The Lazy Person’s Guide To Investing

Author: Paul B. Farrell, J.D., Ph.D.
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About the Author

Paul B. Farrell, J.D., Ph.D.

Paul Farrell, J.D., Ph.D., started working on Wall Street back in the seventies with the investment banking firm of Morgan Stanley. He already had degrees in law, architecture, and city planning from some great schools.

In 1997 he joined the internet bandwagon and became the mutual funds editor at CBS MarketWatch. And since then he continued as a personal finance and investing columnist, frequently writing about the psychology, ethics and spirituality of money, as well as the nuts ‘n’ bolts about getting rich in fact. He has written about 1,100 columns for MarketWatch and has also written five other books, including The Millionaire Code, and the best-seller, The Winning Portfolio, and regularly appears on radio and television.

The Big Idea

This book is a guide to help procrastinators, the financially challenged, and every one who worries about investing their money to create a nest egg for retirement or for sending children to college. Dr. Paul B. Farrell describes the simple no-hassle, low stress, time-saving way of successful investing in lazy portfolios that work in the background allowing most people to do more important things. This book tells the reader why he does not need a stockbroker or even a financial planner; that there is the couch potato type no-brainer easy to understand investment techniques; why the reading investor never have to pay a brokerage commission again; how the reader can use as few as two mutual funds to manage the reader's investments and virtually forget it; and how to adjust the reader's investments once a year in less time than it takes to microwave a potato.

Part I: The Contest Winners, America’s Three Laziest Portfolios

Chapter 1: The Couch Potato Portfolio is Microwavable

Scott Burns, a syndicated financial columnist with the Dallas Morning News, launched the Couch Potato Portfolio in 1991. Back checking into 1973, the portfolio averaged 10.29 percent annual return for the 18 year period.

The Couch Potato Portfolio achieved results with no complicated accounts; no diligent reading of the financial press; no phone calls from brokers with “opportunities”; no meetings with investment...
advisers demonstrating their constant supervision of accounts; and very simple tax
returns.

To create a Couch Potato Portfolio, the reader investor will need only two funds in a
50-50 asset allocation that gives all the diversification through bear and bull markets:
1. (50%) Vanguard 500 Index (VFINX) is a $75 billion no-load fund that tracks
the S & P 500. The market capitalization of the index includes roughly 80
percent of all US companies. The fund’s expense ratio is only 0.18 against
the 1.30 expense ratio for large-cap funds.

2. (50%) Vanguard Total Bond Market Index Fund (VBMFX). Its $15 billion
bond fund matches the performance of the Lehman Brothers Aggregate Bond Index and its expense ratio is just 0.22.

Both the stock and the bond funds need only a minimum investment of $3,000. So the
investor will only need $6,000 to start a Couch Potato Portfolio. For the aggressive
investor or the 75-25 Sophisticated Couch Potato Portfolio, he has only to put 75% of
his money into the Vanguard 500 Index and 25% to the Vanguard Total Bond Index Fund. If the investor has $10,000 he has to put $7,500 in the stock fund and $2,500 in
the bond fund.

Farrell wrote that in Scott’s 2001 report the Couch Potato Portfolio lost only 1.8
percent compared to the 11.32 percent loss suffered by the average domestic equity
fund; a 14.18 percent average annual return that outperforms all funds with 10 year
records; and recent performance indicated the Couch Potato Portfolio provided an
annualized compound return of 10.96 percent and 12.30 percent for the
Sophisticated Couch Potato Portfolio compared to average balanced fund return of
only 9.45 percent and 11.85 percent return on domestic equity funds.

Scott suggests re-balancing your portfolio takes only 10 minutes of your time each
year. This is when you need to add new money to your Couch Potato Portfolio to keep
it back in line if under allocated whether it is a 50-50 or 72-25 model asset allocation.

Wall Street hype machine is silent on the Couch Pot ato Portfolio since they know
they cannot beat this portfolio and none of them will make any money recommending
no-load index funds although they know that indexing is the best and safest solution
for most Americans.

Farrell quotes Scott Burns’ acceptance speech: “Let's hope sloth becomes a
universal virtue for investors.”

Chapter 2: The World Famous Coffeehouse Portfolio
Farrell sums up The Coffeehouse Investor written by Bill Schultheis, a former
Salomon Smith Barney broker in building a successful portfolio:
1. Save. Start early, save regularly, trust compounding to do the rest.
2. Diversify. Spread risks across funds moving on different cycles.
3. Index. All the investor needs to do is to be average and he will come out a
winner.
Bill's simple Coffeehouse Portfolio is a 60/40 stock bond split with the bond portion reflecting an intermediate term corporate bond index and the equity portion equally divided between the S & P 500 Index, Large Value Index, Small Index, Small-Cap Value Index, MSCI EAFE International Index, and a REIT index.

