ALL ABOUT INVESTING

Knowing how to deal with **debt** is easy—**pay it off!** Investing, however, isn't quite so simple. Most people have questions about when and how to invest their money, so here's an inside look at Dave Ramsey's investing philosophy. Just remember, investing is personal. A **financial consultant** can help you create a retirement plan that's right for you.

Any successful investment strategy relies on a firm financial foundation, so it's important to lay the groundwork for financial success by working through the Baby Steps.

Here is Dave's investing philosophy:

- Get out of debt
- Invest 15% of your income in tax-favored retirement accounts
- Invest in good growth stock mutual funds
- Keep a long-term perspective
- Know your fees
- Work with a financial advisor

Are you ready to get your money working for you?

Your income is your most important wealth-building tool. As long as it's tied up in monthly debt payments, you can't build wealth. And if you begin investing before you've built up your emergency fund, you could end up tapping your retirement investments when an emergency comes along.

If you haven't paid off all your debt or saved up six months of expenses, postpone investing for now. After all, avoiding a financial crisis with a fully funded emergency fund and paying off debt are fantastic investments!

A Simple Investing Plan

Once you've completed the first three Baby Steps, you're ready for Baby Step 4—investing 15% of your income for retirement. You'll get the most bang for your buck by using tax-advantaged investment accounts like these.

Pre-Tax Investment Accounts

- 401(k)
- Traditional IRA
- 403(b)
- Thrift Savings Plan (TSP)

Tax-Free Investment Accounts (After Tax)

- Roth 401(k)
- Roth IRA

If your employer matches your contributions to your 401(k), 403(b) or TSP, you can reach your 15% goal by following these three steps:

1. Invest up to the match in your 401(k), 403(b) or TSP.

2. **Fully fund a Roth IRA** for you (and your spouse, if you're married).

3. If you still haven't reached your 15% goal and have good mutual fund options available, keep bumping up your contribution to your 401(k), 403(b) or TSP until you do.

Does your workplace offer a Roth 401(k)? If so, feel free to invest your entire 15% there. Just be sure it offers plenty of good mutual fund options so you can make the most of your investment.

What Does Dave Ramsey Invest In?

You have lots of investment options to choose from, and making sense of them all isn't easy. That's why we've included a quick guide to help you understand what Dave recommends investing in—and what he does not.

Of course, it's your money, and you should always understand what you're investing in. ***Don't copy Dave's plan simply because that's what Dave does***. **Work with a financial consultant** to compare all your options before choosing your investments.

Want to know more of the specifics? Here's an explanation of some common investment options and why Dave does or doesn't recommend them.

Mutual Funds (YES!!!)

Mutual funds enable you to invest in many companies at once, from the largest and most stable, to the new and fast-growing. They have teams of managers who choose companies for the fund to invest in, based on the fund type.

Why is this the only investment option Dave recommends? Dave prefers mutual funds **because spreading your investment among many companies helps you avoid the risks that come with investing in single stocks.**

Exchange Traded Funds (ETFs) (NO)

ETFs are baskets of single stocks designed to be traded on the stock market exchanges. ETFs don't employ teams of managers to choose companies for the ETF to invest in, and that often keeps their fees low.

ETFs allow you to trade investments easily and often, so a lot of people try to time the market by buying low and selling high. **Dave prefers a buy-and-hold approach** with a long-term view of investing.

Single Stocks (NO)

With single stock investing, your investment depends on the performance of an individual company.

Dave doesn't recommend single stocks because investing in a single company is like putting all your eggs in one basket—a big risk to take with money you're counting on for your future. If that company goes down the tubes, your nest egg goes with it.

Certificates of Deposit (CDs) (NO)

A CD is a type of savings account that enables you to save money at a fixed interest rate for a set amount of time. Banks charge a penalty for withdrawing money from a CD before it reaches its maturity date.

Like money market accounts and savings accounts, **CDs have low interest rates that don't keep up with inflation, which is why Dave doesn't recommend them**. While CDs can be useful for setting aside money for a short-term goal, they aren't suitable for long-term money goals that take more than five years to reach.

Bonds (NO)

Bonds enable companies or governments to borrow money from you. You earn a fixed rate of interest on your investment, and the company or government repays the debt when the bond matures. Although bonds' values rise and fall like stocks and mutual funds, they have a reputation for being "safe" investments because they experience less market volatility.

When you compare investments over time, **the bond market doesn't perform** as well as the stock market. **Earning a fixed interest rate might protect you in down years, but it also means you won't profit from the good years**. As interest rates go up, the value of your bond on the market goes down.

Fixed Annuities (NO)

Fixed annuities are complex accounts sold by insurance companies and designed to deliver a guaranteed income for a certain number of years in retirement.

