The 10 Rules of Investing

Best practices for building wealth and taking care of your future self

BY KATIE REILLY

Charlene Rhinehart, a certified public accountant who offers advice to people learning how to invest, tells all her clients to take care of their future self. "Whatever decision you make right now, make sure your future self will be happy," she says.

Rhinehart advises people to manage their expectations and recognize that investing is a long process that requires patience as well as trial and error. "Everybody looks forward to the slam dunk and making a ton of money, but you should also focus on the process," she says.

Investors should prioritize their long-term goals, including purchasing a home, paying off student debt, building a college fund, and preparing for retirement. And experts say it's important to start slowly, building your confidence and continuing to learn more about investing as you go.

Whether you're new to investing or just in need of a refresher, some key guidelines can help you navigate the process. In no particular order, here are Investopedia's 10 rules of investing.

1 START NOW!

The first key to investing is starting as soon as you can, putting aside money now with the goal of achieving long-term wealth, so that your future self will be in a stronger financial position. "The best time to start investing is now," Rhinehart says.

Money you invest now compounds over time, earning interest that is then reinvested, allowing the principal investment to grow. The longer you leave your money to compound, the more it will grow, generating even larger interest payments.

"You want to make sure you're taking advantage of compounding," Rhinehart says. "When you have time on your side, you have the ability to allow your investments to compound over the long term and create a more productive, prosperous portfolio."

Investing as soon as possible, and staying invested over the long run, tends to be more lucrative than waiting and trying to invest at exactly the right time, based on when the market is up or down. The latter is known as "timing the market." But because that strategy is so difficult to get right, experts say that holding onto your investments and allowing your money to spend more time in the market, is the better approach. Research by Charles Schwab concluded that "the cost of waiting for the perfect moment to invest typically exceeds the benefit of even perfect timing." Instead, the brokerage firm recommends that people invest as soon as possible, a strategy that requires less effort and expertise than timing the market.

Experts also recommend investing the same amount of money on a regular basis, thereby reducing the impact of market volatility—a practice known as dollar-cost averaging. In an ideal world, it would be best to always invest when the market is down and your money goes further. But timing the market is difficult even for professionals, so dollar-cost averaging is the more practical alternative. It helps investors lower their average cost per share, enabling them to take advantage of the best share prices without having to predict them in advance. This practice also helps enforce consistent investing habits.

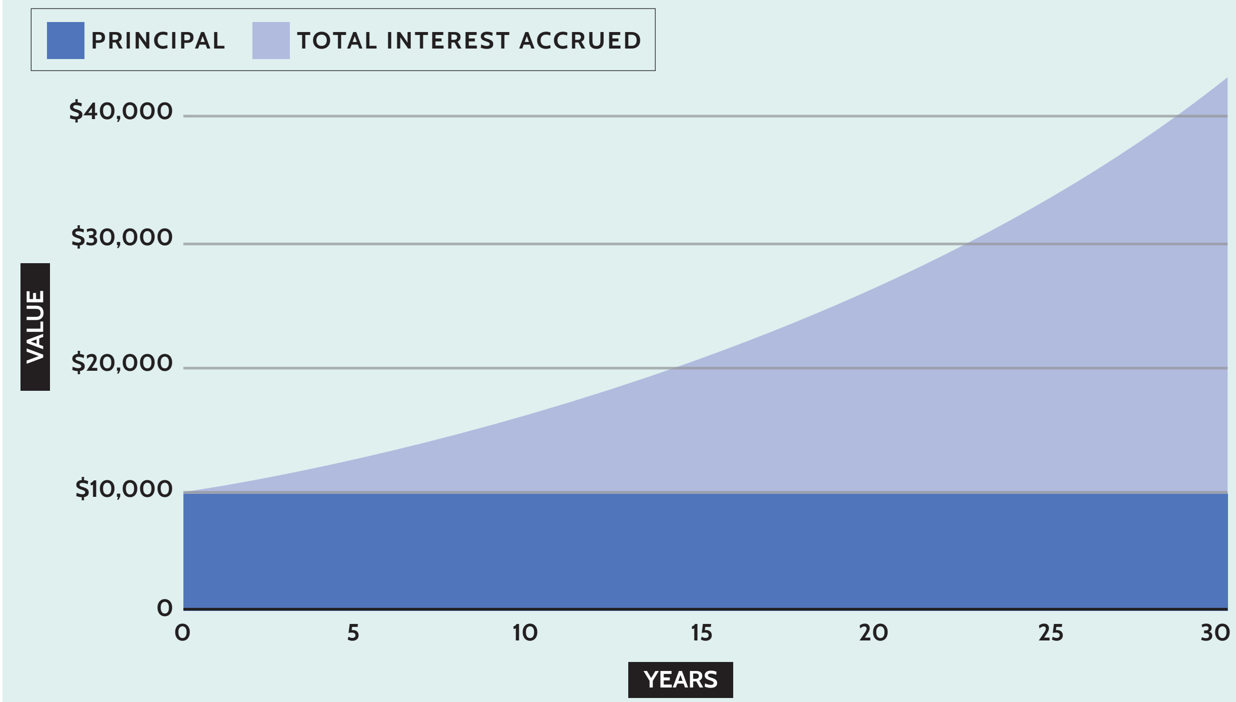
"Stick with it and automate it," says Samantha Silberstein, a certified financial planner and wellness coach and a member of the Investopedia Financial Review Board.

