1 THE COFFEEHOUSE INVESTOR

YOU ARE ABOUT TO EMBARK ON A JOURNEY that will change the way you invest forever. Along the way we will talk about things like pitching tents and pumpkin pies, because even though building and maintaining a successful investment portfolio today is essential for you to achieve your financial goals tomorrow, we will discover that the simple things in life, like pitching tents and pumpkin pies, are much more important to your investment success than the hype and hysteria of Wall Street, which never makes much sense anyway.

This journey is for everyone – long-time stock market investors as well as beginners – people who can't afford to make a mistake because their financial goals of tomorrow depend on making the right decisions today.

In our efforts to do the right thing with our investment decisions today, though, it's easy to get caught up in the empty words of Wall Street and do lots of wrong things. Well, if there is one place in your life where you don't want to make a mistake it is with your investment decisions, because when it comes to realizing your financial goal someday, if you make a mistake here, you won't get a second chance.

I must caution you though: This investment journey will not show you how to pick hot funds and cool stocks, analyze balance sheets, predict business cycles or forecast interest rates. This investment journey simply reveals the three principles of investing and explains why these principles are infinitely more important to your investment success than all the "stock market experts" who try to convince us they know more than we do about all this hot and cool stuff.

In fact we will discover that one of the requirements for a successful journey is to ignore the "stock market experts" of today in much the same way Aristotle ignored the "flat world experts" 2,400 years ago when suggesting that the earth was round.

Oh, by the way, the last time I climbed Mt. Rainier, I stopped just short of the 14,410-foot summit to drink some water and eat some food, and while hanging on to the side of the glacier at about five in the morning I looked over my shoulder (briefly, because I suffer from acrophobia) and saw the sun…

rise...

and somewhere between Canada to the north and Oregon to the south, I think I detected a slight curve on the earth's horizon.

Now, I am not one to imply there is any correlation whatsoever between the flat earth experts of yesterday and the stock market experts of today, but I will say, unequivocally, that stock market acrophobia, which is fueled in large part by stock market experts, causes many investors to make investment mistakes they are sure to regret when it comes time to retire.

Whether the earth is flat or round doesn't matter much anymore. What does matter is that most of us get up in the morning, put on our working shoes and go to work,

meeting deadlines,
raising children,

learning new technologies,
building careers,
attending school functions,
keeping up with the competition,

and generally giving it all we've got.

For most of us, somewhere between the chaos of giving it all we've got today and achieving a financial goal tomorrow lies the daunting task of building and maintaining a successful investment portfolio.

It's hard enough putting a successful investment plan in place amidst the chaos of giving all we've got every day. But when our efforts to do so come face-to-face with a financial industry that pretends to have all the right answers, there is a tendency to feel like we are slowly sliding off the side of a glacier.

As the world continues to gently spin 'round and 'round, as the days turn into nights and back into days again, our financial goals that seem so far away get closer and closer. The problem is, the world spins so gently, and we are so busy, that it's easy to put off dealing with far-away financial goals, especially when we have the misconception that dealing with something so far away means sorting through thousands of mutual funds, hundreds of stockbrokers, and dozens of financial magazines…

when all we really have the energy for is dealing with today.

That's why, with our lives so busy and our financial goals so far away, it's critical that, in addition to meeting deadlines, raising children and keeping up with the competition, we learn about the three fundamental principles of investing. Once we do this we can ignore Wall Street and get on with our lives, secure in the knowledge that by implementing the three fundamental principles of investing, our portfolios will be ready for us when we are ready for them.

Focusing on what really counts and ignoring everything else is a major step in any successful journey, because it is easy to get caught up in irrelevant things and follow along with the crowd. Then, even though you begin to notice that what you are doing is not getting you any closer to your goal, it is difficult to change your actions, especially when you see everyone else continuing to do the same thing.

