The New Investors Blueprint

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Learn the three most common mistakes investors make and how to avoid these with a simple strategy to change your future.

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Letter from the Author

I have always fancied myself a bit of a writer. In fact, when I went off to the University of North Carolina at Chapel Hill, I intended to study journalism. It's funny how things turn out. Instead I pursued business and finance ultimately getting an MBA {from a different nearby UNC in Greensboro} and becoming a Certified Financial Planner™. So, I spend most of my day on the phone, in meetings and most writing is done in the form of an email. Lately, the itch to write kept gnawing at me. I kept seeing the same struggles in clients and felt like there were many, many more people facing the same challenges with finances.

I kept meeting with people who got a late start and couldn't help but feel like they would have started earlier in their lives had they known how. Sure, some people are born procrastinators but (a born optimistic myself) I would suggest most people want to plan for their future. Most people want to buy a house, save for children's education and retire. They may even day dream about it but they don't prepare. Why? I feel strongly that it's often because they do not know where to start. They are afraid to make a mistake particularly with the investments they choose. My hope is that given this guide those fears would be reduced and more people will start earlier investing for life's big goals.

Starting earlier should set you on a path to achieving those goals more easily. As you read, if you have questions, feel free to contact me directly at jjohnson@bluerockwm.com. I am available on LinkedIn and on twitter using the handle @advisorsrock. Even if you don't have questions, I would still love to hear of your progress. My goal with this book is to touch as many lives as possible. I hope you are one of them positively impacted by this book but enough about why I'm writing. Let's get into the subject matter.

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Three Possible Mistakes

There are three possible ways to screw up your investment plan. Yet having met with thousands of couples over the years as a financial advisor it is clear that people do not understand basic ways to create a solid investment plan. You'd think that there were a million possible mistakes based on the poor investment results of most people but really if you avoid these three especially when you start, you are far and away ahead of the game. Starting strong makes achieving your goals so much easier. Starting off poorly creates a lifelong uphill battle. This guide will identify those three common pitfalls, offer a simple strategy to avoid them, and help set the new investor on a path to success.

> "It's clear that people do not understand how to create a solid investment plan."

In the next few pages, we'll walk through those three mistakes: under saving, poor asset allocation & market timing. It's not enough to identify them. We'll also talk about how to avoid them.

Mistake # 1
Under Saving

Most people underestimate the cost of big goals especially retirement. With increased longevity and health care costs, the majority of savers are vastly under saved for retirement. They often overestimate their Social Security & Medicare benefits and underestimate their life expectancy.

The same could be said for college. The average undergraduate graduates with $35,000 in student loans.[1] He or she will delay buying a home, getting married, and starting a family as a result. The burden will follow the student long into adulthood. I have clients in their 40s and 50s still paying student loan debt and I have retired clients paying for loans for their own children.

This is mistake number one. They fail to save enough to accumulate an amount to cover a 30 year retirement or 4 years of college for two children, for example. This is the new investors guide and the assumption is that beginners are reading this eBook. Perhaps the best advice I can give you is to start saving and NOW. Even if you don't get everything right the first time *(and honestly who does?)* starting somewhere is better than not starting at all.

It's my personal belief that a late start is often the result of not knowing *where* to start. I believe that investors fear making a mistake and don't know who to trust for advice but are uncertain tackling it on their own. If that's you, the next couple of sections will walk you through the basics on how to get started.

Note: The other part of cash flow is withdrawals. Once you are retired, you can withdraw too much from your accounts sabotaging your goals or spend too much on early college years. I often see retirees who believe they can withdraw 8%, 9% or more from their accounts which is likely double a safe withdrawal amount. Again, we're assuming you are just starting in this guide so that is a problem for another day.

[1] Wall Street Journal May 8, 2015. Congratulations Class of 2015, You're the Most Indebted Ever.

The American Institute of CPAs did a study on the impact of starting early saving for retirement. What they found was that someone at age 20 saving $200/month earning 8% would accumulate over $1,000,000 by his or her age 65 just saving $200 per month. Waiting until age 40, that same person saving $200/month accumulated only $190,000 at that same return!! Waiting to age 50 to being meant only $69,000 by age 65!

Here is a summary of their calculations at different ages & return expectations:

Contribute $200/month to age 65 at different hypothetical earnings rates:

	Start at age 20	**Start at age 30**	**Start at age 40**	**Start at age 50**
2%	$174,931	$121,510	$77,764	$41,943
4%	$301,894	$182,746	$102,826	$49,218
6%	$551,199	$284,942	$138,599	$58,164
8%	$1,054,908	$458,776	$190,205	$69,208

If you learn nothing else from this guide, please take away this: Begin saving as early as you can even in small amounts!!