It has a seven Vanguard index funds: Vanguard S&P 500 (VFINX); Vanguard Large-Cap Value (VIVAX); Vanguard Small-Cap Index (NAESX); Vanguard Small-Cap Value (VISVX); Vanguard International (VGTSX); Vanguard REIT Stock Index (VGSIX); and, Vanguard Total Bond Market Index (VBMFX).

During the bear market years of 2000 and 2001 when tech stocks are being wiped out and dot coms were going bankrupt by the hundreds and DOW was down 12 percent, S & P 500 down by 20 percent and Nasdaq down by over 50 percent, the Coffeehouse Portfolio was averaging 5.3 percent.

Bill Schultheis' Coffeehouse Portfolio is a big winner in a bear market. An investor with $100,000 in the Coffeehouse Portfolio's index funds beginning in 2000 would have grown to $110,905 at the end of 2001.

Over a long term period of investing in the Coffeehouse Portfolio with annual re-balancing, a $100,000 investment in 1991 would have grown to $328,590 by 2001 an average return of 11.42 percent annually beating the market easily. Without re-balancing, the Coffeehouse Portfolio managed to average higher at 11.79 percent.

The Coffeehouse Portfolio investment philosophy works by simply ignoring the financial markets for the past two years amid the worst investing period in the last quarter century.

Chapter 3: Dr. Bernstein's No-Brainer Portfolio

As a practicing neurologist, Dr. Bernstein's No-Brainer Portfolio prescription is to split the investor's money equally to just four funds: Vanguard 500 Index (VFINX); Vanguard Small-Cap Index (NAESX); Vanguard European Stock Index (VEURX); and, Vanguard Total Bond Market Index (VBMFX).

Dr. Bernstein's No-Brainer Portfolio averaged 10.8 percent over the past ten years from 1991-2001. He also built Vanguard funds because they are no loads with low expense ratios and well diversified across thousands of stocks and fixed-income securities.

You, the investor, don't need the sophisticated skills of a Wall Street analyst or neurologist to build a No-Brainer Portfolio. While it is handicapped by some lazy investors because the No-Brainer Portfolio relies on mathematics and numbers, his math is easy to follow in Dr. Bernstein's book entitled Four Pillars of Investing.

For high net worth clients, Bernstein recommends the No-Brainer Coward's Portfolio.
Alternative with modifications. He uses all the Vanguard index funds in developing the portfolio which remain his core portfolio until today.

These are: (40%) Short Term Corporate Bond Index (VFSTX); (15%) Total Stock Market (VTSMX); (10%) Small-Cap Value Index (VISVX); (10%) Large-Cap Value Index (VIVAX); (5%) European Stock Index (VEURX); (5%) Pacific Stock Index (VPACX); (5%) REIT Stock Index (VGSIX); (5%) Small-Cap Index (NAESX); and, (5%) Emerging Market Index (VEIEX).

While the Coffeehouse Portfolio uses a broad international index, Bernstein splits his allocation to European, Pacific, and Emerging markets and he prefers to use Total Stock Market Index to S&P 500.

The Sophisticated No-Brainer Portfolio gave an 11 percent annual average return for five year return reporting. All the three lazy person's portfolio seems to be pretty much in line.

In the long run, diversification is the key to having a winning portfolio by diversifying portfolio assets on a buy and hold strategy across multiple categories of funds.

Chapter 4: A Challenger Jumps in Ring! Scores on Points

The simple truth is that the vast majority of investors still find it impossible to believe investing is as simple as the 3 laziest portfolios. The $15 billion “Hype Machine” of Wall Street tell investors that it has the secret to beating market averages. The truth is, according to Farrell, Wall Street can't beat the averages.

According to mutual fund guru, Sheldon Jacobs, load funds are more costly and are therefore inferior to no-loads because of commissions, hidden transaction costs, high turnover, higher operating expenses and taxes.

According to Kiplinger and others, an investor who seeks a long term portfolio will need is a simple three fund portfolio and a bond fund to smooth out the volatility for a total of four. The investors will simply have to forget the 9,111 other funds.

