WORTH **READING**

New to AAII? Here's a sample of the quality education we provide to individual investors. We hope you find it useful. It touches on one aspect of the broad subjects we cover for anyone who has an interest in handling their own investments. AAII teaches you what you need to know about financial planning, comparing mutual funds, investing for income, screening for and analyzing stocks, asset allocation strategies, handling taxes, saving for and investing in retirement and more.

We appreciate your interest!

For more information and to sign up for AAII membership, please visit our website at AAII.com. For speedier service, call AAII at 312-676-4300.

©2020 Reprinted with permission from

The American Association of Individual Investors
625 N. Michigan Ave., Chicago, IL 60611
312-676-4300
www.aaii.com

The American Association of Individual Investors is a nonprofit group whose sole purpose is to assist its 150,000+ members with their investment information and education needs. For over 40 years, AAII has been providing guidance and tools to both the beginner and advanced investor. AAII helps members build their investment wealth through guides, model portfolios, the monthly *AAII Journal* and a comprehensive website.

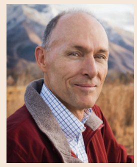
© 2020 by the American Association of Individual Investors, 625 N. Michigan Ave., Chicago, IL 60611; (312) 676-4300.

PORTFOLIO STRATEGIES

Helping Kids and Grandkids Become Investors

Teach someone else what you have learned about investing. Give them the gift of time to experience the power of saving and the magic of compounding.

BY CRAIG L. ISRAELSEN, PH.D.



***Craig Israelsen**, Ph.D., is a contributing editor to the AAII Journal. He teaches as an executive-in-residence in the Personal Financial Planning Program at Utah Valley University in Orem, Utah. He is also the developer of the 7Twelve Portfolio (www.7twelveportfolio.com) and the author of three books, including "7Twelve: A Diversified Investment Portfolio With a Plan" (John Wiley & Sons, 2010). Find out more about Israelsen at www.aaii.com/authors/craig-israelsen.*

You can lead a horse to water ...

You know how that ends. We can't force our kids and grandkids to be excited about investing. But we can provide information and motivation. This article hopes to provide both. If you feel it does, share it with them.

Perhaps the most important aspect of investing is time. While it's important to focus on appropriate investments, if we start investing too late, we simply won't achieve what could have been accomplished.

Now Is the Time

This issue is quite straightforward. Starting to invest sooner is far better than starting later—particularly if we're talking about saving for retirement. There's a bunch of fancy math that proves all this, but I think Table 1 pretty much nails it.

If you start saving (i.e., investing) 6% of your annual income each year beginning at the age of 25 (assuming you are earning $35,000 and that your income increases by 3% each year), you'll have a bit over half a million dollars in your retirement investment portfolio when you reach the age of 65 (assuming you earned a 6% investment return each year—on average). That is a great achievement. But even if you can only save 3% of your income right now, great! Simply do your best at every age.

If you're able to invest 10% of your income starting at age 25 in a portfolio that earns an average annual return of 10%, you could have over $2.3 million 40 years later. But, if you wait until you're 45 (and after you've had 20 years of 3% annual raises), you'll have less than $500,000 in your portfolio. Pretty clear, isn't it? Start now and invest as much as you feasibly can.

APRIL IS: Financial Literacy Month

You may have noticed something very interesting in the table. If your annual savings rate goes from 8% to 10%, that is a 25% increase. Likewise, if your investment portfolio return goes from 8% to 10%, that's also a 25% increase. But, your account value at age 65 goes up by more than 100% (from $1,116,611 to $2,309,847), assuming you started investing at age 25. Pretty cool, huh? That's the power of saving more money combined with the magic of compounding at higher rates of return.

