Investing Life Skills for Early Savers

PARKYN - DOYON
LA ROCHELLE

PWL CAPITAL

In over 25 years as an advisor, a comment I have often heard from clients is that they wish they'd started investing earlier to take even more advantage of compounding. They often tell me they want to get this message through to their children. I wrote this eBook to help anyone who might be starting out on their investing journey.

James Parkyn

Table of Contents

Please note that this ebook is also available in French.


5

Introduction

Warren Buffett, Chairman of Berkshire Hathaway and one of the most successful investors of all time, once said:

> **Investing is simple, but not easy.**

When you're starting off, it's not easy to find the best route to achieving the financial goals you have set for yourself and your family. There are so many competing priorities to consider and only limited resources to commit to any one of them.

Besides your day-to-day responsibilities, you have to figure out how to save and invest to achieve your most important financial objectives like buying a house, educating your children and building a nest egg for retirement or for an early financial independence.

This eBook is here to help. In the following pages, you will find practical information and advice that is based on scientifically proven principles of financial planning and investing. While not exhaustive, this short guide is designed to help set you on the right path.

We explain key concepts to help you take the first critical steps on your financial journey. You will learn how to make good decisions and avoid mistakes.

As you gain experience, make progress and overcome barriers, you will be creating a foundation for long-term success.

Our Team has helped many families build their wealth with an approach that is evidence-based and time-tested. From the beginning, we have been formally committed to putting our clients' interests ahead of our own. We bring that same mindset to everything we do, including producing this eBook.

We want you to reach the goals you have set for yourself and your family and we hope this publication will put you on the right track to get there.

1. Getting Started

When it comes to investing (as in so many other things), getting started is often the hardest part. There is so much information to wade through; so many options to consider and decisions to be made. It can all seem overwhelming.

While it's tough to get past the psychological barriers and take that first step to becoming a saver and investor, the payoff will be more than worth the trouble. The biggest reason to get started right away is to give more time for compound interest to work its magic over the long term.

What is compound interest? It's the interest on the interest you've already earned. In other words, compounding is the money you earn on your original investment, plus the money you earn on the returns already accumulated over time.

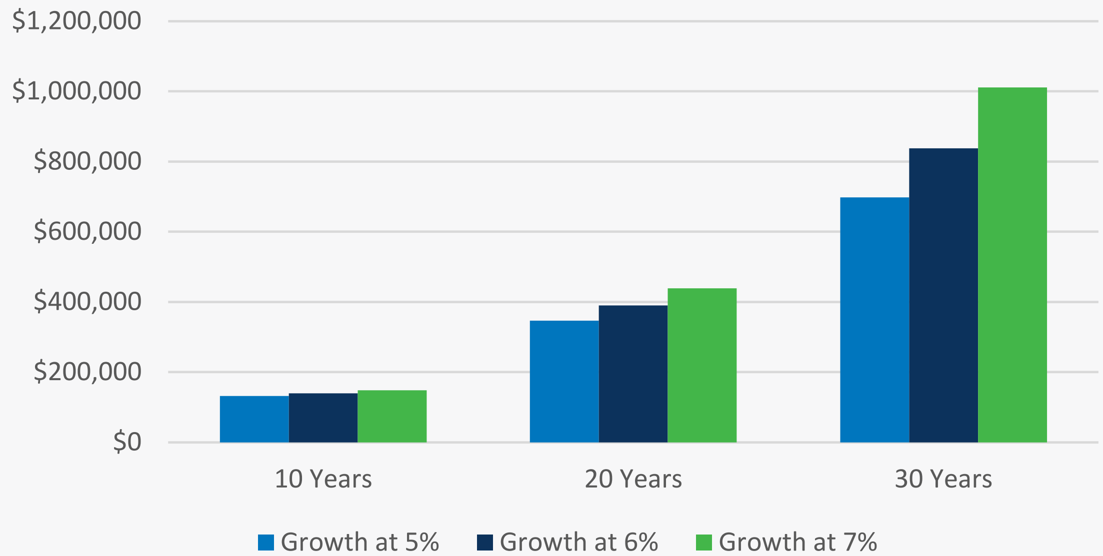
Compounding is no small thing. Albert Einstein is reputed to have called it the eighth wonder of the world.