Workers who put money into their employer's 401(k) retirement plan with every paycheck are engaging in dollar-cost averaging by investing a consistent amount of money regularly, regardless of the state of the market. It's a key way to build wealth over the long term.

Rhinehart often hears from people who think they don't have enough money to begin investing, but even setting aside a small amount of money each week is a good strategy. "Start where you are, and give yourself a chance to grow," she says. "If you only have $10 to invest, invest that."

How Compound Interest Grows over Time

If you invested $10,000 that compounded annually at 5%, it would be worth more than $40,000 after 30 years, having accrued more than $30,000 in compound interest.



"Not investing is worse than being invested during challenging markets."

—PRESTON CHERRY
Founder and President of Concurrent Financial Planning in Green Bay, Wisconsin

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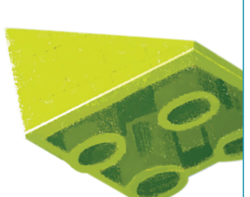
ECONOMY ≠ MARKET



The U.S. economy is the broad system of production, consumption, and distribution of goods and services that influences the country's wealth. A financial market is the place where people buy and sell investments, such as securities, currencies, and bonds. While the two are different, they influence each other.

When the economy is growing and business activity is expanding, that tends to lead to stock market gains, improving returns for investors. When the stock market slumps, that results in losses for investors and a decline in consumer confidence, leading people to spend less, which can cause a downturn in the economy.

"The stock market is a leading indicator of the sentiment of the country's economy. It's a reflection of how people are feeling, and money, unfortunately, is emotional," Silberstein says. "So we have to understand that there are going to be current, short-term fluctuations."

When investing, Silberstein cautions people against reacting impulsively to market changes in the short term. "Historically, the stock market has recovered from broad slumps throughout time," she says, noting that those slumps can be just minor blips in a long-term investing plan. "A three-month period over a three-year period has a very limited impact."

The goal, she says, is to continue investing for long enough that you hit some lows and enough highs, leading to slow and steady gains over time. She recommends staying invested through the highs and lows of economic cycles.

She uses 2020 as an example. In March 2020, at the start of the COVID-19 pandemic, the global economy "closed overnight," and she saw portfolio losses of 10% to 30% for her clients that quarter. But by the end of the year, the market had improved, and Silberstein says she had clients who ended the year positively, with 20% returns in some cases.

But clients who pulled out their investments in March 2020 ended the year with a loss, she says, and many were cautious about returning to investing again.

"It's hard, emotionally and behaviorally, to get back in," says Silberstein, who witnessed similar behavior after the Great Recession in 2008. "Unfortunately, I sometimes still run across people who, after 2008, 2009, just never went back in the market. And they've missed out on the last 15-plus years of positive returns."

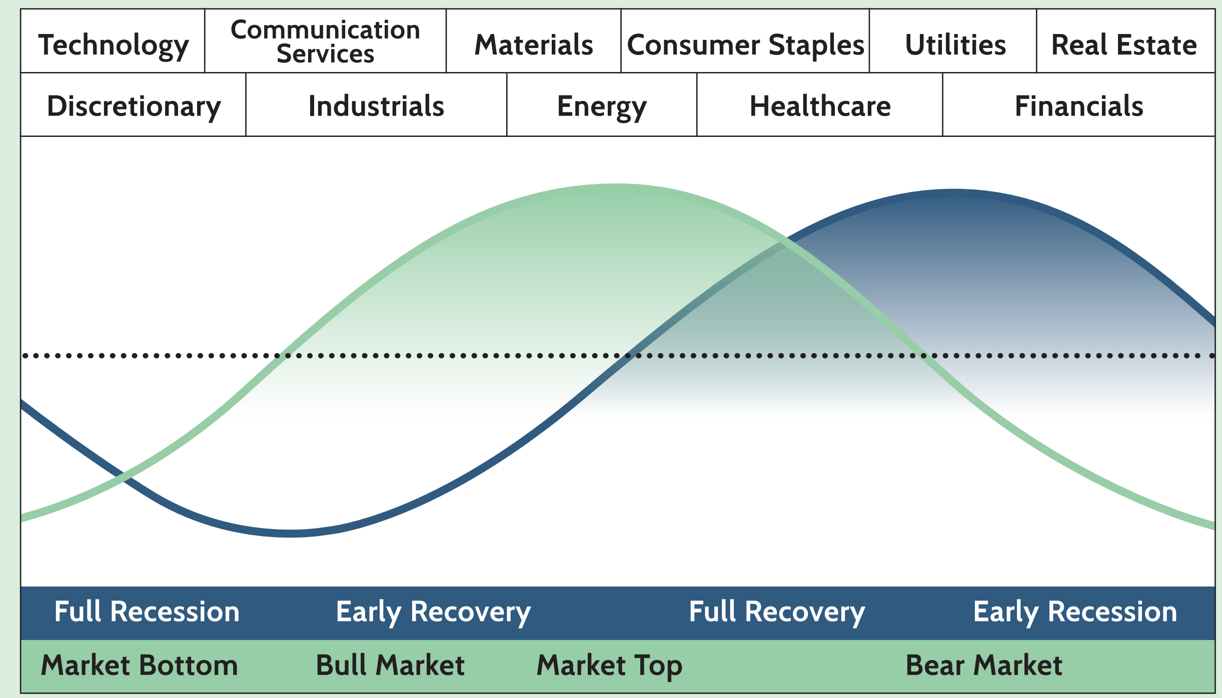
In 2022, the U.S. stock market experienced the biggest annual percentage decline since the 2008 financial crisis. But the market rallied in 2023. While the S&P 500 fell 19% in 2022, it had risen 14% by August 2023.

