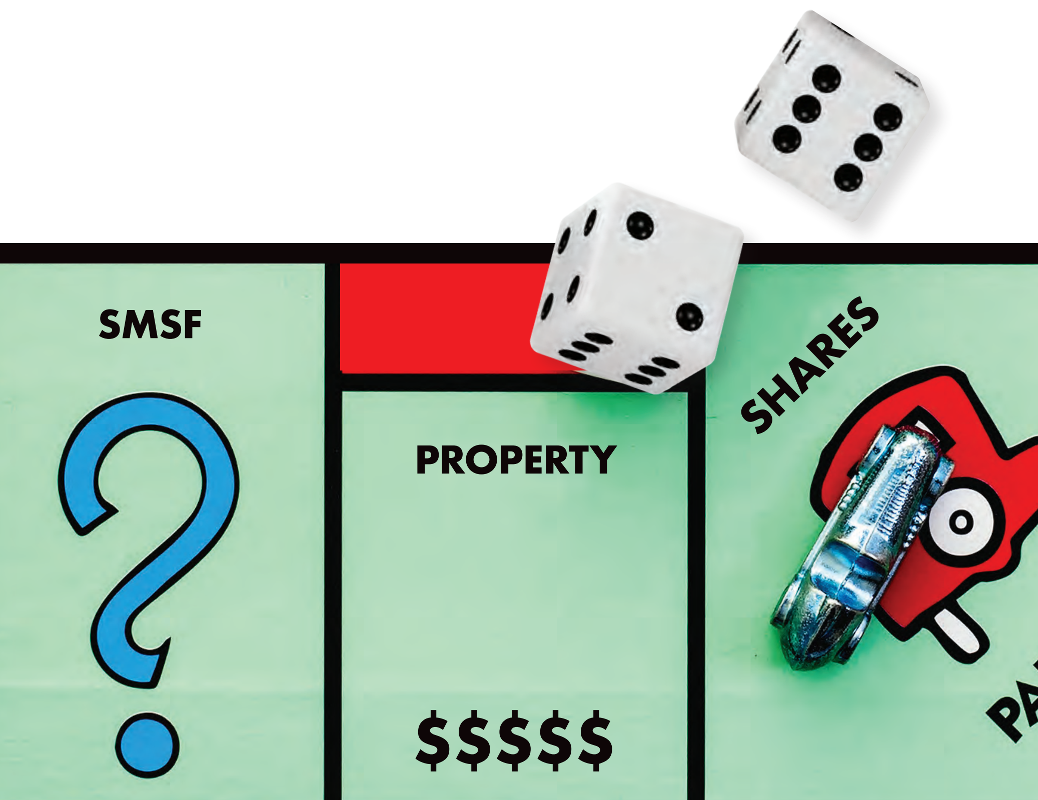
INVESTOPOLY

THE 8 GOLDEN RULES FOR MASTERING THE GAME OF BUILDING WEALTH



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ABOUT THE AUTHOR

Stuart Wemyss is a qualified chartered accountant, independent financial advisor and mortgage broker with over 20 years' experience. He founded his business, ProSolution Private Clients, in 2002 and has helped hundreds of clients invest successfully. Stuart is licensed to provide financial, credit and tax advice, which means he is able to give holistic advice.

Stuart has always passionately believed in the need for people to be able to access a trustworthy source of independent financial advice. Nothing upsets him more than to hear about selfish advisors ripping off their unsuspecting clients! This passion is what drives him daily to write books and blogs, publish podcasts, appear in the media, advise his clients, mentor his staff and give presentations – whatever it takes to help more people access a source of unbiased information and advice.

Stuart is married, lives in Melbourne and has two children. He is a passionate Cats supporter (AFL) and loves a glass of wine (or three)!

If you would like to hear more from Stuart, you can subscribe to his blog and podcast at www.investopoly.com.au.

HOW THIS BOOK IS DIFFERENT AND WHY IT MIGHT HELP YOU

As a financial advisor, when I meet people for the first time they tend to ask questions like the following:

- ‘I know I need to do something, but where do I start?!’
- ‘Should I focus on repaying my home loan as my top priority?’
- ‘Do I need to invest in property as well as shares, contribute more into super or look at different options?’

No doubt you have similar questions (you’re reading this introduction after all), and helping you answer questions like these is exactly why I’ve written this book. In it, I outline how you can plan your financial journey using a robust and proven investment framework: my eight golden rules to winning the ‘game’ of building personal wealth.