But for compounding to work, money must not only be invested but stay invested over a long period. That's because compounding reveals its power slowly but can create remarkable wealth over time. An investment that grows at a rate of 7% a year doubles every 10 years.

There's another important reason for getting started early on your investing journey. You will be getting into the habit of saving while learning the principles of investing and building your confidence.

What's a good way to get started? Set up an automatic withdrawal from your bank account that goes directly to an investment account. That's called paying yourself first (before all your other expenses), and it works because you naturally adjust your spending to the amount of money you have on hand.

Growth of $10,000 Invested Annually



Source: PWL Capital – Team Parkyn-Doyon La Rochelle


Chart 1
Chart 2
Chart 3
Growth
Amount

2. Managing Your Human Capital

Many people are unaware of their most valuable asset. It remains hidden in plain sight because it's taken for granted. What is this asset? Your potential to generate income over your lifetime.

It's called your human capital and can be defined as the present value of all your future earnings. For most people, that works out to a huge number, especially if you're young. Your human capital is even more valuable because it's a hedge against inflation. Earnings tend to rise with the cost of living.

Despite its immense value, most people overlook their human capital. Instead, they focus on financial capital—stocks, bonds, real estate and other assets. Of course, financial capital is important, but you also need to grow your human capital. How do you do it? By increasing your value to the marketplace through education, skills and your ability to successfully interact with other people.

As it grows, you also need to protect your human capital in the same way you safeguard other important assets.

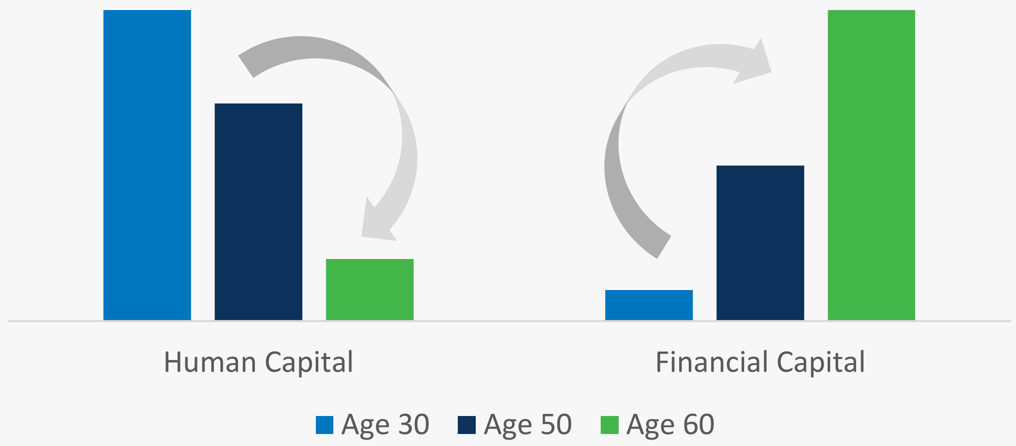
At a certain point, most people know they need life insurance to provide for their spouse and children in the event of their death.

But they often fail to think about insurance for a disability that would prevent them from earning a living. Statistically, that's a much more likely possibility than premature death.

Besides these risks, you should also consider how your choice of career might affect your human capital. How stable is your industry? Could your earnings be interrupted for an extended period? Are you increasing your exposure to your sector by investing too much money in your company's stock or that of other businesses in the same industry?

If you're like most people, you'll be rich in human capital when you start out in your working life, but poor in financial capital. As you move through your career, your goal should be to convert your human capital into financial capital by earning, saving and making good investment decisions. Both forms of capital are important, give them both the attention they deserve.

Human Capital vs Financial Capital



3. Cultivating an Investor Mindset

Many people approach investing as if it were a game of chance that can be won by placing bets on the latest hot stock or investment fad.

The brokerage industry encourages this mindset by making trading cheaper, easier and faster than ever before. And the financial media fans the flames on a daily basis by hyping market winners and losers. It's no wonder that 51% of Canadians said they believe investing is like gambling in a survey conducted by BlackRock.

