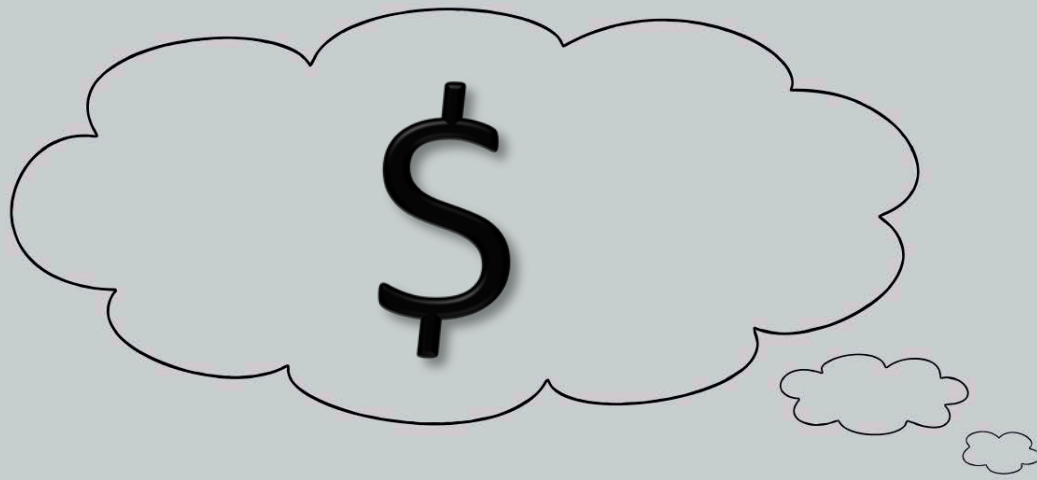


Financial Psychology





Financial Psychology

In this unit you will develop an understanding of how your financial psychology relates to achieving your financial and lifestyle goals. You will explore these concepts by looking in-depth at how your personality, goals, dreams, and emotions can affect your attitude toward money.

The Most Important Thing

Warm-Up Activity

Take a moment to reflect on the following quote:

“Money frees you from doing things you dislike. Since I dislike doing nearly everything, money is handy.” ~*Groucho Marx*

Lesson Activity: Money Motivation

BELIEF STATEMENT: I believe the most important thing money can buy is _____

THE BEN FRANKLIN CLOSE

Reasons For	Reasons Against

The Most Important Thing

Lesson Questions

1. What is the most important factor determining your overall financial success?
 - a. Your current net worth.
 - b. Accumulation of material goods.
 - c. Developing financial skills.
 - d. Freedom from want.
2. Which of the following supports your motivation to acquire money and attain your financial goals?
 - a. Your dreams and personal goals.
 - b. Graduating from school.
 - c. Living without negative emotions.
 - d. Living without stressors.
3. What is motivation?
 - a. The drive to do something.
 - b. Drive to do nothing.
 - c. Lack of energy.
 - d. None of the above.

Essential Questions

What motivates you to get money? _____

Why do these things motivate you to obtain money? _____

How does your motivation affect your desire to earn money? _____

Can your motivation for money affect your wants and needs in life? _____

Goals

Warm-Up Activity

What is a goal? _____

What is the difference between goals and dreams? _____

A dream exists only in your head. Think of your dream as a target. Unless you shoot an arrow toward that target, you'll never hit it. Dreams are your ideas of success; goals define the action you must take in order to make dreams real. Goals are expressions of your personal dreams about your ideal future. They are statements of anticipated outcomes you are looking to achieve.

Setting goals and priorities, and then following through with active plans to make them happen, is the essential process for turning dreams into reality. Goals are basically your dreams written down with a solid plan to reach them. The simple act of writing down what you want from life helps keep you focused and in control. How your life pans out is entirely your choice—so write your goals out now, and create a plan to achieve them.

HOW TO SET GOALS TO ACHIEVE YOUR DREAMS

- ☐ Daydream about how you want to live your life and the lifestyle that you picture for yourself.
- ☐ Get these daydreams down in writing — just write. Do not judge.
- ☐ Organize your goals on paper by the date you want to accomplish them.
- ☐ Create a rough plan to accomplish your goals.
- ☐ Review your goals often — every day would be excellent!
- ☐ See it. Believe it. And think about achieving your goals.

You have the ability to get whatever you want in life. Setting goals may sound simple, but that simple action will make a tremendous impact on all areas of your life.

