MIND your MONEY

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MIND your MONEY

Smart investing@your library ®

- Practical Steps to Building Wealth
- Net Worth & Basic Investment Options
- **Principles of Investing**
- Creating and Managing a Portfolio

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Diversify

- Don’t put all your eggs into one basket.

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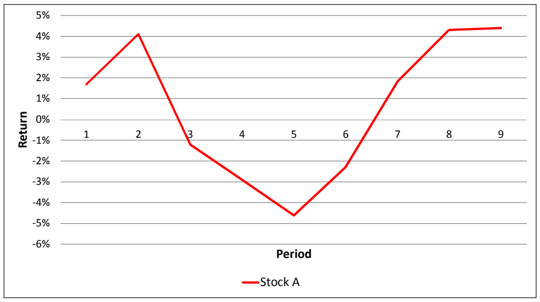
Stock A's return



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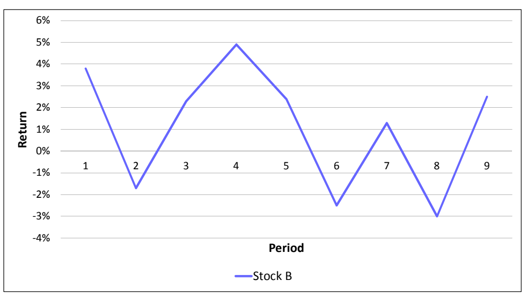
Stock B's return



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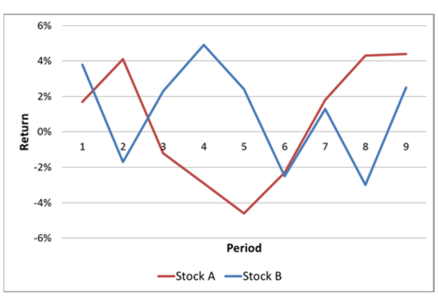
Stock A and B returns



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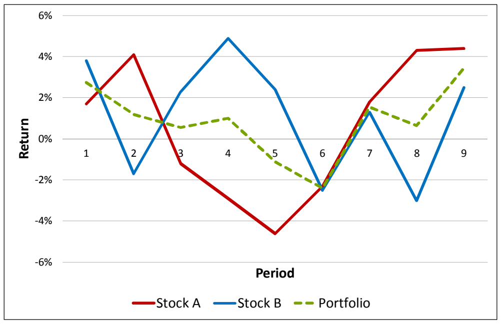
Portfolio return



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Standard deviations of annual portfolio returns

Average Standard Deviation of Annual Portfolio Returns	(2)
1 23.93%	49.24%
50	20.20%
100	19.69%
300	19.34%
500	19.27%
1,000	19.21%

Number of Stock
in Portfoli

These figures are from Table 1 in Meir Statman, "How Many Stocks Make a Diversified Portfolio?" *Journal of Financial and Quantitative Analysis* 22 (September 1987), pp. 353–64. They were derived from E. J. Elton and M. J. Gruber, "Risk Reduction and Portfolio Size: An Analytic Solution," *Journal of Business* 50 (October 1977), pp. 415–37.

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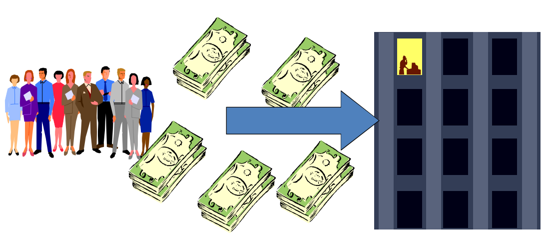
Mutual funds



Pool money from investors with similar goals

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Why invest in mutual funds?

- Instant diversification
- Level the playing field between professional and individual investors
- Clear objectives
- Share administrative expenses
- Liquidity
- Minimal transaction costs
- Convenience

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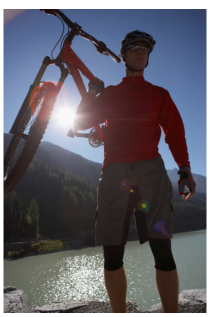
Types of mutual funds



- Money market mutual funds
- Stock mutual funds (U.S. and international)
- Fixed income funds
- Asset allocation funds
- Real estate investment trusts
- Life cycle (target date) funds

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Making money with mutual funds

- Mutual funds own money market securities, bonds, stocks, etc.
- Mutual fund shares increase in value as securities in mutual fund increase in value
- Dividends or interest are reinvested into more shares

The costs of mutual funds

- **Loads –** sales commissions charged to the investor
- **Management fees and expenses** – fees associated with the operation of the company
- **12b-1 fees** – annual fees charged to cover the fund's cost of advertisement and marketing

Actively-managed vs index funds

- Index funds
  - S&P 500, Wilshire 5000, Russell 3000
- Actively-managed funds
  - Large-cap value funds, emerging market equity
- Which performs better on average?

Mutual fund information

- Morningstar
- FINRA (Financial Industry Regulatory Authority)
  - http://apps.finra.org/fundanalyzer/1/fa.aspx
  - Find mutual funds and compare their performance and cost.

