Appendix: *The Loser's Game*

> To achieve satisfactory investment results is not difficult, but to achieve superior investment performance is much more difficult than it looks.
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> — Ben Graham, *The Intelligent Investor*

Who should play investing as a Loser's Game? – Pretty much everyone without the time, inclination, and ability to play investing as a Winner's Game. That's about 99% of humanity. Though some discipline is required, the mechanics of the Loser's Game are actually quite simple: Live within your means. Identify and maintain an appropriate mix of stocks and bonds. Use index funds to mirror the stock and bond market averages and to keep management fees/taxes to a minimum. Lastly, hold on through the stock market's inevitable ups and downs.

1. **Spend less than you make** – For most people, this seems impossible. They barely get by on the money they make, so how can they possibly save for retirement? I tell people that no matter what your income, there are people making do with even less. And if they can figure out how to make it work, so can you. If, for example, your salary is $75,000 a year, pretend you make $65,000 and invest the rest.

2. **The appropriate mix of stocks and bonds** – The general rule of thumb for the percentage of your portfolio that should be in stocks is 100 to 120 minus your age. I'm inclined to take the midpoint of these two numbers, which implies a 40 year-old, for example, would put 70% in stocks and 30% in bonds. There are, to be sure, more complicated ways of trying to calculate the right mix of stocks and bonds, which investment professionals often use to dazzle their clients. But since the stock market's chaotic nature defies mathematical modeling, my view is that these methods are of limited value. As Buffett once wrote: "Techniques shrouded in mystery clearly have value to the purveyor of investment advice."

Generally, you want to lower the risk (or volatility) of your investment portfolio the closer you get to actually needing the money, and the 110-minus-your-age formula, while simple and somewhat arbitrary, accomplishes just that.

There are a few caveats: The greater your assets and the higher your wage income, the more risk you can generally tolerate. A 40 year old lucky enough to have $5 million to invest, for example, could take the risk of investing more than 70% of his money in stocks. (The wealthy often act contrary to this principle.) Similarly, a 40 year-old with $100,000 in assets, but earning $300,000 a year, could also allocate a higher percentage to stocks. On the other hand, a 50 year-old widow with $3 million in assets, but without the prospect of high future wages, would probably be better off with somewhat less than 60% of her money in stocks.

3. **Invest in total stock and bond market index funds** – By definition, investors as a group must achieve average performance, though, of course, some will do better and

some worse. Success in the Loser's Game means making sure you're not one of those doing worse. The beauty of index funds is that they guarantee "satisfactory" investment results with the added benefit of very low management and other fees and taxes.

To achieve adequate diversification, allocate money to different geographies based on market capitalization or size. Putting 90% of your money into Chinese stocks and 10% into U.S. stocks, for example, does not represent adequate diversification even if you use index funds. Since the U.S. stock market represents about 40% of total world stock market value, I suggest putting no more than 50% of your *stock* money into U.S. stocks. The Vanguard Total Stock Market Index Fund (Ticker: VTSMX) is a good choice. The other 50% should go into international stocks. Vanguard has a good fund here, too, called the Vanguard Total International Stock Index Fund (ticker: VGTSX). Invest 100% of your *bond* money in a total bond market index fund like the Vanguard Total Bond Market Index Fund (ticker: VBMFX).[*] This fund invests solely in U.S. bonds. Unfortunately, as of the time of this writing there are no low-cost options for foreign bond index investing.

If your retirement plan at work lacks the option of stock and bond index funds, try to invest in the lowest fee, most broadly diversified stock and bond funds available. Do your best to accomplish the 50/50 split between U.S. and foreign stocks.

I'm not a fan of direct real estate investment, particularly residential housing. Most people have plenty of exposure through their home. Also, according to a study by the economist Robert Schiller, the average home's value merely keeps pace with inflation over the very long term, as the periodic booms and busts more or less offset each other. In addition, broad stock market indexes already include companies (called real estate investment trusts, or REITs) that specialize in commercial real estate investment. Even companies not in the real estate business usually have exposure through the property they own to conduct their business.

Avoid limited partnerships, commodities, annuities, derivatives (e.g. futures and options), hedge funds, or any other complex investment product. The reason? You know less than the person selling them to you, and there's a good chance you'll end up with an illiquid (hard to sell), poorly performing, and costly investment product. Remember that you're playing the Loser's Game. Play defense and keep the ball in play.

4. **Concentrate on how much you save, not on how your investments perform** – NEVER check your investments' performance other than to make sure your stock and bond percentages are where they should be (based on the 110-minus-your-age rule) at the end of each year. Avoid the financial news at all costs! Save as much as possible and invest those savings each and every year no matter how badly the financial markets act. In fact, the worse stocks do, the better, as you'll be able to buy more shares more cheaply. As Warren Buffett once explained:

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[*] I don't work for Vanguard, I promise.

> "A short quiz: If you plan to eat hamburgers throughout your life and are not a cattle producer, should you wish for higher or lower prices of beef? Likewise, if you are going to buy a car from time to time but are not an auto manufacturer, should you prefer higher or lower car prices? These questions, of course, answer themselves.
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> But now for the final exam: If you expect to be a net saver during the next five years, should you hope for a higher or lower stock market during that period? Many investors get this one wrong. Even though they are going to be net buyers of stocks for many years to come, they are elated when stock prices rise and depressed when they fall. In effect, they rejoice because prices have risen for the "hamburgers" they will soon be buying. This reaction makes no sense. Only those who will be sellers of equities in the near future should be happy at seeing stocks rise."

5. **Maximize contributions to tax-deferred retirement accounts** – Generally, you want to put as much of your savings for retirement (as opposed to short-term needs like a down payment on a home) as allowed by law into tax deferred retirement accounts like a 401(k) or personal IRA. This has two advantages: First, you don't have to pay taxes on the money you place in these accounts until you retire and start taking the money out. By then, your marginal tax rate should be lower because you'll be working less or not at all and therefore earning a lower income. Second, investments grow tax-free in retirement accounts, which means they'll grow faster.

6. **When to seek professional help** – In my opinion, investment professionals add the bulk of their value in two areas: First, they can help with specific financial planning needs like estate planning or determining and setting up the most advantageous tax-deferred retirement accounts. Second, by acting as a dispassionate advisor, they can help you "hold on" through stock market volatility. At our firm, we think this is the most important service we provide for clients because few amateur investors have the capacity to withstand the pain of a serious market tumble, or conversely, stay disciplined – by continuing to own bonds – when the stock market soars. Good investment advisors, then, are as much psychologists as investors and play an important role helping their clients stay disciplined.