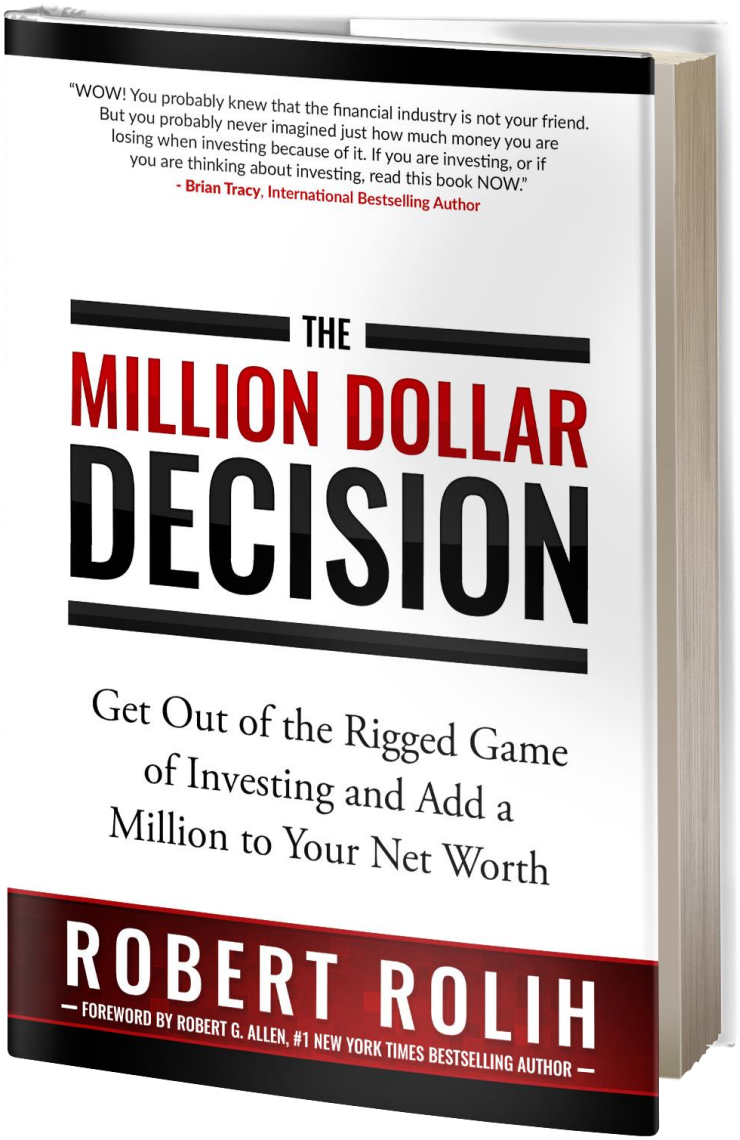
ROBERT ROLIH
Fast forward your wealth

The Six Dark Forces of Investing

(a sample chapter)



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Chapter 2:
Six Dark Forces of Investing: You Are Losing Money Without Even Knowing It

"If I had an hour to solve a problem I'd spend 55 minutes thinking about the problem and 5 minutes thinking about solutions." – Albert Einstein

The biggest problem of investing is that we are not aware of the problem that is sitting right underneath our noses.

When my business took off, I frequently hired advisors and consultants who helped me to grow my company and make it successful. That strategy worked wonders for me. When I started to invest, I thought that the same would apply to investing. I trusted financial advisers, bankers and investing gurus. I thought that the world of investing was fair and that I could win the financial game of life by trusting their advice.

I lost a lot of money because of that, and I am not alone. From my experience of talking to thousands of people who attended my seminars, I can say that most investors are in the same position as I was. Most investors think that their invested money works for them; but in reality, it works mostly for the financial industry. And when they realize it, it's usually too late.

So, before you invest another cent, you need to be aware of the hidden problems that we all face when investing, if you are not, your chances of getting good returns are close to zero.

I spent years studying the workings of the financial industry, and I found six major problems that people face when investing their money. These problems are the reasons why most investors lose a very big part of their potential returns. I call them *The Six Dark Forces of Investing*.

Get to know them, and Darth Vader will seem like a good guy to you.

Dark Force #1: The Commission Camouflage Effect

To understand the first dark force that 'helps' investors lose a large part of their potential investing returns, we need to go to Las Vegas.

I don't gamble, but I like to visit Las Vegas from time to time. It's a nice experience, and it can be fun.

I'm writing this chapter from my hotel room overlooking the Vegas Strip. I will be staying here for five days, attending a mastermind event with fellow public speakers and business owners.

You probably agree with me that when in Vegas, you can hardly avoid casinos. It's just amazing to see all these people putting money in the slot machines and playing Roulette. People are always drawn to the opportunities that offer big rewards for little or no work, although they know that most players lose money. Maybe a few people get lucky sometimes, but in the end, it's the house that always wins.

The house has an edge, and there is a mathematical certainty that it will earn 2 to 25 percent of all the money that goes through that casino. But this is actually OK — when we are in a casino, we know our odds. We are aware that our chances of winning, over the long run, are next to none.

Now you are probably wondering, "what do casinos have to do with investing and retirement planning?" The answer is a lot. We all know that we have to invest if we want to provide for ourselves in old age, for our family, to have a better lifestyle and make our money work for us.

We're also trying to win the game – that means getting good returns on our investments, such as stocks, funds, bonds and other financial instruments.

We also know that the investing world has a 'house' with an edge — 'the house' always gets some commissions and fees. And again, that's OK, as long as we are aware of that.

But now comes the ugly part. Investors are mostly unaware that the house not only has an edge, but that it has also rigged the game. And by 'the house,' I mean the financial institutions, fund managers, financial advisors, brokers, etc.

"If you are playing the rigged game of investing, the house always wins."

They have rigged the game in such a cunning way that even experienced investors don't notice it most of the time. Because of that, most investors lose 50 to 70 percent of all the investing gains they would get over the course of their investing career.