What financial steps you need to take next will only become clear when you understand how this game and its rules work.

Games are won by applying proven rules and strategies

You’ve likely noticed the title of this book is a play on the board game Monopoly – the ultimate trading game. Let’s be honest, winning Monopoly requires a little bit of luck – for example, land-

ing on unowned property and avoiding properties already owned by your opponent. But, in truth, the key to winning this game is making the most of your luck and applying certain rules – such as buying as much property as possible, not spending all your cash (having some savings) and negotiating to get a full set as soon as you can. Following these rules will see you winning more games of Monopoly than you lose (and perhaps flipping fewer boards over in frustration).

Building wealth is no different. You can win at the game of building personal wealth by applying a set of proven rules. These golden rules are all proven (they work) and are rooted in logic and simple maths – they are not my or anyone else's opinion and can be verified with historical evidence. These rules include things like have a plan, spend less than you earn, forget about the short term and always make decisions that maximise long-term wealth and, if you are going to invest in property, make sure it's 'investment-grade'.

Follow my eight fundamentally sound, easy-to-understand golden rules – it's that simple!

I believe that mapping out a financial plan so that you can have a safe and secure retirement is a lot easier than you might think. Understanding and consistently applying my golden rules will help you work out what you should do next (investment-wise), with virtually no chance of making a mistake – even if you don't have a 'financial brain'.

If you already use a financial advisor, the golden rules will help you work out if the advice you receive is sound. They will put you in control of your financial destiny.

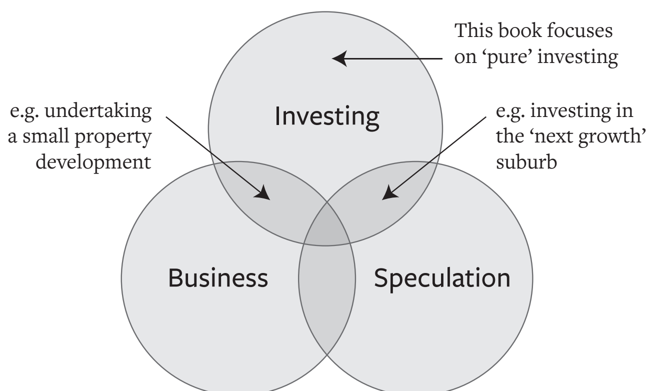
Virtually all mistakes are predictable – my golden rules will filter out mistakes before they occur

Very few investment mistakes occur because of random bad luck, and virtually all investment mistakes are predictable. In other words, mistakes are caused by doing something fundamentally wrong.

I propose that if you test all your past and current investment decisions against the eight golden rules outlined in this book, you'll be able to highlight where you went right or wrong. More importantly, if you filter all future investment decisions through these eight golden rules, you'll be able to prevent all predictable mistakes. Applied consistently, these golden rules guarantee success (putting aside random bad luck, which rarely occurs).

This book is all about 'pure investment'

You can build personal wealth in three ways: by investing, speculating and business ownership. These three strategies are illustrated in the following figure.



When trying to build wealth, you need to understand which of these strategies you're using (that is, investing, speculating or

owning a business) because they each have very different risks and wildly different success rates.

You also need to be aware that you could be doing a bit of both. For example, investing in property in a location that is unproven but that you expect to 'take off' is closer to speculation, rather than investing. Many people may fool themselves into believing they are investing, but they are not.

To build wealth safely and successfully, you need to employ an easily repeatable strategy. Good investment strategies and methodologies generate ongoing investment returns, year on year, with virtually no input from you. However, in contrast, success in speculation and business is rarely repeatable without a lot of intellectual input from you. That is, you must keep discovering new ideas (for example, picking a new stock or new asset such as bitcoin, or predicting the next growth suburb or development site) each year to make money, which is very difficult to do consistently.

This book is about pure investment. Pure investing is all about generating the highest return for the absolute lowest risk, using proven, repeatable strategies and rules.

I outline my golden rules in more detail over the course of this book, showing you how simple it is to understand money and build wealth safely. But first, a bit about me ...

I'm a practitioner, not a journalist or commentator

I am a doer, not a teacher or commentator. This book consolidates my 21 years' experience as a financial advisor, chartered accountant, mortgage broker and investor into my eight golden rules.