Dave doesn't recommend annuities because they are often expensive and charge penalties if you need to access your money during a defined surrender period.

Variable Annuities (VAs) (NO)

VAs are insurance products that can provide a guaranteed income stream and death benefit.

While VAs do provide an additional option for tax-deferred retirement savings if an investor has already maxed out their 401(k) and IRA savings accounts, you lose much of the growth potential that comes from investing in the stock market through mutual funds. Plus, fees can be expensive, and VAs also carry surrender charges.

Real Estate Investment Trusts (REITs) (NO)

REITs are companies that own or finance real estate. Similar to mutual funds, REITs sell shares to investors who are then entitled to a portion of the income produced from the company's real estate investments.

Dave prefers to invest in paid-for real estate bought with cash and does not own any REITs.

Cash Value or Whole Life Insurance (NO!)

Cash value or whole life insurance is a type of life insurance product often sold as a way to build up your savings.

Cash value or whole life insurance costs more than term life insurance. When the **insured passes away**, the beneficiary **only receives the face value of the policy** and loses the money saved within it. Dave recommends term life insurance instead, with coverage that equals 10–12 times your income. **Start with a 15-year policy—longer if you have young children.**

Separate Account Managers (SAMs) (NO)

SAMs are third-party investment professionals who buy and sell stocks or mutual funds on your behalf.

Dave prefers to invest in mutual funds with their own teams of experienced fund managers who have long track records of above-average performance.

How Do You Choose the Right Mutual Funds?

Your employer-sponsored retirement plan will most likely offer a selection of mutual funds, and there are thousands of mutual funds to choose from as you select investments for your IRAs. Dave divides his mutual fund investments equally between each of these four types of funds:

Growth(also called Mid-Cap)--Fund that buys stocks in medium-sized companies that have experienced some growth and are still expanding

Growth and Income(also called Large-Cap)--Fund comprised of large, well-established companies

Aggressive Growth (also called Small-Cap)--Fund that seeks to provide maximum long-term capital growth from stocks of primarily smaller companies; the most volatile fund

International--Fund that contains international or overseas companies

Choosing the right mutual funds can go a long way toward helping you reach your retirement goals and prevent unnecessary risk. That's why it's important to compare all your options before making your selections. Here are a few questions to consider as you determine which mutual funds are best for you:

- How much experience does the fund manager have?
- Does this fund cover multiple business sectors, such as financial services, technology, or health care?
- Has the fund outperformed other funds in its category over the past 10 years or more?
- What costs are associated with the fund?
- How often are investments bought and sold within the fund?

If you can't find answers to these questions on your own, **ask your financial consultant for help**. It's worth the extra time if it means you can make an informed decision about your investments.

Understanding Investing Fees

The fees associated with investing are often confusing, but they are an unavoidable part of investing for retirement. Fees will also have an effect on your savings, so **it's important to understand how much you're paying and why**.

For example, most investing professionals are paid one of two ways.

- A **fee-based** pro receives ongoing compensation based on a percentage of the assets they manage for you. Their pay rises and falls with the value of your assets.

- A **commission-based** investing professional is paid up-front based on a percentage of the money you invest. That percentage varies from one investment to another.

Each arrangement has its pros and cons, and you can find trustworthy, client-focused professionals who use either method. However, if your financial consultant doesn't take the time to explain the costs of their services or the fees associated with your investments, that's a huge red flag. **Never invest in anything until you understand how it works**, how much it will cost, and how that cost will affect your savings long-term.

How Does Saving for College Fit Into Dave's Investing Philosophy?

Once you're investing 15% of your income for retirement, you can start **saving for your kids' college fund**. Just remember, retirement saving comes first! Your kids will have options as they pay for college: scholarships, grants, part-time jobs—anything but student loans. But you will only have your retirement savings to get you through your golden years.

You will have some tax-advantaged college savings options that are similar to your retirement accounts. Education Savings Accounts (ESAs or Coverdell Savings Accounts) are simple and work like an IRA. You can also save for college through a state-specific 529 plan.

Each type of college savings account has its pros and cons, like income limits on ESAs and state-by-state differences between 529 plans. Your financial consultant can help you decide which choice is right for you.

Working With Your Financial Consultant

Even though Dave has a thorough understanding of how retirement investing works, he still prefers to work with a financial advisor. It's a pro's job to stay on top of investing news and trends, but their most valuable role is keeping you on track to meet your retirement goals.

A good financial consultant provides insight and direction based on years of investing experience, but they know you're the decision-maker. Look for a pro who takes time to answer your questions and gives you all the information you need to make good investing choices.

