7 Habits of Successful Investors

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What is a successful investor?

▷ On track to meet his/her financial goals:
  ▷ Planning for or living well in retirement
  ▷ Saving for college
  ▷ Saving up for a major purchase (house, car, etc.)
  ▷ Just wants to have enough money to enjoy life, help others

▷ Understands investing basics
  ▷ Getting educated
  ▷ Developing good habits
  ▷ Avoiding bad habits
  ▷ Knowing where to go for help

▷ Has peace of mind
So what are the 7 habits of successful investors anyway?

- They cheap out
- They focus on the big stuff
- They know themselves
- They build in discipline
- They multitask
- They focus on limiting taxes
- They keep it simple
Habit 1: They cheap out

- Investing costs are a major drag on returns.
  - Fund expenses
  - Brokerage fees
  - Advisor fees (although a good advisor can more than pay for his or her services)
  - Administrative costs (such as those charged by your employer’s 401(k) or your state’s 529 plan)
- Morningstar research has found that low-cost funds consistently outperform high-cost funds.
Habit 1: They cheap out

Example: Two funds: A and B
- Fund A charges 1% per year
- Fund B charges 0.1% per year
- Start with $1,000 in each
- Same portfolio, gaining 10% per year before expenses
- After 20 years owner of Fund B has 17% ($869) more than owner of Fund A
Habit 1: They cheap out

Cost-effective investing means:

- Looking for low-cost funds—index funds are usually cheaper than actively managed funds
- Avoiding paying sales loads
- Considering ETFs, which are often cheaper than traditional mutual funds, though you might have to pay a brokerage fee
- Using a low-cost brokerage
- If using a financial advisor, look for one that is fee-only (no commission) or, better yet, paid by the hour
Habit 2: They focus on the big stuff

- Saving enough
  - Example: Saving at least 10-15% of your pay in your 401(k)
- Starting early
  - The earlier you start saving the more time your money has to grow--and the less pressure you’ll be under later to catch up.
- Asset allocation
  - Stocks tend to outperform bonds in the long run, albeit with more volatility. Pick an asset allocation that is appropriate for your time horizon and risk tolerance/capacity.
- Security selection matters, too, but the above are most important.
Habit 2: They focus on the big stuff

Asset allocation examples:

**Age 35**
- Stocks (U.S.): 57%
- Stocks (Foreign): 31%
- Bonds: 8%
- Commodities: 5%

**Age 60**
- Stocks (U.S.): 37%
- Stocks (Foreign): 12%
- Bonds: 35%
- Commodities/TIPS: 14%
- Cash: 0%
Habit 3: They know themselves

► What has been your experience with money and investing?
  ► Did you grow up in a household where saving and investing was encouraged?
  ► Your experiences in adulthood
► How confident are you in your investing abilities?
  ► Under-confident: Good news--investing has never been easier.
  ► Over-confident: Warning--don’t think you know more than you do!
Habit 3: They know themselves

▶ How comfortable are you with risk?
  ▶ How did you react when the market was plummeting in 2008?
  ▶ What about when it was soaring in 2013? Or during the tech bubble of the late ‘90s?
▶ What sorts of money mistakes have you made in the past?
  ▶ Fallen for get-rich-quick schemes?
  ▶ Impulse buying?
  ▶ Taking on more risk than you could handle?
Habit 3: They know themselves

▶ Understand that in investing your instincts can work against you.

▶ “Be fearful when others are greedy and greedy when others are fearful.” — Warren Buffett

▶ More trading usually means lower returns.

▶ Morningstar data show investors are lousy at timing the market.

▶ Find a risk level that lets you sleep at night.

▶ But playing it too safe is a danger, too--your money may not grow fast enough.

▶ If you’re still not sure about managing your own portfolio it may be worth paying a financial pro. (But remember to watch fees!)
Habit 4: They build in discipline

▶ Automation is your friend
  ▶ Set contributions and forget it.
  ▶ Money never gets to your wallet, so you won’t be tempted to spend it.
  ▶ Applies dollar-cost averaging to your investing habits--you buy more shares when prices are low and fewer when prices are high.

