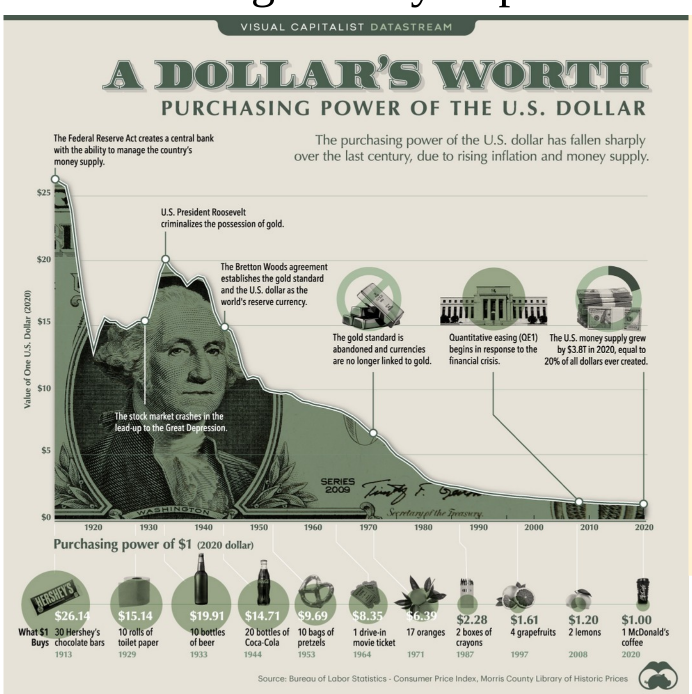
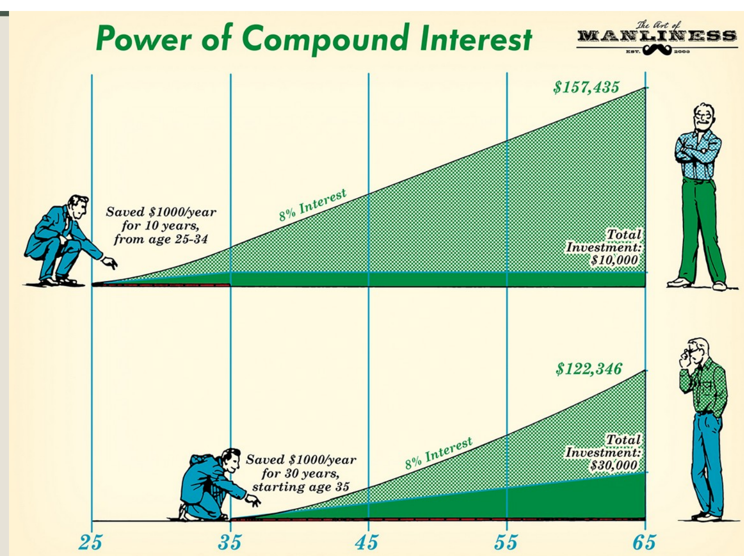
A Simple Wealth Building Strategy

The following is an outline and guide for organizing your personal finance and implementing a simple investing strategy. Sorry if it reads too beginner friendly at times, the goal was to create something that could be applicable for anyone but specifically those starting out.

There is no "right" way to investing. There are multiple pathways to wealth and trade-offs for each one which should be considered for each individual and their unique situation to determine the best route that suits their investment goals and risk appetite.

To build wealth, one must have positive net income and must be accumulating assets with that net income. Positive net income or free cash flow is the amount of money one brings in or saves after all expenses are paid. Assets are resources that produce or increase in economic value. Government currency is literally designed to lose value over time so one cannot simply save their way to wealth but instead must invest if they wish to retire someday. The primary way wealth is amassed is through the power of compounding and the benefits of compounding get exponentially better with more time. So time is of the essence and it is critical that you start investing as early as possible.





The simplest way to start investing is through the stock market although it could also be accomplished by purchasing real estate or starting a business. These are all acceptable ways to invest and there is no reason why one cannot diversify and invest in multiple ways. Any sum of money may be used to start investing in the stock market unlike when purchasing real estate, which requires a substantial down payment. One can also invest consistently and automatically in the stock market which is a great advantage compared to other types of investments. Automatic investments are nice because once set up they work like fixed expenses, such as rent or utilities. Timing the automatic deposits into your investment account so they occur right after your normal paycheck cycle helps eliminate any temptation to spend that money on unnecessary items.

So to set up automatic investments into the stock market, one must first have a good grasp of their financial numbers and how much they can afford to deposit per time frame. Time frame is up to the individual, but would typically occur weekly, biweekly or monthly. This may be determined using the *financially free calculator*, which may be adjusted anytime. Adjustments usually make sense after big events happen that may affect one's net income such as with a new job, a raise, or a new expense like the purchase of a new car or home. Once the estimated net income is determined, one needs to decide in what order they should be funding accounts and paying off debt.

Here are the steps that I personally take and what I recommend for anyone else:

1. Pay off debt
2. Contribute to retirement accounts
3. Contribute to taxable accounts

Steps 1 and 2 can be done in conjunction with each other but Step 3 should (ideally) be done only when all debt is payed off and all retirement accounts are maxed out.