What does this mean for you as an investor? Simply put, if your investments could bring you a gain of, let's say $100, over the long run, you are getting only $30 to $50, because the game is rigged. Ouch! Think about that for a second. You are now 60 years old, and instead of seeing a million dollar gain in your investment account, you only have $300,000 or $500,000. Think of all you could do with the difference: buy a beach house, retire early, do what you enjoy most…the possibilities are endless.

But you can't, because the house got your money!

Now you are probably wondering how does this happen? How did they rig the investing game?

First is the way that the commission and fee system works. We all know that there are some fees and commissions associated with any investment product. But what we can hardly grasp is how the commissions influence our long-term investing returns.

Let me give you an example. If you invest your money in a simple mutual fund, you are paying a 2% annual fee, give or take. And this doesn't sound like much. When your financial advisor tells you that you are paying a 2% annual fee, your brain says "OK… this is not a problem. They take 2 and I keep 98."

Right?

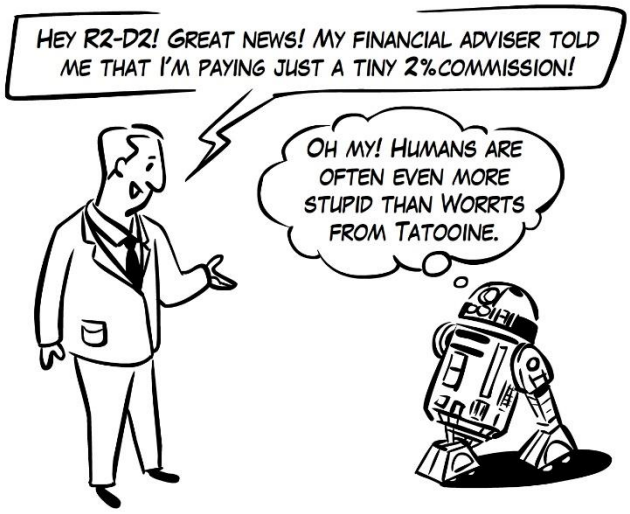
Wrong!

The problem is that our brain can only do simple calculations: "2% out of $1,000? Hmmm… 1% of $1,000 equals $10, so 2% must be $20. No problem! We did that in school! I'm a math genius!"

But, when you add a longer time period – and most investors are investing for the long run – maybe 10, 20, 30 or even 40 years, our brain just can't process the math anymore. If I ask you how much is 2% deducted annually for 30 years in a market that grows by 8% on average, your brain goes, "Are you kidding me? I'm not R2-D2!"

Our brains are just not wired to calculate complex calculations like this. And that is perfectly normal. Most people wouldn't be able to calculate this, even with the help of a computer.

That is why we subconsciously make some approximations and assumptions: "If 2% of my invested money in one year is a small number, then a 2% annual fee can't be a serious problem over the long run."



But unfortunately, our brains fail us badly in this case. The financial industry knows this and takes full advantage of it. That is why they will never explain the effect of commissions over the long run to you. Even if you have the best financial adviser, it just doesn't happen.

A small annual commission is a devil in disguise. In the best case, it can cause you a lot of financial problems when you retire, and in the worst case, it can wipe you out. We will go into all the details, and I will give you some specific numbers later in chapter 5, but for now, just remember, that, as a rule of thumb, a 2% annual fee halves your retirement pot in the long run.

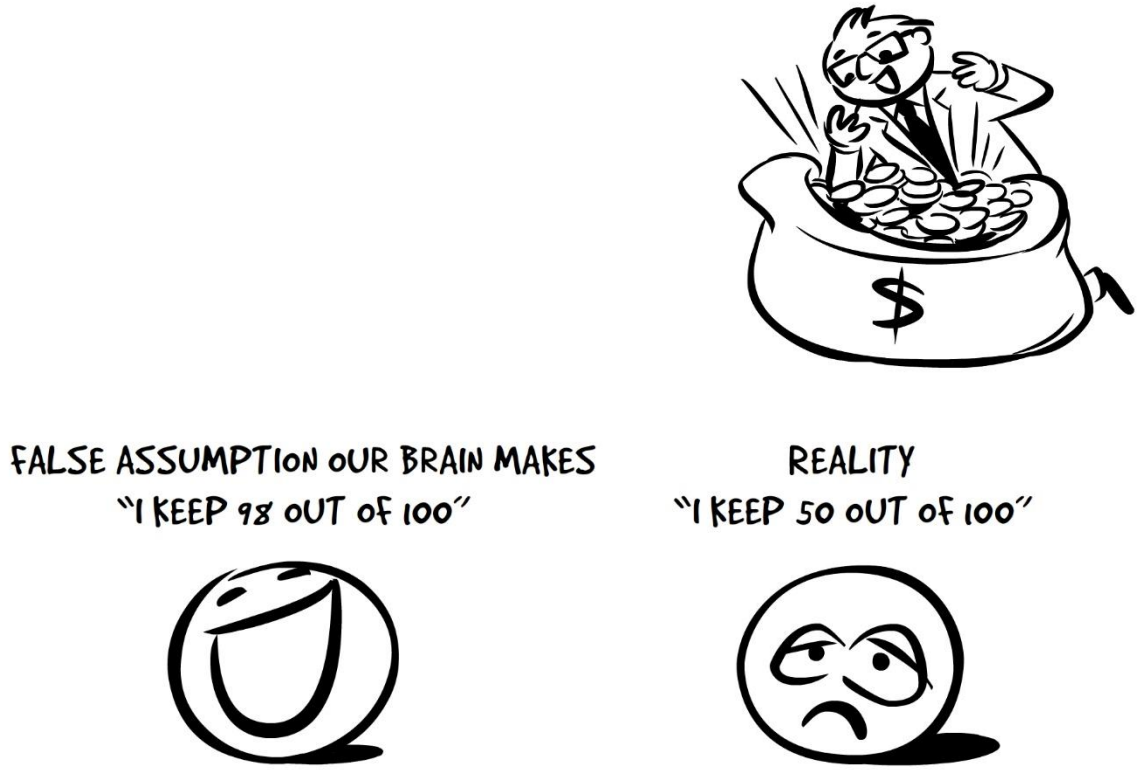
Now let me ask you a question: What would you say if your financial adviser offered you a financial product where you got to keep only half of the future returns?

