Chapter Three

A More Peaceful Mindset

"When you change the way you look at things,
the things you look at change."
– Max Planck, the father of quantum physics

Retirement can be so anxiety producing. I've seen it turn hardened CEOs into jelly. You've worked your whole life, had some success and built up a nest egg. Now, after 40 years of working and making money, you retire. Suddenly, the cash flow stops and the growth of your savings comes to a screeching halt. Then the withdrawals begin, and your net worth starts to slide. From this point forward, the best you can hope for is to not outlive your portfolio. Needless to say, it can be a very stressful race.

Planning for retirement can be just as dreadful. You tally up your assets, make some assumptions—none of which are likely to come true—and hope for the best. Some of the more fortunate can relax; they can invest very conservatively and meet their retirement needs without a blink.

But for most of us, retirement is a calculation of fine lines. We need to earn a certain return to make it work. Even still, there are so many

dynamics involved in retirement that calculations by even the most sophisticated financial planners amount to pure guesswork. Every plan will be wrong, in some respect.

Bob was the CEO of a multinational company. I'll never forget his reaction to the day he retired: "I felt so insecure! I know I have enough assets and I'll still earn more than a million over the next year, but I still have this feeling of insecurity. It's very strange."

Interesting isn't it: even the most secure individuals can suddenly feel terribly insecure when their career ends and they have to live off their savings. Their safety net—their income stream—is suddenly gone, and a new set of unknowns fill their future.

Investing for Retirement: The Stress Multiplies

The seemingly infinite list of unknowns combined with the imperative of success can make retirement investing a terribly stressful endeavor. And that's even before you consider all the mental anguish that goes into the investment process. Just think of all the decisions that go into investing with stocks:

- When to buy? What to buy? At what price?
- How can I construct a diversified portfolio?
- How can I track the 50 or so stocks in my portfolio?
- When do I sell? At what price?

- When I sell, how do I maintain diversification?
- How do I manage risk?
- If the market falls, should I sell? Should I buy?
- What if economic conditions change, then what?
- How can I beat the S&P 500?

The questions with bonds could go on just as long. Here are just a few:

- What are interest rates going to do?
- What length of maturities should I choose?
- What credit level should I select?
- What types of bonds should I buy?
- How do I know if I'm paying a fair price for my bonds?
- Who should I buy bonds from? My broker or a specialist?
- How many bonds are needed for adequate diversification?
- If rates change, how can I adjust my portfolio?

These are just some of the questions that can arise during the investment process. The stress is compounded today by the 24-hour news cycle. News hits our screens with amazing speed, and the impact is felt by the markets moments later. Presently, Europe is in the throes of a debt crisis, and stocks are leaping or plunging on a daily basis, or at least that's how it seems. Even bonds are volatile, especially on the corporate and international fronts. How can anyone maintain peace of mind investing in such a crazy environment?

Why Suffer So Much Anxiety?

There seems to be no end to the number of questions and considerations that go into building and maintaining an investment portfolio. Trying to generate benchmark-beating performance only raises the degree of difficulty.

The reality is that you can knock your head against the investing brick wall day and night, and still not beat the S&P 500. Relatively few investors beat the benchmarks on a consistent basis, and independent research suggests that their winning ways may actually be more a case of luck. Even if you beat the benchmark regularly in one market cycle, that doesn't mean your strategy will prosper in the next. In fact, odds are you won't. Heroes don't last long in the investment field.

Rather than suffer all of this anxiety, let's consider another approach.

- If researching stocks is challenging, maybe you can avoid those headaches and use a simpler investment vehicle.
- If developing and maintaining a diversified portfolio is difficult, maybe there's an easier way.
- If managing risk is so stressful, maybe we can develop sensible guidelines.
- If beating the S&P 500 is so unrealistic on a consistent basis, maybe we can focus on something else.

Imagine taking all of that pressure off your shoulders? Wouldn't that make investing a lot less stressful? Maybe your investing would become more productive, too.

Shift Your Mindset: Peace of Mind Investing

So many questions, so much stress—what's the point? Let's turn the tables and examine a different way of investing.

