PRINCIPLES EVERY INVESTOR SHOULD KNOW

By Loring Ward, Illustrations by Dan Roam

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Introduction

Investing can sometimes feel a little overwhelming. Since it is such an important part of our lives, not knowing where to turn for reliable information can be frustrating. Most of us want an approach that we can believe in and understand, one based on research, analysis, and evidence — not luck or prognostication.

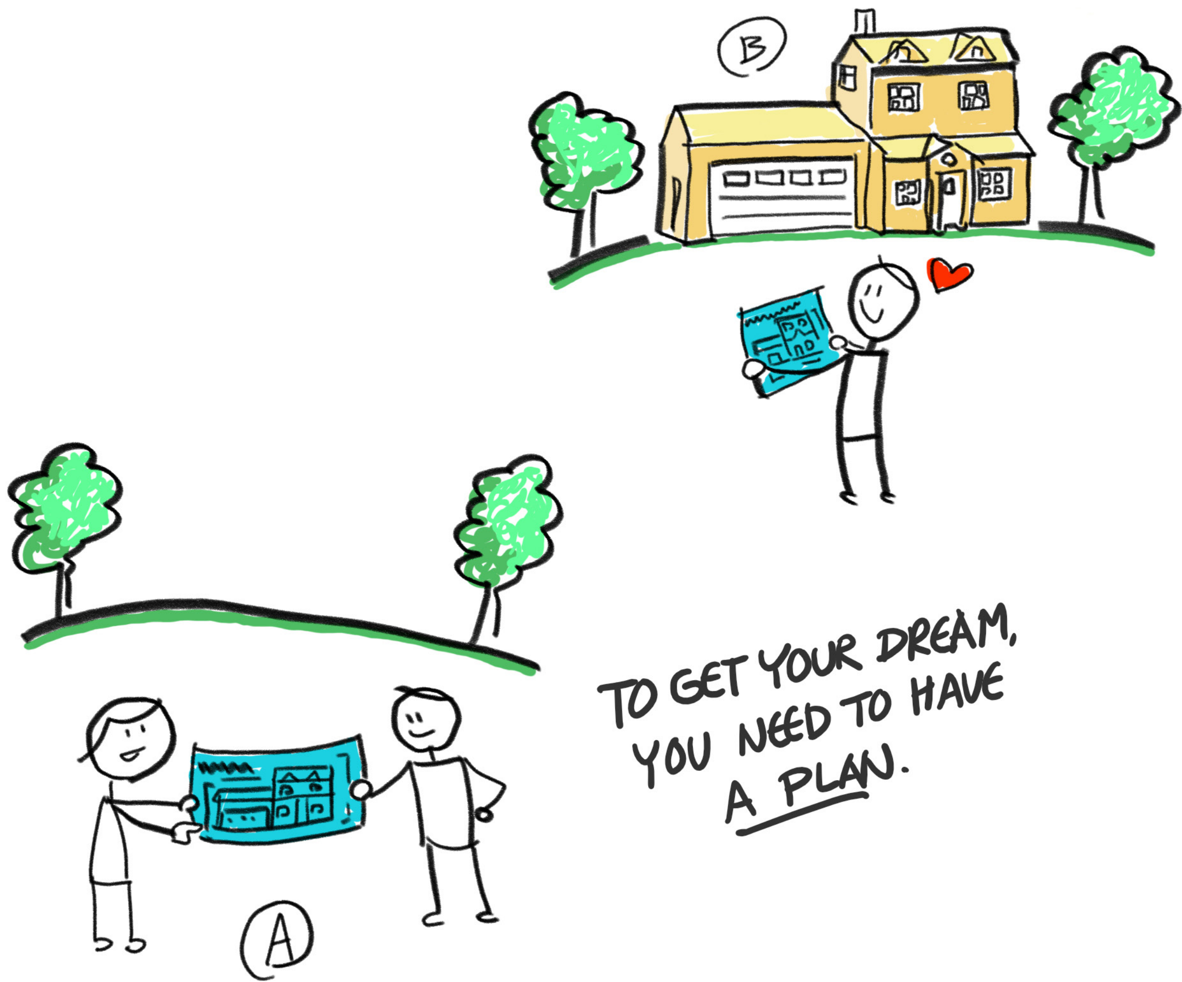
The good news is that in recent years, academic research has made enormous progress in understanding how to improve our chances of success as long-term investors. Unfortunately, the academic community doesn't necessarily do a good job educating investors. Research papers filled with charts and data are useful, but they are not always easy to follow.

This book began with us asking how we could communicate the science of investing and the principles every investor should know in a simple and unforgettable way using sketches, stories and soundbites.

We've had the good fortune to work with some amazing people who have spent their careers helping to educate financial advisors and their clients in memorable ways. Their examples and stories are the foundation of this book.

We believe that understanding — and applying — the 27 principles in this book can help make you a more patient and — ultimately — successful long-term investor. We hope they will empower you to understand the difference between the noise (not useful information for your personal goals) and the science (relevant information for your personal goals).

This book is for all the ordinary people who have dedicated their lives to working and saving in order to achieve important goals such as providing for children's education and enjoying a secure retirement. Life is complicated. Investing shouldn't be.


B
A
TO GET YOUR DREAM,
YOU NEED TO HAVE
A PLAN.

Rule 1:

Successful Investing Starts with a Plan

"If you fail to plan, you are planning to fail."
— Benjamin Franklin, Founding Father

Many think investing is simply about making smart investments and getting good returns, but it is critical to have a plan in place beforehand to ensure that you know WHY you are investing. This plan, which is built in close collaboration with your financial advisor, should reflect what is most important to you — your values, needs, concerns and hopes.

It is similar to building a new house. Initially you meet with an architect to share what you are looking for. Your architect will ask a lot of questions to make sure he or she understands your preferences and has a good feel for your vision.

Your architect will put together a blueprint for your dream house. Then you can start construction. There will be some changes along the way, but without this blueprint, your dream home could become a nightmare.

Financial planning works the same way. Your financial advisor will help clarify your goals and dreams for the future, focusing on key life areas such as helping and protecting your family and building a legacy. Your advisor will then create a plan that is both specific and unique to your situation. Then put together a portfolio to make this plan possible.

Because life changes along the way, you will meet regularly with your advisor to ensure that the plan is still on track and that your circumstances or goals have not changed.

INVEST EARLY.

Rule 2:

Start Investing as Early as You Can

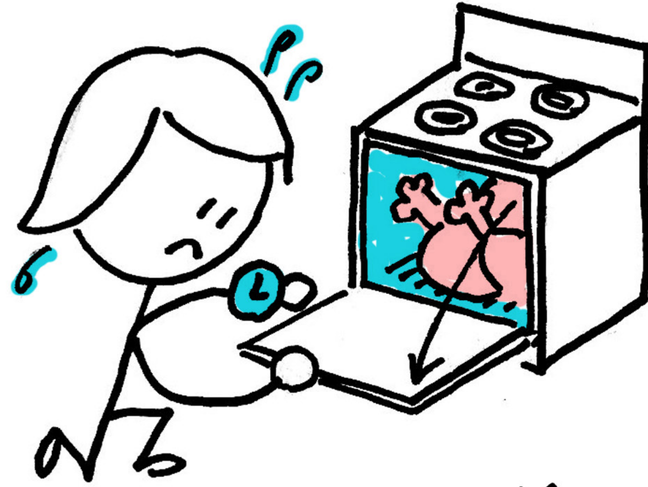
“The best time to plant a tree is twenty years ago. The second best time is now.”
— African Proverb

When it comes to retirement, time really is money. While the amount you can expect to receive from Social Security will vary depending upon your income, the reality is that Social Security will replace only about 35-40% of your income. Even if you’ve saved a little, it might not be enough, since we are living longer than ever. If you’re in good health when you retire, there’s a good chance you’ll live well into your 80s and beyond. It’s possible that you will be retired for 30 years — almost as long as you worked!

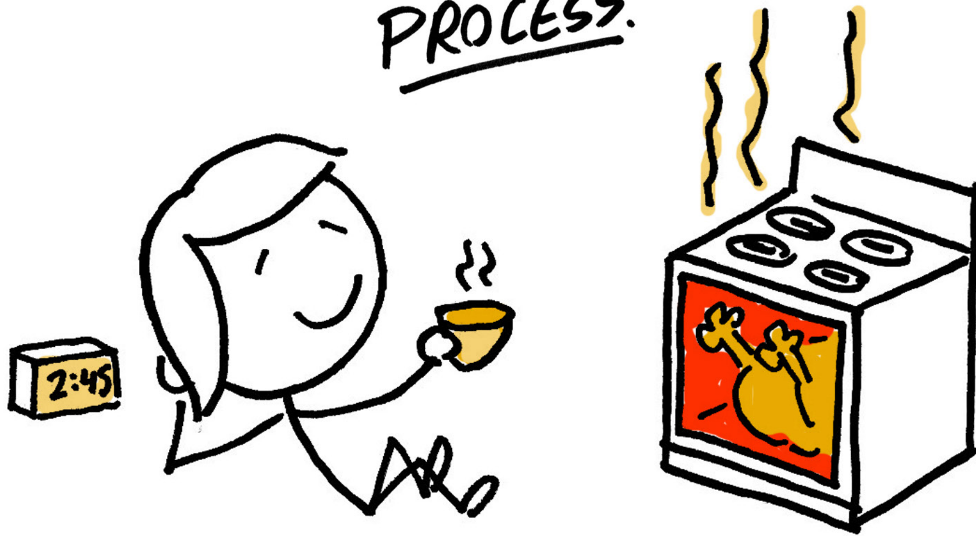
The sooner you invest, the longer your money has to grow. Even a few extra years can make a big difference

Consider two investors: Investor A, a 21-year-old, saves $100 a month for 9 years and then stops at age 30 for a total contribution of $10,800. Investor B saves $100 a month from age 30 to age 65 (35 years) for a total contribution of $42,000. Assuming an 8% rate of return, Investor A is able to retire at 65 with $231,047, while Investor B retires with $215,635.[1]

Just think how much further ahead Investor A would be if he’d kept investing right up until retirement. Or been able to save more than $100 a month.



