"Apply even some of this book's teachings and you'll owe its author a debt of gratitude. And that's smart debt!"
DAVE CHILTON, "THE WEALTHY BARBER"

THE SMART DEBT COACH

$1,000 BENEFIT GUARANTEED OR MONEY BACK

Secrets of the Rich to Increase *Your* Wealth and Security

Talbot Stevens

Book Excerpt

To make it easier to quickly learn and benefit from one or two concepts, this document contains a small part of *The Smart Debt Coach: Secrets of the Rich to Increase Your Wealth and Security*. The entire publication, as well as other brief excerpts, is also available.

For more information, or to get more ideas to help you increase your wealth and security, please contact

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- David Chilton, "The Wealthy Barber"

"Help a Friend"

Since we're not taught about money, let alone more powerful strategies used by the rich, you're probably not the only one who could benefit from the ideas in *The Smart Debt Coach*. **If you find some of these concepts valuable, please *"Help a Friend"* and spread the word, giving them a copy of this document.**

If a friend knew of a way that you could benefit significantly, and they didn't tell you about it, how would you feel?

Please share this content with those you care about: your friends, relatives, and co-workers. Helping a 'friend' learn how to create their own financial independence might be the most valuable thing you do for them.

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As everyone's situation is different, these ideas are not, and should not be construed as advice. Readers should use their own judgment and/or consult a financial expert for specific applications to their individual situations.

About Advisor Name

This page explains WHY someone should choose you as their financial advisor, instead of their current advisor.

You might identify your target market and your Ideal Client Profile, so you only attract clients you want to work with.

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Behavioural Coaching. More important than knowledge is the ability to execute strategies effectively, managing the biggest threat to clients' financial success: behaviour. Your clients refer their friends because of your ability to help them understand and stick to the financial plan that is best for them.

You might include a personal anecdote about your family or community involvement, to show your human side.

You would close with a Call to Action, perhaps including a hook or free offer to entice a prospect to meet with you.

A Commonsense Way to Beat the Market

"ONLY DRIVE AND INCREASE SPEED WHEN IN VALLEYS"

"Now that we've addressed the fundamentals and some of the ways to use investment debt more safely," Bruce began as our entrees arrived, "we can discuss the more interesting Smart Debt strategies, including my favourite. It enables investors to beat the market in a commonsense way and benefit from market drops."

I was puzzled. "How can an investor benefit from drops in the stock market?"

"Before we explore how to do that, I want to make sure we're all really clear about something," Bruce replied. "Does anyone *know* what the stock market will do in the short term?"

"No," I answered immediately. "You've helped us accept that it's impossible to predict the markets. No one can do it, no matter how intelligent they are. Heck, now I wouldn't even believe *you* if you told us where the markets would be in a year."

"Good! Then you're recognizing the difference between what's knowable and what isn't. It's critical for investors to accept that **equity investing vehicles only have rear-facing lights**. But even though we can never see what lies ahead, investors can use what they've seen in the past to great benefit. As we'll discover, having a better understanding of what stock markets have historically done under various conditions gives us a better sense of what's likely to happen in the future.

"Has anyone seen a chart of the historical stock market returns?"

"Yeah," I nodded. "It almost looks like a mountain."

"You're more knowledgeable than you think," Bruce smiled. "Some in the industry actually do refer to the graphs of stock market growth over many decades as 'mountain charts.' And the experience of investing in an equity market *is* like moving up a mountain, with many peaks and valleys along the way.

"If you narrowed your focus and just looked at short periods of time, you'd see a wide range in the height of those peaks and valleys. The S&P/TSX index, which represents the Canadian stock market, has complete data all the way back to 1956. Based on monthly index values, the highest one-year return since then was a gain of 87 percent, while the lowest was a loss of 39 percent."

"That's quite a range," Michelle murmured.

