IT ALL STARTS WITH SAVING

This is a short, straight-talk book about investing. Our goal is to enhance your financial security by helping you make better investment decisions and putting you on a path toward a lifetime of financial success and, particularly, a comfortable and secure retirement.

Don't let anyone tell you that investing is too complex for regular people. We want to show you that everybody can make sound financial decisions. But it doesn't matter whether you make a return of 2 percent, 5 percent, or even 10 percent on your investments if you have nothing to invest.

So it all starts with saving.

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I

SAVE

Save. The amount of capital you start with is not nearly as important as organizing your life to save regularly and to start as early as possible. As the sign in one bank read:

> *Little by little you can safely stock up a small reserve here, but not until you start.*

The fast way to affluence is simple: Reduce your expenses well below your income—and Shazam!—you *are* affluent because your income exceeds your outgo. You have "more"—more than enough. It makes no difference whether you are a recent college graduate or a multimillionaire. We've all heard stories of the schoolteacher who lived modestly, enjoyed life, and left an estate worth over $1 million—real affluence after a life of careful spending. And we know one important truth: She was a saver.

But it can also go the other way. A man with an annual income of more than $10 million—true story—kept running out of money, so he kept going back to the trustees of his family's huge trusts for more. Why? Because he had such an expensive lifestyle—private plane, several large homes, frequent purchases of paintings, lavish entertaining, and on and on. And this man was miserably unhappy.

In *David Copperfield*, Charles Dickens's character Wilkins Micawber pronounced a now-famous law:

> *Annual income twenty pounds, annual expenditure nineteen pounds nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery.*

Saving is good for us—for two reasons. One reason for saving is to prevent having serious regrets later on. As the poet John Greenleaf Whittier wrote: "Of all sad words of tongue and pen, the saddest are 'It might have been.'"* "I should have" and "I wish I had" are two more of history's saddest sentences.

Another reason for saving is quite positive: Most of us enjoy the extra comfort and the feeling of accomplishment that comes with both the *process* of saving and with the *results*—having more freedom of choice both now and in the future.

No regrets in the future is important, or will be, to all of us. No regrets in the present is important, too. Being a sensible saver is good for you, but deprivation is not. So don't try to save too much. You're looking for ways to save that you can use over and over again by making these new ways *your* new good habits.†

The real purpose of saving is to empower you to keep *your* priorities—not to make you sacrifice. Your goal in saving is not to "squeeze orange juice from a turnip" or to

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* This line is from a poem entitled "Maud Muller," written in 1856.

†Or as Malcolm Gladwell suggests in *Blink*, you might try to get taller. Being six feet tall adds over $5,000 a year to your income because our society prefers taller people—so they enjoy better-paying careers.

make you feel deprived. Not at all! Your goal is to enable you to feel better and better about your life and the way you are living it by making your own best-for-you choices. Savings can give you an opportunity to take advantage of attractive future opportunities that are important to *you.* Saving also puts you on the road to a secure retirement. Think of saving as a way to get you more of what you really want, need, and enjoy. Let saving be your helpful friend.

FIRST DO NO HARM

The first step in saving is to stop *dis*saving—spending more than you earn, especially by running up balances on your credit cards. There are few, if any, absolute rules in saving and investing, but here's ours: *Never, never, never take on credit card debt.* This rule comes as close as any to being an inviolable commandment. Scott Adams, the creator of the Dilbert comic strip, calls credit cards "the crack cocaine of the financial world. They start out as a no-fee way to get instant gratification, but the next thing you know, you're freebasing shoes at Nordstrom."

Credit card debt is great—but not for you (or any other individual). Credit card debt is great for the lenders, and only the lenders. Credit cards are a wonderful convenience, but for every good thing there are limits. The limit on credit cards is *not* your announced "credit limit." The only sensible limit on credit card debt is *zero.*

Credit card debt *is* seductive. It's all too easy to ease onto the slippery slope—and slide down into overwhelming debts. You never—well, almost never—get asked to pay off your debt. The bank will "graciously" allow you to make low monthly payments. Easy. Far too easy! Your obligations continue to accumulate and accumulate until you get The Letter, saying you have borrowed too much, your interest rate is being increased, and you are required to switch, somehow, from money going *to* you to money going *from* you to the bank. You are not just in debt, you are in *trouble.* If you don't do what the bank now says you must do, legal action will be taken. Be advised! Never, never, never use credit card debt.

