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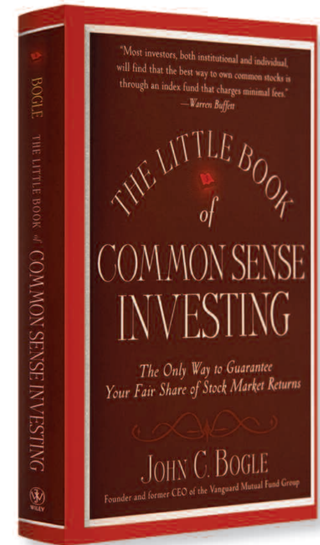
Personal Finance

The Only Way to Guarantee Your Fair Share of Stock Market Returns

The Little Book of Common Sense Investing



by John C. Bogle

THE SUMMARY IN BRIEF

Investing is all about common sense. Owning a diversified portfolio of stocks and holding it for the long term is a winner's game. Trying to beat the stock market is theoretically a zero-sum game (for every winner there must be a loser), and after the substantial costs of investing are deducted, it becomes a loser's game. Common sense tells us, and history confirms, that the simplest and most efficient investment strategy is to buy and hold all of the nation's publicly held businesses at very low cost. Earning a fair share of whatever returns that our business enterprises are generous enough to provide is the definition of investment success.

Filled with in-depth insights and practical advice, this summary will show you how to incorporate this proven investment strategy into your portfolio. Not only does John C. Bogle show you what to do, he also shows you what not to do. He explains why the accepted market wisdom is designed to keep you in the dark. An understanding of the tyranny of compounding costs and the folly of speculation will lead investors to the only investment strategy that guarantees them their fair share of stock market returns. Successful investing is not easy; it requires discipline and patience. But it is simple, for it's all about common sense.

IN THIS SUMMARY, YOU WILL LEARN:

- Why business reality — dividend yields and earnings growth — is more important than market expectations.
- How to overcome investment costs, taxes and inflation.
- Why simplifying your investment strategy makes you a winner.
- How common sense investing trumps investment advisors.
- How compounding costs overwhelm compounding returns.

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THE COMPLETE SUMMARY: **THE LITTLE BOOK OF COMMON SENSE INVESTING**

by John C. Bogle

The authors: John C. Bogle is founder of the Vanguard Group, Inc. and president of its Bogle Financial Markets Research Center. He created Vanguard in 1974 and served as chairman and chief executive officer until 1996 and senior chairman until 2000.

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Don't Allow a Winner's Game to Become a Loser's Game

Successful investing is all about common sense. It is simple, but it is not easy. Simple arithmetic suggests, and history confirms, that the winning investment strategy is to own all of the nation's publicly held businesses at very low cost. By doing so, you are guaranteed to capture almost the entire return that they generate in dividends and earnings growth.

The best way to implement this strategy is indeed simple: Buy a fund that holds this market portfolio, and hold it forever. Such a fund is called an *index fund*. The index fund is simply a basket (portfolio) that holds many, many eggs (stocks) and is designed to mimic the overall performance of any financial market or market sector. Classic index funds basically represent the entire stock market basket, not just a few scattered eggs. These funds eliminate the risks of individual stocks, market sectors and manager selection. Only stock market risk remains.

The Investment Game

Over the past century, our corporations have earned a return on their capital of 9.5 percent per year. Compounded at that rate over a decade, each $1 initially invested grows to $2.48; over two decades, $6.14; over three decades, $15.22; over four decades, $37.72; over five decades, $93.48. The magic of compounding is little short of a miracle. Thanks to the growth, productivity, resourcefulness and innovation of our corporations, capitalism creates wealth, a *positive-sum game* for its owners.

As a group, investors are, by definition, average. Each extra return that one of us earns means that another of our fellow investors suffers a return shortfall of precisely the same dimension.

