What Matters Most In Investing

My interpretation of the finance and investing literature is that the best way to invest is to primarily use a low-cost, broadly diversified, fixed asset allocation of equity and fixed income index funds tilted to small and value factors. Coupled with starting early, smart use of tax-advantaged accounts, an appropriate level of risk for the investor AND his goals, a reasonable investing temperament, and an adequate savings rate, this strategy is highly likely to allow a high-income professional to meet all of his reasonable financial goals.

However, I am often "challenged" by people who have selected a different way to invest. It might involve a little tweaking around the edges (which I do as well with asset classes like direct and syndicated real estate or Peer to Peer Loans), a total market strategy, a dividend based strategy, an individual stock (or bond) based strategy, a tactical asset allocation strategy, a primarily real estate based strategy, or even a significant reliance on the various types of permanent life insurance. The truth is, as Taylor Larimore, one of the authors of The Bogleheads Guide to Investing, frequently states, "There are many roads to Dublin." Some things matter more than others when it comes to investing and frankly I could care less how you choose to invest. In my view, the following are the most important factors in reaching your investing goals.

 # 1 Setting Appropriate Goals

Far too many investors have no financial goals. Without a goal of some type, you can't even start formulating an investing plan. Uncertainty about the future bothers a lot of investors. Perhaps its the fact that I have to deal with a great deal of uncertainty in my daily work (1/2 of patients coming to the ED with abdominal pain leave without a definitive diagnosis), but I'm just fine with it. With investing, it is far better to have a plan that you know you will have to change and tweak as the years go by, than to not have a plan at all.

#2 Taking an Appropriate Amount of Risk

Many investors take too little risk, squirreling their money away solely in bank accounts, CDs, muni bonds, whole life insurance, gold, or burying it in the back yard. Their portfolio never grows enough to meet their goals. Other investors take on too much risk, becoming overleveraged or using a portfolio they can't stick with when the inevitable downturn comes. Still other investors take on the wrong kinds of risk, and aren't even compensated over the long term for doing so. Examples of this include using a "black hole asset class" like small growth stocks, or gambling on one or several individual stocks.

#3 An Adequate Savings Rate

I generally recommend docs put 20% of their gross income toward retirement. There is data behind that recommendation,

but depending on your goals and investment methods, you may need anywhere from 10-30%. However, 5% isn't going to cut it. It doesn't matter what your investment return is if you don't have much money invested. It takes a certain amount of brute force savings simply to "get in the game."

#4 Starting Early

You're not going to win a football game if your offense doesn't arrive at the stadium before the 4th quarter. Likewise, its unlikely you'll reach reasonable retirement goals if you leave all your retirement savings for your last decade. Even the difference between starting at 30 instead of 40 can be very significant. Imagine a doc who wants to retire at 55 with $2 Million. If he earns 8% on his money and starts at age 30, he needs to save $25K a year. If he starts at 40, he needs to save $68K a year, almost 3 times as much.

#5 Broad Diversification

The future is not the past, and might not even resemble it. Diversification protects you against what you don't know and what you can't know. The best way to "shorten your tails" (making the distribution of possible outcomes more narrow) is to invest in many different securities, asset classes, and factors. Even if your chosen investment vehicle is something like real estate or life insurance, get as much diversification as possible by buying multiple properties of different types in various locations managed by different people. Or in the case of insurance, use policies from different companies of different types. Putting all your eggs in one basket is a recipe for disaster.

#6 Keep Your Costs Low

Every dollar you pay in commissions, loads, expense ratios, bid-ask spreads, insurance costs, hedging costs, advisory fees etc is a dollar out of your pocket. Small numbers add up to

very large numbers over long periods of time. The reason index funds work is primarily due to their low cost. Active managers can often beat the indexes. They just can't do it once they subtract out the costs of doing so.

#7 Pay Attention to Taxes

One of the most significant expenses for investors is their associated tax bill. Become familiar with the tax benefits of tax-deferred accounts, Roth accounts, tax-loss harvesting, tax-gain harvesting, qualified dividends, long-term capital gains, the step-up in basis at death, life insurance, annuities, UGMA/UTMAs, 529s, ESAs etc. Nearly every doctor feels like he pays too much in taxes. Most of them are right. If you are not intimately familiar with the tax rules associated with each of these types of investment accounts, a little education on the matter has a very high yield.

#8 Staying the Course

Once you have developed any reasonable investing plan highly likely to reach your goals, it is far more important that you stick to it than what the actual plan is. Bailing out of stocks in the depths of a bear market is a retirement killer. So is frequent buying and selling of real estate due to the transaction costs and associated tax bill. Eliminating emotions (both fear and greed) from your plan is critical for success.

As I mentioned at the beginning, I don't really care how you invest. There is zero benefit to me if you choose to invest the same way I do. In fact, I am nearly 100% certain that not one of my readers invests exactly the way I do. But if you want to be successful, I suggest you make sure your investment plan, whatever it is, incorporates each of these critical factors into it.

What do you think? Did I miss anything important? If you had

to write a # 9 and a # 10 to this list, what would they be? Comment below!