START SAVING EARLY: TIME IS MONEY

The secret of getting rich slowly but surely is the miracle of compound interest. Albert Einstein is said to have described compound interest as the most powerful force in the universe. The concept simply involves earning a return not only on your original savings but also on the accumulated interest that you have earned on your past investment of your savings.

The secret of getting rich slowly, but surely, is the miracle of compound interest.

Why is compounding so powerful? Let's use the U.S. stock market as an example. Stocks have rewarded investors with an average return close to 10 percent a year over the past 100 years. Of course, returns do vary from year to year, sometimes by a lot, but to illustrate the concept, suppose they return exactly 10 percent each year. If you started with a $100 investment, your account would be worth $110 at the end of the first year—the original $100 plus the $10 that you earned. By leaving the $10 earned in the first year reinvested, you start year two with $110 and earn $11, leaving your stake at the end of the second year at $121. In year three you earn $12.10 and your account is now worth $133.10. Carrying the example out, at the end of 10 years you would have almost $260—$60 more than if you had earned only $10 per year in "simple" interest. Compounding *is* powerful!

THE AMAZING RULE OF 72

Do you know the amazing Rule of 72? If not, learn it now and remember it forever. It's easy, and it unlocks the mystery of compounding. Here it is: $X \times Y = 72$. That is, X (the number of years it takes to double your money) times Y (the percentage rate of return you earn on your money) equals . . . 72.

Let's try an example: To double your money in 10 years, what rate of return do you need? The answer: 10 times $X = 72$, so $X = 7.2$ percent.

Another way to use the rule is to divide any percentage return into 72 to find how long it takes to double your money. Example: At 8 percent, how long does it take to double your money? Easy: nine years (72 divided by 8 = 9).

Try one more: at 3 percent, how long to double your money? Answer: 24 years (72 divided by 3 = 24).

Now try it the other way: If someone tells you a particular investment should double in four years, what rate of return each and every year is he promising?

Answer: 18 percent (72 divided by 4 = 18).

For anyone whose attention is attracted by the Rule of 72, the obvious follow-on is surely compelling: If a

10 percent rate of return will double your money in 7.2 years, it will double your money again in the next 7.2 years. In less than 15 years (14.4 years to be exact), you'll have *four times* your money—and *sixteen times* your money in 28.8 years.

So if you're 25 and you skip one glass of wine at a fancy restaurant today, you might celebrate with your spouse the benefit of compounding with a full dinner at that same restaurant 30 years from now. The power of compounding is why everyone agrees that saving early in life and investing is good for you. It is great to have the powerful forces of time working for you—24/7.

Time is indeed money, but as George Bernard Shaw once said, "Youth is wasted on the young." If only we could all train ourselves at a young age to know what we know now. When money is left to compound for long periods, the resulting accumulations can be awe inspiring. If George Washington had taken just one dollar from his first presidential salary and invested it at 8 percent—the average rate of return on stocks over the past 200 years—his heirs today would have about $8 million. Think about this every time you see Washington on a U.S. dollar bill.

Benjamin Franklin provides us with an actual rather than a hypothetical case. When Franklin died in 1790, he left a gift of $5,000 to each of his two favorite cities, Boston and Philadelphia. He stipulated that the money was to be invested and could be paid out at two specific dates, the first 100 years and the second 200 years after the date of the gift. After 100 years, each city was allowed to withdraw $500,000 for public works projects. After 200 years, in 1991, they received the balance—which had compounded to approximately $20 million for each city. Franklin's example teaches all of us, in a dramatic way, the power of compounding. As Franklin himself liked to describe the benefits of compounding, "Money makes money. And the money that money makes, makes money."

A modern example involves twin brothers, William and James, who are now 65 years old. Forty-five years ago, when William was 20, he started a retirement account, putting $4,000 in the stock market at the beginning of each year. After 20 years of contributions, totaling $80,000, he stopped making new investments but left the accumulated contributions in his account. The fund earned 10 percent per year, tax free. The second brother, James, started his own retirement account at age 40 (just after William quit) and continued depositing $4,000 per year for the next 25 years for a total investment of $100,000. When both brothers reached the age of 65, which one do you think had the bigger nest egg? The answer is startling:

- William's account was worth almost $2.5 million.
- James' account was worth less than $400,000.

William's won the race hands down. Despite having invested less money than James, William's stake was over $2 million greater. The moral is clear; you can accumulate much more money by starting earlier and taking greater advantage of the miracle of compounding.

We could run through dozens of other examples using actual stock market returns. One investor might start early but have the worst possible timing, investing at the peak of the stock market each year. Another investor starts later but is the world's luckiest investor, buying at the absolute bottom of the market every year. The first investor, even though she may have invested less money and had the worst possible timing, accumulates more money.