TRUST THE PROCESS.



Rule 3:

Invest for the Long Term

"All good things arrive unto them that wait — and don't die in the meantime."

— Mark Twain, Author

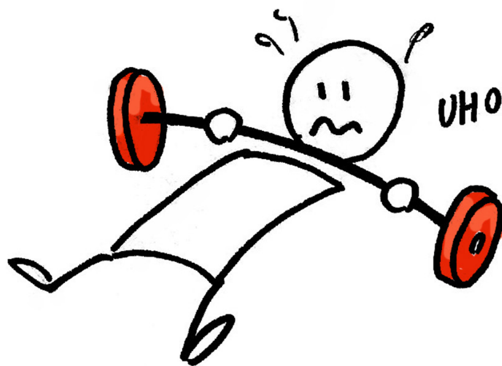
Over the last nine decades, the U.S. experienced 9 bear markets and 15 recessions or depressions, the Second World and Vietnam Wars and any number of crises big and small.

Yet markets have shown a remarkable ability to reward patient, long-term investors for staying invested. This is important, since most of us are investing for the long term.

For a 65 year-old couple, there is a good chance that one of them will live to be at least 95 years old.

We must keep this long time horizon in perspective when judging the success of our portfolio and the financial plan it supports. It is like cooking a turkey for Thanksgiving. Because a 20-pound turkey requires 4 to 5 hours to cook, we do not measure success by opening the oven every 2 to 3 minutes to see how things are going. Instead, we give the oven time to work, checking only periodically to make sure everything is on track (and make any necessary adjustments).

When it comes to your portfolio, don't judge success on a quarterly or even annual basis. Instead, focus on how you are progressing towards your goals, including any life changes that may impact those goals. This helps you to stay focused on and not let short-term market fluctuations compromise your future. Trust the process and your plan, and don't open the oven all the time. That way, there is only one turkey involved.



ALONE:
- [x] Hard

w/ ADVISOR:
- [x] Competence
- [x] Coaching
- [x] Convenience
- [x] Continuity

Rule 4:

Investing is Hard — Get Help from a Trusted Advisor

> "It is not enough for a professional to be right: An advisor's job is to be helpful."
>
> — David H. Maister, Professor

Some things are just too difficult or stressful to do on your own. Like a dietician or a personal trainer, a financial advisor can help set up the right plan for you, then monitor and motivate you so you end up with the results you want.

A good advisor provides four key benefits:

Competence: providing the critical things that help drive successful long-term outcomes, including planning, asset allocation, rebalancing, and working with other financial professionals.

Coaching: providing education and guidance through the emotions of investing, which can cause us to compromise long-term goals.

Convenience: delegating the complex and time-consuming work of investing and planning to your advisor.

Continuity: having someone who can help your loved ones if anything happens to you. Someone who knows your wishes and goals and can help preserve your legacy and protect those you care most about.

Remember, choosing a financial advisor is one of the most important decisions you can make.

ADVISORS + SALESPEOPLE
DON'T HAVE
THE SAME DREAMS.

ADVISOR

SALESPERSON

Rule 5:

Know the Difference Between Advisors and Salespeople

"Are you willing to sell a person a shoe that doesn't fit vs losing the sale because you don't have the right size?"

— David Booth, Founder of Dimensional Fund Advisors

Unfortunately, too many financial firms and their employees focus more on selling products versus trying to provide advice and solve investor needs. Only independent financial advisors are legally required to act as a fiduciary — which means they must always put your interests as a client ahead of their own. In addition they must disclose all important information to you, including fees charged and any conflicts of interest.

So when independent advisors make a recommendation, it has to be in your best interests — not because they just want to make a quick sale. It is like the difference between getting health advice from a doctor versus a pharmaceutical salesperson. Pharmaceutical sales reps can only sell the medicine their company manufactures. A doctor, on the other hand, must prescribe the right medicine for each patient, regardless of the manufacturer. Independent advisors take the same approach when advising their clients. They are indifferent to who made a financial product: their only focus is getting the best resources to help solve each person's unique situation.

PORTFOLIO
ALLOCATION
EUREKA!

Rule 6:

Put Science and Academic Research on Your Side

"The important thing in science is not so much to obtain new facts as to discover new ways of thinking about them."

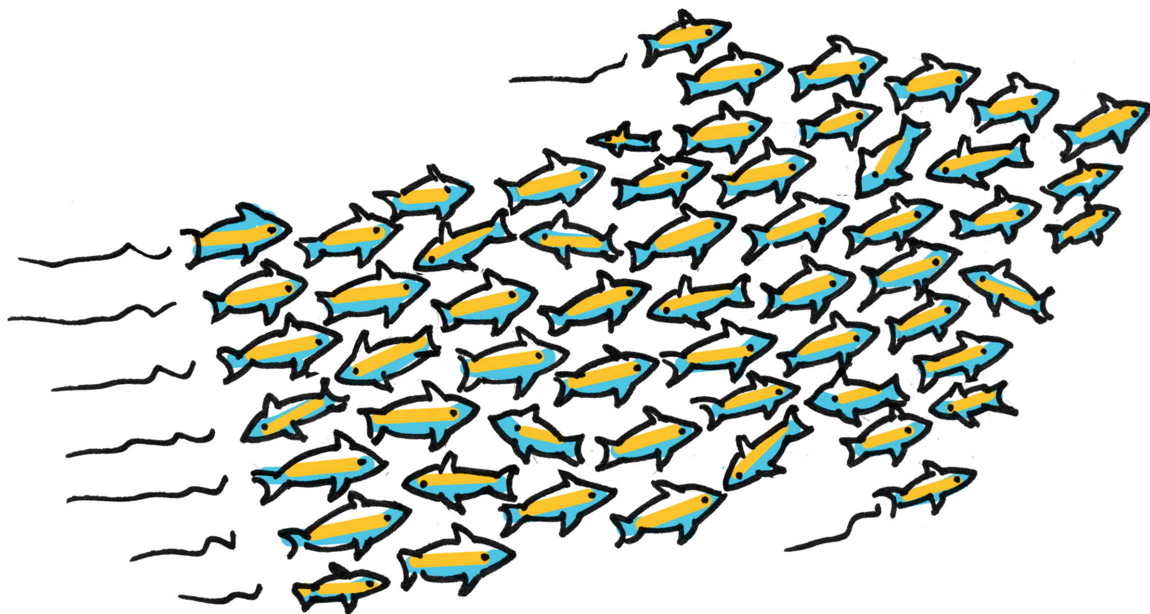
— Sir William Bragg, Scientist

Many of us want to be in better shape and live a healthy lifestyle — but wish it were easier to do. The health and fitness industry understands this perfectly. They bombard us with advertisements and testimonials of how to lose weight and get in shape easily.

Alternatively, consider the evidence-based approach the medical community has developed for weight-loss and healthy living. It might not be exactly what we want to hear (eat sensibly – exercise more) but at least we have a path to success to follow if we choose. This evidence-based approach increases our probability of success, and we don't have to waste time and money on solutions that don't work!

As with the fitness industry, there is no magic pill for successful investing. CNBC and financial magazines hype stories on "How to Pick the Best Stocks Now" or "Why You Need to Own This Company." Sadly, these ideas almost never work.

The good news for investors is that there are evidence-based investment strategies, grounded in academic research, that may increase potential return and decrease potential risk. Sound advice may not sell magazines or drive TV ratings, but it can do something much more important: ultimately increase your probability of reaching your financial goals. Because life changes along the way, you will meet regularly with your advisor to ensure that the plan is still on track and that your circumstances or goals have not changed.



GO WITH THE GROUP.

Rule 7:

Don’t Try and Pick Individual Stocks

“One of the funniest things about the stock market is that every time one man buys, another sells, and both think they are astute."

— William Feather, Author

If you’ve ever watched a flock of birds or school of fish, you’ve seen how they all move in unison, changing directions quickly and precisely all together.

But if you focus on just one fish (or bird) things get much more random. It may not be doing what the others do exactly. It might go left when the school goes right. It might lag or straggle.

It is much easier to see what the group is doing and where it is headed.

Stocks are the same way. Individual companies may or may not follow what the rest of the market is doing. Perhaps their CEO was just fired. Perhaps a new product isn’t selling well. This idiosyncratic risk makes them much riskier than investing in the market as a whole. It is also really difficult to pick stocks that will do better than the market, that will swim ahead. But over time, the market as a whole tends to move in predictable directions and reward investors.