Lesson Activity: I Want It!

I want it!

The best way to get what you want is to set a plan to achieve it.

- What is it that you really want to buy in the next 5-10 years?
- What are you going to do to get there?
- Make your plan today to get started!

I really want ...

I will buy what I want by using the following plan:

- This month I will _____
- Next month I will _____
- Within 6 months I will _____

- This year I will _____

- Next year I will _____

- Two years from now I will _____

- In 5 years I will _____

- In 10 years _____

- In 25 years _____

■ Creating Life and Financial Goals

What's standing between you and your dreams, your future success? **NOTHING** — if you can set goals and make an actionable plan for achieving them!

If you've ever aspired to be comfortably secure or financially independent — even to be a millionaire! — reaching those aspirations requires goal- setting. Just like in sports, you can't score without a goal, right?!

Successful people have written goals. You will achieve a higher percentage of your goals by imagining the successful achievement of those goals. When you write your goals and use mental imagery to focus your thinking, you can actually rewire your brain so the neurons form new connections and make new pathways. This helps you achieve a higher percentage of your goals.

Setting goals for financial planning and life success has many benefits, for example:

- **MOTIVATION.** Goals motivate you. Your life is moving toward some- thing instead of floating to nowhere.
- **SAVING VS. SPENDING.** How much of your monthly paycheck should you save? How much should you spend on shoes and music? Good questions—and without a set goal, you might see your shoe and iPod flourish while your finances suffer.
- **FREEDOM.** Once you've set a goal — believe it or not — you become liberated from constantly worrying and wondering what you're going to do with your life. Plan and set goals when you're young, or else wake up when you're 95 years old and say, "Hey! What happened to my life, my money, and my dreams?"
- **SCORING.** You achieve success by scoring. How can you score if you don't even know where the goal is? Set goals, achieve them, and feel rewarded. Planning ahead makes scoring so much easier.

Goal-setting can improve every area of your life. For a well-balanced life, set goals in each of the following areas:

- Family/Relationships
- Physical Health and Well-being
- Giving Back
- Fun & Toys
- Spiritual Self
- Money/Career
- Personal Growth

■ The S.M.A.R.T. Guidelines

Turning your dreams into reachable objectives takes some thought, but there's a proven technique. Use the **S.M.A.R.T** guidelines:

S – SPECIFIC, SIGNIFICANT

Be **specific**. Describe what you want to accomplish in clear and specific terms. If you can really visualize your goal, it's easier to achieve.

Example: If you're saving money to buy a car, it's much easier to keep to that savings plan when you have the model, color, and features picked out

Significant. Make sure your goals are for what *you* want. Goals should match your personal interests and values.

M– MEASURABLE, MOTIVATIONAL.

Measurable. You must be able to measure your goals; that is, you will know when you get there.

Example: "I will have a net worth of \$2.5 million by my 40th birthday."

Motivational. Your goals should motivate you to move to the next level — and beyond!

A – ATTAINABLE.

Goals must be **attainable**.

Example: Wanting to be President is a tough goal, but possible. Wanting to be Spiderman is a fantasy; you'll never get there.

R – RESULT-ORIENTED, REASONS.

Result-oriented: Phrase your goals in the positive. "I accomplished. I have. I am enjoying." Positive phrases direct your mind to focus on outcomes. When your mind is on board, the rest comes naturally.

Example: I will earn enough money by next January to afford the \$1,000 vacation I've always wanted.

Reasons: Why do you want to accomplish the goal? Deciding on the reasons behind each goal provides inspiration. For instance, if your goal is to be financially-free, some reasons behind that goal might be:

- Spend more time with family or friends.
- Feel more secure about your future.
- Free time to do favorite activities — travel, sports, etc.
- Stand out among friends and associates.
- Be able to afford things you want.
- Ability to help family members and take care of loved ones.

The reasons behind a goal are the fuel that keeps you motivated to accomplish all your hopes, and more!

T – TIME DRIVEN.

Good goals are time-driven. In other words, give yourself a deadline. For your plans to operate smoothly, you need to write down specific dates. You need a sensible time frame in order to work toward a goal and track your progress along the way.

Example: “I have paid of my \$2,300 credit card by Memorial Day, and will be enjoying myself on vacation”

Lesson Activity: Writing S.M.A.R.T. Goals

Remember that your goals must fit together. Goals should be headed in the same direction, not contradictory. For instance, having two goals of “saving up enough money by the end of summer to buy a LED Smart TV” and “taking the summer off to travel” contradict each other—you would only be able to accomplish one or the other. You must decide which is more important to you: TV or travel?