Even if you start your investment portfolio later in life, there is still a great benefit from investing more each year. In fact, if you're already over the age of 45, your annual investments (the amount you contribute to your investment account each year) can have a greater impact on your ending portfolio balance than attempting to earn a higher portfolio return. So, rather than increasing the risk of your portfolio in hopes of getting a higher return, simply invest more money into your portfolio if possible. Do more of the heavy lifting yourself and don't expect the portfolio to be the hero, as I explained in the May 2018 *AAII Journal* ("The Impact of Saving Versus Return on Wealth"). You can be a hero, too.

TABLE 1

How Age, Savings Rates and Returns Affect Wealth

	Retirement Portfolio Value at Age 65 (assuming 3% increase in annual income)		
Start Investing at:	6% Savings Rate 6% Portfolio Return	8% Savings Rate 8% Portfolio Return	10% Savings Rate 10% Portfolio Return
Age 25 ($35,000 Annual Income)	$521,157	$1,116,611	$2,309,847
Age 35 ($47,037 Annual Income)	$330,690	$620,605	$1,110,367
Age 45 ($63,214 Annual Income)	$187,756	$311,845	$488,872

Source: Calculations by the author. Salaries for ages 35 and 45 assume a starting salary of $35,000 at age 25 and 3% annual raises.

TABLE 2

Long-Term Returns of Major Asset Classes

For the 50-Year Period From 1970–2019

	Large U.S. Equity (%)	Small U.S. Equity (%)	Non-U.S. Equity (%)	U.S. Bonds (%)	Cash (%)	Real Estate (REITs) (%)	Commod-ities (%)	All 7 Asset Classes* (%)
50-Yr Avg Annualized Return**	10.6	10.9	8.7	7.4	4.7	11.6	6.7	9.7
% of Time With Positive Annual Return**	80.0	70.0	70.0	94.0	100.0	82.0	70.0	86.0
Worst 1-Yr % Return**	(37.0)	(33.8)	(43.4)	(2.9)	0.0	(39.2)	(46.5)	(27.6)

**Equally weighted portfolio with all seven asset classes.*

***These figures do not account for the impact of inflation. The portfolio with all seven asset classes was rebalanced each year.*

Sources: Returns were based on the S&P 500 index, Russell 2000 index, MSCI EAFE Index, U.S. Barclay's Capital Aggregate Bond Index, three-month U.S. Treasury bills, Dow Jones U.S. Select REIT Index and S&P Goldman Sachs Commodity Index.

How to Start?

Some fund companies allow surprisingly small investments to be made if you agree to make them on a regular, scheduled basis. For example, if you are able to commit at least $5 per month, you can invest in a mutual fund at Homestead Funds. Among the options available to you is the Homestead Value Fund (HOVLX). You will need to use the automatic investing program (AIP) at Homestead Funds—otherwise, the minimum initial investment is $500. You can do this online at Homestead Funds' website (www.homesteadfunds.com). If you have questions, the number for Homestead Funds is 800-258-3030.

If you have $1,000 to invest, there are more options. They include, but are not limited to, opening an account at Vanguard. Vanguard's STAR mutual fund (VGSTX) is a fund of funds that invests in 11 other Vanguard mutual funds—meaning that it provides broad diversification inside of just one fund. More information is available on Vanguard's website (www.vanguard.com). You can also call at 877-320-3099. Just tell them you want to open an account and give the name of the fund you are interested in. A representative will guide you through the process.

To find information about similar options at other fund companies, simply do an online search for the fund family's name and the words "automatic investing program." If you decide to invest in mutual funds, make a commitment to invest additional money each month. If you choose the AIP at Homestead, that will already be happening. If you decide to invest in the Vanguard STAR fund, in a different Vanguard fund or with a different fund family, you will also want to establish an automatic monthly investment with the mutual fund firm.

Of course, there are web-based investment advisory services (aka, robo-advisers), such as Wealthfront (www.wealthfront.com) and Betterment (www.betterment.com) that will choose investments for you. If web-based investing is more your style, go for it.