THE FUTURE IS UNCERTAIN.

Rule 8:

Don't Try to Predict Markets

> “It would be wonderful if we could avoid the setbacks with timely exits, but nobody has figured out how to predict them.”
>
> — Peter Lynch, Money Manager

Wall Street and the popular financial press want you to believe that in order to make money in the stock market, you need to invest based on what’s about to happen. That’s the message sent out every day by market strategists, brokers, analysts, mutual fund managers and the media — predict the future accurately, and you’ll score big.

In truth, no one can accurately forecast market movements on a consistent basis. Why? Because we’re talking about the future, and the future is by its very nature uncertain. We cannot predict with absolute confidence the future direction of the economy, stock prices, or events that will have an impact on the markets.

Consider this one notable example (of many). At the beginning of 2008 right before the beginning of the Great Recession, all the major firms on Wall Street were predicting up markets for the year. As we now know, their predictions were disastrously wrong.

The upshot: Even the brightest analysts, the most highly regarded money managers in the world or the most plugged-in and well-respected financial publications can seldom tell you what’s going to happen next, let alone give you reliable advice on how to position your investments to take advantage. That doesn’t mean that a fund manager, a talking head on CNBC or the guy who walks his dog down your street every morning won’t sometimes get it right. They will. The credit, however, usually goes to luck — not skill. And your financial future is too important to leave to chance.

IT ONLY TAKES TWO
TO CREATE A MARKET!

Rule 9:

Invest as if Markets are Efficient

> "[T]hose who disagree with market efficiency simply assert that it stands to common sense that greater effort to get facts and greater acumen in analyzing those facts will pay off in better performance... By this logic, a cure for cancer must have been found by 1955."
>
> — Paul Samuelson, Nobel Laureate in Economics

At a neighbor's garage sale, you notice there is a Babe Ruth rookie baseball card on sale, priced at 25 cents. Obviously, your neighbor is not a big baseball fan, since this card is worth tens of thousands of dollars.

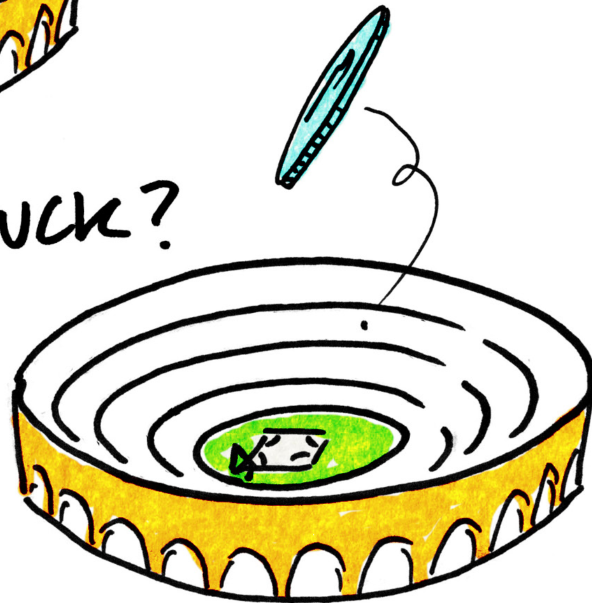
Just as you are about to hand over a quarter, another neighbor walks up. She also knows the value of the card is way more than 25 cents and offers $5. Pretty soon, you and your neighbor are having a bidding war, until the price you pay for the card is close to its actual value. And it only took one additional participant to get there.

Financial markets work similarly on a larger scale, with millions of investors buying and selling securities each day to determine fair market value.

Because markets usually do a good job incorporating all publicly known information into prices investors are better off acting as if current prices are correct instead of trying to guess their future direction. This also allows you to focus on your overall plan instead of trying to predict how markets will react to news on a particular stock.

SKILL?

OR LUCK?



(COULD HE DO IT AGAIN?)

Rule 10:

If You Can't Beat the Market, Own the Market

"Very few investors manage to beat the market. But in an astonishing triumph of hope over experience, millions of investors keep trying."

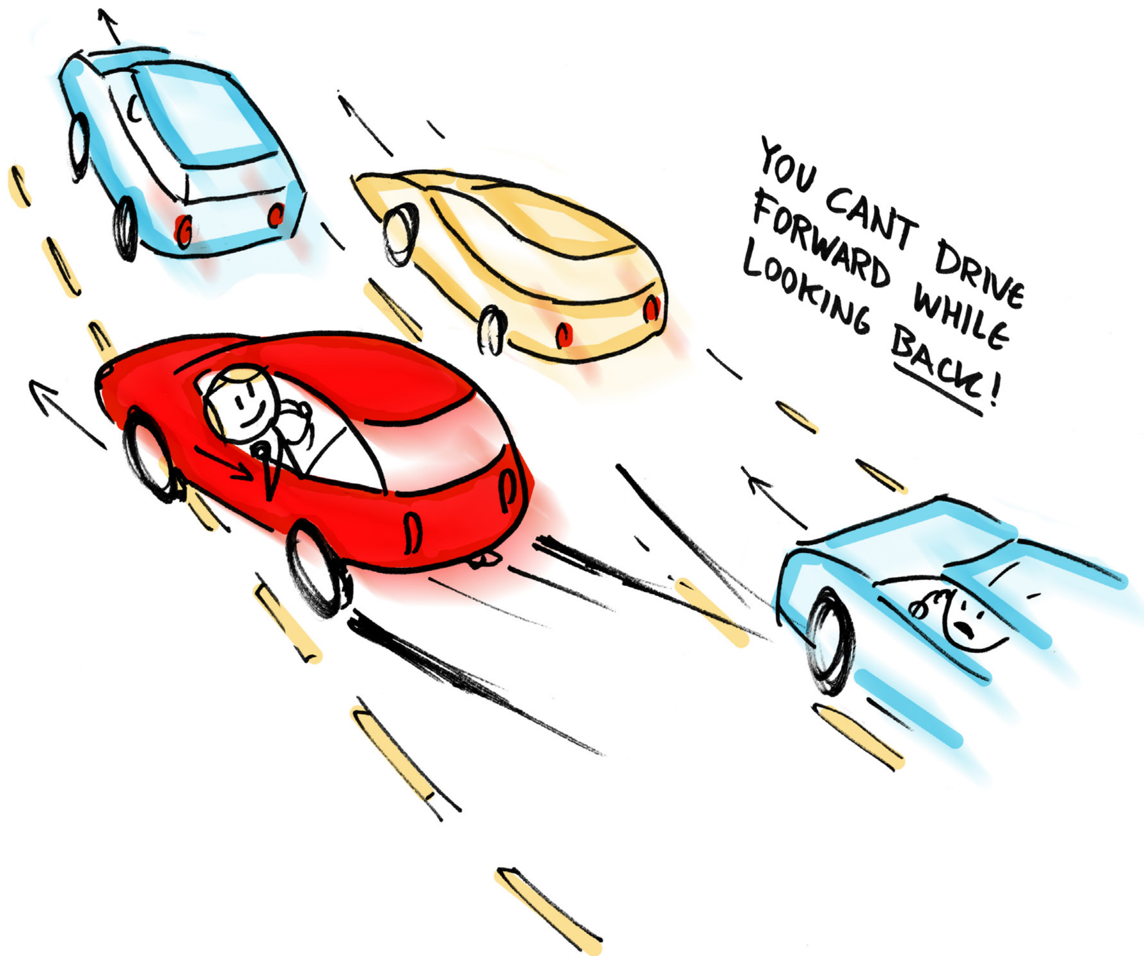
— Jonathan Clements, Author

It isn't easy to beat the stock market. In fact, most money managers typically underperform. And those who are able to beat the market one year struggle to stay on top in subsequent years.

Why? Turns out that outperforming the market may require more luck than skill. Imagine a baseball stadium filled with 20,000 fans. You give each fan a quarter and ask them to flip it at the same time. Heads they can stay, tails they must leave the stadium. Because the odds of heads or tails is 50/50, after the first flip about 10,000 fans will stay and 10,000 leave. The remaining fans flip again and 5,000 stay and 5,000 leave.

After a total of 14 flips, the odds are that only one person is left, having managed to flip 14 heads in a row. Now fill the arena back up. Would you expect the same person to flip 14 heads in a row? Probably not. A great stock picker is like a great quarter flipper — its mostly about luck. In fact, studies have found that active managers as a group do worse than random chance. Meaning they might actually improve their stock-picking performance if they used coin flips to make stock picks.

Since trying to beat the market leads to a high probability of underperformance, most investors would be better off simply just owning the market.


YOU CANT DRIVE
FORWARD WHILE
LOOKING BACK!

Rule 11:

Past Performance is No Indication of Future Results

"Events in the past may be roughly divided into those which probably never happened and those which do not matter."