1. Pay off debt

When you consider the power of compounding for assets and how beneficial it can be, having debt is like reverse compounding due to the interest of the debt creating more and more cost to you. Not all debt is bad, however, and certain types may actually be helpful in the long run like educational debt, which helps increase one's income. Of note, it may also be profitable to leverage debt during inflationary eras since you could potentially pay off borrowed money with devalued currency. Borrowing depreciating assets (currency) to purchase appreciating assets (property) has been a tried and true strategy for multiple generations. In general, it is advisable to pay off debt as quickly as possible.

2. Contribute to retirement accounts

These are the 401(k)’s, 403(b)’s, Roth IRA’s, Traditional IRA’s, Health Savings Accounts, etc.

Each one has its own rules and contribution limits and may only be applicable to certain individuals. This information is readily available online. The main idea is to take full advantage of these types of accounts because of their tax benefits. They all reduce taxes in some way. Since taxes are inevitably going to be the largest expense over your lifetime, it is imperative to utilize them. Everyone’s scenario will be different in terms of how much they should contribute to each but I would recommend (if possible) the minimum to be maxing out a Roth IRA and enough to get any match that an employer might offer on a 401(k)/other applicable accounts.

If there is an option between traditional (pretax) or Roth type retirement account, I believe the Roth is the better choice. To see the math behind why I think that, click the link to my Roth vs pretax spreadsheet.

3. Contribute to taxable accounts
Taxable accounts are just regular investment accounts that can purchase stocks/ETFs but do not have a tax advantage (An ETF is an Exchange Traded Fund and is a fund that owns multiple individual stocks or other assets that trades with a ticker on a stock exchange). Building up this account can help in creating a separate source of income before you are even allowed to withdraw from your retirement accounts. Separate sources of income are essential when trying to achieve financial freedom, especially if you are trying to retire early.

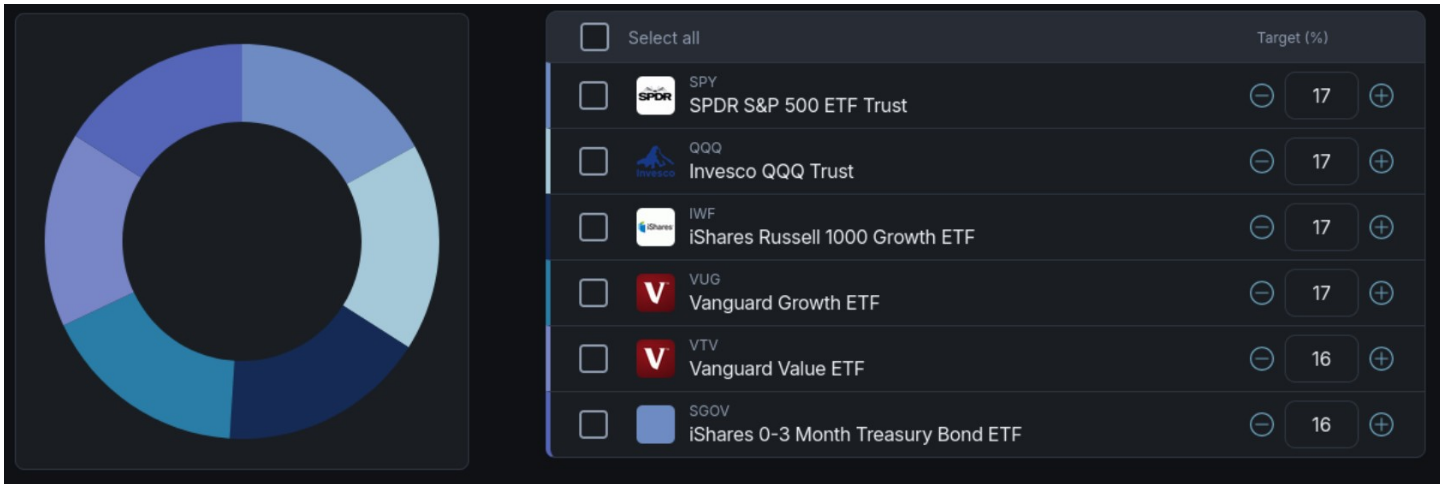
Now, the next step to consider after one sets up these investment accounts and starts contributing a portion of their net income to them is how to actually pick and manage their investments. This may be an intimidating topic but with the help of the highly developed technology and tools we have today, it can be considered easy.

There are a variety of different Robo-Adviser type investment accounts that one can choose from or "old-school" type accounts where one manually sets up trade orders and if these suit your style then use them. What I personally use and recommend is M1 (m1.com) finance due to its simplicity, automation and flexibility. At this time the accounts are free; however in the future they may charge a $3 monthly fee for accounts under $10,000. With some of the Robo-Adviser accounts, the investment options are limited to standard stock/bond portfolios based on one's age and risk appetite. With M1, the options are limitless since you have full control to how your portfolio is set up. Limitless options and full control may seem overwhelming but the plan is to walk you through a few basic portfolio options that you can then use and adjust as much or as little to suit your preferences.

One of the primary reasons why I advocate for M1 is because of the automation technique it uses. Again, automation is an ideal strategy because it produces effortless investment once direct deposit is setup. This method also precludes timing risk of purchasing at the wrong price and the emotional involvement in the purchase when stocks are driven to all-time highs and lows.