"Yes it is. But **while equity returns fluctuate a lot in the short term, they fluctuate very little in the long run**. Over all of the possible 20-year holding periods since 1956, the compounded annual return has ranged from six percent in the worst case to a high of 14 percent.

"There's no denying that, in the short term, investing in the stock market is very risky. But over the long term, the peaks and valleys smooth out and your average speed travelling through the cycles is much more predictable. Historically, equity markets have elevated wealth by about 10 percent a year – a much higher return than with bonds and GIC investments."

"So over the short term, stock markets go up and down a lot. And long term, returns have averaged about 10 percent," I summarized. "But how does that allow us to benefit from market drops?"

"You just answered your own question, and identified how to outperform the market."

"How? What'd I say? I don't understand."

"You said that short-term returns fluctuate a lot but, over the long term, they average out to about 10 percent."

"Um, yeah, but I'm still not connecting the dots."

"Let me see if I can help you discover the answer on your own," Bruce responded. "Personally, I find that I understand better and remember longer when I figure something out instead of simply being told.

"Consider this: for the five years leading up to the 2008 financial crisis, the Canadian stock market index wasn't down over any one-year period, and the compounded annual return was almost 16 percent."

"So?"

"Joe, you just said that over the long term, returns average about 10 percent," Kim noted.

"And Bruce said that the highest annual return over any 20-year period was 14 percent," Michelle added.

"So I think what Bruce is trying to help us realize is that what goes up must come down," Kim shrewdly concluded. "When returns are way above the average, they eventually have to come down."

Bruce said nothing, impressed with Kim's insight.

"And that's exactly what happened," Michelle realized. "The stock market returns were way above average for many years and then crashed – in a big way. Are you saying that investors could outperform the markets by knowing when they're overvalued and getting out before they fall?"

"Not at all," Bruce clarified. "Remember that no one has a clue what the markets will do in the short term. I don't know of anyone who has been successful at market timing when they invest their own cash into the stock market. After accounting for your transaction costs, to come out ahead, you have to be right on both when you buy *and* when you sell. Tough to do consistently.

"But when it comes to borrowing to invest many years' worth of cash flow all at once – to make one big, lump-sum investment, where there's an interest cost to pay – that's another matter. And I think that we'll all agree that *when* we borrow to invest *lots* has a big impact. As I've said, as one of the keys to safer, Smart Debt, we certainly don't want to borrow to buy *more* when the markets are high."

"So how can we benefit from short-term market fluctuations?" I pressed.

"Every coin has two sides," Bruce hinted. "If high, short-term returns must eventually come down towards the long-term average ..."

"Then low, short-term returns must eventually move *up* towards the long-term average," I finished, triumphantly.

"Mathematicians call this behaviour 'regression to the mean,'" Bruce elaborated. "But the way you said it is better. In the short term, equity markets fluctuate a lot but, eventually, returns tend to converge to the long-term average."

"So when markets are down, that's when you borrow to invest *more*," Kim deduced, "so your gains are increased when the market recovers."

"Exactly, and then the more cautious investors will cash out completely," Bruce expounded. "In traveling through the peaks and valleys of the stock market, **the Buy More Low strategy is where you only drive and increase speed when you're in the valleys**. You invest as normal without borrowing until the market is low. Then, and only then, do you temporarily jump into a Buy More Low vehicle – borrowing to invest more – to take advantage of the market being 'on sale.' As soon as the market rebounds, which might be six to 24 months later, you're out of the vehicle and continuing on as before, without any investment debt."

"I like the idea of only using investment debt temporarily," Kim admitted.

"And strategically waiting until the markets are down before using good debt at all," Michelle added.

"Those two factors significantly reduce financial and emotional strain," Bruce claimed, "and make the Buy More Low strategy comfortable for many who would never consider using good debt."

"Although I'm not a big risk taker, this Buy More Low concept is something I might consider," Kim mused. "Can you walk us through a simple example to show how it works? I think I've got the general concept, but sometimes working through an illustration helps me understand things better."

