10 Things You Need to Do Before You Start Investing

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Over the years, I've answered literally thousands of questions from readers in the weekly Reader Mailbag articles here on The Simple Dollar (these great questions and answers appear every Monday morning), and many of those questions have to do with investments. Readers get excited about the possibility of getting a nice return on their money through investing, so as soon as they have a little bit of cash in hand, they're ready to invest. They want to make their money work for them, and that's completely understandable.

However, **not everyone is in a financial situation where it makes sense to invest in anything more risky than a savings account or a ready-made retirement plan.** People simply see the numbers that a rising stock market is putting out and want to throw all their money in, or else they hear some apocalyptic wannabe guru telling them to invest in gold and they're ready to start putting their money down. Often, these are people who aren't financially ready to invest and don't have the mindset or the knowledge to make it work.

Make no mistake about it, though: **The groundwork needed for investing is something that anyone can achieve with some time and effort.** It just takes a little time, a little learning, and a little bit of self-evaluation.

Here are 10 things that you really should do before you even consider investing in anything beyond your savings account or your retirement plan.

1. Your Net Worth Needs to Become the Primary Personal Finance Number You Care About

First of all, what exactly is “net worth”? Net worth simply means the total value of everything you own – your home, your car, any valuables that could easily be resold, and the balances of your checking account, savings accounts, and any investments you have – minus the total of any and all debts you have – mortgage, credit cards, student loans, and so forth. So, if I owned a house worth $100,000 and a car that I could sell for $10,000 but I had $50,000 in student loans (and no other debts), my net worth would be $60,000.

More than anything else, **your financial focus should be on this number and how you can make it bigger.** There are a lot of ways to make it bigger: paying off debts, not spending money on foolish or wasteful things, improving your income, and, yes, investing.

This might seem like an obvious thing, but it’s not. At an earlier stage in my financial life, my primary focus was on *my checking account balance*. Did I have enough to make ends meet for the month? How much money did I have left over to just spend on whatever comes to mind?

The best way to sum up the transition is that focusing on your checking account is a very short-term perspective, while focusing on your net worth is decidedly a long-term perspective. If you don’t have a long term perspective about things, you shouldn’t be investing, and if you find your checking account balance to be more important and compelling than your net worth, you don’t have a long-term perspective yet.

You need to focus on the long term before you start investing.

2. You Need to Pay Off All of Your Credit Cards and Other High-Interest Debts

If you have high-interest debts – anything above, say, an 8% interest rate – there is absolutely nothing better you can be doing with your money than to pay down that debt. There is no investment that offers anything approaching a stable long-term return that beats what you'll save from paying off your credit cards.

Think of it this way: Making an extra payment on a credit card with a 15% interest rate is functionally the same as making an investment that returns 15% per year *after taxes*. If you pay off $100 of that balance, that's $15 in interest charges that you don't have to pay *each year* until the card is paid off. There is no investment out there that can even come close to that with any consistency.

Not only that, paying off your credit card will have an immediate positive impact on your net worth *and* it will cause your net worth to start climbing steadily because it's not being held back by interest payments and finance charges.

Not only *that*, getting rid of your debts means fewer monthly bills, which means that you'll immediately have more money to invest with than ever before.

It's simple: **If you have high-interest debts, you should be paying those off as your highest priority, far above any sort of thoughts about investing.** Not only will they offer you a better return than any investment, paying them off will rapidly improve your net worth *and* it will improve your monthly cash flow. This is your first step. Take charge of it.

3. You Need to Eliminate Most of Your Worst Personal Spending Habits

When I look at my finances each month, I tend to look at it as a pile of income from which I have expenses that subtract from that income. What's left is a much smaller pile. I call it "the gap" – the difference between my income and my spending. That "gap" is the money that I can use to invest. Naturally, I want that "gap" to become bigger so that I have more to invest, which means I'll be able to reach my goals sooner than before!

When it comes down to it, there are really two ways to effectively increase your "gap." You can either spend less money or earn more money. I could write endlessly about methods of earning more money – getting a better job, getting a raise, starting a business – but I'm actually going to focus on the spending part of the equation because that's something you can take direct action on right *now* and see results almost immediately.