Andy Smith, a certified financial planner in Wyoming and Investopedia Financial Review Board member, says investors shouldn't let dips in the market scare them and should instead stay focused on long-term goals.

"It's going to go up and it's going to go down, and sometimes the down is going to scare the heck out of you," Smith says. "The biggest thing you cannot do is panic and take your money out. Because as history shows us, the market always comes back. And when it comes back, it usually goes to new heights."

How Business-Sector Cycles Impact Market Performance

The business cycle influences the rise and fall of stock market sectors and industry groups. Certain sectors perform better than others during specific phases. Knowing where you are in the cycle can help you position your investments in the right sectors at the right time. Here, the blue corresponds to the economic world, and the green represents the stock market. The sectors of stocks at the top perform best during these phases.



Source: Stockcharts.com

FAST FACT

A bear market occurs when market prices decline by more than 20%, often accompanied by negative investor sentiment and declining economic prospects. Bull markets are characterized by rising prices and investor optimism.

3 TIME IS EVERYTHING

The right investing approach will vary for each person depending on a range of factors, including their age, stage of life, and financial goals.

While trying to time the market, discussed in our first rule, is not a sound strategy, it's important for people to consider the time in their life at which they're investing.

Those who are investing when they're young and at the beginning of their career should take a different approach than those who are older and approaching retirement. Younger investors can tolerate more risk than older investors.

"If you start younger, you have more flexibility to have more exotic assets in your portfolio, because you can recover," Rhinehart says. "But if you are nearing retirement, you want to make sure that your risk appetite matches those investments in your portfolio. You may want to reduce the stocks in your portfolio, because those are riskier than other more stable assets, like bonds."

She encourages people to think about why they're investing—to pay off student loans, to buy a house, to save for retirement—and what their time frame is.

If your goal is to buy a house, are you aiming to do that in five years or 15? If you're saving for retirement, are you aiming to retire in 20 years or 40? Investors should use those goals and timelines to determine their individual investing strategy.

Typically, young people can afford to take more risks while investing because retirement is still decades away for them.

Meanwhile, older people should pursue more stable stocks and bonds as part of a balanced portfolio.

When deciding whether to buy, sell, or hold a stock or fund, it's important to start by doing research. If a company is sustainably growing revenue year-over-year, and if the company's future earnings are predicted to grow, it could be a good time to buy that stock.

It's better to focus on details and data points that suggest long-term growth and stability rather than a short-term bump.

Investors could explore selling stocks if that company loses market share or if its earnings fall below expectations.

But experts emphasize that, especially for investors who are just starting out, it's important to play the long game, stay patient, and stick with investments over time.

"The big thing to focus on is remaining constant and steady, regardless of what's going on, as you're trying to build significant assets," Smith says. "Because trying to time the market is very difficult to do. Even the professionals don't do very well at it."

"Knowing your why will help make every other decision on your investing journey so much easier. It's so important to construct the portfolio based on those long-term goals."

–CHARLENE RHINEHART,
CPA and Investopedia Financial Review Board Member

4 AIM FOR BALANCE

A portfolio is the mix of all of a person's investments. A balanced portfolio includes investments in a diverse variety of assets—including stocks, bonds, mutual funds, or exchange-traded funds (ETFs)—to reduce volatility. The process of investing in those different asset classes is known as diversification.

"Don't dump all of your money into one investment," Rhinehart says. "Diversify your portfolio with different types of assets so that when one company is not performing well, all of your portfolio is not damaged because of that."

Experts recommend that investors regularly review their portfolio and make changes, or "rebalance," when necessary—maybe once a year—to make sure their portfolio is still allocated in the way they would like.

For example, if an investor built a portfolio with 60% stocks and 40% bonds, but over time the portfolio shifted to a combination of 70% stocks and 30% bonds due to market performance, the investor could review and readjust their portfolio back to the original allocation in order to meet their financial goals.

