Principle 1: Develop a workable plan

[Applause]

Jim Dahle: This is my third Bogleheads conference. I've been coming every few years for since--I don't know--2008 or something and this one's going to be spectacular.I'm pretty excited about it. Bogleheads University has a fantastic faculty lined up. As you can see I am the least of them and that's why I am the host.

Let's get into it a little bit. First a few disclosures. Okay all these faculty members, they work for or they own successful businesses. They are published authors. If you buy their books they make money. We're not going to tell you what any of these businesses are. We're going to work very hard not to have any conflicts of interest in our presentations today.

All right, Rick says I have to tell you about boglecenter.net, which is an awesome place. Many of you have been coming to the Bogleheads forum for a long time and may not have known about this fantastic resource. But the boglecenter.net should be your front page for all things boglehead. You can see there's all kinds of things there, including a way to donate to boglecenter.net and I'm going to bribe you into making a donation when they do the book signing tomorrow.

I have a few copies of my book that I was able to stuff into my carry-on that I will give you if you make any sort of donation to boglecenter.net, but you have to donate more than $257 because apparently that's what it costs to process a donation. So you've got to donate more than that.

But boglecenter.net is the hub, right? Bogleheads has a podcast; it has both virtual and live events like this one. There's the Forum that most of you probably already know about. The wiki is a fantastic resource when you're just trying to look something up. The problem with looking stuff up on the Forum is something that was there yesterday is already at the bottom of the page. The wiki is not like that and it tends to be more peer-reviewed and more up to date. And also we'll give you that information that you're looking for in a more digestible format.

There's also a Bogleheads blog. If you're on Reddit there's a Boglehead subreddit. There's a YouTube channel and of course there are Twitter and Facebook social media outlets. And all that is accessible from boglecenter.net so be sure to check that out.

All right, here's what we're going to do today. We're running this operation with military precision. We started right at one o'clock. We're going to end right at four o'clock because they've got to turn this room for the reception, so all these chairs have to be hauled out. They've got to bring in the reception stuff so we all have to leave at four o'clock. That means we have to be done at four o'clock. So all the speakers have been whipped into line so they're going to follow this schedule more or less, and then we're going to make up the slack with the Q&A at the end.

But this is the plan. We're going to talk about developing a workable plan. That's my part. Then we get Christine Benz to teach us about investing early and often. And then Alan Roth is going to teach us about risk. Christine's going to come back and talk about diversification. Then we're going to take a break. It's a 10 minute break--no kidding 10 minutes after we start you've got to be back in your seat.

We're going to be talking, then we're going to Rick Ferri..Show comes on, right. He's going to talk about not timing the market and he's going to talk about using index funds. Then we're going to go back to Alan who's going to talk about keeping your costs low. And then the treats you've been waiting for all day is going to come on with Mike Piper talking about minimizing taxes--and that is such good stuff we're going to give you a break right in the middle of it--another 10 minute break.

And then he's going to come back and talk about investing with simplicity. I'll finish up with a short bit about "stay the course" in case you didn't get the hint from the book you were handed when you registered. And then we're going to do a Q&A with the five of us.

Okay, all right let's get started with my part here and talk about developing a workable plan. And this, in my opinion, is one of the most important things in personal finance and investing. But since no one's here to do an introduction of me, those who don't know me, I'll tell you a little bit about myself. The picture is what I'd like to do. The rest is why I get to stand up here and talk to you. I'm an emergency physician by education and training. I have zero financial training, at least formally as it goes, but I've been at Bogleheads since 2004.

I had a net worth of zero in 2004 and I've been with the Bogleheads all the way from there until financial independence a few years ago. At one point--- I'm now the 25th most prolific poster on the Forum--- at one point I was the eighth most prolific poster on the Forum. And my wife turned to me and said you're spending way too much time online talking about investing to not be making any money doing it.

And so I took the Boglehead philosophy to my peers, to my profession, with a successful online business. It wasn't successful initially but it was eventually. I've authored four books on personal finance and investing, in asset protection, multiple book chapters including one in *The Bogleheads Guide to Retirement*. I've created the most widely read physician specific investing website in the world, and popular podcasts, and have also created a conference.

Now this is the fun part about the faculty. They've all been keynote speakers at my conference. I paid them thousands of dollars to come and speak to the people that come to my conference and they've come here voluntarily for free to speak to you. They are really a star-studded faculty that we have. Except me, you're stuck with me.

All right, so let's talk about a workable plan. Okay, single most important piece of advice that I can give to you is to have a plan. If you fail to plan you plan to fail. And I want you to write the plan down. The reason why is that when you write a plan down it forces you to actually make the plan, right. We all think we have a plan in our head but what it is is some half-baked notion of what we're going to do. And when you actually write it down it exposes the gaps in your thinking, the gaps in your plan.

