Your Monthly Money Newsletter

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Invest Money Wisely at Any Age: Seven Simple Principles

The COVID-19 pandemic and economic crisis have triggered extreme Stock market volatility. This week, Wall Street also saw the stock price for GameStop, a video game retailer, skyrocket far above what many people think it's worth.

Seeing huge daily spikes and drops in stocks and the overall market may leave you wondering what to do with your investments or whether you should be investing in the first place.

Fortunately, the answer to wise investing has not changed. In fact, the market turmoil and GameStop stock frenzy prove that using simple, tried-and-true investment strategies is the best way for investors to get through any crisis. When you have a strong investment strategy, you will never panic or wonder if you are doing the right things with your money, no matter what the news headlines say.

This post will review seven simple principles to grow your net worth no matter if you are just starting to invest or you have been at it for decades. You will learn how to achieve long-term financial goals, such as retirement or paying for a child's college, even if you do not have much money to invest. I will include an explainer on why everyone has been talking about GameStop and if it matters to average investors.

Follow these seven simple principles to invest money for healthy returns without taking too much risk.

1. Separate savings from investments.

Though we tend to use the terms saving and investing interchangeably, they are not the same thing. Savings is cash you keep on hand for short-term planned purchases and unexpected emergencies.

2. Invest to reach long-term goals.

While market values can swing wildly in short periods, such as days, months, or even a year or two, they have consistently gone up over more extended periods. That's why investing is only appropriate for goals you want to achieve in at least three to five years in the future, such as putting kids through college or retiring.

Historically, a diversified stock portfolio has earned an average of 10%. But even if you only got 7%, by investing $400 a month for 40 years, you'd have over $1 million to spend in retirement.

A good rule of thumb is to invest a minimum of 10% to 15% of your gross income for retirement. Yes, that is in addition to the emergency savings that I previously mentioned. So, if you do not have a healthy emergency fund, make accumulating some cash a top priority before you begin investing.

3. Start sooner rather than later.

One of the most critical factors in how much investment wealth you can accumulate depends on when you start. There is no better example of how the proverbial early bird gets them worm than with investing. Starting early allows your money to compound and grow exponentially over time – even if you do not have much to invest.

Consider two investors, Jessica and Brad, who set aside the same amount of money each month and get the same average annual return on their investments.

Jessica

- Begins investing at age 35 and stops at age 65
- Invests $200 a month
- Gets an average return of 8%
- Ends up with just under $300,000

Brad

- Begins investing at age 25 and stops at age 65
- Invests $200 a month
- Gets an average return of 8%
- Ends up with just under $700,000

Because Brad started investing ten years before Jessica, he has $400,000 more to spend in retirement. Even though he only contributed $24,000 ($200 x 12 months x 10 years) more than Jessica, Brad's investments had much more time to compound, making him more than two times wealthier.

Unfortunately, many people believe that they do not earn enough to invest and can just catch up later on. If you wait for a someday raise, bonus, or windfall, you are burning precious time. Catching up becomes more difficult and expensive the longer you wait.

Please remember that you are never too young to begin planning and investing for your future. Even if you only have a small amount to invest now, it is better over the long run than waiting. The bottom line is that the earlier you start investing, the more financial security you will have.

But what if you did not get a head start on investing and you're worried about running out of time? You have to dive in and get started now. Most retirement accounts allow for additional catch-up contributions to help you save more in the years leading up to retirement.

4. Use tax-advantaged accounts.

One of the best ways to invest money is under the umbrella of one or more tax-advantaged accounts, such as an IRA or a workplace 401(k). If you are self-employed, you have even more choices. My newest book, Money Smart Solopreneur, can help you choose the best business retirement plan, such as a SEP-IRA or a solo 401(k), based on your company size and goals.

Investing inside of retirement accounts helps you accumulate a nest egg and cut your tax bill at the same time. When you use "traditional" retirement accounts, you contribute on a pre-tax basis. That means you defer paying tax on both contributions and earnings until you make withdrawals in the future.