Another way of looking at automatic reoccurring investments is through dollar cost averaging. Dollar cost averaging is using the same amount of money to buy an asset regardless of price in each time period. For example, you set up reoccurring deposits for $100 weekly. Every week that $100 is automated to buy a S&P500 index ETF regardless of what price it is. If the S&P500 ETF is trading for $100 one week then you only purchase 1 share. Then the following week, the ETF is trading for $20, then your $100 buys you 5 shares. As price fluctuates, you naturally are buying more when the asset is cheaper and less when it is expensive. This can eliminate the stress of trying to time the bottom or top of a cycle and allows you to win if the price goes up (your portfolio increases in value) or down (you get to purchase more assets at a cheaper price).

Another reason I like M1 is because of its dynamic re-balancing system, which is effective once you set up a portfolio pie similar to the graphic shown below.

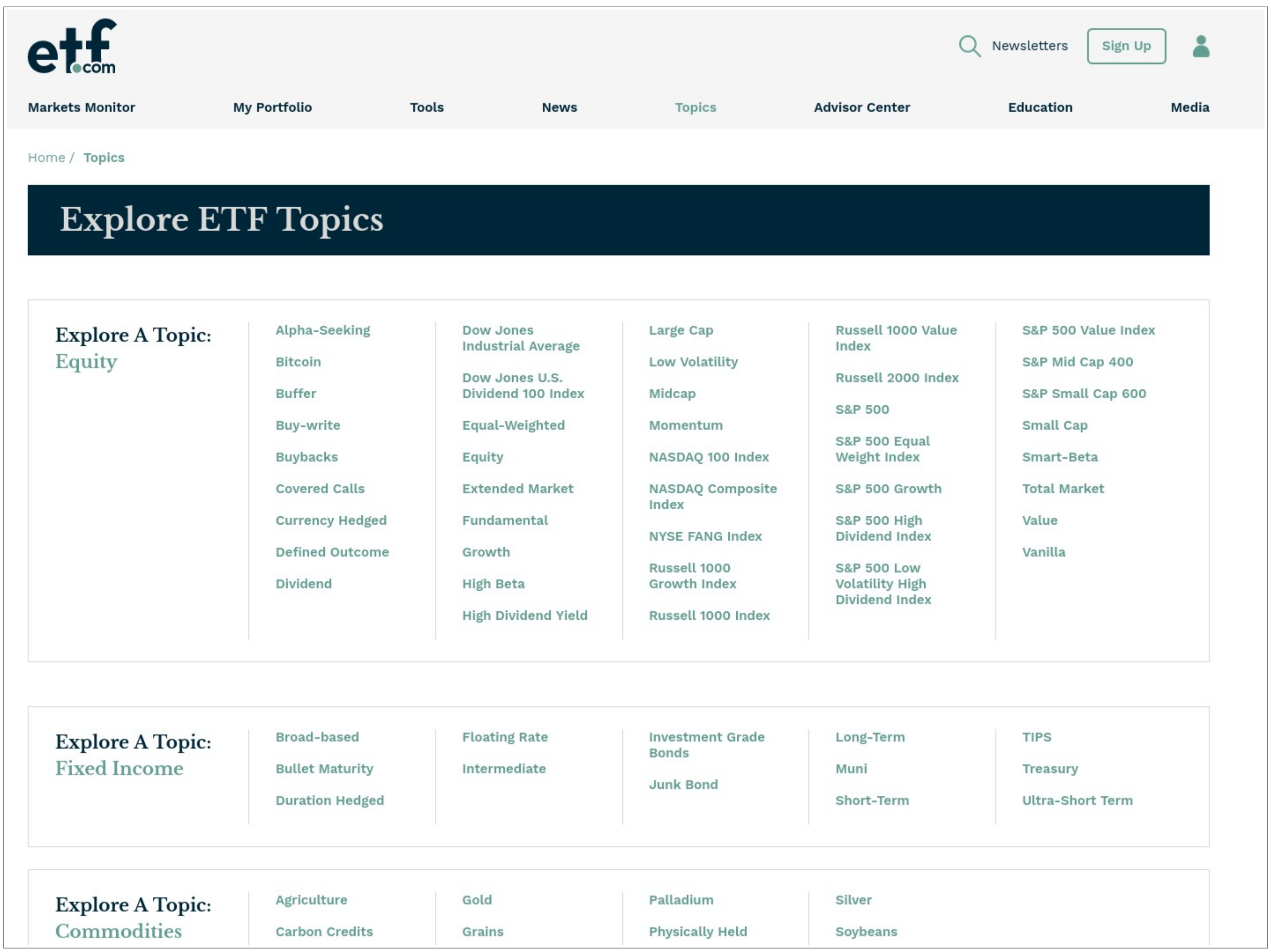


As money is deposited into the account, the system will buy the investments that are under target first until all targets are met. It will then proceed to purchase all investments equally unless there are investments that are over target. It will not buy those. Selling over target investments to buy under target investments would incur a taxable event and you would actually be divesting winners to invest in losers. The method of re-balance on this platform is to stick with the under target investments. As asset prices fluctuate, this stabilizes purchasing power so you are able to buy more when things are down and less when things are expensive. Read more about dynamic rebalancing here: [M1 Dynamic Rebalancing]

