, and I actually talked about it in a YNAB Podcast if you want to listen (about five minutes long).

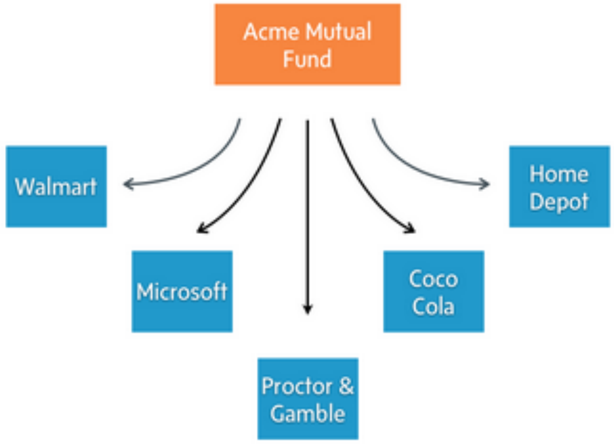
This is a key concept: While stocks are riskier than other investment types, they have provided a greater return historically.

Mutual Funds

Let's say I think it's prudent to not put all my eggs in one basket, and I want to spread my investments over many stocks (this is a *really, really, really important principle*) to be *diversified*. I would consider investing in stocks via a mutual fund.

With a mutual fund, *many* investors pool their money and then the fund purchases investments on behalf of the investors. The fund bears its own expenses (remember a few days ago, where we talked about investment expenses). This allows you to purchase one share of a fund, and have that share represent a lot of separate stocks.

For example, I just googled "best mutual fund" (don't ever do this) and found an article listing...the best mutual funds. If only it were that easy! But anyway, TheStreet.com rated some mutual funds, and as of 9/30/2012, COBYX was listed first. Again, NO IDEA how TheStreet.com rates these. It was my third time on that site.



My point, is that this fund, called "The Cook & Bynum Fund" holds the following stocks: Wal-Mart, Microsoft, Arca Continental, Berkshire Hathaway (Warren Buffet's company), Tesco, Mondelez International, Proctor & Gamble (investing is not gambling...), Coca-Cola Co, and Orchard Sply Hardware Stores Pfd.

You can own pieces of each of those nine companies, by purchasing one piece (share) of this COBYX fund. Wait until we get to Index Funds and ETFs. You can own a whole *slew* of companies when you buy one of those!

(To be clear, mutual funds don't just have to be invested in stocks. They can invest in bonds, cash, real estate... I only used stocks as the example because we just talked about those. Each mutual fund has a goal, and that goal can lead the fund managers to purchase any number of different investment types.)

At the end of the day, mutual funds are a great way for you to diversify your investments. Some are better than others. My favorite kind of mutual fund, is the kind that isn't actively managed by an investment team, but is passively managed. This leads us to a special kind of mutual fund, called an Index Fund.

Index Funds

Index funds are mutual funds that automatically invest in all of the companies in an index, or list. For instance, if you're listening to the news while headed to work, you'll hear talk of the S&P 500. The S&P 500 is an index (list) of 500 top publicly traded companies in the US, and is maintained by Standard & Poor's (a private company).The S&P 500 index is based on the market value of the 500 companies chosen by S&P.

A Hairy Example

Let's make our own index, so I can explain it better :)

I'm going to make an index of companies with left-handed CEOs that are 70 inches tall, and extremely good looking. I come up with five:

- YouNeedABudget.com, valued at a bajillion dollars, but for our example, valued at $100,000.
- Company B valued at $80,000.
- Company C valued at $60,000.
- Company D valued at $50,000.
- Company E valued at $10,000.

  Total value of the Index: $300,000

I'll then *weight* my index, based on the company's values.

Since YNAB is valued at $100,000 and the total index value is $300,000, YNAB represents 33% of the index ($100,000 / $300,000). Now I can do the same math for each of the companies (company value *divided* by index value):

YouNeedABudget.com $100,000 / $300,000 = 33%
Company B $80,000 / $300,000 = 27%
Company C $60,000 / $300,000 = 20%
Company D $50,000 / $300,000 = 17%
Company E $10,000 / $300,000 = 3%

So my Left-handed-70-inches-tall-extremely-good-looking company index would have those weights. And if someone wanted to create a left-handed-good-looking index *fund* to follow my left-handed-good-looking index, they would purchase shares in those proportions. In other words, if this index fund owned 100 total shares, it would have:

33 shares of YouNeedABudget.com (33% of 100 shares)
27 shares of Company B (27% of 100 shares, etc.)
20 shares of Company C
17 shares of Company D
3 shares of Company E

If you purchased ONE share of the left-handed-good-looking index fund, you would own bits of those five companies, in those proportions.

Oh my gosh, go take a break. That was intense.

The IMPORTANT Difference Between Mutual Funds and Index Funds

I mentioned that many mutual funds are run by a management team. These are investment professionals and it's their mission to earn the highest returns for their investors. They want to attract other investors to their fund, because their percentage-based management fee will be larger.

You have these investment professionals out there basically investing on your behalf, if you're invested in a mutual fund. These funds, where investment professionals actively manage them, are called "actively managed funds." Cute, I know.

