'Lars Kroijer takes a refreshing look at how everyday people can improve their fortunes by taking some simple investing steps.'

DR DAVID KUO, THE MOTLEY FOOL

LARS KROIJER

INVESTING DEMYSTIFIED



HOW TO CREATE THE BEST INVESTMENT PORTFOLIO WHATEVER YOUR RISK LEVEL

SECOND EDITION



Investing Demystified

How to create the best investment portfolio whatever your risk level

Second edition

Lars Kroijer



Harlow, England - London - New York - Boston - San Francisco - Toronto - Sydney Dubai - Singapore - Hong Kong - Tokyo - Seoul - Taipei - New Delhi Cape Town - São Paulo - Mexico City - Madrid - Amsterdam - Munich - Paris - Milan

Investing Demystified

Table of Contents

Contents

Acknowledgements

About the author

Read this first

Who is this book for?

The rational investor

Who am I to write this book?

Part one

Introduction

Chapter 1

Introduction to markets and portfolios

Our objective

Where do we hope to end up?

1 Embrace that we do not have an edge

An immodest claim

2 Understand the components of a rational portfolio

A major point of this book: Only world equities

3 Tailor your portfolio to your specific needs and circumstances

The 60-second version

Chapter 2



What is an edge over the markets and do you have it?

The competition

It is hard to pick the right moment

The costs add up

Even if you disagree with me, at least consider this:

Should we give our money to Susan and Ability?

Is it because investors have a feeling that IT stocks (or whatever sub-sector of the market a fund specialises in) will outperform the wider markets?

Is it because of Susans impressive CV (investors think that someone with her impressive background will find a way to outperform the market)?

Is it because investors feel Ability has come up with some magic formula that will ensure its continued outperformance in its fungenerally?

Is it because your financial adviser considers it a sound choice?

They have done so well in the past

You need to pick the best mutual fund out of 10 for it to make sense!

Outside stock markets

Being rational

Chapter 3

What are the key components of the rational portfolio?

Asset split in a rational investment portfolio



You probably only need two investments!
Understand the level of risk you are comfortable with
Dont put all your non-investment eggs in one basket
Reducing tax has a large impact on long-term returns
Paying too much in fees destroys asset growth
Implementation of the rational portfolio
Speculate less, sleep better!

Part two

The rational portfolio

Chapter 4

The minimal risk asset safe, low-risk returns

Buy government bonds in your base currency if credit quality is high

Consider diversifying even the very low risk that your domestic government fails

Match the time horizon

What will the minimal risk bond earn you?

Do not believe your cash is safe in the bank!

Who backs the deposit insurance?

Summary

Buying the minimal risk asset

Summary

Chapter 5

World equities increased risk and return



Only buy world equity index trackers

The advantage of diversification

Do alternative weightings do better?

What are world equities?

Expected returns: no promises, but expect 45% after inflation

Larss predictions

In summary

Chapter 6

The risk of equity markets

Understanding the risk you take to get returns

You can lose a lot!

Dont assume that markets always bounce back

Diversification and the false sense of security

Risk rethought

Chapter 7

Adding other government and corporate bonds

Adjusting the rational portfolio

The rational portfolio allocations

Return expectations of the rational portfolio

Special case: if you want a lot of risk

Typical criticisms of adding bonds to a portfolio

Compared to equities there are fewer good bond indices and they are not as well known



You will tend to overweight the debt of indebted countries and companies (they have more debt outstanding as a fraction of company value or GDP)

In certain countries the trading of bonds is very expensive, rendering them a bad risk/return prospect

The income from bond coupon payments renders them tax inefficient

Bond products only represent a portion of the total bonds outstanding

Bonds are mainly dollar denominated. This is an issue for non-US investors

It is expensive to trade bonds and hard to get the exposure right

Chapter 8

Thinking about non-portfolio assets

What else do you have?

Other assets

Tangible assets:

Intangible assets:

Liabilities:

Not just geography

Currency matching

The institutional investor

Other assets rethought

Chapter 9

What is omitted from your rational portfolio and why



Avoid investments that require an edge or those you already have exposure to

Residential property dont do it unless you have an edge

Has residential property really been that great?

A home

Private investments (or angel investing)

Other asset classes left out

Part three

Tailoring and implementing the rational portfolio Chapter 10

Financial plans and the risks we take

Building your savings

Expected outcomes

The super-cautious saver

Risk/return

An unfortunate soul caught out by the drop

Generalising the examples

Keeping it real

Reacting to disaster

Liquidity and the rational portfolio

A few ways to think about portfolio allocations

Stages of life

Early savers



Mid-life savers

Retirees

It really does depend on your circumstances

Risk surveys

A few rules of thumb

Do you need a financial adviser?

Chapter 11

Expenses

An expensive, active choice

Patience

Believing in an edge can be expensive

Where are we heading?

Tax and the rational portfolio adjustment

Chapter 12

Products and implementation

Total expense ratio tells you the cost of owning the product

The best ETFs: liquid, tax efficient and low cost

Advantages to owning ETFs

Index-tracking funds

A few issues with index replication through ETFs or index funds

Different indices on the same market will perform differently?

(Related to first one) Index-tracking funds and ETFs have a tracking error



The US market is overrepresented in many world equity products

Not all countries are in the world equity and bond indices

Most indices dont represent all stocks or bonds in a country

Licence fees will eat into my returns

Your performance will only be average

Comparison sites

Execution

Trading is expensive and pulling the trigger can be nerve wracking

Rebalancing your portfolio

Summary

Part four

Other things to think about

Chapter 13

Pension and insurance

Defined contribution pension plans

Defined benefits schemes

Annuities and insurance

Figure out expected return on a standard annuity

Buying insurance

Chapter 14

Apocalypse investing

Gold as security



If not gold, then what?

How could 2008 and 2009 have happened?

Avoiding fraud

Chapter 15

A wish list aimed at the financial sector

Enhanced independent comparison sites

Risk expertise

Tax advice

Customisation

How it used to be and how it might become!

Chapter 16

Conclusion

A checklist of things to do now

Appendix

Appendix A

For the brave: portfolio theory and the rational investor

Adding assets

The optimised market minimise risk and maximise returns

Bullshit in, bullshit out

The beautiful shortcut follow the crowd

The best theoretical and actual portfolio

So what is the market?



So only publicly listed equities?

Summary

Appendix B

Inflation-protected bonds

Appendix C

The standard deviation

So what does this mean for you?

The standard deviation is useful, but hard to predict and has some flaws

Appendix D

Adding government bonds to the rational portfolio

Only add government bonds if they increase expected returns

The government bonds we should add to the rational portfolio

Appendix E

Adding corporate bonds to the rational portfolio

If history is any guide

Getting practical

Corporate bond returns also depend on credit quality

Appendix F

Asset classes left out of the rational portfolio

The marginal case for commercial property



Private equity, venture capital and hedge funds

Fees are very high

In summary

Commodities

Returns from commodities

But should we expect to make money from commodities?

Gold as a special case?

Collectibles

Appendix G

Portfolio risk when adding government and corporate bonds

Appendix H

Tax considerations for the rational portfolio

Tax adviser or accountant

Ask your adviser

Appendix I

Liquidity and the rational portfolio

Selling your investment

Minimal risk liquidity

The equity portfolio and risky bonds are highly liquid

Getting paid illiquid investments should generate better returns

Liquidity rethought



Appendix J
Physical or synthetic ETF?
Index
Praise for the first edition of Investing
Demystified