To do so, we can use a use a different investment vehicle: exchange-traded funds (ETFs). These securities are traded daily on major stock exchanges, much like common stocks. While a stock generally represents a single company, an ETF is usually based on a market index, such as the S&P 500 or the Dow Jones Industrial Average.

ETFs are well-suited for peace of mind investing because they:

- Comprise entire asset classes
- Offer broad diversification
- Have lower volatility than a single stock
- Provide transparency (you always know what you own)
- Are liquid (can be traded during exchange trading hours)

Let's take a look at how a peace of mind investor might handle that daunting array of questions posed earlier:

1. **What to buy and sell?** Rather than research 50 or so stocks, let's buy a few indexes to cover the entire stock and bond markets. No research, no guesswork. Just create a simple asset allocation with a few ETFs. Since ETFs can comprise entire asset classes, such as the US stock market, there's no need to sell. Just buy 'em and hold 'em. The individual indexes will rebalance themselves. Occasionally you may want to rebalance the portfolio among equities and bonds, but with just a few holdings, that's easy.

2. **How to manage risk?** Invest like a professional and let your asset allocation manage the risk for you. Your portfolio can be as minimalist as three ETFs: the US stock market, the international stock market, and the US bond market. If equities are terribly overvalued or economic conditions are great cause for concern, you can manage risk by decreasing your two equity holdings and increasing your bond holding. Again, easy.

3. **How to beat the market?** Don't bother, it's unrealistic. You may beat it now and then, but not on a consistent basis. Besides, should your goal really be to beat the S&P 500? How is that relevant to your life? For example: if the S&P 500 falls 30%, do you want to beat the market and still lose 28%? You reached your goal, but you wrecked your retirement. Did that make you happy?

   Rather than drive yourself crazy trying to beat the market, doesn't it make more sense to focus on achieving your own personal objectives? If you need to generate 6% growth over the next 20 years—that's your goal—it's realistic and meaningful to achieve. Forget the S&P 500; let the institutions suffer with that benchmark.

Investing doesn't have to be so anxiety-ridden. Indexing with ETFs will enable you to generate reasonable returns over the long term, provided you don't fall into traps that so often ensnare investors. These get in the way of you taking advantage of your biggest advantage as an ETF investor: the market's long-term uptrend.

Let's quickly summarize the ways in which indexed investing can reduce your stress and give you peace of mind:

- **Fear of Mistakes:** There's no need to pick stocks or mutual funds. ETFs should increase the consistency of your returns, since you're simply investing in broad market indexes. While a single company may see its returns diminish as it matures—or become obsolete, like many former stocks even in the esteemed Dow Jones Industrial Average—ETFs don't share that risk. You almost can't make a mistake: just buy the entire market with a few ETFs and watch your portfolio rise over the long term.
- **The Need to Correctly Predict the Market:** There's also no need to feverishly watch the market or the fortunes of 50 stocks or 15 mutual funds. Buy a few ETFs that give you global diversification across the stock and bond markets, rebalance your portfolio occasionally, and take advantage of market volatility by occasionally trimming risk at times of euphoria and overvaluation, or buying equities during times of panic and undervaluation. Relax and take your eyes off the market, and let the long-term trend of increasing stock prices do the work for you.
- **Market Volatility:** While most investors fear market volatility, there are times when it can actually be to your advantage. Ironically, volatility creates opportunity. More on this later.
- **Performance:** Don't worry about quarterly or even annual performance. They're irrelevant to you. All you care about is meeting your return goals over a full market cycle—both up and down.

For bonds, ETFs are an even more attractive solution. You can buy a single bond ETF and generate long-term returns that often rival the best bond managers in the world. Better yet, you don't have to worry about maturity length, credit level, diversification or any other variable. This single bond ETF is based on the index that most all bond managers use as their benchmark, and very few beat it over the long term. It's the ETF based on the Barclays Capital US Aggregate Bond Index, and it can comprise your entire fixed income portfolio. Could anything be simpler? Talk about peace of mind!