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23 lessons about money and investing

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BY JAMES GRUBER

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In his book, *The Laws of Wealth,* behavioural finance expert Daniel Crosby offers this one-page summary of the most important lessons on money:

There are good lessons here as well as some that may be best ignored. Let's go through them one-by-one:

1. The Jones' aren't as rich or happy as you think they are.

This lesson reminds me of a story by finance author Morgan Housel about his days as a hotel valet:

"In college, I worked as a valet at a fancy hotel in Los Angeles. When an expensive car drove in, I used to always think, "Wow, he's rich!" But as I got to know these "rich" people, I saw a different side. A few opened up about their finances (people love talking to valets), and I couldn't believe their stories. Some of them weren't that successful. Certainly not like I imagined. Instead, they made modest incomes and spent most of it on a car. It's amazing how fast you can go from admiring someone to feeling bad for them.

I learned something from that. When you meet someone who owns a $100,000 car, you only know one thing about their wealth: That they have $100,000 less in the bank, or $100,000 more in debt, than they did before they bought the car. That's the only information you have.

We rarely think of it that way. So much of our perception of wealth is driven by what we see other people buying. Since we can't see their bank accounts, that's all we have to go on. But it gives us a distorted view of wealth. Some people we think are wealthy really aren't; they just spend most of their income. Others we think of as less well-off are actually the rich ones. They're rich not despite driving the old car, but because of it. **Financial wealth isn't what you see. It's what you don't see."**

Comparing yourself to others creates envy. And envy is a shortcut to despair. As Warren Buffett's business partner, Charlie Munger, says: "Envy is a really stupid sin because it's the only one you could never possibly have any fun at. There's a lot of pain and no fun. Why would you want to get on that trolley?"

Maybe that's why the Stoic philosopher Seneca described a wise man as "Content with his lot, whatever it be, without wishing for what he has not …"

SOME THINGS I'VE LEARNED ABOUT MONEY

THE JONESES AREN'T AS RICH OR HAPPY AS YOU THINK THEY ARE

THE MORE COMPLICATED THE INVESTMENT ADVICE THE LESS USEFUL IT IS

GET RICH QUICK AND GET POOR QUICK ARE 2 SIDES OF THE SAME COIN

TIME IS A SCARCER RESOURCE THAN MONEY

ASK ABOUT ANYTHING YOU DON'T UNDERSTAND

A HOUSE IS A PLACE TO LIVE, NOT AN INVESTMENT

ADMIRE PEOPLE WHO EARN MORE MONEY THAN YOU, NOT PEOPLE WHO SPEND MORE MONEY THAN YOU

YOUR MORTGAGE BROKER IS LYING TO YOU ABOUT HOW MUCH HOUSE YOU CAN AFFORD

YOU DON'T NEED TO BE A MATH WHIZ TO MAKE GOOD MONEY DECISIONS; FINANCIAL SUCCESS IS 5% INTELLIGENCE AND 95% DISCIPLINE

A RAISE IN INCOME SHOULDN'T MEAN A RAISE IN LIFESTYLE

FORECASTING IS FOR THE WEATHER

NEVER REACH FOR YIELD

FEES ERODE PERFORMANCE

THERE IS AN INVERSE RELATIONSHIP BETWEEN INVESTMENT PERFORMANCE AND TIME SPENT WATCHING FINANCIAL NEWS

DON'T PAY INTEREST TO ACQUIRE SOMETHING THAT LOSES VALUE

YOUR LIFE IS A BETTER BENCHMARK THAN THE S&P 500

YOU DON'T HAVE TO BE RICH TO INVEST, BUT YOU HAVE TO INVEST TO BE RICH

COMPOUND INTEREST IS THE EIGHTH WONDER OF THE WORLD. SET YOURSELF UP TO BENEFIT FROM IT RATHER THAN BATTLE AGAINST IT

A PENNY SAVED IS MORE THAN A PENNY EARNED

INVEST IN YOUR MIND AND YOUR SKILLS FIRST

INFREQUENT SPLURGES BRING THE GREATEST HAPPINESS

IF YOU'RE EXCITED ABOUT AN INVEST-MENT, IT'S PROBABLY A BAD IDEA

MARKET CORRECTIONS COME MORE REGULARLY THAN BIRTHDAYS - EXPECT THEM

2. The more complicated the investment advice, the less useful it is.

Complex financial advice often comes with more risk or more fees going to an adviser. Simple advice and strategies are less profitable for advisers yet can be the best options for individual investors to follow.

