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# Financial Advice for the Kids

## Background

Moving from country to country as I did in my adult years meant that I had to worry about saving and investment in a lot of countries. This meant in particular I needed to figure out a way to invest money for the future. Coming from Australia the best place to “put your money” is real-estate. While a lot of money can be made that way in the US there were other places, such as the stock market, that pulled.

I set out to find out about the stock market. Below you will find the distilled set of thoughts I have as of today on how to invest in the stock market. Its based on the books below and is the information I wish I had of had when I first arrived in the US.

But there is a little more. The kids are getting to the age where they need to start assuming responsibility for their financial health. Rather than just trot out the advice to the kids any time they'd listen to us, I thought we'd try a different approach. On the kids birthday or christmas when we didn't feel like the gift list was particularly inspired, we work with the kids set up an investment account and then seeded it with a small amount of cash to allow them to “buy something.” But before they got the gift, they had to sit down and answer a set of questions to help them understand how to think about investing and what might work for them. In particular, the questions were there to help them discover why they should start an investment strategy early, like right now.

Below are the questions we gave as “homework” on the relevant birthday / event. The list is basically copies of the emails we sent to the kids. I publish this because other parents have expressed an interest in helping their kids get started in preparing for the future.

## Questions to Help You Understand Investment Basics

A few questions to help you understand impact of various investment decisions:

1. You and a friend have a bet. You will both see whether you can save \$100 month for until you get to the age of 65. On you 65 birthday you both report success and how much money you each have. Your friend reports an amount based on taking the money and putting it under a mattress every year. You've put your money into an account that earns (what seems like a tiny amount) 6% a year. What is the difference in the amounts of money you two have at the age of 65? Who has the most “free” money - money that they didn't have to put away but is still theirs.
2. On the date of your birth you were given \$100 and were told that you could invest it any way you wanted to. Being a very bright baby, you look at investments as general classes of investments (just keep the money, put money in savings account, put money in real estate, put money in stocks, put money in gold). Where is the best place to put your money? If you go back to the year

- 1900 where should you have put your money?
3. What is a quick way to figure out how long it would take to double your money given a particular rate of return? For example, how would I quickly figure out how long it would take to double my money given the rate of return is 7% per year? (Hint: answer has something to do with the number 72)
  4. You are given the choice of 2 investments. One is expected to return 10% per year, while the other returns 9.5%. Because of the better rate of return for the first investment, the manager of that investment charges a small 1.25% fee on the amount of money that he is managing. Over 40 years, which investment should you choose? What is the difference? Why?
  5. A measure of the performance of the stock market is the S&P 500 index. You can get this performance simply by investing in a index fund or exchange traded fund that tracks the performance of the S&P 500. If you did, based on history, you would get about 10% return. Professional money managers need to outperform the performance of the S&P 500 to be considered any good. Warren Buffet has managed to do this. Some questions:
    1. How much has Warren Buffet out performed the S&P 500 by?
    2. What percentage of portfolio money managers beat the performance of the S&P 500? What does this tell you about investing?
    3. Warren Buffet is about to retire and hand all his money to a foundation with a set of guidelines the investment approach. What is the approach and what does that tell you about investing?
  6. The year is 2008 and the financial markets are in turmoil with the S&P 500 going down by 38%. Wow! Its a crash. Everyone is saying "sell", "sell", "sell", you can feel the panic around you and see the results as each day the stock market goes lower. You don't need the money and won't need the money for the next 10 years or so and so don't have need to sell. But you still have a choice - do you sell now and cut your losses or just leave the money in the in the stock market. Why? If you sell it, where would you put the money?

Note: For questions 1 and 4 [this calculator site](#) might help.

## Investment Books

Here are the books that I wish I'd had when I started investing. None of these books are new but sometimes good understanding of the basics is timeless:

- [Random Walk Down Wall Street](#) by Burton G. Malkiel. Solid understanding based on statistics showing why it is unlikely that you'll beat the market. This lead me to ...
- [Common Sense Mutual Funds Imperatives](#) by John C Bogle. Bogle basically invented index fund investing and made Vanguard what it is today. If you cannot beat the market, then at least stay with it as there is a lot of money to be made, but you have to watch costs. The real question then is ...
- [Four Pillars of Investing Building](#) by William Bernstein. Talks about how to allocate your money between different types of investment in such a way that you maximize returns and minimize risk. You can then apply this to how you select you index funds.
- [The Intelligent Investor](#) by Benjamin Graham. This is the book that Warren Buffet swears by and the approach I use in my "play money" accounts. I then leverage the [Motley Fool "Hidden Gems"](#)

service to do my purchases (see below for thinking).

## My Approach

You might be wondering what approach I take in investing in stocks as a result of all of this. A lot of this section is also a response to what I know about my psychology I've put it in place to help me **NOT** do stupid things:

1. Stocks are the best place to put most of your money, especially if you have a long (> 7 year) investment horizon
2. Watch costs (in long run they will allow you to keep more and that more builds up quickly because of compounding effects)
3. Always take free money (eg max out your 401K)
4. You probably cannot beat the market, but you also do not have to as, if you work the market properly then you will end up way ahead of the average punter
5. If you want to beat the market aim at a long term approach based on purchasing companies you understand and know will probably serve you well
6. People (me included) make real strange (and in retrospect stupid) decisions. You have to set things up in your investment approach that much of it happens without conscious thought. This is a long subject and a lot of the investment books don't really cover it but this lead me to an investment approach of:
  1. Core investments in index funds
  2. Pushing the amount I save by setting up automatic transfers to investments so I don't ever see the money (regulates lifestyle to the amount of money I can spend)
  3. Set up a "Play money" fund so I can do things that are stupid if I really want it (I've found that I have to have this else otherwise I will play with my core accounts, adding risk).
  4. Understand when I need money and make sure I don't sell before I need it (this is to stop me from indulging in panic selling when the market heads in the wrong direction, for example).
  5. Don't be afraid to make a sell decision by asking yourself "would you buy this stock today?"

Good luck!

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