Smart and Simple Matters 009:

How to Find and USE the Investing Start (or Restart) Button

Show Notes at: http://valueofsimple.com/smart-and-simple-matters-podcast-009-investing-start-button

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In this episode you'll learn about:

- The considerations you *must* make before investing your first dime
- The simple – sometimes comically easy – five step process to select an investment company
- Why investing increases more than just your financial health
- How to approach investing with fresh eyes and shed bad habits
- Why I'm a heretic and disliked by most of the investment industry
- My surprising answers to the question, "what do I invest in?"
- How the value of your investments can skyrocket…but you still lose money
- The online course *Start Investing with $100* and how it can help

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Now for the transcript.

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Hey there, and welcome to the **Smart and Simple Matters** show with your host, **Joel Zaslofsky**. It seems like I need help getting this Pink Floyd song stuck in my head out. It has something to do with money but I can't seem to remember the name. This is episode number nine.

<Intro music>

Welcome to another exciting episode of the Smart and Simple Matters show folks! It's a beautiful day in my neighborhood as I look out the window and reflect on the topic I'm covering solo today. Last time I recorded a show on my own, I covered a subject that very few people know about and don't normally think about…at least that was the case before I published that episode.

That subject was the ins and outs of curating if you're curious. But the topic today? It's something **everyone** at least *believes* they know something about and definitely thinks about.

That topic? Investing.

This has really been front and center in my mind for a few months and today seemed like the perfect opportunity to get all my thoughts out of my head and into the microphone.

Now, for all you listeners whose gag reflex kicked in when I mentioned the word "investing" or who had to take another sip of coffee to keep you awake because the topic normally bores you to tears, this won't be your typical investing talk. In fact, I'm going to say some things that make me a heretic in some circles and definitely don't endear me to some entrenched interests in the business. All the while, this will be as lively a conversation with you as any I've ever had because my excitement is shining through in a major way right now.

I'll start off with why I'm doing an investing specific episode and talk a little bit about my experience with investing. Then I'll run you through a sequence of how to get started with investing or, if you're already investing, how to approach it with a fresh set of eyes and shed some bad habits you may have accumulated over the years.

As we really get into it today, I'll challenge you to define or refine your investing goals and then help you decide what kind of account structure will give you a great chance at meeting those goals. Then we'll move on to the crucial and always hot topic of "what do I invest in?" and my approach to answering that classic question is definitely going to surprise you. Towards the end, I'll be covering a strangely simple five step process to select an investment company that makes a decision almost comically easily for some people.

And at the end, I'd like to explain a bit about my online course – *Start Investing with $100* – along with why I created it, who it's for, and how it could be a great fit…maybe even for you.

Fair warning: I'm covering a lot of ground today so if you sneak away for a moment, fast forward through part of this, or mute this to do something else, you might miss something important.

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Why I'm Doing an Investing Specific Episode

Now, besides enjoying doing a solo podcast from time to time, there are topics that I can cover most efficiently when all I have to worry about is me.

I've been in enough conversations with people where I know, as much as I'd like to assume everyone just simply gets why investing is so freakin' important, that I still need to justify why you should invest. I have about a hundred reasons I could cover, but first and foremost, if you're not investing your money, then your current and future purchasing power is getting devoured every second of every day.

I'm fascinated by how people are generally familiar with the concept of purchasing power, but forget what a huge role inflation and taxes has in it. You just heard me use the word devour to note what can happen to your purchasing power when you don't invest. Here's what I actually mean by that.

First, I want to talk about one of the two heads of what I think about as the double-headed monster looking to gobble up your idle money. **And *that* would be inflation**.

Here's a very real scenario to help you understand what I mean. Let's say you buy a $100.00 Treasury bill from the United States government with a promised return rate of 10% per year. 365 days from now, that initial $100.00 investment is going to be worth $110.00 for a rate of return equal to 10%. Now that sounds pretty good, but hold on just a second here. Let's say that inflation over those 365 days was 8%. All of the sudden, the *real* return on your $100.00 investment is not $110.00 or 10%, it's actually $102.00 or **2%**. This is the destructive power of inflation and wise investing to outpace inflation is just about the best way to combat it.

Now, the other head of the double-headed monster hungry to eat up your hard earned cash is **taxes**. It's not a concept I need to explain to you, but assuming your personal tax rate is something greater than 0%, it's a constant force biting into your ability to buy the things you need right now *and* in the future. Once again, investing is a tremendous way to fight back against the presence of taxes.

And don't get me started about the preferential treatment of investment income vs. work income, especially in the U.S. The amount that tax laws favor the income earned on investments – like capital gains, interest, and dividends – over the income earned from working, in other words your paycheck, is *downright insane* sometimes.