3. Get rich quick and get poor quick are two sides of the same coin.

Making a fast buck will inevitably involve taking large risks. Put another way, the greater the returns on offer, the greater the risks.

When you hear of a hedge fund making 600% in a year, or a friend who punted big on a small cap and made a lot of money, it likely means they took on large risks, perhaps with leverage. And it could have easily turned out poorly for them.

4. Time is a scarcer resource than money.

This is a lesson that gets repeated by financial authors who write more about self-help than investments (how did self-help infiltrate finance?), but it's one I disagree with. Time isn't a scarce resource, it's just that we're experts at wasting it.

I can think of many examples where the lesson doesn't match with reality. For instance, I speak to my retired parents and their friends, and they have all the time in the world to fritter away. Yet I'm sure they'd all love more money, no matter what their circumstances.

5. Ask about anything you don't understand.

A 'hard agree' on this one. There's no such thing as a dumb question.

6. A house is a place to live, not an investment.

You can tell this is an American author, not an Australian one! In Australia, it might read: "Every Australian has the right to have a house as an investment."

More seriously, it's amazing how this simple lesson has been ignored over the past 30 years.

7. Admire people who earn more money than you, not people who spend more money than you.

Not sure I agree with this one. Why admire people who earn more money than you? It seems to me that there are far more admirable human traits than earning more money. Wisdom, kindness, compassion, happiness, leadership, intellect, creativity, to name a few.

8. Your mortgage broker is lying to you about how much house you can afford.

This shouldn't be a lesson though it aligns with Warren

> **If you want to get really wealthy from investing, you will need to be a maths whiz. Warren Buffett, Jim Simons, George Soros – all are maths geniuses. For the rest of us though, discipline is key.**

Buffett's famous saying that you shouldn't ask a hairdresser if you need a haircut.

9. You don't need to be a maths whiz to make good money decisions: finance success is 5% intelligence and 95% discipline.

If you want to get really wealthy from investing, you will need to be a maths whiz. Warren Buffett, Jim Simons, George Soros – all are maths geniuses. For the rest of us though, discipline is key.

10. A raise in income shouldn't mean a raise in lifestyle.

This is a good one. British entrepreneur James Caan once said that upon selling his company, he was advised to hold off spending any of the proceeds for 12 months. It was a cooling-off period before he decided on how to spend the money.

A cooling-off period is a good idea for anyone getting a raise or a bonus or any other windfall.

11. Forecasting is for the weather.

Mostly true, though not totally true. Wharton Professor Philip Tetlock suggests there are 'super forecasters' out there yet they're rare, niche experts who focus on forecasts of less than 12 months. Any forecasts beyond 12 months are largely worthless, he says.

If you aren't a rare, niche expert, the lesson is worth following.

12. Never reach for yield.

Yes! It's critical to remember that dividends rely on earnings. Dividends can't continually grow if earnings don't. And earnings growth depends on the quality of the company. That's why Morningstar advocates buying stocks with 'moats', or sustainable competitive advantages.

13. Fees erode performance.

Wherever John Bogle is, he'll be nodding. Bogle founded Vanguard on the premise that low-cost index funds would outperform most investment funds, largely because of the latter's fees. The premise has revolutionized the investment industry over the past 40 years.

14. There is an inverse relationship between investment performance and time spent watching financial news.

This is cute, though not entirely accurate. I think the point it's trying to make is that if you spend all day watching Bloomberg news, you'll be more inclined to trade stocks, and the constant trading of stocks will lead to subpar investment performance.

The flip side is that being better informed about finance issues is a good thing. Watching and reading about investments can make you a better investor.

As with life, being selective about what you consume is important too.

15. Don't pay interest to acquire something that loses value.

Crosby likely had cars in mind and it's a good rule.