POORLY WRITTEN GOALS	WELL WRITTEN GOALS
<input type="checkbox"/> I want to have more money for vacation.	<input type="checkbox"/> I will have saved \$5,000 by New Years’ Day and will reward myself with a trip to Hawaii with my family.
<input type="checkbox"/> I’ll try to invest more.	<input type="checkbox"/> I will take a class on investing and find a trusted advisor by my birthday this year.
<input type="checkbox"/> I’ll pay my credit cards and hospital bills.	<input type="checkbox"/> By focusing on keeping expenses low, I will pay in full my \$4,200 credit card bill and cleared my hospital bills from my credit by the end of this year.

YOUR SMART GOALS

MAKE IT HAPPEN!

Once you've written down your goals using the S.M.A.R.T. guidelines, follow these steps:

- **Plan of Attack.** Write down each step you need to take toward accomplishing the goal. These step-by-step plans may sound corny, but they work. Reaching goals is like climbing stairs: without steps, how can we ever move up? Build steps in your staircase of life. Suddenly the next level will seem that much closer!
- **Review your goals often.** Write your goals on the back of an index card and tape it to the mirror where you brush your teeth. Put an identical card by your bedside table and another on the dash of your car. Look at your goals daily. Keep them in the forefront of your mind.
- **See it, believe it.** Visualize your goals coming true. The body goes only where the mind has already been. That means you must see, hear, smell, touch, and feel what it will be like to accomplish your goals. Visualization is like daydreaming with a purpose. By imagining yourself already accomplishing your goal, you are well on the road to success.
- **What you think about, you become.** You have the ability to get whatever you want in life. All you need to do is change your thoughts. The law of attraction says you will get whatever you think about, whether wanted or unwanted.

Lesson Question:

1. To set a good goal, you should
 - a. Set a clear timeline for achieving the goal.
 - b. Identify what you are willing to give up in order to attain the goal.
 - c. Both a. and b.
 - d. Neither a. nor b.
2. Goals
 - a. Are just dreams.
 - b. Should only be long-term.
 - c. Should only be short-term.
 - d. Should be specific and achievable.
3. Setting financial goals
 - a. Is not really necessary.
 - b. Is only important if you own a business.
 - c. Is only necessary once per year.
 - d. Is required in order to achieve financial security.

Essential Questions:

How are dreams and goals related?

What do goals have to do with finances?

What is the importance of setting goals to reach your dreams?

Evaluating Your Current Retirement Situation





Evaluating Your Current Retirement Situation

In this unit you will gain an understanding of the importance of long-term planning. Within this instruction you will learn the importance of cash flow, personal financial plans, wills and trusts.

Exploration of money, lifestyle choices and relationships will help you proactively prepare for your financial future.

Questions about Retirement

Warm-up Activity

Use the following space to take a first stab at defining how you want to spend your retirement.

Jot down any thoughts you have about family and relationships, physical health and well-being, philanthropy, fun, toys, your spiritual self, money, career, hobbies, and personal growth. Just get some rough ideas on paper.

▀ Road to Retirement - Current Road Conditions

Each of us has a different vision of retirement. For some people, it means spending more time with family. Others want to travel the world. Some folks might have to continue working, but still want a sense of financial security.

Even though there are millions of possible retirement goals, we all have one thing in common: we have to find a way to pay for our senior years. The definition of retirement has changed over the years.

- The old definition of retirement was “withdrawal from one’s position or occupation or from active working life.”
- The new definition of retirement is “achieving a state of financial wellness and security so you can live the lifestyle you desire.”

Questions about Retirement

Even if you do keep working, your goal in this new retirement age is to have enough financial security to earn income doing something you enjoy and feel passionate about.

There are lots of compelling reasons to start your retirement plan as soon as possible:

- Have enough money to feel secure.
- Be able to work if it aligns with your passion.
- Be able to live the lifestyle you want to live.
- Be able to take care of your family.
- Rid yourself of the worries and stress that go hand-in-hand with bills and debt.
- Be free to do what you want when you want.
- Have independence and security.
- Be able to make a difference in the world.
- Freedom from worrying about having enough money to enjoy life.
- Be able to purchase things like toys or travel.

