Siva's portfolio and his style of investing

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*In the last few weeks, I was involved in quite a few discussions relating to investing. Sharing my investment strategy might give others a starting point to explore. Tax code is complex; every situation is different so tax strategies are outside the scope of this blog.*

*The key for investing is to protect and increase the real value of the principal. This means that the return should be more than inflation, otherwise the buying power for the principal is reduced. This is the same as losing money. Many beginning investors seem to be comfortable with inflation risk. By investing in secure investments such as CDs, although the principal invested is protected, the real value is often reduced.*

*WARNING: I am not a financial consultant. Do your own research before investing. Everyone’s situation is different, so what works for me, might not work for you.*

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# Basic Investment types

I will touch on the ones that are related to my portfolio. You can read more at [link](http://www.investor.gov/investing-basics/investment-products).

Bonds (Debt) – Are debt based securities. Buying a bond means that you are essentially lending money to the institution, which will give you interest. Some debt securities like municipal bonds get preferential tax treatment but have lower returns. Be sure to check out if it is better for your situation.

Stocks (Equity) – If you buy a company stock (share), it means that you own part of the company. You get to share the profits and participate in company’s growth.

Mutual Funds – The company that offers a mutual fund, pools money from a group of investors, and manages the investment on behalf of the investors. The company will charge a fee for this service. The advantage of mutual fund is a) a professional manages your money, b) you get better diversification. This is called expense ratio. Expense ratio is expressed as a percent of your principal amount. Say if the expense ratio is 1%, and you invest $100 in the fund. You will pay a fee of $1 per year regardless of the fund makes profit or loses. The expense ratio is deducted at the backend, so you don’t see this transaction explicitly in your statement. You are still paying this fee!

Stay away from mutual funds that have transaction fees or loads. More info at [link](http://www.fool.com/school/mutualfunds/costs/loads.htm). A load can be a front end load or a backend load. Front end load means you pay a sales fee when you buy the fund. This can be as high as 8.5%. The backend load means, you pay the sales fee when you sell the fund. There are thousands of no-load funds available, so stay away from load funds. BEWARE: Financial advisors may want to sell local funds to you.

ETF – This is a basket of stocks but is traded like a regular stock in the stock exchange. ETFs are typically managed passively and will follow an index. An index is an average of the stocks selected based on certain criteria. (e.g.) Vangaurd S&P 500 ETF ([VOO](https://personal.vanguard.com/us/funds/snapshot?FundId=0968&FundIntExt=INT)), tracks the large cap in US. The expense ratio for VOO is 0.05%, which is nothing.

# Taxable vs Tax deferred accounts

Regular investment accounts are taxable. At a high level a) you need to pay the tax on dividend distribution yearly even if you reinvest. b) Capital gain need to be paid when you sell the security.

On the other hand, in a tax deferred account, investment grows tax free. Generally there are two kinds of accounts, a) the account that lets you invest pre-taxed dollars (this lowers your current taxable income), you will pay taxes when you withdraw (for both principal and growth). 401k and Traditional IRA fall in this category. b) The second type of account is the one where you put in after tax dollars. ROTH IRA falls in this category. This account is advantageous because you don’t have to pay taxes during withdrawal (both on earnings and principal).

Be sure to read about the restrictions and understand the differences before you invest.

# My style

Lazy long-term investing. By that I mean I don’t actively manage my portfolio and don’t even look at my portfolio for months together. I make some adjustments maybe once a year. I picked the end of December to rebalance my portfolio as it coincides with holidays.

I don’t believe in timing the market; my philosophy is no one can consistently beat the market. Of course there are some god fathers in investing like Warrant Buffet, who was able to beat the market consistently, but for all practical purposes, I assume that no one can consistently beat the market. Beating the market means making more than the market average.

Keep the investment cost low. Any fee paid is the money taken away from investing. In the long-term compounding this lost investment expense will have a significant negative impact.

I am willing to take the downward ride as the market goes down. As someone who is investing in a broad market index and who has a long-term perspective of investing, I am willing to follow the market. This means the investment can drop to 50% or more….

Don’t be greedy or emotional. It is very tempting to gamble in the stock market or panic when market goes down. Define the strategy upfront and stay the course.