16. You don't have to be rich to invest, but you have to invest to be rich.

This reminds me of a quote from Robert Allen: "How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case."

17. Invest in your mind and your skills first.

Investing your money and time in other things such as your health as well as your family and friends are also important.

18. Infrequent splurges bring the greatest happiness.

I'm not sure what science says about this, though it rings true in my life.

19. Your life is a better benchmark than the S&P 500.

Or the ASX 200. Money is just one component to living a good life and should never become your whole life.

> **Warren Buffett started his investment firm, the Buffett Partnerships, in his 20s, and had a net worth of US$1 million (US$9 million in today's money) by the time he was 30. Since that time, till now at the ripe age of 92, Buffett has compounded his money at 22% annually to be the world's sixth richest person, worth around US$113 billion.**

20. Compound interest is the eighth wonder of the world, set yourself up to benefit from it rather than battle against it.

Warren Buffett started his investment firm, the Buffett Partnerships, in his 20s, and had a net worth of US$1 million (US$9 million in today's money) by the time he was 30. Since that time, till now at the ripe age of 92, Buffett has compounded his money at 22% annually to be the world's sixth richest person, worth around US$113 billion.

Yet his net worth could've end up very differently if he'd started his investing career later and retired earlier. If he'd saved US$25,000 by the time that he was 30 and retired at the age of 60, yet still compounded his money at same rate of 22% p.a., then Buffett today would be worth closer to US$12 million or just 1/10,000th of his current fortune.

That's the power of compounding, and it's a lesson that should be drilled into children and adults alike.

21. A penny saved is a penny earned.

Thomas Stanley writes of seven common traits among those who've accumulated wealth in his best-selling book, The Millionaire Next Door. One of the key traits is frugality -the wealthy live well below their means and save more than they earn: "They became millionaires by budgeting and controlling expenses, and they maintain their affluent status the same way."

22. If you're excited about an investment, it's probably a bad idea.

Recently, my brother-in-law contacted me and suggested that electric vehicles were the future and key suppliers such as lithium miners would make good investments. My response was that a lot of investors were thinking along similar lines, and that means it's probably a bad idea.

23. Market corrections come more regularly than birthdays – expect them.

If you define a market correction as a market decline of 20%, then this lesson is false. However, the point is valid. Markets go up and they go down, and you need to be able to handle both with equanimity.

James Gruber is an Assistant Editor for Firstlinks and Morningstar.com.au.

Firstlinks (formerly Cuffelinks) is a publishing service providing content written by financial market professionals with experience in wealth management, superannuation, banking, academia and financial advice.

What investors need to know about the surge in interest rate volatility

EXECUTIVE SUMMARY:

- Interest-rate volatility on shorter-duration assets is running near historical highs, even as rate changes begin to level off.
- Interest-rate volatility typically coincides with strong fixed income returns. However, elevated volatility can be a signal that rougher times are ahead for the Treasury market and passive investments.
- We believe the current environment offers several exciting opportunities for active fixed income managers.

BY EMILY STEINBARTH, BIN WANG

Republished from russellinvestments.com

Since interest rates started rising in 2021, investors have closely followed changes in interest rates: Taking bets on what will be announced at an upcoming Fed meeting or expressing shock at the latest mortgage rate are common discussion topics today versus three years ago, but are interest rates more volatile? And as rate changes start to level off, is volatility leveling off too?

What's the difference and why should it matter to investors?

Interest rate volatility refers to the degree of fluctuation in interest rates over time, while changes in interest rates refer to the actual movements in interest rates. We leverage two standard measures of interest rate volatility: 1) the MOVE Index, a market-implied measure of Treasury bond volatility, and 2) standard deviations of Treasury futures contracts of different maturities. Decomposing the overall MOVE Index into components such as 2-year, 5-year, 10-year, or 30-year allows us to look at what part of the curve is the most volatile. What's interesting for investors is that interest rate volatility can be high even if the changes in interest rates are relatively small, and vice versa. Currently, we are experiencing a period where changes and volatility are decoupling: the rate of change is slowing but volatility continues to rise.