If you are like me, you would run away as fast as you could.

But most investors don't, and buy their financial adviser a box of chocolates because he or she provided them with great advice. Why? Because nobody told them about what I call the "Commission Camouflage Effect."

The Commission Camouflage Effect states that small annual commissions tend to eat a large part of our investing returns over the long run. It's one of the deadliest concepts in investing, and just by getting to know it, you can save a surprisingly large amount of money. For most investors, this amount can easily go into the six-figure range.

Exhibit 2.1 The Commission Camouflage Effect of a 2% annual fee over the long run



Let me summarize. The first Dark Force of Investing is the destructive power of the Commission Camouflage Effect that makes you believe that you are paying a small fee when you are, in fact, paying a very large one. Because of that effect, I sometimes joke that the odds of winning in Las Vegas are greater than on Wall Street. Unfortunately, there is a lot of truth in that claim.

Dark Force #2: Reward Corruption

Once upon a time, there was an insurance intermediary company that employed a couple of hundred insurance brokers. Life was good. The agents were meeting their clients, identifying their needs and advising them on which insurance policies to use for their situations. They were happy; the customers were happy.

But then something happened. The insurance company they represented created a new product. A whole life insurance policy where a part of your monthly payment goes toward insurance, and a part towards investment in mutual funds.

There was something fascinating about this product that made quite a stir with all the brokers. The sales commissions they would get when they sold this product were three times higher compared to any other product.

Human nature quickly took hold, and in a period of one month, all the brokers focused on selling this product. After all, who wouldn't grab a carrot like this!

All of a sudden, this product became a solution for almost all the needs of their customers. The typical sales approach was, "Customer, for any problem you might have, we will sell you this product. It's the best and the only option. Buy it now! Resistance is futile!" And it sold well because brokers were very motivated to sell it. A big payout was just around the corner for them.

The CEO of the company was ecstatic. He hadn't seen profits like this for a long time. And when something sells well – why not give it an additional kick.

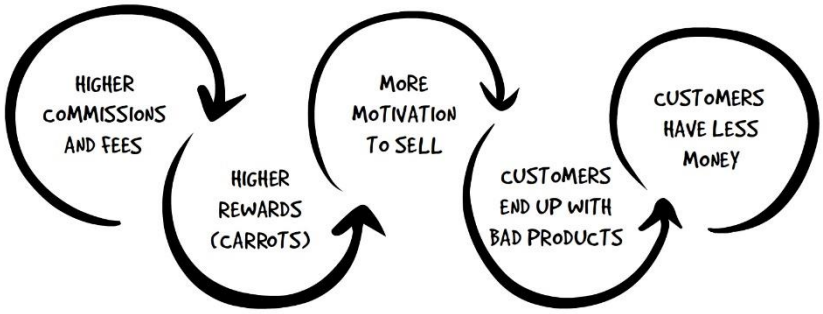
So he organized a sales competition. The broker who sold the most policies in the next quarter would win a six month lease on a new Ferrari. If the brokers were very motivated before, they were on fire now.

Now, all this would not be so bad if the product was a good product for the customers. But the reality was that this product was one of the worst financial products out there, charging enormous commissions and fees.

The second Dark Force of Investing is the reward systems of most financial institutions. These reward systems can motivate their employees and partners to be biased and highly motivated to sell something that is not right for the customer and often leads to unethical or corrupt behavior.

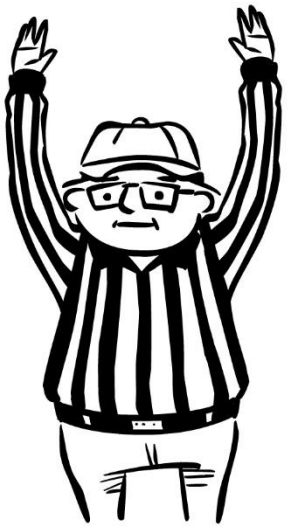
When employees sell high commission products, they make more money, and customers make less. It's that simple. The higher the commissions and fees, the worse off are the customers. That is why the most popular financial products are the worst ones for the customer. I call this the Chain of Financial Ruin.

Exhibit 2.2 The Chain of Financial Ruin



It is the main reason why the financial industry is one of the most profitable industries around. In the U.S., it employs less than 5% of the population, but it produces more than 30% of all the corporate profits, according to the U.S. Bureau of Economic Analysis[i]. How is that profit made? From the customers, of course.

Dark Force #3: Bad Guys Setting the Rules of the Game



I met with someone not too long ago. He was a typical alpha male in his 50's. He was wearing an expensive dark grey suit with a black tie. If you talked to him, you could detect a hint of a superiority complex.

"We put Apple stock in every managed portfolio," he said. "We think that Apple stock will underperform in the future, but it's better to have it in all of our customer's portfolios."

"Why would you do that if you think that Apple's stock will underperform?" I replied, surprised.

"Do you know the saying that nobody ever got fired for choosing IBM?" he said without a sense of wrongdoing. "People love the Apple brand and their products, that is why it looks good to have Apple in their portfolios. It's good for the sales! But if the stock underperforms, the customers will not blame us for choosing it. So it's a win-win proposition for us. We sell more and they will not blame us if the stock doesn't do well."

I must say that at first I couldn't decide if he was joking or if he was serious. Unfortunately, for his clients, he was serious. I think that was when I gave up hope that the financial industry even remotely cared about the customer.

I wanted to say to him, "Wouldn't you rather take 30 minutes of your time to record a video educating your clients about why you don't put Apple in their portfolios?" but I saw that it would be useless.

It really doesn't matter what will happen with the Apple stock. Maybe it will go well in the future, maybe not. I don't know. But I'm sure as hell not in good hands when I hire a financial adviser or wealth manager that thinks like this – and neither are you!

The third Dark Force of Investing is that there are just too many bad guys in the industry. Lack of ethics is so ingrained in most companies that they are not even aware of it any more. It's just a normal way of doing business. In short: they don't really care about their customers – about you – all they care about are their sales targets and profits.

