JACK BRENNAN
FORMER VANGUARD CEO
WITH JOHN WOERTH

MORE STRAIGHT TALK ON INVESTING

LESSONS FOR A LIFETIME

WILEY

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To my growing and loving family. Once we were 5 and now we are 11, with another on the way!

and

To the millions of Vanguard investors, thousands of crew members, and hundreds of investment professionals who have inspired me and taught me for four decades.

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Preface

In July 2002, I began the preface for the first edition of *Straight Talk on Investing* by observing that the previous "five years have been extraordinary in the history of investing. A record bull market swelled into one of the largest speculative bubbles in history. Then we saw the bursting of that bubble and the onset of a prolonged bear market, the worst one that the U.S. stock market has experienced since World War II. If many investors seem shaken and unsure of what to do, no wonder. Within half of a decade, we have been presented with a lifetime's worth of lessons about investing."

It is with a dose of cruel irony as I sit down to write the preface for the second edition in late 2020. The world at large is struggling with the coronavirus pandemic, which initially brought on a swift and severe drop in the global stock markets. While the markets quickly recovered, this marked the third shock experienced by investors in the first 20 years of the twenty-first century. Given this backdrop, it is no wonder investing can appear to be so daunting.

Albert Einstein once said, "The only source of knowledge is experience." Maintaining a long-term perspective and controlling one's emotions are valuable lessons that investors can glean from trying times. However, the impetus for updating this book with a second edition goes beyond the teachings of these distinct market events. While the financial planning and investing principles covered in these pages are timeless, a considerable amount has changed in the nearly 20 years since the first edition. I've learned a bit more along the way, including framing investing as a series of trade-offs—a theme that I will weave into this latest version.

At the outset, a new generation of investors has come of age and could benefit from understanding that sensible investing is an effective way to achieve financial security. I will note, too, studies indicate that members of the Millennial Generation—one of the audiences for the initial book—are far more wary of the stock market than Baby Boomers. Their wariness is understandable, having seen their parents withstand the bear market of 2000–2002, or experiencing 2008–2009 and 2020 themselves. But participating in the market is a must for long-term financial security, and for this generation now in the prime of their investing years, as well as for Generations Z and Y, a primer may be helpful.

I also underscore the concept of thinking of yourself as a *financial entrepreneur*—managing your financial life as an owner manages his or her business. And it is your financial life and no one else's, which is saying that financial planning and investing are highly, highly personal. While your age and goals may be similar to those of a friend, colleague, or neighbor, your investment program may be vastly different based on your ability to withstand risk, your means, and your time horizon, among many other factors.

The investing landscape has also changed considerably, and changed for the better in terms of choice, cost, and convenience. I genuinely believe that there has been no better time to be an investor.

Perhaps most obviously, the costs of investing have declined dramatically. Commissions or front-end loads, once as high as 8-1/2% on mutual fund purchases, have virtually disappeared. The average asset-weighted expense ratio of stock funds has dropped nearly by half, from 0.99% in 2000 to 0.52% in 2019—roughly $100 on a $10,000 investment to around $50, according to the Investment Company Institute. Costs, risk, and reward are the three critical factors when considering any investment. But only cost is actually known in advance and, all things equal, lower costs will result in higher returns for investors. As you can see from the cost figures cited here, investors today have a strong relative tailwind compared to only a short two decades ago.

Products such as exchanged-traded funds (ETFs) and target-date funds, which were nascent in 2002, have become core investment tools today and offer low-cost, diversified exposure to the global stock and bond markets. Today, the growing number of environmental, social, and governance funds offer an opportunity to align your investing with your values. There are newly popular options, too, for using your money for charitable purposes, such as donor-advised funds.

We have also seen the advent of robo-advisors and other digital money management services. A growing number of start-ups, banks, and asset management firms offer apps featuring asset allocation guidance, investment recommendations, and saving rate suggestions. These digitally delivered services have made financial advice more accessible and affordable.