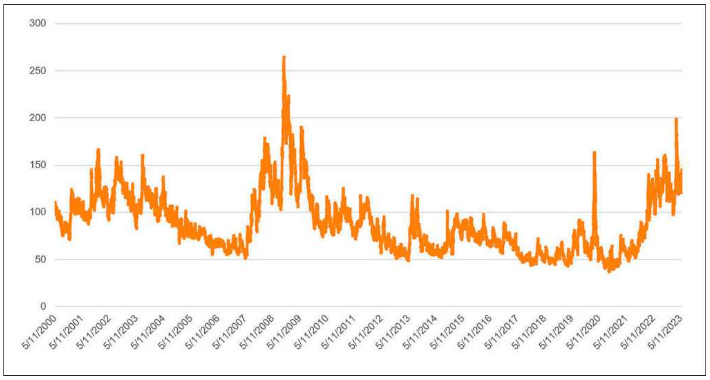
What does that mean for investors? At the most basic level, volatility matters to investors because it increases risk and the chance of loss, especially for investors who need to sell bonds before maturity. Interest rate volatility impacts different bonds differently, and investors can benefit from being aware of these differences. But it's not all bad news. As active investors, this type of environment also presents more opportunities. From our vantage point, this backdrop underscores the importance of partnering with a skilled OCIO provider who has extensive experience in risk management, including the ability to identify and exploit both risks and opportunities.

How does today's rate volatility stack up against past levels?

Let's start by examining how current interest rate volatility compares to historical levels before we turn to how it can impact portfolio performance.

In a nutshell: current volatility levels are historic. The MOVE Index, a frequently cited measure of interest rate volatility, is a yield-curve weighted index of volatility on Treasury options. Volatility has been on a steady rise since mid-2021, and while it has come off its March 2023 highs slightly, it remains historically elevated.

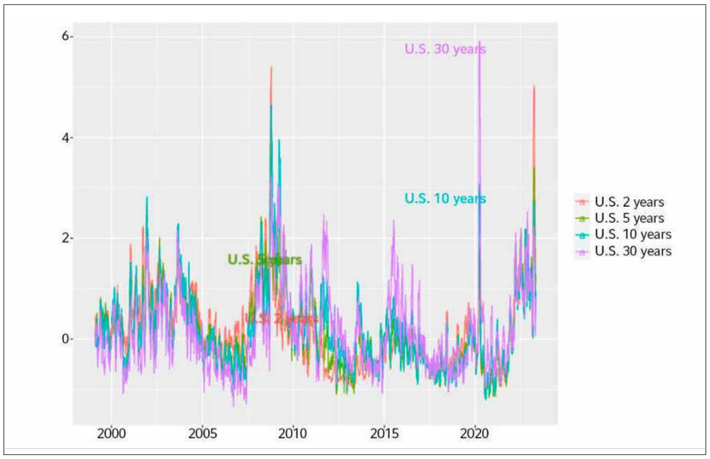
Figure 1: The MOVE Index



Source: Bloomberg

Because it is a weighted average of different tenures, the MOVE Index does not allow us to see how volatility varies across the curve, so next we'll break down the Treasury market by maturity. Here we find that subcomponent volatilities are at all-time highs (2 and 5 year) or close to it (10 and 30 year), comparable only to 2008. Longer maturity bonds consistently will have higher volatility, so to make an apples-to-apples comparison we standardize[1] volatility of each maturity to compare it to its own historical levels.

Figure 2: Treasury Futures Standardized Volatility, by Maturity



This higher frequency data reinforces what an exceptional period we are experiencing in 2023: as of the end of March, two-year volatility is at a near-historic high, having increased sharply in 2023. The current level is more than five times its inter-quartile range above the median, which has only happened once before—in 2008, during the height of the global financial crisis (GFC).

