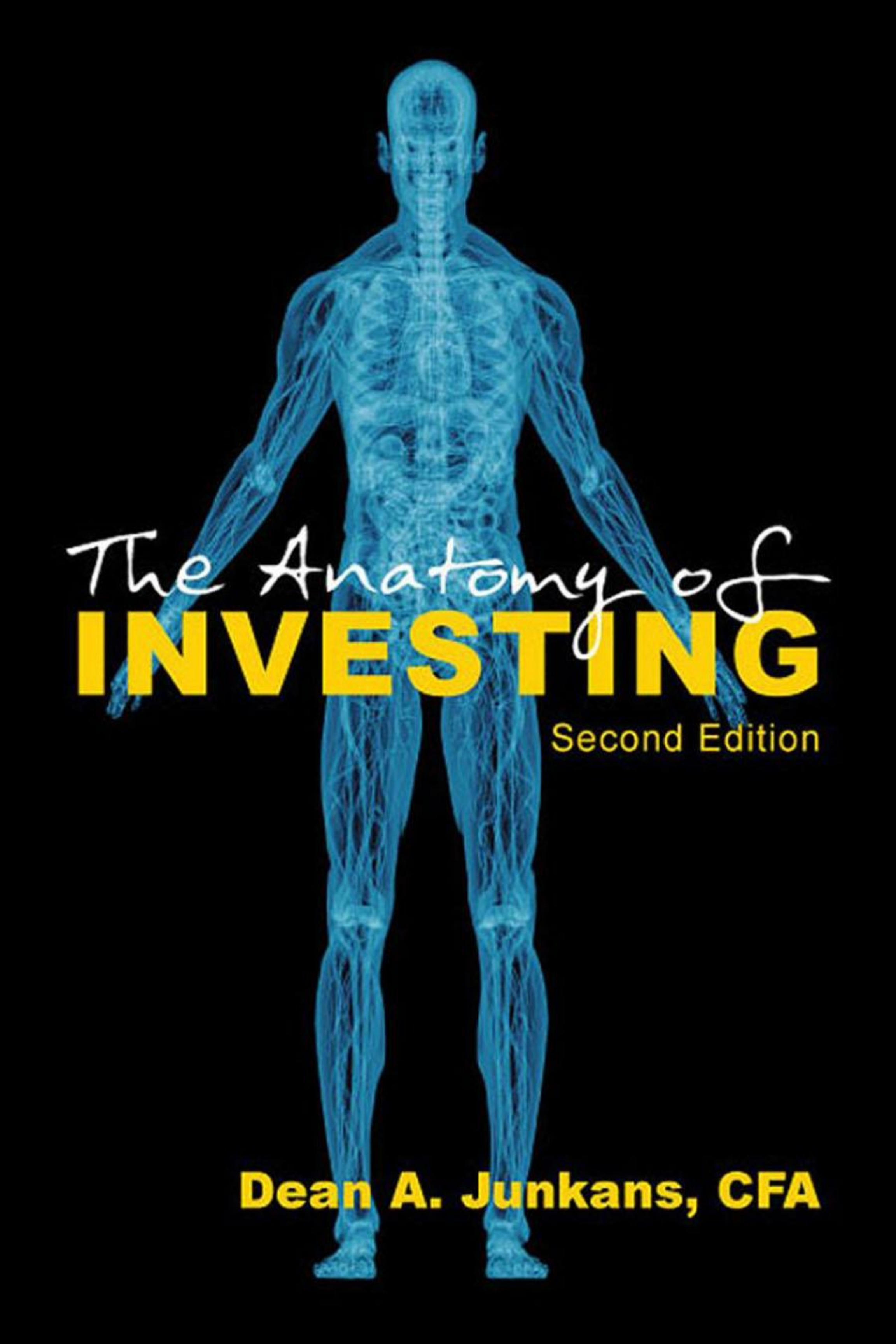

The Anatomy of INVESTING

Second Edition

Dean A. Junkans, CFA

The Anatomy of Investing

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ANATOMY: *The art of separating or dividing something into parts for detailed examination.*

INVESTING: *The act of committing (money) in order to earn a financial return.*

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Endorsements

"As a business owner, I value wisdom based on simplification of great knowledge and experience into practical advice for decision-making. This book provides true wisdom. I highly recommend The Anatomy of Investing which provides an overall understanding of investing in understandable terms and a "how to" reference guide for all stages of investing...it will pay high dividends for your time and investment."