Until you realize that's a problem. I don't know what that is and you go do more research, or you get some help, and you can fill those gaps in the plan. So you need a written plan. The other benefit of a written plan is that you can go back to it and remind yourself of why you're doing things the way you're doing them. Or how you decided you were going to do them.

And so it's really important to write it down and I've been harping on this now with my audience for the last 12 years and so I was really depressed to do a survey last year and find out that half of them still didn't have a written financial plan. And so I want you to get a written financial plan.

Okay, if you need professional help to do that get the professional help. A few thousand dollars to have someone help you make a financial plan may be the best money you ever spent. It is a fantastic investment and way cheaper than paying them for investment management.

Okay, so what's in a financial plan? Well there's a lot more to it than just an investment policy statement. It's not just about investments, right? You should have a plan about how you're going to get rid of your student loans or other debts, and how you're going to reduce them. What you're going to do for your insurance, we're talking about disability insurance and life insurance and property insurance and that kind of stuff.

All right, a housing plan. Where you're going to live. How you're going to pay for it. Spending plan, aka a budget, right. Then of course you’ve got to have an investing plan. And then eventually you're going to need some sort of an estate plan and probably an asset protection plan as well.

So all that goes into your written plan. I'm going to focus mostly today on just the investing portion but all of that should be part of your plan. And this document is not something you write down once and file away and never look at again. This is a living, changing, working document.

So let's zero in on it. There are five pieces to an investing plan. Okay the first one---and the problem is one of these pieces is sexy and the other four are not--okay the sexy one is number four, choosing the investments, right. Everybody likes that. Everybody likes talking about the investments. But the truth is that's a very difficult thing to do if you haven't done the three steps above it. If you have done the three steps above it, it's really simple. And so it's important that you do them in order.

Set your goals; choose what accounts you're going to invest in for each goal; determine an asset allocation for each of your goals; select the investments to fulfill that asset allocation and then determine whatever rules you're going to use for changes and maintenance to the plan. Those are the five pieces.

Okay, so let's talk about setting goals, right. You’ve got to set your goals. Just set up, it's okay if they change. This is what keeps us from setting them because we're afraid they're going to change, or I'm going to want something different. Just set a goal. So what if it changes in three months. You can adjust the plan for that. But the goals need to be smart goals, specific measurable,attainable, relevant to you and time limited.

Okay, here's some examples and these come from my original plan that we wrote In 2004. Our investments will provide an income of a hundred thousand dollars per year, and two thousand six dollars while still growing at the inflation rate providing us financial independence by June 28, 2030. That's a smart goal. Get rich, not a smart goal. Be a millionaire, not a smart goal.

That's a smart goal. Okay, so some goals may have to do with your net worth; some with your income; some with your savings rate. Okay, here's another example. We'll be worth

1 million by June 28, 2017. Or this one, we'll have the equivalent of four years of in-state tuition at BYU-- that's my alma mater--in each 529 plan by the time each child turns 18, right. These are smart goals. That's what you want to set.You might be wondering the relevance of June 28th- it's my birthday.

All right it's also important that one great benefit of these goals is it allows you to define "enough" so that you recognize it when you get there. Because there are far too many people in our society that don't know how much enough is.

All right, next you've got to choose what accounts you're going to invest in. So you choose an investing account for each goal. So retirement's the obvious one, it's the big one, as Jonathan Clements says it's basically the whole point of your financial life, is saving up enough money to pay for retirement. You tend to do that in accounts like 401-k's and 403-b's, 457-b's, IRAs and Roth IRAs. To find benefit plans if you work for the federal government, the Thrift Savings Plan. And of course you can save as much as you want in a taxable account.

For education we have 529s--are probably used most commonly- but you can also save up for them with Coverdell's, Uniform Transfer To Minor transfer to minors accounts and a taxable account.

Health care expenses health savings account. Any big purchases or your emergency fund tends to be in a taxable account but it's important to find what accounts you're going to invest in for these goals before you get started. Recognizing that it will change as you change employers, as account contribution limits change these ratios of how much you have in tax protected accounts like tax deferred and tax-free accounts as well as taxable accounts-- is likely to change over the years.

There was a time when I didn't have a taxable account at all. Now it's my largest account and that often happens to people. Tax diversification means having some money in tax-free accounts, some money in tax deferred accounts, and some money in taxable accounts.That's a good thing but in general you don't want to seek after that if it means paying a whole lot extra in taxes to have it. So try to get some tax diversification but try to get it at a good price.