But the costs of playing the investment game both reduce the gains of the winners and increase the losses of the losers. So, who wins? The people in the middle (the brokers, investment bankers, money managers, marketers, accountants, lawyers, and operations departments of our financial system) — the croupiers in the market casino, if you will — are the only sure winners.

Academic studies suggest that if you are a typical investor in individual stocks, your returns have probably lagged the market by about 2.5 percentage points per year, largely because of the costs they incur. Applying that figure to the annual return of 12 percent earned over the past 25 years by the Standard & Poor's 500 Stock Index, your return has been less than 10 percent.

A Parable: The Gotrocks Family

Perhaps this homely parable — a version of a story told by Warren Buffett, chairman of Berkshire Hathaway Inc., in the firm's 2005 Annual Report — will illustrate the foolishness and counter productivity of our vast and complex financial market system.

Once upon a time . . .

A wealthy family named the Gotrocks had grown over the generations to include thousands of brothers, sisters, aunts, uncles and cousins, and owned 100 percent of every stock in the United States. Each year they reaped the rewards of investing: all the earnings growth that those thousands of corporations generated and all the dividends that they distributed. Each family member grew wealthier at the same pace, and all was harmonious. Their investment had compounded over decades, creating enormous wealth, because the Gotrocks family was playing a winner's game.

1-800-SUMMARY
service@summary.com

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Rebecca S. Clement, Publisher; **Sarah T. Dayton,** Editor In Chief; **Athena Nicolaides,** Art and Design; **Dee Burks;** Contributing Editor

After a while, a few fast-talking Helpers arrive on the scene, and they persuade some "smart" Gotrocks cousins that they can earn a larger share than the other relatives. These Helpers convince the cousins to sell some of their shares to other family members and to buy other shares from them in return. The Helpers handle the transactions and they receive commissions for their services.

To the Gotrocks' surprise, the family wealth now grows at a slower pace. This is because some of the return is now consumed by the Helpers. To make matters worse, while the family had always paid taxes on their dividends, some of the members are now also paying taxes on the capital gains they realize from their stock swapping, further diminishing the family's total wealth.

The smart cousins quickly realize that their foray into stock picking has been a failure and conclude that they need professional assistance. So they hire stock-picking experts — more Helpers! These money managers charge a fee for their services and now feel compelled to earn their keep by trading the family's stocks at a feverish pace, not only increasing the brokerage commissions paid to the first set of Helpers, but running up the tax bill as well. The family's share of the dividend and earnings pie is further diminished.

Undeterred by their previous two failures, the smart cousins decide to hire still more Helpers. They retain the best financial consultants and financial planners they can find who agree to help them pick the right stocks — for a fee. Once again the family's share of the pie tumbles.

Alarmed at last, the family sits down together and takes stock of the events that have transpired since some of them began trying to outsmart the others. "How is it," they ask, "that our original 100 percent share has dwindled to just 60 percent?" The wisest family member, an old uncle responds: "All that money you've paid to those Helpers and all those unnecessary extra taxes you're paying come directly out of our family's total earnings and dividends. Go back to square one and do so immediately. Get rid of all your brokers, money managers and consultants. Then our family will again reap 100 percent."

They follow the old uncle's advice, returning to their original passive but productive strategy, holding all the stocks of corporate America and standing pat.

That is exactly what an index fund does.

Adding a fourth law to Sir Isaac Newton's three laws of motion, Warren Buffett puts the moral of the parable this way: *For investors as a whole, returns decrease as motion increases.*

Additionally, the parable reflects the profound conflict of interest between those who work in the investment business and those who invest in stocks and bonds. The way to wealth for those in the business is to persuade their clients, *"Don't just stand there. Do something."* But the way to wealth for clients in the aggregate is to follow the opposite maxim: *"Don't do something. Just stand there."*

Rational Exuberance

In the long run, stock market returns are determined almost entirely by the economics of investing — the earnings and dividends produced by American corporations. Indeed, the long-term investment return of 9.5 percent (4.5 percent from dividends and 5 percent from earnings growth) nearly matches the market's return of 9.6 percent. The 0.1 percent difference represents the market's speculative return, or the changing price investors are willing to pay for a dollar of earnings (or the P/E ratio). While investor emotions, represented by the speculative return, can dominate over the short term, it is the economics of investing that hold sway in the long term.