For instance, one of my goals was to break eighty in golf. I practiced and practiced and practiced some more. I could not break eighty. Then one day I played golf with a woman twice my age and half my weight, who not only broke eighty, but shared with me the secret for doing so. After playing eighteen holes of golf on an old public course in West Seattle, she looked at me and said, "The problem with you is, you can't make your four-foot putts."

There is nothing like someone stating the obvious. From then on, instead of going to the driving range to practice my driver, I went to the putting green to practice my four-foot putts.

Before long, I broke eighty.

Had I never run into that delightful woman who cleared up my misconception that the secret to breaking eighty was hitting a perfect driver, I would still be practicing my driver and ignoring the most important thing of all – my four-foot putts.

It's not easy to go against the grain of popular opinion, especially when you show up at the putting green with your putter while everyone else is at the driving range, smacking their drivers. The same is true when building a successful portfolio – the challenge is to go against the grain of Wall Street by ignoring much of what they throw our way and focusing exclusively on the investment equivalent of four-foot putts . . .

or what I call the three principles of investing:

1. Asset allocation
2. Approximate the Stock Market Average
3. Saving

Asset Allocation means choosing the best combination of stocks, bonds and cash to provide you with the greatest chance of achieving your financial goals with the least amount of risk.

Approximating the Stock Market Average means making sure your stock market investments are doing at least as well as what the stock market as a whole is doing. (That is, if the stock market is up 2 percent, your stock market investments should be up 2 percent. If the stock market is up 33 percent, your stock market investments should be up 33 percent.)

Saving means knowing how much money you need to set aside each month to reach your financial goal and eventually saving it.

The important thing about *asset allocation, approximating the stock market average* and *saving* is that these three principles are in our control. That is important, because we will see that when we focus on Wall Street, things that are out of our control, such as weekly economic numbers, quarterly earnings reports and year-end mutual fund summaries, tempt us to fiddle around with our investments instead of leaving well enough alone.

Speaking of leaving well enough alone, I find it interesting that less than 10 percent of the millionaires of this country consider themselves "active" traders, and 42 percent of the millionaires of this country make less than one transaction per year in their investment portfolios.[1]

Not one transaction per hour,
not one transaction per day,
not one transaction per week,
not one transaction per month...

less than one transaction per year.

Maybe, just maybe, the millionaires of this country have discovered that the more they leave well enough alone and get on with their lives, pursuing their dreams and fulfilling their passions, the better off they and their portfolios will be.

1. Thomas J. Stanley and William D. Danko, *The Millionaire Next Door* (Atlanta, Ga.: Longstreet Press 1996)

On the other hand, Wall Street types have a tendency to portray this world of investing as fun, exciting and full of busy portfolios. To them, what could be better than waking up each morning, logging onto the Internet after reading *The Wall Street Journal*, then calling Stan the stockbroker and instructing him to buy a little of this and sell a little of that, and please do it immediately because you don't want to miss out on this great investment opportunity that is here today and gone tomorrow, and oh boy,

isn't this fun,
isn't this exciting,
isn't this luxurious...

and isn't life grand.

But for those of us who are greeted each morning with children to be fed and dressed for school, and who are completing projects for a ten o'clock seminar; running to catch a bus, train or automobile; and hoping for an extra three minutes to stop by the local coffeehouse for a cup of our favorite blend before dashing off to earn a living, spending time each day on our investments is the *last* thing we want to do.

I have never quite figured out how busy portfolios can somehow produce successful portfolios, but I *have* figured out that the secret to breaking eighty is making my four-foot putts.

As long as Wall Street has a vested interest in lots of transactions and busy portfolios, investors will continue to latch on to the hype and hysteria of Wall Street, perpetuating the misconception that by carefully reviewing market trends, diligently studying mutual fund tables, religiously researching global economies and closely watching interest rates, anyone and everyone can successfully switch in and out of…

mid-cap health-care funds,
emerging market growth funds,
small-cap micro tech stocks
and large cap blue chip funds...

and own a successful portfolio.