Luck in picking the right time to invest is all well and good, but time is much more important than timing. There is always a good excuse to put off planning for retirement. Don't let it happen to you. Put time on your side. To get rich surely you have to do it wisely—which means slowly—and you will have to start now.

Like all financial tools, the Rule of 72 needs to be applied wisely. It's great when it's working for you but ghastly when working against you. That's what makes credit card balances so dangerous. With credit card debt, 18 percent is the "normal" interest rate charged. And if you don't pay promptly, you'll soon be paying interest on interest—and interest on the interest on the interest.

Credit card debt is the exact opposite of a great investment. Wouldn't you like to have an investment that compounded at such a rapid rate? Of course you would. We all would. At 18 percent, a debt doubles in just *four* years—and then redoubles again in the next four years. Ouch! That's four *times* as much debt in just eight years—and it's still compounding! That compounding is why banks have distributed credit cards so widely to people they don't even know. And that's why you should never *ever* use any credit card debt.

SAVVY SAVINGS

We can hear the chorus of complaints already: "I *know* that the only sure road to a comfortable retirement is to spend less than my income. I *know* that regular savings is the key to building wealth, but I can't make ends meet as it is!" In this chapter, we offer you some help by presenting a number of savvy savings tips. Still, success will be up to you.

Saving is like weight control. Both take discipline and both depend on the right framing—the right way of thinking about the discipline. Start with a single and powerful insight: People who are thin *like* being thin, and people who save *like* saving. For many, the key to successful saving is to see saving as a game, a game of control where you put yourself in control and make the important choices even though your world is filled with thousands of daily temptations.

In both saving and weight control, successful people concentrate their thinking on the *benefits* they will enjoy. Savers take pleasure in being savers and in having savings just as weight watchers take pleasure in being thin, looking their best, receiving compliments, being in good health, and knowing they'll enjoy longer lives. Savers enjoy the inner satisfaction of being in control of their finances and knowing they are ensuring their own financial independence and future happiness.

Warren Buffett, widely regarded as the world's greatest investor, is famous for modest personal spending even though he counts his net worth in the tens of billions. To Buffett, a dollar spent early in his life costs him $7, $8, or more—the amount that dollar would have become over time if he had invested it.

Because they center their thinking on enjoying the benefits of achieving their goals, most savers and most slim people take pleasure in the *process* of saving and the *process* of keeping trim. They do not think in terms of deprivation; they think in terms of making good progress toward achieving their goal. As they make progress toward their goal, they have the fun and satisfaction of achievement.

You can, too.

The secret to saving is being rational. Being rational is simple, but by no means easy, because we're all so human and are hard wired to be flawed as savers and investors. For most of us, the best way to start being more nearly rational is to discuss the topic openly and honestly with one or more good friends. This works best if your friend is your spouse because he or she is as important to you as you are to her or to him and, of course, you depend on each other.

If, after candid discussion, you like what you see about your spending, that's really great. Carry on! However, if like most of us you notice some things you do that you don't like, think of these "misses" as invitations to do better.

The easiest way to save is to skip all impulse purchases. Make up a shopping list *before* you go to the store and stick to your list. This will help you stay focused on figuring out not only *what* you do with your money, but *why.* Practice "double positive" shopping when you and your spouse or friend go together: Agree that nothing gets purchased without both of you saying yes.

Saving provides you with the extra money you can use to make your future better. Learn by self-observation how you could increase your success rate on spending wisely *and* on saving. The goal is clear: Get the most of what *you* really want out of *your* life.

Every month or two, go over your expenditures, including credit card charges, together. Did each expenditure give you equal value for money? Were they all equally worthwhile to you? Probably not. Now focus on the most questionable few. Could you have had as much fun or memories as good without one or two of them? Could you have quite happily substituted an alternative?

Do you ever get talked into spending more than you meant to by friends or salespeople or advertisements? Have you *never* been showing off—not even a little? Since almost all of us are influenced by what we see our peer group doing, chances are high that you are influenced, too. So take a little extra time to decide for yourself.

Here's an easy test of whether you are being influenced by what your neighbors will think: If you were the only person who would ever know, would you spend the money? Keeping up with the Joneses and the Smiths, as we all know, is a powerful force for spending. We like to be like our friends. Teenagers are not the only ones who dress the way "everyone" dresses. That's why brands like Prada, Givenchy, and Polo are so valuable.