But in our foolish focus on the short-term stock market distractions of the moment, we often overlook this long history. We ignore the fact that when returns on stocks depart materially from the long-term norm, it is rarely because of the *economics* of investing. Rather, the reason that annual stock returns are so volatile is largely because of the *emotions* of investing.

Reality Rules

While the prices we pay for stocks often lose touch with the reality of corporate values, in the long run, reality rules. So, while investors seem to intuitively accept that the past is inevitably prologue to the future, any past stock market returns that have included a high speculative stock return component are a deeply flawed guide to what lies ahead.

It is economics that controls long-term equity returns; emotions, so dominant in the short term, dissolve. Forecasting the long-term *economics* of investing carries remarkably high odds of success, while accurately forecasting swings in investor *emotions* is not possible.

The stock market is a giant distraction that causes investors to focus on the transitory and volatile emotions of investing rather than on what is really important — the gradual accumulation of the returns earned by corporate business.

Cast Your Lot with Business

By far the simplest way to own all of U.S. business is to hold the total stock market portfolio. For most of the past 80 years, the accepted stock market portfolio was represented by the Standard & Poor's 500 Index (the S&P 500), which was created in 1926 and now lists 500 stocks. It is essentially composed of the 500 largest U.S. corporations, weighted by their market capitalizations. In recent years, these 500 stocks have represented about 80 percent of the market value of all U.S. stocks.

The beauty of such a *cap-weighted* index is that it automatically adjusts to changing stock prices and never has to buy and sell stocks for that reason. The S&P 500 remains a valid standard against which to compare the returns earned by the professional managers of pension funds and mutual funds.

In 1970, an even more comprehensive measure of the U.S. stock market was developed. Originally called the Wilshire 5000, it is now named the Dow Jones Wilshire Total Stock Market Index. It includes some 4,971 stocks, including the 500 stocks in the S&P 500. However, because its component stocks also are weighted by their market capitalization, those remaining 4,471 stocks account for only about 20 percent of its value. Nonetheless, this broadest of all U.S. stock indexes is the best measure of the aggregate value of stocks, and therefore a superb measure of the returns earned in U.S. stocks by all investors as a group.

The two indexes have a similar composition so it is hardly surprising that the two indexes have earned returns that are in lockstep with one another.

Investors should remember the relentless rules of humble arithmetic — gross returns of the market, minus costs, equal the net returns earned by investors. Common sense, then, tells us the obvious; while owning the stock market over the long term is a winner's game, beating the stock market is a loser's game.

Birth of the Index Mutual Fund

The world's first index mutual fund — now known as the Vanguard 500 Index Fund — started in 1976. At a dinner on September 20, 2006, celebrating the 30th anniversary of the fund's initial public offering, the counsel for the fund's underwriters reported that he had purchased 1,000 shares at the original offering price of $15 per share — a $15,000 investment. He proudly announced that the value of his holding that evening (including shares acquired through reinvesting the fund's dividends and distributions over the years) was $461,771.

This cumulative long-term winning record confirms that owning American business through a broadly diversified index fund is not only logical but incredibly productive. Sir William of Occam expressed it well in his famous precept: *when there are multiple solutions to a problem, choose the simplest one.* Instead of joining the crowd of investors who dabble in complex machinations to pick stocks and try to outguess the stock market, choose the simplest of all solutions — buy and hold the market portfolio. ●

How Most Investors Turn a Winner's Game into a Loser's Game

Beating the market before costs is a zero-sum game; beating the market after costs is a loser's game. For individual investors holding stocks directly, trading costs average about 1.5 percent per year. The cost is lower (about 1 percent) for those who trade infrequently and much higher for investors who trade frequently (for example, 3 percent for investors who turn their portfolios over at a rate above 200 percent per year).