All right, I'm a big fan of a top-down approach to investing. To have an overall asset allocation or division of how you're going to invest your assets, and then selecting Investments to fulfill that plan. So it turns out that your asset allocation is the most important determinant of your investment return. The mix of assets, the mix of

Investments that you invest in is going to cover something like 80 percent of your investing return. It's going to come from that asset allocation. So it's really important. It's probably not the most important thing that actually determines you reaching your goal. That probably has more to do with your savings quite honestly, but it matters for your investment return.And the further you get into your investment career the more your investment return affects you reaching your goals.

You want to make sure you're taking on enough risk to beat inflation long term and to meet your goals. Alan's going to be talking in a little while about a little more in depth about risk. But you don't want to take on more risk than you can handle. I like to think of it like The Price is Right-- you've seen the game show, right---you've got a bid and try to guess the price of whatever they have up there on stage and you want to get as close as you can without going over. And that's kind of like risk tolerance with investing. You want to take on about as much risk as you can handle, but not too much that you panic and end up selling low in a nasty bear market.

I generally recommend people include at least three asset classes in their asset allocation. I think you can get a lot of benefits by going up to as many as seven asset classes. Maybe there's some benefit as you push that up to eight, nine, ten. Beyond ten you're just playing with your money. That is just complexity without additional benefit. So if you look at your portfolio and you've got 16 different asset classes, simplification is probably in order and Mike Piper is going to be talking about that today.

Avoid analysis paralysis. This happens to a lot of people. They realize there are a million different ways you can set up an asset allocation and they can't move, they can't get started because they can't decide. Well the truth is there is no perfect asset allocation. Nobody knows in advance what the best one is. So just pick something reasonable and stick with it for the long run. And that's the most important thing, is that you stick with what you've chosen rather than what exactly you've chosen. Because each of those asset classes you included in your mix of investments is going to have its day in the sun.

It's okay to make adjustments to your plan but what usually happens when we're making an adjustment is you do what I did in 2007 when I added REITs to my portfolio--subsequently watch them drop 78 percent in value over the course of the next year. Now they've done fine in the long run because I've kept them in my portfolio ever since and my long-term returns are something like 11% or 12% or something on that asset class. But that first year it wasn't very good And truthfully I was probably performance chasing. And that's what happens a lot when you're adding new asset classes to your portfolio. So be aware of that.

You should also spend some time on asset location. Asset location is what assets go in which account. I'm not going to get into the details of that, but the idea is that you can add a little bit of extra return there by managing the taxes well.

All right, the fourth step is to choose your Investments. You just want to choose investments to fulfill your asset allocation based on the availability in those accounts. It can be really easy, like 25% of my portfolio is in U.S stocks, it all goes in one fund, VTI or VTSAX, the Vanguard Total Stock Market Index Fund. It's my favorite mutual fund and that's literally 25% of my portfolio. Super simple, right.

Other things might be more complicated, though, like I have an asset class for inflation indexed bonds. Some of that money is in a TIPs ETF, some of it is in individual TIPs bought at treasury direct. Some of it is in I-bonds. A little more complexity there. And if you get into some more exotic asset classes such as direct real estate investing, or private equity, or crypto assets, it can get really complicated.

Okay, so in general, as Rick will tell you later today, favor broadly diversified low-cost index funds. You can just pick one fund per asset class. That works five asset classes in your portfolio you’ve got five funds. Super simple. You can even consider a simple fund-of-funds if you're only investing in retirement accounts and you have a good fund-of-funds available in every account. We'll have one of our speakers that will teach you about simplicity who does just that.

Lastly, set up some rules. Things change. For example, when are you going to rebalance, how are you going to rebalance, right. So you need a rebalancing policy in there. How are your investments going to be selected, what's the criteria for adding or subtracting asset classes from the portfolio. How will your asset allocation change over time? A lot of people like to get less aggressive as they approach retirement. How's that going to change? You should put that in your written investing plan.

What are you going to do in a bear market? How are things going to change in a bear market, if at all. Put that in your asset allocation plan, and of course one thing that we like to have is we have a waiting period to keep us from doing anything stupid on a whim. We have to wait three months before we can make any changes. So that keeps us from hopefully doing as much performance chasing as we did in 2007.

So here's some examples of rules. No asset class will represent more than 30% or less than 5% of our portfolio. We'll rebalance our asset allocation as frequently as necessary using the 5/25 rule using new investment money as much as possible if selling a taxable account or selling an investment with significant trading costs is required. Rebalances may be performed no more than once a year. These are examples of what I mean by rules. And then, of course, there's our three-month waiting period rule.

So to recap. You set your goals. You choose accounts for each goal. You determine an asset allocation for each goal. You select Investments. And then you determine the rules for changes and maintenance.