The thing is, most people get an immediate bad taste in their mouth when they consider cutting their spending. And they *shouldn't*. The reason people get that negative reaction is because they initially think of the spending that they *care the most about* and they don't *want* to cut it. They

think about money spent on slightly extravagant meals with good friends. They think of the last hobby item they bought that they really enjoyed. The idea of cutting those things seems terrible.

And it *is* terrible. Those aren't the things you should be cutting.

What you should be cutting are the forgettable things, the purchases you won't remember in a day, the things that are just quietly purchased and quickly forgotten. A drink at the convenience store. An extra item tossed in the cart at the grocery store. The digital item bought on a whim, enjoyed once, and then forgot about. The latte consumed without thought or real pleasure in the morning. Those are the things you should be cutting, the things you won't remember a day after you spend them.

Watch for those things. Be on guard for them. When you see yourself about to thoughtlessly spend money on something that doesn't really matter, stop yourself. Don't spend that money. Cut that purchase from your life. Focus on eliminating whatever routine that brought you to the point of making that thoughtless purchase.

Do that throughout your life and you'll find yourself spending a lot less money on unimportant things, which frees up a lot more money for investing.

4. You Need to Establish a Cash Emergency Fund

Like it or not, life sometimes intervenes in the best laid plans. You might have a great investment plan, but what happens if you lose your job? What if you get sick? What if your car breaks down?

In those situations, many people turn to credit cards, but credit cards aren't the best solution. They don't help you with identity theft problems at all. If you're struggling financially, banks can sometimes cancel the cards. Not only that, even if everything goes well, you still have a new debt to contend with which can still upset your plans.

That's why I encourage anyone who is investing to have a healthy cash emergency fund stowed away in a savings account somewhere. It's there solely to ensure that life's emergencies don't upset your bigger financial plans.

I'm an advocate for what I call the "perpetual" emergency fund. Set up an online savings account somewhere with an online bank of your choice (I like Ally and Capital One 360) and then set up an automatic weekly transfer from your primary checking into that account for some small amount that won't kill your budget but will build up reasonably rapidly.

Then forget about it. Let the cash build over time. Then, whenever you need some money for an emergency – a job loss or something else – transfer money back into your checking. I recommend never turning off the transfer; if you find that the balance gets too high for your tastes, take some money out of the account and invest it.

That's the system I personally use and it works like a charm.

5. You Need to Figure Out What Your Big Life Goals Are

One of the key principles of investing is to never invest without a purpose. There are many reasons for that, but the big one is that without a specific purpose in mind, you can't really assess your timeframe for investing and how much risk you're willing to take on, both of which are *vital* questions when it comes to investing.

Take the stock market, for example. It's very volatile, meaning that there is significant short-term risk in an investment in the stock market. However, over the long haul – decades, in other words – the stock market tends to gravitate toward a fairly stable 7% average annual return. You just have to be in for the *long term* for stability.

Thus, if you have a short-term goal, investing in the stock market makes little sense. However, if you're investing for the long term, it can be a great avenue for you.

All of this thinking should start with your own personal goals. Why are you investing? What are you hoping to do with this money? Are you hoping to become financially independent and live off the returns? That's a long-term goal, so stock investing might make sense. On the other hand, maybe you're investing to buy or build a house in a few years. In that case, investing in stocks probably isn't the best idea, since you'll need the money reasonably soon.

What's your goal? Why are you doing this? Figure that out before you invest a dime.

6. You Need Your Spouse to Be on Board with Your Plans

If you're married, any investment plan you take on should be discussed in full with your spouse. That discussion needs to cover at least three key points.

First, *what is the goal?* Why exactly is this investment plan going to happen? What are we hoping to achieve?

Second, *what is the plan?* How exactly are we investing to achieve this goal? Do the investment choices make sense? Where are the accounts and whose name is on them?

Finally, *is this something we both agree on?* Is the goal something that we both value? Is the plan something that matches our values while also achieving the goal?

If you don't have this conversation with your spouse before you start investing, you're begging for trouble down the road, trouble that can start as soon as your spouse notices the money vanishing into an investment account.