Most federal governments are practically begging you…**begging** you to invest with their enormous incentives, so why not take advantage of them if you can do it smartly and legally.

What I'll only mention but not touch on today are some of the psychological, emotional, mental effects of investing. Done well, regardless of whether you're making money with your investments, the simple fact that you **are** an investor and have a **system** in place can do wonders for your worry and stress levels. There are decades worth of research that back up that statement, so let's not discount the very real power of investing to increase more than just your financial well-being.

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Before I get too far, there are a few disclaimers I need to throw out here. For one, I am **not** a Certified Financial Planner. I can't legally give investment advice – nor would I want to – and I don't have any formal investment credentials. Some of what I say is personal opinion and should not be used to make direct or indirect investing decisions. So there, I'm glad we got that out of the way.

The last reason I'm doing an investment specific podcast is because the timing seemed perfect since I'm launching my first product on November 20th and it's all about investing. It's called *Start Investing with $100* and it achieves exactly what the title promises it will: to get you started investing with as little as $100…but also to get people who are investing but don't own the decision making process to take control of their investing future as well. More on that later in the show.

My Experience with Investing

At this point, you might want to know if *I* know what the hell I'm talking about. Well, I've been an independent investor since I was 21 and have been consuming investing magazines, articles, videos, and more for two decades. I also worked in the investment industry for over a decade in various roles ranging from moving really rich people's money around the world to helping form the strategy around spending a $40 million technology budget on the firm's goals to improve the investing lives of their clients.

I can't show you any investing account statements with huge gains that make your eyes pop out of your head, although I've done well for myself over the years. My results mirror the performance of key investing benchmarks, like the S&P 500, because unlike most investors who try to beat the market and end up doing *worse* instead, I merely pick the markets I want to invest in and then get the best index mutual fund for it.

So hopefully you're at least partially convinced by now that I'm qualified to talk investing shop with just about anyone out there.

The Sequence to Getting Started with Investing

However, I just realized I've said the words investing and investment about a hundred times and have yet to create a common understanding between us of what investing actually *means*. You can go to Wikipedia and look it up if you want, but I'm not a fan of how they break it down. Like everything in life, different people and different sources have *very* different definitions of something and investing is also this way. Investopedia, darn near my favorite investing related resource of all-time, explains investing as "The act of committing money or capital to an endeavor with the expectation of obtaining an additional income or profit." But I actually like Warren Buffett's definition of investing the best. That may have something to do with him being perhaps the greatest investor to ever walk the Earth. He says, **"**Investing is forgoing consumption now in order to have the ability to consume more at a later date."

Ah ha. Now we're getting somewhere. Buffett is saying that investing is part saving – meaning intentionally not spending every last dime to our name right now – and part growing our money so that we can buy stuff in the future. But as we'll get to in a little bit, there are a lot of forces conspiring to prevent us from being able to buy the stuff we want and need in the future, save what I've already talked about with inflation and taxes.

Now we have a bit of a baseline of what investing actually means from a practical perspective. How long has this investing thing actually been around though? Well, it's been around a really long time. Like as in the days of the Code of

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Hammurabi in 1700 B.C. provided the first legal framework for investing and the oldest forms of it include trading commodities like gold and real estate like farm land or, more modern terms, that lovely villa in the French hillside.

It's not important to know that investing has been around for over 3,800 years, but the modern version of it sure as hell doesn't look anything like the original version of it. There is sooo much more to know and do with our investments these days.

You know, I did an investing related workshop in July for the members of the Puttytribe, and awesome online community I'm a part of. I joked when I did it that personal investing in the 21st century is like walking into a dark chocolate factory and being told all 500 products are free. Where the hell would you start?!

I'll tell you where **not** to start first though. That would be trying to learn and fully understand all the investing principles and definitions out there. I assure you, nothing bad will happen if you don't know what the "P/E" in a "P/E ratio" stands for. That's price to earnings ratio by the way. I'd also like to mention that someone saying they are going to "the farmer's market" is equivalent to saying that they invest in "The Market." In both cases, different markets in different places sell different things at different prices and with different terms. So don't worry about the differences between all the types of markets right now.

But there is a really great place to start and it's in defining your needs and goals. And there are a series of questions you can answer for yourself in order to do that logically and fully.

First off, before you do anything else, ask yourself if having an emergency fund is critical to you. By emergency fund I mean having in your bank account or somewhere easily available to you, anywhere from 3 to months' worth of living expenses. I know for me personally, I wouldn't start to invest or continuing investing if I didn't already have some months' worth of financial cushion for the living expenses I know will be coming do. So that's something that's really important and I highly encourage you to determine if an emergency fund is something you need, and if so, how much.