Exchange traded funds (ETF)

- Security that tracks an index
- Trades throughout the day
- Buy and sell through brokerage account
- "Spider"

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Tax-sheltered investing

- Retirement
- Education

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Tax-sheltered retirement options

- Options available through employer
- Options available outside employer

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Through your employer

- 401(k), 403(b), 457
- Profit Sharing

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401(k), 403(b), 457 plans

- Employer-sponsored savings plan
- Employee contributions are made by payroll deduction – a 'deferred' compensation plan
- Many companies pay a matching contribution into the employee's account

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401(k) matching

- Companies usually match a percentage of each dollar contributed up to a given percentage of the employee's total pay.
- Let's say your company matches 50¢ for each dollar you pay in, up to 5% of your yearly salary.
- If you make $30,000 and you pay in 10% of your salary, you save $3,000 per year and you avoid $750 in taxes (at a 25% effective rate). Your company will match up to 5% of your salary, or $1,500.

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401(k) matching

- If you make $30,000 and you pay in only 5% of your salary, you save only $1,500 per year and avoid only $375 in taxes (at a 25% effective rate). Your company will match 50¢ of each dollar you save, up to 5% of your salary, or only $750.
- How much free money do you give up by saving 5% of your salary instead of 10%? $750 every year!
- How much free money do you give up if you don't save in the 401(k)? Up to $1,500 every year!

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Growth of $100 monthly contribution to 401(k) with $100 employer match

Number of years	Amount you contribute	Amount with match	Contributions plus 5% growth	Contributions, matches, plus 5% growth
5	$6,000	$12,000	$6,800	$13,601
10	$12,000	$24,000	$15,528	$31,056
15	$18,000	$36,000	$26,729	$53,458
20	$24,000	$48,000	$41,104	$82,207
25	$30,000	$60,000	$59,551	$119,102
30	$36,000	$72,000	$83,226	$166,452

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401 (k) basics

- Individual stocks and bonds, including company stock
  - RESIST THE TEMPTATION
- Mutual funds.
  - Employees are offered several funds to choose from, with varying levels of risk and diversification.
  - Employees may move money between funds to increase returns or reduce risk.

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401 (k)…remember

- The account earns interest tax free until you withdraw the money.
- If you withdraw the money before age 59 ½ , you will pay a fairly severe penalty.
- Only invest money for retirement, and don't plan on accessing this money any sooner.

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Profit sharing

- In some companies, a portion of the year-end profits are divided among employees
- You do not invest your own money
- Like a yearly bonus

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Non-employer tax-sheltered retirement plans

- Traditional IRA
- Roth IRA
- Keogh plan
- SEP-IRA

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Traditional versus Roth IRAs

- Traditional
  - You pay taxes on investment gains and your initial contributions when you withdraw the money
- Roth
  - You pay taxes on your IRA deposits when you make them but pay no taxes on the gains when you withdraw the money

http://www.irs.gov/Retirement-Plans/Traditional-and-Roth-IRAs

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Small business plans

- Keogh plan – self-employed full-time or part-time, for self or employees, tax deferred
- Simplified employee pension plan (SEP-IRA) – like Keogh aimed toward small businesses usually with no employees

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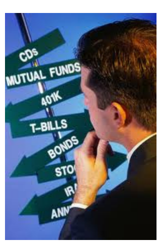
Investing in non-employer plans

- Same as before
  - Money market mutual funds
  - Stocks
  - Bonds
  - Mutual funds
  - Real estate
  - Other



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Remember Cliff and Sarah?

Cliff:

- By the time he stopped putting in money at age 30, Cliff would have around $37,000.
- By the time he retires at age 65, his $24,000 investment would have grown to $596,128.

Sarah:

- Sarah would contribute $200 a month for 35 years— a total of $84,000
- When Sarah retires at age 65, her investment (at 8% return) would have grown to $458,776

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Tax-sheltered education plans

- 529 Plan
  - Prepaid tuition plan versus college savings plan
  - Pay no taxes on the gains on savings used for education
  - Set up by the states and not restricted to Alabama's plans
- Coverdell Education Savings Accounts
  - College and K-12
  - Pay no taxes on the gains on savings used for education

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Resources for tax-sheltered education investing

- http://www.irs.gov/uac/529-Plans:-Questions-and-Answers
- http://www.sec.gov/investor/pubs/intro529.htm
- http://www.savingforcollege.com/college_savings_101/
- Alabama 529 Plan
- http://www.collegecounts529.com/planbenefits.asp
- FINRA expense analyzer http://apps.finra.org/investor_Information/Smart/529/Calc/529_Analyzer.asp

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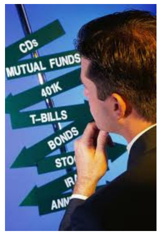
Investing in education plans

- Same as before
  - Money market mutual funds
  - Stocks
  - Bonds
  - Mutual funds
  - Real estate
  - Other



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Investing on your own

- Open a brokerage account
  - Buy individual securities or mutual funds
  - Check out a broker at FINRA http://www.finra.org/Investors/ToolsCalculators/BrokerCheck/
- Go to a mutual fund site
  - Buy mutual funds
- No special tax advantages or tax penalties
  - Pay taxes on interest, dividends, and capital gains
- Watch the fees and commissions!

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Let's review!

Diversify to reduce risk!

- Mutual funds give instant diversification.
- Invest to reach your goals.
  - Use employer and non-employer retirement accounts to reduce taxes.
  - Use employer retirement matches to the maximum.
  - Use tax-sheltered methods for education savings.
  - Invest on your own to add to your savings.

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Your money tools

- Ballpark E$timate for Retirement
- Financial Tasks Check Sheet

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Next lesson

Creating and Managing Your Portfolio

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