There's another group of mutual funds that are not actively managed. They're called "passive funds." Index funds are passively invested. Again, the creativity is breathtaking. An index fund's investment choices are governed solely on matching the index that the fund is following.

From our hairy example, if our index fund that followed left-handed-good-looking-CEO companies received an investment of $1,000, we would automatically use 33% of that money to purchase YNAB, 27% of the money to purchase Company B, 20% of the money to purchase Company C, and on down the line. This would keep our index fund in sync with the index that it's tracking. Because there's no active decision to make on how much (or what) to invest in, this is passive investing.

I'm a huge fan of passive investing because:

- It's completely hands-off.
- Fund expenses are lower.
- Your investment performance improves*

*That's IF you follow the principles outlined later in this course. If you "actively manage" your passive funds by jumping in and out of them every other week, you're kind of your own worst manager at that point.

Index funds are, in my book, a great way to passively invest. And passive investing, in my book, is a sure-fire way to outperform almost every other investor out there.

But hey, don't just take my word for it. What does the greatest active investor of all time think?

"Most investors, both institutional and individual, will find that the best way to own common stocks is through an index fund that charges minimal fees. Those following this path are **sure to beat the net results (after fees and expenses) delivered by the great majority of investment professionals.**" - Warren Buffet, 1997

Warren Buffet may not know what he's talking about. I concede. But what about William F. Sharpe, a Nobel Laureate in Economics? He said:

"Properly measured, the average actively managed dollar must underperform the average passively managed dollar, net of costs. Empirical analyses that appear to refute this principle are guilty of improper measurement."

Burton Malkiel, author of one of my favorite investing books, "A Random Walk Down Wall Street" says this:

"...Experience shows conclusively that index-fund buyers are likely to obtain results exceeding those of the typical manager, whose large advisory fees and substantial portfolio turnover tend to reduce investment yields."

Oh wait, you *do* think Warren Buffet has some credibility? Let's end on this one then, straight from the Oracle of Omaha's mouth, and as always, very concise:

"The best way to own common stocks is through an index fund."

Warren Buffett wrote that in 1996. Since then, ETFs were born.

Exchange-Traded Funds (ETFs)

ETFs are also mutual funds, but they're traded like stocks, and have some very attractive advantages that normal mutual funds just can't beat.

ETF expenses can't be beat

Because ETFs are traded like stocks, they don't have all of the management overhead that a normal mutual fund has. Where mutual fund expense ratios can be anywhere from one to three percent (index funds can be lower than one percent), ETFs usually have expenses around one *tenth* of one percent.

As we saw when we discussed compound growth, the expenses you pay can have a *massive* effect on your returns over a long period of time.

More tax-efficient than a normal mutual fund

Taxes are your life's single biggest expense, so I encourage you to take them seriously. ETFs are tax efficient *as long as you don't sell them*. If you're buying and selling constantly, then you'll be paying taxes on any gains. You shouldn't do that, and we'll discuss why in a few days.

Beware of trade commissions

Most brokers will charge you per trade, anywhere from $10 to $20. (My favorite broker, Betterment, does not charge per trade, which is one of the reasons I recommend them.) If you're investing $100,000 then paying $10 for the trade isn't too big of a deal (it's one-hundredth of a percent, if you were wondering). If you invest $500? Suddenly that $10 commission just ate two percent of your return.

My recommended way to invest in stocks, is through ETFs.

How are Stocks Valued?

We've talked about stocks, and the different investment types that hold stocks (and bonds, which we'll get to). But how are stocks valued?

Basically the same way anything else is valued. It's what someone else will pay for it.

That's totally a copout answer.

What factors determine what someone will pay for a stock? I'm going to grossly simplify this, because 1) I don't know and 2) you shouldn't care. The only reason I even bring this up is so you have a better understanding of what you're investing in.

Future Earnings

Investors *project* what the future earnings of a company will be, mainly using a combination of Magic 8-Balls, Darts, and Historical Performance. None of those methods determine future results. But based on whatever future earnings they come up with, they'll then determine if the stock, as it's priced now, is a good buy.

Dividends

Company's will sometimes elect to pay back some of the earnings to shareholders in the form of dividends. It's the company's way of saying, "Hey thanks, here's some money." Or it might also mean, "We have no idea how to further invest the excess cash, maybe you do." It might also mean, "We're so profitable right now, we don't *need* this money. You have it."

All else equal, if a company is paying a higher dividend, then their stock's value will also be higher.

Stocks in Summary

Owning a stock makes you part-owner in a company. They're risky in the short-term. Less-risky in the long-term. You can't predict how a single stock will move over the short-term, and over the long-term, you can't either. When investing in stocks, you should be well-diversified (more on that later). The best way to invest in stocks is passively. The best investment type for diversified, passive investing, because of its tax efficiency and extremely low expenses, is ETFs.

Tomorrow we'll discuss bonds! No worries. They're just a fancy way of governments and corporations saying, "We want to borrow some money," and the buyers saying, "We want to lend it to you!"

