

December 2007 Newsletter

20 Timeless Money Rules

Carla Fried from America's Money Magazine collected the best advice from some of the smartest investors (and other people) who have ever lived. I thought it was an excellent article which reinforced investment fundamentals. A "must read" for any investor!

1. Be humble

When you do not know a thing, to allow that you do not know it--this is knowledge. --Confucius

Investing is a big bet on an unknowable future. The mark of wisdom is accepting just how unknowable it is. Granted, that's not easy. Our brains are built to think the future will be like the near past. And we're too ready to act on the predictions of pundits, who are no more clued in than we are about what lies ahead. Being humble in the face of uncertainty keeps you from costly mistakes. You won't jump on yesterday's bandwagon. And before you invest, you'll be more likely to ask a key question: "What if I'm wrong?"

2. Take calculated risks

He that is overcautious will accomplish little. --Friedrich von Schiller

The returns you get are proportionate to the risk you take. This is a fundamental law of the markets. It's why five-year CDs typically pay more than six-month ones and why you're disappointed if your emerging markets fund does no better than its stodgy blue-chip stablemate. History unequivocally supports this "no free lunch" principle. Going back to 1926, stocks (high risk) have paid more than government bonds (medium risk), which in turn have beaten low-risk Treasury bills. Among many, many other things, this law suggests:

- ◆ To earn returns high enough to build true wealth, you have to put some of your money in risky assets like stocks--the only investment to handily beat inflation over time.
- ◆ If a financial salesperson tries to tell you his product offers a high return with no risk, get that claim in writing. Then send it and his business card to the SEC.

3. Have an emergency fund

For age and want, save while you may; no morning sun lasts a whole day. --Benjamin Franklin

The first step in constructing any serious financial plan is to create an emergency cash fund--ideally, three to six months' living expenses--stashed in a low-cost ultrasafe bank account or money-market fund. Without this financial cushion, any unexpected expense can derail your long-term plans. These

days, happily, that emergency stash won't just sit idle.

4. Mix it up

It is the part of a wise man to keep himself today for tomorrow and not to venture all his eggs in one basket. --Miguel de Cervantes

Nothing can break the law of risk and reward, but a diversified portfolio can bend it. When you spread your money properly among different asset types, a rise in some will offset a fall in others, muting your overall risk without a commensurate drop in return. It's the closest thing to a free lunch there is in investing. To make the alchemy work, you must load up on assets whose up and down cycles don't run in sync: stocks (both U.S. and foreign, as well as large-company and small), bonds (of varying maturities), cash, real estate and commodities.

5. It's the portfolio, stupid

Asset allocation...is the overwhelmingly dominant contributor to total return. --Gary Brinson, Brian Singer and Gilbert Beebower

Most investors concentrate on trying to choose the best stock and pick the perfect moment to buy or sell. It's a waste. What really matters to your long-term returns is asset allocation--that is, how you split up your portfolio. Since researchers dropped this bombshell 20 years ago, experts have debated the size of the asset-allocation factor. Some say it accounts for 40% of the variation in investors' returns; others (like the original researchers) say 90%. But no one refutes that it's major.

6. Average is the new best

The best way to own common stocks is through an index fund. --Warren Buffett

Here's the logic behind index funds, which aim simply to match the return of a market index: The average fund in any market will always earn that market's return (because in aggregate investors are the market) minus expenses. Since index funds match the market but have much smaller expenses than other funds, they will always beat the average fund in the long run. It's hard to argue with the math, and history bears it out (see the performance stat at right). Besides, if the Greatest Investor of Our Time believes that index funds are superior for most investors, shouldn't you?

7. Practice patience

It never was my thinking that made the big money for me. It was always my sitting. Got that? My sitting tight! --Edwin Lefevre

This blunt warning was issued in Lefevre's 1923 fictional memoir,

reportedly based on legendary trader Jesse Livermore and treated by many financial advisers like the Bible. Some 77 years later, behavioral finance professors Terrance Odean and Brad Barber's research into transactions by some 66,000 households between 1991 and 1996 found that those who traded least earned seven percentage points a year more than the most frequent traders. Moral: Once you arrange your assets into your ideal allocation, don't tinker. Rebalance once a year to keep your mix on track, but otherwise, listen to Livermore and sit tight.