If you want to build a house, would you prefer to engage a licensed builder with 30 years' experience on the tools or someone who is building their first home? We all make mistakes while we are

learning our trade. The experienced builder probably made mistakes on the first few houses they built, and so had to go back and rectify them. After 30 years, you'd expect them to no longer make the same mistakes. The experienced builder has had to solve many problems and challenges over the 30 years. There probably aren't many challenges they haven't solved yet – they've seen it all.

I don't know of anyone who wouldn't say that they aren't a lot better at their job after 20 years of experience. Learning and doing are two very different things.

The golden rules contained in this book have been formulated and refined over my two decades of practice, observation and experience. They are not just theory. They have been tested and proven to work.

I have nothing to sell you

As mentioned, I'm a qualified and licensed chartered accountant, financial planner and mortgage broker. I am a registered tax agent and hold my own Australian Financial Services Licence and Australian Credit License. My 21 years' experience includes running my own financial advisory business in Melbourne – ProSolution Private Clients – for the last 16 years.

I do not make any money selling or recommending investments – and never will. Many property books are written by buyers' agents. Many share investing books are written by stock brokers and fund managers. This doesn't make them bad books. It just means that this book is different because I'm an independent umpire. I don't care if my clients invest in shares, property, bonds or whatever – because I have no vested interest. My only interest is that they invest in what is appropriate and helps them achieve their goals.

I would love to hear your feedback...

If you enjoy this book, please share it with the people you care about. If you love it, I would greatly appreciate it if you spent a few minutes to share your review on Amazon or Google. Doing so will help people better understand how this book may help them.

Finally, throughout the book I direct you to www.investopoly.com.au to download additional materials at no cost. Here you can also subscribe to my weekly blog.

As we launch into my golden rules and how you can apply them to your financial situation, I wish you the best success with your investing.

GOLDEN RULE #1

PLAY THE LONG GAME

In this chapter, I discuss why taking a long-term approach with almost all financial decisions is critical. I outline why the best quality financial decisions are almost always long-term ones, and why short-term profit does not create long-term value for anyone. In short, this chapter demonstrates why you will ultimately become an unsuccessful investor by thinking short-term, and being impatient and greedy.

Delayed gratification is your best friend – and an indicator of success

Delayed gratification is the conscious decision to direct money in a manner that will not enhance your lifestyle in the short term (in fact, it might have a negative impact on your lifestyle right now), but will substantially improve your financial position and lifestyle in the long run.

Delayed gratification has been proven to provide improvements in many parts of life, including finances. A famous longitudinal study on the impact of delayed gratification – called the 'marshmallow test' – was conducted by Professor Walter Mischel at Stanford University in the 1960s. The test involved offering preschoolers the option of one marshmallow now or, if they waited approximately 15 minutes, two marshmallows (during which time the tester left the room). Several follow-up studies were completed years later in the 1980s and 1990s, and these found that the children who exhibited a capacity for delayed gratification went on to have higher educational achievement, a higher sense of self-worth and a better ability to cope with stress.

Let's look at a real-life example. Ben is a 30-year-old project manager. He has just received a $15,000 p.a. pay rise. Ben is faced with two decisions. He can upgrade his car and spend approximately $9000 on a car lease (which is the equivalent to his after-tax increase in income – that is, $15,000 minus $6000 in tax). Or he can invest this extra income with some borrowings – that is, invest $750 per month in cash plus $750 per month from borrowings (making a total investment of $1500 per month) into a diversified low-cost share market investment. In my experience, people tend to get used to a certain standard of living and rarely make voluntarily decisions that will result in a 'downgrade' to their standard of living. As such, if Ben chooses the first option, it is reasonable to assume that he will continue to spend $9000 p.a. on a car lease for the long run (because he'd continue to update his car at the end of each lease period).

In ten years' time, if Ben chose to invest, he would conservatively have $159,000 in equity in his share market investments (and this would snowball to over $550,000 in 20 years' time – assuming a 5 per cent p.a. dividend yield plus 5 per cent p.a. growth).

Alternatively, if Ben had the capacity to borrow more, he could use the $15,000 of pre-tax income to fund the cash flow shortfall of a $400,000 investment-grade property. In ten years' time following this option, Ben would have over $350,000 of equity in that property (and over $1 million in 20 years' time – assuming a 7 per cent p.a. growth rate plus 3 per cent p.a. gross rental yield). Of course, if Ben chose the car, his financial position would not have improved.

