

BURTON G. MALKIEL

bestselling author of *A Random Walk Down Wall Street*



THE
ELEMENTS
OF
INVESTING

Easy Lessons *for* Every Investor



CHARLES D. ELLIS

bestselling author of *Winning the Loser's Game*

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Easy Lessons for Every Investor
10th Anniversary Edition

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Charles D. Ellis

Preface to Anniversary Edition by Gus Sauter
Foreword to Original Edition by David Swensen
10th Anniversary Foreword by Tim Buckley

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To our delightful grandchildren,
Porter, Mackie, George, Jade, Morgan,
Charles, and Ray

CONTENTS

Preface to Anniversary Edition	xi
Foreword to Original Edition	xv
Foreword to the Anniversary Edition	xix
Introduction	xxi
It All Starts with Saving	1
I. Save	3
First Do No Harm	5
Start Saving Early: Time Is Money	6
The Amazing Rule of 72	7
Savvy Savings	11
Small Savings Tips	14
Big Ways to Save	15
Let the Government Help You Save	17
Own Your Home	18
How Do I Catch Up?	19
II. Index	23
Nobody Knows More Than the Market	24
The Index Fund Solution	27
Don't <i>Some</i> Beat the Market?	29
Index Bonds	33

Index Internationally	34
Index Funds Have Big Advantages	36
One Warning	37
Confession	39
III. Diversify	41
Diversify Across Asset Classes	43
Diversify Across Markets	46
Diversify Over Time	47
Rebalance	51
IV. Avoid Blunders	57
Overconfidence	59
Beware of Mr. Market	61
The Penalty of Timing	65
More Mistakes	66
Minimize Costs	67
V. Keep It Simple	71
Review of Basic Rules	72
Asset Allocation	79
Asset Allocation Ranges	81
Investing in Retirement	85
Getting Specific	86
VI. Timeless Lessons for Troubled Times	95
Volatility and Dollar-Cost Averaging	97
Diversification Is Still a Time-Honored	
Strategy to Reduce Risk	99
Rebalancing	101
Diversification and Rebalancing Together	103
Index at Least the Core of Your Portfolio	104
Fine-Tuning a Bond Diversification Strategy	107
A Final Thought	111

A Super Simple Summary: KISS Investing	113
Appendix: Save on Taxes Legally	115
Individual Retirement Accounts (IRAs)	115
Roth IRAs	117
Pension Plans	118
Tax-Advantaged Saving for Education	120
Recommended Reading	123
Acknowledgments	125
About the Authors	127
Index	129

PREFACE TO ANNIVERSARY EDITION

At her death in 1999, at the age of 91, Oseola McCarty bequeathed \$150,000 to The University of Southern Mississippi. For her generosity, she received an honorary degree from the university and the Presidential Citizens Medal, the second-highest civilian award in the United States. Her gift was all the more extraordinary because she earned her living washing clothes.

At a very young age, Ms. McCarty was taught by her mother to be a great saver. She made tradeoffs, spending what she needed to live on, but forgoing any luxuries. She had a used TV, but only watched shows that she could pick up over the airwaves. She did not own a car, electing to walk everywhere. She lived in a house that she had inherited from her uncle. Over the course of her lifetime, she amassed a remarkable nest egg, estimated to be about \$250,000.

Ms. McCarty was the very model of a disciplined saver. Her example shows that a little bit of will power—and yes, thrift—can add up to big things. This is Lesson Number 1 in any sound financial plan, and it is the first lesson in this wonderful book by Burton G. Malkiel and Charles D. Ellis.

Over the past several decades, Malkiel's *A Random Walk Down Wall Street* and Ellis's *Winning the Loser's Game* have helped millions of people to understand the fundamentals of investing and to reach their financial goals. In *The Elements of Investing*, Malkiel and Ellis distill their wisdom and experience into a sensible plan for people to save and invest.

Some money managers warn that successful investing can be carried out by only the most sophisticated and talented professionals. And, of course, these managers claim to be members of that small club. Malkiel and Ellis argue that successful investing should not be the province of a select few. Football games are not always won by the best quarterback; they are won in the trenches. Investors have to win the war of blocking and tackling.

The Elements of Investing provides a roadmap that can multiply your savings to reach your financial target. It starts with understanding some basic questions, like: When will you need this money? How well can you tolerate investment risk? The answers to those questions can help you build an appropriate asset allocation between stocks, bonds, and cash.

The approach should be balanced and the investments should be broadly diversified. Most importantly, the authors stress that the investments must be low cost. One certainty about investing is that, for a given return, the more you spend to earn it, the less of it you will keep. The authors conclude that the best way to implement your plan is to invest in low-cost index funds.

Like blocking and tackling, this approach is certainly not sexy. But, I daresay that most investors would be better off if they followed this strategy. Indeed, it's the kind of approach that we espoused at Vanguard and it has served many clients very well over the years.

Pundits bombard us daily with claims that the old rules no longer apply. They say that people should abandon buy-and-hold investing and become more opportunistic. Malkiel and Ellis take umbrage with these claims. To be sure, the pundits have been saying this for many decades. While it may seem intuitive that a smart professional should be able to identify the highs and lows of the market, the majority of such professionals have not been able to achieve the long-term returns of the disciplined, low-cost approach that the authors of this book espouse. Do we believe that results will be different in the future? The authors reaffirm the views they expressed in their earlier editions and they provide supporting evidence. Diversification, rebalancing, dollar-cost averaging, and low-cost indexing remain the best path to achieve investment success.

The Elements of Investing is a must-read for all investors—those new to investing and those who have been at it for a while. It's for people of all ages. It should be required reading in high school because the power of compounding is particularly valuable when investors start at a young age. But veteran investors will also benefit from reading this book because it debunks misconceptions and identifies behavioral biases that stand in the way of successful investing. And, just to make sure you do not fall prey to the siren's song of a better way, you should reread this book every several years.

Over the course of my career, I've seen time and again how the principles discussed in this book have helped ordinary people achieve extraordinary results.

George U. "Gus" Sauter
Retired Chief Investment Officer, Vanguard
July 2019

FOREWORD TO ORIGINAL EDITION

In *The Elements of Investing*, Charley Ellis and Burt Malkiel, two of the investment world's greatest thinkers, combine their talents to produce a remarkable guide to personal finance. Having already written two of the finest books on financial markets, Ellis's *Winning the Loser's Game* and Malkiel's *A Random Walk Down Wall Street*, why should the authors revisit the subject of their already classic volumes? The sad fact is that in the cacophony of advice for individual investors, few sane voices are raised. In writing *The Elements of Investing*, the authors provide an important service to the lay reader, honing their message to the bare essentials by heeding Albert Einstein's dictum that "everything should be made as simple as possible, but not simpler."

Investors have three tools to deploy in the portfolio management process—asset allocation, market timing, and security selection. Asset allocation involves setting long-term targets for each of the asset classes in which an investor invests. Market timing consists of short-term bets against the long-term asset allocation targets. Security selection deals with the construction of the asset classes that an investor chooses to employ.