Next, why do you even want to invest in the first place? Is it to pay for your retirement, your higher education needs or the education bills you expect your kids to have, funding a big ticket item like a wedding, car, or a well-deserved vacation? *Really* dig deep into this one because if you don't understand the motivation…the needs…the goals behind investing, you better not start yet.

Then, start thinking about how comfortable you are paying taxes on your investments. Some people avoid paying taxes in general or on investments specifically like the plague. Others don't mind paying taxes at all and the approach to investing coming from these two sides of a spectrum can look very, very different.

So let's say you've now nailed your reasons to invest and are now thinking about how much to invest and how often. Well first off, different investing companies and investment types have wildly differently minimum amounts to open an account or gain access to a specific investment. Do you want to just plunk down a single lump sum up front, or would you rather spread your investing dollars out over a longer time horizon? And of course, let's not forget where you're going to come up with the money to invest in the first place.

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You might be able to start investing with as little as $1, but most likely you'll need $100 (or more) depending on the account type, investment type, and investment company. When determining how much you can invest, there are several points to consider.

First, you'll need some money to open the account and meet any account opening minimums and investment type minimum thresholds. If you're employed, you could reduce your paycheck withholding amount to get more take home pay. Or if you have flexible and lenient debt repayment terms, you could – after *very* careful thought and analysis – defer a debt payment for a month and use the money to invest instead.

Second, you'll need to decide to invest just an initial lump sum or if you plan to invest small amounts on a weekly, monthly, or semi-regular basis. These periodic investments can have a number of potential advantages like:

- Lowered minimum investment and ongoing minimum account balance amounts
- Eliminated inactivity fees or periodic "standard account fees"
- Dollar cost averaging, which is openly debated whether it's actually an advantage or not

Third, you'll have to assess how soon the money you're investing will need to be accessed. This will inform the account structure decision you'll ultimately have to make.

At this point I want to mention a big note for people with all kinds of debt except mortgage payments. The biggest consideration for people with debt is how much they should pay off before starting to invest. This is *highly* contextual based on the debt rate, length, amount, type, etc.

Some people will say it's as simple as "if you can earn a higher after-tax return on your investments than the after-tax interest rate expense on your debt, you should invest. Otherwise, you should pay off your balance." And others will throw calculators at you and ask you to do the math yourself. And even other folks will offer their opinion or experience in reputable places like Forbes.

My stance is you should look at debt and investing from a holistic perspective. Even if it makes financial sense to invest instead of paying down debt, it might not make sense from a health, emotional, mental, or even spiritual angle. This is too complex to address fully here. **But don't let someone convince you to pay down debt or invest solely based on financial analysis**.

Picking an Investment Account Structure

You might want to pause this episode right now and actually write down your thoughts on these initial considerations I've presented. Or play back the last few minutes and let these questions really sink in deeply so you can define why, in highly specific words, you want to invest and what the associated goals are. If you have all this down, we can move on to picking an investing account structure that's not just compatible with your goals, but actively increases the chances of those goals being met.

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I don't have anywhere near enough time to talk through all the different types of investment account structures and help you clarify which ones could be right for you. I will say this though. The federal and state/provincial governments of many countries create incentives to save for many different life goals. And each goal seems to require a different law and therefore different account type structures.

Want to invest for retirement? Depending on your country, you could have one good option or ten. Want to invest for your own future higher education or your child's? Just in the U.S., there are three different account types of for that (depending on your state, because why would anyone want to make this easy?). Want to grow your money to pay for a wedding, big trip, or new car in a few years? Who knows if a plain vanilla account, meaning a standard single or joint account, would be good for that.

I'm not going to talk about account types like trusts, limited partnerships, futures, derivatives, credit default swaps, hedge funds, foreign currency…all that stuff. I'd rather focus on the account types that are suitable for 99% of people and don't have the level of complexity those other types do.

This is where your goals come back into play. If your primary goal is to fund your retirement, then a retirement account structure probably makes the most sense. That's serious genius analysis, I know. But here's where it gets tricky. For many account types, there are sub-account types with different incentives, rules, and quirks that are really frickin' hard to understand at first. In the U.S., you need to choose between Individual Retirement Accounts, also known as IRAs…a 401(k), a 403(b), and potentially 457, and even more. And many of these sub-account types don't just come in one flavor. For instance, IRAs and 401(k)s come in traditional formats and Roth formats. Now, I won't explain the significance of that right now because I'm bound to get carried away, but already you can see how complex this can get if you let it.

Going back to goals, if paying for a big higher education bill is first and foremost for you, college saving plans could work out nicely. They take different forms and have different terminology in various countries, but the structure of these higher education accounts is for the same purpose. To incentivize you to save for college, university, trade school…whatever form post-secondary school education takes in your country, and then spend that money you've invested **only** on those higher education needs.