Take a careful look at all your expenditures and "triage" them into three baskets—best value, good value, and dubious value. Then look for a few that, on reflection, are not really of high value to you. Then stop them from taking your money away from you! Drop that money into a jar, or a bank, just as a squirrel saves acorns for winter.

If you stayed in a smaller, plainer hotel room, would you really care? If a superior room is worth it to you, fine.

But if not, you have an opportunity to save and direct your savings to something you really do care about.

For some city dwellers, taking a subway is better than finding a taxi because it is a lot cheaper and often faster. For others, a taxi is worth the extra expense. And some people—each with one of those two different kinds of preferences—are happily married to each other. Their secret is to agree to disagree and to set limits.

One of us loves fine wines, knows a lot about them, and has a substantial collection. He "shops" the wine list in a restaurant for value and almost always orders a superb wine at a bargain price. He gets great joy from the selection process *and* from drinking the wine with dinner. The other never drinks any wine. To each his own. Both are happy campers.

There are small ways to save and there are big ways to save. Let's list some of each.

SMALL SAVINGS TIPS

Here are some ways to save on a few "little things," but they can be fun and they do add up:

- Buy Christmas cards on December 26 or 27—for next year.

- If you're out for dinner, find the two dishes you like best and order the less costly one and pocket the difference. Or consider ordering a second appetizer—often "starters" have the best flavors—and pocket even more.
- Instead of going out to the movies, rent a recent release from Netflix, make your own popcorn, and drink what's in your refrigerator.
- Buy books—even current best sellers—secondhand on Amazon.com.
- Set the thermostat a few degrees lower in winter and wear a sweater.
- Exchange your morning $4 latte for a simple cup of coffee.
- Keep a record of all your expenditures. You'll likely find that you really don't need a lot of things you are now buying.
- Take the change out of your pockets each day and put it into a piggy bank. It can eventually add up to a vacation. Or at the end of each month, put the funds into an investment plan.
- Shop for low-cost auto insurance—and a further discount if you have a good driving record.

- Next vacation, think of a fun place that is nice but out of season.

BIG WAYS TO SAVE

Here are some big ways to save. These *really* add up:

- If you feel you need life insurance, buy inexpensive term insurance sold by local savings banks or available on the Internet.

  Term life insurance rates have been going down because people are living longer, insurance companies are better at segmenting customers by risk, and the Web is cutting the cost of distribution. (Check out Term4Sale.com and Accuquote.com.) Ten years ago, the "standard" man at age 40 paid $1,300 for 20-year $100,000 term life insurance. Today he pays only $600. Nice savings.
- Concentrate your investments with low-fee managers. We will show you later what the low-fee investment products are and how you can get them.
- Buy nearly new pre-owned cars or use a smaller car—or both.

- Self-insure small and moderate risks by having high deductibles on your auto insurance or fire insurance. Much of the cost of insurance is paperwork on numerous small claims. Chances are, you can self-insure on most losses and really only need insurance against major problems that are unlikely.
- Cut your spending back to what you were spending two or three years ago.
- Ask your employer to help you save by automatically deducting 5 percent or 10 percent of your weekly pay and adding it to your tax-advantaged investment account. If you pay yourself first, you'll pay less in tax and be less likely to spend every nickel you earn.
- Enroll in a "Save More Tomorrow" plan. These plans commit you to save some part—and only part—of next year's raise.

Think in terms of opportunity cost. Think of every dollar you spend as the amount it could grow into by the time you retire. Ben Franklin famously advised, "A penny saved is a penny earned." He was right but not entirely right. The Rule of 72 shows why. If you save money and invest it at, say, a 7 percent average annual return, $1 saved today becomes $2 in about 10 years, $4 in 20 years, and $8 in 30 years, and so on and on, inevitably growing. So the dollar a young person spends on some nonessential today would mean that $10 or more will be given up in retirement.

If you need further discipline, remember that some say the only thing worse than dying is to outlive the money you have set aside for retirement.

LET THE GOVERNMENT HELP YOU SAVE

Throughout history, people have changed their behavior to avoid taxes. Centuries ago, the Duke of Tuscany imposed a tax on salt. Tuscan bakers responded by eliminating salt in their recipes and giving us the delicious Tuscan bread we enjoy today. If you visit Amsterdam, you will notice that almost all the old houses are narrow and tall. They were constructed that way to minimize property taxes, which were based on the width of a house. Consider another architectural example, the invention of the mansard roof in France. Property taxes were often levied on the number of rooms in a house and, therefore, rooms on the second or third floor were considered just as ratable as those on the ground floor.