Understanding that a significant long-term reward comes from making long-dated financial decisions is very important. Most people don't appreciate how significant the differences are in financial terms. Think back over your life. Did you make decisions 5, 10 or 20 years ago that continue to affect your finances now? Would taking a different path have resulted in a significantly improved financial position?

Of course, I am not suggesting that every decision we make should only consider the financial implications. Lifestyle considerations are important and it's imperative to enjoy the journey rather sacrificing everything until you reach your destination (that is, financial independence). I think the key word here is 'balance'. For more on this, see Golden Rule #3.

The perils of short-term thinking

Short-term thinking isn't just dangerous when thinking about your lifestyle versus investment choices. When you have decided to invest, a short-term outlook often creates a lot of anxiety about possible changes in the market. What if the market drops 5 per cent next week? What if the property market bubble bursts? And so on. Fear causes people to worry about investing in an asset one day, only for its price to plummet the following day, week or

month. This fear often results in paralysis – that is, when faced with a risky decision, it's far easier for humans to do nothing at all. Conversely, if we take a long-term approach (for example, you ask yourself which stock or property you can invest in today that will be worth four times its current value in 20 years' time), any short-term market price volatility is put into perspective and becomes largely inconsequential. This is the best way to quell any anxiety that you might have about making investment decisions.

Howard Schultz, the man who built the $100 billion Starbucks behemoth, once said in an interview with Oprah Winfrey that 'short-term profit does not create long-term value for anyone'. This is a very profound and important point when it comes to investing. Take stock picking as an example. Let's say that I have a crystal ball and I can pick a stock that's going to perform very well over the next two years, meaning I can invest in that stock and enjoy the returns. However, in two years' time, I must find the 'next winner'. And then again two years after that. And again, and again. Putting aside the fact that it is near on impossible to pick winning stocks consistently year after year after year (more on this in Golden Rule #4), this is not a strategy that generates long-term value. We can all choose from many investment strategies. My proposition is that you should select the ones that are focused on generating long-term value, because they have a significantly higher probability of working.

Markets are not efficient in the short-run – so invest accordingly

The efficient-market hypothesis – formulated by economist Eugene Fama – essentially states that stocks always trade at their fair market value. I think this theory is broadly correct in the long run, but also believe, in the short run, markets are often affected

by irrational levels of confidence and pessimism. If you invest in the stock market today and intend to hold that investment for at least the next 10 years, I don't think you need to worry too much about the impact of irrational human behaviour. However, if you take a short-term approach towards investing, this irrational behaviour is another thing you probably should worry about.

Let's look at another example. In October 2007, the S&P 500 index (the best gauge of the US large-cap share market) was trading at over 1500 points. By March 2009, it had lost more than half its value and fallen to below 700 points. At the time of writing, the S&P 500 is trading at above 2,600 points which equates to an average capital return (excluding dividend income) of over 5.5 per cent p.a. over a 10-year period that included a massive stock market crash – that's not too bad, considering! If your investment approach is fundamentally sound, then 'time heals all wounds'.

The Australian property market is less susceptible to irrational behaviour because high entry (stamp duty) and exit (agent selling fees) costs render it uneconomical to speculate. However, the property market is made up of literally thousands of small geographical submarkets that are affected by their own idiosyncratic supply and demand factors. Due to this, irrational pricing of property can occur in these submarkets. A recent and excellent example of this was the property markets in mining towns. At the peak of the mining boom in 2012, a four-bedroom house in Moranbah, Queensland, sold for $850,000. In December 2016, that same house resold for only $300,000, crystallising an estimated loss of $590,000 including costs. Thousands more examples like this one can be found. People who invested in mining towns were encouraged by the prospect of short-term profit but, as Howard Schultz intimated, this came at the cost of long-term value.

In summary, we can't predict what markets will do in the short term. If you believe this to be true, the only solution is to take a long-term approach.