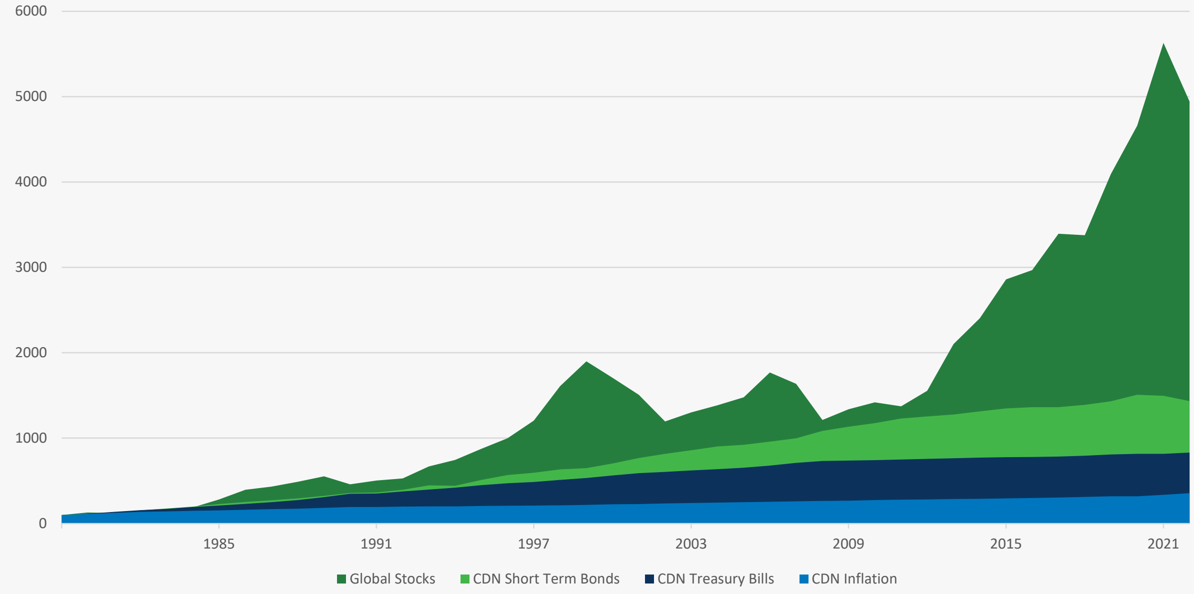
Speculating in the markets, like a trip to the casino, can provide a momentary dopamine rush, but will most likely lead to bad financial outcomes. The sad reality is that for every story of someone making a bundle speculating on the latest hot stock, IPO or crypto-currency, there are many more people who quietly suffer a permanent loss of their savings.

While investing and gambling both involve risking money in hopes of realizing a financial gain, that's where the similarity ends. Investing --when done right--is about buying assets that have a positive expected return thanks to the income they pay and/or their long-term capital appreciation.

The U.S. stock market, for example, has generated an average return of 9.8% annually in Canadian dollars over the 30 years to the end of 2022, reflecting the historic growth of the economy and company profits.

Patiently sticking to a broadly diversified portfolio that reflects your risk tolerance may not produce the excitement of trying to hit the jackpot on a hot stock or a cryptocurrency. But you shouldn't be investing for thrills. Your aim should be to achieve your long-term goals, and that's not something to gamble on.

Growth of $100 Canadian, 1980 to 2022



Source: Dimensional Fund Advisors

4. Keeping Your Eye on the Long Term

Successful investors make consistent, smart money decisions and stick with them through market ups and downs over a period of decades. That requires discipline, an essential skill to learn early in your investing life.

First and foremost, discipline comes from having a comprehensive financial plan you can turn to when the going gets tough. It will help you resist the temptation to jump in and out of the market in an effort to maximize gains or avoid losses.

That's called market timing and researchers have found it's one of the worst wealth-destroying mistakes you can make. A sharp downturn in the markets can be particularly difficult for some people to stomach. They talk themselves into the idea that they can pull out now and get back in when things get better.

However, trying to time the market presents at least two problems.

