Investing FOR BEGINNERS

2 INVESTING PRINCIPLES

HOW TO BE SUCCESSFUL

Welcome to book 2!

Before we look at picking your shares, we need to go over a few key principles for investing success. These principles will keep you safe and successful in your investing, and should make you feel more confident when you come to picking your shares in later videos.

This book will cover the following:

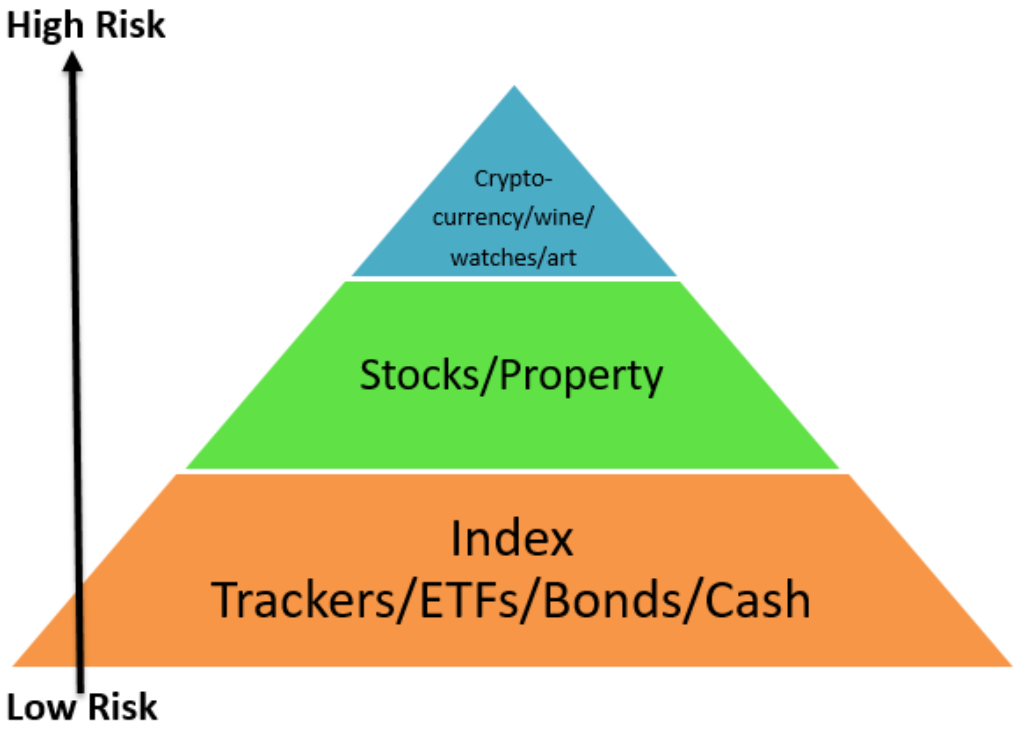
- The Investment Pyramid
- Diversification
- Transaction fees, ongoing charges and brokerage fees
- Cost averaging
- Compounding

Enjoy!

The Investment Pyramid

If you follow the concept of the investment pyramid, then you will always make sensible and safe choices.

Just to remind you - the pyramid is a structure with a broad bottom and a peaked top. Here it is in 2D....



As you can see, this is roughly how you should be splitting your investments. The bulk of your money will be in index trackers, ETFs, bonds and cash (your emergency fund etc). The middle third is for individual stocks and rental property. The top is reserved for speculative investments and things that may or may not be tricky to sell on.

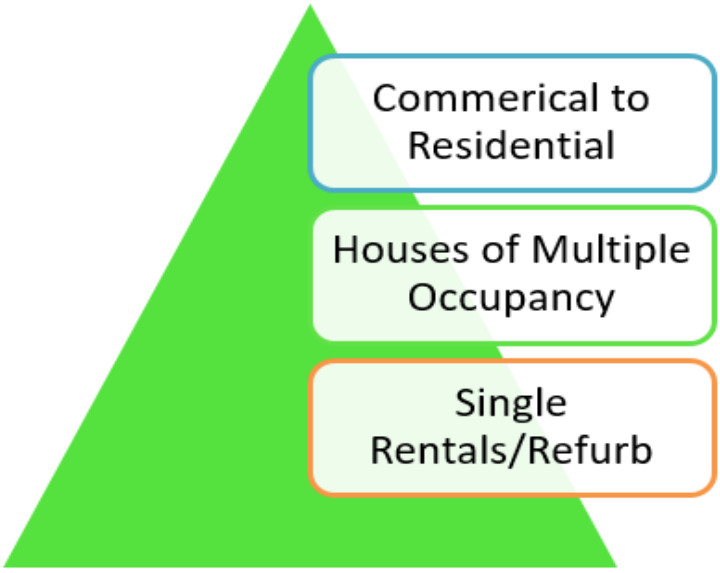
So now you can see where stocks and shares investing fits in. This is a safer way of investing rather than throw your life savings into crypto-currencies like bitcoin, only for the bubble to burst and you lose everything.