In the U.S. you have your 529 College Savings Plan, 529 Prepaid Tuition Plan, and Coverdell Education Savings Account, while in the U.K. you sort of have an account type that's aligned with higher education in the Junior Individual Savings Account. And in Canada, you have the Registered Education Savings Plan and Canada Education Savings Grant.

If you want the easiest and most flexible road – at the expense of giving up some potentially huge benefits from a retirement account or higher education savings account structure – the plan vanilla account type, again, also known as single or joint accounts, works pretty darn well.

Hopefully this serves as a good overview of investment account type structures and should come in handy for our next essential subject in this elaborate investing journey.

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Selecting a Suitable Investment Type

Now I'm going to talk about the part of investing that most people want to jump immediately into. And that's the answer to the question, "what should I invest in?" I already told you how important it is to define your goals and find an account structure to match them **first**, but after that's done, **then** you can get started thinking about what to invest in.

Now, I could spend days – literally days – talking about what to invest in. But this is so highly subjective and personalized that it makes no sense to get deep into the theory, performance, and skill set needed to handle each investment type. Instead, I want to discuss selecting a **suitable** investment. This is essential so please listen up to this next part. **There is no *one* perfect investment type for you or anyone else**. There is only a *range* of **appropriate** investments and you'll need to choose which one is most appropriate for your needs and goals.

So if you keep hearing the words "**suitable**" and "**appropriate**" instead of "ideal" or "best," it's because there probably isn't a "best" investment type for you. There are *definitely* unsuitable and inappropriate investments in general or specific to you, but consider your choice on a sliding scale of "you couldn't pay me to invest in that" all the way to "Yeah, that seems to check all the boxes."

I want you to throw all your preconceived notions out the window for what type of investment you think is best for you. Even if you already believe that you want to invest in X because of reason Y or because person Z said you'd be an idiot not to.

Learn the principles of investing first, **then** use them to pick an investment type. You don't even need to be a master of the principles, but you have to understand the context and their relevance to each other.

When I say something like this, I'm reminded of the Ralph Waldo Emerson quote when he said, "As to methods there may be a million and then some, but principles are few. The man who grasps principles can successfully select his own methods. The man who tries methods, ignoring principles, is sure to have trouble."

End of quote. That's is gold right there Ralph. And following those words…understanding the principles of investing first before picking an investment type, will mean the different between, say, blindly running to buy gold and appropriately knowing whether it's a suitable investment for you.

You'll probably notice me going extremely light on the types of investments – like stocks, bonds, mutual funds, real estate, commodities, annuities…even alternative investments. That's because definitions of investment types are so easy to find while well-reasoned explanations of investing principles is not nearly as common.

I can't talk about all the important principles today, but let me highlight what I feel are the top ones to understand and be able to communicate with others about.

First, let's tackle the concept of risk because this one is so fascinating and the perspectives on it vary so widely. For people who know me, it should come as no surprise that I like how Warren Buffett addresses risk better than anyone else. He has said, "The riskiness of an investment…is measured by the probability of that investment causing its owner a loss

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of purchasing-power over his contemplated holding period. Assets can fluctuate greatly in price and not be risky as long as they are reasonably certain to deliver increased purchasing power over their holding period. A non-fluctuating asset (i.e. a fixed-income security, like a bond) can be laden with risk."

End of quote. Now, I'm going to quickly flash back to an article I wrote on Value of Simple in May 2012 where I attempted to translate this for folks. I wrote, "The key here is the contemplated holding period. A suitable investment for money you need in a month is different than the right investment for money you tap in a decade. (Buffett's) statement is that volatility in the value of your investment is not the same as the risk of the investment. If the value of an investment swung fifty percent every day, it still wouldn't be risky if you're confident it will increase your purchasing power over the holding period."

If you like, check out Wikipedia or Investopedia's definition of risk, but I'm going to stick with Buffett's. Regardless of whether you consider one type of investment low, medium, or high risk, the principle is the same. **The greater the amount of risk you're willing to take on – as conventional wisdom and metrics decide – the greater the potential return**. For this reason, a U.S. Treasury bond is extremely low risk in the conventional sense compared to the bond from a business much more likely to default than the U.S. government.

Alright. How about I cover this principle of investment objectives next. Unlike an investment goal which is specific and defined by you, an investment objective is abstract and defined by your investment company. Now formally, you won't be asked to define your investment objectives until you open an account. Informally, you should have the components of your investment objectives defined well before being asked what they are.