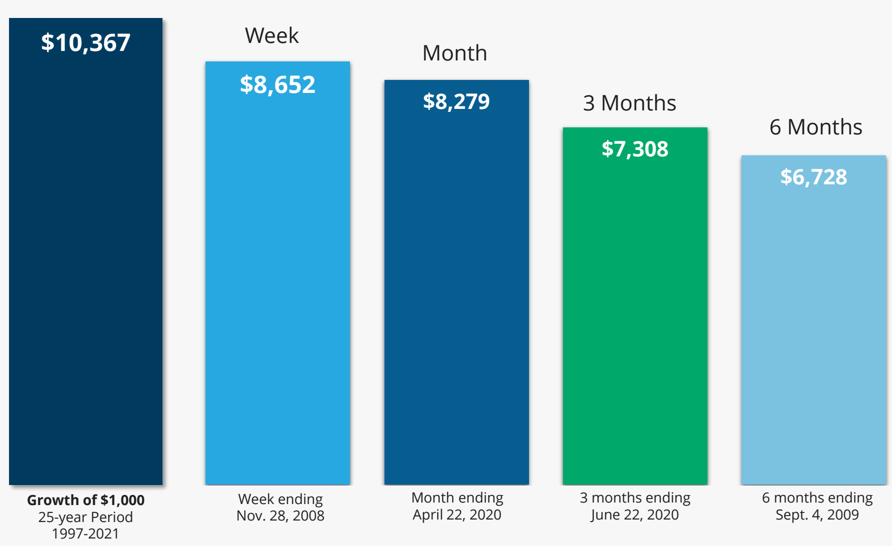
First, if you sell now, when will you know it's safe to buy back into the market? Second, you risk missing out on gains while you're on the sidelines and that can have a huge impact on your long-term returns.

A study by Dimensional Fund Advisors found that $1,000 invested in an S&P 500 index fund in 1970 and held until August 2019 would have turned into $138,908. Miss the S&P 500's five best days and the return would have shrunk to $90,171. Miss the 25 best days and the return would have dwindled to $32,763.

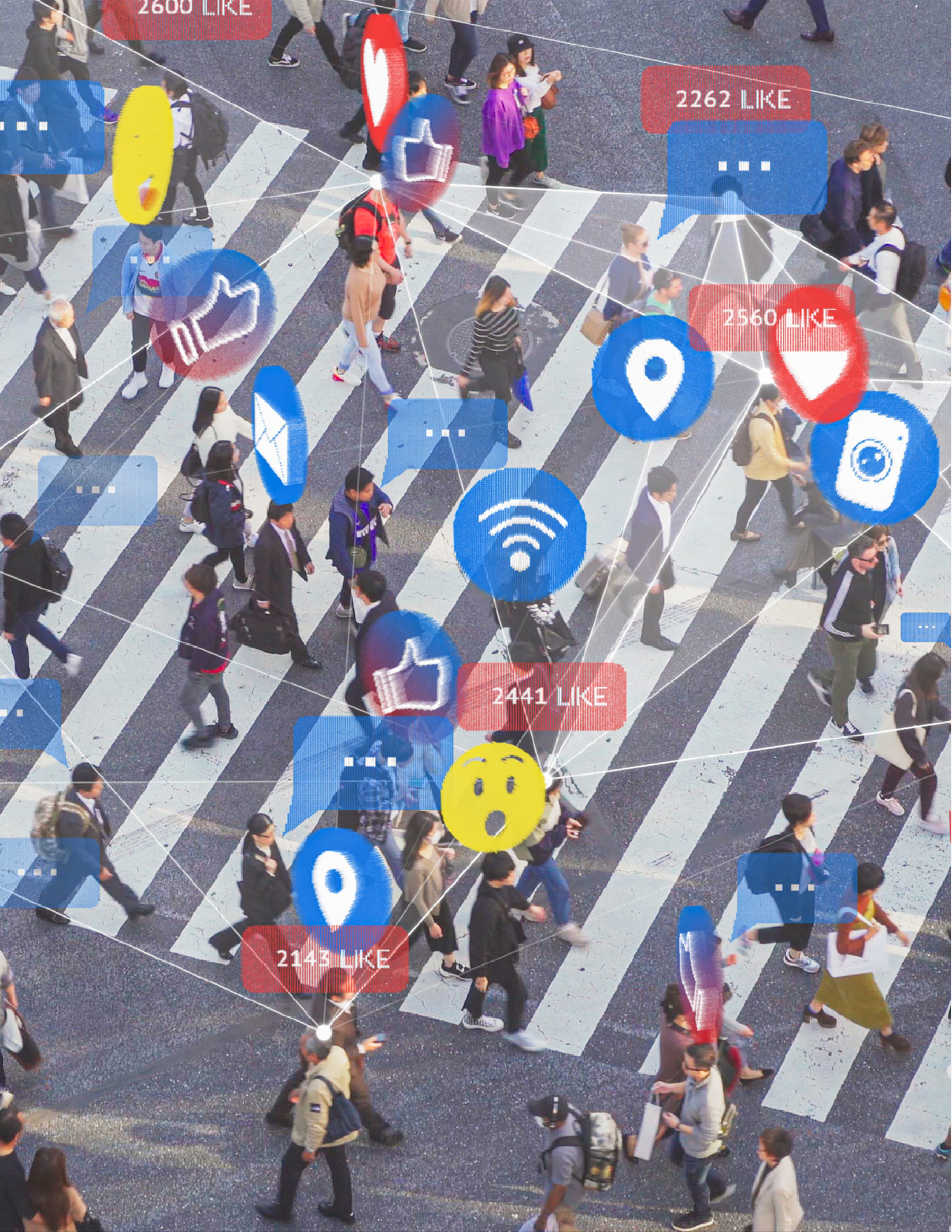
While it can be challenging, the best invest-ment strategy--as supported by decades of academic research--is to hold a portflio of broadly diversified, passively managed investments through good times and bad. Why passively managed? Because research clearly shows that a majority of active fund managers underperform their index benchmark over an extended period of time.

