Beginner Investors: 2 Strategies to Simplify Investing

Description

Starting out can be the hardest part of investing for many. One can easily become overwhelmed with the breadth of options available to the average investor to choose from.

For those just starting out, I am going to outline two investment strategies that can help simplify these choices. The first strategy is for the passive investor. The second strategy is for the active investor.

Simplify your portfolio: For the passive investor

For those who have not explored the benefits of exchange-traded funds (ETFs), there is perhaps no better time than now. The fees paid by investors for access to these widely diversified funds (management expense ratios) are a fraction of those charged by mutual funds. This translates directly to profit and long-term capital appreciation for investors with very long-time horizons (i.e., retirement accounts).

As capital inflows to ETFs have surged over the past two decades amid a swath of passive investors seeking lower fees, the range of options has increased immeasurably. For truly passive investors with no desire to pick and choose specific companies to invest in, I'd recommend an index-tracking ETF such as the **iShares Composite S&P/TSX index ETF** (TSX:XIC). This ETF tracks the broad TSX index and provides investors with exposure to the Canadian economy that is as diversified as can be.

Other index ETFs track various U.S. indices, as well as European, Asian, and other stock markets around the world. These are good options for investors seeking further geographic portfolio diversification. I'd recommend picking one Canadian, one U.S., and one global ETF. Having a fully diversified, global portfolio of stocks should help smooth out returns over long periods of time.

Simplify your portfolio: For the active investor

For those who enjoy the Foolish advice we provide here, and want to pick specific stocks, I'd recommend the following strategy. Simplifying investing can come down to creating a process. This can differ for each investor based on personal preference and risk-tolerance levels. There's one process I've used in the past which has helped me to maintain patience and remove a lot of emotion from investing.

The first step is to pick the number of stocks one wants to hold. As iconic investor Warren Buffett has said in the past, putting all of one's eggs in a basket isn't a good idea, but if you believe in some baskets more than others, overdiversification can reduce one's returns over time. In other words, putting a higher percentage of one's eggs in good-quality baskets is a better idea than spreading out investments too widely. This latter strategy will also lead to incurring higher trading fees as well.

I think less is more. Assuming you can only pick the 25 of the best stocks in the world, what would you buy? This approach helps to narrow one's focus to only the best companies that one would want to hold for very long periods of time.

Assigning a 4% weight to each of the 25 companies one has picked simplifies this further. If you have $100,000 to invest, buy $4,000 of each stock once. This will keep trading fees low. Every year, re-balance your portfolio. If one stock goes down 50% and is now worth $2,000, top it up so it becomes 4% of your portfolio again.

If a stock doubles, sell some to bring it down to your desired percentage. Having a process like this allows for automatic buying low, selling high. This will remove all emotion from investing and lower stress levels across the across the board — a win-win!

Stay Foolish, my friends.

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