The Investment Answer

LEARN TO MANAGE YOUR MONEY &
PROTECT YOUR FINANCIAL FUTURE

DANIEL C. GOLDIE, CFA, CFP
& GORDON S. MURRAY

The Investment Answer

LEARN TO MANAGE YOUR MONEY & PROTECT YOUR FINANCIAL FUTURE

DANIEL C. GOLDIE, CFA, CFP
& GORDON S. MURRAY

www.TheInvestmentAnswerBook.com

Praise for the Book

"Gordon Murray and Dan Goldie have written a book that every American should read. Its clarity de-mystifies the investment process and its insights can make anyone who reads it a better investor."
– Bill Bradley, former United States Senator

"An excellent primer for the investor who is not a finance specialist."
– Eugene F. Fama, Robert R. McCormick Distinguished Service Professor of Finance, Chicago Booth School of Business, widely recognized as the "father of modern finance"

"Murray and Goldie use simple yet compelling logic to explain the fundamental principles of investing. Their clear advice will improve your investment experience."
– Kenneth R. French, Heidt Professor of Finance, Dartmouth College, Tuck School of Business

"I'm glad to see Gordon and Dan collect these insights into a handy, easy-to-use primer so Gordon can stop explaining these principles at Sunday brunch and family birthdays. Full disclosure: Gordon's my brother-in-law. That said, I found this slim volume incredibly helpful in explaining how to think about investing. It's reassuring to know there are some simple principles anyone can keep in mind to make decent decisions and banish the vague anxiety most of us have about where we've put our money."
– Ira Glass, Edward R. Murrow Award winner, Host of NPR's *This American Life*

"Gordon Murray and Dan Goldie share secrets that Wall Street would rather you not know. You can implement a few simple strategies at a very low cost that will outperform most of the stock picking and complicated advice hawked by high-priced brokers. Read this book and prosper."
– Joseph A. Grundfest, former SEC Commissioner, co-founder of Financial Engines, and Professor of Law and Business at Stanford Law School

"Goldie and Murray have distilled the essence of the matter, and explain in clear English, the advantages of using a fee-only financial advisor, how to select such, and how to work with one in the short and long run. This is sound advice, which you will rarely if ever get from a daily financial newscast."
– Harry M. Markowitz, PH.D., Nobel Laureate in Economics, 1990, Father of Modern Portfolio Theory

"Wow! Goldie and Murray have just hit a home run. If I could give only one book on investing to my friends and family, this one would be it."
– Bob Waterman, co-author, *In Search of Excellence*, former director of McKinsey & Company

Dan Goldie Financial Services LLC
750 Menlo Avenue, Suite 200
Menlo Park, CA 94025
www.dangoldie.com

Ordering Information:

Individual sales. This book is available through Amazon.com and other online and brick-and-mortar bookstores.

Quantity sales. Special discounts are available for quantity purchases by corporations, associations, and others. For details please contact the publisher above.

Educational sales. Special discounts are available for books purchased for use in college courses and adult-education programs.

Financial advisors. Special order books with a customized forward are available. Contact the editor above for information.

Printed in the United States of America

First edition

Library of Congress Control Number 2010933176

ISBN 978-0-9828947-0-5

Prologue

Wall Street brokers and active money managers use your relative lack of investment expertise to their benefit… not yours.

The financial press uses your inclination to be afraid during falling markets and confident during rising markets, to its benefit… not yours.

The record shows that our elected representatives, once-trusted ratings agencies, and government regulators have placed their own interests first… not yours.

None of these parties has demonstrated an understanding of what you are about to read in this book. It's time for you to put yourself first and take charge of your investment future. It will be much simpler than you think.

Table of Contents

Why We Wrote this Book

We hear stories like these too often:

Ron and Judy work with a broker who invested their money in some of the brokerage firm's popular investment products (a hedge fund-of-funds, a managed futures account, two separately managed stock accounts, and several municipal bonds). They have no idea what they are paying in fees, or whether their investment results have been good or bad. Their broker has not developed a long-term investment plan for them, so they don't know whether they are on track to achieve their goals. In fact, they are not even sure what their investment goals are! Their broker is now recommending a gold fund, because his firm is forecasting a rise in inflation. Ron and Judy don't know what to do.