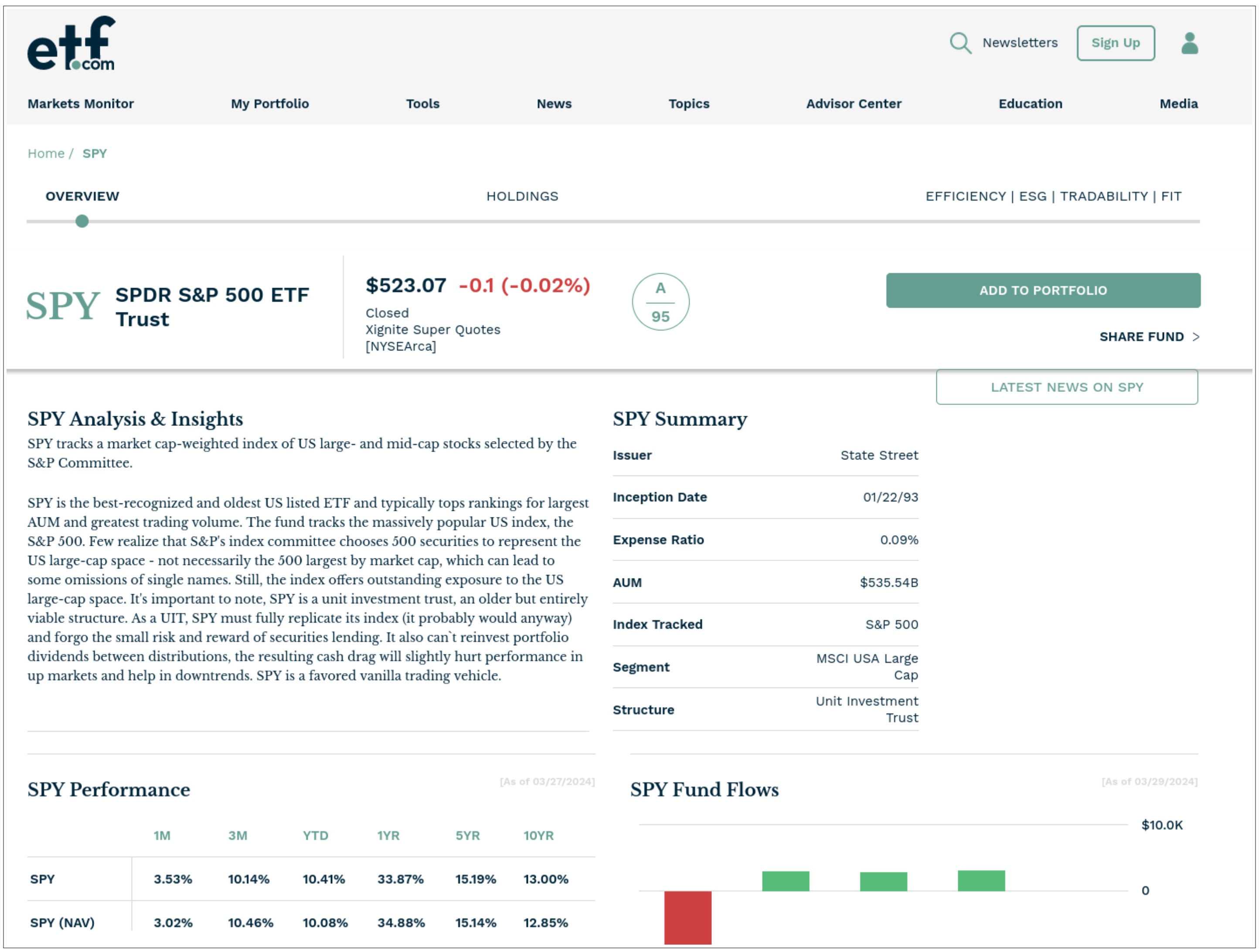
Yet another reason why M1 is great is because it can buy fractional shares so it does not matter if your account size is small, the allocation percentages still work. For example, if an ETF is trading for $1000 per share but you only have $100 to invest, it will purchase 10% of one share.

Now, how does one actually go about building a stock portfolio? The options are truly limitless but I think the most effective approach for an individual retail investor is to **keep it simple**. And a great way to keep it simple is to use ETFs. ETFs are funds that actively or passively manage a basket of stocks, bonds, commodities, etc. but has a ticker symbol like a single stock that can be purchased and sold in the market at will. There are thousands of ETFs, each one serving a different purpose. For example, the purpose of the ETF $SPY is to track the S&P500 index and the purpose of the ETF $EWJ is to provide exposure and ownership to the Japanese stock market. A good website to look up and research ETFs is ETF.com

You can explore a variety of ETFs through the topics page.