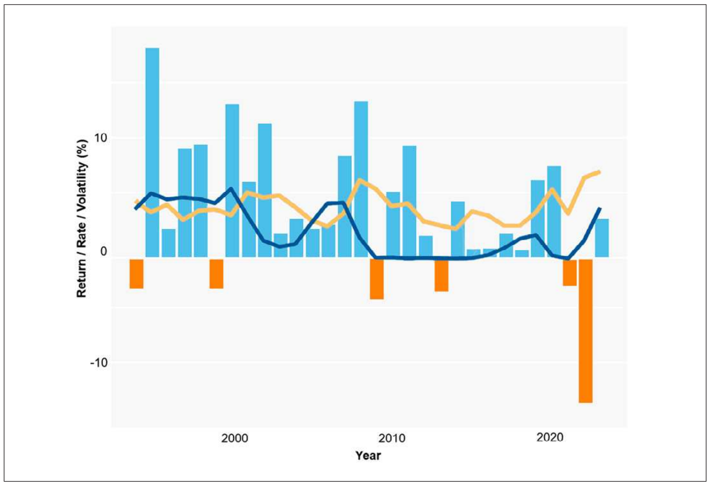
This volatility is largely centered on shorter-duration assets, which is also notable. Case-in-point: The 30-year Treasury note experienced much higher volatility during the COVID-19 crisis than today, and while the current 30-year volatility is at the higher end of its typical range, it's been relatively consistent over the last 12 months. 2-year volatility, on the other hand, has increased precipitously this year—even as rate changes have leveled off.

How does heightened rate volatility typically impact bond performance?

So, we are clearly experiencing a period of elevated interest rate volatility—especially on the shorter end of the curve—but what does this mean for investors? How does this impact bond performance? The short answer is that volatility has not historically been bad for bond performance—at least not immediately. However, it can portend difficult times ahead.

Going back to basics, below we consider annualized Treasury returns (blue/red bars) versus interest rate levels (green line) and interest rate volatility (green line). Here, we'll abstract from a discussion of different tenured bonds to look at the basic historical relationship. Broadly speaking, periods of high interest rate volatility (red line) are often good years for bond performance (bar). 2008 and 2020 are examples of this pattern: peaks in volatility coincided with exceptionally good years, compared to recent history. Importantly, however, both these periods were followed by negative performance. So, while volatility isn't necessarily a reason to run for the exits, it is a good time to pay attention to what you're invested in and question if you are ready for the rough ride ahead.

Figure 3: Bloomberg U.S. Treasury Index Annual Return (bar) and Volatility (yellow line) vs. Fed Funds Rate (dark blue line)



> **All this volatility is associated with new risks. But for active investors, it also presents new opportunities. In a low-rate and low-volatility environment, a straightforward playbook has performed well: exposure to duration (long-dated assets) and credit (higher yield).**

Let's recap:

1. Interest rate volatility levels are historic
2. Volatility is most extreme for the short end of the curve (relative to historic levels). This contrasts with what we observed during the COVID-19 crisis and instead is more similar to the time period immediately before the GFC.
3. Volatility typically *coincides* with strong fixed income returns, but it can portend periods of poor performance ahead, at least for the Treasury market and passive investments like we've investigated here.

What does this mean for investors?

All this volatility is associated with new risks. But for active investors, it also presents new opportunities. In a low-rate and low-volatility environment, a straightforward playbook has performed well: exposure to duration (long-dated assets) and credit (higher yield). Today, we are experiencing inverting and twisting yield curves, with historically large and fast moves. This means the bets that have worked for the last ten years are in jeopardy.

But it also presents a much wider range of ways to express active views. Taking a step back from interest rate volatility, this is a consistent theme right now for fixed income investors. The yield curve has been inverted for some time, a classic harbinger of difficult times ahead. This is also an environment where differentiating between which high yield issuer will survive versus who will default—i.e., being active and not passive—becomes critical.

We won't sugarcoat it: uncertainty about where we are going from here is high. The latest spikes in volatility caused by the recently resolved debt ceiling impasse mean there has been little let-up. However, what is clear to us is that this will be an exciting time for fixed income active management. Amid this backdrop, we're digging in with our active subadvisors and clients to get the most out of the opportunities this market presents.

[1] Current observation minus its mean divided by its interquartile range.

