Rick Kahler's

Personal Finance

Weekly Column

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First Step To Investing

Fewer Americas are living in poverty.

My hunch is that most people would agree they "should" invest for the future. My second hunch is that many of them don't know how to start and are afraid of making serious mistakes.

One of our resident planners, Sterling Gray, summed up that fear eloquently in a post on the KFG blog: "I noticed that my friends and colleagues . . . saw retirement planning as a dark, treacherous terrain that they could never safely travel alone. Unsure of where to turn for help, they often chose to ignore saving for retirement completely . . ."

Here are some pointers to help you take the first steps into the unfamiliar terrain of investing.

1. First and foremost, create a habit of living on less than you make. Spend frugally and invest as much as you possibly can. Ideally, while you are young, start with 20% of your paycheck, but at least start with something. The older you are, the greater the percentage you need to be saving.

2. Choose an investment method that will help reduce the taxes you pay on your contributions and the earnings they produce. This commonly means 401(k) retirement plans and IRAs—Roth IRAs for those in low income tax brackets and traditional IRAs for those in high tax brackets. You typically want to contribute a portion of every paycheck to your retirement plan.

3. Pick an investment. This is the part that scares many people away from investing, so let's be specific.

3a. The best way for small investors to accumulate wealth is by owning stocks. But you don't want to fall into the trap of picking individual stocks yourself, or worse yet, trying to buy low and sell high. That is called "playing the stock market," and according to the research there is a high probability the only thing that will get played is you.

3b. The best way to own stocks is in a mutual fund that owns thousands of stocks of companies from around the globe. My favorite fund for people under age 40 is Vanguard Total World Stock (VT). It owns 7,781 stocks of companies located in 41 countries, including both developed and emerging markets. Over the last 48 years an investment in a globally diversified portfolio of stocks returned 8.9% annually, according to the MSCI World stock index. A $10,000 initial investment turned into about $600,000. If you are over 40, you may want to consider the Vanguard Global Wellington Fund Investor Shares (VGWLX. If you are over 60, the Vanguard Managed Payout Fund (VPGDX) is my favorite.

3c. If your 401(k) doesn’t offer these mutual funds, it probably will offer a number of Target Date Funds. Pick one that is closest to the year you will turn 70. If you are age 30 now, select the 2060 Target Date Fund.

4. This is the most important part of accumulating wealth, and it is absolutely the hardest part. *Keep investing out of every paycheck,* even when markets are falling or seem sure to fall. Even when the talking heads are sure the world is coming to an end and the financial press is screaming that you need to get out before you lose it all. Never suspend your monthly investment. Never sell out of your stock mutual fund and go to cash. Never sell out even 10% of your stock fund and go to cash. Keep breathing, focus on the long term, and stay the course.

Like any trip into new territory, the path to financial independence starts with a single step. Take that first step, and you're on your way to a successful journey.