Another option is to contribute to a Roth 401(k) or a Roth IRA, where you pay tax on contributions upfront but take withdrawals in retirement that are entirely tax-free. If your employer offers a retirement plan, start participating as soon as possible, especially if they pay matching contributions.

Let us say you get a full match on the first 3% of your salary contributed to a 401(k). If you earn $40,000 a year and contribute 10%, that equals $4,000 (10% of $40,000) a year or $333 a month. If that is all you invested over 40 years and earned an average 7% annual return, you would have a nest egg worth over $875,000.

Consider the benefit you would get from matching funds: If your employer matched contributions up to 3% of your salary, they would add $1,200 (3% of

$40,000) a year or $100 a month to your account.

Now, you are socking away a total of $5,200 ($4,000 plus $1,200) a year, which means you will have over $1.1 million after 40 years. That is about $260,000 more to spend in retirement, thanks to those free, additional matching funds!

Even if your employer does not match contributions, I'm still a big fan of
workplace retirement accounts. Not only do they automate investing by deducting contributions from your paycheck before you see them, but a retirement plan also cuts your taxes. And you can take all your money with you, including your vested matching funds, if you leave the company.
In addition to retirement plans, there are other types of tax-advantaged accounts you can use to invest for different purposes, including:

- A 529 college savings plan allows your earnings to grow tax-free if you use the funds to pay for qualified education expenses.
- A health savings account (HSA) is available to pay eligible medical costs on a tax-free basis when you have a high deductible health plan.

5. Don't be a stock picker.

Buying and selling individual stocks, such as Apple, Amazon, Google, or GameStop comes with substantial risk. Even professional money managers cannot predict with certainty whether a stock will go up or down.

The GameStop frenzy you may have heard about this week is a great example. In a nutshell, here's what happened. The game retailer has not been doing well, so professional investors shorted the stock. That means they were so sure the company would fail that they bet on it. Shorting means you profit if a stock price goes down, and it's completely legal.

When a vast group of investors in a Reddit forum discovered the huge short positions on GameStop, they decided to do the opposite and buy the stock. That pushed up the price, causing the short sellers to lose billions. Many trading platforms and apps put on the brakes by temporarily restricting users from buying and selling GameStop and some other volatile stocks.

You might say the GameStop move is like individual investors banding together to "stick it to the man" or wealthy investment firms. It is the first time we have seen online groups of day traders inflate a stock price so much that it hurt huge retail investors. However, the artificially inflated GameStop stock price will eventually drop because the company is not fundamentally healthy.

The takeaway is that any individual stock can fluctuate wildly from minute to minute, making it too risky for an average investor. The best strategy for getting high stock returns with much less risk is to own one or more diversified funds. A stock fund is made up of hundreds or thousands of underlying stocks, which spreads out risk.

I recommend that you start by figuring out how much stock you should own based on your goals, such as a retirement date.

You might allocate your stock percentage to various stock funds or put it all into one, such as a total stock market index fund that mirrors an entire index, such as the S&P 500. The remaining amount of your portfolio would own investments in other asset classes such as bond funds, real estate, and cash.

6. Avoid high fees.

Different investment funds charge different fees, known as an expense ratio. For instance, a 2% expense ratio means that each year 2% of a fund's total assets will be used to pay expenses, such as management, advertising, and administrative costs. If you choose a similar fund that charges 1%, that may seem like a small difference, but the savings add up.

For instance, if you invest $100,000 over 30 years with an average return of 7% instead of 6%, you will save about $200,000. So, be sure to choose low-cost funds, such as exchange-traded funds (ETFs) and index funds, so more of your money stays in your account, helping you earn higher returns.

7. Use automation.

To be a successful investor, you need to invest consistently over a long period. A great way to maintain an investing habit is to automate it.

Have money automatically transferred from your paycheck or bank account into a savings or investment account every month before you get tempted to spend it. Yes, sometimes you have to outsmart yourself to manage money wisely.

Putting your investments on autopilot is by far the best way to build wealth safely. Years from now, when you have savings to fall back on and investments to fund your dream lifestyle, you will be so happy that you took control of your financial future.