After you start investing, don't expect overnight success. Investing is like a crockpot, not a microwave. It takes time—as in, 15 to 20 years. Don't be a helicopter investor (you know, the one that hovers over their portfolio, freaking out over every hiccup). Investing is a long-run experience that isn't helped by over-managing your portfolio.

So, what type of returns should we expect over the long run? Table 2 provides a summary of the performance of seven core investments (or asset classes) over the past 50 years from 1970 to 2019.

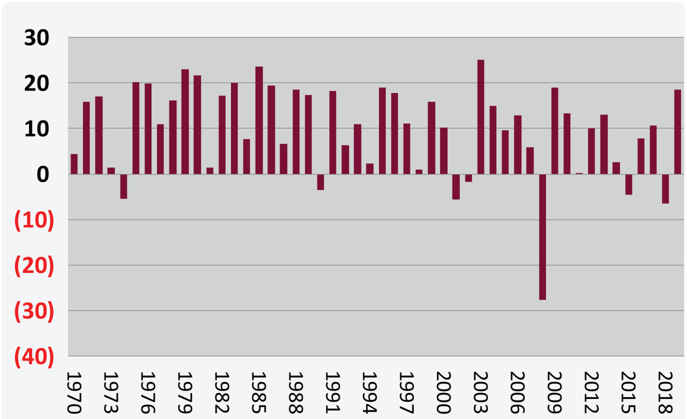
Over the past 50 years, an investment in a diversified investment portfolio with all seven asset classes (using a variety of mutual funds) produced an average return of 9.7%. Of course, there was quite a bit of variation in the year-to-year returns, as shown by Figure 1. The cool part is that a diversified portfolio had a positive annual return 86% of the time. The bad return in 2008 is pretty easy to see in the graph. The important realization is that the meltdown in 2008 is the odd duck experience over the past 50 years—certainly not the norm.

Here is the important thing to remember: The longer you invest, the more likely you are to experience a positive return. Stay in the saddle for at least 10 years and you'll very likely have a positive experience—particularly if you build a diversified investment portfolio with a variety of

(continued on page 20)

FIGURE 1

Annual Returns for Multi-Asset Portfolio (50-Year Period: 1970–2019)



Source: Calculations by the author.

PORTFOLIO STRATEGIES (CONTINUED FROM PAGE 8)

types of mutual funds or exchange-traded funds (ETFs).

To build a diversified investment portfolio, you can invest in a mutual fund or ETF that focuses on large U.S. stocks, another fund that targets small U.S. stocks, another that invests in non-U.S. stocks, a mutual fund that invests in bonds, one that focuses on real estate investments and another that invests in natural resources and commodities. Finally, you will want to keep some of your investment dollars "liquid"—and that's where the "cash" asset class comes in. Cash is a fancy term for a savings account or money market account.

When you retire, if you only withdraw 4% of your portfolio's account balance, your money will likely last for at least 40 more years.

There's More to Life

While this article has focused on how to and why you should start investing, I would encourage you to also think about the "why" of investing:

- To be a wise steward of your resources and to prepare for future needs and goals.
- To grow your talents and abilities by setting financial goals and sticking to them.

After you have chosen your mutual fund(s) and have initiated the automatic investing program, turn your attention to other important parts of your life. Care for the physical, emotional, social and spiritual needs of yourself and those around you. Focus outward. Money is a means to achieve goals, not an end in itself. Use financial resources to facilitate life experiences with others as well as meaningful service opportunities. Memories last far longer than things. Remember that money is a magnifier—of our virtues and vices. Seek to have your money magnify your virtues.

Finally: Teach someone else what you have learned about investing. One way is to give this article to your kids and grandkids! ■

JOIN THE CONVERSATION ONLINE
Visit AAII.com/journal to comment on this article.

MORE AT AAII.COM/JOURNAL
First Cut Mutual Funds: Funds With Low Initial Minimums by AAII Staff, April 2020
The Power of Compounding by AAII Staff, April 2019
Beginning Investor: How to Start by Charles Rotblut, CFA, April 2010