Book The Gone Fishin' Portfolio

Get Wise, Get Wealthy...and Get on with Your Life

Alexander Green
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Recommendation

BooksInShort recommends this excellent, straightforward, hype-free and solidly grounded guide to investing. Research analyst and investment adviser Alexander Green draws on portfolio management methods used by the world's biggest institutional investors. He goes straight to the basics, emphasizing financial discipline, saving and awareness of costs. The portfolio he recommends consists entirely of low-cost Vanguard mutual funds, mostly index funds. He recommends keeping 70% of your portfolio in stocks. That recommendation may seem risky, especially in view of volatile stock market performance. However, he cites historical and financial research to demonstrate that, over time, equities have been the highest returning class of investments, even during such catastrophes as the Great Depression. This kind of straight talk is an excellent prophylactic against both the panic of crashes and the euphoria of bubbles.

Take-Aways

- Many investors ignore the risk of outliving their retirement savings. You need enough to be able to spend only 4% of your assets annually after retirement.
- Asset allocation is responsible for 90% of the total return on investment portfolios.
- Common stocks have returned more than bonds over the long term, and were a better investment choice than bonds even during the Great Depression.
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Summary

Money Facts

The following investing tactic can make you financially independent, which is why institutional investors use it to manage some of the world's biggest portfolios. In 1990, the thinkers who discovered the principles behind this approach, Merton Miller, William Sharpe and Harry Markowitz, won Nobel Prizes in Economics for their ideas. Their approach to asset allocation underpins the *Gone Fishin' Portfolio* strategy. In *Portfolio Selection*, a seminal paper, Markowitz explained the way that "a portfolio constructed of uncorrelated assets can allow you to master uncertainty and generate excellent investment results." He laid out "the concept of the efficient frontier, the point where you are generating the best returns within a given level of risk."

> "The quest for financial independence begins with having a clear, specific vision – with realistic expectations – of where you are trying to go."

First, be smart. Understand that no one knows exactly the right asset allocation pattern in advance. Don't take chances with your money. Save. Don't rely on the government or anyone else to manage it. Social Security will help you retire, but you probably don't want to live on it. Even the U.S. government admits that the current system will be untenable in the future. The population won't include enough working people to pay retiree benefits as rich as those received by previous generations.

Meanwhile, corporate pension plans are endangered and inflation continuously erodes the value of money. That means your financial future is in your own hands. You can't trust stockbrokers – they are out to earn commissions. You can't trust financial planners – they're trying to earn fees. You can't trust the press – they're trying to sell ads. You need objective facts.

Declaration of Financial Independence

To be financially independent, start saving so you are able to invest. Many workers save too little. Of course, saving requires discipline. Build your fiscal rigor by following these five tips:

1. **Keep a record of what you spend** – Update it daily. Study it to find costs to cut.
2. **Save as much as you can** – If your employer offers a matching contribution to your savings in a 401(k) or other account, take advantage of it, but don't count it as your personal contribution to your savings. If you're younger than 30, save 10% of your gross income; if you're older than 30, try for 15% at least.
3. **Educate yourself about investing** – Don't get fancy. Your goal is not to build dazzling financial sophistication but to develop the expertise to save and invest effectively.
4. **Don't try to keep up with the Joneses** – Ignore the marketing messages that you have to buy this car or that house to have a respectable standard of living. Your goal isn't to spend like your peers. Your goal is to save, invest and achieve financial independence.
5. **Stick to your strategy** – Write down your plan and your goals. Post them where you'll see them. Every time you fail to save enough, you make it harder to reach your goals.

Don't Trust Wall Street

Wall Street is a sales machine. It is not very good at making its customers rich, but it is very good at enriching itself at its customers' expense. Wall Street is not a place where you "get what you pay for." You cannot trust it to manage your money. As investment sage Peter Lynch warned, "Thousands of experts study overbought indicators, oversold indicators, head-and-shoulder patterns, put-call ratios, the Fed's policy on money supply, foreign investment, the movement of the constellations through the heavens and the moss on oak trees, and they can't predict the markets with any useful consistency, any more than the gizzard squeezers could tell the Roman emperors when the Huns would attack."

Known Unknowns

You don't know the future. No one can predict the market or the economy on a sustained basis. Just recognize that fact and accept it. Don't pretend to know what you don't or can't know. Be humble enough to acknowledge your limitations. Be skeptical. The really outstanding investors don't try to time the market. Deciding whether to invest in a stock based on your forecast of future performance is just gambling or guesswork, and those are poor foundations for the serious business of securing your financial future.

Stocks Can Make You Rich

If you want to think about a scary risk, think of the risk of running out of money before you die. That is a real problem. History demonstrates that investing in common stocks is a great way to build wealth for the future. Common stocks have returned more than Treasury bills, which are guaranteed to be safe. Is there risk in common stocks? Yes, but return requires risk. Even in the Great Depression, stocks returned more than T-bills, as they always have through every phase of the business cycle from boom to recession. Moreover, stocks are a much safer investment than T-bills because they help you avoid the risk of outliving your savings. Stocks are more volatile – that is, their price fluctuates more – but you can manage that risk.

Caveat Emptor

The Gone Fishin' Portfolio is based on mutual funds because they offer investors numerous advantages: They make it easier to diversify, they are professionally managed, you can begin with a low minimum investment, you don't need a financial adviser, and liquidating your investment or arranging for automatic reinvestment is easy. Mutual fund companies do a lot of the record keeping for you, and you can usually reach a customer service representative when you want someone to answer your questions. While no one can predict the market, research shows that, on average, over time, passively managed index funds that aim to match the market outperform actively managed funds that try to beat the market.