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"Using the anatomy analogy, Junkans is able to clearly explain serious investment truths in a creative and entertaining way to the benefit of novices and pros. This is excellent teaching from a real leader in the investment profession."

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"If only I had access to your book when I got my first job, I know I could have done much better with my investments. This book should be read by anyone who wants an easy to understand, interesting and practical guide to investing.

I am going to give a copy to my daughter!"

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Business and Economics, University of Minnesota Duluth

"The Anatomy of Investing is a full-bodied tour of the ins and outs of planning for one's financial future and avoiding the vast number of pitfalls that face individual investors every day. Uncluttered by finance-speak and thoughtfully organized, Dean brings to his subject a wealth of experience and practical advice. From beginning to end, it's clear that he cares deeply about both his subject and the everyday investors he's trying to help."

—Tony Carideo, CFA, President, The Carideo Group, Inc.

"Dean Junkans has been a key thought leader for us on investment strategy and asset allocation for many years. Now everyone can benefit from his well thought out views on investing. The Anatomy of Investing is a terrific resource for anyone interested in learning more about the foundation of successful investing. Ignore the promises made by those who advocate the home run trades to riches approach. This book will equip the reader with the understanding and right tools to build a sound and diversified investment decision making approach which has been the hallmark of the industry's best money managers."

—Jay Welker, Executive Vice President and Head of the
Wealth Management Group at Wells Fargo

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Foreword

By Joel Larson, MD

The human body is a sophisticated, highly integrated composition of unique organ systems. These organ systems work together reacting to changing conditions in order to optimize the body's health, well-being and performance. We all have a basic understanding of these individual organ systems and the role they play in our body's homeostasis. The author has used this basic knowledge of human anatomy and physiology as an analogy to the unique features (organ systems) of a healthy financial portfolio. By doing so the author has created a process of sharing and teaching financial planning that is both simple and entertaining. I found myself curious about which organ system would represent which part of a financial portfolio and how well the analogy would work as a teaching tool. I welcomed with anticipation the portfolio priorities comparing them with the importance of an organ system always realizing that all organ systems were necessary for an optimally functioning body.

By using this analogy to teach financial planning the author has simplified and refocused the features of a financial plan in such a way that readers will better understand these financial tools and their place in a financial portfolio.

Start reading and you will enjoy the anatomy lesson as you learn about your investment portfolio.

Have fun! This, too, is an important feature of staying healthy and becoming wealthy.

Acknowledgments

Thank you to my family who believed that I could somehow find the time to revise and update The Anatomy of Investing. Thank you, Tammie, Erin and Daniel.

Thanks to all my colleagues at Wells Fargo who have been continually supportive of my writing over the past several years.

Thanks to the team at Strategic Book Publishing who work together to take the written word and create a book and provide high touch support to the author through the whole process.

This book would not have been possible without the support of my executive assistant, Sally Bjerke, and the help and encouragement from Sarah Douglass in our marketing department. They were really the glue that kept this project together. I owe both a huge thank you!

Introduction

I grew up on a dairy farm in Wisconsin and, at a relatively early age, was more interested in investing than I was in tractors, combines, or cows. Nearly every spare dollar I earned was invested in either mutual funds or ham radio equipment, my other passion at the time.

One of the greatest benefits of growing up on a farm is gaining an appreciation for hard work. A second benefit is learning how to focus on the long term. This is especially important when crop and milk prices or the weather do not cooperate in the short run. And third, you get a close view (sometimes too close) of how simple, yet complex, the world and everything in it can be.

Thirty years after leaving farm life, having for the most part converted to being a certified (hopefully not certifiable) city person, I have retained many of those same views of the world. As a result, I thought I would take a subject that has become a career and a passion for me—investing—and break it down in a simple approach using human anatomy as a guide.