However, I believe that most investors in the accumulation stage (i.e., saving for retirement or college) can—with some *knowledge*, *confidence*, and *discipline*—manage their investments on their own and not incur the extra costs of obtaining professional advice. Let's consider these three traits for investing success, and I will come back to them again and again. For those near or in retirement, obtaining professional help at a reasonable price is a valuable option for navigating the complexities of maintaining and drawing upon their nest eggs. The options available to obtain that advice at attractive prices—digital, in-person, or virtual—are now more plentiful and convenient.

Regulatory and legislative developments have improved investor protections and disclosures; brought forth new savings options, such as the Roth IRA; and enhanced the inner workings of the financial markets. 529 plans, in their infancy two decades ago, have emerged as the funding and investment vehicle of choice for college savings. There will be additional developments that impact the financial services industry in the years ahead, some of which will benefit individual investors and, unfortunately, some that may not. This is why it is important to stay abreast of things that could impact your investments, as well as changes in your own personal circumstances, that may require changes to your investment program.

What has not changed is the overabundance of information on investing. Entire TV networks are devoted to covering the markets' minute-by-minute movements, accompanied by provocative commentary by personalities and colorful graphics. You don't need a financial SportsCenter to manage your money effectively. In fact, it's more likely to hurt than help you perform that task. Further, the internet and social media abound with advice from self-professed financial experts. Some are legitimate and offer practical guidance. Most do not and actually are a hazard to your financial well-being.

I will share some insights from the mistakes and missteps of professional investors—Wall Street financiers, hedge funds, and university endowments. A short-term mentality, a lack of diversification, and an underappreciation of liquidity, among other things, have tripped up the "smart money" time and time again.

The goals of this book have also not changed. First, this is the type of book that parents give their children when they strike out on their own. Like many of my contemporaries, I wish I had had such a book. In my case, I am looking forward to giving this second edition to my grandchildren.

Second, I want this book to serve as a useful refresher about the basics of sound financial planning and prudent investing. No matter what one's age, sophistication, or experience, a back-to-basics course is always helpful—particularly during difficult times, when conflicting advice typically abounds. On a personal basis, I consider working on this book my own back-to-basics course and a very helpful one at that.

Finally, this book is aimed at helping people to think about their serious money—the dollars that they set aside for long-term goals, such as retirement or the education of their children. Frankly, this book won't do much good for those who are seeking guidance about finding "hot stocks" or tips on how to "play the market." That is why I will focus on mutual funds and ETFs as your primary investment vehicles.

The simple approach to investing that I present here is not derived from my years in the university classroom, but from the wisdom of many smart minds that I've had the privilege to meet and learn from during my nearly four decades in the investment industry. These include former and present colleagues at Vanguard, the world-class advisors we hire to oversee the Vanguard funds, and other investment professionals, including the managers of college endowments and non-profit organizations with whom I have had the privilege to be associated over the years.

I've also picked up a great deal from friends, family members, and Vanguard retail clients—"Main Street" investors who've navigated the markets and achieved financial success over the long term. There is simply nothing that I enjoy more than being stopped in the grocery store by someone who says "I just want to say 'thank you' for what you and your colleagues have done to provide me with a comfortable, secure retirement." If this book helps you with your financial future, I look forward to running into you at the market!

Jack Brennan
Valley Forge, Pennsylvania
December 2020

Author's Note

In this book, I cite several Vanguard funds to buttress specific investing lessons. These citations should not be construed as endorsements or recommendations. I use Vanguard funds simply because I am more knowledgeable about them than other funds. One of the lessons I hope to impart is that you should never make investment decisions based on incomplete information. If you become interested in one of the funds mentioned here (or any fund or exchange-traded fund, for that matter), consult its prospectus before taking any action.

Note that in the writing of this book, I sought to avoid investment jargon to the extent possible. In the appendix, you will find definitions of investment terms to help you along the way. When warranted, I employ call-out boxes titled **Baseline Basics** to make clear terms and concepts that will add to your foundational knowledge. You'll also come across **Portfolio Pitfall** sidebars, which offer caveats about common investor mistakes and cautions about questionable industry practices. At the end of each chapter, I wrap it all up with **In a Nutshell**—a bulleted summary of key takeaways.