Hey! Wall Street now offers "mutual fund supermarkets," so investors can not only switch from fund to fund and stock to stock and sector to sector, they can now switch from one *family* of funds to another *family* of funds –

kind-of like one-stop shopping.

And now Wall Street lets investors do all this one-stop shopping with the flick of a switch and the click of a mouse on the Internet.

How totally cool.

There's only one problem.

If the millionaires of this country aren't obsessed with trading their accounts every hour on the hour, who is?

You?

I have a good friend named Marilyn who is too busy juggling her activities as a great mother and successful attorney to design a sector-filled mutual fund account, but she still wants to own a successful portfolio for her retirement.

I have a good friend named Bernard who farms and is too busy raising produce for supermarkets to come home at night and shop at a mutual fund supermarket, but he wants to own a successful portfolio for his retirement.

I have a good friend named Margaret who is a physical therapist and is too busy charting progress reports on her computer to trade stocks and mutual funds on the

Internet, but she wants to own a successful portfolio for her retirement.

To these three people and millions like them who live life with a passion and purpose, and quite frankly couldn't care less about busy portfolios and Wall Street things, congratulations –

you are on your way to becoming successful investors.

For those of us who already ignore Wall Street and are getting on with our lives, the challenge we face in building wealth is to spend a little time learning the difference (and what a difference it is) between busy portfolios and the three fundamental principles of investing.

It doesn't matter whether you have a regular (taxable) account and can choose between 20,000 stocks and funds, or a company-sponsored 401(k) retirement plan that gives you a choice of eight. If you allocate your assets properly, approximate the stock market average and save enough, you maximize your chances of achieving your financial goals.

It's a good idea to learn about these three fundamental principles of investing now because the longer you wait the more painful it becomes, and the last thing you want to do is get caught in the middle of a growing national crisis resulting from too many people reaching retirement age with too little money to sustain themselves – not to mention enjoy themselves.

We've all read the surveys of the average baby boomer who has socked away exactly $26.32 and a few peanut butter sandwiches for her retirement. I suspect these surveys overstate the problem, but not by much.

If the people of this country who work so hard to earn a living continue with their current saving and investing habits, there will be lots of folks who are in for a big surprise when they want to retire, and this surprise won't come in the form of a surprise retirement party. It will come in the form of a dramatically reduced standard of living or a need to prolong their working years at a time in life when the shelf life of a peanut butter sandwich is the last thing they should have to worry about.

Do yourself a big favor. Put this book down, close your eyes and contemplate what your life would be like, today, on 20 percent of your current income.

I would guess that for most people, living on 20 percent of their current income would be extremely painful, and if we're honest with ourselves we wouldn't begin to know where to cut and trim so our expenses match an 80 percent reduction in income.

If we slow our lives down just enough to determine whether there is a distant financial crisis looming, and then keep our lives slowed down a little longer to learn about the three fundamental principles of investing, it's a crisis that can easily be averted.

There is an enormous benefit to allocating your assets, approximating the stock market average, and saving.

It is the benefit of taking control of your financial life so that you, and you alone, are responsible for your actions today and the quality of life when you retire.

When you take control and accept full responsibility for *how your assets are allocated*, you are at the same time letting go of the mistaken belief that the secret to a successful portfolio is to accurately forecast bull and bear markets.

When you take control and accept full responsibility for *approximating the stock market average*, you are at the same time letting go of the mistaken belief that the secret to making money in the stock market is relying on stock market experts.

When you take control and accept full responsibility for *how much you save*, you are at the same time letting go of the mistaken belief that the government safety net will be there to catch you and millions like you when the time comes to retire in style.

A funny thing happens when you begin to take control of one part of your life – whether it is taking control physically, financially or mentally: You gradually notice a positive change in other areas of your life, such as your personal relationships, your performance at work and your ability to embrace your true passions.

Franz Schubert, the great Austrian composer, once said, "I am in this world only for composing."

Wouldn't it be nice to take some of our new-found energy and use it to discover or rediscover a sense of purpose in this world as strong as Franz Schubert's?