Russell 3000 Index Total Return

But if you missed the best...



Source: Dimensional Fund Advisors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5. Understanding Human Biases

It's human nature—we all fall prey to mental and emotional biases that can lead to serious investing errors. To control the influence of biases, you must first be aware of them and then guide yourself back to rational thinking and good decision-making processes. Here are some of the key biases Identified by Nobel Prize winning academic researchers that you should watch out for in your thinking about investments.

Recency Bias

This is the tendency to give greater importance to events that have occurred in the recent past. It can skew your perceptions toward market developments that have just happened and cause you to give less importance to ones further in the past. For example, an investor might be persuaded a rally or downturn in a certain stock or market will continue indefinitely without giving due consideration to the possibility of a reversal. Recency bias can cause you to depart from your investment plan to jump on a hot market trend or sell during a market downturn.

Over-Confidence

It's common for people to develop an unwarranted confidence in their own abilities, including their ability to make exceptional profits in financial markets. Overconfidence can lead investors to make risky bets based on a misguided belief in their ability to predict the future. It's useful to remember that a multitude of highly trained professionals spend their days studying the market. They're paid to find any profitable edge they can. Are you really better equipped than they are to reap above-average gains?

Confirmation Bias

This occurs when investors seek out information that confirms their point of view and discount divergent opinions. For example, a simple Internet search will likely turn up both positive and negative news and analyst opinions on virtually any major stock. An investor who is thinking of buying that stock, or has already done so, will have a tendency to give much more weight to positive news and opinions about that stock. Falling prey to this kind of thinking can cloud your judgment and cause you to make unsound decisions.

Loss Aversion

Behavioural finance researchers have determined that people feel the pain of a loss about twice as strongly as the pleasure they get from an equivalent gain. Loss aversion is another bias that can distort your decision-making by causing you to prioritize avoiding losses over earning gains.

You need to guard against these and other cognitive and emotional biases as you proceed through your investing life. Good investment advice and processes such as annual portfolio reviews, automatic contributions and periodic portfolio rebalancing can help keep your emotions in check and your plan on track.

6. Diversifying to Reduce Your Risk

Diversifying your portfolio by holding a large number of investments in different markets is a fundamental strategy for successful investing. Indeed, Noble Prize-winning economist Harry Markowitz famously described it as "the only free lunch in finance."

Markowitz demonstrated that when you combine assets that perform differently over time you lower the overall riskiness of your portfolio without reducing expected returns.

