



Farm Creek Securities, LLC
Farmcreeksecurities.com
fc@farmcreeksecurities.com
89 Roton Avenue, Rowayton, CT 06853
(203) 838-1025

The Sound Investor Series #15

How Much Money Do You Need to Start Investing?

Ed Hynes, CFA

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New investors often ask how much money they need before they start investing. There is no one right answer, but investing with less than \$1,000 is fairly difficult. At \$1,000 you can open an account at a few, but not that many, brokerage firms. With about \$3,000, more firms will be happy to do business with you, but as I discuss below, watch out for the fees.

There are two primary avenues investors can use to invest. The most common is by opening a brokerage account at a registered broker-dealer. The other is to deal directly with a mutual fund company such as Vanguard or Fidelity.

With a brokerage account, investors can direct their broker-dealer to buy and sell various securities such as individual stocks, bonds and most mutual funds. While brokerage accounts allow investors substantial flexibility, they often have charges such as an annual maintenance fee if the account balance is small.

For instance, it is common for brokers to charge annual maintenance fees of \$25 or more on accounts with less than \$25,000. If you have \$5,000 invested, that \$25 comes out to 0.5% a year, which is a fair amount to pay every year.

For investors with a modest amount of money, opening an account directly with a mutual fund company is probably the best bet. You will be limited to investing only in their funds, but you can avoid maintenance and inactivity fees.

In my opinion, one of the best fund companies is Vanguard Group (Vanguard.com). Vanguard is a leader in low-cost index funds and with \$3,000 you can open an account and invest in any of their funds. And even if you do not do anything else for years, you won't get nicked and dimed to death by fees.

Even considering the fees, some investors may decide to go the brokerage account route. One possible benefit is the additional attention from a broker. Depending on the firm, the broker might review your account once a year and contact you with suggestions.

No matter which route you take, hopefully you will be adding to your investments over time and it is important to consider those costs as well.

When you invest additional money in most mutual funds, the costs are very low. And it does not matter if the funds are held in a brokerage account or if you are dealing directly with the fund company.

However, if you have a brokerage account and want to buy securities like stocks or Exchange-Traded Funds (ETF) when you add money, you will probably have to pay a commission. And the level of commissions you pay should partly determine how much additional money you need before you add to your investments.

For example, if a broker charges a minimum of \$25 a trade, you certainly do not want to add money every time you save \$100. The \$25 would be 25% of your investment and that is a huge waste.

Even at Farm Creek, where we charge \$15 a trade, clients are recommended to invest at least a \$1,000 each time they trade. I hate to see investors waste money and at \$1,000, the \$15 still comes out to a hefty 1.5%. With larger trades, the \$15 quickly becomes less of an issue. For a \$5,000 investment, the \$15 fee drops to only 0.3% of the investment.

In summary, new investors need about \$3,000 to start investing efficiently. And since fees can severely impact a small portfolio, these investors need to be especially careful. My recommendation to most small investors is to start with Vanguard and invest in their low-cost index funds.

Finally, I would like to ask and encourage readers to send their investment questions and comments to me at ed@farmcreeksecurities.com. I look forward to hearing from you.

Ed Hynes, CFA, is President of Farm Creek Securities, LLC based in Rowayton, CT. (203) 838-1025. This series of articles is available at farmcreeksecurities.com. Before putting money in any investment, you should carefully consider your investment objectives; and the risks, charges and expenses of any investment. Past performance is not an indication of future performance and there are risks to investing including the loss of principal.

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