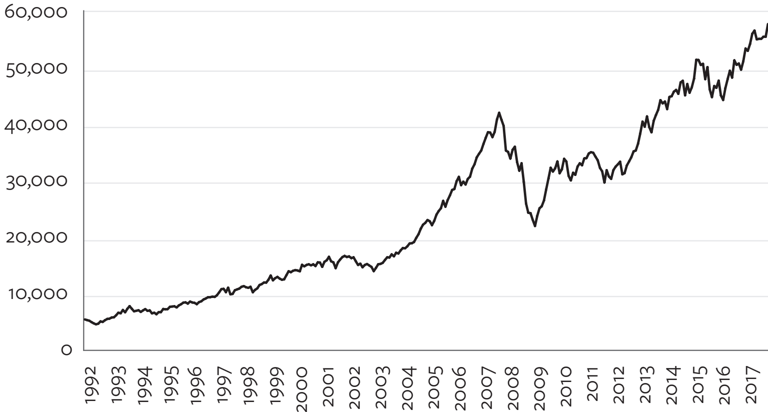
If I take a long-term approach, what investment returns can I expect?

I prefer to assess market returns over the long term – that is, over 20 to 30 years. Doing so means the assessment period includes various political environments, different economic growth periods, numerous interest rate cycles, and changes in law and taxation. The returns from the major growth asset classes of property and Australian and international shares do not vary that much over these longer terms – over the past 25 to 30 years, for example, total returns for these main asset classes ranged from 9.30 per cent to 12.0 per cent p.a. This highlights you can build wealth using any or all of these asset classes so long as you use the correct methodologies (which are outlined in this book). Which asset class you select depends on your situation and goals. The following sections look in more detail at the long-term returns from the major asset classes in Australia, starting with the Australian stock market.

Australian stock market 25-year returns

The following chart sets out the S&P/ASX 200 Total Return Index over the past 25 years. This index includes the top 200 Australian listed companies on the ASX and so represents approximately 80 per cent of the total Australian market (by market capitalisation). The Total Return Index also includes the impact of capital growth and dividends (reinvested). The growth in the S&P/ASX 200 Total Return Index (from 5920 in 1992 to 56,609 by October 2017) equates to a 9.3 per cent p.a. total return over the past 25 years.

S&P/ASX 200 Total Return Index from 1992 to 2017

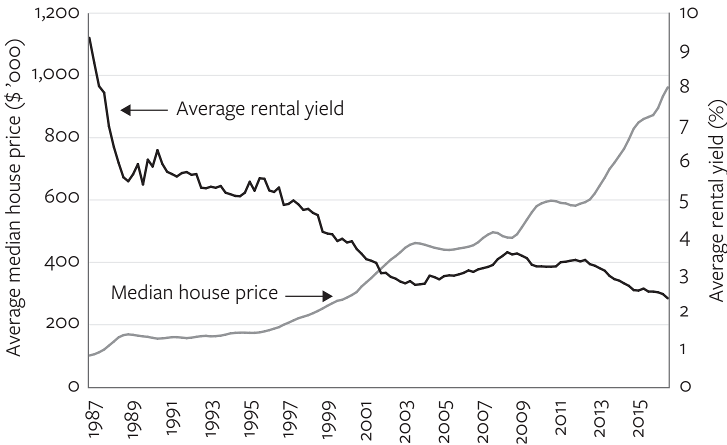


Data source: www.marketindex.com.au

Australian property market 30-year returns

The next chart overleaf sets out the average median house price for Melbourne and Sydney over the 30 years since June 1987. The average capital growth rate over this period was 7.86 per cent p.a., with the average rental yield for houses in Melbourne and Sydney over the same period being 4.19 per cent p.a. Therefore, the overall return for these markets was just over 12 per cent p.a. over the past 30 years. As you may be aware, rental yields are greatly affected by interest rates (because when rates are high, it's cheaper to rent than own and vice versa). This means they have been sitting between 2.5 per cent and 3.5 per cent since approximately 2002. Based on this data, I think it's reasonable to expect an annual capital growth rate in the range of 7 to 9 per cent over the long term and a rental yield of 2 per cent to 3 per cent p.a. if you invest in investment-grade property (see Golden Rule #8 for more on what 'investment-grade' means).