"There is no magic mix that's going to work under every circumstance," says Gordon Scott, an Investopedia Financial Review Board member and active investor with 20 years of experience educating individual traders and investors. "But the conventional wisdom is that 60% stocks and 40% bonds is a really safe, easy way to think about it."

He suggests starting from that combination of stocks and bonds and then potentially moving smaller percentages into other investments, such as cash, gold, real estate funds, or global stocks. Scott says investing a small portion of your portfolio in global stocks —markets in India, Singapore, or South Korea, for example—can help support balance.

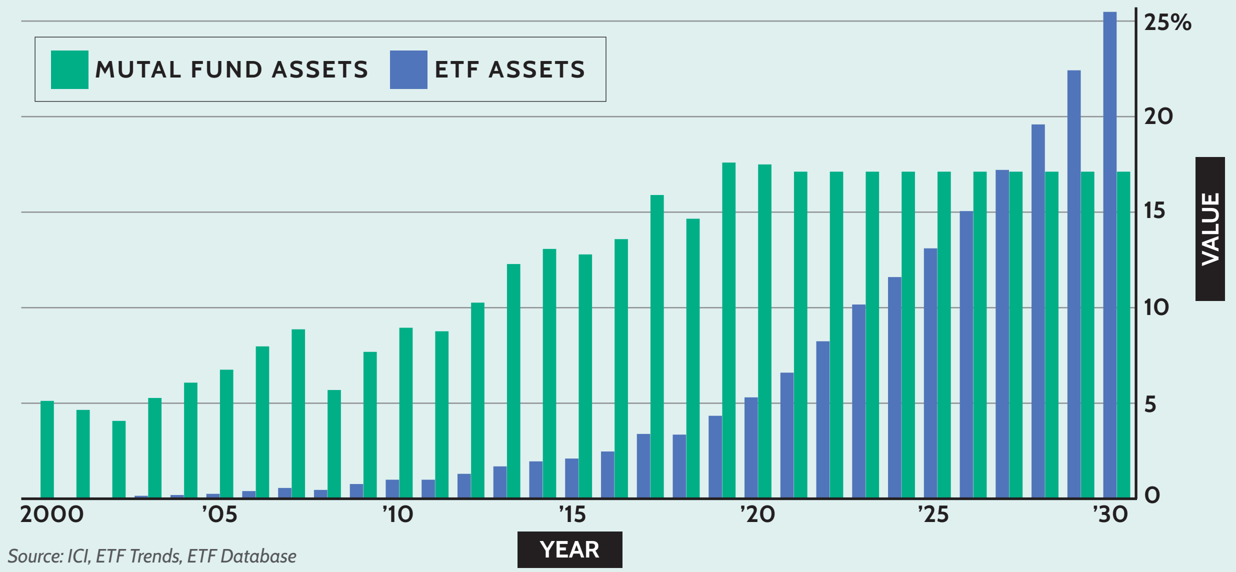
"Non-U.S. markets are more volatile, so you would never want to put the majority of your money in those markets. But putting some can make sense," he says. "Having some money in there when they get into a growth cycle can really help.

"You're not going to have a situation where U.S. markets are going to increase triple digits, year after year," Scott continues. "But you could experience that in some Asian markets."

However you choose to divide your investments, it's most important to ensure that you're not investing all your money in one place. "If you were shopping at the mall and you were looking for shoes, you wouldn't buy all the same type of shoes, because they wouldn't work in all types of conditions," Rhinehart says.

ETFs Keep Gaining on Mutual Funds

By 2027, there will be more ETFs under asset management than mutual funds.



Source: ICI, ETF Trends, ETF Database

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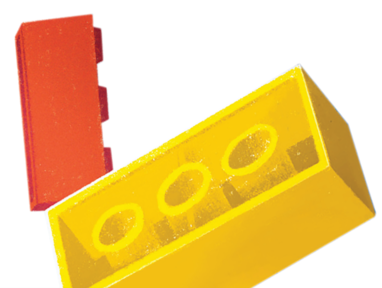


KNOW WHAT YOU OWN (AND WHY YOU OWN IT)

Peter Lynch, the investor famous for managing the Magellan Fund at Fidelity to great success, often advised people to "buy what you know." Smith takes that tip a step further: "Don't invest in things that you can't explain to somebody so they understand."

It's important to understand how your portfolio is allocated and what purpose each asset is serving.

When considering which stocks to buy or sell, there are several data points that are helpful to understand. Look at the market's general direction, such as the moving average of the S&P 500 Index.

If the market is trending upward overall, that likely bodes well for the individual stocks you're considering. Investors could consider pursuing a growth stock or value stock investing strategy.

Growth stocks are shares of newer companies that are expected to outperform the market over time because they have the potential to achieve high earnings growth in the future. Value stocks are shares of a more well-established company with solid fundamentals that are priced below those of its peers at present, based on analyses of the price-to-earnings ratio, yield, and other factors.

To evaluate a bond's potential performance, consider its price compared to its face value; its maturity, which is the date when your investment will be repaid; and its yield, which is the amount the investor will receive if they hold the bond until maturity. Another useful data point is the bond's duration, which measures its sensitivity to interest rate change. A longer duration means the value of the bond will fall more as interest rates rise. A shorter duration means the value of the bond will fluctuate less.