"Sure," Bruce obliged. "Let's pretend that Kim's interested in the Buy More Low strategy. And for simplicity, let's pretend that she can comfortably handle an investment loan of $100,000 with negligible financial or emotional strain. For some, this would be way too much. For others, they could easily add a zero. But it's a nice, round number to keep the illustration simple. Okay?"

Kim grinned. "If we're just pretending."

"To keep things easier for everyone, I use a simple 'two-gear' approach," Bruce continued. "When the market is down a little, you shift into first gear and invest half of your good debt total – in this case, $50,000. If the market drops below a second threshold, that's when you shift into second gear by borrowing and investing the other $50,000."

"So you use a little good debt when the market is down a little, and only invest all of what you're comfortable with when the market is down even more," Kim affirmed. "I like that approach. It makes sense."

"And the safest, most profitable time to invest in the market is when …?" Bruce prompted her.

"When it's scariest," Michelle leapt in. "When markets are already down. It's common sense that we need to 'buy low, sell high.'"

"It is common sense, and well known," Bruce conceded. "But it's not common practice. Most investors have heard 'buy low, sell high' so many times that it no longer has any meaning. As we've discussed, because our brains are hard-wired to avoid *perceived* pain, investors tend to do the opposite of what makes sense, and we end up buying high and selling low. When it comes to financial behaviour, emotion trumps logic nine times out of ten.

"Uncle Brian used to suggest that most investors would actually be better off if they'd never heard 'buy low, sell high,' and their investment timing was purely random. At least that way, half of the time they would get the timing right!"

"Cute," Kim commented, "and probably true."

"In terms of understanding what it takes to be more successful at investing in the stock market," Bruce went on, "no one explained it better than Ben Graham. He was Warren Buffett's mentor. It's a concept that every investor should be aware of.

"Graham characterized stock investing as being in business with a partner he called Mr. Market. Each day, Mr. Market provided a price at which he would buy your share in the partnership – your stock – or sell you his. Most of the time, Mr. Market would quote a reasonable value for your business partnership, based on a rational assessment of future profitability and general economic conditions.

"But, unfortunately for him, Mr. Market had incurable emotional problems and suffered from severe bouts of manic depression. Occasionally, he would be in a jubilant mood, confident that the future of the business would only get better. At those times, he would name a very high price, fearing that you would buy his share and rob him of imminent gains. At other times, he would be depressed and see nothing but darkness on the business horizon. Then, he would quote a very low price for fear that you would unload your stake on him.

"But, like Cinderella at the ball, you must heed one warning or everything will turn into pumpkins and mice. **Mr. Market is only there to serve you, not to provide guidance**. If he is in one of his manic-depressive moods and quotes an unreasonable price, **you are free to ignore him or take advantage of his foolishness**. But **it will be disastrous if you are influenced by his emotional swings**. In fact, the more manic-depressive Mr. Market's behaviour is, the better for you."

I raised my eyebrows. "So investing in the stock market means being in partnership with a lunatic."

"Sometimes," Bruce laughed. "If you think it makes sense to learn how to increase your wealth from those who have been successful and are willing to share their ideas, Warren Buffett is a goldmine for investment wisdom, too. And one of Buffett's more famous insights is: 'Look at market fluctuations as your friend rather than your enemy. **Profit from folly rather than participate in it**.'"

"So how much can this Buy More Low strategy benefit investors?" I asked. "I accept that no one *knows* what will happen, but what is typical?"

"Well, this is where a little study of historical returns becomes valuable," Bruce suggested. "Let's just consider one-year returns, because that's how most investors gauge performance and because a typical holding period for buying more low might be about 12 months.

"First, it's useful to know that about 26 percent of the time, the stock market loses money and one-year returns are negative."

"But that means that **about three-quarters of the time, the market goes up**," Kim optimistically pointed out.