Case in point: the Wells Fargo shocking scandal, where federal regulators found out that Wells Fargo employees secretly created millions of unauthorized bank and credit card accounts from 2011 - 2016[ii]. In order to meet their sales targets, employees would, for example, create a new savings account for a customer and then transfer funds from his or her existing checking

account into the new bogus savings account without customer's permission. Wells Fargo bank admitted the "widespread illegal practices," fired more than 5,000 employees, and agreed to pay $185 million in fines.

Perhaps the most worrisome thing about all this is the sheer scope of this scandal. When more than 5,000 employees are involved in illegal behavior, you have to think that similar activities were probably a normal way of doing business at the bank. And, when you think about that, you have to wonder how many illegal and unethical activities that we don't know about are really going on in the financial sector.

> *"Lack of ethics is so ingrained in the financial industry that they are not even aware of it any more. It's just business as usual for them."*

When I was young I watched a western movie, where the last scene of the movie stuck in my mind for a long time. In this scene, the protagonists of the movie, the good guys, ended up surrounded by an army of bad guys and were killed, one by one.

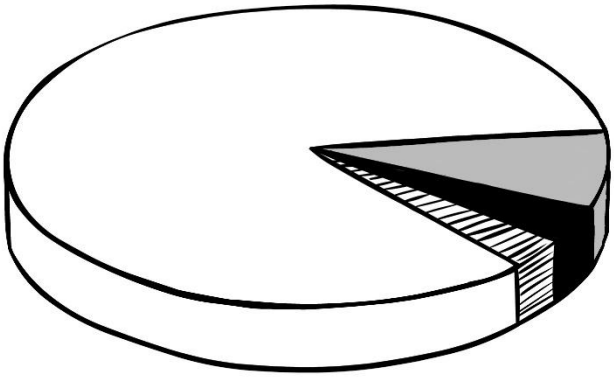
Even though the good guys fought bravely, there were just too many bad guys out there.

I can still remember how bad I felt at that time. I was still young and I believed that good always prevailed. I believed that life was fair and that wrongdoings always got punished. But unfortunately, life is not always fair and bad guys do get away without punishment a lot of the time.

In my opinion a very similar thing is happening in the financial industry – there are just too many bad guys in the industry.

From my experience of observing and researching the industry, I was able to construct a chart that classifies people working in the financial industry depending on their behavior. Mind that this chart is just my estimation.

Exhibit 2.3 People working in the financial industry



The Bad Guys

First let's take a look at the dark gray part of the pie. These are the bad guys of the financial industry. They are not necessarily bad people. But in their business lives, they are not working for their clients' interests. They produce or sell financial products that are bringing in a lot of profit for them, but are very bad for clients. Or, they are giving harmful financial advice in order to profit for themselves.

So, these are the people who are producing and selling very bad financial products and they know it.

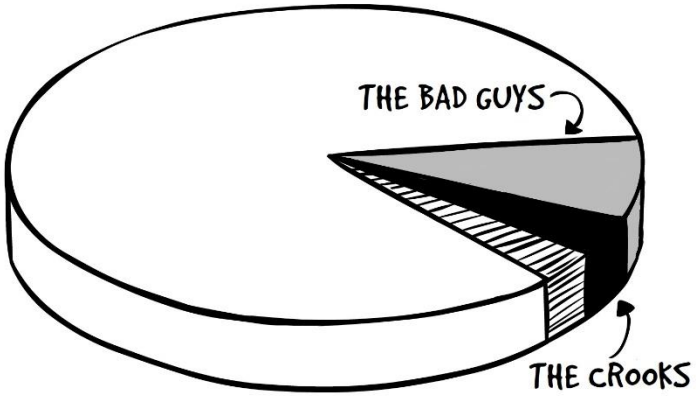
I once worked with a bank that hired me to train its sales staff. We talked about how important it is to believe that your product is the best solution for the client. During a break, one of the participants came to me and said, "Robert, I understand that you need to believe in your product, and, for most of our products, I believe that they are the best. But a couple of weeks ago, we had a meeting with our sales manager, and he told us that we need to push a certain product. After that, he told us that this product has very high fees, and that he would never buy it for himself. Now, how can I recommend this product to my customers after that?"

Now…that is a good question!

The Crooks

Next is the black part of our chart. These are the fraudsters who should be in jail. If the bad guys are operating legally, fraudsters or scheme artists are not. They are usually operating an illegal business practice called the Ponzi scheme.

Exhibit 2.4 The Bad Guys and the Crooks



A Ponzi scheme is named after Charles Ponzi, who constructed one such scheme at the beginning of the 20th century. It's a pyramid scheme where the newest members of the group think that they invest money in a legitimate opportunity, but in reality, their money is not being invested – it's only used to pay people higher up in the pyramid.

One of the most famous Ponzi scheme operators was Bernard Madoff, who orchestrated the biggest Ponzi scheme to date and stole an estimated $20 to $65 billion from his investors[iii].

Why do people invest in these kinds of schemes? Because they are drawn in with the promise of very high returns. In other words: greed. A Ponzi scheme operator is getting people to join by promising them 20%, 50% or even 100% return on their investments. And, on top of that, he is usually guaranteeing these returns.

"When investing, greed can be your worst enemy."

But the system needs a constant flow of new investors in order to exist, because the money is not really invested; it just flows to the top of the pyramid. And once the scam artist feels that enough money has been collected, he disappears – taking all the money with him. Ponzi schemes have ruined millions of financial lives. Don't let yours be next.

So how can you spot a Ponzi scheme? Your alarm should go off if somebody is offering you an investment that seems too good to be true. As a rule of thumb: if somebody promises or guarantees annual returns of 7% or more, it's probably a Ponzi scheme. Why? Because nobody can guarantee these kind of returns.

But are 10% or 50% per year returns possible? Yes, of course! Stocks have historically provided an annualized return of approximately 10%. But these returns are not constant. Some years can be great for stocks; and some years can be terrible.

Remember: you can get high returns of 50% or 100% in a short period of time when investing. But this always carries a lot of risk. So, if somebody tells you that you can get a 50% return on your investment, but you can also lose 30, 50 or 70% of your money - than it's OK. But if someone guarantees you returns like this, then something stinks!

