

Module 3: Investing & Wealth Building

Financial Freedom Blueprint

Lesson 3.1: Index Funds and Passive Investing Basics

Most people shouldn't pick individual stocks. Index funds give you instant diversification, low fees, and historically strong returns with minimal effort.

What Is an Index Fund?

A mutual fund or ETF that tracks a specific market index (S&P 500, Total Stock Market, etc.). Instead of trying to beat the market, you own a small piece of all of it.

How it works:

- S&P 500 index fund owns stock in 500 largest US companies

- You buy one share of the fund = small ownership in all 500 companies

- When the index goes up, your investment goes up proportionally

- When companies pay dividends, you receive your share

Why Index Funds Win:

Low Fees:

- Average expense ratio: 0.03-0.10% (vs 1-2% for actively managed funds)
- Over 30 years, 1% higher fee can cost you 25-30% of your final balance
- \$10,000 invested for 30 years at 7% return = \$76,000 with 0.05% fee, \$60,000 with 1% fee

Diversification:

- Own hundreds or thousands of companies instantly

- One company's failure barely impacts your portfolio
- Reduces risk dramatically compared to individual stocks

Performance:

- Over 15+ year periods, 85-90% of actively managed funds underperform their index
- S&P 500 has averaged 10% annual return over last 100 years
- You get market returns without trying to beat them

Best Index Funds for Beginners:

US Total Stock Market:

- VTI (Vanguard), ITOT (iShares), SCHB (Schwab)
- Owns 4,000+ US companies (large, mid, small cap)

- Expense ratio: 0.03%

S&P 500:

- VOO (Vanguard), SPY (SPDR), IVV (iShares)
- Top 500 US companies
- Expense ratio: 0.03-0.09%

International Stocks:

- VXUS (Vanguard), IXUS (iShares)
- Diversification beyond US market
- Expense ratio: 0.05-0.11%

Recommended allocation for beginners:

- 60% US Total Stock Market (VTI)
- 30% International (VXUS)
- 10% Bonds (BND) — for stability

Lesson 3.2: Retirement Accounts (401k, IRA, Roth)

Tax-advantaged accounts are the #1 wealth-building tool. Use them before taxable investing.

401(k) / Employer Plan:

What it is: Employer-sponsored retirement account with tax advantages.

Contribution limit (2026): \$23,000/year (\$30,500 if 50+)

Key features:

- Pre-tax contributions (reduces taxable income now)
- Tax-deferred growth (no taxes until withdrawal)
- Employer match (free money — always take the full match)
- Withdrawals taxed as ordinary income in retirement

The Match Strategy:

- Always contribute at least enough to get the full employer match
- Example: 50% match up to 6% of salary → contribute 6% minimum
- Skipping the match is leaving free money on the table

Vesting: Some employers require you to stay X years to keep their contributions. Check your plan details.

Traditional IRA:

What it is: Individual retirement account you open yourself.

Contribution limit (2026): \$7,000/year (\$8,000 if 50+)

Key features:

- Tax deduction on contributions (if income below limits)
- Tax-deferred growth
- Withdrawals taxed as income in retirement
- No income limits for contributions
- Income limits for tax deduction (phase out at \$78K-\$138K for single, \$125K-\$208K for married in 2026)

When to use: If you don't have a 401(k), or as a supplement after maxing 401(k).

Roth IRA:

What it is: Individual retirement account with different tax treatment.

Contribution limit (2026): \$7,000/year (\$8,000 if 50+)

Key features:

- Contributions are after-tax (no deduction now)
- Growth is completely tax-free
- Withdrawals in retirement are tax-free
- Income limits: \$150K-\$165K single, \$236K-\$246K married (2026)

Why Roth is powerful:

- Tax-free growth for decades
- No required minimum distributions at age 73

- Flexible withdrawals of contributions anytime (not earnings)
- Great if you expect higher tax rates in future

Account Priority Order:

1. 401(k) up to employer match (free money)
2. Pay off high-interest debt (anything above 7% interest)
3. Max Roth IRA (\$7,000)
4. Max 401(k) beyond match
5. Taxable investment account (no limits)

Lesson 3.3: Building a Diversified Portfolio

Diversification reduces risk without sacrificing returns. It's the only "free lunch" in investing.

The Three-Asset Framework:

Stocks (Equities):

- Ownership in companies
- Higher long-term returns (historically 10% annually)
- More volatility (can drop 30-50% in bad years)
- Best for: Long-term goals (10+ years)

Bonds (Fixed Income):

- Loans to governments or corporations
- Lower returns (3-5% historically)

- More stable, especially during stock market crashes

- Best for: Stability, near-term goals, capital preservation

Cash / Equivalents:

- Savings accounts, CDs, money market funds

- Lowest returns (4-5% in 2026 high-yield savings)

- Zero volatility, instant access

- Best for: Emergency fund, short-term goals (under 2 years)

Sample Portfolios by Age:

20s-30s (Aggressive):

- 90% stocks (70% US, 20% international)

- 10% bonds

- Long time horizon, can ride out volatility

40s (Moderate):

- 70% stocks (60% US, 10% international)

- 30% bonds

- Starting to think about retirement timeline

50s (Conservative):

- 50% stocks (40% US, 10% international)

- 50% bonds

- Approaching retirement, protecting gains matters more

60s+ (Very Conservative):

- 30% stocks
- 70% bonds and cash
- Need to preserve capital and generate income

Rebalancing:

Once a year, adjust back to target allocation. If stocks did well and now represent 75% of portfolio (target was 70%), sell some stocks and buy bonds to get back to 70/30.

Most brokerages offer automatic rebalancing. Set it and forget it.

Lesson 3.4: Real Estate and Alternative Investments

Once you've maxed retirement accounts, consider alternative investments for further diversification.

Real Estate Investing Options:

Your Primary Home:

- Forced savings through mortgage paydown
- Appreciation (though not guaranteed)
- Tax benefits (mortgage interest deduction)
- Not a great investment compared to stocks historically, but provides housing

REITs (Real Estate Investment Trusts):

- Companies that own/operate real estate
- Trade like stocks, highly liquid
- Pay high dividends (required to distribute 90% of income)

- Start with VNQ (Vanguard REIT ETF) or SCHH (Schwab)

- Best for: Passive real estate exposure, small amounts

Rental Properties:

- Direct ownership and management
- Cash flow + appreciation + tax benefits
- Requires capital (\$30K+ for down payment, closing, repairs)
- Time-intensive (tenants, maintenance, vacancies)
- 10-15% annual returns possible but not passive

House Hacking:

- Buy multi-unit property, live in one unit, rent others

- Other units' rent covers your mortgage

- Live nearly free while building equity

- Great for first-time investors

Other Alternatives:

Target Date Funds:

- One fund that adjusts allocation as you age
- Example: "Target 2050 Fund" for someone retiring around 2050
- Set-and-forget option for hands-off investors
- Expense ratio: 0.08-0.50%

Commodities / Crypto:

- Gold, silver, Bitcoin, etc.
- High volatility, speculative
- Limit to 5% of portfolio (if any)
- Don't invest what you can't afford to lose

Peer-to-Peer Lending:

- Lend money to individuals or small businesses
- Platforms: LendingClub, Prosper
- 5-10% returns possible but high default risk
- Limit to 5% of portfolio

The Core Strategy:

For 90% of people, maxing out tax-advantaged accounts with low-cost index funds is the optimal strategy. Real estate and alternatives are supplements, not replacements.

Wealth is built through: Time in market + Consistent contributions + Low fees + Diversification. Not through picking hot stocks or timing the market.