Out of the blue it occurred to me that there are many parallels between human anatomy and a successful investment process for the individual investor. In the human body, a number of key organs and body parts must work together to sustain life. An individual investment portfolio, the various parts of it, and the individuals managing it, must also work together to have a sustainable and successful experience.

My intent in this book is to outline a basic approach to investing that nearly any investor can understand and implement, either on their own or with the help and guidance of an advisor. If you are looking for a book that goes in depth into new breathtaking investment approaches, this will not be the book to purchase. If you are looking for a quick and easy way to make money in the market, this book will be of little use to you. If, however, you are willing to work hard and focus on the long term or, if you grew up on a farm or always wished to, please read on.

In this book I will match ten basic parts of our human anatomy to the principles of a successful investment experience. This book will explore each of these principles in a separate chapter. Each chapter provides an explanation of these principles in layman's terms rather than typical investment jargon and will include some examples of how real investors or their advisors can implement them.

Because I do not believe that you can separate an individual investment plan from the individual, I have also touched on some financial planning concepts that would normally be covered in a separate book. I make no apologies for not following the prescribed tradition of separating investing from personal finance, as I have never understood how that tradition makes sense.

In order to help you craft your own game plan, I have organized each chapter with a summary called Healthy Investment Tips. These tips highlight and summarize the important points for you to consider as you invest your money. My intent is to address topics that can help you wherever you are in your investment journey, and regardless of whether you are doing it on your own or with the help of a professional advisor.

I hope you find that this book offers many useful investment ideas and maybe you will learn a little about anatomy along the way!

Note to the Reader

The publisher and author have presented the information and ideas in this book on a best-efforts basis, but do not warrant the accuracy or completeness of the content or strategies discussed. The advice, ideas, and strategies contained herein may not be suitable for your particular situation. You should consult with a professional, as appropriate. Neither the publisher nor the author shall be liable for any loss or damages of any kind resulting from action taken or not taken from this publication.

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Learning to Walk: The Difference Between Saving and Investing

Walking: The act of moving your body with your legs and feet

Some people never get beyond the crawling stage. They crawl from one thing to the next without a thought about where to crawl next. This approach of carefree living and spontaneity can be very appealing. It may even be okay for you, as long as you are only responsible for yourself and nothing in your life goes wrong, and as long as you do not care if you have any money on which to fund your retirement. If you *are* concerned about this, however, stop crawling and learn to walk.

When it comes to investing, going from saving to investing is like going from crawling to walking. Sometimes saving and investing are used synonymously, yet like crawling and walking, they are very different. The notion of saving is best described as the act of setting aside and accumulating money for a specific purpose. The specific purpose could be buying a car, taking a vacation, purchasing furniture, accumulating an emergency fund, etc. In other words, savings is money that you are setting aside now, but will likely spend in the future.

Investing, on the other hand, is money that you will live on in the future. Think of it as building a foundation that will provide you with spendable income down the road. Investing allows you to build a portfolio that will generate income and returns that will someday allow you to buy things that you used to save for from your regular income. I found one definition of walking that called it "the act of taking steps." Investing is also a process of taking steps. I will discuss these steps in Chapter 12.

It is important to understand that you can save and you can invest regardless of your income level. I often hear people say that they don't make enough money to save, much less invest. I do believe there is some income level at which you need all your income for food, shelter, and clothing. For some, however, perhaps this list of basic necessities becomes food, shelter, clothing, and more clothing, the latest electronic gadgets, luxury cars, and fancy vacations. In other words, if you really are tapped out but are serious about saving and investing, you may need to ask yourself if you are willing to give up some of these things to get beyond the crawling stage.

LIVING BELOW YOUR MEANS VERSUS LIVING WITHIN YOUR MEANS

This is a critical issue if you want to create some financial margin in your life. What am I talking about here? You have likely heard the phrase, "too many needs chasing too few dollars." Many people can probably relate to that, and they almost automatically know what it means. I would maintain that, in many cases, the problem is simply too many needs. These are needs that started as wants and, over time, became needs. These needs then require more dollars to fulfill.