"True," Bruce said. "The vast majority of the time, the stock market does go up, and we'll come back to that point when we discuss the new strategy Lisa mentioned to Joe.

"We know that the long-term, compounded annual return for the Canadian stock market has been about 10 percent, with the best one-year return of about 87 percent and a worst case of minus 39 percent."

"And?" Michelle inquired.

"But what if we just looked at those times when the market was already down – which happened about a quarter of the time? What do you think the market did after that?"

I was ready to hazard a guess. "After being down, returns were higher than the average of 10 percent to move in the direction of the long-term average?"

"Correct," confirmed Bruce. "Historically, **after the stock market has had a negative one-year return, the following one-year return has averaged 19 percent** – almost double the long-term average.

"So if the only time you borrowed to invest a little more was when the market was down over the past 12 months, based on average historical results, your investment debt strategy would be up 19 percent a year later. But we can do better than that."

"Better than that?" Michelle gasped. "That sounds pretty good already."

"After the market has fallen at least 15 percent – which has happened about seven percent of the time – the average one-year return has been about 25 percent."

"That's why you use a two-gear approach," Kim reasoned. "You wait until the market is even more 'on sale' before investing the other half of the borrowed money."

"Which on average means an even bigger rebound," I concluded.

"And because the market at that point is even lower," Bruce added, "it is less likely to fall much further compared to when it has had normal or above-average returns."

"Which makes the strategy safer," chimed in a pleased Kim.

"So let's answer Joe's question about how much a Buy More Low approach could benefit an investor," Bruce resumed. "If Kim had this strategy in place before the financial crisis temporarily caused many stock markets to drop about 50 percent, she would have done okay."

"How okay?" I pressed.

"In that instance, the market dropped very quickly – over 30 percent in a few months," Bruce explained. "That means that all of Kim's $100,000 would have been invested in one shot."

"And when do you sell and exit the strategy?" Kim wondered.

"Good question," Bruce acknowledged. "Most who use the Buy More Low strategy like it because it generally only involves using investment debt briefly. So some choose to pay off their loan completely after the market rebounds the average amount it has historically. Others hold on a bit and aim a little higher.

"As we said, after being down at least 15 percent, historically the average market rebound has been a one-year return of 25 percent. So some investors chose to eliminate the investment debt when their investments gained 25 percent, which ironically happened 13 months later."

I was incredulous. "A gain of $25,000 in about a year?"

"Per $100,000 invested," Bruce nodded.

"What annual return does that equate to?" Michelle asked.

"In this example, the return on the lender's money – which you're responsible for repaying – was 25 percent," replied Bruce. "But the return on the money actually invested by the investor is … almost unbelievable."

Michelle persisted. "How unbelievable? Over 100 percent?"

"Well, at six percent interest, it would cost a little over $6,000 to rent $100,000 for a bit more than a year. After deducting the interest, the after-tax investment might be $4,000 – less for a higher-income taxpayer like a doctor. So for an annual investment of let's call it $4,000 out of pocket, Kim gets to own the investment gains *or losses* on $100,000."

Kim was astonished. "Turning an investment of $4,000 into a gain of $25,000 in about a year is an annual return of far more than 100 percent!"

"Yes, it is. The four grand invested increased by a factor of over six," Bruce concluded, "for an annual return of over 500 percent."

"Wow!" a stunned Michelle whispered. "What if the market doesn't rebound in a year or two?"

"You wait," Bruce calmly replied. "Most of the time, the market has rebounded within two years. In the case of the 2008 market crash, it recovered from its low, back to its pre-crash peak, two years later and rebounded over 80 percent.

"But as we all know, that doesn't guarantee anything in the future. Even if you have to continue long term, at least you got in when the market was lower, which means your short-term experience is less likely to be stressful."

"But if you were ever going to use investment debt to magnify returns like the rich do," I recognized, "the Buy More Low approach seems like a safer way to go."