Retirement Quotes

"Retirement has been a discovery of beauty for me. I never had the time before to notice the beauty of my grandkids, my wife, the tree outside my very own front door. And, the beauty of time itself." Hartman Jule

"I enjoy waking up and not having to go to work. So I do it three or four times a day."
Gene Perret

"Retirement gives us the freedom to spend our days following our passions and making a lasting difference in the world." Vince Shorb

"The question isn't at what age I want to retire; it's at what income." George Foreman

"It's nice to get out of the rat race but you have to learn to get along with less cheese."
Gene Perret

"Retirement is like a long vacation in Las Vegas. The goal is to enjoy it to the fullest, but not so fully that you run out of money." Jonathan Clement

Lesson Activity: Getting Off Course

Following is a list of the most common reasons people get into financial problems. Place a checkmark next to each area on the list where you feel you need to improve.

- ☐ Do not clearly define how much money you need to live the lifestyle you desire once you retire.
- ☐ Lack a clear financial plan.
- ☐ Do not have a trusted financial mentor, advisor, or coach.
- ☐ Poor financial choices due to the lack of financial knowledge.
- ☐ Lack the confidence they need to make necessary financial moves.
- ☐ Poor financial choices due to emotions. Fear and greed motivate most choices.
- ☐ Take advice from the wrong people. Most advice comes from unqualified salespeople and friends.
- ☐ Had a few problems that snowballed.
- ☐ Unrealistic expectations of investment returns.
- ☐ Do not invest properly due to lack of knowledge.
- ☐ Do not take advantage of employee benefit plans or tax laws.
- ☐ Continue with poor financial habits they developed at an early age.
- ☐ Do not properly plan their estate.

Many people will have quite a few checkmarks on this list. If you do, it's okay. You're taking the right steps by studying this material.

Now you know some ways people get off course. Let's talk about how to avoid these common pitfalls and stay on track with your dreams.

Money and Emotions

Managing your money can be scary, exciting, worrisome, motivating, or stressful; but don't wear your heart on your sleeve. Responding to money emotionally could result in hasty decisions based on your emotions instead of on logic. Try to keep your emotions in check.

Questions about Retirement

Before making a financial move, determine that you’re making a decision for the right reason, not just as an emotional response.

Emotions make us do things that we wouldn’t normally do. Have you ever liked someone so much that you did something risky to show off, or got so nervous that you put your foot in your mouth? That’s because emotions block out logical thinking.

The biggest negative emotions that affect people when they make financial decisions are greed and fear. They want more money and at the same time are scared of losing what they have.

Your levels of happiness, sadness, and stress all have an impact on how you view your money situation and make decisions to change it. People who manage their money while carrying this emotional baggage make bad decisions more often than someone with a clear, relaxed, business-focused mind.

Lesson Activity: Money and Emotions

List the emotions Cynthia may experience in each of the following situations:

SCENARIO	EMOTION(S)
Cynthia gets her 401K statement and it’s gained 10% in one month.	
The next month, Cynthia’s 401K statement shows a loss of 12%.	
Cynthia thinks she should move the money, but she’s not sure what investment would be best.	
A friend tells Cynthia about a stock that’s ready to shoot up. This friend knows someone who works for the company and is putting his entire savings into the investment.	
Cynthia pulls her money out of her investments and uses it all to buy the “hot” stock tip. It’s down 35% this week ... but she’s holding on.	

Current Retirement Situation

Now that you've identified the connection between your emotions and money, it's important to learn how to remain emotionally detached during financial decisions. Consider the following equations:

$$1 + 1 = 2$$

No emotional attachment.

$$1 + 1 + \text{stress, worry, fear} = -1$$

Fear will keep you from taking a risk.

$$1 + 1 + \text{greed, overconfidence} = 5$$

Greed will force you to take a risk that might not be wise.

Lesson Activity: Financial Stress Indicators

Rank each of the statements below to gain a better understanding how your emotions may play a part in your financial decisions.

How do you feel about your current financial situation?

1 2 3 4 5 6 7 8 9 10

Not Stressed

Highly Stressed

How do you feel when you make **small** financial decisions?

1 2 3 4 5 6 7 8 9 10

Not Stressed

Highly Stressed

How do you feel when you make **large** financial decisions?

1 2 3 4 5 6 7 8 9 10

Not Stressed

Highly Stressed

How do you feel when you think about retirement?

1 2 3 4 5 6 7 8 9 10

Not Stressed

Highly Stressed

How do you feel when you talk to your loved ones about money?