I am sure you have read some articles on the importance of living within your means. In my opinion, the notion of living within your means misses the mark. Living *below* your means is a better way to save, invest, grow your wealth, and just plain live. Okay, so what's the difference?

Living within your means implies spending all your income, but no more than your income. This is certainly preferable to spending more than you make. However, unless you inherited a large amount of money or you plan to cash out of a business in the not too distant future, this is not a recipe to accumulate wealth. Living below your means implies not spending everything you make. In other words, earmarking a portion of your income to either saving or investing. In addition to saving and investing, living below your means gives you financial margin in your life.

Having financial margin in your life allows you to deal with unexpected expenses or take advantage of unexpected opportunities. These expenses or opportunities could take the form of a spontaneous vacation, helping a child pay for a wedding, donating funds to a charitable need that arises, and so on. Having this margin in your life puts less stress on your overall financial plan and can help with your overall peace of mind.

My recommendation is to draw very strict boundaries between accounts you use for savings and those you use for investments. I would further recommend that you have the following accounts set up:

1. **Emergency savings account:** This is a sum of money that is not earmarked for anything in particular. It is for an emergency. That emergency could be the loss of a job, an unexpected house or car repair, etc.

   There is a tremendous amount of advice out there on how big this account should be. Most of the advice is centered on having enough in this account to handle all of your basic living expenses for some period of time, typically ranging from three to six months. If you are living paycheck to paycheck, don't think you can't save for this account. My advice is to do *something;* don't become discouraged and do nothing.

   My personal view is that with more and more employers paying their employees a salary and an annual bonus, the annual bonus could be a great way to jumpstart an emergency savings account. Rather than look at the bonus as just more discretionary income, stash some of it in this savings account.

   If you do not get any type of bonuses throughout the year, start with a smaller goal and celebrate the success along the way. For many investors, it is unrealistic to be able to stash away six months' worth of living expenses. Instead, start with the goal of stashing away two paychecks' worth of living expenses and build from there. If you do not receive an annual bonus, ask your employer's payroll department to deduct $50 to

$100 from every check to automatically go into a savings account and get your fund started that way.

2. **Savings accounts for specific purchases:** This could be for any type of expense, ranging from a vacation to a car to a house project. Personally, I think it is useful to have a separate account for each major item, such as savings for a house or a car, so you can track the progress of saving for each one. I know this sounds old-fashioned with the advent of home equity loans, multiple credit cards, second and third mortgages, and so on, but, if you want to actually enjoy these purchases rather than stress out about how you are going to pay for them, sometimes old-fashioned is not so bad.
3. **Investment accounts:** These are for long-term investing. I suggest you have at least two types of investment accounts: your tax-qualified accounts—such as your individual retirement account (IRA), 401(k), 403(b), etc.—and your taxable accounts. Investing money in taxable accounts will provide you with assets and a stream of income should you want to retire before your normal retirement age. (Note that if you have not invested any money in a taxable account in addition to your tax-qualified accounts, it is probably a pipe dream that you will be able to retire early.)

   My advice on your retirement investment accounts is to never borrow from them, even if your tax-qualified plan may allow you to do so easily. This will potentially slow down the amount of assets you accumulate in your retirement plan, and you will receive no tax benefit from the interest you pay yourself as you pay back the account.

   If you change employers, roll your tax-qualified plan into either the new employer's plan or an IRA, and enroll in new contributions as soon as possible. Frequently, investors "cash in" or take a distribution from their old plan, which can derail their long-term investment plans as well as result in sizeable tax and penalty hits.

   Additionally, never, *ever* take money out of your investment accounts for any reason before you retire. If you develop the bad habit of doing so, it will be hard to break and it will likely throw you off track toward accumulating a sufficient nest egg for the future.

Healthy Investment Tips

1. Separate your savings from your investments.
2. Separate your savings into accounts for specific purchases versus emergency needs.
3. Hold your investment accounts sacred. Do not borrow from them, and never, ever take money out of them for any reason prior to retirement.
4. Live below your means to create financial margin in your life.