It comes down to not putting all your eggs in the one basket. When you own just a few stocks, the failure of any one of those companies can lead to a permanent loss of your savings. But when you own many stocks—ideally all of them in a given market—the poor performance of some will be offset by the better performance of others.

This doesn't mean you will never lose, but your gains and losses will reflect those of the overall market. You've removed what's known as unsystematic risk--the risk unique to a specific company or industry.

The same principle applies to holding different asset types such as stocks, bonds and real estate. Each produces different returns in any given period and by combining them in a portfolio you reduce its riskiness.

This is also true of geographic diversification. Its benefits can be seen in what occurred in the U.S. between 2000 and 2020. From 2011 to 2020, the S&P 500 produced an excellent annualized compound return of 13.9%. That compared to 3.7% for the Canadian market, 5.7% for developed markets outside the U.S. and 4.0% for emerging markets. (All returns are in U.S. dollars).

However, it was a different story from 2000-2009. Back then, the U.S. stocks suffered what's come to be known as the lost decade. During that time, the S&P 500 produced a total compound return of -9.1% in U.S. dollars. By contrast, MSCI Emerging Markets Index generated a +154.3% return in U.S. dollars.

Research shows that many investors hold woefully under-diversified portfolios. Fortunately, you can avoid this basic investing error by owning passively managed funds that allow you to broadly diversify at very low cost.

Diversification Helps Take the Guesswork Out of Investing

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Higher Return	39.8	8.8	79.0	28.1	9.4	18.6	38.8	32.0	5.4	21.3	37.8	2.1	31.5	20.0	45.9
	8.2	6.6	48.8	26.9	3.4	18.6	32.4	13.7	4.5	12.0	31.7	1.9	25.5	18.7	28.7
	6.3	4.7	28.5	22.4	2.3	17.1	27.6	4.9	1.4	11.6	21.8	1.5	24.2	18.4	14.8
	5.9	-33.8	27.2	19.2	2.1	16.3	1.2	1.9	1.0	6.7	14.6	-4.2	23.1	11.1	14.0
	5.5	-37.0	26.5	15.1	0.6	16.0	0.6	1.2	0.9	5.8	3.8	-4.4	18.9	4.4	-0.1
	5.2	-39.2	2.3	3.7	-4.2	2.1	0.3	0.2	0.2	1.5	1.1	-11.0	4.2	3.2	-0.8
	-1.6	-46.7	0.8	2.0	-13.3	0.9	-0.1	-1.8	-4.4	1.0	0.7	-14.2	3.9	1.8	-1.2
Lower Return	-17.6	-53.2	0.2	0.8	-18.2	0.2	-2.3	-5.8	-14.6	0.8	0.6	-18.6	2.9	-11.2	-2.2

- S&P 500 Index
- Russell 2000 Index
- Dow Jones US Select REIT Index
- Dimensional International Small Cap index
- MSCI Emerging Markets Index (gross div.)
- ICE BofA One - Year US Treasury Note Index
- Bloomberg US Treasury Bond Index 1 - 5 Years
- FTSE World Government Bond Index 1 - 5 Years (hedged to USD)

Source: Dimensional Fund Advisors (in U.S. Dollars)

7. Controlling Your Emotions

Warren Buffett is often quoted for his words of wisdom about making smart investing decisions. A lot of his sayings are really about managing your emotions. Louis Simpson, who was one of Warren Buffett's favorite fund managers at Berkshire Hathaway, once said about how Warren Buffet invests:

> **We do a lot of thinking and not a lot of acting. A lot of investors do a lot of acting and not a lot of thinking.**

Down markets are a fact of life when you invest. Taking a controlled amount of risk is what allows you to earn returns and build your wealth. However, falling markets can create anxiety and pressure to act that can feel overwhelming at times. This is when investors most often make errors that lead to a permanent loss of capital.

On the flipside, some investors are unnerved by markets that seem to be rising too much, too fast. They seem to believe in the old adage what goes up must come down, worrying that after a good run, the market must be headed for a fall.

Your thoughts can be deceptive. You may think you're making rationale decisions when in fact your actions are being driven by fear.