To determine your investment objectives, you'll need to answer questions like these:

- Number 1: When it comes to money, how worried are you that you'll lose the principal value of your investments? The answer is going to help determine how risk-adverse you might be.
- Number 2: How long will it be before you need to access the invested money? This helps determine your investing time horizon.
- Number 3: How liquid do you need your investments to be and are you OK with not being able to sell one immediately because of restrictions? This helps determine your liquidity needs, which we'll get to in a moment.
- Number 4: On a scale of 1-10, how comfortable are you having income on your investments taxed?
- Number 5: Do you need to invest in securities that constantly pay out income or are you OK if you only make money when the value of the security itself increases?

Feel free to pause this, play those questions back, and actually take a crack at answering them. This concept of investment objectives is huge, especially since they can vary from one account type to the next. The objectives you have for a retirement account could be very different than the ones you have for a plain vanilla account. And the terminology used for investment objectives varies greatly from one company to the next and from one country to the next.

Now I'm going to cover the highlights of our friend "diversification." Like risk, diversification has a lot of different definitions and contexts but generally, the common saying of you "don't put all your eggs in one basket" if what people are getting at.

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Some people say, “To be diversified, you need to have lots of different *kinds of* investments. That means you should have some of all of the following: stocks, bonds, real estate funds, international securities, and cash.”

Other people say “True portfolio diversification can only be achieved by diversifying across return drivers and trading strategies, not asset classes.” OK, my head hurts after reading that sentence about risk and yours probably does too.

The best, simplest explanation I can offer is that **you want to reduce risk to your overall assets by having different types with low correlations to each other**. A classic example is that the value of stocks and gold tend to move in opposite directions, meaning they have a low correlation and theoretically make for components of a diverse portfolio.

Right now, I don’t want you to worry about advanced things like the standard deviation of returns and I want you to ignore scare tactics about diversifying among asset classes being risky or the equivalent of gambling.

Your goal, in the simplest of terms, is to not end up like the employees of Worldcom and Enron who put all their 401(k) account money into company stock before those companies imploded and wiped out their entire savings.

And please, **please** be aware that diversification rules of thumb can be really dangerous. A common one is to subtract your age from the number 100, put the resulting percentage into stocks, and then the leftover percentage in bonds. For example, if you're 25-years-old, put 75% of your money into stocks and 25% in bonds.

Another common one states maintaining a portfolio of 25 to 30 stocks will yield the most cost-effective level of risk reduction. And yet another one says you should have at least 25% of your investments in the assets of any country you aren’t living in. Most likely, those rules of thumb were not created with you, your goals, or your needs in mind.

Hell, diversification might not even be important to you after some thinking about it. It is after all potentially time-consuming and more expensive to be diversified, among other reasons why you may not want to bother with it at all. If you’re a first time investor though, trying to put a little money here, a little there, and a little everywhere is going to make your life a nightmare by taking up too much time and causing too much stress.

Just know that you’ll graduate to better methods when you have more experience and potentially more money, but now’s the time to grasp the concept so you can act on it in the future. I talk more about diversification and a couple more principles coming up at length in *Start Investing with $100*, but I digress.

OK, so what about this thing people call liquidity? This principle gets really simple when you ignore all the “official” liquidity ratios and gibberish out there.

All investments should be able to convert to cash, but the key question is how fast. So anything you can convert to cash immediately, during traditional business hours, with a minimal loss of value between when you want to sell it and when it’s actually sold, like the stock of a large company or a money market fund which are both very highly liquid. The only tricky thing about liquidity is that the illiquid nature of the underlying asset of an investment – say real estate – doesn’t necessarily mean the investment itself has low liquidity. If you invest in real estate through a Real Estate Investment

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Trust, otherwise known as a REIT, the operator always has enough cash on hand to pay you immediately. Just because it might take you months to sell your own house doesn't mean a REIT has the same problem.

But why is liquidity so important? Well, if you need to sell an investment asset and get your money from it *immediately* to do something like wire transfer money to buy a house or get money to fund your life in exile while fleeing the country from government agents, at least *some* of your investments will need to be highly liquid. If you're not careful, you could find yourself placing an order to sell an investment but not getting any money into your bank account from that trade order until days, weeks, or even months later.

I'm going to switch gears to another principle and talk about rate of return. I can't tell you how many times I've seen even legitimate investments and investment companies mislead or lie about a rate of return. And by rate of return I mean the gain or loss on an investment over a specific length of time, normally expressed as a percentage against the initial investment cost. Uhh, I think I need to use less fancy talk after hearing myself define this concept.

At any rate, here's the absolutely, positively, "you gotta always keep this in mind" thing about rate of return.

Always, **always** identify if any advertised historical rate of return or projected rate of return factors in inflation, different tax rates, income generated like dividends, interest, and capital gains, and how the income is compounded.