Betty has never trusted the stock market. She and her late husband always invested their savings in bank CDs and money market funds. She now realizes that her savings have not grown enough for her to maintain her current lifestyle, and she will be largely dependent on social security income for the rest of her life. She is not sure where to turn next.

Steve manages his money through an online brokerage account, buying individual stocks. He has made a few good picks, but for the most part his portfolio has done poorly. He selects his stocks after researching companies online, watching CNBC, and reviewing financial periodicals, but feels uncertain about this approach. He is spending a lot of time on this, yet he knows that he's not really getting anywhere. He wonders whether the time he spends on his portfolio would be better spent building his career.

Amy has been contributing regularly to her company's 401(k) plan, and has also purchased some stock mutual funds with additional savings. After the stock market dropped in 2008, she sold everything in a panic and has been sitting in cash ever since. She has heard that stocks have a good long-term record, but her personal experience has not been good. She wonders if she is just not cut out to be an investor.

We want to change the way you think about investing. Clearly, the traditional financial services industry is failing to serve investors properly. Our hope is that this book will influence the way you select financial advisors, invest your money, and assess your results.

Our Story

We have a common belief about how markets work and how individuals should approach long-term investing. We came to this shared view from different places: Gordon from a successful 25-year Wall Street career interfacing with the most sophisticated institutional investors in the world, and Dan from nearly two decades of working with individual investors as an independent financial advisor. The fact that **we have come from opposite sides of the industry and have reached the same conclusions about how to invest** is a testament to the universal logic of this approach.

When we first came to appreciate the unshakable logic and compelling evidence supporting the investment concepts described in this book, each of us experienced an epiphany that we describe as a "light bulb turning on."

There are numerous other books and papers that address the ideas you are about to read here…and in far more detail. However, therein lies part of the problem. For most of us, these publications are too long or too technical. **Our goal is to express these important concepts in a way any investor can understand.** We have purposely kept this book brief and to the point. We want you to be able to get from beginning to end in one sitting!

We need a better way to invest. We need a better understanding of how Wall Street really functions and how markets work. We need to feel confident that we are investing prudently and making smart financial decisions.

There is an answer. You'll find it in this book.

Introduction

Today, the good news is that we expect to live much longer, healthier lives. The life expectancy of a newly retired, 65-year-old couple in the U.S. is more than 20 years — far longer than it was just a few decades ago. Furthermore, new medical advances are announced almost every day to enhance the quality of our lives and help us age more gracefully.

The bad news is that many of us will not have enough money to retire comfortably. In addition, we are told not to count on traditional pension plans, Social Security, or Medicare. Whether we are saving for a down payment on a house, our child's college education, or a comfortable retirement, **the need for us to invest wisely is more important now than ever**.

Some of us believe the self-serving hype from the financial media, who tell us that we can do it all ourselves. They tell us we can beat the market if we buy the mutual funds or stocks they recommend. They want us to believe that we can get rich quick if we follow their trading recommendations.

As a result, we might waste countless hours scouring the latest financial periodicals, studying brokerage house research reports, or watching the financial news, all with the hope of finding the next hot stock, superstar fund manager, or right time to jump into or out of the market. Or we may do the opposite — ignore the importance of financial planning, simply "hope for the best," or spend more time making our vacation plans than our financial plans.

Thus, most of us end up taking unnecessary risk, not diversifying our portfolios properly, and paying too much in fees and taxes — resulting in poor investment results with too *little* return and too *much* risk.

The unfortunate truth when it comes to investing is that many of us are scared and don't know where to start. Wall Street feels like a casino with the odds stacked against us. We are intimidated by the language of investments and are wary of recommendations from Wall Street research analysts. As a result, it is not hard to understand why so many of us are confused about what to do with our money and are uncertain about how to make smart financial decisions.

As a patient and disciplined investor with a longer time horizon, financial markets can become your *ally* rather than your *adversary*. **All you have to do is make five informed decisions** that will allow you to take advantage of the wisdom that Nobel Prize winners have acquired over the past six decades to stack the investment odds in your favor.

You CAN have a successful investment experience!

These decisions are:

1. The Do-It-Yourself Decision

   Should you try to invest on your own or seek help from an investment professional? And if so, which type of advisor is best?

2. The Asset Allocation Decision

   How should you allocate your investments among stocks (equities), bonds (fixed income), and cash (money market funds)?