Day 7: All About Bonds

Bonds

A bond is a loan You'll mainly see bonds being issued by governments (federal, state, county, city, etc.) and corporations.

A Quick (honest!) Example

Let's use YNAB as an example.

YNAB wants to issue bonds, to borrow some money, to buy an office building (we would never borrow money in real life, to be honest). So we go to the bond *buyers* and say, "Hey, if you'll each lend us $1,000 we promise to pay you 7% interest."

We issue 100 bonds, we have 100 bond buyers, and those bond buyers will all be paid 7% interest. That interest is called the coupon rate. YNAB gets $100,000 total (100 bond buyers * $1000 bond value), and each buyer can expect $70 of interest payments (7% * 1,000) each year.

This is pretty straightforward isn't it? The government does the same thing. They promise to pay a certain amount of interest if you buy one of their bonds.

Bonds are less risky than stocks

Bonds are less risky than stocks, and there are good reasons why:

- If a company goes belly up and has to liquidate, bondholders would be paid *before* stockholders. Stockholders get what's left.
- There is an expiration on the bond, meaning your money will eventually be paid back to you (the $1,000 you lent YNAB, at the end of the bond's term, will be paid to you). If you own a stock, it's very rare that your capital is returned to you.
- Bonds are paid interest *before* stockholders are paid any dividends (the company is obligated to pay the interest, they are not obligated to pay a dividend).

But bonds are still risky

Bonds are less risky than stocks, but there are still risks! If you own a bond, you're worried about three things:

- Default risk. If the company goes bankrupt, they may not be able to pay you back. Your initial investment, and the future interest payments that investment would have earned, would be lost.
- Interest rate risk. You may buy a bond from YNAB at 7%, and then watch as interest rates rise across the market! Suddenly, you're stuck with a 7% payment on your $1,000, while your neighbor (who doesn't even cut his grass!) invests in a bond that's paying him 10%.
- Inflation risk. We talked about this risk as it relates to your overall investment return, but it specifically affects bonds. In an environment where a dollar buys less and less each day, the $1,000 you invested that bought a nice computer ten years ago, may only be "worth" $750 when it's paid back to you.

Types of bonds, and their relation to risk

We'll just examine two popular categories of bonds:

Government Bonds

Government bonds carry the least risk (and lowest return, as we've discussed). A federal bond is less risky than a municipal bond, because the municipality may become insolvent, but the federal government will never become insolvent.*

*That's a pretty loaded sentence there, isn't it? If the government couldn't honor its bonds, it would print money to pay those bonds, which would introduce inflation, which would devalue the bonds anyway. It's a whole other area that I don't want to get into.

Corporate Bonds

Corporations have different credit ratings, just like your own personal credit score. So according to those ratings, bonds from some corporations are less risky than bonds from another. Corporate bonds are riskier than government bonds, because corporations can fail and end up not paying their bondholders.

How a bond is valued

The valuation gets kind of tricky, so I don't want to go into the math of it. Just know that if people anticipate interest rates going up, then bond values will go down. If they anticipate interest rates are going down, then bond values will go up.

Remember, if you've been promised 7%, and then market interest rates drop to 3%, you have a winner on your hands! Your neighbor will be so jealous that you've locked in 7% earnings, he may come to you and offer you more than the $1,000 you invested, giving you an instant return, and giving him the 7% payment now.

Bonds in Summary

Bonds are less volatile than stocks, and certainly belong in a well-diversified portfolio. Because they are less volatile than stocks, they're used to make a portfolio more conservative. The same rules that apply to stocks apply to bonds: there are inherent risks, you want to diversify to spread those risks, and you want to invest in bonds passively. Luckily, there are ETFs for bonds *as well*, that let you instantly diversify, and invest passively. The risks with bonds are obviously still present in a bond ETF.

Conclusion

We covered a ton of ground in the last two days. It's important you understand every investment you make, and if you don't understand it, don't do it. Hopefully with this section of the course under your belt, you have a great basic understanding of stocks and bonds, mutual funds, index funds, and ETFs. You should know that both investment types should be part of a diversified portfolio, and that investing in ETFs gives you the greatest tax advantage (if you buy and hold!), and smallest investment cost.

Day 8: Investments and the Vehicles They Drive In

Today we are not going to talk about investments. We are going to talk about investment vehicles.

Too often, when someone asks me a question about investing, it goes something like this:

"Should I invest in stocks, bonds, or maybe a Roth IRA?"

That person is confused, stuck between investments (stocks and bonds), and investment vehicles (a Roth IRA).

Just like a car carries around people, an investment vehicle carries around investments. That's it.

A checking account holds cash. A 401k holds mutual funds. You don't invest in a 401k. You invest in a stock or bond, which may or may not be held in a 401k.

Investment vehicles just drive the investments around. Different vehicles are headed to different destinations. Cool?

Investment Vehicle Destinations

These destinations offer great ways to "get away" (see what I did there?) from some tax liability, which is always a great thing. Most of these vehicles mainly have something to do with your tax bill.