In equity mutual funds, management fees and operating expenses — combined, called the *expense ratio* — average about 1.5 percent per year of the fund assets. Then add, say, another 0.5 percent in sales charges, assuming that a 5 percent initial sales charge is spread over a 10-year holding period. If the shares are held for five years, the cost would be twice that figure — 1 percent per year.

But then also add a giant additional cost, all the more pernicious by being invisible, the hidden cost of portfolio turnover, estimated at a full 1 percent per year. The average fund turns its portfolio over at a rate of about 100 percent per year, meaning that a $5 billion fund buys $5 billion worth of stocks each year and sells another $5 billion. At that rate, brokerage commissions, bid-ask spreads and market impact costs add a major layer of additional costs. Result: the "all-in" cost of equity fund ownership can come to as much as 3 percent to 3.5 percent per year. So yes, *costs matter.*

Obvious Reality

It is hardly in the interest of our financial intermediaries to encourage their investors/clients to recognize the obvious reality of the detrimental impact of these costs. Investors pay far too little attention to the costs of investing. But they are truly confiscatory over an investment lifetime. Over 50 years, a $10,000 investment earning 8 percent annually would grow to $469,000. Annual costs

of 2.5 percent would reduce that return to 5.5 percent, a rate which would grow that initial $10,000 investment to just $145,400 — a shocking loss of 69 percent of the market's total return.

Where returns are concerned, time is your friend. But where costs are concerned, time is your enemy.

The humble arithmetic of investing — the logical, inevitable and unyielding penalty assessed by investment costs and rising living costs — has devastated the returns earned by mutual fund investors. Unless the fund industry changes and improves the net return it delivers to fund shareholders, it will falter and finally fail.

The Grand Illusion

The traditional *time-weighted* return reported by the funds — the change in asset value of each fund share, adjusted to reflect the reinvestment of all income dividends and capital gains distribution — does not tell us what return was earned by the average investor. And that return turns out to be far lower.

When we compare traditionally calculated fund returns with the returns actually earned by their investors over the past quarter century, we find that while the stock market index fund was providing an annual return of 12.3 percent and the average equity *fund* was earning an annual return of 10.0 percent, the average fund *investor* was earning only 7.3 percent. Thus, instead of earning $17 on each dollar invested in the market, the average investor instead earned just $4.80.

What explains this shocking lag? Simply put, counterproductive market timing and fund selection, as investors, following their emotions, poured their money into the market not only at the wrong time, but into the wrong funds. In both failures, investors simply failed to practice what common sense would have told them.

Taxes are Costs, Too

There is yet another cost — too often ignored — that slashes even further the net returns that investors actually receive: federal, state and local income taxes. The fact is that most managed mutual funds are astonishingly tax-inefficient, a result of the short-term focus of their portfolio managers.

A paradox: While the index fund is remarkably tax-*efficient* in managing capital gains, it turns out to be relatively tax-*inefficient* in distributing dividend income. Why? Because its rock-bottom costs mean that nearly all the dividends paid on the stocks held by the low-cost index fund actually flow directly into the hands of the index fund's shareholders. With the high expense ratios incurred by managed funds, however, only a tiny portion of the dividends that the funds receive actually find their way into the hands of the fund's shareholders.

Here is the unsurprising and relentless arithmetic: the annual gross dividend yield earned by the typical active equity fund *before deducting fund expenses* is about the same as the dividend yield of the low-cost index fund — 1.8 percent in late-2006. But after deducting the 1.5 percent of expenses borne by the typical active fund, its net dividend yield drops to just 0.3 percent (!) for its owners. Fund operating costs and fees confiscate fully 80 percent of its dividend income.

The wise investor will seek the dividend "tax-inefficiency" of the index fund dividend rather than the "tax-efficiency" of most actively managed funds engendered by their confiscatory operating costs.