The first step in discovering our true passions and talents is to isolate and eliminate clutter in our lives, including in our finances, and a good place to start is to look at how our addiction to clutter is born out of the society we live in.

For instance, if a person is raised in a household that has a habit of watching television four hours a day, there's a good chance that person will become addicted to watching a lot of television.

I am not one to say four hours of television a day is too much television, but there is a little voice inside me that says four hours of television a day will not help me in my journey toward discovering my talents and passions and living a healthy and productive life. Unless people who watch four hours of television a day are creatively shown why watching that much television might be counterproductive to living healthy and productive lives, chances are these people will have a difficult time breaking an addiction to television.

Even though this addiction to television might hinder someone's ability to think creatively and communicate effectively, watching television is still a difficult habit to break, because for the most part those who are addicted probably don't know any better.

The same is true in investing.

If a person is raised in a society that has a habit of focusing on last year's top mutual funds, this year's hot stocks, and what the Dow Jones Industrial Average did today, eventually this person becomes addicted to the clutter of glossy mutual fund magazines, brokerage firms' recommended buy lists, and high-speed internet sites, all proclaiming to have the right answers and top funds for you. Unless this person is creatively shown why paying attention to all this financial clutter is counter-productive to one's investment success, he will continue this addiction to Wall Street, all the while ignoring the three most important aspects of investing: asset allocation, approximating the stock market average and saving.

It is a hard addiction to break, because after discussing the weather it seems like everyone wants to talk about cool companies and hot mutual funds, and if you don't own cool companies and hot mutual funds some people might think you are dull and boring.

Don't worry.

It's better to be dull and boring and a successful investor than it is to be loud and obnoxious and unable to retire.

The ironic part of all this dull and boring stuff, if I do say so myself, is that the people who talk only about stocks and bonds are the people who end up being dull and boring. But the people who are embracing life and in their conversations reveal a sense of being immersed in the world at large are the people we enjoy the most.

Come to think of it, that's how this journey got started – meeting up with close friends at a corner coffeehouse in Seattle on rainy Saturday mornings, talking about the week behind us, talking about the week ahead, and talking about the kids to be coached, mountains to be climbed and stuff to be done that day.

Those 6:30 a.m. coffeehouse discussions that helped us reconnect with the world after a hectic week usually got started around 6:45, when someone woke up enough to read something in the morning newspaper worth reading, like how bad will traffic get before we finally pass a rapid transit proposal (it passed), or how will the Seattle Mariner's bullpen perform this year (not great)… or how much higher (or lower) can Microsoft go?

The thing I liked most about those 6:30 Saturday morning coffeehouse discussions is that they were over and done with by 7:15, because by 7:15 it was light enough to see through the rain from our corner in the coffeehouse.

And even though we weren't that jazzed to leave our warm coffeehouse corner and go out in the rain to coach kids, climb mountains or get stuff done, we got going anyway, because we learned early on that if you wait for a dry day to do stuff in Seattle it might just never get done.

Looking back on our discussions of soccer games and stock splits, those 6:30 a.m. coffeehouse investors seemed to be the independent types who enjoyed, among other things, the satisfaction of owning successful portfolios.

And even though they had fun talking about high-flying stock market issues, these investors understood the importance of diversification, and they also knew that when you take a risk in the stock market you better make sure it is a risk worth taking.

Abraham de Moivre, the French-born mathematician and pioneer in the understanding and application of risk management, never sat with us at our corner coffeehouse table because he died in 1754, but to me he is the ultimate coffeehouse investor. He used to spend his afternoons in an English coffeehouse, selling his knowledge of risk to gamblers, merchants and brokers.

I'm convinced that, were he alive today, Abraham de Moivre would tell us that investing in the stock market to achieve our long-term financial goals is clearly a risk worth taking…

relying on Wall Street experts to invest our money in the stock market for us is clearly a risk that is not.

Don't take my word for it, though.

This journey will let you decide for yourself.

Let's get going.