With some vehicles, your investments pay taxes before they can even get in the car. With other vehicles, your investments pay taxes after they get *out* of the car. And finally, with most vehicles, investments grow inside the car and aren't taxed until they get out.

Tax-Deferred (Investments pay tax after they get out)

If you take some investment dollars and shove them in a tax-deferred vehicle, that means you won't have to pay taxes on that income until you let the dollars out of the vehicle.

The catch with tax deferral is that you can't let the dollars out until you're really, really old (59 1/2) (I'm a thirty-something brat, so I'll continue saying stuff like that until I'm 48), or you'll pay a hefty penalty (and the taxes).

This isn't a "catch" but recognize that you don't know what your tax rate will be when you let those investment dollars out of the vehicle. If you defer your dollars when you're being taxed at 15 percent, then pull those dollars out when you're being taxed at 40 percent…not the greatest.

Tax-Deferred Growth

While your investment dollars are driving around in some vehicles, they're picking up hitchhiking dollars found on the roads of Economic Growth Way, Dividend Drive, and Asset Allocation Avenue. Those dollars will not be taxed until they exit the vehicle as well.

Tax deferred growth is a HUGE factor.

Take two, one-time $1,000 investments, A & B. They both grow at eight percent for 30 years. Investment A's growth is taxed at 20% all along the way. Investment B's growth is taxed at 20% only at the very end (once the dollars get out of the vehicle). After thirty years:

Investment A (taxed along the way): $6,786
Investment B (taxed only at the end): $8,749

Yeah, maybe you're saying that's just a small difference, two grand. Alright Mr. Moneybags, that's a 29% difference in your *retirement*. To get your eyes to grow big, let's pretend you invested $1,000 monthly, instead of just at one time. After thirty years at eight percent, your tax-deferred-growth investment would have an extra hundred thousand dollars in there.

Or let me put it another way, because you chose to use a vehicle where growth wasn't taxed until you pull the money out, you can spend 29% *more* on 4:00 early-bird dinners, bingo night, golf, and your grandkids!

Bear in mind, you're investing the money ANYWAY, so why not have it hop in a vehicle where the growth is sheltered from taxes until you choose to take it out?

Employer Matching

This is free money. At YNAB, our team members have three percent of their salary contributed to their 401k, and it vests immediately (vesting is just a fancy word that means it becomes the employee's money). They get the contribution whether they choose to contribute their own dollars or not.

But, at a lot of companies, you'll get employer contributions to your retirement only if you also contribute.

At my prior employer (the only other employer I've had, so pardon the lack of a broad perspective here), they would match each percentage of an employee's contribution with an employer contribution--up to three percent.

Put this way, you elect to save a dollar, and your employer will toss a dollar in there as well. And it's yours! (Depending on vesting schedules of course.)

Put another way, you just invested one dollar, and your return on investment was 100%. You instantly doubled your money!

Taking your employer match is an absolute no-brainer. Let's just hope your employer's investment vehicle (401k, 403b, etc.) has some decent investment options, with reasonable fees (even with somewhat lousy fees, the match still makes it worth it).

Taxed Now, Not Later

One final investment vehicle will take you to a tax FREE destination (eh, sort of). The trick is that you pay taxes on the dollars just before they hop in the vehicle, and then you won't be taxed on those dollars when they come out.

This makes particular sense if you're in a low tax bracket now, and expect to be in a higher tax bracket when you actually want to pull those dollars out of the vehicle. But...

I spent some time digging into historical tax rates and, man, they've been all over the board. In 1913 if you made under $453,000 (in today's dollars) you'd pay one percent. In 1944, toward the end of World War II, at that income level you would have paid 72 percent! A Taxed-Later vehicle would have been nice then. Thirty years later, in 1974, you would have paid 62 percent. And now, in 2012 at the time of this writing, you'd pay 40 percent.

Without knowing what your tax rate will be when you pull dollars out of the vehicle, what should you do? Nothing. Don't worry about it. Remember, one of our keys to winning the investment game is to focus on what we can control. We can't control Congress.

Bonus Material You Can Skip, Or Become Really Savvy by Reading:

When you're looking at tax-now, or tax-later and comparing the two, it's common for your brain to melt. Mine did a little bit in writing this.

One important aspect of all of these numbers, is the behavioral side of things. Let me give you a very on-topic example.

If you compare a tax-now vehicle, with a tax-later vehicle, the math will work out to be the exact same (if you're in the same tax bracket when you put the dollars in, and when you pull them out).

See, it goes like this.

Let's say I have $1,250 to invest in a tax-later vehicle. Since I don't have to pay taxes on those dollars, I put all $1,250 in there.

OR

I have a tax-now vehicle, and I'm taxed at 20%, so I take my $1,250 and pay $250 in taxes. I now can only invest $1,000 and stick it in my tax-now vehicle.

They both grow at the same rate. In thirty years (or whenever), I pull them out. The tax-later vehicle has to pay 20% in taxes on the contributions and growth, where the taxed-30-years-ago vehicle has already paid all of their taxes!

Well, guess what happens? You end up at the exact same amount.

So, tax rates aside (because we can't predict them), does it even matter? Yes, it does. Because you're human.