If the rate of return doesn't *explicitly* state if and how these factors come into play, be skeptical or outright dismissive of it. And please don't waste your time trying to research it and find out if they do, indeed, are factored into play. Remember that only fixed-income investments like a bond can predict a future rate of return and if you ever see someone advertising a predicted rate of return on a stock or real estate…consider it complete speculation or worse.

I'm turning it back over to my man Warren Buffett to hammer this point home. He gave an example that basically said you could have invested in U.S. Treasury bills for almost fifty years and that would have produced a rate of return of 5.7% annually. That sounds pretty good, but…if you paid personal income taxes at a 25% rate, this 5.7% annual return would have yielded *nothing* in the way of real income."

How's that possible? He goes on to say that your taxes ate up 1.4% of the stated yield and inflation devoured the other 4.3%. For this reason, Buffett evaluates his investment performance on an **after-tax** and **after-inflation** basis. If you lived in post-World War II Hungary, even the astounding absolute returns Buffett has generated in his life time as an investor would mean nothing. I guess that's what happens when hyperinflation is 41.9 quadrillion percent in one month and prices double every 15.3 hours.

Along the same line, you'd assess your investment returns very differently paying a 62% tax rate in a country like Denmark than a 15% tax rate in a country like the United States.

So if you want the rate of return bottom line, here it is.

- Number 1: Historical rates of return are **highly** contextual

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- Number 2: The ever-present disclaimer that "historical returns are not an indicator of future performance" exists for a very good reason
- Number 3: Your personal rate of return won't track the historical rate of return. This is because the timing of your money flowing in and out of investments is often unpredictable and the amounts invested aren't always the same.

This is the exact reason why you always, **always** identify if any advertised historical rate of return or projected rate of return factors in inflation, different tax rates, income generated and how the income is compounded. I feel like repeating that about a million times but I want to make sure I have the time to discuss my last investing principle which is enormously important.

So check this out. Here's a scary, if rather extreme scenario. Your mutual fund has an astonishing 50% rate of return in the first six months you own it and you decide to sell. But, you actually *lose* money. Now how the hell can that be?

Well, the fine print states that if you sell the investment before holding it for a year, the investment company is entitled to half of your gains. And the terms of the sale also state there's a 25% back-end cut given to the mutual fund company when you sell the mutual fund it. Not to mention your investment company has a semi-annual "account maintenance fee". You know, just for the honor of holding your investments with them.

So if your initial investment was $100.00 and you sell the mutual fund after six months, here's the math.

Your six month rate of return was 50%, making your initial $100.00 investment worth $150.00. You had to pay a 50% penalty on gains if you sold the mutual fund before holding it a year, meaning $25.00 of your $50.00 investment gain was just wiped out, leaving you with $125.00. Then, you have to pay that 25% back-end cut of your gross investment value, also knows as a back end load, to the mutual fund company. 25% of your gross investment value is $37.50, which subtracted from the $125.00 you had left after the 50% penalty from selling before a year was up, means you're left with $87.50.

Not to mention your investment company assesses that $5.00 semi-annual "Account Maintenance Fee," leaving you with $82.50 now. So to recap, **your gross $150.00 investment value was almost cut in half** by the time they paid out your net amount from selling. And in absolute terms, you just lost $17.50 over six month, or *17.5%* of your initial $100.00 investment.

What's the point of all this? A huge factor – sometimes the biggest factor – in determining a potential rate of return are the one-time and ongoing costs associated with an investment itself and the investment company. And if that wasn't enough, costs and fees are a better predictor than almost anything else when it comes to the rate of return on an investment.

I wish I could show you some graphs like the one's at Bogleheads.org of the amazing difference in investment returns for a mutual fund with a small cost associated with it and one with a seemingly minor increase in cost…until you look at that difference over a couple of decades.

Year after year, study after study, research shows that we can't control the market based returns of our investments. But **we can directly control a huge portion of our net returns by choosing low or no fee investment options and**

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investment companies. So unless you have a *really* good reason to invest in securities with a high cost structure or an investment company who dings you with various fees all the time, pick the no-cost or low-cost alternatives every single time.

So to review, we just covered the investing principles of risk, investment objectives, diversification, liquidity, rate of return, and keeping costs and fees low.
When it comes to using these principles to actually choose an investment, some awesome online investment filtering tools and screeners can really help. I'll link to the best ones like Morningstar, TD Ameritrade, and others in the show notes.

The last thing I want to mention before moving into the final big part of the getting started *or* restarted with investing process – namely picking an investment company – is socially and environmentally conscious investing.