Kiplinger’s concept is simple. A portfolio of four index mutual funds gives the investor all the diversification he needs in these four asset classes:

1. (25%) Large-Cap Stock Funds. Either the Vanguard S&P 500 Index Fund or the Vanguard Total Stock Market Index Fund which tracks to the Wilshire 5000.
2. (25%) Foreign Stock Funds. The Vanguard European Stock Market Index or the Vanguard Total International Stock Market Index.
3. (25%) Small-Cap Stock Funds. Either the Vanguard Small Cap Index or the Vanguard Small-Cap Value Index Fund.
4. (25%) Domestic Bond Funds. The Vanguard Total Bond Market Index Fund or the Vanguard Short-Term Bond Index Fund.

However, financial adviser and money manager, Paul Merriman challenges the four-
fund index portfolio with a ten fund version. According to Merriman, his research showed that owning ten asset classes increases the investor's overall return and decreases his risks much better than a four fund portfolio over a long period of time.

Merriman's mantra is that the very wide asset diversification available from ten funds is likely to give investors a significant extra edge over four funds sometimes with higher returns and other times with less volatility and less risk.

Merriman shows that Kiplinger/Bernstein four fund portfolio had solid returns of 13.5% over a 20 year period. This means a $10,000 invested in that portfolio would have appreciated to $125,315 over that period. However, the four omitted categories with 20 year data had average returns of 15.8 percent. Thus, a $10,000 investment in these four new categories would have been worth $188,819 considerably higher than the basic four funds portfolio.

While the ten funds beat the four funds portfolio over the long haul, many investors simply lack the time, motivation or the sophistication to handle complex portfolio.

Bernstein concludes that an average investor may find a four asset portfolio easier to implement and follow. While a four-fund strategy may not have the best returns, it is good enough for most American investors and good enough for the classic laziest investors who average only 6 minutes a day on investing and personal finance.

Farrell recommends Merriman's Fund Advice web site which has a huge library of investment information for investors who want to do the investing themselves and who hate the idea of being hustled. Merriman tells his investors that "I'll show you exactly how to do it yourself as an investor. And if you don't want to do it yourself, I'll do it for you."

Farrell advises investors to always look for a no-load fund and never buy a load fund again.

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Part II: Recess Fun: Testing The Six Laziest Strategies

Chapter 5: Strategy One: Zero Timing Wins

Everybody's a financial genius in a bull market. Raven, a Hollywood star is a dart throwing chimp, which did in fact made a monkey out of Wall Street.

Farrell predicted the frenzy and the insanity accompanying the dot com boom but nobody cared and some of his column readers labeled him an out-of-touch idiot or an old economy fool.

Monkeydex is a stock index picked by Raven which did made a monkey of out of the best Internet fund managers of 1999 by beating all the major high tech/new economy funds with a 365 percent return.
CMGI is a penny stock after trading $165 in early 2000. Two of the ten Monkeydex vanished, three trade for less than a dollar and one is in the $3 range as of late 2002.

To Raven’s credit, 7 of his stock pick are alive and well, 30 months after the Nasdaq reached its peak and crashed.

Autopilot investing is a winning strategy since no one can be a perfect timer. It is a no-brainer for the investor with no timing just the good old “dollar-cost averaging” investing like clockwork according to an automatic saving schedule like a payroll or bank account deduction plan.

Based on the Monkeydex caper, the stock market is totally random. A few good lessons learned from this adventure are:

1. It is the target, stupid not the picker.
2. Actually random pickin’ ain’t always random.
3. Asset allocation beats stock picking.
4. Indexing beats stock picking.

Professor Malkiel states that a simple buy and hold strategy can typically make as much or more money.

Chapter 6: Strategy Two: Frugal Saving Wins

There is a fundamental distinction between making good money each year and wealth building. If you earn a good income each year and spend it all you are not getting wealthier. Wealth is what you accumulate not what you spend. Wealth is the result of a lifestyle of hard work, perseverance, planning, and most of all self-discipline.

The consensus is that one does not get rich, and then get frugal. No. One has to be frugal first and then get rich.

Millionaires are frugal since they live below their means regardless of how much they are making. A penny saved is a dollar earned thanks to compounding.

So how can a person be frugal when investing? Farrell advises buy low-cost index funds, the ultimate cool, the ultimate in frugal.

Gavin Quill, senior vice-president and research director of the Financial Research Corporation came up with two conclusions:

1. The best portfolio strategy is asset allocation.
2. Expense ratio is the only reliable predictor of fund performance.

Chapter 7: Compounding Wins

The explosive power of compounding is as follows: a mere $16,000 invested for just eight years in your twenties will grow to $1.0 million by the time you retire.
Farrell urges people to harness the power of compounding by starting early in saving for a nest egg and retirement.