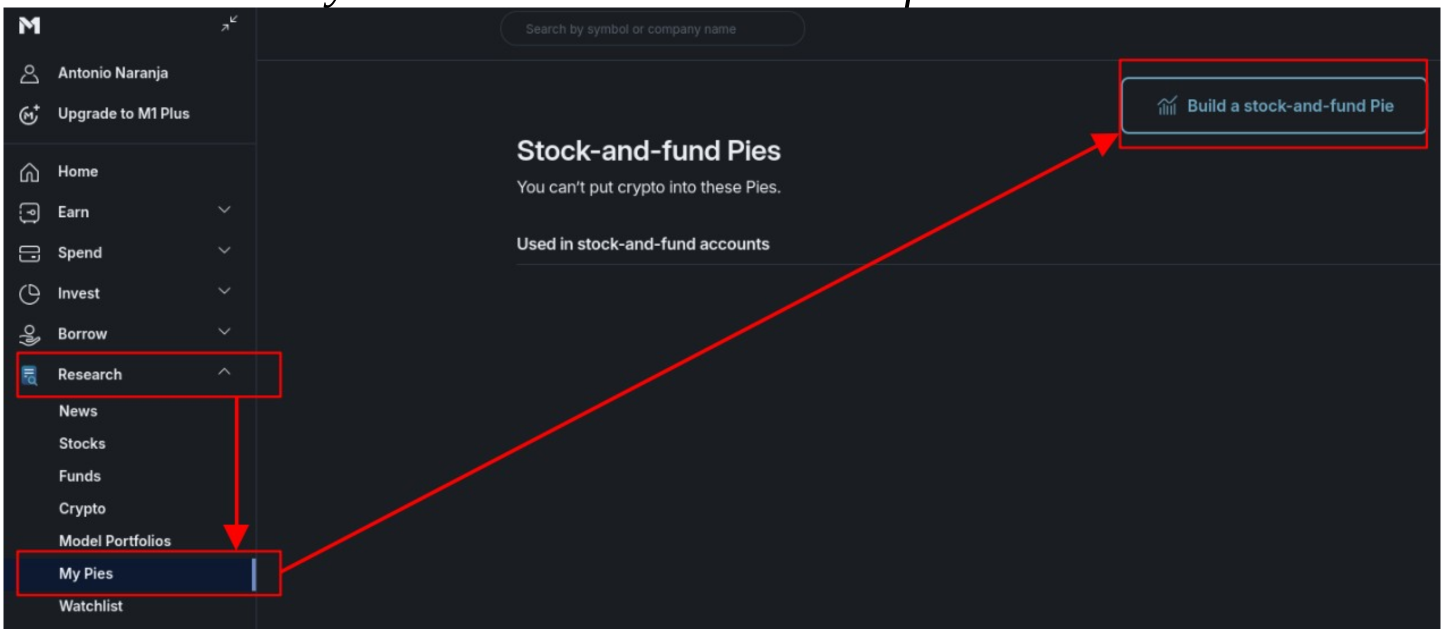


If you click on an ETF, you can get a ton of information on it such as the summary, expense ratio, assets under management (AUM), the holdings and the percentage of each holding, etc. The expense ratio is the service fee that you pay to the ETF issuer. This is a bit opaque because this fee is not actually taken out of your account rather just reflected in the price of the ETF. An expense ratio of 0.09% means that if you owned $1000 of that ETF, you would pay a fee of $0.90 per year ($1000 x 0.09%). This may not seem like a lot but this does eat into your returns and dampens the compounding effect so it is best to find ETFs with lower expense ratios.

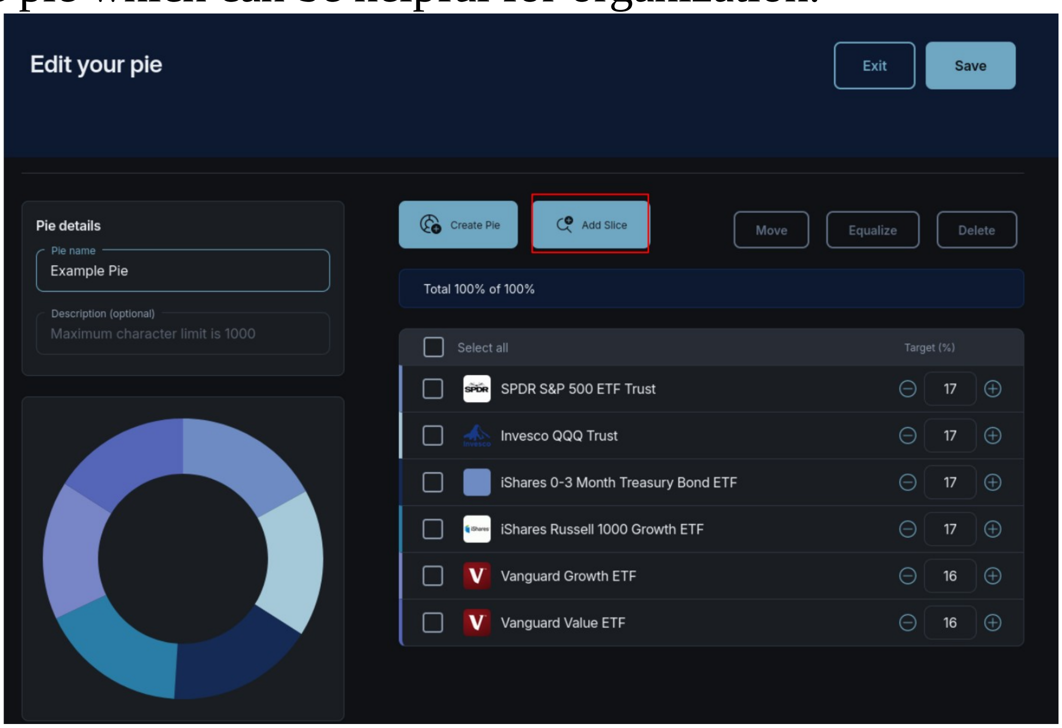


Now that you know a little bit about ETFs, you can start building your portfolio.

