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Sustainable Architecture for Finance in Europe (<https://safe-frankfurt.de/>)

SAFE Finance Blog

Rules of Thumbs for Private Investors

01/24/2017

Guidelines for decision making / Opinion piece in Frankfurter Allgemeine Sonntagszeitung on 22 January



In an opinion piece in the weekly newspaper “Frankfurter Allgemeine Sonntagszeitung”, Andreas Hackethal (<https://safe-frankfurt.de/de/forschung/wissenschaftler/details/showauthor/109-hackethal.html>), Professor of Finance, points out the importance of rules of thumbs for private investors. Hackethal quotes four guidelines which could help in decision making and in checking plausibility of investment advice.

Hackethal highlights diversification over a number of different instruments as one of the major rules for investing in securities. Assets should be allocated in equal shares in accordance with the so-called 1/n-rule. For example, if investors can choose among ten investment funds, they should put one tenth of their

money in each of them.

With regard to the optimal portion of stocks, Hackethal recommends to stick to the 100-minus-age rule (investor's age minus 100). With increasing age one's investment horizon declines and risk-bearing capacity decreases. The present value of future work income shrinks with growing age, because there are less working years to come. Therefore, investors should reallocate their capital from risky to less risky assets. "Workers with safe incomes, like young civil servants, should invest the major share of their money in stocks – keeping a cash reserve of three month," Hackethal recommends.

For dissaving in higher age Hackethal presents the so-called four-percent-rule: People can spent up to four percent of the total financial assets, which they have saved until retirement, on a yearly basis. For example, total assets of EUR 600,000 result in an annual pension of EUR 24,000 and a monthly pension of EUR 2,000. However, Hackethal concedes that this rule of thumb does not apply if workers retire early or exceed average life expectancy.


"Rules of thumbs can be dangerous if the individual case differs from the average or if they are followed blindly or unconsciously," Hackethal concludes. "However, applied cautiously they can provide a valuable estimation."

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Contact

Leibniz Institute for Financial Research SAFE

Theodor-W.-Adorno-Platz 3
60323 Frankfurt am Main

Phone: +49 69 798 30080
Fax: +49 69 798 30077
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