**Average median house price in Melbourne and Sydney/
Average rental yield**



Data source: REIA

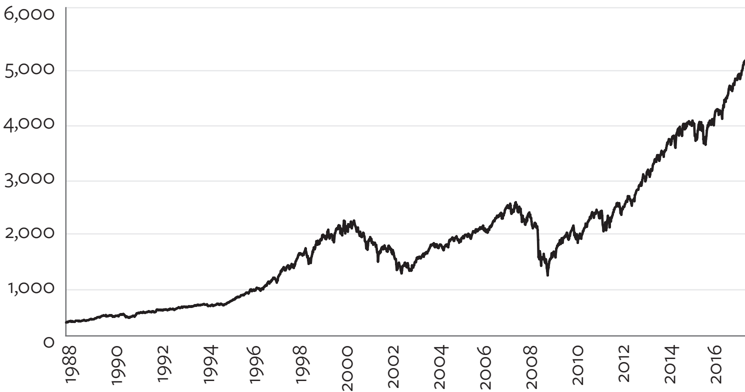
US stock market 30-year return

The chart opposite sets out the S&P 500 Total Return Index over the past 30 years. This index includes the top 500 companies listed on the New York Stock Exchange and NASDAQ by market value and accounts for approximately 80 per cent of the total market. The Total Return Index includes the impact of capital growth and dividend income (reinvested).

I have selected the S&P index because it's a broad-based index that, in my opinion, best represents the US market. In addition, the US market accounts for 54 per cent of the MSCI World Index. The second most dominant country/region is Europe, excluding the UK which accounts for 14 per cent. As you can see, the US market is a reasonable proxy for international markets.

The growth in the S&P 500 Total Return Index (from 256 in 1988 to 5150 by December 2017) equates to a 10.5 per cent p.a. total return over the past 30 years.

S&P 500 Total Return Index (US) from 1987 to 2017



Data source: www.finance.yahoo.com

Comparing markets

The assessment provided in the preceding sections shows that the total market returns for shares versus property over the long run are not massively different from each other. (One important factor to consider is that the split of income and capital is quite different between these asset classes. I discuss this further in Golden Rule #5.)

Based on these market returns, taking a long-term approach means you can expect an investment return of approximately 10 per cent p.a. if you invest in any of these assets classes. With the correct investment strategy, these returns will be sufficient for most investors to achieve their goals – and if you're hoping for materially higher longer term returns than this, I suggest you probably need to adjust your expectations.

As discussed in the introduction to this book, a big difference exists between speculation and investing. If you can obtain a long-term return of 10 per cent p.a., why would you ever need to speculate?

The only answers I can think of are that you are impatient or greedy or both. Or you feel it's a more exciting approach that, if it works, will make you feel smarter than the average investor. All these reasons are flawed in my opinion and you are better off sticking to what works.

When is it appropriate to think short term?

In some situations, it may be appropriate to take a shorter term approach. These situations will more likely relate to 'timing' decisions rather than asset-selection decisions – for example, where your financial situation might be changing in the near future because your employment income is either increasing or decreasing. In this situation, of course it is important to take these events into account. That said, such decisions must still be made in the context of having a longer term strategy.

What is the best question you can ask yourself today?

As world-renowned author Jim Collins says, great questions are better than great answers. I believe the single best question you can ask yourself is 'What investment decision can I make today that with dramatically strengthen my financial position in 10 to 20 years?' The answer to this question often yields the highest quality answer from an investment perspective. And if you ask yourself that question regularly and act accordingly, it won't be long before you are well on the way to achieving financial independence.

Golden Rule #1 Summary

Here are the main points we've covered in this chapter:

- Greed and impatience entice us to think short term. This might generate short-term profit but rarely results in the accumulation of long-term value – because short-term, greedy thinking seduces you into adopting fundamentally flawed investment strategies.
- Thinking short term when investing fuels anxiety because you end up worrying about short-term market movements. This either results in you making emotionally charged financial decisions (which almost always result in mistakes) or paralysis – that is, the inability to make any decisions.
- No-one has a crystal ball, and no-one has developed a reliable and proven methodology for predicting which asset class will perform best in the short term. No-one knows what's going to happen in the short term so give up trying to predict it and focus on maximising your long-term outcomes.
- Long-term returns produced by the major asset classes are healthy enough for you to be able to fund retirement. Therefore, it's not which asset class you choose or when you invest that determines how successful you'll be – it's how you invest that counts. Focus on your methodology (which I cover in Golden Rules #7 and #8) and stick with that investment for the long term.

Now that you understand how important it is to think long term, let's talk about the next golden rule – which is making sure you have a clear goal, and a clear destination. Many people make the mistake of investing aimlessly and this results in them investing in the wrong assets and in the wrong order – thereby compromising their success. The next golden rule will save you from making the same mistakes.

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