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

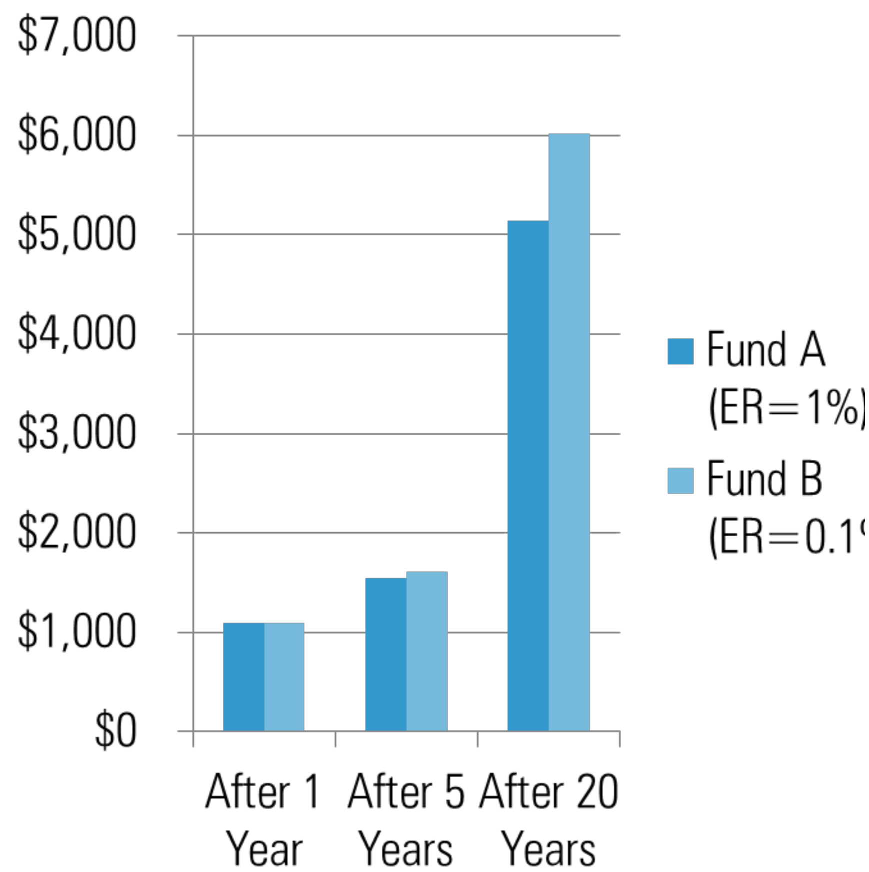
Habit 1: They cheap out

- 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



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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

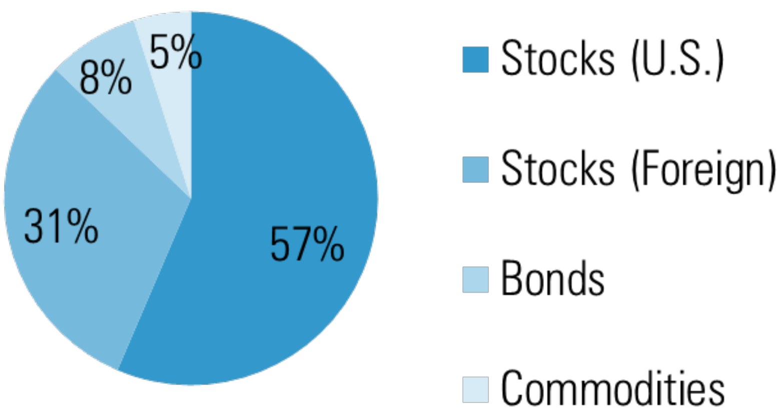
Habit 2: They focus on the big stuff

- 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.

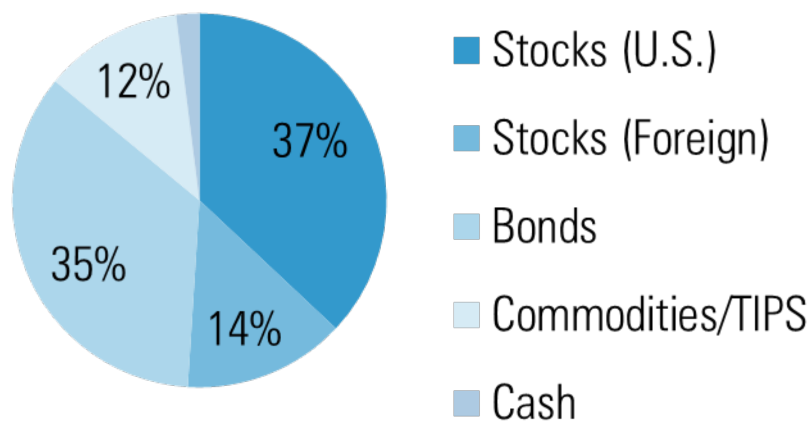
Habit 2: They focus on the big stuff

Asset allocation examples:

Age 35



Age 60



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)