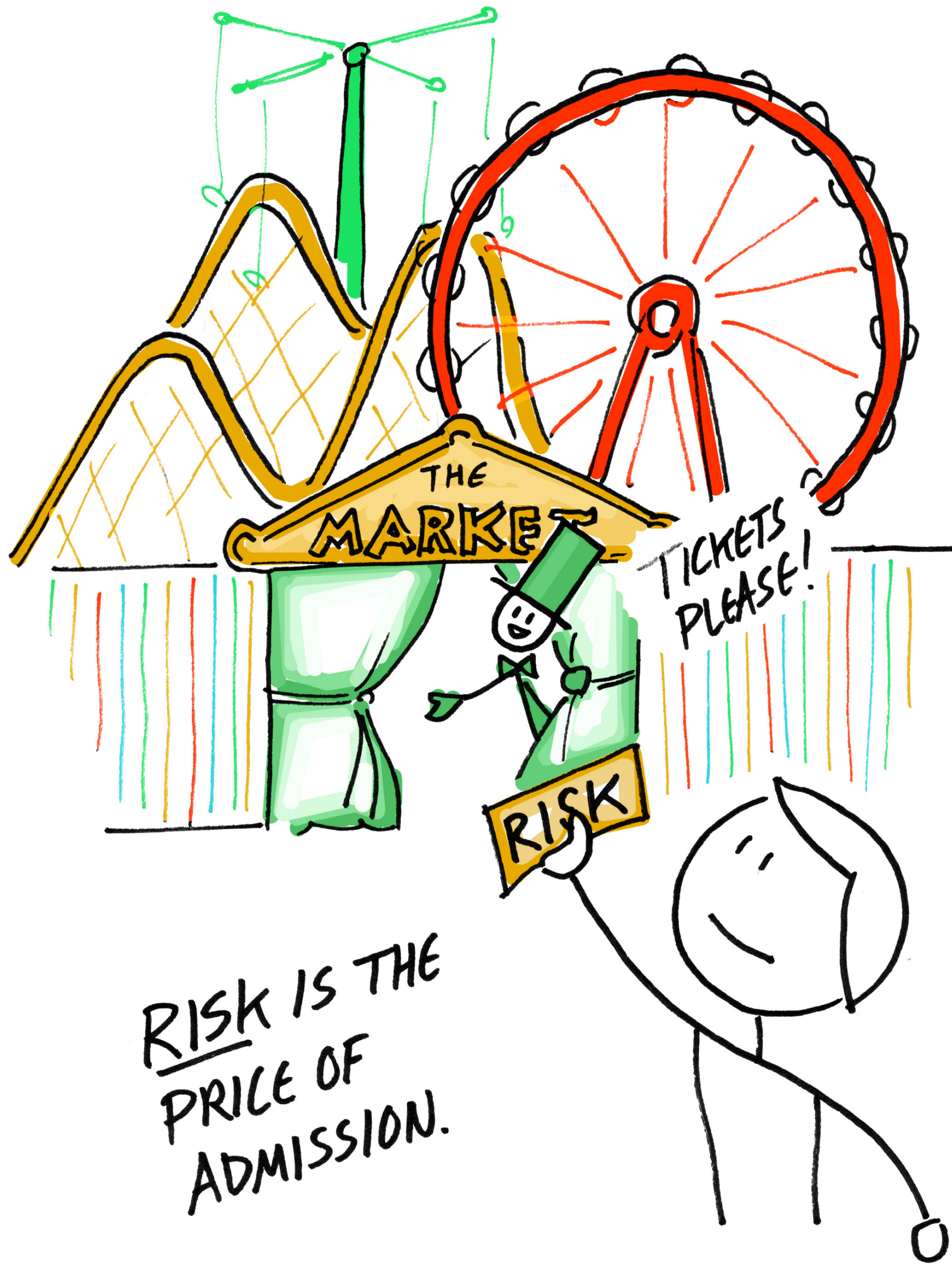
— William Ralph Inge, Author

You need to get to the airport, and you are not sure how long it will take. You call a friend, and she says it takes 30 minutes to two hours. That's somewhat useful, but it is a wide range, and it is based on past performance. You need more current information, so you don't miss your flight.

That's when you open a mapping app that uses the most current traffic and weather conditions, to let you know almost exactly how long it will take to get to the airport right now.

Investing is similar. The past is a good rough guide. It gives you a range of what you can expect. Stocks will generally outperform bonds over the long-term. International stocks are usually riskier than U.S. stocks. And so on. But if you only rely on the past, you might be led astray. It is like driving forward while looking backward.

Instead, using the most current information typically leads to more sensible decisions. Not what the market did or will do, but what is happening right now. This is what smart money managers do, every day. And it gives you a much better chance of getting where you want to go with fewer surprises.


THE MARKET
TICKETS PLEASE!
RISK
RISK IS THE PRICE OF ADMISSION.

Rule 12:

Risk is the Price of Admission to Investing

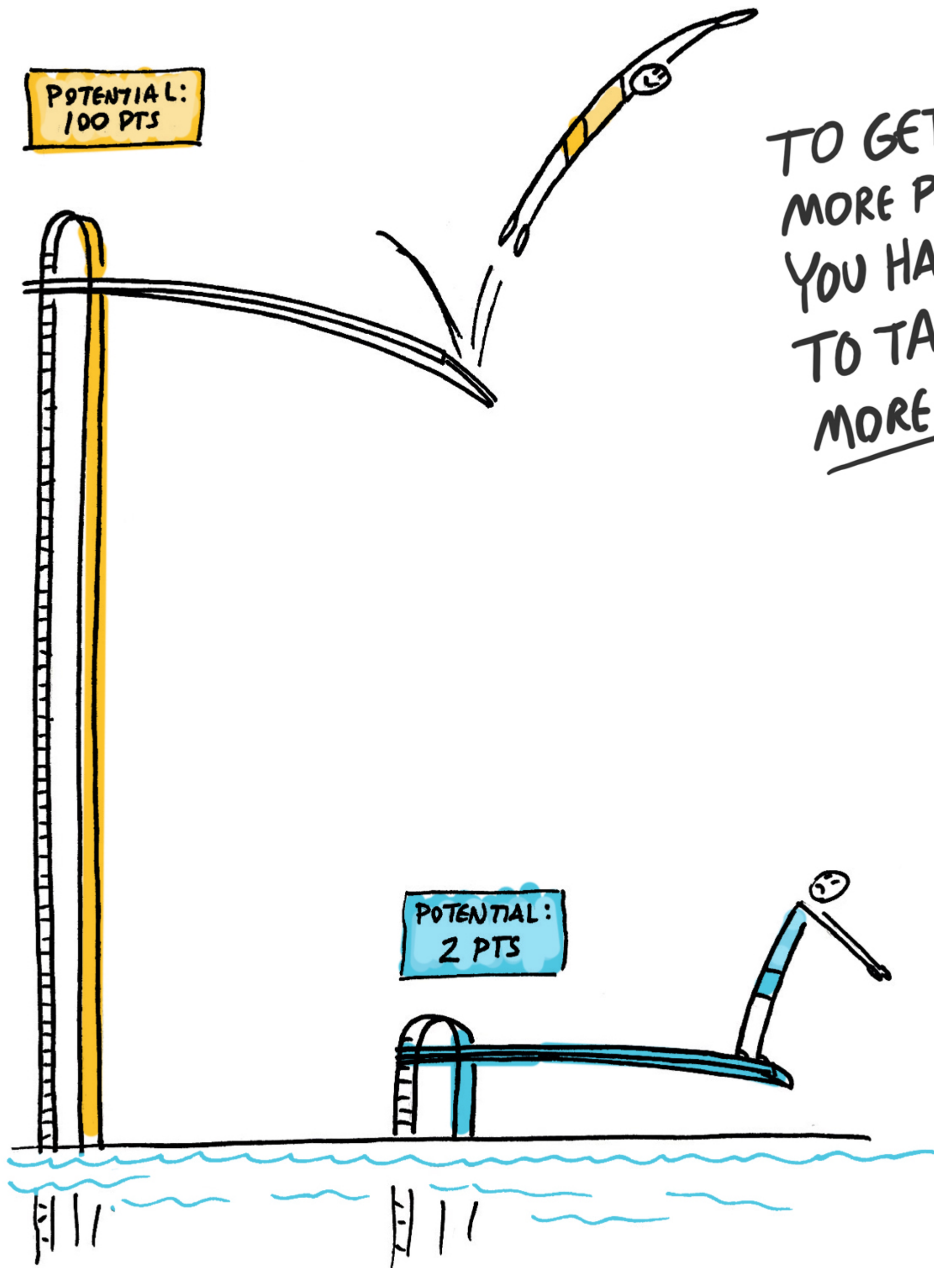
"Everything in life, individually or socially, is a trade-off. We determine the risk levels we're willing to tolerate."

— Robert Merton, Nobel Laureate in Economics

The fact is simply this: where there is no risk, there is little reward, which is why it is so hard to make much money on a "sure" thing.

Stock markets that always rewarded investors or, conversely, never made anyone money would quickly collapse. Only a market that has both up and down periods offers the potential for long-term returns. While we can't predict when these ups and downs will occur, we do know — in general — that markets rise and fall for rational reasons — strong or weak economies, geopolitical issues, new technologies, etc. One of your major decisions as an investor is how much risk you can tolerate. Which in turn determines how much potential return you might expect.