When the Good Times No Longer Roll

Common sense tells us that we're facing subdued returns in the stock market over the coming decade. Why? First, because today's dividend yield on stocks is not the 4.5 percent historical rate, but slightly below 2 percent. Combined with an optimistic projection of 6 percent earnings growth, the projected 8 percent investment return would be slightly below the historical norm. Second, it seems more likely that the current P/E of 18 might ease down a bit to, say, 16 (15 times is the historical norm) rather than rise to 20 or higher. Such a decline would reduce the investment return by about 1 percentage point, to an annual rate of 7 percent.

The fact is that lower returns harshly magnify the relentless arithmetic of excessive mutual fund costs, even ignoring all those unnecessary taxes. While costs of 2.5 percentage points would consume "only" 16 percent of a 15 percent return and "only" 25 percent of a 10 percent return, such costs would consume nearly 40 percent of a 7 percent *nominal* return and nearly 60 percent of the 4.5 percent *real* return on stocks that rational expectations suggest.

While many investors will attempt to find managers and/or advisers they believe will improve upon this projected performance, history demonstrates, clearly, that their efforts are overwhelmingly likely to fail. Indeed, further reducing these humble returns by the costs and taxes imposed by the typical equity fund produces a projected annual return of 1.4 percent for the average equity fund, a number that is unacceptable.

Selecting Past Winners

Selecting winning funds in advance is more difficult than it looks. Sure there are always some winners that survive over the years. But as easy as it is to identify past winners, there is little evidence that such performance will persist in the future.

Of the original 355 equity funds in 1970, 223 have gone out of business, mostly the poor performers. Another 60 remained, yet significantly underperformed the S&P 500 by more that 1 percentage point per year. Together, 283 funds — nearly 80 percent of the funds among those original 355 — failed to distinguish themselves. Another 48 funds provided returns within one percentage point, plus or minus, of the return of the S&P 500 — market matchers, as it were.

That leaves just 24 mutual funds – *only one out of every 14* – that outpaced the market by more than one percentage point per year. Just nine of those outpaced the S&P 500 by 2 percentage points or more during the period, and six of those achieved their superiority many years ago, often when they were of small size. Three peaked no more recently than 1993, so just the remaining three funds out of the 355 that started the race in 1970 have survived and mounted a record of sustained excellence: Davis New York Venture, Fidelity Contrafund, and Franklin Mutual Shares. But before you rush out to invest in these three funds, think about the next 35 years and the odds that they will continue to outperform. Funds with long-serving portfolio managers and records of consistent excellence are clearly the exception rather than the rule in the mutual fund industry.

In selecting mutual funds, most fund investors seem to rely not on sustained performance over the long term, but on exciting performance over the short term. But history demonstrates that shorter-term performance is an even more perilous guide than long-term performance. The top ten performing funds from 1997-1999, for instance, earned a cumulative return averaging 279 percent — stunning! But during the three years that followed, their average cumulative return pummmeted to -70 percent.

Seeking Advice to Select Funds?

The overwhelming majority of investors rely on brokers or advisers for help in penetrating the dense fog of complexity that, for better or worse, permeates our financial system. If you consider the selection of an adviser, make sure you are paying a fair fee (which results in a deduction from whatever rate of return your fund portfolio earns). Be sure to balance the worth of the peripheral services that advisers provide against the reduction in your returns that those fees are likely to represent over time. Finally, look with particular favor on advisers who recommend stock and bond index funds in their model portfolios.

Focus on the Lowest-Cost Funds

How can successful fund selection prove so difficult? Because of something that, deep down, our common sense tells us: *Performance comes and goes, but costs go on forever.*

If investors could rely on only a single factor to select future superior performers and to avoid future inferior performers, it would be fund costs. The record could hardly be clearer: *the more the managers and brokers take, the less the investors make.*

If the road to investment success is filled with dangerous turns and giant potholes, never forget that simple arithmetic can enable you to moderate those turns and avoid those potholes. So do your best to diversify to the nth degree; minimize your investment expenses; and focus your emotions where they cannot wreak the kind of havoc that most other people experience in their investment programs. Rely on your own common sense. Emphasize all-stock-market index funds. Carefully consider your risk tolerance and the portion of your investments you allocate to equities. Then stay the course.