On the M1 website, you can build a portfolio “pie” by clicking on *Research* then *My Pies* then *Build a stock-and-fund Pie*.

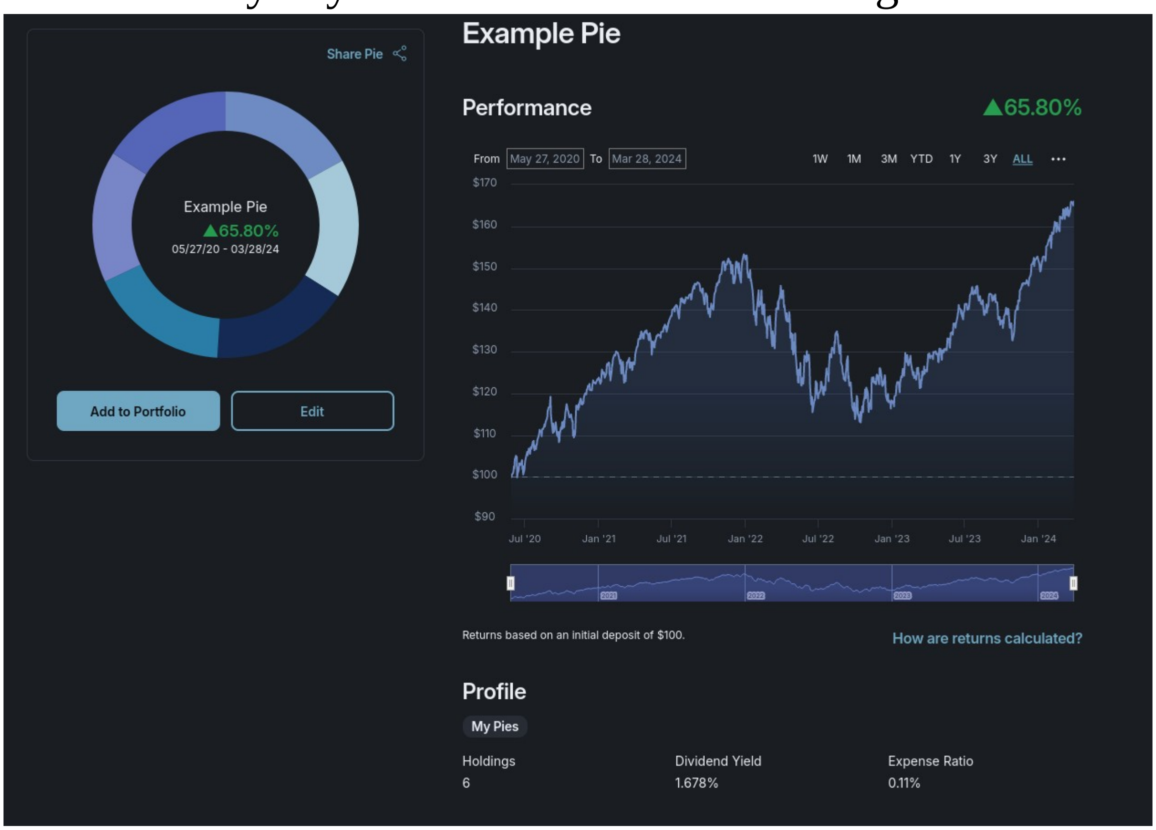


From there you click on *Add Slice* and add the ETFs or stocks that you want in your portfolio. They will be added in as equally weighted but can be changed easily using the *Target* column numbers. You can also create a pie inside pie which can be helpful for organization.



Now, as you fund your account, M1 will allocate those funds according to your target numbers in your portfolio pie starting with the most under allocated slices. Your pie, slices and target numbers can be revised at any time.

Once your portfolio is created, you can analyze the performance over the past few years as well as see its total dividend yield and expense ratio. The data on M1 only goes back a few years so there is no where near enough data to conclude anything moving forward but it can still be helpful to see how well your portfolio would have done in recent years. The year 2021 was a very good year for most assets so if it shows that your portfolio did not perform well during that time then it might indicate that this portfolio may under perform the benchmark index (S&P500 or DOW Jones). The year 2022 was a very bad year for most assets so if your portfolio held up during that time then it might indicate that your portfolio has more of a defensive strategy. Again, it is not enough data to extrapolate any future expectations and past performance is no indication of future results anyway but it is still worth checking out.



So which ETFs should make up your portfolio pie? Well, that is totally up to you but I will provide some simple example portfolios that you can use to revise to your liking.