Investing in stocks is investing in thousands, of companies who have created something the economy finds valuable. Those companies that survive and thrive are innovating over time, developing or acquiring the expertise to bring newer and better products to market. Not every company will survive, and markets as a whole will keep going up and down. But if you can handle the risk, you will probably be rewarded over the long term for staying the course.



TO GET MORE POINTS, YOU HAVE TO TAKE MORE RISKS.

Rule 13:

Understand How Risk and Return are Related

"Yes, risk taking is error prone, otherwise it would be called sure thing taking."

— Jim McMahon, Football Player

Imagine you are a competitive diver in the Olympics. You will be judged on your form, your technique, and the difficulty of your dives. The more complicated a dive, the higher your potential score. But also, the higher the chances of not executing the dive perfectly and getting a lower score.

Investing is similar. The more risk you take on in your portfolio, the greater your expected return potential. Academic research has shown that different stocks have different expected returns. For example, small company and value company stocks have greater expected returns — and risks — than growth and large company stocks.

Why? Let's say you wanted to invest in a tech company. You narrow your options down to two. Joe's Tech is a small company, newly listed on the stock exchange. They have a lot of innovative ideas and hope to become a great business. They also aren't generating a profit yet and have substantial debt. The other company is the largest firm in the world — Apple. In 2018, they have strong financial statements, impressive sales, extensive research budgets, a strong product pipeline, and so on. If the returns of these stocks were expected to be the same, no one would invest in a lesser known and riskier company like Joe's Tech. The reason smaller companies can attract investors is because of their higher expected return (vs. an established company) if they achieve their ambitious goals. They might become the next Apple. They also might go out of business. This is the risk, but also the potential reward.

STAY IN
THE CENTER!

Rule 14:

Unnecessary Risks are Unnecessary

"Diversification is the only free lunch in finance."

— Dr. Harry Markowitz, Nobel Laureate in Economics

The Golden Gate Bridge in San Francisco is one of the most beautiful and iconic bridges in the world. It is also a good way to think about your pathway to retirement — from the hustle and bustle of the city (work) to the calm, rolling hills (retirement).

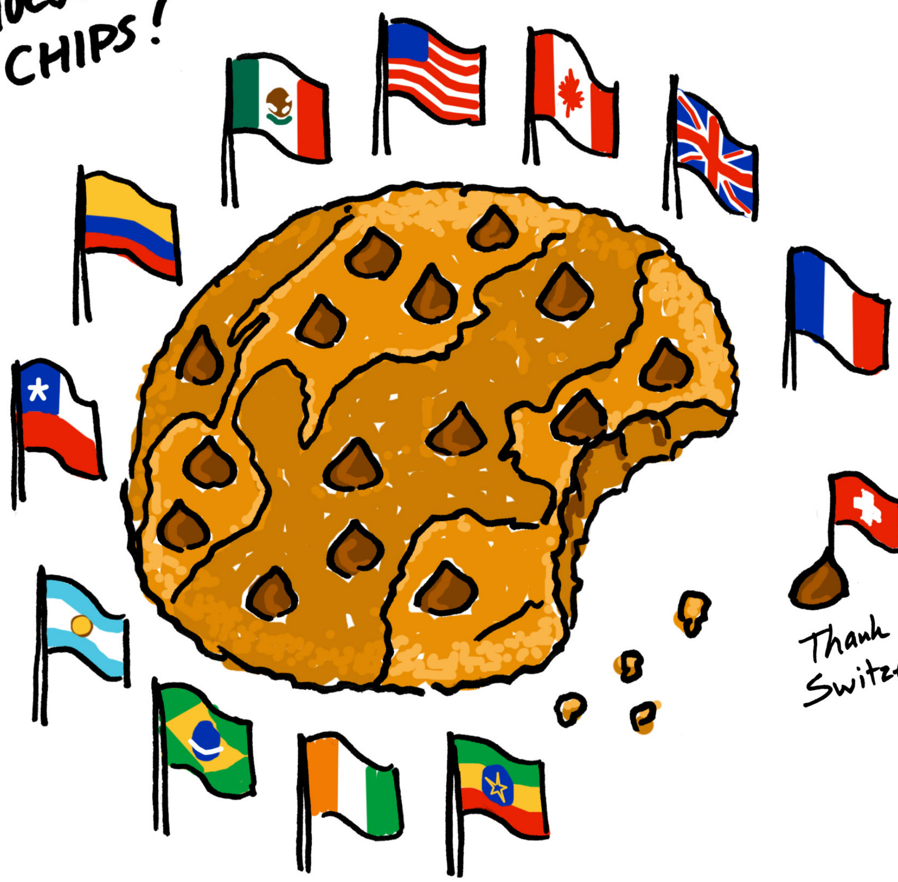
But first you have to cross the bridge. Seems easy enough. But what if they removed the guardrails? Where would you drive? Along the edges, with nothing to stop you from plummeting into the waters below? Or right down the middle?

When it comes to your retirement portfolio, you drive down the middle of the bridge via a broadly-diversified portfolio that holds thousands of companies around the world.

The less diversified you are, the closer you will get to the edge of the bridge. Sometimes this could mean higher returns, but it also might mean — potentially — much greater losses.

With a globally-diversified portfolio, you won't be the single best performer in any period, but you also have fewer reasons to worry about poor returns from a single asset class. And that keeps your portfolio in the center of the bridge as you head towards retirement.

For most of us, whether we are crossing a bridge or investing, we want to follow a safer path. Our future is too important to risk.


THE WHOLE WORLD LOVES CHOCOLATE CHIPS!
Thank you Switzerland!

Rule 15:

Invest Globally

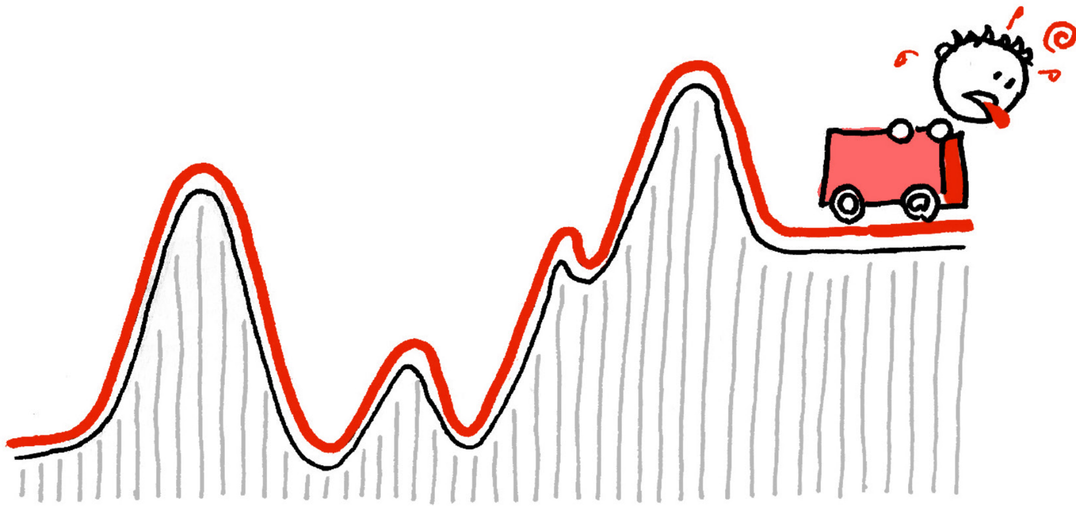
"Nothing is more expensive than a missed opportunity."

— H. Jackson Brown, Jr., Author

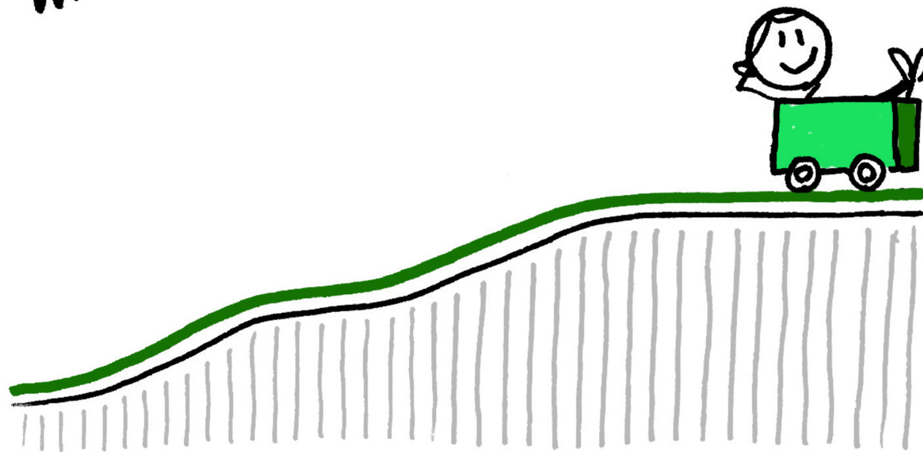
For many of us, the smell of fresh batch of chocolate chip cookies brings back happy memories of childhood, coming home after school with friends or after playing catch in the yard. Often, the chocolate chips are Nestle Toll House. Chocolate chip cookies may be an American invention, but Nestle is actually a Swiss company — though their products have been sold in America and part of our everyday life for a very long time. Perhaps you bought your baking supplies at Trader Joe's, which is owned by a German company. And baked them in an oven made by Korean-owned Samsung.