As you read this book, you'll encounter bolded passages that highlight key, stand-alone investing principles. These principles are condensed and summarized in the **Afterword** at the end of the book and serve as a handy compilation should you need to reference it in the future. In some ways, this compilation represents my off-the-cuff response when someone in a social setting—be it on the sideline at a grandkid's soccer game or at a dinner party—is looking for my high-level thoughts on successful investing. I hope you find these CliffsNotes, if you will, useful and practical, too.

Finally, I use a considerable amount of data—market returns, hypothetical examples, and fund performance—throughout the book to support my points. **(Due to production constraints, most of the data is cited through December 31, 2019. The addition of 2020**

would not substantially alter the long-term data featured in the figures and text.) You need not be facile with advanced calculus, but having some faculty with numbers will help you become a better investor. I also draw on events; some may appear ancient or irrelevant to you. However, the wisdom offered by the past will help make you a sharper and more discerning consumer of investment products and services.

I am pleased to report that all proceeds from the sale of this book will be donated to Vanguard's signature charitable initiative—the Vanguard Strong Start for Kids Program™. Strong Start for Kids invests in tomorrow by supporting the development, learning, and joy of young, especially underserved, children today. The program aims to create partnerships that advance early learning programming in Greater Philadelphia, Phoenix, Charlotte, and London, and focuses on respecting and building upon local strengths to ensure families, programs, and communities have the resources needed to help all children have the best possible start in life.

An investment tenet emphasized in this book is similar to the approach that Vanguard takes to make a difference in the community: Investing early pays off. Research shows that investing in early learning opportunities for young children pays off in lifelong benefits. When children are supported during the first few years of life, they are more prepared to succeed in school, lead healthier lives, and contribute to creating stronger communities. But the reality is that significant barriers exist that disproportionately shut out some children from these meaningful opportunities. Strong Start works to increase access to a rich ecosystem of support so all young children are able to benefit and reach their full potential. Having spent much of my civic time on this endeavor, I can assure you that the return on an investment on high quality early childhood services would make most professional investors jealous!

Acknowledgments

I'm amazed at how many people it takes to move a book like this from concept to reality—even if it's the second time around. And, of course, I'm grateful to all who have been part of that journey. I'll take the risk of naming names, with the full expectation that I will leave someone out, and for that, I apologize in advance.

I want to start by thanking my collaborator, John Woerth. John is a three-decade colleague and, more important, a friend for all that time. It has been a joy to work with him on this book. He's a superb editor, a gifted writer, an astute observer of markets and investor behavior and, fortunately, a brutal taskmaster. I am confident that without that final character trait*, More Straight Talk on Investing* would still be mostly in my head.

As with the prior edition, I want to acknowledge the wonderful, trusting investors at Vanguard, with whom it has been my pleasure to be associated for nearly 40 years. These investors—small and large; sophisticated and new to investing; beginning their careers and enjoying retirement—have demonstrated all the good traits that we try to articulate in this book. They are disciplined, long-term oriented, cost conscious, and continually learning how to be better investors. It's been a remarkable journey together.

A second acknowledgment goes to my colleagues over the years at Vanguard, especially my two predecessors as chairman of our funds, the late Jack Bogle and Walter Morgan, as well as my successor as chairman, Bill McNabb. What a gift it was for me to be colleagues with Jack and Mr. Morgan, to learn from them, and have the honor of succeeding them. And throughout his career, Bill's engagement with investors and his commitment to their success and well-being is legendary. I have learned much from him from his first days as a colleague and continue to do so today as we discuss this topic as friends.

It has been an equal honor to serve with, and learn from, the thousands of Vanguard crew members who believe in Vanguard's mission and relish the chance to serve investors on their way to financial success.

Our first version of this book could not have been published without the wonderful work of my collaborator, Marta McCave, and several members of our team of writers and editors at Vanguard, particularly Mary Lowe Kennedy and Craig Stock. *More Straight Talk on Investing* is built on the chassis that they helped construct, and I hope they'll be as pleased with this version as I was pleased with their work on the first.