3. The Diversification Decision

   Which specific asset classes within these broad categories should you include in your portfolio, and in what proportions?

4. The Active versus Passive Decision

   Should you favor an actively managed approach to investing that seeks to outsmart the market, or a more passive approach that delivers market-like returns?

5. The Rebalancing Decision

    When should you sell certain assets in your portfolio and when should you buy more?

Each of these decisions has a significant impact on your overall investment experience. Whether you know it or not, every day you are making these decisions. Even if you decide to just stay the course and do nothing with your investment portfolio, you are inherently answering all of these five questions.

We will provide you with the necessary background to make these decisions. And to help you make smart choices, we will share our opinions and recommendations with you.

By learning how to make five informed investment decisions that capture the essence of investing, you will never again be afraid of financial markets or uncertain about what to do with your money. You will no longer be a *speculator*…you will be an *investor*.

The Decisions

CHAPTER 1

The Do-It-Yourself Decision

DO-IT-YOURSELF

The do-it-yourself (DIY) approach is increasingly popular in some industries: home repair and renovation, decorating, self-publishing, and fashion. However — we are not going to beat around the bush here — in most cases, we do not believe it is prudent when it comes to investing. Finance is complex, the odds are stacked against you, and the stakes are very high: your entire financial future. Most people would never make serious medical decisions without consulting a doctor. We believe you should take care of your financial health the same way you take care of your physical health — with the appropriate professionals by your side!

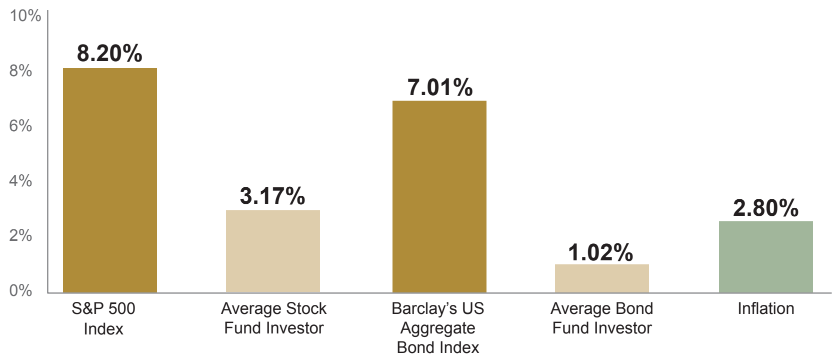
Attempting to invest on your own can be difficult, time-consuming, and emotionally taxing. Most individual investors do not have the skills or the inclination to manage their own investments. However, even for those who do, this may not be a good idea. In today's world of global markets and complex financial instruments, professionals have access to superior resources. It is difficult for an individual investor to effectively put together and maintain an efficient portfolio that is properly diversified, minimizes fees and taxes, and avoids overlapping assets. In addition, the ongoing monitoring of your portfolio and maintenance of your desired risk exposure can be challenging and overwhelming without access to the tools that are used by competent professional financial advisors.

What's more, our own natural instincts can be our worst enemy when it comes to investing. This is illustrated in an annual study conducted by Dalbar, a leading financial services market research firm that investigates how mutual fund investors' *behavior* affects the returns they actually earn. Figure 1-1 shows data from the most recent Dalbar study covering the 20-year period ending in 2009:

- The average stock fund investor earned a paltry **3.2** percent annually versus **8.2** percent for the S&P 500 Index;
- The average bond fund investor earned only **1.0** percent annually versus the Barclays U.S. Aggregate Bond Index return of **7.0** percent; and
- What is perhaps most remarkable and unfortunate is that **the average stock fund investor barely beat inflation, and the average bond fund investor barely grew his money at all**.