The Good Guys

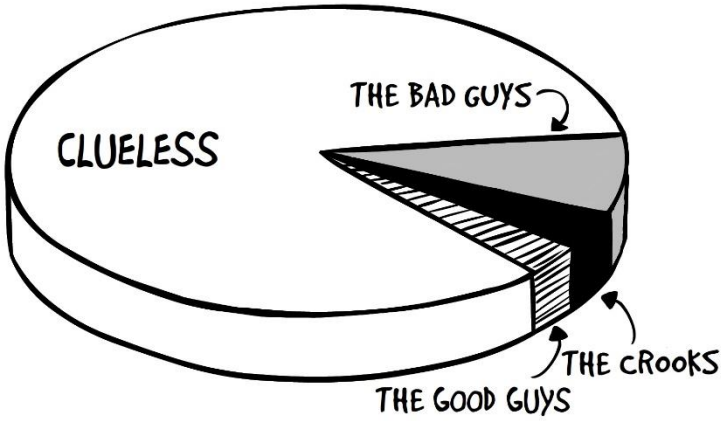
The next slice of our pie is the smallest one. These are the good guys. Percentage wise, they are few, but they do exist!

These guys are producing financial products that are good for their clients. We'll talk about them later in the book.

Clueless

And then we have the remaining – the largest – part of the pie. Approximately 85% of people working in the financial industry operate under the influence of the bad guys. This means that they are either employed by them, or rewarded by them. These are the salesmen, advisers, brokers and others who are selling financial products.

Exhibit 2.5 People working in the financial industry (continued)



They are good people and they think that they are recommending viable investments to their clients but, unfortunately, they aren't. The problem is that they know only the nice parts of the story regarding the products they are promoting. Nobody has told them the bad parts. So, these guys are not bad guys. They are merely promoting what bad guys tell them to promote, and, in most cases, they do not even know that this is bad for the clients.

If I summarize: The third Dark Force of Investing is the sheer number of bad guys and people under their influence in the industry. Sometimes even those who think that they are really helping you can be a great hindrance to your financial well-being.

Dark Force #4: Fortune-Telling Investing Gurus

There was a psychic with the strange name of Baba Vanga that predicted the 9/11 terrorist attacks. Even though the prediction she made was quite ambiguous, she received a lot of media attention.

A Zimbabwean preacher, Uebert Angel, correctly predicted the death of ex South African President Nelson Mandela. He got quite a bit of media attention.

Paul the Octopus (yes, this was really a common octopus and not a person) correctly predicted the results of eleven 2010 Soccer World Cup games. Are you were wondering how the octopus did that? Well, writing it on an aquarium wall would certainly be a feat! But that is not what happened. Paul's owners would present him with two boxes containing food. Each box was identical except for the fact that, on each box, there was a country flag of the competitors of an upcoming football match. Whichever box Paul ate from first would be considered his prediction for the winning team. Correct predictions brought him worldwide attention as an animal oracle.

John Poulson, now famous fund manager, correctly predicted the housing crash of 2007-2009. He made a lot of money and there was even a book, *The Greatest Trade Ever*, written about him.

Now here it starts to get interesting…

Baba Vanga is just one out of thousands of psychics who make predictions every year. 99% of them are wrong, but nobody writes about them. The headline that says, “Psychic X missed his last three predictions about the future,” doesn’t sell newspapers.

There are thousands of preachers and prophets who predict different events every year. The most popular ones are, of course, the ones about the end of the world. Now, as you are still alive reading this book, I assume that none of these predictions were correct.

After Paul the Octopus, there were thousands of other animals, including elephants, cats and even worms whose owners tried to predict the outcome of different sports tournaments and games. I guess you can figure how that turned out.

There are thousands of investing gurus writing articles, books and making predictions on TV about what will happen next with the stock market or the price of oil. How come the media forgets about them when they are proved wrong?

Even John Poulson's performance after his winning trades of 2007 is far below average. Let me just give you a short excerpt from a Bloomberg Business article about him from 2015[iv]:

"Billionaire John Paulson posted the second-worst trading year of his career in 2014 as a wrong-way energy bet added to declines tied to a failed merger and investments in Fannie Mae and Freddie Mac.

The worst performance was in the Advantage Plus fund, which plummeted 36 percent last year, two people with knowledge of the returns said…

The manager, who shot to fame after making $15 billion on the housing crisis in 2007, has struggled to regain its footing since 2011 when bets on the U.S. recovery went awry, losing money in all of its main strategies - including a 51 percent tumble in the Advantage Plus fund. Paulson also lost money in investments tied to gold and Europe's economy, causing assets to dwindle to $19 billion, half the peak in 2011."

See the pattern here?

There are thousands of fund managers and gurus out there. Some of them get lucky in a certain period of time. They become famous. They start attracting a lot of new investors with fresh money. Then they run out of luck and start producing below average or even negative returns. So, all the people who started to invest with them, or who invested based on their recommendations, get burned. This has happened thousands of times in recent history and will happen again and again.

"You only get to know which predictions will be correct afterwards. When it's too late."

Let me illustrate this point with a simple thought experiment. Let's say that you have a thousand computers. They are all programmed to make one exact prediction about the next price-move of a randomly selected stock. For example, the stock is now at $7 and the first computer predicts that in one year it will be at $9, the second one forecasts it will be at $6.5 and so on.

Do you think that some predictions will come true? Sure they will! There is a mathematical probability that a small number of computers will hit the mark.

But will you jump around with your hands in the air claiming that the computers that hit the mark have predicting powers? And would you bet your retirement fund that their next prediction will be on target? Probably not.

So, whether you are Paul the Octopus, or John Paulson, you can just admit it: you were just lucky once or twice. I couldn't emphasize this more: the fact that somebody correctly predicted the last crisis, or the last big gold price-move, doesn't mean that he/she has reliable predicting abilities. He or she was just lucky.

Are there some exceptions? No. We have yet to find an investing guru who correctly predicted more than one or two big price movements or important events.