1 2 3 4 5 6 7 8 9 10

Not Stressed

Highly Stressed

Questions about Retirement

To lessen the impact emotions play on your financial decisions, consider the tips shown below. Check those tips that you choose to follow.

STRESS REDUCTION TIPS

- ☐ Only invest with ***risk capital*** — that is, money you can afford to lose.
- ☐ Gain a high-level knowledge base about any investments you're considering
- ☐ Build a team of trusted advisors.
- ☐ Before making any decision, take time to evaluate it logically.
- ☐ Reduce the influence of emotions by partaking in an activity that reduces your stress levels. Weigh your options at times when your emotions have less impact — during exercise, prayer, meditation, deep breathing, a relaxing morning cup of coffee, or whatever method works for you to reduce your emotional response.

Lesson Activity: Risk Tolerance

It's important to choose investments with which you are emotionally and financially comfortable. People have different levels of tolerance for risk-taking in financial matters. But with most investments, the greater risk you're willing to take, the greater the potential return.

Take the risk tolerance test below to give yourself a rough idea of the amount of risk with which you are comfortable.

1. You won \$20,000 in a contest. What do you do with that money?
 - a. You invest it all into a hot stock tip that you think will quadruple your money.
 - b. You decide to spread it across various investments that you feel can generate good returns.
 - c. You want to keep the money safe, so you put it into an investment that gives you minimal growth but cannot lose money.
2. You invested in a few stocks and now you're down 50%. Your account started at \$20,000; now you're at \$10,000. What do you do?
 - a. You let it ride and hope it goes up.
 - b. You sell and make other investments you believe will be better.
 - c. You sell and put the money into a safe investment that offers low returns but where you can't lose money.
3. In which of the following would you rather invest?
 - a. A stock where you can lose all your money but which has the potential for huge returns.
 - b. An investment where you can limit your losses, but your gains are likely to be average.
 - c. An investment where you cannot lose money, but you are making consistent, small returns each year.

For a more comprehensive risk tolerance test, visit www.njaes.rutgers.edu/money/riskquiz to take a quiz that was developed by two university personal finance professors: Dr. Ruth Lytton at Virginia Tech, and Dr. John Grable at Kansas State University.

Questions about Retirement

Lesson Questions

1. Which of the following is one of the compelling reasons to start retirement planning as soon as possible?
 - a. To indicate what will happen to my dependents if I should pass away.
 - b. To make sure I have adequate insurance coverage for all my properties.
 - c. To avoid feeling emotional about financial decisions.
 - d. To rid myself of the worries and stress associated with debt and bills.

2. What are the most common emotions influencing money decisions?
 - a. Greed and anger.
 - b. Love and disgust.
 - c. Fear and greed.
 - d. Trust and respect.

Essential Questions

What is the new definition of retirement? _____

What are some important questions people need answered about retirement?

Retirement & Family

Warm-up Activity

Is there one person in the world to whom you tell everything?

☐ Yes ☐ No

If yes, who is that person? _____

Would you give that person complete access to your finances and your financial plans?

☐ Yes ☐ No

Why or why not? _____

Relationships and Money

It's important to understand how personal relationships and communication affect money. Follow the directions provided by your instructor to use the graphic to answer each of the questions:

Rate your level of communication with your family and parents.

1 2 3 4 5 6 7 8 9 10

Nonexistent

Excellent

Rate your level of communication with your spouse or significant other.

1 2 3 4 5 6 7 8 9 10

Nonexistent

Excellent

Money issues often cause disagreements in relationships. Many couples and families have issues around discussing finances, and have trouble being open with each other about their spending/saving habits.

Family and other loved ones can greatly affect your long-term financial planning, for example:

- You might have to take care of a parent;
- Your decision whether to have children affects your finances;
- Your loved ones' lifestyle choices have an impact on your finances.

DISCUSSION POINTS FOR FAMILIES WITH PARENTS

- ☐ Do your parents and loved ones have a plan to take care of their own retirement, or ...
- ☐ Will you be taking care of them?
- ☐ Do your parents or loved ones have health care coverage?
- ☐ Do your parents or loved ones have long-term care insurance?
- ☐ Can they afford to pay for assisted living on their own, or ...
- ☐ Will they need to live with you?
- ☐ Do your parents or loved ones have enough funds to pay for their funerals?
- ☐ Do your parents or loved ones have a will or living trust in place?
- ☐ Is each sibling clear about his/her responsibilities if a parent or loved one passes?