People will not think to themselves, "Okay, this is going into a tax-deferred account, so I'm going to take the $1,000 that I have and divide it by 1 minus-my-marginal-tax-rate to get to my with-tax-savings investment amount. And THAT is what I'll invest." Nope. Only person I know that does that is my friend Nate, who's a CPA, CFP, and probably CIA.

What I'm saying is this: people will invest what they have available. They will NOT invest the EXTRA they're saving on their taxes along with it.

For that reason, and that reason alone, I recommend a tax-now versus tax-later vehicle.

(There's actually one more reason why the Roth is superior to the traditional IRA, and that has to do with the contribution limits. You can listen to that podcast here.)

Types of Investment Vehicles

The numbers I cite here will change. Probably tomorrow. But the principles should remain the same. They have limitations attached to them, special rules, etc.

One common limitation you'll find is how MUCH you're allowed to contribute (further limited by how much money you earn). Another limitation is what kind of access you have to the money. Finally, some of them are more of an administrative nightmare than others (especially for the self-employed. Been down that road, not fun.)

4-0-What?

They sound really confusing, because they're named after the section of the tax code where they were created. Creative, I know.

A 401k is a "defined contribution plan" put in place by private, for-profit businesses. YNAB has a 401k for its team members.

A 403b is virtually the same vehicle as a 401k, but it's set up by not-for-profit businesses.

Then you have the 401(a) and 457 plans, which are virtually the same as the two above, but they cover employees of local and state governments.

Another similar vehicle is the Thrift Savings Plan, which is a 401k for all federal employees that are not covered by CSRS (Civil Service Retirement System).

All of these are:

- Contributions taxed later
- Growth taxed later

Profit-sharing plans, KEOGHs

These are varied quite a bit, so I can't go into details. But know that contributions are taxed later, along with growth. Also, if you're an employer/employee you could potentially contribute as the employee and then have the employer (also you) contribute quite a bit more. So your total deferral can be very high.

Traditional IRA, Roth IRA, SEP IRA, and SIMPLE IRA

The IRA and Roth IRA are easy to set up (literally, clicking a mouse a few times), so that wins points in my book. The IRA and Roth IRA have very low contribution limits ($5,500 for 2013, or $6,500 if you're 50 or older). That's their big downside.

The SEP IRA is for self-employed individuals. It comes with more administrative nightmare, but you can contribute as an employer/employee to potentially defer quite a bit of income (up to $49,000 for 2012 I believe).

The SIMPLE IRA is exactly like a 401k (it's run by an employer), but it doesn't allow you to contribute as much--not nearly (though it's more than a traditional or Roth IRA). Honestly, I'm not sure what the draw is on SIMPLE IRAs except that they're easier/less costly to administer.

IRA, SEP and SIMPLE IRAs are all taxed *later* with tax deferred growth. The Roth IRA is taxed *now* with tax deferred growth. From our earlier discussion on the behavioral side of things, I recommend the Roth over the traditional IRA. However, if you can find a vehicle that lets you contribute more (SEP, SIMPLE, or a 401k), I'd go that route.

Roth 401k

Say What?

That's right.

If you're liking the sound of the Roth IRA, then you should hope against hope that your employer offers a Roth 401k. It's just like the Roth IRA except you can contribute a bunch more, and you're not subject to income limitations.

The only downside to the Roth 401k is that you are forced to begin taking distributions at age 70 1/2. Still, the ability to more than triple what you can contribute outweighs that.

Um, Jesse. I just woke up. Is there maybe a cheat sheet or something, that will tell me which vehicle to use when investing?

Yep (said the former accountant). Listed by preference/priority:

- Roth 401k (or equivalent) up to the match.
- Traditional 401k (or equivalent) up to the match.
- Roth IRA up to the maximum.
- Roth 401k (or equivalent) up to the maximum.
- Traditional IRA up to the maximum.
- Traditional 401k (or equivalent) up to the maximum.
- Traditional non-deductible IRA up to the maximum.
- Just invest without an investment vehicle.

Conclusion

Investment vehicles are not investments! Vehicles just change the investments' destination. Some destinations will be taxable deposits and tax-free withdrawals, others will be tax-deductible deposits, and taxable withdrawals. From a what-you'll-actually-end-up-doing standpoint (not a mathematical standpoint), tax free withdrawals are superior to tax deferrals. For that reason, things with "Roth" in front of them are better than their non-Roth counterparts. A 401k (or its equivalent) is superior to an IRA because you can put more away.

In the end, use these vehicles if they're available to you. They'll help you cut down on one of the biggest investment costs you bear: taxes.

Tomorrow we're going to get into the nuts and bolts. Getting started. You'll be pleased to know that it is dead simple, AND you'll be investing the right way. Oh, and you won't have to spend any time maintaining it. Beach. Good book. That type of thing.

Day 9: Starting!

We've discussed why you're investing, how investments grow, and specific principles on winning the investment game. We've also covered the various investment types (though admittedly, not all of them), and investment vehicles that may be available to you.

And now we get to start.