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4 emotions that can affect your investment decisions

BY ELE DE VERE

Republished from sharecafe.com.au

How emotions can affect your investment decisions

Have you ever become emotional about money? Even the most rational investors sometimes experience feelings of anxiety or euphoria when their money is involved. Why? Because we are human.

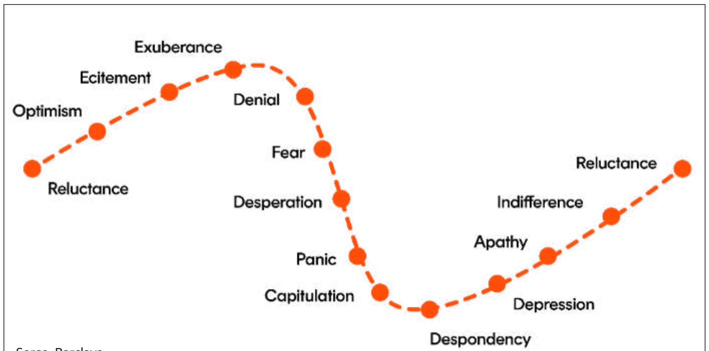
Understanding emotions, and how we project different emotional biases, can help us better understand our decision-making processes, so we can act more rationally, hopefully leading to better investment outcomes.

Role of emotions in investing

One way of better understanding how emotions affect investor behaviour is to look at the chart below - commonly known as the cycle of market emotions. It suggests that typically our emotions work against us when investing.

In a rising market, our optimism, and the excitement of rising values, can lead us to think that we will continue, or start, making gains easily. Fuelled by feelings of hope and greed, we may increase our level of risk just when prices have already risen significantly, investing more at precisely the time we should be cautious.

Conversely, when markets are falling, we may be presented with strong buying opportunities. However, anxiety, fear and panic can prevent us from investing, and in some cases



Sorce: Barclays

are enough to drive us to exit the markets - at precisely the wrong point in time, when prices are at lows.

There are fascinating examples of this cycle, repeated over many decades, from the 2008 Global Financial Crisis all the way back to the Dutch tulip bulb market bubble in the 1630s, also known as 'tulip mania', one of the most famous market bubbles and crashes of all time.

By understanding this cycle of market emotions, we may be able to better take advantage of investment opportunities while potentially mitigating risks.

Behavioural biases to watch out for

As well as this simplified cycle of emotions, there are biases that can affect our decision-making processes in both strong and weak markets. It's important to be conscious of

> While almost everyone is susceptible to the influence of emotional factors, it is important to raise these influences from the unconscious to the conscious. Educate yourself on the biases that investors are commonly prone to and ask yourself whether your decisions are being influenced by them.

how your emotions may be playing into behaviours when buying, selling, or reviewing your investments.

1. Anchoring bias

Faced with making a decision, we often use an 'anchor' or focal point as a reference to guide our choices. Psychologists have found that we tend to lean heavily on the first piece of information we learn (the 'anchor'), regardless of how accurate that information is.

If you catch yourself relying on your anchor too much, step back and consider all the available information before making your decision.

2. Overconfidence bias

Confidence is generally to be valued as a human trait, but when it veers into overconfidence, the result can be the 'overconfidence bias', whereby we overestimate our abilities and underestimate our weaknesses.

Applying this to investing, overconfidence bias can lead people to overestimate their understanding of financial markets or specific investments and disregard hard data and expert advice.

For example, overconfidence bias can trick the brain into believing it's possible to consistently beat the market by making risky bets. This bias can be countered in several ways, such as making room for other people's perspectives.

3. Confirmation bias

Confirmation bias favours information that confirms our current beliefs or thinking. This is when we actively seek, favour, and remember information supporting our views, while discounting anything opposing.

Social media is an example of how confirmation biases are perpetuated, given that its algorithms learn what we like over time and serve us more and more of this same content. The result is that many people end up living in 'echo chambers', having their own views continually fed back to them.

In investing, confirmation bias may lead investors to focus only on information that reinforces their opinions about an investment. Selectively choosing which information to use can lead to a lack of diversification and investments that are not researched or that carry higher risk.