How does this relate to us as investors? It is important to realize that many of the companies that we buy products from on a daily basis are headquartered all over the world. We don't limit our consumption to U.S. products, so why would we want to limit our investment portfolios to U.S. companies? Instead, it makes sense to invest in as many of the great companies of America and the rest of the world to maximize the potential of our portfolio.

We like to think of the U.S. as a world leader, but over the past several decades, America has never been the #1 market in the world in annualized performance. Nobody knows what the future will bring. But if you own a lot of companies around the world you can worry less if any one company or even one country experiences losses. Nor do you need to be concerned about picking countries that might outperform. Keep in mind that international stocks can be riskier than U.S. stocks, due to currency and political risks, among others. This is why it is so important for you to carefully decide how to allocate your portfolio between U.S. and international stocks.



Which would you rather ride?



Rule 16:

Retirement Success Depends More on Lower Volatility than Higher Returns

"Fragility is the quality of things that are vulnerable to volatility."

— Nassim Nicholas Taleb, Author and Statistician

If you've been invested since 2000, you've certainly lived through more than your share of excitement: two bear markets, the Great Recession, war, terrorism and some of the worst days in the history of the stock market!

All these events led to extremely volatile markets. No one likes volatility, but if you are in retirement, taking money out of your portfolio, volatility can compromise your long-term success. Think of it like riding rollercoasters at the amusement park. If you were going to be on for a long time, would you rather ride the big, exciting rollercoaster? Or the kiddie rollercoaster?

Lowering volatility is important for investors, especially those making regular withdrawals, because it can help keep your money working for you longer. And that can make a big difference in retirement, when every dollar counts.

Your financial advisor can put together a portfolio that helps minimize volatility in retirement and increases the odds of not outliving your money.

Different climates.

Same average temperature.

Rule 17:

Average Returns can be Misleading

"I abhor averages...A man may have six meals one day and none the next, making an average of three meals per day, but that is not a good way to live."
— Louis D. Brandeis, Supreme Court Justice

You are looking to retire somewhere with a mild climate. So you do a little research and find two cities that have an annual average temperature of about 65 degrees: San Francisco and St. Louis.

But then you do a little more research and find that while San Francisco is pretty much 65 degrees most of the year, St. Louis has hot summers and cold winters — something you would never know just looking at the averages. Similarly, many investors make the mistake of focusing only o average rates of return, sometimes with disastrous consequences.

Consider the S&P 500. Over the last nine decades, it has had up years and down years, but there were just a handful of years where the annual return came close to the average return. And this can be tough for some investors to handle

This is why it makes sense to work with a financial advisor who uses tools that account for variability in returns. Good planning is an ongoing and dynamic process between you and your advisor that helps minimize uncertainty and maximizes your potential for future success.

LITTLE CHANGES THAT YOU DON'T NOTICE...

1950

... ADD UP TO **BIG** CHANGES THAT YOU DO!

2018

Rule 18:

Plan for Inflation

"Inflation is taxation without legislation."

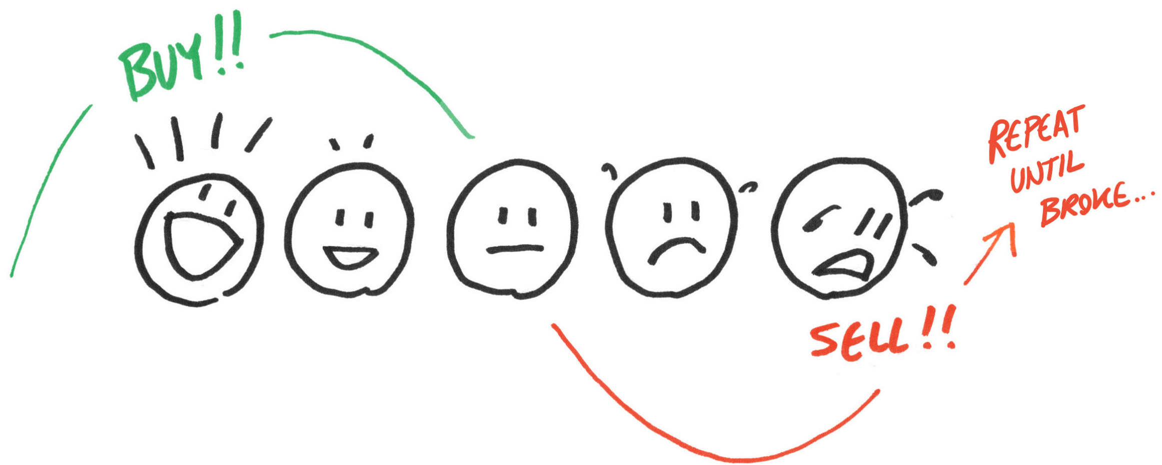
— Milton Friedman, Nobel Laureate in Economics

A typical 65-year old baby boomer couple has a joint life of 30 years, meaning there is a high probability that at least one of them is going to live to age 95. And 30 years is a very long time to plan for. Think of your own life and where you were 30 years ago and all that has happened since...changes in career, family, where you live and how. Think what it may mean to spend a similar amount of time in retirement.

Many of us do a pretty good job saving and investing for retirement, but we can overlook one of the great dangers to a secure retirement — inflation. Historically, inflation has averaged around 3%. Doesn't sound like much, but over time, the impact can be substantial. A 3% inflation rate means that $1 this year will be worth 97 cents next year. In 10 years, $1 will be worth 73 cents. In 20 years, $1 will be worth just 50 cents. In 30 years, $1 will be worth just 41 cents. This means today's $100,000 in the bank could be worth just $41,000 30 years from now.

If your nest egg isn't keeping up with inflation, your money is disappearing without you even realizing it! And while inflation Is cutting your purchasing power, it is also making many things more expensive. Think of a bottle of coke that used to cost 75 cents 30 years ago and is now more than $1.50. Or a gallon of milk that was $2.50 and is now $3.50. And prices of some things such as education, healthcare and housing have actually increased significantly faster than the overall rate of inflation.

The corrosive impact of inflation is one of the primary reasons we invest. While yearby-year inflation eats away at all we've earned and saved, stock markets, offer us significant opportunities to grow our wealth.



YOUR EMOTIONS ARE **NOT** YOUR INVESTMENT STRATEGY.

Rule 19:

Your Behavior Can Impact Your Success

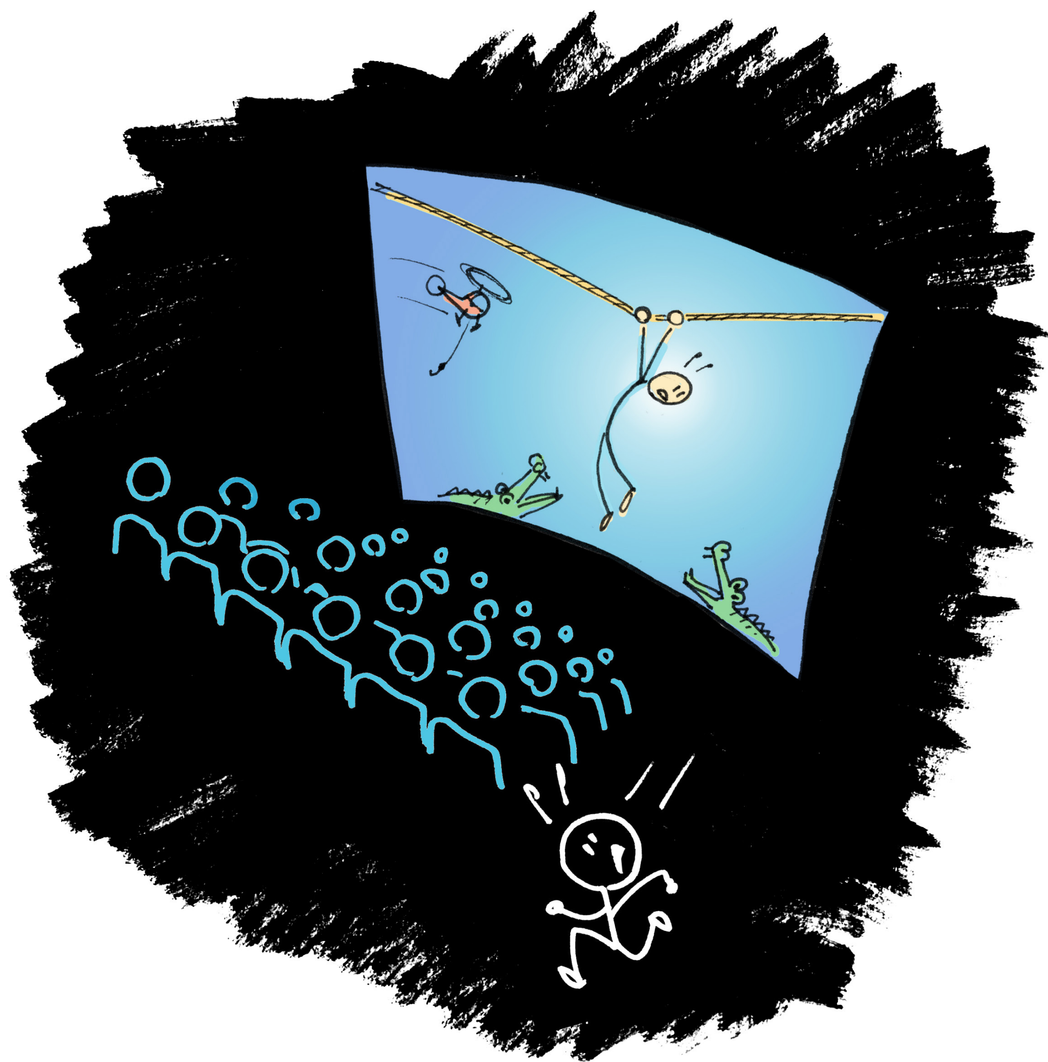
"The dominant determinants of long-term, real-life, investment returns are not market behavior, but investment behavior."