# Concrete Tips (based on my style)

* Start investing early in life. Let us take an example of investing $100 a month with a target to retire at the age of 70. For this calculation assume an annual return of 8%. If you start to invest at age 50, you will end up having a grand total of $54,914. On the other hand if you start at 20, you will end up with $688,924! As you can see the growth is not linear. This is the power of compounding. You can try this at [link](http://investor.gov/tools/calculators/compound-interest-calculator).
* If you are eligible for a 401k plan, put the maximum amount possible. At the minimum you should contribute to the extent that company contributes. Otherwise you will lose the company contribution.
* Invest in IRA to the yearly limit. Chose ROTH IRA if you qualify, otherwise go with Traditional IRA. Find info about ROTH and Traditional IRA at [link](http://www.fool.com/money/allaboutiras/allaboutiras03.htm) and [link](https://www.fidelity.com/retirement-ira/ira/ira-comparison).
* Irrespective of the income bracket, at the present moment you are allowed to transfer funds from Traditional IRA to ROTH IRA. Do some research, you might be able to take advantage of this. If you have lot of growth in your traditional IRA this might not be a good option. Some info at [link](http://www.forbes.com/sites/josephsteinberg/2012/12/12/warning-about-roth-ira-conversions-often-misunderstood-irs-rule-can-cost-you-money-and-aggravation/).
* Plan well so that you don’t have to dip into your retirement accounts.
* Invest for your kids’ education early. My favorite is 529 account.
* Use credit cards only if you have the discipline to pay off your monthly bills. If you can pay off the credit card bill then pick a rewards card. My favorite card is fidelity rewards card which can get you 2% back and has no annual fee. The nice thing is, cashback is directly deposited into fidelity account. You can even use this amex card in Costco, meaning you get 2% back on your Costco expenses. Check out this [link](https://www.fidelity.com/cash-management/american-express-cards).
* It is beneficial to have high dividend yield funds in nontaxable accounts like IRA/401k. This is because you need to pay taxes on yearly dividend distribution. In IRA/401k you don’t need to worry about this. Bond funds typically have high dividend distribution.
* Don’t invest in the company stock you work for. This has nothing to do with how good your company is performing. (i.e.) don’t put all eggs in the same basket.
* If your company offers stock purchase plan (offered at a discount), max out that you can buy. Best to sell it right after you get it (for the same reason (i.e) don’t put all eggs in the same basket).
* If your company does offer stock options, you might consider keeping it longer and not sell right after it is eligible for vesting. This is because of the leverage, potentially to make more money. This depends on future prospect of the company. In general I don’t believe in timing the market, in this case I think it is worth the risk. Again this is my opinion, given my situation.
* To reduce risk, diversify your investment.
* Invest only in no-load, no transaction fee mutual funds. No-load means that there is no commission either when you buy or sell the fund.
* Pick funds with a low expense ratio. Typically vanguard index ETF/funds are lowest in this respect.
* Something like a brokerage link account might give you flexibility to choose your 401k investments. Some info at [link](http://retireby40.org/2012/02/401k-plan-review-fidelity-brokeragelink/). Talk to your company/brokerage.
* DO NOT invest in a security that you don’t understand. The financial market is filled with complex instruments.

# My asset allocation goal

Based on risk tolerance and diversification goals, pick an allocation. The [link](http://www.sec.gov/investor/pubs/assetallocation.htm) talks about asset allocation, diversification, and rebalancing. At a very high level, I strive to achieve the following allocation.

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| --- | --- | --- |
| **Security** | **Percent** | |
| Stock US | | 50% |
| Stock International | | 20% |
| Bond US | | 10% |
| Bond International | | 20% |

Every December, I will do minor adjustments to get back to this allocation. At the moment I am debating if I should further increase my international exposure. NOTE: International investment has both market risk and also currency fluctuation risk.

# My portfolio

My combined investment portfolio is shown below. I was able to get Franklin Templeton funds via employee purchase, otherwise it would have incurred a load.

|  |  |
| --- | --- |
| **Security** | **Percent** |
| [Fidelity New Markets Income (FNMIX)](http://investing.money.msn.com/investments/etf-list/?symbol=FNMIX&ocid=qbeb) | 11% |
| [FT - Mutual Global Discovery (MDISX)](https://www.franklintempleton.com/retail/app/product/views/fund_page.jsf?fundNumber=077) | 10% |
| [FT - Templeton Global Bond Fund (TGBAX)](https://www.franklintempleton.com/retail/app/product/views/fund_page.jsf?fundNumber=616) | 12% |
| [Mairs & Power Growth (MPGFX)](http://investing.money.msn.com/investments/mutual-fund-rates/?symbol=MPGFX&ocid=qbeb) | 5% |
| Pimco Total Return | 6% |
| [Royce Premier Fund (RYPRX)](http://investing.money.msn.com/investments/etf-list/?symbol=RYPRX&ocid=qbeb) | 5% |
| [T.Rowe Capital Appreciation (PRWCX)](http://investing.money.msn.com/investments/etf-list/?symbol=PRWCX&ocid=qbeb) | 9% |
| [T.Rowe Mid-Cap Value (TRMCX)](http://fundresearch.fidelity.com/mutual-funds/summary/77957Y106) | 5% |
| [Vangaud All-World Ex-Us Index (VEU)](http://investing.money.msn.com/investments/etf-list/?symbol=VEU&ocid=qbeb) | 15% |
| [Vanguard Total Stock Market Vipers (VTI)](http://investing.money.msn.com/investments/etf-list/?symbol=VTI&ocid=qbeb) | 22% |

Explore & Enjoy!

/Siva