Bond Funds and Money Market Funds

The relentless rules of humble arithmetic also apply — arguably even more forcefully — to bond funds and money market funds.

While a seemingly infinite number of factors influence the stock market and each individual stock that is traded there, a single factor influences the bond market and the money market (and for that matter, each individual fixed-income security) far more than any other: the prevailing level of interest rates. Managers of fixed-income funds can't do much, if anything, to influence rates. Virtually 100 percent of the return on any bond fund or money market fund is accounted for by the net interest income it generates for its shareholders. The only way for a manager to add an increment to that return is to make interest rate bets — for example, by selling bonds when he expects rates to go up (and prices down), and then buying bonds when the reverse

is expected to happen. Even the best bond and money market managers can add only a few fractions of one percent per year to your long-term returns, albeit only by risking a comparable shortfall.

Investors are far more focused on equity funds and the stock market than on fixed-income funds. Nonetheless, smart investors will save themselves lots of money — and substantially improve their returns — if they apply the same principles of broad diversification, low-cost, no-load, minimal turnover and long-term investing when they select fixed income funds. These are the very commonsense characteristics that enable index funds to guarantee your fair share of the returns in the bond and money markets, even as they do in all financial markets.

Index Funds That Promise to Beat the Market

The only way to beat the market portfolio is to depart from the market portfolio. And this is what active managers strive to do, individually. But collectively, they can't succeed, for their trading merely shifts ownership from one holder to another. And in the aggregate, of course, they all earn the market's return, minus their costs.

There are now financial entrepreneurs who believe they can create indexes that will beat the market. This new breed of indexers — not, in fact, indexers, but active strategists — focuses on weighting portfolios by so-called fundamental factors. Rather than weighting by market cap, they use a combination of factors such as corporate revenues, cash flows, profits, or dividends. And — no surprise — back-testing demonstrates that such strategies would have improved returns in the past. But even if those margins persist in the future — which is highly unlikely — these hypothetical returns would be significantly eroded, if not entirely eliminated, by costs and taxes.

When active managers of equity funds claim to have a way of uncovering extra value in our highly efficient U.S. stock market, investors will look at their past record, consider the manager's strategies, and invest or not. These new index managers are in fact active managers. Be skeptical.

Investors should not be tempted by the siren song of paradigms that promise the accumulation of wealth that will be far beyond the rewards of the classic index fund.

The Exchange Traded Fund

Simply put, the exchange traded fund (ETF) is a fund designed to facilitate trading in its shares, dressed in the guise of the traditional index fund. The growth of ETFs has approached a stampede, not only in number but also in diversity, as there are now ETFs that track virtually every possible market segment and style.

All-stock-market ETFs are the only instance in which an ETF can replicate, and possibly even improve on the original classic index fund. *But only when they are bought and held for the long term.* Their annual expense ratios are usually — but not always — slightly lower than their mutual fund counterparts, although commissions on purchases erode any advantage, and may even overwhelm it. While their tax efficiency should be better, actual practice has failed to confirm theory, and investors who trade them are subject to their own taxes.

Too many ETFs may prove, if not suicidal to their owners in financial terms, at least wealth depleting.

The Relentless Rules of Humble Arithmetic

Historical returns are of no value unless we can explain the source of those returns. The two basic sources of the superior returns achieved by the index fund are: (1) the broadest possible diversification, eliminating individual stock risk, style risk and manager risk, with only market risk remaining; and (2) the tiniest possible costs and minimal taxes. Together, they enable the index fund to provide the gross return earned in the stock market minus a scintilla of cost.

What Should I Do Now?