This is a hypothetical example and is not intended to reflect the actual performance of any specific investment. Earnings are pretax, and may be subject to income tax when distributed.

Source: http://www.360financialliteracy.org/Topics/Retirement-Planning/Retirement-Planning-Basics/Getting-an-Early-Start-on-Saving-for-Retirement#.dpuf

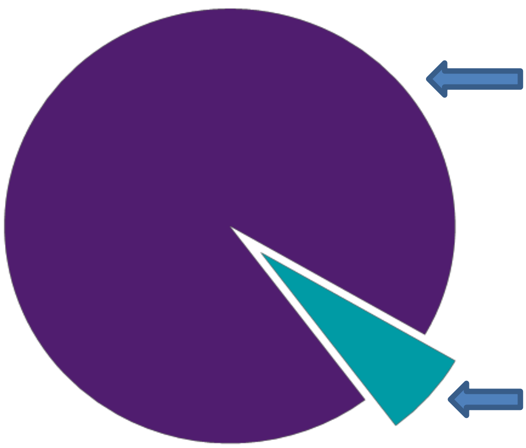
Mistake # 2
Poor Asset Allocation

It's not enough just to save. You've got to decide how to invest it. What makes someone a successful investor? Do they just watch the markets more closely? Are they smarter than others? Is it just luck?

All of those things can come into play but picking the *right* stock or bond or *timing* your investment just right only make up a very small percentage of one's success. The decision that makes far and away greater impact is something much less exciting. It's asset allocation.

What is asset allocation? It's determining the right mix of different investments. If you're 25 and just started working, should you be more growth oriented and have most of your 401k in stock investments? If you are 60 and looking to retire in just a few years, what if you still had most of your 401k in stock investments? These choices make far greater impact on your success. You need to give yourself the growth opportunities needed to accumulate enough to hit your longer term goals but as those goals approach you need to be mindful of going backward in a way you could not overcome.

This choice makes up over 94% of your probability of success[2]. Picking the right investment at the right time matters too and even some plain old luck. Since its clear asset allocation makes the greatest impact, most of this guide will focus on those decisions.



93.6% of the variability of performance was driven by an asset allocation policy.

Only 6.4% of the variability of performance was driven by security selection and timing of investment.

Let’s take asset allocation further and talk about diversification. Diversification is combining different asset classes together in an effort to optimize risk and return. Ideally, you combine investments that do not move in the same direction at the same time.

Follow a color on this periodic table of investment returns to see how asset classes go through cycles of performance.

2006	2007	2008	2009	2010	2011	2012	2013	2014
REITs 34.35%	Commodities 16.23%	Global Bonds 12.00%	Large Cap Growth 37.21%	REITs 27.58%	Bonds 7.84%	REITs 20.14%	Small/ Mid Cap 36.80%	REITs 27.15%
International 26.86%	Large Cap Growth 11.81%	Bonds 5.24%	Small/ Mid Cap 34.39%	Small/ Mid Cap 26.71%	REITs 7.28%	International 17.90%	Large Cap Growth 33.48%	Large Cap Value 13.45%
Large Cap Value 22.25%	International 11.63%	Cash 1.80%	International 32.46%	Commodities 16.83%	Global Bonds 7.22%	Small/ Mid Cap 17.88%	Large Cap Value 32.53%	Large Cap Growth 13.05%
Small/ Mid Cap 16.17%	Global Bonds 10.81%	Diversified Portfolio –26.72%	REITs 27.45%	Large Cap Growth 16.71%	Large Cap Growth 2.64%	Large Cap Value 17.51%	International 23.29%	Small/ Mid Cap 7.07%
Diversified Portfolio 15.00%	Bonds 6.97%	Commodities –35.65%	Diversified Portfolio 23.08%	Diversified Portfolio 15.93%	Large Cap Value 0.39%	Large Cap Growth 15.26%	Diversified Portfolio 13.21%	Bonds 5.97%
Large Cap Growth 9.07%	Diversified Portfolio 4.92%	Small/ Mid Cap –36.79%	Large Cap Value 19.69%	Large Cap Value 15.51%	Diversified Portfolio 0.13%	Diversified Portfolio 11.70%	REITs 3.21%	Diversified Portfolio 5.39%
Global Bonds 5.94%	Cash 4.74%	Large Cap Value –36.85%	Commodities 18.91%	International 8.21%	Cash 0.08%	Bonds 4.21%	Cash 0.05%	Global Bonds 0.67%
Cash 4.76%	Small/ Mid Cap 1.38%	REITs –37.34%	Bonds 5.93%	Bonds 6.54%	Small/ Mid Cap –2.51%	Global Bonds 1.30%	Bonds –2.02%	Cash 0.03%
Bonds 4.33%	Large Cap Value –0.17%	Large Cap Growth –38.44%	Global Bonds 1.90%	Global Bonds 6.42%	International –11.73%	Cash 0.07%	Global Bonds –4.50%	International –4.48%
Commodities 2.07%	REITs –17.83%	International –43.06%	Cash 0.16%	Cash 0.13%	Commodities –13.32%	Commodities –1.06%	Commodities –9.52%	Commodities –17.01%