That's why you should prepare yourself for market downturns by striving to recognize when you're feeling under stress and cultivating strategies to deal with anxiety.

Among the most important of these is to tune out media noise about the day-to-day movements in the markets and focus instead on a long-term financial plan. It should have asset allocation targets that reflect your objectives and risk tolerance. As markets move up or down, you periodically rebalance your portfolio back to your target asset allocations and keep your faith that the process works overtime.

Conclusion

The important financial milestones in your life--especially retirement--can seem very far away. But the decisions you make today can have a profound impact down the road. Now is the time to develop the mindset, knowledge and habits you need to successfully navigate the years ahead.

In this eBook, we've looked at steps you can take to lay down a solid financial foundation:

- Get started saving and investing early to take advantage of the magic of compounding and build your knowledge and experience.
- Pay yourself first by setting up automatic contributions to an investment account.
- Grow your human capital through education and skills development. Protect it with insurance.
- Resolve to approach the markets with an investor mindset rather than a gambler mindset.
- Cultivate the discipline to stay in the markets through ups and downs, understanding the key to wealth creation is time in the market, not timing the market.
- Recall that the majority of active fund managers do not beat the market.
- Buy low cost passively managed funds to capture market returns. Reduce your risk by broadly diversifying across geographies and asset classes.
- Be aware of your cognitive and emotional biases and work to control them as you consider decisions.

The start of your career is a time of great expectations, possibilities and challenges. However, as the author Gretchen Rubin has famously observed, "the days are long, but the years are short." That's surely the case when it comes to building your wealth.

Changes come fast in life and time passes surprisingly quickly. That's why it's so important to put yourself on the right financial course now. It will pay dividends throughout your life and allow you to reach your financial goals.

Book Recommendations

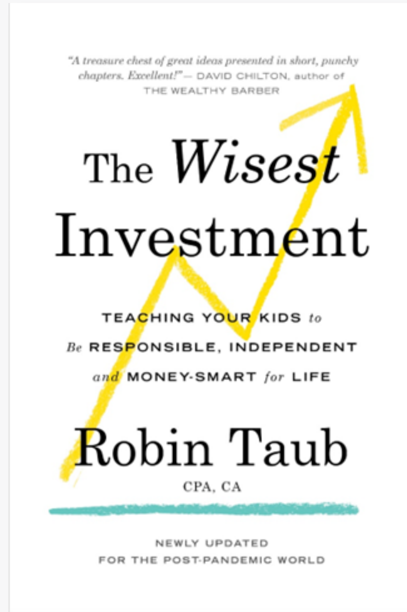
Seven Deadly Sins of Investing *by James Parkyn*

The principles of smart investing are well known, thanks to many years of academic research into market history, asset characteristics and human behaviour.

Yet, investors often don't benefit from this research because they are either unaware of it or are led astray by the media, the investment industry or their own emotions. The result is poor investment decisions that can lead to a serious loss of wealth with real consequences for your lifestyle, including a less comfortable retirement.

We've called this eBook the *Seven Deadly Sins of Investing* not because we blame people for falling victim to the pitfalls of investing, but because the "sins" are so easy to fall prey to. We understand it's often hard to know which choices will be best for building your wealth.

Book Recommendations for Parents



It Makes Total Cents
by Tom Henske

Take a stroll through your local book store's self-help section and you'll notice a void of advice books to build good financial habits in your children. Financial literacy has been a long-ignored subject and the end result has been generation after generation entering adulthood without a grasp of money basics. This eventually leads to unnecessary stress in adulthood and ultimately causes stress leading to health issues.

This is no longer the case. It Makes Total Cents is a short, easy-to-read bite-size guide to help parents end this perilous trend for their own kids. This concise book is meant to be read a chapter per month covering the 12 most important money topics that a child should understand BEFORE they head to college.