Numerous members of the Vanguard crew have provided statistical assistance and counsel, and I mention a few here. David Walker and Dominick Petruso, who did a remarkable job updating and developing the myriad statistics featured in the book. Many of their colleagues also contributed along the way, including Corinne Morrone, Michael Damico, Adam Schickling, Arvind Narayanan, Antonio Picca, Roger Aliaga-Diaz, Don Bennyhoff, Chris Tidmore, Andrew Hon, Jean Young, John Hollyer, James Rowley, Michael Johnson, Doug Grim, Dan Newhall, Jon Cleborne, Bill Oppelt, Ted Dinucci, Inna Zorina, and Hank Lobel. I thank them for their hard work in the background to ensure that we produced a high-quality book that will provide good value to our readers.

I'm particularly grateful to three wonderful Vanguard investment professionals—Maria Bruno, Fran Kinniry, and Rodney Comegys—who took the time to read and comment on our final draft to ensure it met their standards of quality, which are high on all counts. And, finally, a hearty thanks to Tim Buckley, Vanguard's terrific CEO and my good friend, who endorsed and supported this project from the beginning.

We relied on a number of data sources for this book, including Standard & Poor's, FactSet, Dow Jones, Frank Russell Company, Morningstar, Bloomberg, Morgan Stanley Capital International, the Investment Company Institute, the Federal Reserve Bank of St. Louis, and the Center for Research in Security Prices. Our thanks to all of them.

Of course, none of this happens without a great support team. Vickie Leinhauser and Katie Kimmel have been of invaluable assistance to John and me throughout this project. Again, without their help, this project would have gone nowhere.

Two last points. First, I mention here, and often in the body of this book, the value of being a continual learner with respect to investing. I believe that's true whether you are 25 or 75; whether you are just starting out or have years of experience under your belt; whether you're an amateur or a seasoned professional. I love it when someone approaches me (usually starting out by being nice and saying, "Other than *Straight Talk*, which I loved ...") and then asks, "What would you recommend that I read to help me be a successful investor?" I usually mention three books. *Winning the Loser's Game* by Charles Ellis and *A Random Walk Down Wall Street* by Burton Malkiel are investment classics that have been continually updated, a tribute to their enduring value to generations of investors. Each had a significant influence on me before I began my career at Vanguard. The third book is a newer classic, first published in 1996, *The Millionaire Next Door*, by Thomas Stanley and William Danko. It provides real-world examples of people who have found long-term financial success and security through very unglamorous actions—the type of actions that we catalogue for you here.

Finally, our editor at Wiley, Bill Falloon, has been a constant source of guidance and support to us as we marched down the field and carried the book over the goal line. I'm grateful for his efforts.

PART I
MASTER THE BASICS

1

Successful Investing Is Easier Than You Think

Successful investing is not difficult. But it can seem intimidating. Some assume that you have to be rich or possess an advanced degree to accumulate wealth as an investor. They think you have to be able to understand all the topics covered in *The Wall Street Journal*—the ups and downs of the stock markets; the interest-rate decisions of the Federal Reserve Board; corporate earnings announcements and dividend policies; the meaning of economic indicators; and so forth. All of these things have meaning, but you don't have to follow them closely to invest successfully. In reality, investing is easier than most people think.

The purpose of this book is to give you the understanding you need to accomplish your financial goals through investing. Over the past 40 years, I've talked to tens of thousands of successful investors. They come from all backgrounds and all stages of life. Some are young; others are old. Some are sophisticated; others are unsophisticated. Many have elite undergraduate and graduate educations; some never went to college.

Despite their differences, all the successful investors I've met share several traits, beginning with a very important one: **They invest with confidence.** They don't spend their lives searching for a get-rich scheme or investment gimmick that will lead them to a pot of gold, or worrying about what other people are doing with their money. Frankly, they really don't care—nor are they influenced by—how their neighbors, friends, or relatives invest. Confident investors make decisions based on their own personal financial situations, goals, and ability and willingness to take risks.