MARKET SEGMENT & ANNUALIZED STANDARD DEVIATIONS[12]
20 YEARS ENDED 12/31/14

Cash[2]	0.64
Bonds[3]	3.56
Global bonds[4]	6.53
Diversified portfolio[5]	10.58
Large Cap Value stocks[6]	15.03
Commodities[7]	15.90
International stocks[8]	16.66
Large Cap Growth stocks[9]	17.42
Small/Mid Cap stocks[10]	18.41
REITs[11]	19.31

- International stocks: investing in foreign and/or emerging market securities involves interest rate, currency exchange rate, economic, and political risks. These risks are magnified in emerging or developing markets as compared with domestic markets.
- Small-/mid-cap stocks: Investing in small and/or mid-sized companies involves more risk than that customarily associated with investing in more-established companies.
- Bonds: Bonds, if held to maturity, provide a fixed rate of return and a fixed principal value. Bond funds will fluctuate and, when redeemed, may be worth more or less than their original cost.

For more information on any MFS fund, including performance, please visit mfs.com.

[2]The MSCI EAFE Index measures the non-U.S. stock market.

[3]The Russell 1000 Growth Index measures large-cap U.S. growth stocks.

[4]The Russell 1000 Value Index measures large-cap U.S. value stocks.

[5]The Russell 2500 Index measures small- and mid-cap U.S. stocks.

[6]The Barclays U.S. Aggregate Bond Index measures the U.S. bond market.

[7]The JPMorgan Global Government Bond Index (Unhedged) measures government bond markets around the world.

[8]The FTSE NAREIT All REITs Total Return Index tracks the performance of commercial real estate across the U.S. economy.

[9]The Bloomberg Commodity Index is composed of futures contracts on physical commodities.

[10]The Citigroup Three-Month Treasury Bill Index is derived from secondary market Treasury bill rates published by the Federal Reserve Bank.

[11]Equal allocations among the market segments are represented by the various market indices above (excludes cash).Note that the portfolio’s assets were rebalanced at the end of every quarter to maintain the equal allocations throughout the period.

[12]Standard deviation is an indicator of the portfolio’s total return volatility, which is based on a minimum of 36 monthly returns. The larger the portfolio’s standard deviation, the greater the portfolio’s volatility.

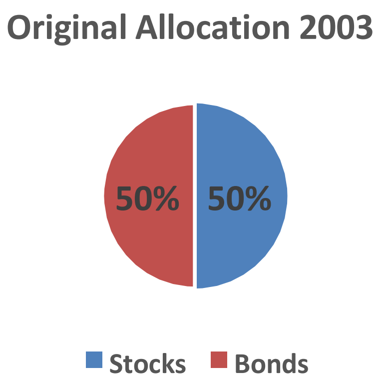
Investors cannot invest directly in indexes. The performance of any index is not indicative of the performance of any investment and does not take into account the effects of inflation and the fees and expenses associated with investing.

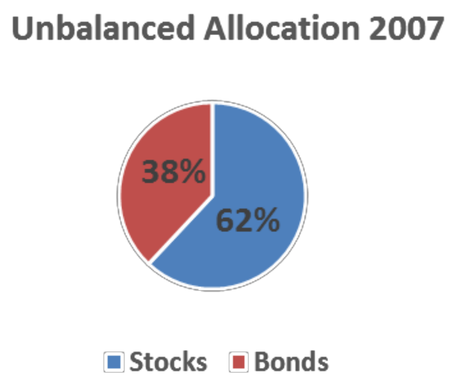
Unfortunately, many people buy funds comprised of last year's top performing asset class only to watch that investment underperform simply due to the cyclical nature of returns. The key is to combine these different asset classes into a well-designed allocation that is appropriate for your goals and risk tolerance. An example is in the black square on that periodic table chart. The top performer is never black in any single year; however, it's never the worst either.