8. Don't time the market

The real key to making money in stocks is not to get scared out of them. --Peter Lynch

It would be so nice, wouldn't it, to sell before every market downdraft and then get back in just as the good times roll again. But it's too hard to pull off. Nobody knows when markets will turn (see Rule No. 1). And when they do, they tend to move in quick bursts. By the time you realize an advance has begun, most of it's over. Miss that initial stretch and you'll miss out on most of the gains. The lesson: The surest way to investing success is to buy, then stick to your guns.

9. Be a cheapskate

Performance comes and goes, but costs roll on forever. --Jack Bogle

If you choose a fund that eats up 1.5% a year in expenses over one that costs 1% (let alone the 0.2% that index funds may charge), your fund's return will have to beat the other's by half a point a year just for you to come out even. Past returns are no guarantee of the future, but today's low-cost funds are likely to stay low cost. Buying them is the only sure way of giving yourself a leg up.

10. Don't follow the crowd

Fashion is made to become unfashionable. --Coco Chanel

Or, as the legendary financier Sir James Goldsmith has said, "If you see a bandwagon, it's too late." In the late 1990s, there was no more fashionable bandwagon for investors than Firsthand Technology Value fund. It returned 23.7% in 1998, but investors really piled into it after it rocketed an incredible 190.4% in 1999. But by then, the bust of 2000 was about to unfold, and Firsthand was soon to become as passé as plaid trousers. The result was a chilling example of the perils of following the herd: While the fund posted a respectable 16% annualized gain over the four years through 2001, the average shareholder in the fund actually lost more than 31.6% a year.

11. Buy low

If a business is worth a dollar and I can buy it for 40 cents, something good may happen to me. --Warren Buffett

The best Dow stocks of the past 10 years don't include Microsoft or Intel. But Caterpillar (Cat) makes the cut with a 212% return. In 1997, in the midst of tech madness, the market was so bored by the company's industrial-machinery business that investors paid just \$11.50 for each dollar of earnings. If the stock's current value of 16.1 times earnings is right, that's nearly a 30% discount. Smart investors didn't need to foresee the coming construction boom. They only needed to call a bargain a bargain and trust the market to eventually wise up.

12. Invest abroad

The World is a book, and those who do not travel read only a page. --St. Augustine

Over the 10 years through 2006, a portfolio split 80%-20% between U.S. and international large-cap stocks would have returned an average 8.4% a year, roughly the same as a portfolio invested 100% in domestic stocks. But because U.S. and foreign markets partially offset one another's ups and downs, the global portfolio was 4% less risky than the all-American (see Rule No. 4). Most Americans have less money in foreign funds than the 15% to 25% experts recommend. But you don't have to be like most Americans.

13. Keep perspective

There is nothing new in the world except the history you do not know. --Harry Truman

When the Dow sheds 300 points in a day, it's natural to feel doomed. And when the market surges, it's easy to be convinced that stocks have entered "a new paradigm," to echo a bubble-era phrase. Don't delude yourself. As Sir John Templeton notes, "The four most expensive words in the English language are, 'This time it's different.'"

To keep your perspective, remember:

- ◆ In every bull market since 1970, stocks have dropped by 10% or more at least once. Average time to get back to even: 107 days.
- ◆ Over time, markets tend to stick close to their long-term trends, called "regression to the mean." Manias and panics never last.

14. Just do it

It takes as much energy to wish as it does to plan. --Eleanor Roosevelt

Financial planning is an unnatural act. The brain is wired to make us undervalue long-term goals and exaggerate the cost of short-term sacrifice. Yet studies show that people who do even a little retirement planning had twice the savings of those who did almost none. Heed the words attributed to Mrs. Roosevelt by doing the following:

- ◆ Set concrete, attainable goals. "I'll pay an extra \$100 a month on my credit card" is more likely to succeed than "I'm going to get my act together."
- ◆ Then commit. Tell someone your plan and agree to a penalty--you'll do your spouse's chores for a month if you haven't saved \$10,000 extra by June.