"There is one thing I want to clarify about getting out of the strategy," Bruce disclosed. "After the market has rebounded and they have a comfortable profit, some may want to convert to the Investment Acceleration strategy. Instead of selling and paying off the good debt, they choose to continue the larger investment long term, taking advantage of the down market as a safer, more profitable time to start.

"But let's say you wanted to stick to the Buy More Low concept, and strategically only use good debt temporarily. If Kim's $100,000 grew to $125,000, does she need to cash in all of it to pay off the debt?"

"She only needs to cash in the amount she borrowed: $100,000," I answered.

"And a little more to cover the capital gains taxes," Bruce corrected me. "But what about the rest of the profit? What should happen to that?"

"Whatever I want!" Kim proclaimed.

"Exactly," Bruce agreed. "And if your priority is building long-term wealth, and three-quarters of the time the market goes up, with an average annual growth of about 10 percent a year …"

"Then the best place for the profit," Kim took over, "is to keep it invested."

Bruce nodded with a gentle smile of approval. It was clear that Kim was committed to improving how effectively her hard-earned dollars were growing.

"There's another thing that makes the Buy More Low strategy one of my favourites. It turns a natural part of the equity market journey – the downturns which almost everyone interprets as a negative – into a positive. It becomes an opportunity to increase wealth. And as a financial advisor, I can tell you it's nice to have something positive to discuss during periods when every client's portfolio is down."

We took a minute to appreciate that fact and savour some food before Bruce resumed.

"The reality is that **you can't get the higher, long-term gains of the stock market without the higher, short-term volatility**. And **if we recognize that, and accept it, we can profit from it**.

"In fact, a few of my clients, who initially said there was no such thing as good debt, are pleased with how they've profited from the strategy. They're actually looking forward to the next big drop in the market – as long as it's temporary.

"I'd like to make one final point before I ask you regulars where the restroom is. It's one of the ideas that's easy to share with others you care about who might also want to increase their wealth and security."

"And that is?" Michelle asked.

"**Recognizing that the stock market will drop 20 to 50 percent at some point in the future, how are you going to react?**" Bruce allowed time for us to process the question before continuing. "How can you benefit? How are you *going to* benefit? And the most valuable question to answer before the market drops is: **How are you going to benefit *automatically*?**"

I glanced at my wife to confirm that she was in agreement. "I can't speak for Kim, but I know how Michelle and I are going to benefit," I declared. "Is the market down now? If so, I think we're ready to set up a Buy More Low program so we can benefit from the next market drop – automatically. Right honey?"

"I like it," she beamed.

"I like it too," Kim seconded. "Maybe **the old maxim of 'buy low, sell high' should be upgraded to 'Buy *More* Low, Sell *Some* High**.' Is that the new strategy that Lisa mentioned to Joe?"

"No. My new Debt-Opportunist Combo strategy is related, though," Bruce replied. "It's like the little sister to Buy More Low. It's another commonsense way that investors who are even more cautious can outperform the market.

"Why don't we discuss it over dessert, after I navigate to the washroom."

About The Author

Talbot Stevens' true passion is helping people benefit from effective financial strategies and behavioural solutions. Confessing to be one of those weirdos who likes math, he has degrees in engineering and computer science. But he's committed to not letting that handicap him. His previous books, *Financial Freedom Without Sacrifice* and *Dispelling the Myths of Borrowing to Invest*, have sold almost a quarter of a million copies.

Whether speaking to the public, corporate staff, or the financial industry, Talbot's focus is to educate, entertain, and inspire others towards what financial success means for them. He has started a "*Help a Friend*" campaign to encourage everyone to share valuable ideas with others. He grew up on a small farm, and currently lives in London, Ontario, with his wife, Theresa, and their three wonderful but patience-testing kids, Derek, Ryan, and Kristin.

To learn more about how Talbot's speaking, books, or consulting can help increase your wealth and security, visit www.TalbotStevens.com.