When interest rates go up, bond prices go down, and vice versa. So when it seems like interest rates have reached a peak and are starting to come down again, that's a good time to invest in bonds, Scott says.

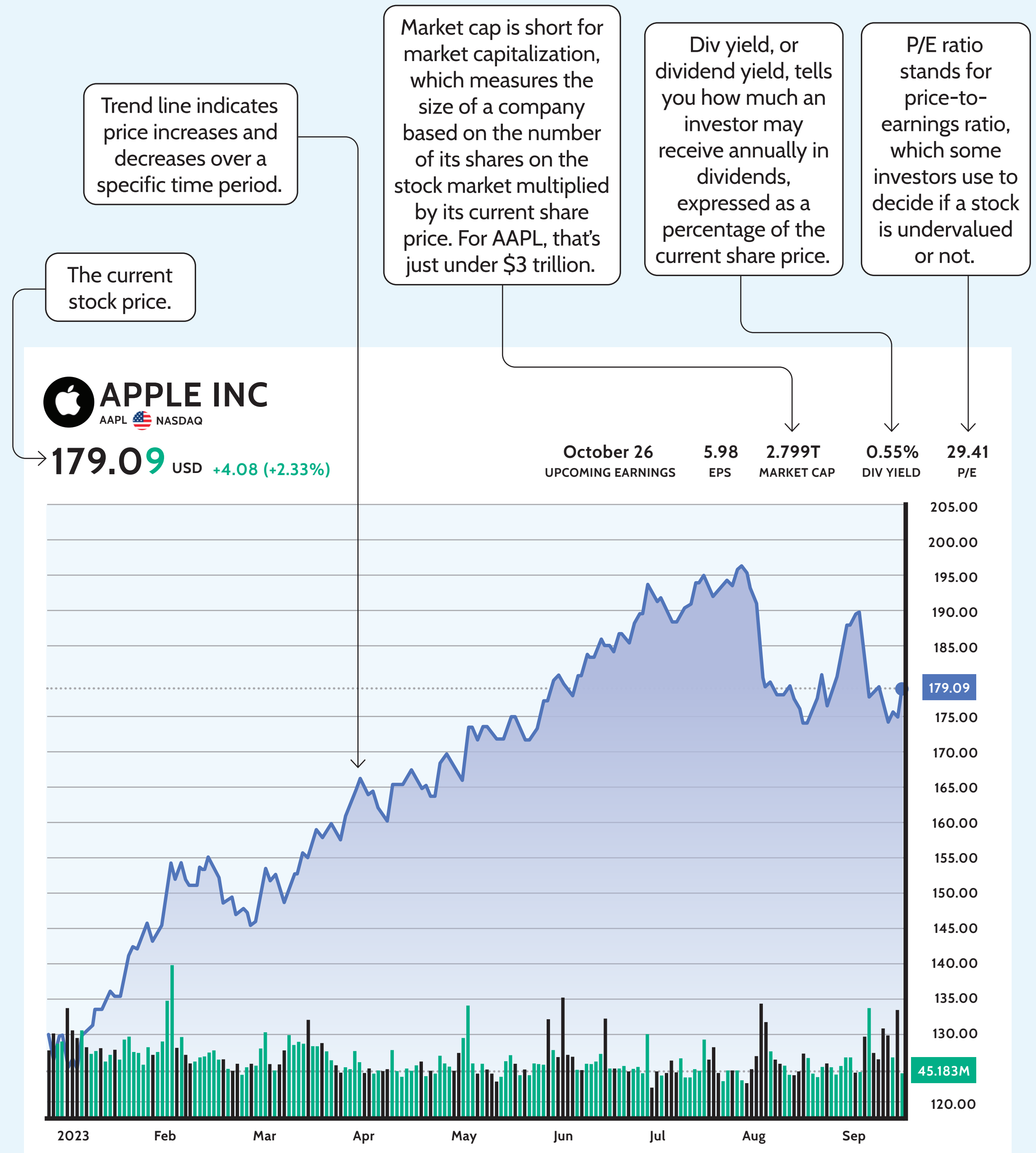
Knowing what you're invested in is also critical if you're interested in putting your money toward certain issues or causes, such as environmental or social issues.

Vikram Gandhi, a senior lecturer at Harvard Business School who teaches a course on sustainable investing, recommends that investors seek out financial gains while also paying attention to the mission and actions of the companies in which they invest. Look at what they produce, what they stand for, and whether they're creating positive change in the world.

"I think there's an opportunity for even a retail investor to be investing in things that are important to them from a values [perspective]," he says, "and at the same time generating a proper return."

How To Research Stocks

Knowing what you own can start with understanding how to read a stock chart. Here are a few things worth noting when you research a stock such as Apple (AAPL), currently the largest stock by weight in the S&P 500.



6 TAME YOUR ANIMAL SPIRITS

"People set goals that are too high, and they take on imprudent risks as a result—risks that, on average, don't pay off."