Chapter 8: Strategy Four: Asset Allocation Wins
The one key to investing success is discipline. It is a prerequisite in maintaining effective risk control. You need it to apply your method without second-guessing when choosing which trades to take.

Discipline is what it takes to create a market wizard out of an ordinary stock market trader.

Another important trait for market wizards are the sense of mission and passion for what they do.

Chapter 9: Strategy Five: Buy’n’Hold Wins
The most successful investors buy and hold rather than sell.

The following are the 6 powerful reasons why you can't beat the odds at the stock market:
1. The stock market is irrational and unpredictable.
2. The more you trade the less you earn.
3. Online trading makes it easier to lose more.
4. Investors buy high, sell low losing at top and bottom.
5. Overly confident, we lose, deny and fib about losses.
6. Unfortunately, even winning traders don't win much.

Chapter 10: Strategy Six: Do-It-Yourself Wins
Farrell urges the investor to accept the challenge of investing by running the race and taking responsibility on it. Making money is really a game of solitaire that you play with yourself.

Part III: Six More Boring Portfolios for America

Chapter 11: The Dummies Ultimate Keep-It-Simple Portfolio
Eric Tyson's book for dummies recommends many Vanguard funds same with Farrell. The main reason why only 5 percent of total investment is in index funds is because Wall Street can't make money on no-load low-cost index funds.

If you buy a non-index fund you are throwing away 12 percent.
Tyson recommends the Vanguard LifeStrategy funds that are tailored to your age. He recommends a portfolio allocation of tax-friendly Vanguard funds in different mixes on your age. These are:

- Vanguard Total Stock Market Index Fund
- Vanguard Total International Stock Index Fund
- Vanguard Intermediate-Term Tax Exempt Fund

Chapter 12: Dilbert’s Anti-Weasel Defense Portfolio

Weasels are slippery people who live in the Weasel zone, a giant gray area between good moral behavior and outright criminality.

During bull markets weasels multiply and breed fast. So an investor should have an anti-weasel defense. Wherever there is money, there are weasels in direct proportion.

Dilbert’s fabulous one page personal finance book:

1. Make a will.
2. Pay off your credit cards.
3. Get term life insurance if you have a family to support.
4. Fund your 401(k) to the maximum.
5. Fund your IRA to the maximum.
6. Buy a house if you want to live in a house.
7. Put six month’s expenses in a money market account.
8. Take whatever money is left over and invest 70 percent in a stock index fund and 30 percent in a bond fund. Buy them directly from the fund company and never touch them until retirement.
9. If any of this confuses you, or you have something special going on (retirement, college planning, tax issue) hire a fee-based financial planner, not one who charges a percentage fee based on your portfolio size.

Chapter 13: Motley Fools Morph Into Index Champions

The Motley Fools morphed into becoming index champions during the bear market and came up with six investment strategies for the future:

1. Certificates of deposits.
2. Cheap broad market funds.
3. Bond index funds.
4. Companies paying solid dividends.
5. Starbucks and established brands.
6. Manage your portfolio for life.

The Motley Fools also came up with two-fund lazy index portfolio: the Vanguard S&P 500 Index Fund and the Vanguard Total Bond Market Index Fund.
Chapter 14: Idiot proof Portfolios For The Financially Challenged

Farrell tells us that past performance does not guarantee future results in a comparison of performance of 10 major funds from year 2000 and after 2002.

What the investor can do is to create a well-diversified index portfolio that balances out peaks and valleys over time.

Chapter 15: Where Do Active Money Managers Put Their Own Money? In Safer Passive Index Funds

Ted Aronson professes the inherent advantage of the passive index funds since their costs are lower quarter after quarter and year after year. Also they lose less.

According to Aronson, most fund managers are now closet indexers.

Chapter 16: Even Nobel Economists Prefer Lazy Theories

In 1990, three Nobel prize winners in economics Professors Harry Markowitz, William Sharpe, and Meron Miller formulated the Modern Portfolio Theory (MPT). What they discovered is that the classes of assets and the way you slice the pie are more important in the long run than your stock picking genius.

In fact, diversification is ten times more important than the specific stocks or funds you pick. Even Markowitz professed to split his investments 50-50 between stocks and bonds to minimize his future regret.