7. You Need a Healthy Understanding of Your Investment Options

Another important step before you invest is knowing what different investment options are available to you and how to interpret them. Do you know the basics of what stocks and bonds and mutual funds and ETFs and index funds and precious metals and real estate are? Do you know how to compare two similar investments to each other? You need those skills before you begin to invest.

If this is something you're unsure about, I highly recommend picking up an investing book and giving it a full readthrough before making any investment moves at all. My personal recommendation for a really good all-in-one investment book is *The Bogleheads' Guide to Investing* by Larimore, Lindauer, and LeBoeuf. It is a spectacular one-volume book on investing in how it connects real-life concerns and goals to investment options and explains how different options work and meet those various concerns and goals.

Even if you plan to have an investment advisor handle your investing, you should still take the time to understand the things that your money is going to be invested in. Simply trusting someone else to handle it is usually a bad move.

8. You Need to Have a Bank That Handles Online Banking and Automatic Transfers with Ease

This should be a given for most people today, but it needs to be mentioned. Before you start investing, your bank should be equipped to make it easy to do online banking and to set up automatic transfers both to and from the bank quite easily. If your bank doesn't offer these services, look at another bank.

The reality is that most banks today offer these things. Robust online banking is nearly a standard today, as are automatic transfers to and from checking accounts. Banks that don't offer these features are intentionally making themselves obsolete.

Why are these features so important? For starters, you're going to need to make automatic transfers if you want to set up a regular investing plan of any kind. Automation is a big key to investing success – you want your plan to basically run on autopilot. You're also going to want to be able to check regularly and make sure that money is being transferred out of your accounts, which you'll need online banking for in order to make it convenient.

If your bank makes any of this difficult, start shopping around for another bank.

9. You Need a Social Circle That's More Supportive of Smart Financial Moves Than Excessive Spending

While it's absolutely vital that you switch to a mindset that's focused on net worth and positive toward smart financial moves, you should also keep in mind that you are strongly influenced by your immediate social circle as well. If they're not committed to those things, it's going to be substantially harder for you to make those kinds of commitments.

Look at your social circle. Who are the people you see most often, particularly outside of work when you have the freedom to make those choices? Are those people financially minded? Do they make smart spending choices? Or are they constantly buying new things and talking about their latest purchases?

If you find yourself in a social circle that doesn't ever consider smart personal finance and is constantly talking about the latest things and bragging about their latest expenditures, you should *strongly* consider shifting your social circle. Spend some of your free time at gatherings of people with a stronger financial perspective. Look for an investing club on Meetup, or simply explore other friendships with people you might not have ever hung out with before. You'll build some new relationships over time, ones that are supportive of positive financial progress.

10. You Need a Healthy Relationship with Your Wants and Desires

This is the final strategy for getting ready for investing and it's a big one. You need to have a strong grip over your wants and desires. You need to rule them; they shouldn't be ruling you.

It's inevitable to want things sometimes. That's human nature. We see tasty foods, delicious wines, items related to our hobbies and interests, and we want them.

The question is, what do we do then? Do we go ahead and buy that item as soon as reasonably possible? Do we put up the facade of thinking about it for a while before buying? Or are we patient with that desire, giving the impulse plenty of time to fade away before deciding that this is worth paying attention to?

Impulse control is one of the most powerful tools that an investor can have in their toolbox, and one of the most obvious ways that you can see whether you have it or not is when you're considering purchases that you desire. Do you have the self-control needed to avoid giving in to every momentary want and desire? If so, you'll not only find it easy to have the resources you need to invest, you'll also find it easier to have the self-control needed to tolerate the ups and downs of the market.

Final Thoughts

I’m often astonished at how many people want to dive into investing without having the things on this list well in hand. They’re making a mistake, whether they want to hear it or not.

Of course, I do understand *why* people want to start investing. They hear all of the positive spin on investing on channels like the Fox Business Network and CNBC. They get excited about the possibility of getting a big return on their money. They hear constantly about how the stock market went up 1% today and really want to get on board with those kinds of gains.

There’s always a catch, though, and the catch is that if you don’t have your foundation in order, any building you assemble is just going to crumble right to the ground.

Get your foundation in order. Follow these ten steps and be prepared for investing. Get started on the right foot and you’ll never stumble.

Good luck.