—HERSH SHEFRIN
Professor of finance at Santa Clara University's Leavey School of Business

In 1936, John Maynard Keynes famously wrote about the animal spirits that tend to override rational decision-making when it comes to economics. People don't always act in their best interest, including when they're investing.

"If you're really fearful, it tends to make you be excessively conservative and not take risks that are good bets for the long run," says Hersh Shefrin, a professor at Santa Clara University's Leavey School of Business and an expert in behavioral finance.

On the other end of the spectrum, greed can lead people to want more than their fair share. Neither excessive fear nor excessive greed is good.

Shefrin argues that it's difficult to avoid emotions completely; they're part of being human. But finding a balance between emotion and logic is key. "We think emotionally. We think intellectually," he says. "You want those two to work together and be in balance. It's when they're unbalanced that there's a problem."

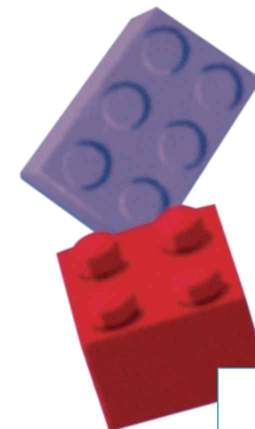
There are strategies people can use to balance their emotions and make optimal decisions. Before deciding to sell stocks, for example, experts suggest sleeping on it and reevaluating the decision in a day or two. Investors should also avoid checking their portfolios too frequently. Instead, make a plan to check in quarterly or meet with a financial advisor semi-annually. Investors should also avoid making decisions based solely on intuition.

"The thing about investing, especially for the long term, is it's a statistical game," Shefrin says. "It's misunderstanding the statistical nature of the game that leaves investors vulnerable."

Some common psychological traps include the sunk-cost fallacy, in which a person is reluctant to abandon a plan because of the resources they've already invested in it. If someone is losing money on an investment, for example, they might be tempted to stick to their strategy because of how much money they've already lost, even though it would be better to get out of that situation and take a new approach. Investors can also fall victim to confirmation bias by seeking information that reinforces their opinions, while ignoring contradicting information.

In his book *The Psychology of Investing*, John Nofsinger identified how cognitive errors, emotions and psychological biases cause people to make poor investment decisions. For example, overconfidence causes people to trade too much, resulting in lower returns. Pride causes people to sell winning stocks too soon and hold on to losing stocks too long. People tend to downplay memories of previous losses, softening their regret and leading to risky decision-making in the future.

"Unfortunately, these psychology-induced decisions create outcomes that often have negative impacts on wealth," Nofsinger wrote.



7 BETTER SAFE THAN SORRY

Exercise caution when making big investment decisions. Do research and consider your options carefully before making any rash decisions with your money.

Smith says it's "dangerous" to borrow money to invest, noting that positive returns are not guaranteed, and investing borrowed money exacerbates the potential for negative consequences if an investment doesn't perform well. "What if what you invest in doesn't pan out?" Smith says. "You're adding unnecessary risk and taking a big chance with what losses could do to you."

Similarly, investors should think twice before tapping their retirement accounts early—in part because they will be subject to penalties if they do so, though there are some exceptions. Money withdrawn from an individual retirement account (IRA) or 401(k) plan before age 59½ is typically considered taxable income and is subject to an additional 10% tax penalty.

Taking out money prematurely also interrupts the tax-deferred financial growth in those accounts, which is one of the key benefits of having a retirement account in the first place.

"You'd have to be in an extreme emergency to ever do it," Smith says. "People are really going to be paying the price if they get to retirement and don't have what they need to get through that period of life."

It's important to do research, but it also matters where that information is coming from. While social media platforms like TikTok have made financial literacy more accessible to a younger generation, they have also made it easier to spread financial misinformation and to mislead investors.

A 2023 study published by the Swiss Finance Institute found low accuracy levels in the advice offered by financial influencers, often called "finfluencers." In an analysis of 29,000 finfluencers, researchers found that 28% provided valuable investment advice, while the majority (56%) were characterized as "antiskilled" because they gave investment advice that led to negative returns on average in comparison to the market at large.

"Surprisingly, unskilled and antiskilled finfluencers have more followers, more activity, and more influence on retail trading than skilled finfluencers," the researchers concluded. "As long as there are any antiskilled finfluencers 'preaching' their message, the investors tend to like their message and are willing to trade on it."

That conclusion is a cautionary tale for investors about the prevalence of low-quality financial advice floating around on the internet. The lesson: Make sure you're taking advice from reliable sources, and don't do something just to follow a friend, family member, or influencer.

"Don't invest in an asset just because your best friend is doing it," Rhinehart says.

8 MANAGE YOUR RISK

Scott says figuring out how to manage risk is the "the most important question of all," and it's what everyone should focus on as they start their investing journey.

Risk tolerance—the level of risk and potential loss someone is comfortable with—varies significantly.