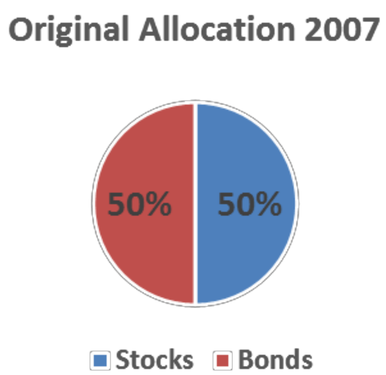
So the natural question at this point is how do I determine what asset allocation is right for me? There are a few ways to figure this out. One is to take a risk tolerance questionnaire. If you are participating in an employer sponsored plan like a 401k, normally there is one available to you in your enrollment materials. There are several available online that you can take in minutes. If you don't feel comfortable going just on a questionnaire, you can seek help from a financial advisor.

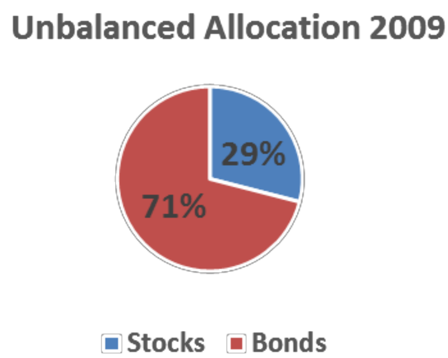
If you've done that, great but don't get too excited. You're not done yet! You have to revisit this over time especially as you get closer to your goals but also you can't just set it and forget unless you have your portfolio rebalanced automatically. What's rebalancing you say?

If you start with a certain makeup of a portfolio, 50% stocks and 50% bonds for example, that makeup will change with market swings. Let's see how.