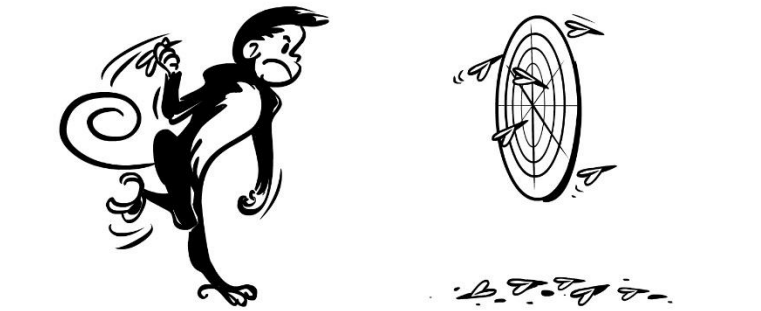
CXO Advisory Group has been collecting data from 68 market forecasters from 1998 to 2012. In that period of time, they collected more than 6,500 predictions made by these famous investing gurus and experts. Some of them predicted that a certain stock would go up or down and some predicted the course that the market, as a whole, would take. Then in a very comprehensive study, they analyzed if the predictions these forecasters made were right or wrong[v].

Now, if you were making 6,500 up or down predictions, you would probably end up being correct half of the time. This is the standard mathematical probability. 50% of your predictions would be proven right and 50% wrong.

But guess how the gurus fared…

There were some of the well-known names analyzed in that study. For example, Ben Zacks, the co-founder of the well-known Zacks Investment Research, and portfolio manager at Zacks Wealth Management Group, had a score of exactly 50%.

James Dines, founder of The Dines Letter newsletter, a guy who is often referred as "one of the most accurate and highly regarded security investment analysts today", was also correct only half of the time. That's really very accurate.



I'M HAVING BETTER RESULTS THAN MOST HIGHLY PAID WALL STREET EXPERTS, AND ALL I GET IN RETURN ARE SOME LOUSY BANANAS!

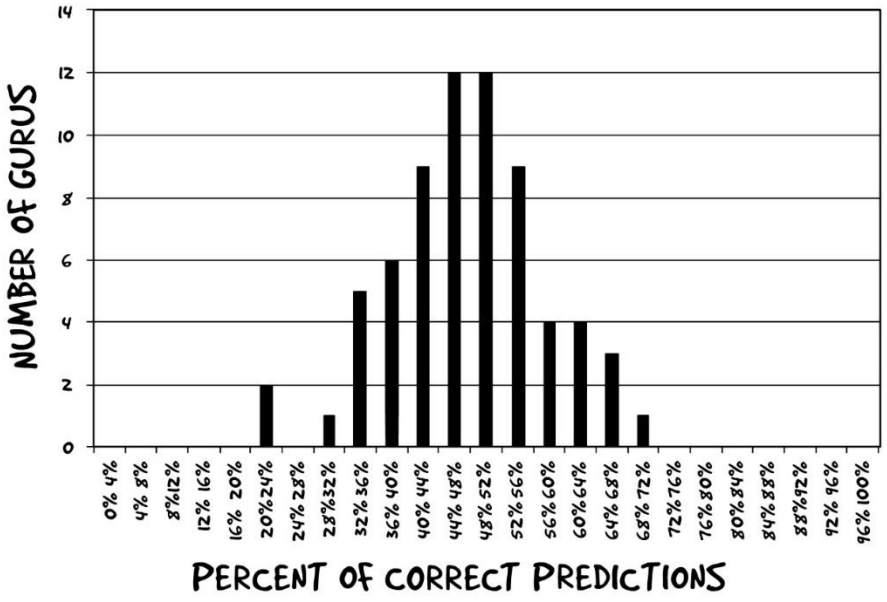
And, my favorite - Robert Prechter, known for his financial forecasts using the Elliott Wave Principle and author of multiple investing books. His score was… wait for it… 20.8%. Now, you really need a lot of bad luck for that.

And the average score across all of their predictions?

Most forecasters were right in the 40% to 60% range, with some deviations to the upper and lower side. So, the best score out of all forecasters was 68.8% and the lowest was 20.8%. That's exactly what you would expect from a random distribution – a typical bell curve.

And the average across all predictions was 46.9%. In less than half of their predictions, they were right. If you would employ monkeys to throw darts (unfortunately octopus doesn't throw darts), they would, on average, fare better than that.

Exhibit 2.6 Guru accuracy



In other words – you can beat these famous investing gurus by just tossing a coin. Assuming that the coin toss is fair, heads and tails are equally likely. And 50% always beats 48%. It's that simple. So, next time you see a famous guru making predictions, simply ignore him or her. He/she just wants to get some media attention and sell some more books or events.

Hmmm… You know what? That might not be a bad idea. If it worked for others, it might work for me, too...

So let's do it!

Drumroll please…

I will predict the price of… let's say oil… for the next 5 years.

Now, this is very demanding challenge. Let me look into my mystic crystal ball that I always keep in my closet. Yes, yes! I see it! I can see more than one path that the future can carve. Make sure to take some notes…

The first scenario that I can see is the price going up. Yes, that's it! There you have the first scenario.

Now, the second scenario. This one is a little fuzzy. But yes, now it's getting clearer! In the second scenario, the price will go down! Oh my god! Did you expect that? I certainly didn't. What a surprise!

And now there is a third scenario. This one is less likely, but still I can see it in the future. So the third scenario is that the price will stay the same.

But wait!!!

Something else is going on in my crystal ball now. I can also see another scenario! There is a big spaceship. And it's firing a huge laser beam directly towards Earth. Looks like the aliens want to make their new hyperspace bypass, and Earth is in their way.

In that case, we won't care what the price of oil will be.

Let me summarize: the fourth Dark Force of Investing is the fortune-telling investing gurus, who give us a false sense of security about where to invest our money. We may think that they have predictive powers but sadly they don't.

Let me end this segment with a warning. Even after all the proof that the predicting abilities of gurus and other domestic or wild animals are zero, I still get a lot of emails asking me what will happen to the price of stocks, gold, some cryptocurrencies and other assets in the next year. And I bet that after this book is published, I will still receive emails like this one:

"Robert, I read your book and I really liked the segment about the predicting abilities of investing gurus. I know that gurus cannot predict what will happen, but still…can you tell me what you think will happen to the price of _____ (insert your favorite asset here) in the next year?"