A person's age, goals, and investing timeline—when they plan to withdraw their money—affect their risk tolerance. Generally, investors who are older and closer to retirement will need to take a less risky strategy because they're operating on a shorter timeline and will have less time to recover any potential losses. Investors with a longer timeline—young people saving for retirement, for example—can afford to make more risky investments because they have more time to recover.

Investors fall into three broad categories of risk: aggressive, moderate, and conservative. Aggressive investors are the most comfortable with risks, willing to take big ones in the hopes of seeing big rewards, even if it means weathering the steep highs and lows of market fluctuations. Moderate investors are less comfortable with risk but are willing to tolerate some losses while pursuing moderate gains. Conservative investors are the least risk-tolerant, seeking out investments that are more stable even though they are likely to yield lower results.

When figuring out where they stand on the risk-tolerance scale, Scott advises people to ask themselves, "What is it that I'm risking?"

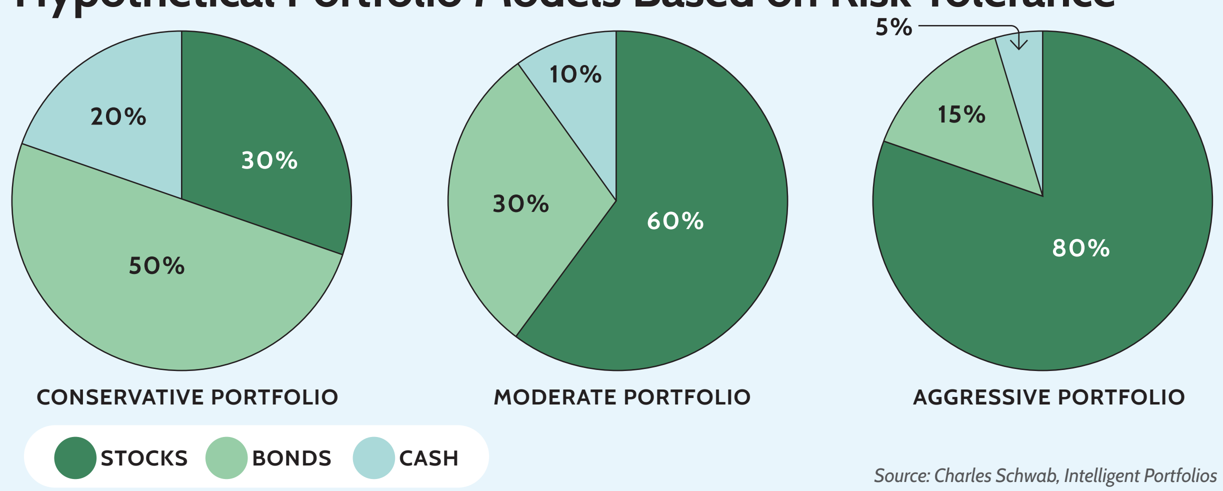
"If I invest this money, and it drops 45%, what's the impact to my lifestyle going to be?" Scott says. "And if the impact to your lifestyle is going to be severe, then that means you've got to find something less risky."

However, being too risk-averse can lead to missed financial opportunities.

"Over time, not being invested is exponentially harmful because you miss out on so much compounding," says Preston Cherry, president of Concurrent Financial Planning and director of the Charles Schwab Foundation Center for Financial Wellness at the University of Wisconsin, Green Bay. He encourages people to examine why they're risk-averse and challenges that aversion with education, teaching about the power of investing over time.

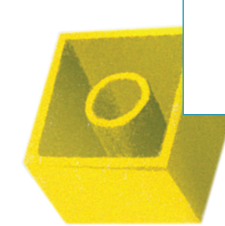
"Your risk-averseness may keep you from achieving your goals," he says. "How would you feel if your life and money goals came up short because of not investing over time?"

Hypothetical Portfolio Models Based on Risk Tolerance



Source: Charles Schwab, Intelligent Portfolios

9 BE A TAX-EFFICIENT INVESTOR



Being tax-efficient means paying the least amount of taxes required by law. It's important for investors to be mindful of tax rates, which differ depending on the asset and the type of income.

One of the best tax-efficient strategies is investing in your employer's 401(k) or similar retirement program. If your employer matches a percentage of your contribution to your retirement fund, try to contribute the maximum amount that your employer will match to make the most of that benefit. "The money you put away will be tax-deferred, so you won't have to pay income taxes on it in this current period," Smith says.

When you eventually make withdrawals from any tax-deferred investments, including IRAs and 401(k)s, they will incur regular income taxes. If you withdraw money from either plan before age 59½, the money will be subject to an additional 10% tax penalty. (Withdrawals from Roth IRAs are not taxed because contributions are made after taxes.)

Profits from the sale of an asset are taxed differently and are subject to a capital gains tax. The tax rate depends on how long you've owned the stock. If you sell an asset after owning it for a year or less, that profit is considered a short-term capital gain. Profits from assets owned for more than a year are considered long-term capital gains and are subject to a lower tax rate. That's why there's a benefit to holding stocks for a long period of time, rather than constantly buying and selling as day traders do.