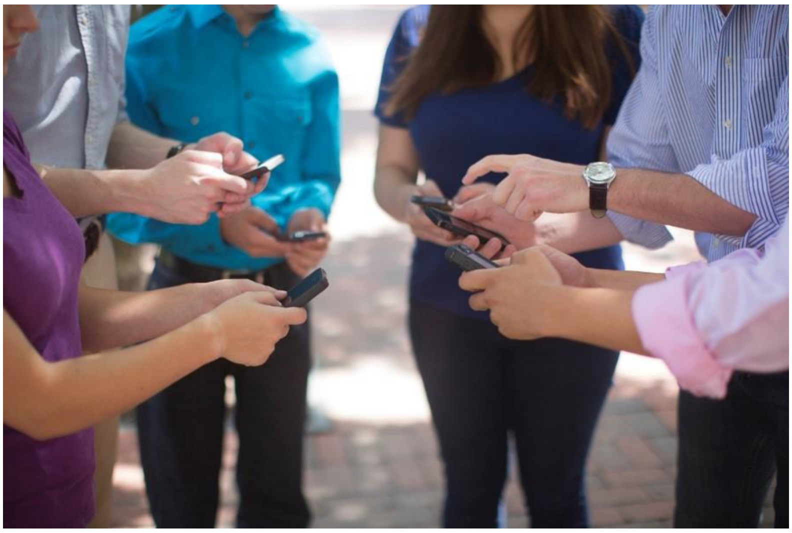


Mistake # 3
Market Timing

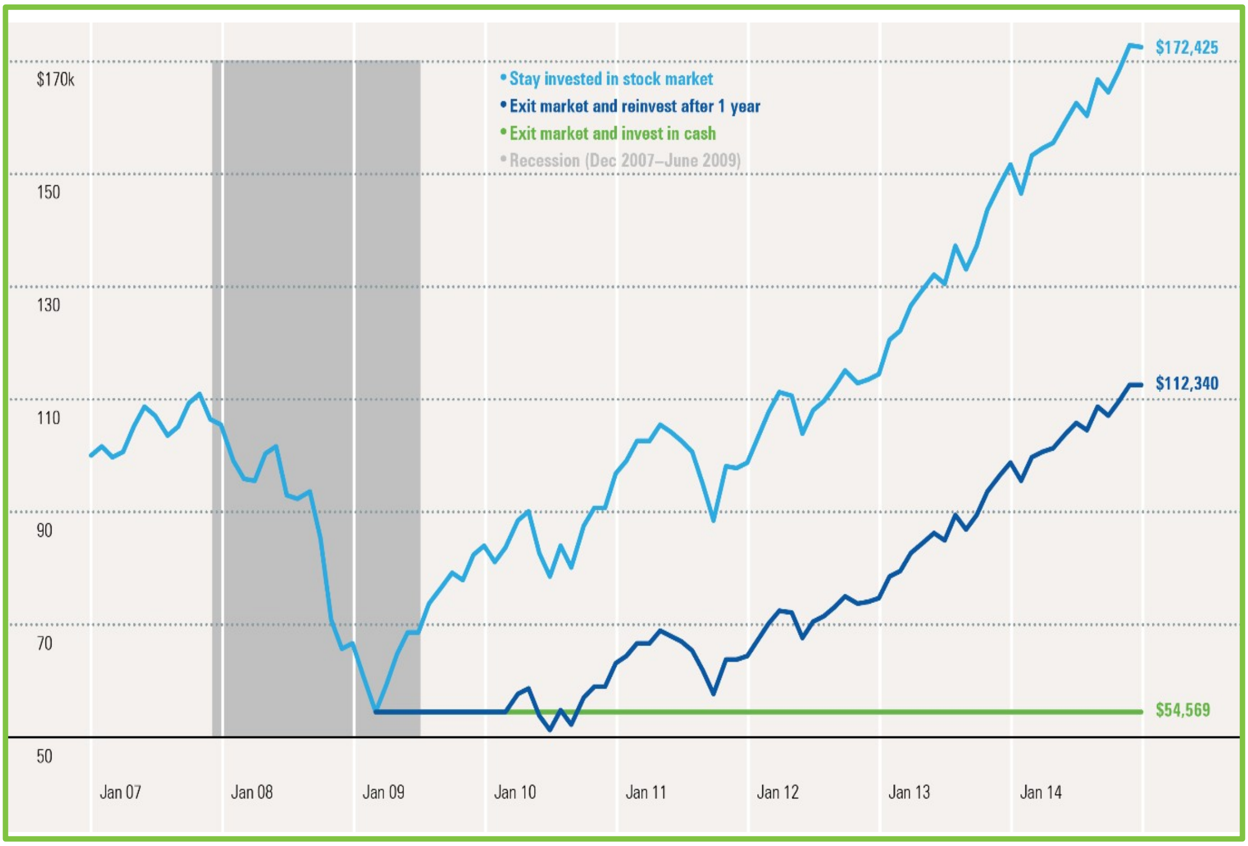
If you've started saving consistently, you've developed an allocation strategy, then you're doing pretty well but there is still one pitfall to avoid, market timing. What's market timing? It's moving your investments based on how you think the market will perform in the short term.

For example, if you believe the market is about to enter a downturn, you might sell all of your stock investments and put those in cash or in fixed income investments. Likewise, if you feel confident about the economy, you might do the opposite and load up on stocks.

What's the problem**?** Sounds smart, right? The problem is we end up allowing our emotions to guide our investment decisions. Often, we feel overly confident when the market is at a peak and feel defeated when the market is at a trough. These feelings can sometimes cause us to sell at bad times & buy back in at higher levels. We'll look at an example on the next page.



24 Hour News can encourage market timing. Don't let short term headlines derail your long term investment plan!



In the chart (created by Morningstar in 2015), see the difference just being out of the market for a single year makes. The investor that got nervous at the end of the financial crisis and sold out ends up with $60,000 less in just a few years. Let's also look at another example. If you followed the news near the end of 2012, you will find a great example of the dangers of market timing. Going into 2013, all we heard about was the looming "fiscal cliff." Pundits insisted the market was poised for a terrible year in 2013 because a number of tax reforms & other legislation was set to expire early that year. The economy was going to fall off the "fiscal cliff." The history book has been written here. We certainly didn't fall off a cliff. In fact, we saw some of the biggest returns of the recovery in that year.

What's the lesson? Even when you can make a logical argument to drastically change your allocation strategy, it still may be a bad decision because short term market movements are all but unpredictable. In the long term, we can better approximate average returns but from year to year we are all but guessing.

Source: Morningstar, Inc. Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index.

Luckily, you do not have to guess properly to be successful. Instead, focus on three big things that you can control. First off, you need to save consistently, starting as early as possible. You need to determine a proper asset allocation & diversification plan which should be rebalanced periodically. Lastly, you need to be patient during times of market downturns and take care to not throw caution to the wind during roaring bull markets. If you do these three things correctly, you will put yourself on the right path and dramatically increase the likelihood of achieving your most important financial goals.

P.S. I'd love to hear about your progress. Please email me at jjohnson@bluerockwm.com to ask any questions or simply to update me on your progress. Can't wait to see what you build with your New Investor BLUEPRINT!