> "No one cares about your money more than you do."

Wall Street sells mutual funds to make money, usually via high fees. That is one reason the recommended portfolio includes only Vanguard mutual funds because their fees are as much as five times lower than the rates most fund companies charge for parallel value. Like other funds that give high-end investors extra incentives, Vanguard offers lower-cost Admiral Shares to large or long-term investors.

The Critical Decision

Your critical choice as an investor, the decision that will be responsible for 90% or more of your total investment return, is how to allocate your assets, that is, what mix of investments to buy. Allocate your holdings strategically, putting money in "uncorrelated" assets whose movements will counterbalance each other. Decide if you're going to be a trader or an investor. A trader tries to make money on short-term market moves. An investor develops a long-term plan and sticks with it. The long-range performance of your portfolio depends on six elements:

1. **Your savings** – The more you save and invest, the more wealth you stand to build.
2. **How long your investments compound** – The more time investments have to compound, the more wealth they create.
3. **Your mix of assets** – You want a portfolio whose assets do not move in lockstep with each other. For example, common stocks offer the most attractive

returns over the long term, but are quite volatile. If you mix stocks with other assets, you can dampen volatility without sacrificing too much return. The Gone Fishin' Portfolio is 70% equities and 30% debt, which includes "REITs [real estate investment trusts], gold shares and three different types of bonds."
4. **The return on assets** – You cannot predict or control how your investments will perform. This portfolio tries to balance risk and return.
5. **Expenses** – The more it costs you to invest, the lower your total return will be and the more time it will take to achieve your objectives. Minimizing expenses is critically important; no investment adviser will be as committed to that objective as you must be.
6. **Taxes** – Savvy tax management can save you thousands of dollars, compounded.

> "Do you really need that new car – or would you rather keep the old one and become free to live where you want, with whom you want, doing what you want?"

The recommended portfolio invests the following proportions in these Vanguard funds:

- **15% each** – "Vanguard Total Stock Market Index" and "Vanguard Small-Cap Index."
- **10% each** – "Vanguard Emerging Market Index, Vanguard European Index, Vanguard Pacific Index, Vanguard High-Yield Corporate, Vanguard Short-Term Investment Grade Bonds" and "Vanguard Inflation-Protected Securities."
- **5% each** – "Vanguard REIT Index," and "Vanguard Precious Metals and Mining Fund."

> "We've long felt that the only value of stock forecasters is to make fortune tellers look good." (Warren Buffett)

This portfolio has a $30,000 minimum investment ($3,000 on each fund listed, though you can substitute other Vanguard funds with lower entry costs). Some of the U.S.'s most astute institutional investors use this approach, which lets you build wealth over the years without investing too much time. Notably, it protects you from four of the biggest investment errors:

1. **Excessive conservatism** – If you need to build wealth, you cannot put everything in "risk-free" investments. The risk of shortfall – that is, of not having enough wealth to see you through retirement – is a big one, but ultraconservative investors seem to ignore it.
2. **Excessive risk-taking** – You need to take a risk, but you need to take it prudently. Some investors act more like gamblers, betting aggressively in order to make up for losses. The only proven way to build wealth is to save and invest with discipline.
3. **Market timing** – No one can time the market successfully over the long run. Trying to do so is a formula for disaster.
4. **Delegating imprudently** – Brokers, insurance agents and financial planners are in business to make money. It's nice that they can also make money for you, but when push comes to shove, you are not their priority. Don't put your financial future in their hands.

> "Time, not money, is your most precious resource."

Periodically, rebalance your portfolio to bring asset proportions back to the appropriate level. Rebalancing imposes a discipline that will require you to sell and buy at the right times. It will prevent you from loading up on cyclical winners or dumping cyclical losers. This portfolio includes some more risky assets – such as high-yield corporate bonds. But you lower your overall risk and raise your overall returns by blending these assets with the others in your portfolio. The big risk you want to avoid is the risk of outliving your retirement nest egg. The only way you can build wealth is by taking risk. This portfolio allocation allows you to take risk prudently.

Avoid Taxes Legally

Don't pay more taxes than you must. Research suggests that, on average, 2% of investors' returns go to taxes. You can reduce your U.S. income taxes very legally by taking some precautions. For example, use tax-deferred retirement accounts for investments that are likely to expose you to high taxes, such as REITs, high-yield corporate bonds and inflation-protected securities. You can keep your tax-efficient investments in taxable accounts. Stock index funds tend to be tax-efficient. When you rebalance your portfolio, be aware of the tax implications. Drastically reduce your exposure to taxes by waiting 18 months before you rebalance each time.

Exchange-Traded Funds

Sometimes, exchange traded funds (ETFs) have lower expenses and better tax efficiency than no-load mutual funds. ETFs trade on the stock exchanges and are always "open" to new investors. Their disadvantages include the cost of buying and selling, and the inability to reinvest dividends automatically. The Vanguard funds in the Gone Fishin' Portfolio will be better for most people, but ETFs may serve some investors, including those with enough to invest that transaction charges are "insignificant" and, conversely, those who can't invest the portfolio's minimums.

Be Specific and Realistic

If you plan to take a conservative 4% out of your portfolio annually after retirement, you probably will be able to beat the risk of falling short. Set clear objectives you can work toward achieving. If you "want $50,000 a year. You'll need to accumulate $1.25 million. Need $100,000 a year? Make it $2.5 million." Discipline is essential to achieving such goals. High living now may cost you dearly later. Cut back on expenses and save if you want to be independent.

About the Author

Alexander Green is the Investment Director of the Oxford Club and Chairman of Investment U, an Internet-based investment research service.