"The people that get in trouble with taxable accounts are the people that are constantly buying and selling," Silberstein says. "That's what causes potential short-term gains, or potential tax implications that they might have not expected."

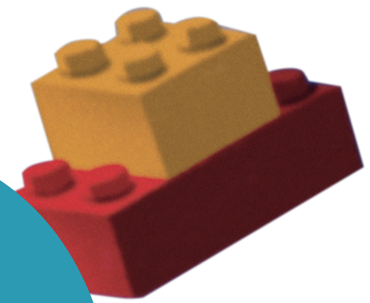
Most U.S. capital gains are subject to a long-term tax rate of 15%. That applies if your taxable income falls between \$41,675 and \$459,750 for single tax-filers. People who exceed that threshold—single people making more than \$459,750 and married couples making more than \$517,200—will face a capital gains tax rate of 20%. In Canada, only 50% of total capital gains is taxable. Meanwhile, if a single person's taxable income is less than or equal to \$41,675 and a married couple's taxable income is less than or equal to \$83,350, they won't have to pay taxes on capital gains.

Both mutual funds and ETFs are subject to capital gains taxes and taxes on dividends, which are earnings passed on to shareholders, typically at the end of the year. But ETFs are known for being more tax efficient, largely because they rarely pay out capital gains. So ETF investors are rarely subject to capital gains taxes until they sell their ETF and turn a profit.

Mutual fund distributions are reported to shareholders at the end of the calendar year on IRS Form 1099-DIV and count as investment income on a person's annual taxes. But the type of investment and type of distribution affect how much you'll owe in taxes.

Tax-loss harvesting is one strategy investors can use to minimize capital gains tax liability. If an investor loses money on the sale of an asset, they can use that loss to offset capital gains and lower the amount of taxes they will owe. For example, if someone made \$20,000 in long-term capital gains from the sale of an asset but lost \$5,000 on the sale of another, they would owe capital gains taxes on \$15,000 instead.

"When you find yourself holding on to a loser, hoping it's coming back, and it's not, sometimes it's just best to say 'Hey, this one didn't work out. Let me take my losses,'" Smith says. "You can use those losses to offset gains."



10 SET IT, DON'T FORGET IT

Automating your investments—setting up regular contributions from your paycheck or bank account—is a great way to form an investing habit and stay consistent. It also ensures that you won't be tempted to use that money for something that's not a necessity, or make an excuse about not wanting to invest that month.

But financial advisors also recommend that you stay aware of what your investing strategy is and whether it needs to change.

"Automate, but don't go on autopilot," Silberstein says, noting that a person's financial goals might change, so it's important to pay attention to your investment strategy and make sure it matches your goals. "Especially over a 30- to 35-year period, you're not the same person. There's going to be six different versions of you, and six different versions of your investment strategy."

There are many options for online brokers—from Fidelity to TD Ameritrade to Charles Schwab—through which you can manage your portfolio and trade stocks, bonds, and mutual funds.

Silberstein recommends choosing the broker that you're most comfortable with and that fits your financial goals. Look for reliability, ease of access, user-friendly technology, and good customer service. You can also compare the account fees and commissions charged by different brokers, as well as their required account minimum. Many major online brokers now require no account minimum and offer no-fee trading on stocks and ETFs.

Some more experienced investors might need more complex advice and assistance from a financial advisor, but especially for people who are just beginning their investing journey, there are plenty of low-cost online brokers that will be easily able to meet their needs.

"Does everyone need a financial advisor? No," Silberstein says. "But does everyone deserve ethical financial advice? Absolutely."

And while paying attention to your portfolio and investment strategy is important, you also don't want to overdo it.

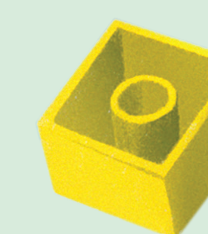
Look at the monthly or quarterly statement from your brokerage firm, and consider rebalancing your portfolio maybe once per year. But also resist the urge to constantly check your portfolio to see how your investments are performing.

"Some people stress over watching the market every day, saying, 'Oh my account's down X amount of dollars,'" Smith says. "That kind of daily roller-coaster ride is totally unnecessary."

THE BOTTOM LINE

Investing is an essential step in building the future you want for yourself, and the best thing you can do is start now. Take advantage of the "magic of compounding" by investing early and allowing your portfolio to grow over the long term. Build a balanced portfolio that will help you weather market fluctuations. Make automated investment contributions, but stay informed about what you're investing in and when you might need to make adjustments. And manage the level of risk you take on by doing research through reputable sources and building a diversified portfolio with a combination of assets that feels comfortable for you. Don't expect to see instant results or to make perfect investing decisions, but keep your long-term goals in mind.

"I typically tell new investors this: It takes courage to get in the game, commitment to stay in the game, and consistency to win the game," Rhinehart says. "That's how you build a portfolio that provides the lifestyle you want for the rest of your life."



TIP

An annual portfolio review is a good time to check investment performance, decide if rebalancing is needed, and see how you're tracking toward goals.