THE *Effective* Investor

20 Secrets for Ordinary People to Build Extraordinary Wealth

MARK LUND

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by Mark Lund

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Visit our website at www.The*Effective*Investor.com.

ISBN-13: 978-0-9831110-0-9

Printed in the United States of America.

Edited by Deric Glissmeyer and Chad Brooks

Book Design by www.KarrieRoss.com

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Table of Contents

ACKNOWLEDGMENTS 13

INTRODUCTION
The Effective Investor 15
Secret Number One: The question every investor must answer

CHAPTER ONE
This Time it's Different 23
The investor's greatest enemy

CHAPTER TWO
The Earth is Flat 33
How to avoid one of the biggest myths of investing

CHAPTER THREE
A Game of Roulette 39
Why an investment's track record means nothing about how well it will do for you in the future

CHAPTER FOUR
Crystal Ball Investing 45
How to know if you should be in or out of the market

CHAPTER FIVE
The Wolf in Sheep's Clothing 51
The number one secret that's killing the return in your portfolio

No, I am not interested!

I think I am fine with how I am doing things.
I don't want to hear what he has to say...
I've got a battle to fight!

**Artist unknown*

INTRODUCTION

The Effective Investor

Secret Number One:
The question every investor must answer

"The person who makes a success of living is one who sees his goal steadily and aims for it unswervingly."
—Cecil B. DeMille

I often get asked how I got into this business. I can trace it to one specific event. When I was in my mid-20s I wanted to go into hotel management. Since the best school for that field was UNLV, I moved to Las Vegas and got a great job at the Monte Carlo Hotel as a bellman to pay for college. I got to meet people from all over the world, including celebrities. This was a fun job and it taught me a lot about people.

While living there, I realized I did not want to go into hotel management. I was saving money and did not know what to do with it; that was always on my mind. I did not just want to keep

putting my savings into the bank. That is why one day a particular TV commercial just jumped out at me. It was about how to make your child a millionaire. I called the TV station, found out who did the commercial, got their number and met with the people who had produced it. While talking with them I realized that they were doing what I wanted to do. With the encouragement of a good friend I made there (named Ed Denyko), I decided to give up the hotel business. To make the story short, I moved back to Utah where my family was, married my sweetheart and shortly after entered the financial services industry in 1999.

From the very beginning I was introduced to many money managers, investment strategists, investment firms and so forth who all said they had it figured out—that their strategy to invest would beat the market. Many of them really made a lot of sense and I was easily pulled into the romance of thinking you can predict the future and beat the market. When this did not happen, I was always told something to the effect, *"We were not able to foresee this terrorist attack or this credit crisis or this housing collapse. If these things would not have happened we would have been just fine."*

Well, hello! Isn't being unknown the very nature of the future? In essence, what these so-called money managers, economists, and investment managers were telling me is that "we could not see into the future, after all, and sorry, but we have lost your client's money." I then had to go meet with my clients and try and explain why the investment strategy we were following ended up not working. Let me tell you: that flat out stinks. One of my favorite quotes says, *"wise people learn from experience, and super wise people learn from other people's experiences."* The author is unknown. Let me share some experiences with you right now.

No matter how good an investment strategy may sound or how good the numbers may be or how good the past performance

nothing to do with their ability to pick stocks in the future. And you would never know until after the fact if they were right. So was I willing to gamble my money or my client's money on one of these ideas? No way!

This book contains the answers I was able to find. These answers will eliminate the need for speculation when investing. They will help you to lower investment expenses, reduce risk and increase returns.

The Question Every Investor Must Answer

While working as a bellman in Las Vegas I was able to meet many interesting people. It was fun to visit with the guests that were checking in and hear their optimism about coming to Vegas. Many had some strategy they had heard about or a book they were reading to help them "win big." However, it was a different story for those checking out of the hotel. I rarely heard about the great winnings.

I remember one guy in particular who had a theory for playing roulette. His theory was that if the marble landed on red so many times in a row, it was then time to bet black. He would sit there for hours waiting for that perfect alignment. However, it did not matter what the alignment was—you still have less than 50 percent chance it will land on black with each spin. In addition, in roulette there is also a green and a double green it can land on. So, sometimes it does not land on red or black at all. Why do I tell you this story? Because this guy was still gambling with his money even though he had a system he was using to help him try and win. He was trying to predict whether he should be in the game or stay out of the game. It is the same with investing.

