How Much Should I invest?

Estimated time: 3 minutes / Difficulty: Basic

We don't really know how much you should invest. Seriously. Because it depends on a lot of different things, but mostly on you.

Your life, your goals, your personality, your income...we could go on. The point is that there isn't a universal answer.

It's important to consider future investments like your home.

It's true that there are some fancy equations like the Markowitz Portfolio Selection Model that some experts use, but you don't need those to get started. Instead there are some basic ideas and questions you can think through to find your own answer.

In any case, don't think in absolute terms. Most of these are not questions with yes or no answers, and instead are prompts meant to guide you to finding a comfortable range of amounts. For some people that can mean as little as a few hundred Euros, while for others it can mean several thousand or more.

Your Capital

How much capital do you have available to invest?

When we say your capital, we are mostly referring to your savings, although it can include other investments. Having some money to start with, of course, is the first step to investing. So how much do you have saved?

A lot. Enough for emergency expenses and leisure activities. You could lose your job and be okay for a few months, and if your friends invite you to a wedding in Thailand, you go without thinking twice. You have little or no debt. If this is you, then you might be able to invest a considerable amount, although keep reading!

A little. You have a good job and some money in the bank, but you haven't been too dedicated to saving. Traveling, shopping, spending time with friends, unplanned expenses, and well, life, all require money, and you haven't been too focused on counting the pennies. Yet, if you sit down and create a budget, and there are lots of tools and applications for this, you'll build up your savings in no time. You should prioritize this over investing in the short term, but very quickly you will have some extra to invest.

None. Your income barely exceeds your monthly expenses like rent, phone bills, or other basics. This is a tough situation for anyone to be in, but the fact that you are looking for alternatives for making money says a lot about your ambition. You may need to look for ways to cut expenses and boost your income by returning to study or changing your career. For now, you shouldn't invest, and whatever you do, do not borrow money to start investing.

Phase of life

It's a personal question but ... how old are you?

Generally speaking, younger people should invest more in the stock market, while people closer to retirement should invest in more cash or bonds. We'll talk about bonds in the lesson on asset classes.

So why is this the case? It has to do with your investment horizon, or when you need your money. People who are younger will continue working and earning money for many more years, and can afford to invest money for longer. They can also afford to lose money and make more again.

People who will be retiring soon won't have income and will need to begin using their investments to pay for daily expenses. This also means they cannot afford to lose meaningful amounts of money as they won't have the time or income to replace it.

Given these outlooks, if you are younger, you want invest your money where it will grow the most. If you are older, you want to invest where it is safest. This makes investing more heavily in the stock market better for younger people with many working years ahead of them.

As we mentioned in lesson one, the stock market can earn more than your bank account but it does come with risk. You surely noticed in recent years that the stock market can go through ups and downs. We'll discuss the reasons why later on, but if you can afford to wait, you can go through economic downturns and come out ahead on your investments.

Diversification

What else do you own?

Diversification is a topic we'll come back to often, and essentially refers to how your assets or possessions are divided. It's most commonly applied to discuss investment portfolios, something we will soon do, but it also applies to your life.

Looking at your own diversification means measuring how it much it will impact you financially if you lose an asset. If you own a house, a car, a bicycle, and more, when someone steals your bicycle, it won't be such a big deal. It's not one of your most valuable assets and it can be replaced. This means you're fairly diversified. On the contrary, you're not very diversified if you only own a bicycle. It would impact you quite a lot to lose your most valuable possession.

If we add financial assets, like money in bank accounts and 1,000 euros in stock market investments into these examples, the same principles still apply. Someone with plenty of savings, a home, and a car etc., won't be significantly impacted if their investment account of 1,000 euros goes through a down period. This is because it represents only a small portion of their wealth and won't change their lifestyle.

Yet, in the case of someone who has 3,000 euros in savings and a bicycle, putting 1,000 euros into an investment account is significant. Seeing that account decrease could greatly impact their life and change their habits.

We hope the takeaway is clear. Your stock market investments should always be only a part of your total assets, and no more than you can afford to lose or wait for.

Needs

What do you have planned? What will you need money for in the short-term future?

Let's say you have 10,000 in savings, you are young, and you have a good job. You should probably invest right?

Well, maybe, but not so fast. Are you going to buy an apartment soon? Have a baby? Begin university studies? Even though you're young and excited to learn investing, you're probably better off keeping most of your money in cash.

The point is, if you will need cash in the short-term, or your income or expenses is going to change drastically, you cannot really afford short-term risk. Because investments move up and down, you could need money when your investment is in a bad moment, and have to sell for less than you want. Furthermore, many great investments take several years or more to provide profit, so by investing only for a few months, you might not make much money. If the upside isn't so big, then it's better to play safe when you'll need money soon.

You should also consider other aspects, such as whether you will be applying for a bank loan or credit card in the short term. They will consider your cash assets and other loans, and having in investments in the stock market is less helpful for your application.

Risk

Are you a risk taker? Can you afford, financially and emotionally, to lose some money, or at least worry about losing some?

In addition to considering your capital, your phase in life, and your needs, you should reflect on your tolerance for risk.

What risk? Well, we repeat again, the stock market, and individual investments, don't always go up. Sometimes they go down. You can take steps, which we'll talk about, to reduce some of these possibilities, but your investment in the market is never 100% safe.

This means that, unless you have millions of extra euros, investing is an inherently emotional activity. Nobody likes to lose. In fact, we take back what we said. Even people with millions saved have been known to act emotionally and even illegally. In 2001, Martha Stewart, a millionaire many times over, illegally sold shares in a company called ImClone to avoid a $45K loss. She just couldn't stand losing the money!

To put it another way, if you are the kind of person who buys new shoes and doesn't wear them for fear of getting them dirty, you might find investing similarly difficult.

Whether you invest a little or a lot, if you can't handle the risk, it probably won't be fun for you. You might eventually find yourself addicted to checking the news and the ninety nine application constantly, looking for good and bad signs about your stocks.

Yet, if you're not sure how you will handle the risk, there is a way to find out. Start small, and see how you feel.

Conclusion

By now you should have a better idea how to answer the question. It takes sitting down and having a look at your finances and your life plans and needs, which is something we recommend doing anyway, future stock trader or not.

If, after expenses are taken care of, you feel comfortable with your savings and you know what cash needs you'll have soon, whatever is left over could potentially be invested.

But be careful here. This is where you need to consider your risk tolerance and your goals.

Perhaps we can sum it all up. If, after asking yourself all these questions, you still want to try investing, start with an amount you feel comfortable doing without. Then, as you gain confidence and improve your ability, invest an amount you can afford to do without.