A recent example of the disastrous effects of confirmation bias is the infamous blood-testing startup Theranos, run by the now-convicted Elizabeth Holmes. Among prominent investors in the company was George Shultz, the former Secretary of State. Shultz was not only an investor, he was also a close friend of the Holmes family.

As a result, when Shultz's grandson Tyler presented him with fact-based evidence that Theranos was a scam, Shultz refused to believe it. Tyler presented him with information that was contradictory to his pre-existing beliefs, yet ultimately turned out to be correct.

4. Regret-aversion bias

The emotional process behind the regret aversion bias is simple. Regret causes us emotional pain. In order to avoid this pain, we do nothing out of excessive fear that we may regret our actions. Or alternatively, we make a less-than-optimal decision, for example, buying into a 'hot' stock to avoid the potential regret of 'missing out'.

In holding off a decision or making a decision that we think has a lower potential to lead to a regrettable outcome, we can alter our investment risk profile, making us more risk-averse or risk-seeking than appropriate, which can result in lower returns over time.

Don't be driven by emotion

While almost everyone is susceptible to the influence of emotional factors, it is important to raise these influences from the unconscious to the conscious. Educate yourself on the biases that investors are commonly prone to and ask yourself whether your decisions are being influenced by them. By doing this, you give yourself the best chance of making rational investment decisions based on facts and logic rather than driven by emotions.

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Q&A: Ask a Question

Question 1

What is the difference between growth and value stocks?

Growth stocks and value stocks are two different investment styles that reflect the characteristics of the companies in which investors are choosing to invest. The choice between growth and value stocks depends on a variety of factors being the investor's individual investment goals, risk tolerance and market perception.

Growth stocks can offer the potential for significant capital gains but come with higher volatility and valuation risks. Value stocks, on the other hand, may be seen as potential bargains with lower valuations, but their recovery and upside potential may take longer. Diversification across different investment styles and sectors is often recommended to mitigate risk and capture opportunities in different market conditions.

We recommend you speak with your financial adviser to discuss which style suits your situation.

Question 2

What is the 50% CGT discount and how does it work?

The 50% CGT (Capital Gains Tax) discount is a tax concession available in Australia that allows individuals and some trusts to reduce the amount of tax they pay on capital gains.

Here's how the 50% CGT discount works:

1. Eligibility: To be eligible for the discount, you must be an individual taxpayer or a trust. Companies are not eligible for the 50% CGT discount.
2. Holding period: The asset must have been owned for at least 12 months before the CGT event occurs. The 12-month period is counted from the date of acquisition to the date of disposal.
3. Calculation: When you sell an asset and make a capital gain, you can apply the 50% discount to the capital gain amount. This means that only 50% of the capital gain is included in your assessable income for tax purposes.

It's important to note that the 50% CGT discount does not apply to all assets. Some assets, such as collectibles and personal use assets, do not qualify for the discount.

We recommend you speak with your financial adviser before selling your assets to understand the CGT implications.

Question 3

What are the tax advantaged to investment bonds?

Investment bonds offer several tax advantages. Here are the key tax benefits associated with investment bonds:

1. Tax-deferred growth: One of the primary tax advantages of investment bonds is the ability to defer tax on the investment earnings. The earnings within the bond, including interest, dividends, and capital gains, are taxed at the bond provider's corporate tax rate (currently 30%) rather than your marginal tax rate. This allows your investment to grow without incurring annual personal tax liabilities.
2. 10-year rule for tax-free withdrawals: If you hold the investment bond for at least ten years, any withdrawals made after that period are tax-free. This is known as the 10-year rule. Withdrawals made before the ten-year mark may still be subject to tax, but the tax liability is reduced by a 30% tax offset if you have held the bond for at least ten years.
3. Contribution flexibility: Investment bonds offer contribution flexibility, allowing you to invest additional funds at any time. There are no annual contribution limits, unlike some other investment vehicles. However, there is a limit on the amount you can contribute to the bond without incurring the excess contributions tax, which is currently 125% of the previous year's contributions.

As with any investment decision, consult with your financial adviser to assess your specific financial situation and goals.

If you have a question that you would like to see answered in **Wealth Adviser**, please send it through to **centraladvice@wtfglimited.com**.

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