CHAPTER ONE

This Time it's Different

The investors greatest enemy

"The ultimate measure of a man is not where he stands in moments of comfort, but where he stands at times of conflict and controversy."
—Dr. Martin Luther King

The most difficult thing to discover in the study of investing are facts. For example:

- What kind of stocks give us the best returns?
- Why do some people almost always make money investing?
- Why do some financial advisors tell you never to own consumer mutual funds?
- How should we know if we should be in or out of the market?

It is easy to get opinions on these questions. It is hard to get facts. The purpose of this book is to answer questions of this kind. The answers are based on results that can be measured. For instance, below you will find a series of events largely labeled as "crises" followed by the S&P 500 Index, immediately after the crises. However, note how the market reacted one year and five years after the event.[1, 3, 4]

Event	Event crisis dates	S&P 500	1yr	5yr
Fall of France	05/09/40 – 06/22/40	-16.9%	5.0%	15.7%
Attack on Pearl Harbor	12/06/41 – 12/10/41	-7.5%	15.8%	18.0%
Korean War	06/23/50 – 07/13/50	-12.2%	42.2%	27.7%
Eisenhower's heart attack	09/23/55 – 09/26/55	-6.6%	11.9%	8.4%
Cuban Missile Crisis	08/23/62 – 10/23/62	-9.9%	41.1%	15.8%
John F. Kennedy assassination	11/21/63 – 11/22/63	-2.8%	27.8%	12.4%
U.S. bombs Cambodia	04/29/70 – 05/26/70	-15.0%	49.0%	9.3%
Nixon resigns	08/09/74 – 08/29/74	-13.4%	30.2%	14.6%
U.S.S.R. invades Afghanistan	12/24/79 – 01/03/80	-1.8%	36.5%	15.0%
U.S. invades Grenada	10/24/83 – 11/07/83	-2.1%	9.4%	15.9%
Financial panic of 1987	10/02/87 – 10/19/87	-31.5%	27.7%	17.0%
Invasion of Panama	12/15/89 – 12/20/89	-2.1%	-0.2%	9.3%
Gorbachev coup	08/16/91 – 08/19/91	-2.3%	14.5%	15.2%
Gulf War ultimatum	12/24/90 – 01/16/91	-4.0%	36.6%	17.3%
World Trade Center bombing	02/26/93 – 03/01/93	-0.3%	8.0%	21.8%
Long-term capital management collapse	08/28/98 – 09/09/98	-2.0%	35.8%	1.8%
Russian ruble devaluation	08/28/98 – 09/11/98	-1.7%	35.8%	1.6%
September 11 terrorist attacks	09/10/01 – 09/21/01	-11.6%	-11.1%	8.3%
U.S. invades Iraq	03/18/03 – 03/31/03	-2.1%	35.1%	11.3%
Subprime mortgage meltdown	09/05/08 – 11/20/08	-32.12%	-12.8%	

What we learn from history is that investors can benefit from staying invested throughout a crisis. Typically, an international crisis breeds fear. The news, media and public perceptions become overly pessimistic. Here are a few examples of headlines from popular media outlets from the past:

In the New York Times, September 1946 there was an article titled, ***"Secondary Sales Beat Down Stocks—Inability of***

we will talk more about that. For now, we will focus on how diversification works.

Our peppermint Life Saver will represent the S&P 500. Had investors stayed fully invested in the S&P 500 stocks, from 1973 until the end of 2009, rather than chasing the market, the annualized rate of return would have been 9.67 percent with a standard deviation or risk of 18.87 percent.[24, 27, 28]

Conversely, let's compare life savers with a variety of flavors to a well diversified portfolio. If over the same time period we had diversified

- 7.5 percent in the S&P 500
- 20 percent in 5-Year government portfolio
- 20 percent in one -year fixed income
- 15 percent in international
- 7.5 percent in U.S. small company growth
- 15 percent in international small cap
- 7.5 percent in U.S. small cap value
- 7.5 percent in U.S. large cap value

We would have obtained an annualized rate of 11.34 percent and a standard deviation or risk of 12.29 percent.[26, 27, 28] This is including the crash of 2008.

Thus, without using any speculative methods of investing like stock picking, market timing, or track record investing, we have followed a simple strategy that has performed 17 percent better than the market as compared to the S&P 500 for 35 years and with less risk.[17, 25, 27]

Just as Edward Noble didn't have his success on the sales of only one flavor of candy, we will not be successful by owning just