A Great Time to Be an Investor

This is a great time to be an investor. You have a wide variety of investment vehicles, including thousands of mutual funds and exchange-traded funds (ETFs), from which to assemble an investment program. Educational material has never been more accessible, which means you'll have no trouble finding resources to help become more knowledgeable about the subject. The internet makes it easy to monitor and manage your investments at any time of day, no matter where you are. And thanks to Individual Retirement Accounts (IRAs), 401(k) plans, and other tax-advantaged vehicles, you can secure attractive tax benefits when you put away money for your future. Generally speaking, the financial markets of today work effectively and efficiently. And, very importantly, the costs to invest have never been lower.

Today, millions of people are investing. For instance, 46% of American households own mutual funds and 63% invest via a tax-advantaged savings plan, according to the Investment Company Institute. Still, many segments of our country are not investing. Data from the Center for Household Financial Stability reveals that three in five millennials have no exposure to the stock market. And for those in this generation who invest in stocks, their holdings are low. Meanwhile, Black and Hispanic households are also more likely to lack investment accounts relative to other races. We will never be the country of equal opportunity that we must be if this holds true in the future.

Today's era offers great advantages, but they are only advantages if you participate. You must also steel yourself for two challenges. The first challenge comes from the traditional and social media, as well as those who make a living or a hobby of sharing their "wisdom." Most pay far too much attention to short-term events in the financial markets. In fact, news stories about the markets and investing read like the articles in the sports pages. Who won today? Who are the hot players? Who's going to have the best season? Who's first in the standings? With so much excited and inescapable commentary about every market move, it's no wonder that ordinary people sometimes feel intimidated or overwhelmed.

This is not to say that there is not thoughtful coverage of investing matters. In investing, less is often more in terms of news flow. Without being too nostalgic, my favorite example of that view is a TV show that ran from the early 1970s to the early 2000s. *Wall $treet Week with Louis Rukeyser* offered sensible and studied observations of the financial markets. One key attribute was that it aired only once per week, which enabled the host and guests to move away from the minute-to-minute commentary that's now all too frequent. (The program continues today on Bloomberg TV.) Today, of course, there are plenty of reputable websites, radio programs, and podcasts accessible to you that can help you take charge of your financial life and become a better investor. I merely encourage you to be a discriminating consumer of financial media. And don't let it become a competitor of your favorite steaming series, radio program, or podcast for your time.

The second challenge comes from the financial services industry itself. To be clear, it's in the interest of many companies to make you think that investing is difficult and complex. They make money by selling investment products and advice. As you've no doubt noticed, there's no shortage of brokers, investment advisors, and financial planners eager to sign you on as a client and charge you for their services. Recognize that there are some financial professionals who want to make you think you can't make your own investment decisions. Don't believe them.

Your task is to separate the proverbial "wheat from the chaff" (i.e., the useful and actionable information from the noise). The reality is that you can succeed at accumulating wealth without spending time trying to keep up with daily events, incessantly listening to talking heads on TV, or paying someone else hefty sums to invest on your behalf. When you feel intimidated by the so-called experts, remember that they don't necessarily know more than you do. Indeed, every few years, we see headlines about financial hotshots who have lost millions and even billions of dollars through complicated trading schemes or big bets that went awry. What you don't see frequently in the news are the countless stories of individual investors who are quietly and prudently amassing wealth through sensible and disciplined investment programs. These individuals follow the four priorities of confident investing:

1. Be knowledgeable: Do your homework.
2. Be disciplined: Develop good habits.
3. Be skeptical: Avoid fads.
4. Be observant: Keep learning about investing.

The following section covers each priority in greater detail.

Be Knowledgeable: Do Your Homework

Building your confidence as an investor begins with developing some level of knowledge on the subject. Yes, you must be willing to put a little time into understanding the fundamentals of investing. But not much time! I am talking about knowledge at the very basic level.