Figure 1-1 Average Investor vs. Markets

January 1, 1990 to December 31, 2009

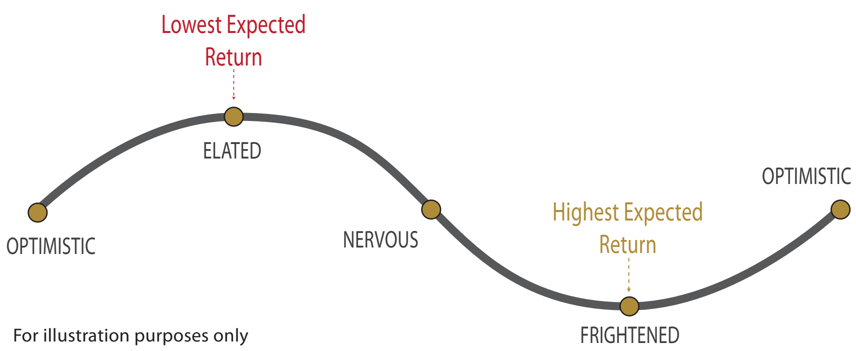


Average stock and bond investor performances were used from a DALBAR study, Quantitative Analysis of Investor Behavior (QAIB), 03/2010. QAIB calculates investor returns as the change in assets after sales, redemptions, and exchanges. This method captures realized and unrealized capital gains, dividends, interest, trading costs, sales charges, fees, expenses, and any other costs. After calculating investor returns, two percentages are calculated: total investor return for the period and annualized investor return. The fact that buy-and-hold has been a successful strategy in the past does not guarantee that it will be successful in the future.

How could this happen? The simple answer is that we tend to buy stocks and bonds after their prices have risen. We do this because we feel comfortable and confident when markets are up. Similarly, when markets are have experienced a downturn, fear sets in and we are often quick to sell. This behavior can result in our **buying at or near market highs, and selling at or near market lows**, thus failing to capture even a market rate of return.

Figure 1-2 illustrates what we call the *emotional cycle of investing* and how it can cause us to make costly mistakes.

Figure 1-2 The Emotional Cycle of Investing



Certainly the media and the Wall Street brokerage industry are motivated to contribute to this phenomenon. As you search for your next great investment idea, you might read a financial periodical such as *Fortune*, *Forbes*, or *Money*, or you might tune into CNBC, Bloomberg, or Fox Business News, all of whom try to turn investing into entertainment. Then when the hook is in and you decide to act on some new idea, your transactions will put additional commissions in your broker's pockets. **Many financial institutions still take far too big a cut as you move your money from one hyped investment to another.**

There are many behavioral inclinations that work to our detriment as long-term investors. For example, do any of the following sound familiar?

Overconfidence. A general disposition to be overconfident can help society in many ways. For example, without this bias, many new inventions, companies, and pioneering research would never come about. However, we need to understand that overconfidence with regard to investing can be detrimental to our financial health. Success in one walk of life does not automatically translate to success in investing. Unfortunately, many highly accomplished people have learned this lesson the hard way — through severe investment losses.

Attraction to rising prices. When the prices of most consumer goods such as gasoline or beef rise, people tend to either cut back or find a substitute. However, with financial assets the opposite seems true. Many investors are more attracted to a stock whose price has risen than one whose price has fallen because we incorrectly extrapolate past price changes into the future. Likewise, mutual funds that have done the best recently are aggressively purchased, while recent underperformers are sold. It is important to know that with investments, **past performance is not indicative of future results**.

Herd mentality. There is a comfort in being part of a group. When others do something we are more comfortable doing the same. A recent example is the influx of money into mortgage-backed securities and risky loans, and the debacle that followed. Of course, history has shown that when the herd moves in one direction it may be time to consider going the other way. (See chapter 5, The Rebalancing Decision, for how to avoid this problem).

Fear of regret. We are often reluctant to make investment decisions for fear they will turn out badly. For example, have you ever left money sitting uninvested because you were afraid to enter the market at the wrong time? Our view is that **the right time to invest is when you have the money and the right time to sell is when you need the money**.

Affinity traps (Bernie Madoff, anyone?). Instead of doing our own research, how often do we make an investment simply because we have mutual ties to an organization, or because it was recommended by a respected friend or famous person?

Certainly, there are other emotions that are hazardous to our financial health if left unchecked. Many of us can relate to an observation made by the economic historian Charles Kindleberger, author of the classic *Manias, Panics and Crashes*: "There is nothing so disturbing to one's well-being and judgment as to see a friend get rich."

Market fluctuations cause us to continuously battle against our biases. We need *discipline* to counter these normal human tendencies. The right discipline begins with an understanding of how markets work. It establishes a process that allows us to focus our time and effort on those things we can control. This helps us achieve our investment goals more efficiently and with less worry.

It is very difficult to accomplish this on your own without a good steward in your corner. This is why we believe most investors who are serious about managing their wealth should seek the assistance of a professional. A qualified financial advisor should bring discipline and clarity to the investment process and help you avoid behavioral traps that can impede your ability to realize your financial goals.

