# Ten Financial Fundamentals

Written by Bill Elson, CFP®

1. **Follow Warren Buffett's advice to "Be fearful when others are greedy, and greedy when others are fearful."**

   When virtually no one wants some type of investment – consider buying it. And when everyone wants something – consider selling it. Rather than buying low and selling high, inexperienced investors may make buy/sell decisions based on greed and fear. When the price of an investment is high after doing well, they get greedy and buy it; but investors who buy after the stock appreciates have missed the opportunity. When investments are believed to be low in price, investors tend to get scared and sell - when in fact the stock may have a greater chance of appreciating from a low price than from a high price.

   Dollar-cost average your purchases by investing systematically (monthly or weekly). By doing this your emotions are not impacting your investment decisions.*

2. **Understand the Power of Compound Interest**

   **Rule of 72**: Divide 72 by a specific interest rate to approximate the number of years it takes to double your original investment. For example, an investment of $10,000 will double in about 10 years, if it earns a rate of 7.2% per year with no additional investments. This is the power of compound interest working for you!

   The interest rate you earn greatly affects the value of your account in retirement. Let's assume Joe invests $10,000 per year for 40 years. Below are the amounts his account could be worth after 40 years at different rates of return. 3% = $754,013 5% = $1,207,997 7% = $1,996,351 9% = $3,378,824

3. **Use Debt Only for Important Things**

   Compound interest works against you in debt… Keep your loan rates as low as possible!

   Try to never let your debt payments total over 25-30% of your income.

4. **Inflation Matters**

   In the 1960's the average home price was $16,500, gas was $0.31 cents per gallon, and a stamp cost $0.04 (*www.1960sflashback.com/1960/economy.asp*).

   Using the **rule of 72,** your cost of living at 3%, inflation doubles roughly every 24 years. At 5% inflation costs double every 14.4 years, and at 10% every 7.2 years.

   It is important that your investments earn more than inflation to maintain purchasing power.

5. **The "type" of investment is the important decision, not the "particular" investment.**

   The majority of the risk and return is determined by asset class, or subclass, not the manager or company offering the investment. The amount of money invested in the particular types of investments depends on the amount of risk you're willing to take and the return you'd like to earn.

**Dollar cost averaging does not ensure a profit or protect against a loss. An investor should consider his or her financial ability to continue to invest in a period of declining markets.*

Equities – stocks, real estate, commodities
Fixed Income – bonds, loans, and mortgages
Cash – bank accounts, CDs, and treasury bills

6. **Keep Appropriate Liquidity and Consider Your Time Horizon**

Have an emergency fund of 3-6 months of living expenses. It's also a good idea to have additional liquid money to take advantage of opportunities that may come your way. Be careful with money you need to spend soon. Don't plan to own equity investments for less than 3-5 years, so that you have enough time to ride out fluctuations in value.

Consider how much you want in one-day money, one-week money, and retirement money.

7. **Don't let taxes drag you down!**

Taxes can erode your investment returns, which can greatly reduce your results. For your long-term savings, consider tax-free investments (Roth IRA or Roth 401k) or tax-deferred investments (traditional IRA or 401k). Consider investing in a Roth IRA now if you think that your tax rate will be higher in the future, since investments in a Roth IRA can be pulled out tax-free after age 59½.

8. **Diversify**

Avoid putting more than 5% of your eggs in the same basket! It may make sense to sell things that have large gains to take advantage of opportunities elsewhere and diversify your risk. It is important to diversify your assets among various asset classes. If one asset class is having a bad year, the other assets in your portfolio may still be able to grow your portfolio.**

9. **Have Appropriate Protection**

Use insurance to protect your assets and loved ones, but make sure you don't pay for more than you need.

Insurance is important to protect yourself against losses of property - such as a car accident or a house fire. Insurance is also important to protect yourself against liability of events that occur by your fault. Adequate insurance is important, but shop around.

Life insurance may be necessary to protect loved ones in case of your premature death. The loss of a spouse or a parent can put the survivors in a tough financial spot. Consider the amount of coverage you need and the length of time you need it.

10. **Your Financial Success Is Important -- Learn About it**

Educate yourself on terms and strategies you don't fully understand.
Ask for help from a trusted person or professional.

Legacy Financial Group

**Bill Elson, CFP®**
Legacy Financial Group
6000 Grand Avenue, Suite B
Des Moines, IA 50312
Bill@LFGplanners.com
(515) 255-3306
www.LFGplanners.com

*Diversification does not guarantee a profit or protect against loss.*