Starting anything is tough. Starting to invest is probably one of the toughest, because the natural tendency is to want to have everything *just right*. Hopefully today's installment will prod you along to just...start--even with a "ridiculously small" amount.

What were our five components of an investment?

Let's review them here, making sure we're covering them all with our Starting Now strategy. I've listed them by order of control, from complete control, to no control.

Time

In order to do this correctly, you have to start. Today. You cannot beat yourself up about not starting yesterday, or ten years ago. Think about it this way: The only correct time to start, is right now. Since you cannot start before now any longer, that is not an option. Starting tomorrow is wrong. Starting "when things settle down" is wrong. Starting today is the only correct choice here.

As demonstrated earlier in the course, investment growth is massively affected by how much time you give it to...well...grow. Let's give your investments every advantage they can get, and start today.

Allocation

Countless research shows that asset allocation drives returns. Having your investments be properly allocated, based on your time horizon, is critical to you meeting your investment goals. My recommendations for investing do this for you automatically. I really love having options available to me that take no work, and work well.

Amount

If you're a YNABer, then you know that your budget tells you how much you have available to invest. And you also know that there might be areas where you could (and should) cut back, in order to free up some investing money.

The amount here, to a degree, is within your control. But admittedly, not many of us could up and decide to just start squirreling away a thousand dollars a month for our luxurious retirement. But we could all probably do $100.

I say that, only based on my experience of seeing, at this point, several hundred personal budgets. Most had some breathing room, once the budgeter narrowed their focus (and their dollars' focus) on what really mattered to them.

There is no amount that is "too small" when it comes to regular, proper investing. You'll just set it up on autopilot, and see if you can't squeeze a few dollars more every few months or so.

Return on Investment

Where we lack complete control is with market performance, which I'll discuss next. Your return is made up of a lot more than just market performance though! What aspects of the return do you control? Expenses, your asset allocation (discussed above), and your tax situation (to a lesser degree). Make sure you're minimizing your tax bill to the extent possible (reviewed quickly below), and choosing investment options that are inexpensive, which my recommendations are.

Market Performance

This is the elusive, sexy, dinner-table-conversation starter, and is not in your control. At all. You cannot predict the occurrence of events that will drive the market's desire to buy or sell stocks. You are in it for the long haul, wanting a small piece of the returns generated by the global stock market (because you're diversified, you get a piece of virtually everything).

It doesn't matter if the market is up today, will be down tomorrow, or stays flat for the next while. The time for you to start investing is today. Do not attempt to "time" the market. Your emotions will get the best of you, and you'll end up doing the opposite of what you'd want: You'll buy high, and sell low. It happens again, and again, and again to novice investors (and many experienced investors as well).

Research has shown that the average mutual fund returns several percentage points MORE than the average investor return *for that fund*. What this tells us is that the mutual fund investor is getting into the fund at the wrong times, and getting out at the wrong times, robbing him- or herself of a massive portion of the potential investment return.

You will not do this! You'll invest now, stay slow and steady, ignore the hype (or doom and gloom predictions), and win, in the end.

The Nuts and Bolts of Starting

So, with the investment principles quickly reviewed, let's dive into the nuts and bolts of exactly how to start investing.

Picking Your Investment Vehicle

Go back to day six if needed, and review the list of priorities for which vehicles you should be using, and in what order.

Low Barriers to Entry

I don't want you intimidated by your investment. That's the whole reason I've put this course together--so you understand what the investments represent, and the principles that will bring you success. We're looking for the following characteristics in our Starting Method:

It needs to be easy
I've checked out numerous brokerages, and for the most part, have been very disappointed with their ease of use--especially in getting started. While most online brokers (there's no reason you shouldn't use an online broker) make the account setup *fairly* painless, once your money is there, huge question marks loom.

My favorite investment option, discussed below, is as easy as setting up an online savings account, and sharing your investment time horizon (one year, three years, or thirty years are all just as simple to set up).

Easy is important, because I don't want you hitting any roadblocks.

The starting investment amount shouldn't be prohibitive

Getting started with some funds, or investment vehicles, requires $1,000-$3,000. I saw that as prohibitive. We are looking for a way to start that's doable for 98% of the people taking this course.

A good broker will waive the required minimum if you set up automatic investments (a good idea anyway) of smaller amounts. My recommended broker lets you start with a $100 per month option. I'm a fan of that.

We don't want to have to become experts

And there are two reasons why:

Experts get it wrong about 70% of the time. It's true. When you follow the advice given in this course (which is the same advice echoed by many investment advisors), you'll beat the average investor expert seven times out of ten.

We don't have the time to become the 30% of experts that get it right. Heck, we don't even have the time to try and *find* those 30% experts and have them invest our money for us!

One of my favorite financial advisors recommends finding good mutual funds, with a long-term performance record, and investing in those. The trouble is that there are so many funds these days, and management of those funds can change, that picking the right mutual fund is almost just as impossible as picking the right stock.

In the end, we just invest in **everything**, and let most of the experts underperform our passive approach.