If you agree with us, the question then becomes which type of advisor to choose: a *retail broker* or an *independent, fee-only advisor*.

Years ago, before the widespread availability of independent, fee-only advisors, retail brokers were the primary means of obtaining investment advice. Now you have a choice. There are significant differences between the two that you must understand.

RETAIL BROKERS

Retail brokers are commissioned agents compensated by their firm or a third party for selling you investment products. Traditionally known as stock brokers, today they call themselves Financial Advisors and Financial Consultants. **Despite the titles they put on their business cards, they should not be confused with independent, fee-only advisors.**

Retail brokers typically offer two different types of accounts — a "classic" brokerage account and an investment advisory account.

Brokerage Account

With a brokerage account your broker will act as an agent for his firm. In this capacity, **your broker's first duty is to his firm, not to you**, even though you are his customer. While he may offer the periodic stock tip or some occasional advice, that is incidental to his main business of generating trades and commissions.[1]

With this type of account, your broker is not held to the legal standards of the Investment Advisers Act of 1940, which requires that anyone who offers both investment advice and charges an asset-based or flat fee to register as an investment advisor. According to the law, advisors must disclose any conflicts of interest and put their clients' interests first. You do not get this protection with a brokerage account.

With a brokerage account, you should be aware of these potential conflicts and drawbacks inherent in the relationship:

Your broker is:

a. better compensated for generating more trades;

b. better compensated for selling certain investment products over others; and

c. limited to selling the investment products approved by his firm.

[1] Robert Barker, "Will the SEC Bless This Masquerade?" Business Week, August 5, 2002.

Investment Advisory Account

With an investment advisory or "managed account" your broker may offer many services such as financial planning and advice on the selection of investment managers and investment products — all for a single fee.

With managed accounts, your broker is held to the legal standards of the 1940 Advisers Act. He is therefore considered to have a fiduciary relationship with you and must disclose any conflicts of interest and put your interests first. While these advisory accounts eliminate much potential for abuse, there are drawbacks with this model as well.

For example, the broker is still limited to offering only his firm's menu of approved investment products. In addition, the investment managers or mutual funds he recommends to you may be paying his brokerage firm to be included as an approved investment for all its clients.

It also might be the case that the investments you have through your broker's current firm may not be transferrable to another firm. This could mean having to sell your investments, potentially triggering costly capital gains, to move your account to another firm, either to switch to a new broker or to follow your current broker when he moves to a new firm.

The Name Game and Changing Hat Tricks

It is important to keep in mind that regulators have done a poor job of policing the dozens of misleading titles that brokers often use. This means that you are on your own when it comes to asking the hard questions about whether they really work for you. Don't believe those glitzy ads that you see in the *Wall Street Journal* or on TV about how they work just for you.

To complicate things even more, not all brokers work for Wall Street firms, although they still face the same conflicts and incentives. Some brokers may call themselves independent because technically they are sample content of The Investment Answer: Learn to Manage Your Money & Protect Your Financial Future

- Europe Central pdf, azw (kindle)
- read online The Dread (The Fallen Kings Cycle, Book 2) online
- read The True Deceiver (New York Review Books Classics) book
- click Fyr here
- read The Landscape of Humanity: Art, Culture and Society (St Andrews Studies in Philosophy and Public Affairs) pdf, azw (kindle)
- read online Jump and Other Stories (UK Edition)

- http://toko-gumilar.com/books/Crimes-and-Mercies--The-Fate-of-German-Civilians-Under-Allied-Occupation--1944---1950.pdf
- http://studystrategically.com/freebooks/Can-Holding-in-a-Fart-Kill-You---Over-150-Curious-Questions-and-Intriguing-Answers.pdf
- http://studystrategically.com/freebooks/The-Guru-Guide-to-Entrepreneurship--A-Concise-Guide-to-the-Best-Ideas-from-the-World-s-Top-Entrepreneurs.pdf
- http://yachtwebsitedemo.com/books/Fyr.pdf
- http://nautickim.es/books/Beginning-Power-BI-with-Excel-2013--Self-Service-Business-Intelligence-Using-Power-Pivot--Power-View--Power-Query
- http://omarnajmi.com/library/We-Are-All-Weird.pdf