The Thrifty Investor

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Publisher: McGraw-Hill [1]

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After writing the book *Investing On A Shoestring* (O'Neill, 1999) I really appreciate what Israelsen has done in his book *The Thrifty Investor*. With two very different approaches to the same topic and audience, both books were written to encourage readers to begin investing with small dollar amounts to grow their wealth over time. Israelsen's book focuses on affordable stocks and mutual funds and provides readers with dozens of specific investment recommendations. Over half of the book consists of helpful tables and detailed appendices. Included in the latter are descriptions of companies in the Standard & Poor's (S&P) 500 stock market index, S&P stocks that offer direct stock purchase plans, and historical performance figures for S&P 500 stocks. Also, stocks available for direct purchase through ShareBuilder.com, historical returns of specific U.S. company stocks, and phone numbers and Web site addresses for Israelsen's recommended lists of "Frugal Forty" mutual funds and "Thrifty Stock Funds" with low expense ratios. It is obvious that considerable research was done by the author to mine available investment data (e.g., from Ibbotson Associates and Morningstar) and convert it into extemely "user-friendly" tables and charts. He has also taken great care throughout the book to describe investing in simple terms, infuse a little humor here and there, and explain investment jargon such as "annual expense ratio" and "dollar-cost averaging."

The basic premise of The Thrifty Investor is that it is possible to identify investments that can fit almost everyone's budget. The book begins with a discussion of compound interest. Israelson repeats Albert Einstein's famous quote that "the most powerful force in the universe is compound interest." Stocks are recommended for long-term investment goals (at least five to seven years in the future). Israelsen notes that, during the 74-year period from 1926 through 1999, large company U.S. stocks (as measured by the S&P 500) had 20 years with negative returns and 54 years with positive returns. Small company stocks also generated positive returns over 70% of the time. Readers are advised to invest for the long term to allow the general upward trend of stock prices to work in their favor. An important ingredient in successful investing is time for invested funds to grow exponentially.

In Chapter 2, investment risk is defined as the amount of volatility in the annual return of an investment. In other words, the swings between high and low prices. Small company U.S. stocks have historically provided higher highs and lower lows than large company stocks. One reason, according to Israelson, is that many small companies don't survive while others that smart small, like Wal-Mart and Dell Computer, grow to become large and successful companies over time. As shown in a table, the best-performing stock during the 1990s was Dell Computer. A $500 lump sum investment in Dell Computer at the start of 1990 was worth about $425,000 by the end of 1999. Since it is impossible to identify the "next Dell" in advance, however, readers are urged to diversify across a variety of companies or purchase mutual funds that hold many stocks, bonds, or other securities.

Chapter 3 discusses mutual funds. While excellent, it seems a bit out of place because it is written in a question and answer format (as is Chapter 4). Readers are taught basic fund investing principles such as establishing an automatic investment plan, selecting funds with low expense ratios, and dollar-cost averaging regular fund purchase amounts (e.g., $50 per month). In Chapter 4, Israelsen uses the phrase "Core and Explore" to suggest that investors select mutual funds for their balance and breadth as well as stocks for their specific focus. Answers are provided to questions such as "Who Do I Call?," "How Much Money is Needed?," and "How long should I leave money in investments?" In keeping with the word "thrifty" in its title, a helpful section of Chapter 5 is Israelsen's "Frugal Forty" list. Of more than 6800 stock mutual funds, he lists 40 that can be purchased with an automatic investment plan (AIP) of $50 per month or less. He also groups these funds according to their capitalization and investment style (i.e., value, growth, or blend). Chapter 5 also contains very understandable explanations of terms such as "Standard deviation of return," "total return," and Sharpe Ratio and numerous

1. *2001, Paperback, 265 pages, $16.95. ISBN 0-07-136158-8 Publisher Web Site: www.books.mcgraw-hill.com*

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charts that support the need for asset allocation.

In Chapter 6, Israelsen explains how to create various low-cost portfolios of mutual funds. Each portfolio is designed around two rules: diversify within the equity style box and diversify between U.S. and non-U.S. stocks. The Ultra Affordable Portfolio, for example, consists of three funds that require a combined $76 a month investment (one of the funds only requires $1). There is also a brief discussion of balanced funds that combine both stocks and bonds in one portfolio. Israelsen notes that the correlation between year-to-year returns of large company U.S. stocks and bonds, and small company stocks and bonds, is about 40 percent and 20 percent, respectively.

Chapter 7 discusses buying stock directly and contains a list of ten companies with direct stock purchase plans that accept $25 per month and 18 companies that accept $50 minimum investments. Some are household names, such as Wal-Mart, Fannie Mae, Merck, IBM, and Goodyear Tire & Rubber. Investors can purchase stocks directly from a company plan or through the Web site www.sharebuilder.com, where there are over 2,000 stocks available for purchase. Combined with the "Frugal Forty" mutual funds, the book thus provides 68 investment choices for $50 a month or less.

Another thrifty investing strategy is purchasing low-cost investments. A chart in Chapter 5 provides performance data for stock funds with a low expense ratio of .50 (one half of one percent) or less, many from the low-cost Vanguard Group. A .50 expense ratio means that 50 cents of every $100 of account value is used to pay fund expenses. Chapter 8, "How Much is Enough," helps readers plan for goals such as college and retirement. Israelsen takes the approach that people should "do their best" and start saving any amount rather than throw up their hands in discouragement and save nothing. Helpful charts illustrate how small dollar amounts can grow at various interest rates over time. In Chapter 9, taxes are discussed with particular emphasis on IRAs and tax-deferred employer plans. A helpful list is provided of direct stock purchase plans that offer IRA accounts.

The book ends with a chapter called "Battle Plan" that outlines the process of becoming a thrifty investor. Steps include: deciding how much you can invest by analyzing household spending, deciding how and where to invest (e.g., a growth fund in a 401(k) account), picking low-minimum stocks and/or mutual funds, and being patient. Israelsen likens investing to raising children: the "payoff" for both usually takes a while. He also concludes by advising readers to keep good records and to enjoy the process of investing. "Investing isn't a goal," he states, "but rather a means to many important ends." This book should be on the shelf of any financial educator teaching new investors how to get started with small sums of money and is a perfect compliment to the Cooperative Extension Investing For Your Future initiative.

References

O'Neill, B. M. (1999). *Investing on a shoestring: Finding the money to invest making up for lost time identifying inexpensiveinvestment options*.Dearborn Trade.

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