Part IV: Adventures Outside The Vanguard Box

Chapter 17: The Care and Feeding of Your 401 (k) Plan

401 (k) Plan is one of the perfect investment vehicle an investor can use since it provides the following six key advantages:

1. Discipline with autopilot savings.
2. More take home pay thanks to tax-deferred contributions.
3. Employer matching contribution
4. Uncle Sam defers taxes on future earnings.
5. Dollar cost averaging buys you more.
6. Transferability.
Chapter 18: Happy Hybrids: One-Fund Mini Portfolios

The one-fund portfolio is called a hybrid because it is a fund that acts like a mini portfolio investing in both stocks and bonds and some cash. Hybrids act like tranquilizers for people who don't trust Wall Street during bull and bear markets.

Americas' Top-Four One-Fund Mini Portfolio Categories are:
1. Balanced Funds such as Dodge & Cox Balanced.
2. Asset Allocation Funds such as Fidelity Asset Manager
3. Life Cycle Funds such as Freedom Funds and Life Strategy Funds
4. Fund-of-Funds such as Vanguard STAR.

Hybrids are actively managed funds and are expensive.

Chapter 19: The ETF Zoo: Spiders, Cubes, Diamonds, Webs, Vipers

Exchange Traded Funds or ETF are considered wild animals crowding around the deck.

The secret to success is to ignore the name tag and focus on the index. The only way to win with ETFs is to buy and hold. Also the investor is cautioned that ETF’s have hidden costs atop the expense ratio.

Index mutuals are still the preferred choice of passive investors.

Chapter 20: DRIP-DRIP-DRIPping With No-Load Stocks

No load stocks are the best kept secret of Wall Street since they cannot charge you any commission. You can start your own fund by using DRIPs (Dividend Reinvestment Programs). You can buy stocks without paying any broker’s commission.

If you do it yourself using DRIP you can save 1.4 percent plus all the hidden transaction costs that active fund managers run up.

Chapter 21: You Wanna Be The Next Super Mario?

Folios will enable an investor to create and manage his own funds. By logging on Foliofn.com which is the brainchild of Steven Wallman, investors can create their own fund portfolios that they can manage on their computer.

It will save you, the investor some serious money and you can even break-even with the fees you pay when compared to an average 1.23 percent mutual fund expense ratio on a portfolio of $30,000 or more.
The folio wizard is an excellent demo trading mentor. It sharpens your skills and you have 100 ready made folios to play with. You can also customize all you want.

Still, mutual fund is the best choice for truly lazy investors.

Chapter 22: The Superpowered Zero Funds Portfolio
Robert Kiyosaki tells us in his book Retire Young, Retire Rich that leverage simply means the ability to build and own an apartment complex or local business.

If you really want to get rich, you have to think like an entrepreneur leveraging other people’s money.

Kiyosaki also says that you are not getting rich but you are making others richer if you are trapped in a forty hour work week without leveraging advantages.

He advocates retiring early and then get rich by leveraging the assets you have.

Chapter 23: Lazy Portfolios For Not-So-Lazy-Kids
You should learn fast and early before the bad habits set in.

To finance a kid, a $5,000 investment at birth could grow $2,451,854 at age 65 or retirement.

The power of compounding is just amazing. A $1,000 mutual fund at birth grew to $1.8 after 60 years for one sibling while his sister's $1,000 grew to $5 million since her fund is more aggressive.

Part V: When Laziness Fails, You and You’re Itchin’ For Some Action

Chapter 24: Sssizzle...Fizzzzzz...That’s Your Brain Frying On A Hot Stock
Neuroeconomics or the science of irrational investing shows that the brain circuits go wild in anticipation of rewards. The brain is a clever machine that often overrides common sense, good judgment, long experience, and even the facts when it is chasing a short-term thrill like a hot stock.

Indeed indexing wins but the brain loves thrills and chills and these goes for investors who are naturally addicted to the thrills and excitements of the marketplace.

When all else fails, say a little prayer--it works for the wealthy.
Chapter 25: Plan B: How Investors Learn To Live With Two Brains And A Split Personality

A two-portfolio strategy is a practical way to preserve your retirement nest egg while having a little trading fun even if it's an expensive entertainment.

This is done by investing 90% of your funds in untouchable portfolio and 10% goes into your mad-money portfolio.

With Vegas rules, you lose, you stop, period.

In the end a two-brain strategy is not a real lazy portfolio since there's far too much trading involved.

Epilogue: The Ultimate Secret Of Success For Millionaires And lazy Investors

The real objectives of investing are peace of mind, financial freedom and independence and other more intangible items. Live with a positive mental attitude one day at a time. It will get you there as a millionaire.