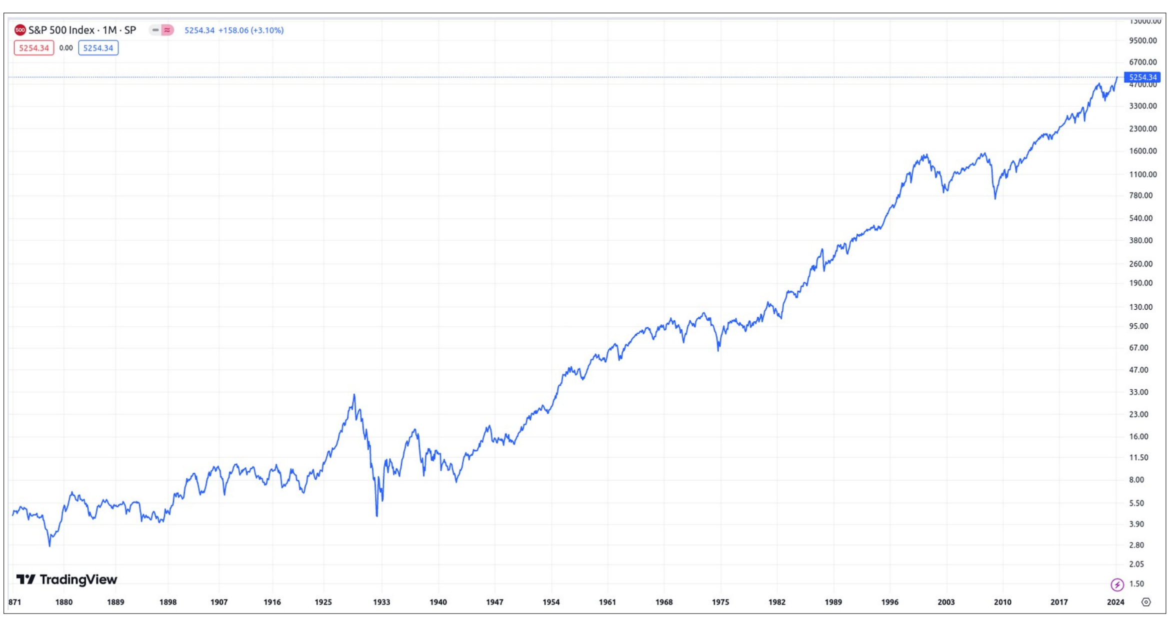
Sample Portfolio 1

A portfolio made up of only 1 or 2 ETFs that track US stock indexes.

- $SPLG which tracks the S&P500 index w/ 0.02% expense ratio
- $QQQ which tracks the NASDAQ100 index w/ 0.20% expense ratio

You could choose just one of the above ETFs and make it 100% of your portfolio, or you could choose both and have them equally weighted 50/50%, or have them weighted differently as you wish. These are the benchmark indexes for most investors and they are a simple yet very effective way to own the top US companies.

One big benefit to investing in index funds is that they have an inherit survivor-ship bias that makes it theoretically impossible for them to go to 0. If a company within the index fund performs poorly enough it will eventually be replaced for a company with a better performance. See below for a logarithmic chart of the S&P500 going all the way back to 1871. The main takeaway is that the primary trend is.. up. That is not to say that it can't go down or you can't lose money (See the down swings during the great depression in the 1930's or the 2008 financial crisis) but over a long enough time horizon, there is a high probability for the index to go up.



Sample Portfolio 2

The same portfolio as *Sample Portfolio 1* but you add a bitcoin slice to it. Could do something like 50% $SPLG, 30% $QQQ and 20% BTC. Bitcoin is far too complex a topic to go into the details of why one should be allocating to it but the main idea is that the returns it provides is like adding steroids to your portfolio. If you are interested in bitcoin, highly recommend owning via cold storage but if that is not possible then owning it through M1 or through an ETF like $FBTC is the next best option. If you do not believe in Bitcoin as an asset then do not add it to your portfolio.

Below shows a comparison between two portfolios. Portfolio 1 is set up as 50% $SPLG and 50% $QQQ. Portfolio 2 is set up as 50% $SPLG, 30% $QQQ and 20% BTC. You can see that the portfolio with bitcoin outperformed the one without it by over 6x. Obviously this does not mean it will continue to outperform but it may be worth having BTC as a portion of the portfolio as it can be beneficial even if it is a smaller slice of the pie.

Performance Summary

Portfolio	Initial Balance	Final Balance	CAGR	Stdev	Best Year	Worst Year	Max. Drawdown	Sharpe Ratio
Portfolio 1	$10,000	$36,088	16.83%	17.24%	40.55%	-25.34%	-28.20%	0.90
Portfolio 2	$10,000	$236,465	46.73%	42.38%	331.89%	-33.98%	-38.09%	1.06

Portfolio Growth

If you want to compare historical performances of different portfolios like I did with the chart above, check out PortfolioVisualizer.com