— Nick Murray, Author

For most of us, money is bound up with powerful emotions such as security, confidence, and even, sometimes, fear. But the emotions of investing can cause us to lose focus on important areas of our life, most of which have absolutely nothing to do with the stock market.

We know that remaining patient and disciplined can be extremely difficult, especially when markets are soaring or plummeting. The way our brains are hard-wired can cause us to make emotional decisions about our money at precisely the wrong moments.

Many investors tend to "buy high" and "sell low." Markets are prone to sharp and erratic movements, which can cause investors to sell at inopportune times. Conversely, during a strong bull market, investors often rush into the market because they feel "elated" and buy at the peak. Ultimately, this kind of emotional, short-term behavior can compromise your portfolio and your financial plan.



DON'T LEAVE THE MOVIE
JUST BECAUSE IT GETS SCARY.

Rule 20:

Don't Turn a Temporary Loss into a Permanent Decline

“It is a rough road that leads to the heights of greatness.”
— Seneca, Philosopher

Imagine there was an electronic sign on your home that always showed its latest price (or you log in to Zillow every day to check your home’s valuation). If your home dropped in value by 15% would you immediately sell it?

Probably not. Our house has a necessary functional value — even if the price goes down, we still need a place to live. The same may be true for investing. Its necessary functional value is to help us achieve our most important goals: educating kids, staying ahead of inflation, enjoying a long and secure retirement.

When markets are open, stock prices change every second. Though markets have historically gone up over the long term, in the shorter term, prices can swing wildly and even decline severely.

This can lead some investors panic and sell, turning a temporary decline into a permanent loss (since you no longer own the investments and can’t benefit from any future rebound). It is little like leaving a great movie, just because there is a scary scene in the middle

So the next time your portfolio value drops, ask yourself if it’s worth creating a permanent loss or whether your reasons for investing in the first place (i.e. retirement) still apply.

KEEP
CALM
AND
LET YOUR
$$$ WORK

Rule 21:

Sometimes the Best Thing to Do is Nothing

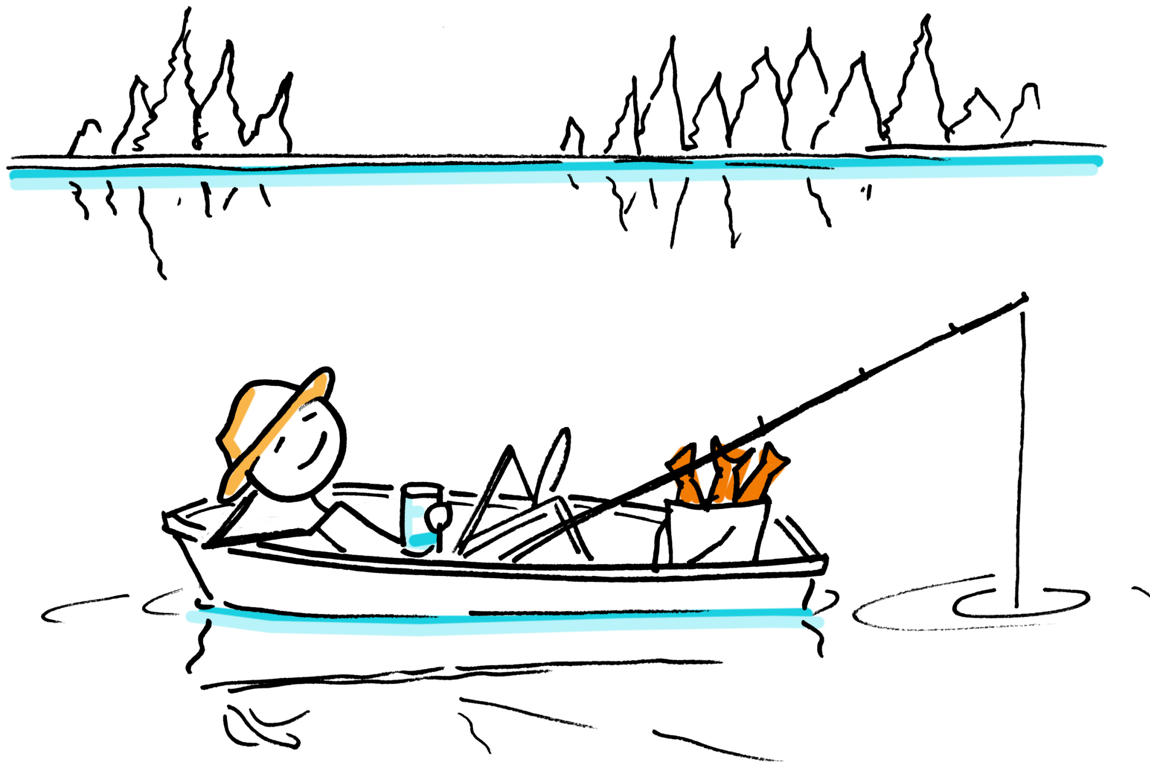
"Your money is like soap. The more you handle it the less you will have."
— Gene Fama Jr., Economist

You're in a hurry, but you're stuck in traffic. It seems like the lane you're in just isn't moving. But the cars in the next lane keep passing you. You're too smart to just sit there, so you change lanes…only to find that now the lane you were just in is moving and you're stuck again. As you keep changing lanes, you realize you're actually going slower and getting more frustrated.

Unfortunately, too many investors are impatient and keep changing lanes and finding themselves getting further behind. And this can be costly. On average, investors tend to significantly underperform the stock and bond markets.

Some might think they know when to buy and sell. But this means they have to be right twice: picking the best time to get in or out of the market, something few investors — even brilliant hedge fund managers — have been able to do predictably and consistently.

Other investors give in to panic or even greed and make hasty, emotional decisions. The objective advice and guidance of a financial advisor can help keep you on track and stop you from making hasty decisions that harm your long-term returns.



TO MAKE A CATCH,
YOU NEED A LINE
IN THE WATER.

Rule 22:

Invest Regularly: Disciplined Investors Catch Unexpected Opportunities

"There is no security on this earth; there is only opportunity."
— Douglas MacArthur, General

If you are a fisherman, you know there will be days when the fish aren't biting, and other days when they take the bait the moment your line hits the water. But on good days or bad days, you will only catch fish if you are actually fishing.

This lesson is lost on many investors who try to pick and choose when to be invested and when not. They believe that if they can figure out the right times when to be the market (or out) they will make more money — and avoid steep declines.

Sounds good in theory. But the reality is that predicting the best and worst times to be invested is difficult.

Consider that the third-best one-day return in the last three decades occurred only two days after the worst one-day return (stock market crash of 1987). Most investors who bailed out of the markets in response to the crash would have missed a significant bounce back.

Over the last 20 years,iIf you'd invested $100,000 in the S&P 500 and missed the 10 best days, your portfolio would have grown to $200,030.[2] However, if you'd stayed invested and "kept fishing," your portfolio would have grown to $400,135. Quite a catch!

BE PREPARED FOR RAINY DAYS!

Rule 23:

Plan for the Unexpected

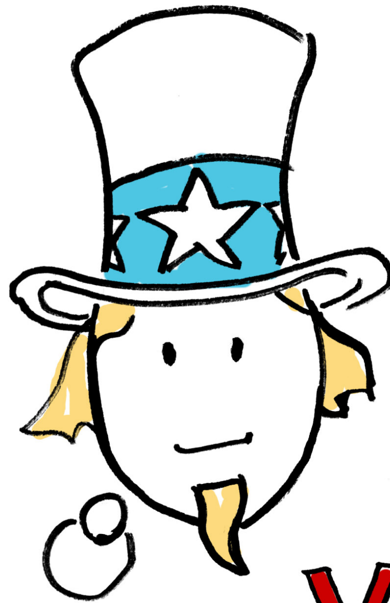
"If you don't have ample liquidity, and it's not durable, in times of stress, as you're looking for liquidity, you're forced to sell assets at declining prices…there's no question that liquidity is sacrosanct."

— Ruth Porat, Financial Executive

Just as you wouldn't take medication without understanding the proper dosage and any side effects, so you shouldn't invest in products you don't fully understand. Unfortunately, Wall Street loves manufacturing complex and often confusing products that may not be in your best interests. And unlike properly-prescribed medication, they may treat problems you don't even have.

