**Personal finance 101**

First principles approach to Personal Finance



**First principles of investing**

Some say that **personal finance** **has already been solved**, and I tend to agree. For the vast majority of retail investors, it’s enough to know and stick to just a few simple empirical rules.

Even if that weren’t entirely true and there was still more to discover in the world of personal finance, it’s always useful to start from **first principles**:

* **Start saving:** track your income and expenses to understand how your cash flows move and build healthy saving habits
* **Define an investment strategy:** identify your financial goals, time horizon and risk profile to design a strategy that fits your needs
* **Invest only in what you know:** take the time to understand the features and risks of the assets in your portfolio. Build an investment thesis for each one, so you can act consciously and intentionally
* **Minimize costs:** in finance, returns are uncertain, but costs are guaranteed. Therefore, understand the cost structure of each asset you hold and favor liquid investments that can be sold quickly and cheaply
* **Build a diversified portfolio:** by spreading your investments across different asset classes, sectors, and geographies, you can reduce overall risk without lowering expected returns
* **Manage your debt:** use debt only when necessary or truly advantageous. Avoid accumulating it and keep it at a sustainable level
* **Build an emergency fund (and keep it separate):** set aside a fund to cover unexpected expenses and don’t mix it with your savings account, which should remain dedicated to your long-term goals and require discipline

**Overview of financial instruments**

I’ve always admired investors who **simplified finance** and I believe that in this context it makes sense not to overcomplicate the list of financial instruments available to retail investors.

| **Financial Instrument** | **Liquidity** | **Risk/ return** | **Description** |
| --- | --- | --- | --- |
| **Cash & Cash Equivalents** | **★★★★★** | **★** | Cash or deposits immediately available, including checking accounts and short-term instruments like certificates of deposit. |
| **Stocks** | **★★★★** | **★★★** | Shares of publicly listed companies, representing partial ownership and participation in company profits. |
| **Bonds** | **★★★★** | **★★** | Debt securities issued by governments or corporations; pay interest and return principal at maturity. |
| **Commodities** | **★★★★** | **★★★★** | Physical goods like gold, oil, or grain, traded directly or via futures/ETFs. |
| **Derivatives** | **★★★** | **★★★★** | Financial instruments whose value depends on an underlying asset, such as futures, options, or swaps. |
| **Crypto** | **★★★** | **★★★★★** | Digital currencies based on blockchain; highly volatile with a relatively young market. |
| **Real Estate** | **★★** | **★★★** | Residential or commercial property investments; illiquid, value influenced by local markets. |
| **Private Equity / Venture Capital** | **★** | **★★★★★** | Investments in private companies, startups, or private funds; illiquid and long-term. |
| **Collectibles** | **★** | **★★★★** | Collectible items like art, rare wines, or coins; illiquid, subjective pricing, and limited market. |

**If you**, Lit Investor, **are familiar with Cash & Cash Equivalents, Bonds and Stocks**, you are essentially **ready to go**. Other types of investments (excluding derivatives) are considered “alternatives” and are more challenging to manage due to their lower liquidity and higher complexity.

Today, **choosing individual instruments** within each asset class **has become easier thanks to** **ETFs**, pre-packaged baskets of securities with a specific sector, geographic and/or factor focus. Through ETFs, you can benefit from **diversification**, reducing the overall risk of your portfolio without lowering expected returns.

**Investment strategy**

Once you’ve learned the basics of personal finance and become familiar with financial instruments, it’s time to develop your own investment strategy. **Strategies must be personalized** – there’s no such thing as “one size fits all”.

The first step is to take a snapshot of your overall financial situation and **identify your financial goals**, which will also depend on your life choices and future financial capacity. These may include buying a home or a car, funding your children’s education, paying off all debts or financing a personal project. For each goal, it’s essential to **define specific time horizons** so that you will have the required funds available at the right moment.

Next, you need to assess your own risk profile – how much market volatility and significant losses (even prolonged ones) you can realistically withstand without panicking. Remember that market is a **transfer of resources from the impatient to the patient**.

Based on these elements, you can **build a personalized and effective investment strategy**. You need to remain disciplined and stick to it even when things get tough, while also being ready to adjust it if necessary.

Finally you have to select the best fitting instruments for your investment strategy and when doing that, don’t forget **Buffett’s golden rules**:

Rule n.1: Never lose money.

Rule n.2: Never forget Rule n.1.