The vast majority of American families will be well served by owning their equity holdings in an all-U.S. stock-market index portfolio and holding their bonds in an all-U.S. bond-market index portfolio. (Investors in high tax brackets, however, would hold a very low-cost, quasi-index portfolio of high-grade intermediate-term municipal bonds.) The rationale for a 100-percent-index-fund portfolio remains as solid as a rock. It's all about common sense.

It is likely that very few investors will follow that approach — the essence of simplicity — for their entire investment portfolio. Investors seem all too willing to opt for costly active funds and trade them to excess. Why?

We are sold funds more often than we buy them. We have far too much self confidence. We crave excitement. We succumb to the distraction that is the stock market. We fail to understand the arithmetic of investing and the arithmetic of mutual funds.

Funny Money

There are no surefire solutions for investment success – – wealth without risk, if you will. It's just not a realistic expectation. Nonetheless, building an investment portfolio can be exciting, and trying out modern remedies for age-old problems lets you exercise your animal spirits. If you crave excitement, enjoy the fun! *But not with one penny more than 5 percent of your investment assets.* This can be your Funny Money account.

Test two or three aggressive investment strategies. You're likely to learn some valuable lessons, and it probably won't hurt you too much in the short term.

Be sure to regularly measure your returns and compare them with the returns you've earned in your Serious Money Account.

Serious Money

At least 95 percent of your investments should be in your Serious Money account. That core of your program should consist of at least 50 percent in classic index funds, up to 100 percent.

Investment Strategies

While the pristine and classic all-U.S. stock market and all-U.S. bond market approach is encouraged, there are perfectly reasonable alternative strategies for supplementing the index funds in your Serious Money portfolio. These include:

• **An international flavor:** Hold a low-cost total international index fund that tracks the returns of all non-U.S. corporations. A modest holding in a low-cost emerging market index fund is also a reasonable approach, but be sure you understand the risks.

• **Slice and dice:** Hold the all-market index fund as the core and add a value index fund and a small-cap index fund as satellites.

• **Bond strategy:** Combine a mix of index funds linked to short-term, intermediate-term and long-term bonds in varying amounts.

• **Inflation protection:** Inflation-linked bonds provide excellent protection against the long-term erosion of the purchasing power of the dollar, particularly in tax-deferred accounts.

• **Asset allocation:** Hold a bond position equal to your age — 40 percent if you are 40, 70 percent when you are 70, and so on — or maybe even your age minus 10 percent.

•**Target date funds:** Investors can begin with an allocation appropriate to their age, which inches gradually toward a more conservative allocation as they approach the retirement age they have targeted.

Common Sense Realities

As you seek investment success, realize that it's never given for us to know what returns stocks and bonds will deliver in the years ahead, nor can we know the future returns that might be achieved by alternatives to the index portfolio. But take heart. For all the inevitable uncertainty amidst the eternally dense fog surrounding the world of investing, there remains much that we do know. Consider these common sense realities:

• We know that we must start to invest at the earliest possible moment, and continue to put money away regularly from then on.

• We know that investing entails risk. But we also know that not investing dooms us to financial failure.

• We know the sources of returns in the stock and bond markets.

• We know that the risk of selecting specific securities, as well as the risk of selecting both managers and investment styles, can be eliminated by the total diversification offered by the classic index fund. Only market risk remains.

• We know that costs matter, overpoweringly in the long run, and we know that we must minimize them. (We also know that taxes matter, and that they, too, must be minimized.)

• We know that neither beating the market nor successfully timing the market can be generalized without self-contradiction. *What may work for the few cannot work for the many.*

• We know that alternative asset classes such as hedge funds aren't really alternative, but simply pools of capital that invest — or overinvest or disinvest — in the very stocks and bonds that comprise the portfolio of the typical investor.

• We *know* what we *don't* know. We can never be certain how our world will look tomorrow, and we know far less about how it will look a decade hence. But with intelligent asset allocation and sensible investment selections, you will be prepared for the inevitable bumps along the road and should glide right through them.