Some people just don't get it. The only two things that are certain in this world are death and taxes!

Dark Force #5: Using the Wrong ROI Calculation

This next one is a super important one. I have seen many lives ruined because people didn't know about it. And on top of it all, hardly anybody even talks about it in the investing world.

You are probably familiar with the term Return on Investment (ROI). ROI is probably the most important metric in the investing world. In simple terms, ROI measures how much money was made on the investment as a percentage of the purchase price.

For example, let's say that you invested $1,000 in the shares of ABC company. After awhile, the price of the stock went up and you were able to sell the shares for $1,150.

What was your ROI in that case?

To calculate ROI, the return of your investment needs to be divided by your initial investment. After that you just multiply the result by 100 to get a percentage.

$$ROI = \frac{RETURN}{INITIAL\ INVESTMENT} \times 100$$

So in this case $150 divided by $1,000 equals 0.15. And multiplied by 100 equals 15.

Your ROI, in this case, is 15%.

Simple and easy. No secrets there. Every investing book and website will tell you that.

But what if I told you that the ROI calculation is wrong and misleading?

You might think that I've gone nuts.

But give me a moment to explain what I mean. At one of the seminars I attended at the start of my investing career, one of the speakers was selling a stock-trading course. His claims about the ROI we would get with his trading system were bold, but he made it look so easy, so I started to believe him. And even though he charged almost $2,500 for the ticket, I bought it.

Now, I won't tell you the embarrassing part of this story, where I lost a lot of money and almost had a nervous breakdown as a result of attending the course. To save myself the embarrassment, I will use an average Joe as an example.

When the average Joe attends this kind of course, the first thing he finds out is that you need to have special software in order to use the strategies covered in the course. Ok, that's $450 per month, but who cares about that? Isn't financial freedom worth $450 per month?

Now, the second thing Joe notices is that you need to analyze a lot of stocks with the software every day. So he ends up sitting in front of the computer screen for two hours a day, watching boring charts. But as you know, Joe's goal is financial freedom and isn't Joe's financial freedom worth a couple of hours per day?

After a couple of years of learning and trying, Joe is an experienced trader. And even though he lost some money in the first two years, he has finally become profitable in the third year!

He started the year with $20,000 in his account and now he has $24,000. That's 20% ROI and he is ecstatic. He jumps around the house; he tells all his friends about his achievements. Life couldn't be better! But think again.

Don't you have a strange feeling that we forgot about something when doing the ROI calculation?

Of course! You guessed it. There is his initial investment in the course and there is the monthly cost of the software.

You are right. But I think there is another cost that we didn't account for, and it is much greater than the other two.

It's Joe's time.

And there you have it. ROI calculation is misleading and incomplete if you don't account for the time you spend making and managing your investments.

If you spend 10 hours per week for investing, it is a cost. And from my experience, almost nobody accounts for that when they are calculating their ROI.

So what does the real ROI calculation look like?

$$\text{ROI} = \frac{\text{RETURN} - \text{COST OF TIME}}{\text{INITIAL INVESTMENT}} \times 100$$

And that makes investing a totally different ball game!

All of a sudden, you realize that if you spend a lot of time investing, your real ROI is much lower than you thought.

But to calculate the real ROI, we need to know what the value of Joe's time is. You can calculate the value of your time by dividing your personal income by the number of hours worked per year. When you calculate this, you get the value of one hour of your time. Try it out for yourself!

$$\text{VALUE OF TIME} = \frac{\text{PERSONAL INCOME}}{\text{HOURS WORKED PER YEAR}}$$

Let's say that Joe's annual personal income is $50,000. And let's assume that Joe works 1,800 hours per year (U.S. average according to OEDC)[vi].

If we divide $50,000 by 1,800 hours, we get the value of one hour of Joe's time. In this case it's approximately $28 per hour.

If Joe spends 2 hours per day on investing, 200 days per year, that means that he spends 400 hours per year investing.

$$2 \text{ HOURS PER DAY} \times 200 \text{ DAYS} = 400 \text{ HOURS}$$

Let's multiply that by the value of his time ($28 per hour) and we get $11,200. That is the value of the time Joe spent investing in one year.

$$400 \text{ HOURS} \times \$28 \text{ PER HOUR} = \$11{,}200$$

Now, let's put that into the real ROI equation. First we need to deduct the value of the time Joe spent on investing from his return:

$$\$4{,}000 - \$11{,}200 = -\$7{,}200$$

And now we can finalize the equation by dividing that negative number by $20,000.

$$\frac{-\$7{,}200}{\$20{,}000} \times 100 = -36\%$$

That means that the real return is minus 36%.

Joe thought that he made a nice 20% return on investment – but, in reality, he lost 36%.

In the time Joe spent on investing, he could have made money working part-time or setting up a new business. Even flipping hamburgers at McDonalds would have brought in more money than what he did investing!

The fifth Dark Force of Investing is using the wrong ROI calculation. When you account for the time you need to make and manage your investments, your returns often turn negative. That is why not accounting for the cost of time is one of the biggest mistakes I see in the investing world.

Dark Force #6: The Lure of the Shiny Next Big Thing

"If you had purchased $100 of Bitcoins in 2011 you would have more than $200,000 today."

“If you had purchased $1,000 worth of Apple stock in 2003, they would be worth $1 million today.”

“If you had …”

I hear these kinds of claims all the time – in the media, at seminars, in books and on social media. The most disturbing fact is that there are some really smart people, who should know better, making them.

Now, you can’t argue against these claims. They are all 100% true. The problem with them is that they are misleading and are responsible for many ruined financial lives.

The goal of making this kind of claim is to convince people that you know what the next big thing is. So a part of the sales presentation where they ask you to invest in a new cryptocurrency (or any other opportunity) will go like this:

“If you had purchased $100 of Bitcoins in 2011, you would have more than $200,000 now. Our new Magic Returns cryptocurrency is next! A small investment of $1,000 could be worth $50,000 in a couple of years, and, if you invest $5,000, you could pay off your entire mortgage!”