There's no need to immerse yourself in thick treatises on financial theory. You don't have to subscribe to investment newsletters or attend seminars. You don't need to watch the financial news networks for the latest insights on why the markets did whatever they did today or this week or month, nor do you have to start each day knowing what happened in the Asian markets or in the Chicago futures pits in overnight trading. None of that is essential homework for individual investors concerned with their serious money.

But before you put your dollars in any investment at any firm, you do need some fundamental knowledge. Right now, I'm going to tell you what you need to know at a baseline level, saving the details for later.

First, you need to know a little about three primary types of investments, or asset classes. You've heard of them: They are stocks, bonds, and cash. (Cash means not just cash money, but ready stashes for it, like a bank savings account, certificate of deposit, or a money market mutual fund.) We cover each in our first Baseline Basics call-out box.

Baseline Basics: Understanding the Asset Classes

To be a successful investor, you need to be an informed investor. For starters, you should have a basic understanding about the risks and rewards of three fundamental asset classes—stocks, bonds, and cash instruments. We'll discuss the asset classes in more detail further on in this book, but for now, an introduction is sufficient.

Asset classes

An *asset* is simply something of monetary value. In finance, a*sset classes* are types of investments that offer different combinations of risks and rewards.

Stocks

Stocks represent ownership. If you own a share of Google stock, then you are a part-owner of Google. That gives you the right to vote on certain policy issues, and it means that you share in the company's business results. If the company does well, you can benefit in two ways: (1) The value of your stock rises, so you could sell it at a profit if you so desire, and (2) The company passes along profits to you and the other owners in the form of a dividend. On the other hand, if the company does poorly, your stock can fall in value and dividend payouts can be cut or ceased altogether. In the worst case, the company could go bankrupt and leave your stock utterly worthless.

What makes a company do well or poorly? There are many variables. A company with prudent management, a sound business strategy in an attractive industry, and high-quality products or services that steadily sell is likely to do well. But other, external forces will also affect a company's prospects. These forces include interest rates and other economic factors, new technologies, competition, government regulation and legislation, and customer preferences. In addition to all those pragmatic influences, a company's stock can rise or fall due to investor sentiment, which is fickle and more difficult to forecast than the weather. In addition, even the smartest company leaders can make mistakes that affect the stock price. As such, many people view stocks as the riskiest investment among the three asset classes.

Stocks are risky—over the short term. As traders constantly second-guess each other about market trends and analysts make predictions, stock prices jump around from day to day and month to month. However, over long periods, stocks as a group have rewarded investors more than any other investment. Since 1926 through 2019, stocks have provided average annual returns of 10.3% a year.

A final note: Stocks are often called *equities*.

Bonds

A bond is essentially an IOU. When you buy a bond, you are lending your money to the issuer, typically a company, a government agency, or state or local municipality. The issuer is promising to pay you a stated amount of interest on the loan and to return the

(continued)

Baseline Basics: Understanding the Asset Classes (*Continued*)

money at a certain time (the maturity date). When you buy a typical bond, you know in advance how much money you are going to receive in interest and when it is going to come; that's why bonds are called *fixed income* investments. (You'll often hear a bond's interest rate called the *coupon*—a term dating to when investors actually clipped coupons from paper bonds and presented them to get their interest.)

Though bond holders are creditors, rather than owners, they care about the soundness of the company or agency that issued the bond because that affects their prospects for payment of interest and repayment of principal at maturity. U.S. Treasury bonds are considered the safest investment in the world because they are backed by the full faith and credit of the U.S. government. Most established companies can be counted on to pay the interest on their bonds and repay the principal at maturity, no matter how their stock prices are faring.

Retirees who need a steady source of income tend to favor bond investments because of the periodic interest payments they provide. But you don't have to be a retiree to appreciate the stabilizing force that bonds can provide in an investment portfolio. As I'll explain later, many stock investors also hold bonds to help smooth out the inevitable fluctuations in the value of their overall investment portfolios.