For example, if you had £10,000 to invest, you might allocate it 70%/20%/10% as you go up the pyramid. This is assuming you want to invest in stocks and shares (why would you have bought this training otherwise!?).

If you are keen on property instead, and would rather throw the whole £10,000 in, you'll need additional training, and there are plenty of options out there. I'll list a few recommendations for you in the resources section at the end of the course.

The higher up the pyramid you go, the returns can be greater (not always, as property can bring about HUGE gains) in exchange for the amount of risk you are taking on. As an example, millionaires are currently being made out of bitcoin investors who started years ago and are now reaping the rewards.

Now there are a few additional points to make. There are pyramids within pyramids. In the middle section of the first pyramid where I've written property, this can also be split into a pyramid of risk depending on your experience and knowledge.



The small pyramid for a beginner might look like the above; with single rental investing at the bottom, and commercial to residential conversion at the top.

This is based on the amount of moving parts involved, and in the amount of money required to make each type of property investment work. As with our main pyramid, the returns get better the further up you go to match the amount of risk you are taking on.

Another point to make is that the pyramid will change as you get older. When you are nearing retirement, you don't necessarily want loads in stocks and shares in case of but swings in the market just as you want to take your money and ride off into the sunset.

The great thing is now we're all living much longer. So retirement isn't just a few years anymore, its 30. This means that your pension plan needs to stretch for 30 years potentially (longer if you plan to retire younger!).

Gone are the days of final salary pensions and security for your old age from your work place. Not only that, you also need to think about how you are going to be cared for should you need it.

I'll go into more detail on this in a later lesson, as it deserves more time than we can cover here.

Diversification

Before picking our ETFs or Index trackers, we need to learn about diversification. Like the investment pyramid, diversification helps keep us safe.

Rather than split your money just three ways into stocks of Disney, Tesco and Microsoft, you instead purchase a package that includes LOTS of different companies. This means that you are not relying on a few companies to make you money. What happens if something disastrous happens and Microsoft goes bust? That's a third of your money gone.

Now it's likely Microsoft isn't about to go under anytime soon, but this is exactly what people do all the time. They put loads of money into one or two companies because they are so sure that they will continue to grow and make money, only to have some disaster take place, and the value of the stock you bought gets wiped out. This is what happened in many of the past crashes, such as the "dot-com" crash in the late 90s and the housing market crash in 2008.

The other point to make is that trading stocks (buying and selling them) like this is EXPENSIVE. On Hargreaves Lansdown for example, for each purchase you make, you currently pay £11.95 in fees. If you split your money into just three different stocks, you're paying three sets of fees. When you sell them, you also pay fees. So "trading" is not the way I will be teaching you to invest. It may seem sexy and exciting, but its costly and most people lose money through doing it.

We're winners, and we're going to invest like winners!

So, back to diversification. This is where ETFs and index trackers come in. Each of these options allows you to make a single transaction, but you're buying lots of companies all at once. The HSBC FTSE 250 index tracker for example, is a slice of every company listed in the UK stock market ranking from 101st largest to 350th largest.

The S&P 500 ETF is a collection of 500 large companies, having common stock listed on the NYSE or NASDAQ. So for each purchase you make, you're getting 500 or 250 for the price of 1. Cool huh?

You're making your investing safer when you follow this principle. Obviously there is still a risk of everything going down all at once, like when stock markets crashed in 2008, but stock markets go up and down all the time. Its nothing to be scared of. In fact, when the market goes down, you can take advantage and buy more (because its like a black Friday sale!).

When everyone stops panicking and the market recovers (which it will), you can be smug in the knowledge that you've been smart by holding on, because now you own more shares, which means you own more of the company, which means you earn more of a share of the PROFITS!

Transaction fees, ongoing charges and brokerage fees

I'm hoping by now you're really excited, and can't wait to begin your investing journey. I know I was by this point. In fact, I will tell you a little story about my first investing mistake!