Think about it. When somebody is making a claim like that, isn’t he or she using just a bit of cherry picking? Ask yourself: how many companies in distress (like Apple) were there in 2003, but didn’t make it big, or worse yet, failed in the end?

And how many other cryptocurrencies were there, apart from Bitcoin, that just disappeared?

The answer is hundreds or even thousands, and they all looked the same. So, the probability of choosing the right one was insignificant. Much less than 1%.

When people hear this kind of claim, they often fall prey to the logic error called “survivorship bias.” In the investing world, this is the tendency for failed companies to be excluded from performance studies due to the fact that they no longer exist. In other words, you focus only on survivors and you ignore all the failed companies. That is why survivorship bias can lead to overly optimistic beliefs.

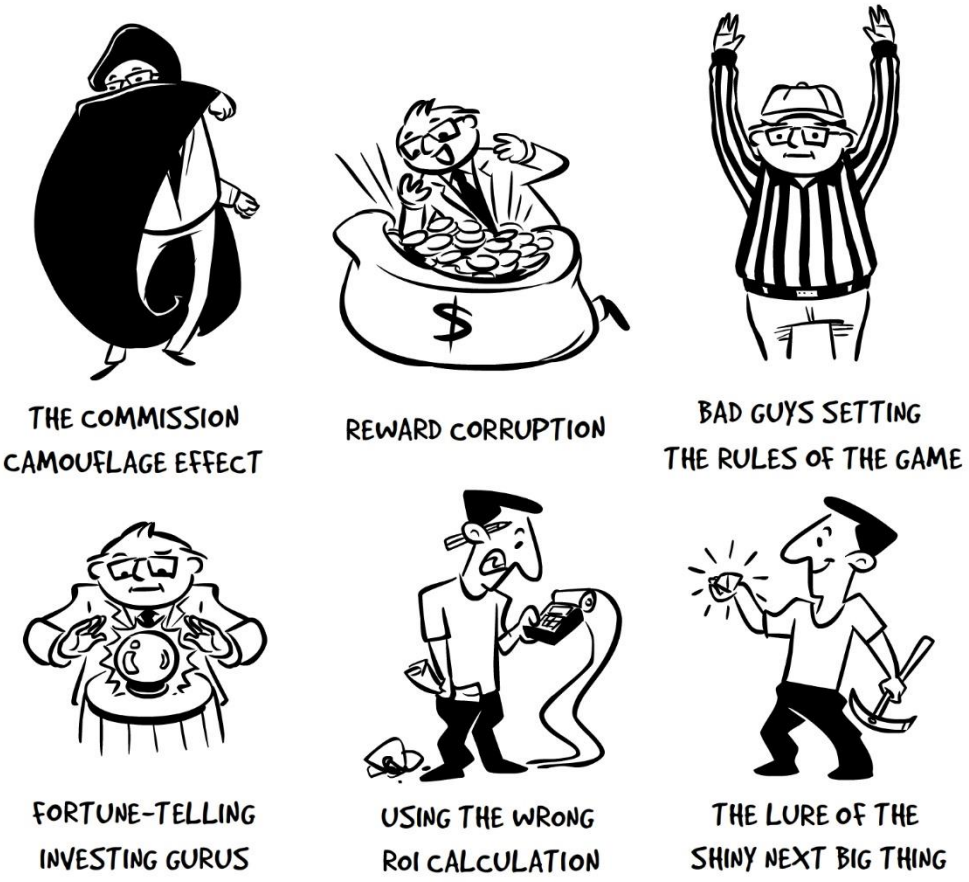
When somebody is making claims like, “If you had purchased…,” he or she is intentionally misleading people into believing that they can pick the next big winner. In other words, it’s a dirty sales technique. Fortunately, you are now immune to this error, because you have read this chapter. Unfortunately, many people have fallen for it.

Investors who read and hear these kinds of claims all the time can get a feeling that it’s normal, and quite probable, to get very high returns on their investments. That is why they try to invest in all kinds of legal and illegal investment opportunities where the seller is claiming that very high returns are possible and even highly probable. And, in most cases, they lose their money.

So the sixth Dark Force of Investing is the lure of the shiny next big thing. People often fall prey to survivorship bias and start underestimating the risks involved with any opportunity that offers high potential awards. They try to catch the next big thing and they lose their money in the end.

If I summarize, before you invest your next dime, pay attention to the Six Dark Forces of Investing. They are out there, trying to get you. So, run away as fast as you can when you spot one.

Exhibit 2.7 The Six Dark Forces of Investing



Now that you are familiar with the *Six Dark Forces of Investing* that prevent you from getting good returns, or even make you lose a lot of money when investing, you are probably asking yourself how to invest successfully.

In the next chapters I will show you exactly how to do it. We will start with the part where most people make the wrong turn right at the beginning of their investing career. And, when they make that mistake, their dreams about financial success in life are basically over - right away.

Notes:

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[i] U.S. Bureau of Economic Analysis (BEA), https://www.bea.gov/

[ii] "5,300 Wells Fargo employees fired over 2 million phony accounts", Money.Cnn.com, September 9, 2016. http://money.cnn.com/2016/09/08/investing/wells-fargo-created-phony-accounts-bank-fees/

[iii] "5 Years Ago Bernie Madoff Was Sentenced to 150 Years In Prison – Here's How His Scheme Worked", BusinessInsider.com, July 1, 2014, http://www.businessinsider.com/how-bernie-madoffs-ponzi-scheme-worked-2014-7

[iv] "Paulson Event-Driven Fund Said to End Last Year Down 36%", Bloomberg.com, January 11, 2015. https://www.bloomberg.com/news/articles/2015-01-11/paulson-event-driven-fund-said-to-end-last-year-down-36-

[v] You can get the complete methodology and results of the study at http://www.cxoadvisory.com/gurus/

[vi] "Average annual hours actually worked per worker", Stats.Oecd.org, https://stats.oecd.org/Index.aspx?DataSetCode=ANHRS