Some people want to ensure their investments reflect their core values of social and environmental responsibility by not having ownership in industries like oil, weapons creation, gambling, or tobacco. Or perhaps someone wants a diversified way to invest in companies leading the charge in environmental sustainability, community-building initiatives, and alternative energy. If this sounds like you, then research into and potentially purchasing a socially responsible fund – a niche of the mutual fund/ETF world – is the easiest way to achieve it. The online mutual fund screeners that I'm going to be discussing will help with the selection process of an appropriate fund. You could also laser target a specific stock of a socially conscious company if you want to literally invest in a particular cause and don't need high diversification of your investments.

I will say this though. Investopedia has strong disclaimers about the marketing and potential returns of socially responsible funds that deserve to be repeated. They say, "Investors should read carefully through fund prospectuses to determine the exact philosophies being employed by fund managers. Just because an investment touts itself as socially responsible doesn't mean that it will provide investors with a good return."

End of quote. Definitely something to keep in mind if you want to get into socially responsible investing. Notice how I didn't talk about how to choose a suitable or appropriate investment this whole time? It's too big to do justice to right now and besides, that's what a course like *Start Investing with $100* is for.

Choosing an Investment Company

So now we're moving into the snooze inducing but incredibly important topic of picking an investment company. I promise to keep it fresh and jumpy. Just to be clear, when I say "investment company," I'm generically referring to the name of the company, organization, place, firm, or shop where you open an investing account. They go by lots of other names like investment organization, brokerage firm, wealth management company, financial institution, broker-dealer.

But if you've already selected an account type with a basket of pre-approved investment choices – like a government or employer-sponsored account, a 401(k) and the Australian superannuation accounts come to mind, or other retirement or higher education accounts, this may not be as useful to you as other folks. But you'll probably have to open an account of your own someday instead of going through a pre-approved company from the government or your employer, so please listen up.

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First of all, why do you even need an investment company to invest? Well, even though you can personally direct your investment activity without the help of a licensed professional, the buying, selling, or trading still needs to occur on a behind-the-scenes exchange, a.k.a. "The Market". You don't have direct access to trade on these exchanges so you need an account with an investment company that does have direct access.
That's the basic function of an investment company; to execute trades on your behalf. Everything else they provide – investing advice, research tools, portfolio management, monthly statements – is technically an add-on. This works a little differently for peer-to-peer lending companies like Prosper, Lending Club, and Zopa, but I'm not going to talk about them now.

After you've defined your investing goals, picked an account structure that enhances your chance of achieving those goals, selected one or more investment types that are suitable for how you interpret core investing principles, you're ready to open an account at an investment company.

The tricky part is knowing enough about your options to determine *what* you need in an investment company and why. And this is exactly what I'm going to cover at an admittedly high-level right now. This is not an exhaustive list of considerations, but it constitutes the most important ones any newer investor needs to make related to investment companies.

You don't actually have to answer all these questions, although write them down if you want, but they all should be in the back of your mind as primary and secondary factors for deciding a winner. It's up to you weight an answer based on its relative importance to the rest.

First up, what are some things specific to you that you must address? In my mind, there are four big items that need analysis right off the bat.

- Number 1: Is the ability to conduct transactions, look up information, and get support without another person being involved important?
- Number 2: Which forms of customer service or support are essential among phone, online live chat, in-person, multi-lingual, online forums, etc.?
- Number 3: Do you need face-to-face interaction with an investment professional, either in person or via an online video conferencing program like Skype?
- Number 4: Do you need paperless options for statements, prospectuses, trade confirms, and other documents?

Once you get your head around those items specific to you, then you need to wrap your head around the things specific to the investment company. I'm talking about what kind of account and investment type cost structure works for you between commission-based, fee-based, or a combination of the two? What are the initial account opening fees and the typical ongoing maintenance fees? How easy and fast is the account opening process? Are there sign-up or referral bonuses when opening an account and are there added perks for opening an account at a company you already have a relationship with like an existing bank account?

Want me to keep going on with these questions? Okie dokie, don't mind if I do. Here's some more, like:

- How about does the investment company have integration or support for financial services you use such as Quicken, Mint.com, or Manilla.com?
- Have they been hacked recently or have a history of privacy breaches?
- And what non-core services do they offer like check writing and access to research?

You get the point right. I could hit more considerations, but I'm going to stop here. Once you consider all this, the most fundamental decision for choosing an investment company is whether to go with one that is online, offline, or both. Even traditionally offline investment companies have websites these days with some of the support they offer in person or through the mail. But I'm still surprised how many of them don't allow for online trading. I mean, the ability to trade securities is the **core reason they exist**. Yet I know, especially as someone who worked in the investment industry for a decade, most companies that don't offer online trading do this intentionally. They *want* you to be dependent on their wisdom, hand-holding, and "high touch" business model.