But if a mansard roof was constructed on the third floor, those rooms were considered to be part of an attic and not taxed. So follow the historical tradition. Tax minimization should be a key objective in the way you organize your financial life. And by minimizing taxes, you can have more to save and invest.

We are not suggesting that you attempt to cheat the government. Don't even begin to think of that. But we do urge you to take full advantage of the variety of opportunities to make your savings tax deductible and to let your savings and investments grow tax free.

In the United States, consumers have long lived beyond their means; consumption expenditures have been excessive, savings inadequate, and indebtedness dangerously high. As a matter of national policy, a number of tax incentives have been established to encourage Americans to save. *But millions of Americans are not taking advantage of these incentives.* For all but the wealthiest people, there is no reason to pay any taxes at all on the earnings that you set aside to provide for a secure retirement. Almost all investors, except the super wealthy, can allow the earnings from their retirement investments to grow tax free. We describe the vehicles available to you in the Appendix at the end of this book.

OWN YOUR HOME

"Neither a borrower nor a lender be," declared Polonius in Shakespeare's *Hamlet.* As usual, Shakespeare had it right—almost. As with every good rule, there's one exception: a mortgage on your family home. While we believe you should never take on credit card debt, a mortgage makes sense for four reasons:

1. It enables a young family to have a nice place to live when the kids are growing up.
2. Your bank will not let you borrow more than you can sensibly handle given your income. (This was true for 70 years. Then, as we've recently painfully learned, banks lent too much and we have all suffered the global financial crisis. Now sensible mortgage lending is going to be the rule again. Thank goodness!)
3. A mortgage is a very special kind of debt: When you take out a mortgage, *you* decide when to pay the money back. (Being in debt is different. When you're in debt, as in credit card debt, the *lender* decides when you have to pay it back. That decision can come your way at a

most inconvenient time.) And remember the tax advantages of owning a home financed with a mortgage. The mortgage interest costs are tax deductible, so Uncle Sam helps out by lowering your tax bill.

4. The rate of interest you will pay on a home mortgage is *substantially* below the interest rate on credit card debt.

The price of homes has risen along with inflation for more than 100 years, so housing usually has been a good inflation hedge. Of course, that wasn't the case during the great real estate bubble of 2006–2008, but house prices have now returned to more normal values and home ownership is once again a sensible investment in family happiness.

HOW DO I CATCH UP?

"Okay, coach," you might say at this point, "I wish I'd read your book when in my twenties. But I didn't begin to save, or get out of debt, early in life. Now, in my fifties (or even sixties), I have little or no accumulated savings. Is there *any* way to close the money gap?"

Fortunately the answer is yes, and Uncle Sam provides some extra tax incentives to help you catch up. But it won't be easy. The only way to make up for lost time is to start a disciplined program of saving—*now.* The tax laws make it possible for investors over 50 to make extra contributions to their tax-advantaged retirement plans. By making additional contributions to employer-sponsored 401(k) or individual retirement plans, older investors can reduce current taxes and ensure that all of the earnings from their investments accumulate tax-free.

While there are lots of uncertainties as you look forward to retirement, one thing is certain: By spending less, you can save more—and saving more is essential. It's never too late to downsize your current lifestyle and start saving. You could consider selling your large house and moving into a simpler, less expensive place. Or you could move to a less expensive location where living costs and taxes are lower. You don't have easy choices, but with discipline you can make up for lost time.

You may decide to push back your retirement date a few years. There's no law that says age 60, 65, or even 75 is the particular age at which you should stop working. Indeed, people who work at least part-time into their seventies are generally healthier and more alert than those who do nothing. And postponing retirement can often fatten your Social Security benefits.

If you do own a home, consider making the most of your home equity. As this book is being written, mortgage rates are low. If you have not refinanced your home, do so now. With long-term mortgage rates below 5 percent in 2012, you can slash your monthly payments and put the savings to work in your investment portfolio. If you are retired and have considerable equity in your home, you might consider a "reverse mortgage," where you borrow against the value of your home. Instead of paying your mortgage off, you gradually receive payments up to the amount of the loan. Of course this is not saving, and it will not provide an inheritance for your heirs, but it may help you meet your expenses.

Even if you failed to save enough on a regular schedule earlier in your life—the first fundamental rule for achieving financial security—it's never too late to start.

Live modestly and avoid taking on credit card debt. Even if you failed to save enough on a regular schedule earlier in your life—the first fundamental rule for achieving financial security—it's never too late to start.