▶ Rebalancing your portfolio
  ▶ Can be automated as well.
  ▶ Can be done when allocation falls out of line by a set amount, i.e. 5 percentage points or more.
  ▶ Less is more--no need to rebalance more than once a year.
Habit 4: They build in discipline

▶ Auto-escalate 401(k) contributions
  ▶ If you can’t contribute at least 10% right away, increase rate by 1 percentage point each year until you get there.
  ▶ When you get a raise increase your contribution amount.
  ▶ Send half your raise to your retirement account if possible.
▶ Avoid the temptation to dip into your nest egg.
  ▶ Don’t borrow from your 401(k) or raid your IRA except for true emergencies.
  ▶ If you transfer jobs, don’t cash out your 401(k). Roll it over to your new employer’s plan or to an IRA.
Habit 5: They multitask

- Most investors are juggling multiple financial goals.
  - Retirement
  - College funding/continuing education
  - Short-term goals: home improvements, new car down payment
  - Debt: mortgage paydown, student loans, credit cards
- The key is to prioritize, look for the highest return on your “investment.”
Habit 5: They multitask

- Retirement savings should usually trump other financial goals because there’s no fallback if you haven’t saved enough.
- Your child/grandchild can get a loan for college; no one will give you a loan for retirement.
- Considering the best “return on investment” (ROI) can also help you direct your investment dollars to the right opportunities.
- Sometimes the best ROI is debt paydown.
Habit 5: They multitask

Consider the following choice sets:

- Choice 1: Pay down a credit card bill
- Choice 2: Invest in a 401(k)

- Choice 1: Invest in a cash account earning 1%
- Choice 2: Pay extra on your mortgage

- Choice 1: Invest in a Roth IRA
- Choice 2: Invest in a taxable brokerage account
Habit 6: They focus on limiting taxes

- Investment-related taxes, like investing costs, can drag on returns.
- The type of taxes you pay depends on the account.

- **Traditional 401(k) or IRA:** Pretax contributions go in and no taxes as long as the money stays in the account; pay taxes when you withdraw the money in retirement
- **Roth IRA:** After-tax dollars go in; don’t pay taxes when you pull money out in retirement
- **Taxable account:** After-tax dollars go in; pay taxes on capital gains and income distributions in the year in which you receive them; pay taxes on appreciation when you sell
Habit 6: They focus on limiting taxes

- Key ways to limit the drag of taxes on your investments

- Take advantage of tax-sheltered wrappers:
  - 401(k), 403(b), 457: $18,000 contribution limit (under 50); $24,000 contribution limit (over 50)
  - IRA: $5,500 contribution limit (under 50); $6,500 contribution limit (over 50)

- Practice tax diversification for greater control over taxes in retirement: Invest in Traditional IRA/401(k), Roth, and taxable accounts.

- Invest carefully in taxable accounts: Limit trading, favor index funds/exchange-traded funds, municipal-bond funds.
Habit 7: They keep it simple

- Beware “the financial complexity complex”: Parts of the industry benefit when people are confused.
- The media also contributes to the idea that your portfolio must be complicated and requires constant tending.
- Not true!
Habit 7: They keep it simple

▶ Tips for keeping your own financial plan simple

▶ Practice strategic asset allocation (versus tactical/market-timing strategies): “Set it and forget it.”

▶ Use investments that provide a lot of diversification in a single, low-cost package.
  - Index funds/exchange-traded funds
  - Target-date funds
  - Balanced or allocation funds

▶ Reduce number of accounts/providers.

▶ Tune out the noise of the financial media.

▶ Check up on your portfolio just once or twice a year.

▶ Make changes only to rebalance, replace problematic holdings.
Simple Model Portfolio for Young Accumulators: 20s/30s

- 50%: Vanguard Total Stock Market (VTSMX or VTI)
- 10%: Vanguard Small-Cap Value (VISVX or VBR)
- 30%: Vanguard FTSE Developed Markets (VEA)
- 5%: Vanguard FTSE Emerging Markets (VWO)
- 5%: Greenhaven Continuous Commodity ETF (GCC): Optional
Simple Model Portfolio for 50-somethings

- 33%: Vanguard Total Stock Market (VTSMX or VTI)
- 5%: Vanguard Small-Cap Value (VISVX or VBR)
- 10%: Vanguard FTSE Developed Markets (VEA)
- 4%: Vanguard FTSE Emerging Markets (VWO)
- 30%: Vanguard Total Bond Market Index (VBMFX or BND)
- 7%: Vanguard Short-Term Inflation-Protected Securities (VTIPX or VTIP)
- 7%: Vanguard Short-Term Bond (VBISX or BSV)
- 4%: Greenhaven Continuous Commodity ETF (GCC): Optional
Simple Model Portfolio for Retirees

- 10%: Vanguard Total Stock Market (VTSMX or VTI)
- 25%: Vanguard Dividend Appreciation (VDAIX or VIG)
- 10%: Vanguard FTSE All-World ex-US (VFWIX or VEU)
- 20%: PIMCO Total Return (BOND or HABDX—Harbor Bond)
- 10%: Vanguard Short-Term Bond Index (VBISX or BSV)
- 10%: Vanguard Short-Term Inflation-Protected Securities (VTIPX or VTIP)
- 5%: Greenhaven Continuous Commodity ETF (GCC): Optional
- 10%: Cash for near-term living expenses (enough to cover 1 to 2 years’ worth of living expenses)