But whether you want to open an account with Internet Superstar Company ABC or Physical Branch Specialists XYZ, the core decision-making process is the same.

Here's how the decision making process works at a very high-level.

- Step one: Does the investment company offer the account type you've already decided you need? If not, toss them out of the running.
- Step two: Does the investment company offer the **sub-account** type you need, assuming you need one in the case of a retirement account or higher education savings account? If not, bye-bye to them as well.
- Step three: Do they allow you to trade in the types of investments that you've deemed suitable? Again, if the answer is no, it's see ya later time.
- Step four: Is their fee structure aligned with the amount you're comfortable paying in one-time or reoccurring costs? If the answer is no, throw them out of the running as well.
- Step five: Do you have enough money to meet the minimum account balance or investment type balance thresholds? If not, either find a way to come up with the money to meet any minimum account opening or investment balance amounts or find someone else with lower minimums.

And that's seriously it. I guess you could factor in what I think of as optional features like types of customer service offered, if they allow foreign accounts, if they have electronic signatures so you don't have to mail or fax paperwork all the time, and so on. But those five steps I just mentioned are how you can go about deciding on an investment company.

Once you've picked one, the only thing left to do is submit an application, get the account opened, and place a trade. And then it's **bada-bing, bada-boom**…you're an investor!

Key Details about Start Investing with $100

With all the stuff I just spoke about in mind, I want to talk about something I'm very proud of that I created to help people get over their fears and the common traps of investing on your own. It's my online course called *Start Investing with $100*

and I couldn't have a podcast about investing without briefly mentioning some details about the solutions I've come up with to help a **ton** of folks join a new generation of confident investors.

First of all, *Start Investing with $100* isn't for everyone. But this online course was specifically designed for people who realize the importance of investing but never take action to start doing it and folks who have a small amount of money to invest but no idea how to get started.

It's also for people who don't know the difference between a stock and a bond or have never invested in "The Market". And I especially want to help folks who have debt to pay off - student, credit card, mortgage, or otherwise - but feel investing can't wait until it's all gone. There are even people like me, solopreneurs and small business owners, who want to invest money somewhere other than back into their business but can't seem to make it happen. And the last bunch of people I want to reach are the people who hit or need to hit a giant restart button on their investments. They already have investments but question whether they are diversified, beating inflation, and avoiding unnecessary fees.

Of course, this class could be useful for just about anyone and I could see it being a solid fit for people in a lot more situations. *Start Investing with $100* greatly expands on the principles, action steps, and skills I already talked about in this episode of Smart and Simple Matters and it does it in a way where anyone in the U.S., the U.K., Canada, or Australia can get started investing with as little as $100 or 100 pounds.

And because educating someone and helping them understand the theory, the strategy, and tactics of a topic doesn't guarantee they'll actually take *action* on that new knowledge, the course is packed with checklists, cheat sheets, and decision guides to empower you to take the steps *yourself* and feel confident at each milestone.

The really awesome thing about this is it's loaded with content to give you skills and a mindset that can be applied well beyond the investment world and I just *know* there are people who will take this course that will then become a go-to investing resource for everyone around them. When that happens, I'll feel damn good inside that I've empowered someone and infused a sense of confidence that other people will benefit from.

If you're looking for a single resource with world-class content from world-class sources, you can get it from the course along with lifetime access to some skill sets you've probably always wanted.

The doors for *Start Investing with $100* are just about to fly open, so please check it out at www.startinvestingwith100.com/join-us. There will be a convenient link in the show notes of this episode to go to startinvestingwith100.com/join-us.

Wrap Up

OK, I'm about to call it a wrap even though I'm tempted to address a number of additional investing resources, knowledge, and tips I have hidden up my sleeve. But I'll save those for another time.

You can probably tell I love talking about how to keep your investments on track and why you should always stay in the investing game instead of flipping over the card table in a rage and declaring "I'm out!" I love, **love** discussing behavioral

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economics and a big old resource list of books, financial forums, wiki sites, blogs, and podcasts, but perhaps you'll get those later…unless you happen to get a pass to *Start Investing with $100* where all that fun stuff is yours right away.

Well, that's it for now everyone. It's time for your partner in simplifying to sign off again. You've just listened to the Smart and Simple Matters show with Joel Zaslofsky – creator of all things Value of Simple.

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Thanks again for reading the transcript of the Smart and Simple Matters show folks!

I don't want you to miss future shows so please remember to go to the Value of Simple website and sign up for the email newsletter and list. Do that here:

http://valueofsimple.com

If you appreciated this specific podcast or the Smart and Simple Matters show in general, go to the iTunes page and leave a review. Every single one is a **huge** help to the show and greatly appreciated! Here's the link:

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