In addition, some financial products make it very hard for you to access your money if you need it unexpectedly. It might be "locked up" for years and even decades. And getting your money early — can mean severe penalties. This isn't necessarily a problem if you are sure you won't need the money, or you are in an established product, such as your 401(k), with early withdrawal penalties to make sure you stay focused on investing for retirement.

Here's how you make sure you have the right investment products for your situation. First: work with an independent financial advisor who has a fiduciary duty to always act in your best interests and will take the time to educate you on what you own and why. Second: have long-term plan that can handle those unexpected "rainy days" when you might need access to some of your money.



I WANT YOU TO PAY YOUR

SHARE

Rule 24:

Taxes Matter: Don't Pay More Than You Need To

"The art of taxation consists in so plucking the goose as to obtain the largest amount of feathers with the least amount of hissing."

— Jean-Baptiste Colbert, French Minister of Finances

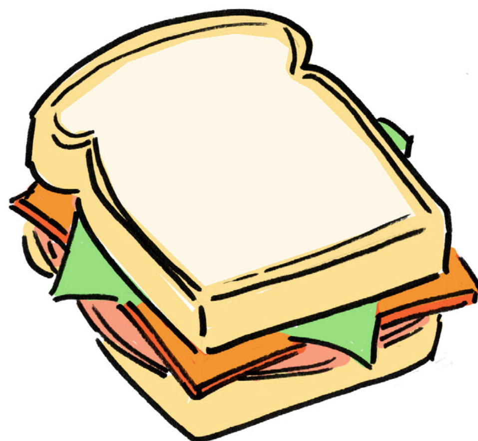
Taxes help make possible many good things in society, but few of us want to pay the government more than our fair share…especially by accident. Many investment mistakes can cost you unnecessary taxes, but there are several areas where smart tax strategies can make a big difference.

Tax-loss harvesting involves selling securities, usually at year-end, to realize portfolio losses, which you can use to offset any capital gains in your portfolio and therefore lower personal tax liability.

What you are invested in can also have a tax impact. The portfolio turnover and volume of trading of many active mutual funds can result in more capital gains taxes than index or asset class funds.

Finally, asset location is a tax minimization strategy that is based on the different tax treatments of various types of investments. Using this strategy, an investor determines which securities should be held in tax-deferred accounts and which securities should be held in taxable accounts in order to maximize after-tax returns.

Everyone's situation is different, and tax minimization is something you should consult with your financial advisor on.



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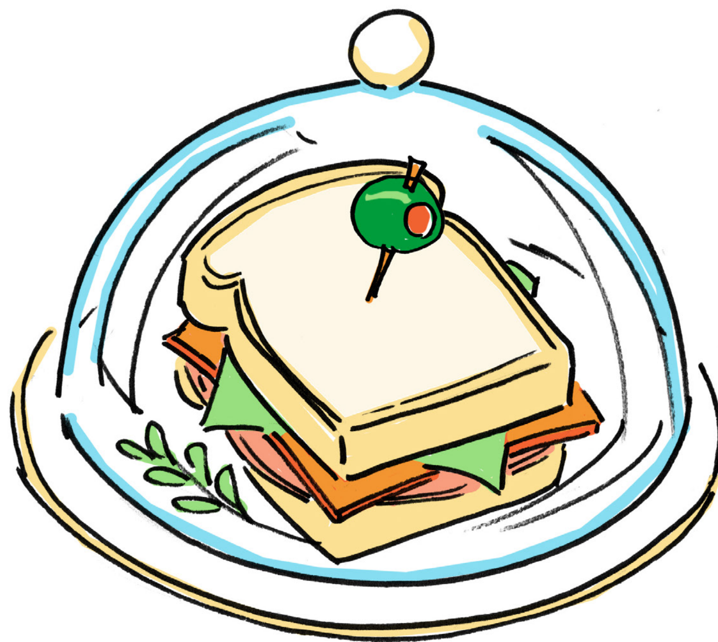

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Rule 25:

Fees and Expenses Matter: Don't Pay More Than You Need To

"When you know the impact of little expenses, you will realize that there is nothing little in this world."

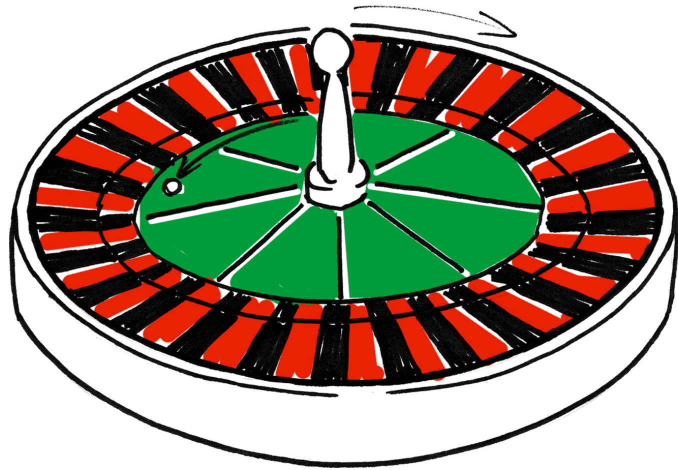
— Manoj Arora, Author

If you've ever ordered room service at a fancy hotel, you know that your club sandwich and soda will be marked up significantly from what you'd pay at the deli down the street. Many investment products are similarly marked up. And unlike an expensive sandwich, unnecessary investment costs can significantly eat into your returns over time.

In addition, a 2016 study by Morningstar, found that costs are the number one determinant of future performance. The higher the cost of an investment, the less likely it is to outperform its peers. And as the complexity of investments rise, so do their costs. Hedge funds, for example, typically charge 2% and 20% of any profits.

The good news is that it is getting easier and easier to understand what you are paying — and find lower cost alternatives.

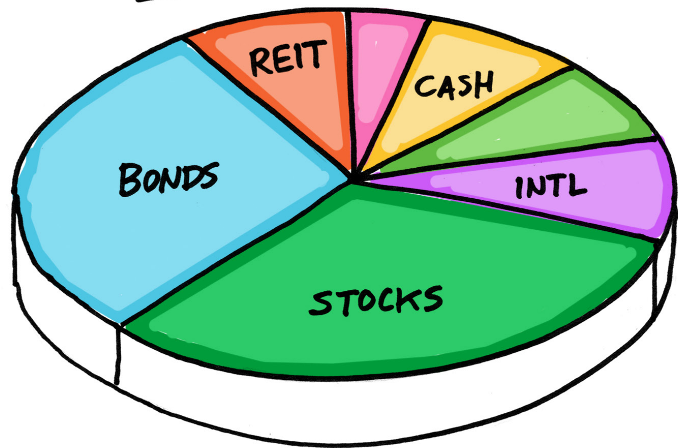
Mutual Funds, especially those that are actively managed, also have a number of fees and expenses that can really add up. In fact, active funds are typically twice as expensive (or more) as index or asset class funds and generally don't perform as well. This is why it is so important to read the prospectus carefully for any product you are considering and understand exactly how much you are paying. Investing isn't free, but it doesn't have to be overpriced.



HOPING FOR A RETURN.

VS.

EXPECTING A RETURN.



Rule 26:

Be an Investor, Not a Speculator

"Investing is expecting positive returns whereas speculating is hoping for positive returns."

— Eugene Fama Sr., Nobel Laureate in Economics

Understanding the difference between investing and speculating can make a significant difference when it comes to growing your money over time. Casinos understand this difference well — it's the foundation of most of their profits.

Any casino game has two parties: the speculator or "gambler" and the house or "investor." Both play the game, but only one is truly investing. Why? It comes down to the odds. At best, gamblers have a 47% chance of winning. They can do little more than hope for a positive outcome. The casino, on the other hand, knows better. They know the odds are in their favor. If they stay disciplined, they win.

Unfortunately, most investors are actually speculating when they think they are investing. They hope for great returns by trying to predict the stock market or find the latest hot stock. These are NOT proven strategies to win, yet people try them every day.

The key to investing is to act like the casino, not the gambler. Diversify across thousands of securities. And don't try to predict markets (or the next hand). Over the long-term, history has shown that these behaviors may improve your odds of success.

BELIEVE IN WHERE
YOU ARE GOING.

Rule 27:

Have an Investment Philosophy and Stick to It

"The important thing about an investment philosophy is that you have one you can stick with."

— David Booth, Founder of Dimensional Fund Advisors

You decide to go on a long cross country hike to a beautiful mountain lake. It will take you a couple of days, and the path will be steep and wind through forests and fields. Before setting off, most of us would get the right gear together, make sure we have enough food and the proper shelter, and carefully map out our route. We wouldn't put a bunch of random things in our backpack and just head off in the general direction of the lake.

Unfortunately, too many investors invest precisely this way, gathering investments together without plan or purpose beyond hoping for good returns. Generally, they are sadly disappointed.

With an investment philosophy, you always know how you will invest and why. You've factored in good markets and bad, and aren't swayed by hype or panic. Hope, gut instincts, and tips from your neighbor or CNBC are not an investment philosophy. Instead, your investment philosophy should always do what it is supposed to, and it should be rational, defensible, and repeatable. No investment philosophy will work 100% of the time, but if your philosophy is prudent and evidence-based, chances are it will get you where you want to go over the long-term.

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[1] Investing involves risk, including possible loss of principal
[2] Past performance may not be indicative of future results

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