5 Foundations

1. **Emergency Fund ($500)**
2. **Get out of Debt**
3. **Pay Cash for Your Car**
4. **Pay Cash for College**
5. **Build Wealth and Give**

7 Baby Steps

1. **Baby Emergency Fund**
2. **Get out of debt**
3. **Fully-Funded Emergency Fund**
4. **15% of income into retirement**
5. **College Savings for Kids**
6. **Pay off House**
7. **Build Wealth and Give**

"The Davis 9" (Combining the 5 Foundations and the 7 Baby Steps)

1. **Baby Emergency Fund ($500-$1000)**
2. **Get out of debt (hopefully none)**
3. **Pay Cash for Car**
4. **Pay Cash for College**
5. **Fully Funded Emergency Fund (3-6 months)**
6. **Invest 15% into retirement**
7. **Save for Kid's College**
8. **Pay off House Early**
9. **Build Wealth and Give**

Three Vital Questions Your Advisor Must Answer

To say that investing is intimidating is an understatement. That's why we recommend you work with an investing pro. You'll save time and money, and your advisor will encourage you to stay invested for the long-term.

Since this person will be so important to your financial life, **feel free to be picky.** We've put together a short list of questions to get you started in your first meeting with potential investment advisors.

What type of experience do you have?

The financial industry does not impose regulations on advisors in order for them to be recognized as professionals, so you'll need to pay attention to this answer. You want a seasoned advisor, someone who has seen the ups and downs of the market. Experience in banking or as a CPA is not the same.

What's your overall investing philosophy?

You want an advisor who believes in investing for the long-term, diversification and mutual funds with a long history of success. **An advisor who recommends a portfolio of single stocks or other risky investments *isn't* a good fit.**
The most important thing to remember is that your avisor does not make decisions for you. You should feel comfortable that your advisor has the heart of a teacher and will take the time to teach you how to make smart decisions that are focused on your needs and goals.

How are you paid?

Your advisor is paid any number of ways, so what you're looking for is an honest answer. Your advisor should be willing to explain all fees and expenses associated with the investments he or she recommends. Don't settle for anything less.

Dave prefers a commission-based advisor and funds. Over the lifetime of an investment, a commission-based fund will cost the least.
Hiring an investment advisor is a wise decision. But don't stop there. Make sure you're comfortable with your advisor's qualifications, philosophy and payment arrangements.

Saving for Your Livelihood

Let's face it, getting older happens every day. We all have thoughts of retiring one day and taking that big vacation or sipping lemonade on the front porch swing. **But so few of us prepare for retirement the right way.** It's your responsibility!

The days of working for an organization for 40 years and it taking care of you at retirement are gone. **It's up to you!** If you keep fooling yourself into thinking the government will take care of you and that you'll be able to handle the bills that come with old age, consider a recent article that SmartMoney.com ran about health care costs. It quotes a report that says a 65-year-old couple that retires today can **expect to spend about $200,000 during their retirement on health care** (everything from premiums to prescriptions). That's huge! And you need to be ready for this huge deal.

If you had to come up with $200,000 in disposable income over the next 20 or 25 years (the duration between retirement and death), could you do it? Probably not; that's while you're working and generating income. You need to prepare! The more you invest today, the more you can smile when medical bills are coming 20, 30 or 40 years from now. Why? **Because you will have prepared.** Here are some steps to help you prepare now.

1. Pay off all debt except the house and have a full emergency fund (3-6 months of expenses) in place.

The reason it's so important to knock out the debt first is because once you've paid off the student loans and other debt, you'll have freed up a considerable amount of income to invest. And the more you invest, the better off you'll be in the long run. You shouldn't work hard and earn money to throw it away at 18% interest to American Excess. That's bad math. **Make the numbers work for you** instead of against you.

2. Put 15% of your earnings into retirement savings, which will ensure that you retire with dignity.

If your workplace offers a **401(k) with company match**, start there, but don't count the match as part of your 15%. If something happens (you change jobs, the company quits matching, etc.), you know you're still putting in what you should. If 4% is matched, put in 4%. Any time your employer gives you free money, take it.

If your company doesn't offer a match or a retirement plan at all, start investing in a **Roth IRA**. If you are married and both spouses are working, you both should take advantage of this powerful wealth-building tool. The best part of the Roth IRA is the interest and distributions on it are tax-free. If you put in $3,000 a year for 30 years in a growth stock mutual funded Roth IRA averaging 12% (the 70-year stock market average), at the end of the 30 years you will have invested $90,000 but it will have grown to **$873,000 with no taxes to pay!**

Currently the contribution limit is $5,000. If you are 50 years of age, you can put in an extra $1,000 on top of the limit to "catch up." Take advantage of this if it's applicable to your situation.

One more thing. If you start this process early enough (and you should start as soon as possible, regardless of age), hopefully you'll know how to swim because you'll be **swimming in money.**