But bonds have risks. The worst-case scenario is default: The bond issuer runs into trouble and can't pay you the promised interest or return your principal. Fortunately, defaults are relatively uncommon. A much more immediate risk involves bond prices. Existing bonds are constantly being traded on the market, and their value changes along with market interest rates. That's no problem for you if you don't need to sell your bond before its maturity date, but for those who do need to sell, the changing prices can result in losses. Also, if you invest in a bond mutual fund, your share price and the income payments you receive will fluctuate based on the ups and downs of the underlying bonds and as the fund buys and sells its holdings.

Finally, there is the invisible risk of inflation. There have been periods when the interest paid on bonds did not keep up with rising prices, so that bond investors were steadily losing purchasing power. At one point in the 1970s, bonds were facetiously known as *certificates of confiscation*.

Cash

You may think of cash as the bills in your wallet, your Venmo balance, or change in your car's cup holder, but it's something a little different in investing. Cash investments are very short-term IOUs issued by governments, corporations, banks, or other financial institutions. Bank deposit accounts and money market mutual funds are among the most popular forms of cash investments. Cash investments have been the least volatile of the three major asset classes historically, which means they are a safer choice than stocks or bonds if your biggest priority is not losing money. But they have also provided the lowest returns. Cash investments are said to have good liquidity because it's generally possible to withdraw your cash immediately and without penalty, but their disadvantage is that they will provide a return that keeps you just about in line or maybe slightly above inflation. While cash investments are a useful vehicle for emergency funds or money that will be needed just around the corner, they don't belong in your long-term investment account.

As you can see, there are trade-offs with each of the asset classes, so you'll need to set your objectives before deciding how to invest. If you want to reach for the greater potential returns that are offered by stocks, you must be willing to also accept their increased risk. If you want to opt for the greater safety of cash instruments, you must be willing to accept lower returns.

You need to know a little about some of the places to invest, including banks, mutual fund providers, financial advisors, and brokerage firms. You'll need to understand the benefits of tax-advantaged accounts, such as IRAs and 401(k) plans. In this book, I'll explain why mutual funds and exchange-traded funds (ETFs) are the best long-term investment vehicles for the bulk of your serious money. Chapter 8 is devoted to a full explanation of funds and ETFs.

You need to know what risk means. And here's a case where many people assume they already know all about it. But as we'll see, in investing, the obvious risk isn't always the most dangerous one.

You need to know yourself as an investor. You can make all kinds of wise investments and adhere to a sound long-term strategy, but still find yourself unable to sleep at night for worry when the markets are down. Life is too short for that! There are many ways for you to invest at a level of risk with which you can live, and I'll be discussing them in Chapter 11.

Portfolio Pitfall: There Is No Free Lunch

Avoiding mistakes (many self-inflicted) and behavioral errors is key to successful investing. One pitfall is failing to understand the risk/reward trade-off.

The single question I've heard most from investors over the years is this one: "What should I invest in if I want to make a lot of money but I don't want to take a lot of risk?" There is no investment that fits that description. I always reply this way: "If you don't want to take risk, put your money in the bank in an insured account. You cannot invest in the markets without taking on risk."

There is a risk/reward trade-off in every investment choice—from publicly traded stocks and private equity to certificates of deposit and money market funds. If you want to reach for bigger returns, you must accept greater risks. Conversely, if you want to minimize your risk, you must accept lower returns. Think of it in terms of the saying, "There is no free lunch." You must give up something to get something. What's important is to understand the risk you're taking on so you won't be surprised.

Be Disciplined: Develop Good Habits

The second key characteristic of successful investors is that they develop good habits. You can start out with the very best investment plan and still end up disappointed if your own behavior undermines your plan. And the first and most important habit to develop is saving money. You simply cannot spend every penny you earn if you hope to accumulate wealth. The sooner you start saving, the better. When people ask me for my best financial advice, I have only one answer: **Live below your means.**

Saving is so important—and for many, so difficult—I am devoting Chapter 4 to the topic. In this chapter, we'll examine the other good habits you'll need for managing your investments. But as you read them, keep in mind that your first priority is a disciplined saving (and, eventually, investing) program. There is nothing that will put you on a sounder footing for success.