My Recommendations

Here's what I do NOT recommend. I do NOT recommend picking your own stocks or mutual funds. I do NOT recommend picking your own index funds or ETFs, and then managing the asset allocation on your own. I recommend having all of that done for you, so you can focus on things you actually enjoy doing.

Your Company 401k, if they offer a match

My 401k is done through YNAB, and that's my first stop for investing. Because I'm the boss, and got to set up the 401k the way I like it (though a bit more expensive for the company), I gave a Roth 401k option, and made Vanguard TargetDate funds available (more on those later).

You may not be so lucky (though we seem to be hiring all the time). You'll want to explore the options your 401k offers. Keep your eye out for index funds that represent a broad basket of stocks (not just the S&P, but the Total Stock Market, not just Domestic, but also International stocks, etc.)

Make sure you're not 100% in stocks. Find an investment option that lets you follow a broad bond index as well. One very quick and dirty option is to allocate your age as a percentage of bonds, the rest should be in stocks. I'm 31, so I should be at 31% bonds, and 69% stocks.

This requires some work on your part, and you'll want to make sure you stay within your asset allocation parameters every quarter or so. (Your 401k should send you a statement every quarter, I believe it's legally required, so when you get that statement, log in and check to see what the percentage allocation has turned into. If your stock portion bumped up a few percentage points, sell that off and buy the bond portion to rebalance.)

I hate asking you to do all of this work in order to follow sound investing advice, but the 401k match is just too appealing, making this bit of hassle worth it.

Betterment

Betterment is my favorite option if you don't have a matching 401k (or equivalent) available to you. I've become acquainted with Jon Stein, the founder of Betterment, through a few phone calls and conferences, and am impressed with what he's accomplishing.

I wrote an *extensive* review of Betterment on the YNAB blog a while back, and that still stands. But in summary, this is what I like:

- Setup is as easy as an online bank.
- The user interface is clutter-less, and unintimidating.
- There is only one investment option.
- That investment option is very diversified across very inexpensive investment types.
- The asset allocation is done for you, based on your time horizon. It's as easy as moving a dial.
- You can have different investment goals with different time horizons (wedding in 20 years, vs. retirement in 40 years, vs. college in eight years).
- The initial investment is $100 per month.
- There are no transaction fees (most online brokers charge you about $7 per trade, which, if you're only investing $100 at a time, is pretty much a deal breaker).
- The management fee is extremely reasonable (.15-.35 percent, based on your account balance).

I encourage you to check out Betterment and see if you don't agree. I invest with Betterment for my new car fund, and also for retirement (beyond my company 401k).

Target Date, LifeCycle Funds, etc.

Most mutual fund houses (Vanguard is my favorite, but there are many others like Charles Schwab, Fidelity, T. Rowe Price, etc.) will offer mutual funds that are targeted to a specific date.

For instance, we have some Roth IRAs from back in the day, invested with Vanguard. Those are all in the Target Date 2045 fund, which means it will change its asset allocation and become more conservative as it comes closer to the year 2045.

Make sure that your target fund is passively managed, and that the expenses on it are quite low. I've found Vanguard's Target Date funds fit the bill nicely.

The only reason I prefer Betterment over these separate options is because it's so much easier to get started, manage on an ongoing basis, and separate into distinct goals with varied time horizons.

Conclusion

Any of the above recommendations will get you MUCH closer to reaching your investment goals than doing nothing :) Don't let perfect become the enemy of the good here! Get started today, either with your company 401k, with Betterment, or with one of the target date/lifecycle funds available.

Remember, the only correct time to start, is right now!

Tomorrow we're going to discuss how to stay the course. It can be tricky when everyone around is yelling that the sky is falling, or looking at you with a wary eye when you're not investing in the latest ____________. I'll see you then!

Day 9: Staying the Course

Yesterday we discussed STARTING, but equally important in that regard is NOT STOPPING! While any bit you can put away for retirement will improve your situation, if you start young, then stop... you'll lose out on a lot of potential gains.

There are four main reasons people quit investing. Quitting, in this sense, means you no longer make regular contributions or you pull your money out of your investments because you're "afraid." (More on that in a second.)

Everyone Around You Knows "Everything"

People aren't rational. I'm not rational. Neither are you. You want to *remove yourself from the equation* when it comes to your investing behavior. Beware of the following pitfalls:

The News

The financial news is a massive sea of chaotic turmoil all finely-crafted and well-honed to instill **fear** in your heart and completely manipulate your emotions.

Steer clear of the financial news (and, honestly, most news for the same reasons). It will make you want to follow some new fad, get out of some suddenly "scary" market situation, and just generally act irrationally. You won't *know* you're acting irrationally, because the news makes it sound like everyone agrees with them, and their answer is definitive, absolute truth. It's not. If budgeting means you get your head out of the sand so you can be aware of what your money is doing, investing means you stick your head in the sand and trust the principles we've discussed throughout this course.

Well-Meaning Friends and Family

The allure of sounding sophisticated means a lot of your friends and family will be quick to tell you about this or that investment, and how well it's done for them, and how you should get in on it too. I've been guilty of that many times.

