HOW MUCH OF YOUR MONEY DO YOU WANT WORKING FOR YOU?

By Brian Hood, CFP®, Partner

We have all heard the cliche – "I want my money working for me, not me working for my money." Sounds great! It even makes sense. But why don't we practice it?

We are seeing more and more people with large sums of money in savings – way more than any financial planning manual or guru will tell you to have.

Why? Well, the reasons and excuses seem to vary, but here are a few of the most common we see:

1. Not knowing you can invest outside of your retirement plan

As humans, we are conditioned to a way of thinking. The retirement industry has trained us well.

- Max out our 401(k)
- Put $6,000 or $7,000 per year into our IRAs
- Dollar-cost average[1]
- Invest for the long term
- Don't time the markets

All of these are good things.

(By the way, the retirement industry is not that old. The 401(k) account wasn't started until the Revenue Act of 1978. The IRA was started slightly before that in 1974, and you could put 15 percent of your income away – up to $1,500.)

[1]Dollar cost averaging may help reduce per share cost through continuous investment in securities regardless of fluctuating prices and does not guarantee profitability nor can it protect from loss in a declining market. The investor should consider his/her ability to continue investing through periods of low price levels.

Today, the retirement account is commonplace. Very few employers do not offer them as an option, and individuals can always do our own via an IRA or Roth IRA.

But, we don't have an industry to train us for our savings – like the retirement industry. We know retirement accounts are for the long term. That's been beaten into our heads. And IRS penalties keep reminding us if we try to spend our money!

Most of us view our savings as delayed spending. For example, as kids, we are taught – "Johnny save your money for the new bike." At least we used to be taught that, thanks to Mom and Dad.

As opposed to the bike, it's difficult for us to visualize the savings and investments from which we will live off the dividends and gains – or at least we haven't been taught that. Very few Americans have investments outside of their retirement accounts.

2. We don't know how to invest in anything outside of our retirement plan

Even investing within our retirement accounts, we don't realize what we are doing as everything is handled for us. We picked from a short list of options when we signed up and haven't looked at it since. In order to become an investor outside of a retirement plan, we must put real effort into learning and developing skills and discipline – without our Human Resources Department hounding us to sign up.

3. Fear of losing our money

There is an assumption that a lot of people have about investing called zero-sum gain. In order for you to make money, someone else must lose money. So, for every winner, there is an equal loser. This may be true if we are gambling – blackjack, poker, roulette. But, not true in the investment world.

Case in point – The Dow Jones Industrial Average[2] (a measure of value) started the year 2000 at 10,737.99, then started the year 2020 at 28,538.44. Where did that difference come from? Clearly not a zero-sum gain. The answer is economic growth and inflation.

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[2] Indices are unmanaged and investors cannot invest directly in an index. Unless otherwise noted, performance of indices do not account for any fees, commissions or other expenses that would be incurred. Returns do not include reinvested dividends.

Definition: The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 actively traded "blue chip" stocks, primarily industrials, but includes financials and other service-oriented companies. The components, which change from time to time, represent between 15% and 20% of the market value of NYSE stocks.

4. We don't think we can ever get the money back

"After I invest, I can't ever get the money back to spend it." Investing in the market should be considered a long-term strategy, but that doesn't mean you can never sell part or all of your investment and withdraw it.

5. It's a bad time to invest

There is always a reason to **not** invest – the market it too high, I don't like the new administration, we are due for a crash, etc.

One thing I think I can get away with saying is – markets are guaranteed to keep crashing.
I started investing money for people in 1988, shortly after "the Crash of 1987" – Black Monday.
The Dow fell 22.6%. Before the crash, the Dow was at 5,054.

Was it a bad time to invest? Short term, yes, it was. Did you lose money? Only if you sold.
And today (January 2021), the Dow is over 30,000 and has crashed many more times – and will continue to in the future.

We are always in a state of waiting for the next crash. Can we do anything about it? Of course, we can. We can dollar-cost average, diversify[3], rebalance[4] our portfolios, and make sure we have ample cash reserve (just not too much.)

Conclusion

I think we all know the answers to the five issues, as we are forced to address them. But they all create roadblocks in our minds on our path to becoming wealthy.

So, what is the correct answer to "How much of your money do you want working for you?"
The answer should be **"All of it!"** - after our cash balance needs are met.

How much cash reserve should you keep? The textbooks say six to nine months of expenses.
Let's be conservative and keep 12 months. Now, let's add in short-term savings goals – such as

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[3] Diversification does not guarantee a profit or protect against a loss in a declining market. It is a method used to help manage investment risk.

[4] Rebalancing/Reallocating can entail transaction costs and tax consequences that should be considered when determining a rebalancing/reallocation strategy.

buying a $40,000 car next year. (Yes, people do pay cash for cars.) Or a known kitchen remodel. And the list goes on. But these all need to be added to the number.

I challenge all of you to work through the math; and I will bet the savers out there are sitting on too much savings. Put the money to work!

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