15. Borrow responsibly

As life closes in on someone who has borrowed far too much money on the strength of far too little income, there are no fire escapes. --John Kenneth Galbraith

Face this truth: If you let them, lenders are only too willing to advance you more than is good for your family. Mortgage banks and credit-card issuers don't care if your monthly payment makes it impossible for you to sock away money in your 401(k) or fund your kid's 529 plan. You need to set your own rules, including:

- ◆ No credit-card debt. Period. It's never okay to pay 15% to borrow for consumption.
- ◆ Borrow only to buy assets that appreciate. A home, yes. Education, sure. A vacation, a fancy dinner or even a 50-inch flat-screen TV? No way.

16. Talk to your spouse

"In every house of marriage there's room for an interpreter." --Stanley Kunitz

Your most important financial partner isn't your broker. It's your spouse--you know, the one who probably owns half of all you do and whose fate is inextricably linked with yours. But research shows that spouses often don't agree on even such basic info as their income and savings. Wake-up call: To make smart decisions, you need to talk, and if you're like most couples, to do a better job at it.

- ◆ **Men:** Don't assume she doesn't care about this stuff. She does. But you need to lay off the jargon and speak English.
- ◆ **Women:** Don't just leave it all to him. At a minimum, know where the key papers are and how your money is invested.
- ◆ **Both:** Focus on goals, not on being right. It's not a contest.

17. Exit gracefully

Only put off until tomorrow what you are willing to die having left undone. --Pablo Picasso

Despite the words he reportedly uttered, Picasso was willing to die without planning his estate. It took years for his heirs to reach a settlement with French authorities. Although you may not have masterpieces to bequeath, you have no excuse not to take elementary steps to make life easier on those you'd leave behind. Covering the basics shouldn't cost more than \$1,500. To find a lawyer, ask friends and colleagues for recommendations or get referrals online.

18. Pay only your share

The avoidance of taxes is the only intellectual pursuit that carries any reward. --John Maynard Keynes

It's all well and good to put time into choosing the right investments. But being conscious of taxes puts money in your pocket too (at least it keeps it from being taken from your pocket, which amounts to the same thing), and the payoff is swift, certain and there for the taking. So take full advantage of tax-deferred benefits at work, like 401(k)s and flexible spending accounts. Stick with tax-efficient investments like index funds. And claim every deduction you're entitled to. According to the Government Accountability Office, taxpayers who could itemize but chose not to ended up overpaying by \$450. Don't be one of them.

19. Give wisely

The time is always right to do the right thing. --Martin Luther King Jr.

Granted, Dr. King did not have money on his mind when he spoke these words. But they also ring true in your financial life, since giving back is always the right thing. Still, there are more right and less right ways to do it.

- ◆ Look beyond the headlines. It's fine to give money to disasters like the tsunami, but don't forget about smaller charities that go wanting.
- ◆ Don't give over the phone. Telemarketers often take a cut of 50% or more.
- ◆ Focus. Identify a cause that really speaks to you. Then devote most of your energy and charitable dollars to the organizations that best support it.

20. Keep money in its place

A wise man should have money in his head, but not in his heart. --Jonathan Swift

People who say they value money highly report that they are less happy in life than those who care more about love and friends. Enough said.

© Copyright 2007 Time Inc. All rights reserved. Reproduced with permission.

Our Best Rates

Basic variable	7.74%
Offset (> \$700k)	7.77% (0.80% ongoing disc.)
Offset (> \$1 million)	7.72% (0.85% ongoing disc.)
Offset (> \$1.25 million)	7.67% (0.90% ongoing disc.)
3 years fixed	8.09%
5 years fixed	8.09%

Rates current as at 12/12/07 and are subject to change without notice. Standard lenders terms and conditions apply. Comparison rates are available upon request.