Resist. Stick to your plan, and focus on what you can control. Instead of scouring stock picking books, or trusting your uncle's take on the market, why not see how you can earn a bit of extra money to invest in your plan? Or maybe sell a few things you don't want anyway to give your investments a one-time shot in the arm?

The Ups and Downs of the Market

Embrace these. Unless you truly *do* stick your head in the sand, you'll be made aware of the market's movements on a fairly regular basis. If you hear the stock market is down, just smile to yourself and say, "Excellent. Now I can invest cheaper!"

When the market is on a tear, most everyone will be riding a frenzied wave, and will be screaming that you should invest more, maybe even leverage your investments, or invest in things that are inherently riskier than what your plan allows. Just stick to your game plan.

Needing to Cash Out for an Emergency

You should be able to head this one off at the pass in 99.9% of cases by having an emergency fund already in place before you begin investing (or at least, having a plan in place to build an emergency fund quickly).

The Roth IRA (remember, it's an investment vehicle, not an investment) allows you to pull out your investments for certain specific expenses, and you won't be hit with a penalty, but at that point, those dollars are no longer earning any dollars for you. Avoid doing this!

The worst offender when it comes to pulling out cash for an "emergency" is with 401k loans. Avoid these! You're basically paying the interest on the loan and ALSO paying the interest of not having your investments earn you money!

Transitioning to Another Job

Too many times, when people transition to another job, they don't roll their 401k (or its equivalent) over into a traditional IRA. They see that money as some kind of "bonus" or "gravy money" (which it is not, I discussed gravy money here), and end up blowing the funds on something "responsible" like paying off their credit cards.

(The "responsible" behavior of using your 401k to pay off your cards is actually irresponsible, because you would never cash out your 401k to *directly pay for those things you charged to your cards.*)

You can get *slammed* when you don't roll the 401k over properly:

1) You pay income tax, which means that money's gone, and no longer available to earn more money on your behalf and

2) You pay a 10 percent penalty to the IRS. That money is *also* now gone, and can't earn more money on your behalf.

Again, if you're moving to another job, roll your 401k over to that new job's 401k, or roll it into an IRA. It'll basically be able to transfer between vehicles with no tax ramifications at all.

Losing "Trust" that Your Money is Safe

There is no truly "safe" place for your money. A brief walk down the history of monetary policy shows us plenty of situations where people's fortunes were gained and lost in the blink of an eye. Read up on the "tulip bubble" if you ever get a chance.

You'll do better maintaining your trust in your plan if you avoid those things mentioned at the beginning of today's material. Avoid the news, friends' pontifications, and constantly fretting over the natural ups and downs of the market.

Now, there is a time where you may genuinely (and rationally) feel that your money is being exposed to too much risk, or too little.

A person approaching their 60th birthday may suddenly realize that their asset allocation is 75% stocks and 25% bonds, where it should be more like 60% *bonds* and 40% stocks. They weigh the risk and reward, based on their retirement horizon of five years, and they make a rational decision to sell off some of their stock funds in order to purchase some more bond funds.

(An aside: with a service like [Betterment], or Vanguard's target date funds, this rebalancing would be done for you automatically because you've specified your time horizon up front.)

On the flip side, which you don't hear as often, there may be a 32-year old software engineer that realizes he was automatically opted in to his 401k, and the default investment was short-term treasury bonds (an extremely safe, minimal return investment). He would want to expose himself to more risk because his time horizon until retirement is so much greater. He would sell off about 70% of his bond holdings and purchase stocks instead.

In other words, it's *okay* to start to become uneasy with your investments, if that unease is from something like your *actual* risk tolerance changing, because your time horizon has changed *not* because your uncle's brother got a hot tip that the market is about to head south.

What Causes Poor Investment Performace?

In short, you do :)

As we discussed earlier in this course, the underlying value of your investments is based on what others are willing to pay for it. To that end, how much people *like buying* stocks will be driver of your stock returns for years and years. Only over the long haul, will stocks perform based on their fundamental drivers like the earnings and outlook of the company.

Investment performance is something you don't want to chase. As a matter of fact, they've found that the more frequently you trade in and out of market, the *worse* you perform. For more information in that regard, I highly recommend reading *A Random Walk Down Wall Street*.

Trying to time getting in and out of the market, or in and out of a specific fund, is a fool's game. Spend your energy on those investment factors you *can* control: when you start, how much you invest, how you're allocated, and how you'll be taxed (to a degree). Just leave the actual market performance alone. You cannot influence it. You cannot predict it. Focus your energies on the controllable stuff!

In the end, your investments will perform better as you automate your deposits, and then do NOTHING. What's not to like about that?

Conclusion

I hope you've found this course useful. I've tried my best to make it understandable, digestible, and most importantly, actionable.

If you haven't yet gotten your investments going, I'd encourage you to set something up. You know now that I use (and recommend) Betterment, but you can do your own research and determine what works best for you.

I wish you the best of luck in your investing! I'll see you in retirement, on the beach, reading some shallow mystery novel.

Warm Regards,

- Jesse Mecham

P.S. Feel free to pass this along to any kids, siblings, aunts, uncles, other family members or friends that you feel may benefit from it. :)