"Parents have to take ownership of educating their children about money." Tom Henske

The Wisest Investment
by Robin Taub

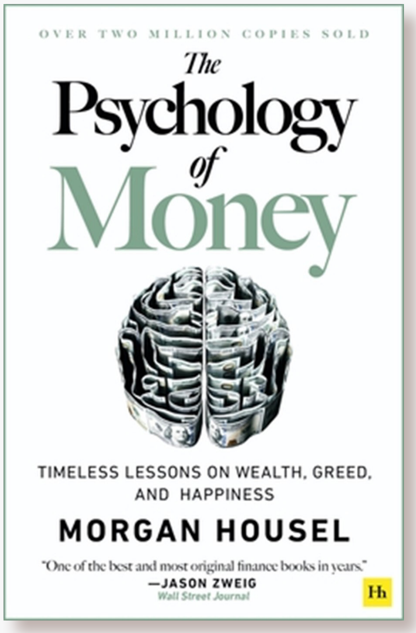
As parents, you know that teaching your kids about money is critical to success in life, but studies show that many parents feel they lack the time, knowledge and experience to do it well. Add the seismic shift towards a cashless, digital society – accelerated in our-post-pandemic world – and it's easy to feel overwhelmed.

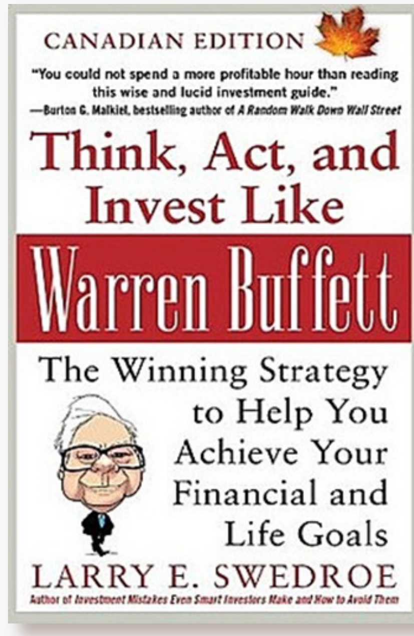
With *The Wisest Investment: Teaching Your Kids to Be Responsible, Independent and Money-Smart for Life,* Chartered Professional Accountant Robin Taub puts you at ease, by laying out a roadmap for teaching your kids about money.

Written in short, punchy chapters, it's a go-to resource for time-starved parents like you. Filled with practical guidance and examples, suggested activities, worksheets and self-assessment tools, it's a book you will turn to again and again.

Teaching your kids to be money-smart will pay off in numerous ways and just may be the wisest investment you make.

Book Recommendations to Build Your Knowledge Foundation





The Psychology of Money *by Morgan Housel*

Doing well with money isn't necessarily about what you know. It's about how you behave. And behavior is hard to teach, even to really smart people.

Money—investing, personal finance, and business decisions—is typically taught as a math-based field, where data and formulas tell us exactly what to do. But in the real world people don't make financial decisions on a spreadsheet. They make them at the dinner table, or in a meeting room, where personal history, your own unique view of the world, ego, pride, marketing, and odd incentives are scrambled together.

In The Psychology of Money, award-winning author Morgan Housel shares 19 short stories exploring the strange ways people think about money and teaches you how to make better sense of one of life's most important topics.

Think, Act, and Invest Like Warren Buffett *by Larry E. Swedroe*

If you wanted to create the next earth-shattering consumer product, Steve Jobs would be an ideal role model to follow. If you planned to become a great golfer, you might look to Arnold Palmer or Jack Nicklaus.

So, if your goals were to outperform other investors and achieve your life's financial goals, what should you do?

Think, act and invest like the best investor out there: Warren Buffett. While you can't invest exactly like he does, Think, Act, and Invest Like Warren Buffett provides a solid, sensible investing approach based on Buffett's advice regarding investment strategies.

When it comes to investing, Head of Financial & Economic Research for Buckingham Strategic Wealth, Larry Swedroe has pretty much seen it all—and he's come to the conclusion that simple is better, that adopting basic investing principles always increases an investor's chance of success and that Buffett is the perfect model for such investing.

Notes

Notes

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James Parkyn is a founding partner, Team Lead & Portfolio Manager at PWL Capital Inc. in Montreal with over 25 years of experience helping clients achieve their financial goals.

James and his team members provide unsurpassed service and honest, well-thought-out advice, driven by an investment philosophy that explains why he has the privilege of acting as a long-standing advisor to many of Canada's corporate elite, private business owners and retirees.

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