Like you, I was super excited to be learning how to invest. I watched a live webinar run by Ann Wilson and Nerina Visser in South Africa where they were talking about an ETF that was specific to South Africa. I got off the webinar, and decided to invest there and then in an ETF. I found one that looked promising. I had looked up the ongoing fees and I had read what was in the ETF – it was an iShares plc S&P 500 ETF. I felt ready to try it out. I hit "place a deal" with £100 (which is the minimum you have to put in if making a one-off purchase of shares). I excitedly looked at my account which read - £93.39. Huh? How come? I'd lost money from day one! What I hadn't realised was that I had forgotten to factor in the cost of doing a trade (i.e. the transaction fee).

ETFs are bought and sold like individual stocks (despite the fact you're buying a share of a lot of them all at once). This means they come with a trading fee. This can be up to £11.95 with Hargreaves Lansdown. It's a factor you just have to include when buying ETFs. The aim is to keep it less than or equal to 1% of the amount of money you are putting in. So if your fee is £5, you need to make sure you put in AT LEAST £500 so that the fee is less than 1%.

My error meant that my fee was just over 6% of the equivalent of the money I put in. Not ideal. This is why setting up a regular monthly investment will avoid this problem – do you remember I said I'd tell you why you set it up like this in the first place?

So if you have enough money to compensate for one off fees, then great, do that. But if you don't, simply set up a regular monthly investment of whatever you can afford, starting at £25 per month.

The other fees you need to be aware of are the ongoing charge/net ongoing charge, and the brokerage fee. These need to be as small as possible.

The ongoing charge needs to be less than 1% (you can get charges of 0.06%, so make sure you look hard at all of these before choosing). The brokerage fee will vary depending on the platform and the amount of money you have invested.

For example, on the HL platform they have the following fees:

Total amount of money invested with HL in a vantage account	Fee per annum
<£250,000	0.45%
£250,000-£1m	0.25%
£1m-£2m	0.1%
>£2m	Nil charge

If you decide to go with another broker, make sure you find out what their fees are for holding the money on their platform. Remember it isn't about getting the cheapest platform, its about finding the one that is suitable for all your needs.

I use HL because I can access everything I want to, and I'm not limited to one company's products. Its keeps it simple, which is what we're all about here right?

Cost averaging

Ok, I'm about to get a little mathsy on your ass right now.... Stay with me, its not hard.

I'm talking about another principle for successful and safe investing. It's a term called "cost averaging".

What do I mean by this?

Take a look at this table:

Month	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Average cost per share
Investment	£25	£25	£25	£25	£25	£25	£25	£25	£25	**£225**
Shares Purchased	20	25	15	12	24	27	30	20	20	**193**
Cost per share	£1.25	£1.00	£1.67	£2.08	£1.04	£0.93	£0.83	£1.25	£1.25	**£1.16**

Can you see how I worked this out?

(Investment cost / shares purchased = cost per share)

Every month, as the stock market goes up and down, the cost of the shares to us goes up and down too. Some months our £25 buys more, and other months it buys less. But when you average this out over the 9 months, you can see that the average cost per share works out to be £1.16.

This is actually cheaper than 5 out of 9 months where the cost per share was higher.

Paying an instalment every month like this means that on average, the cost per share is cheaper overall. It doesn't matter whether the market goes up or down because of this simple concept.

So even if you have lump sums to invest, I still want you to purchase the same shares on a monthly basis so that you can take advantage of cost averaging and have it work in your favour. You can invest lump sums AND set up a monthly direct debit.

Compounding

This is the way in which money increases in value over time. Einstein wasn't wrong when he said that "compounding is the 8th wonder of the world".

One of the problems I have had for most of my adult life is that I had compounding working AGAINST me.

If you have credit card debt that gains a bit of interest every month, making your debt more difficult to pay off, that's compounding working against you (and FOR the banks).

If you have stocks and shares in an index tracker making 8% per year, that's compounding working FOR you to grow your money.

Compounding works best with time, and is a key ingredient in your investing success. So, for example, if you had £100 in your pension and left it alone growing at (a fictional) 10% interest every year, it would in theory look like this:

Year 1	£100
Year 2	£110
Year 3	£121
Year 4	£133.10
Year 5	£146.41
Year 6	£235.79

This is how money grows if you leave it alone, and it grows at the same rate of return. In real life, we have to factor in market ups and downs, fees and tax (if you're not using a tax efficient investment account). Now it doesn't seem like a lot in this example, but this is only if you left £100 on its own and didn't add to it every month (which is not what you're going to do now you know about cost averaging!).

Can you now see why it is so important and NECESSARY to start putting money into investing straight away? The more time you have IN the market the better.