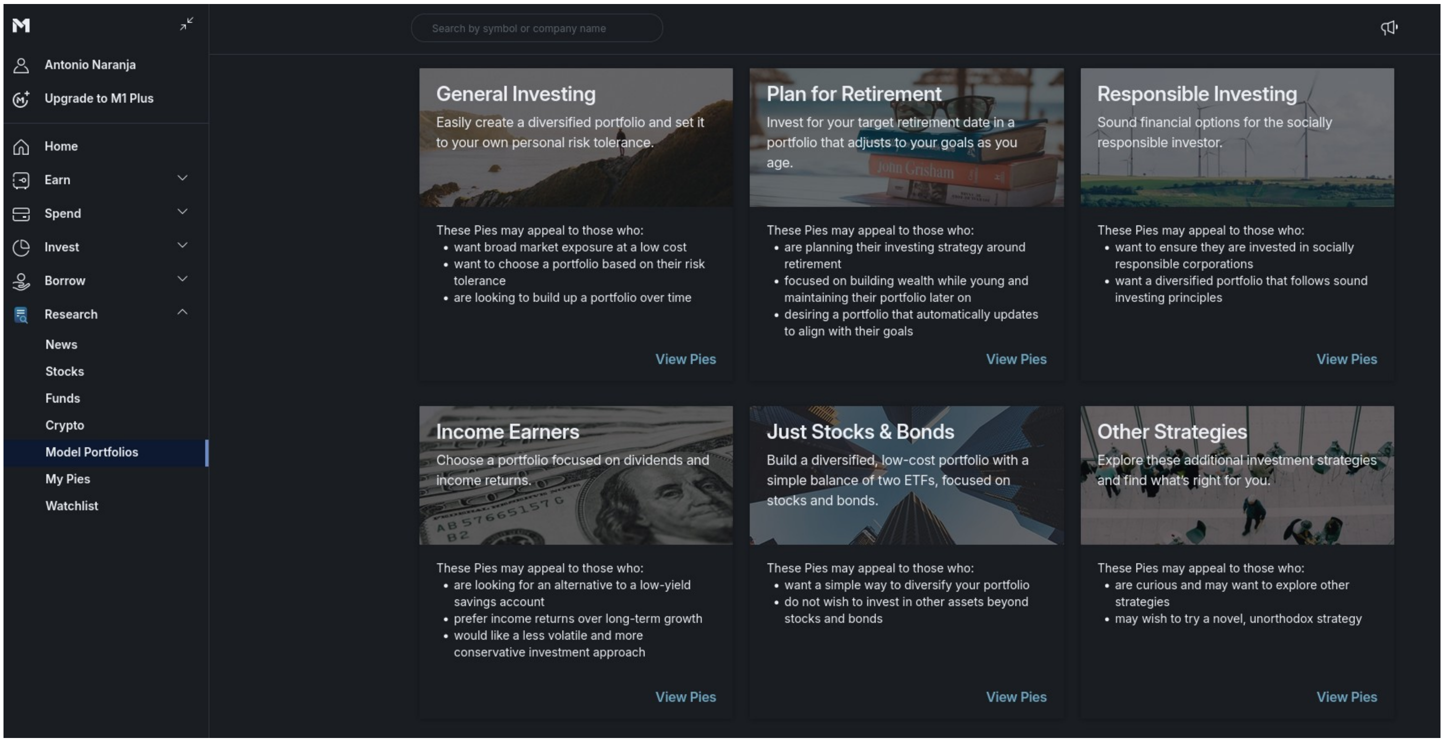
Sample Portfolio 3
This portfolio is the same as *Sample Portfolio 1* or *Sample Portfolio 2* but you add a dividend ETF to it as a source of income for your portfolio. Dividends are cash distributions that equities give out to shareholders from the company profits. An example of an ETF that is focused on dividends is $SCHD, which hones in on companies with a long history of paying dividends, but also uses a fundamental filter to allow quality companies alone into the ETF holdings. The filter accomplishes this by detecting high cash-flow relative to debt ratio, high return on equity, high dividend yield, and high dividend growth rate.

There are definitely trade-offs to consider when thinking about implementing a dividend type investment strategy with the main one being the taxes that must be paid on dividends (unless you are in a non-taxable retirement account). Typically dividends are taxed as ordinary income unless they are qualified dividends which can be taxed as low as 0%. A lot of investors think that dividends are inefficient due to double taxation. The company is taxed on their earnings before paying dividends and shareholders are taxed on the dividends paid out after.

Another route to consider are Master Limited Partnerships (MLP's) which trade on stock exchanges and are not taxed at the corporate level. Tax obligations do still exist so make sure to research this option if interested.

Personally, I am working on building a dividend portfolio pie to add to my main portfolio which focuses on accumulating stocks and ETFs that provide dividends. My main goal with this is to create a secondary source of income that can someday pay for my necessary expenses. This is a small potion of my overall portfolio as I think the tax burden does affect the total returns. I still believe it is worth the trade-off to have a secondary source of income as a safety net in case something happens to my primary income.

M1 also offers a number of other model portfolios that may be of interest. If any of these work well in meeting your needs they are an easy option to use.



These are just ways to get started. Build your portfolio to suit your preferences and change it at any time.

Summary of Steps to Take

1. Open up an M1 finance account
2. Create or transfer Roth or traditional IRA to M1
3. Use the Financially Free Calculator to determine your weekly/bi-weekly or monthly net income or free cash flow
4. Use net income number to set up reasonable reoccurring automatic deposits into your M1 account
5. If your net income maxes out your IRAs, then open up a regular taxable account
6. Create or pick a portfolio pie that suits your investment goals
7. Turn on automatic investing (should be on by default)
8. Check monthly/quarterly/yearly and revise as necessary

Note: If you do not plan to use M1 finance, the steps are basically the same but with the different brokerage that you choose.

Also, M1 has recently implemented a high-yield savings account that currently earns 5% on your cash. If you have excess cash or need a place to keep your emergency fund, highly recommend taking advantage of this or short term US treasury bills which are yielding around 5% currently. I've been doing this by owning the ETF $SGOV which is an ETF that owns and rolls 0-3 Month US Treasury bills and pays a monthly dividend as the yield from the bills but will likely switch to the high-yield savings account on M1.

That's it! If you have any questions you can always ask me