Money is a leading cause of divorce, so it's important to discuss financial matters with your significant other as part of getting to know each other.

- Learn about each other's financial goals. If you're much more frugal than your partner, he/she may have an issue with you saving money. On the other hand, you may have an issue with your partner spending excessively.
- Make sure you ask any new partner about his/her credit history and debt situation.
- Observe a new partner's spending habits. For example, is he always buying things he doesn't need? Is she really cheap? Or is he/she somewhere in the middle?

Considering these factors is very important.

- Share and learn about your partner's savings and investments. Ask about any major expenses he/she is planning.

Homework Activity: Financial Communication Game

Play the **Financial Communication Game** with your spouse or a loved one – anyone who may have an impact on your personal financial situation. Follow these guidelines:

1. Before starting the game, make sure you're currently on good terms and are both open to communicate. If you had a recent argument or if there's tension in the air, wait to play the game. Also, if you are seeking counseling, work with your counselor to facilitate the game.
2. Together, brainstorm your financial and retirement goals. Initially, write down every thought. Just write – do not judge.
3. Once each of you has put ideas on paper, discuss each one together. Prioritize and list them in order of importance. You will disagree on some items. If, after a minute or two, you are unable to reach consensus, mark that item for later discussion.
4. During the game, be sure to remind each other that you're doing this because you care about each other. That will help you stay on course.
5. This game typically requires multiple meetings and planning to ensure proper alignment.

Lesson Questions

1. What is the leading cause of relationship problems?
 - a. Infidelity
 - b. Children
 - c. Money
 - d. Cooking
2. What financial issues should you discuss with your partner/spouse/significant other?
 - a. Each other's credit and debt history.
 - b. Your plans for major expenses in the future.
 - c. Your financial goals.
 - d. What savings and investments you have.
 - e. All of the above.

Essential Questions

How do relationships affect money? _____

Why is it important to have open communication about money?

Retirement Income & Net Worth

Warm-up Activity

When I retire, I expect to receive income from the following sources:

Retirement Income Sources

For people who seek financial freedom, planning a retirement budget is essential. The first step in the process is to identify any future income sources you will use to fund your retirement. Then you can adjust your expenditures based on your lifestyle goals and income. Below is a list of potential retirement income sources.

1. Social Security

Social Security is a retirement benefit offered at age 62 and older. If you start claiming SSI at age 62, your benefits will be about 30% less than if you wait until age 67. If you wait until age 67, you qualify for full payments. In 2012, a worker who retired at age 66 received a maximum check of about \$2,500. Get an individualized benefit estimate at the Social Security website <http://www.socialsecurity.gov/estimator/>.

SSI benefits are likely to be significantly reduced in the future. Estimated benefits are based on current law, and the law governing benefit amounts may change. By 2033, the payroll taxes collected will be enough to pay only about 77 cents for each dollar of scheduled benefits. Although SSI suggests using 77 cents to calculate potential benefits, that figure might represent the “best case scenario.” Ideally, you should avoid depending on SSI benefits when you plan retirement income.

2. Pensions

A pension is a type of retirement plan that provides people with an income after they retire. Pensions come in various forms; either defined benefit or defined contribution. A defined contribution distributes income depending on the employee’s contribution and investment performance. A defined benefit provides retirement income based on an employee’s salary and number of years in the plan. A hybrid plan combines features from both.

3. Assets

Compared to Social Security and pensions, you have much greater control over your assets. An asset is something of monetary value under your control that you expect will provide future benefits to you and your family. Examples of assets include stock holdings, IRAs, home equity, bonds, treasury notes, rental properties, precious metals, and mutual funds.

Asset income may come from interest, rental payments, royalties, and dividends. You also can sell assets to generate income.

4. Annuities

Annuities are insurance products that pay income to investors. Annuities are commonly used as an income source at retirement.

Investors can set up an annuity to provide income for a specific period of time, usually their expected lifetime. Annuity income depends on investment, length of payments, performance, and type of annuity. There are two common types:

Fixed income provides a guaranteed payout;

Variable income is determined by performance of the underlying investments.

5. Employment

Continued employment is another potential source of retirement income. Some retirees choose jobs that provide medical benefits to reduce health insurance costs. To achieve true financial freedom, you want to be in a position where you don't *have* to work, but *choose* to work.

If you decide to work after retirement, try to find a job that aligns with your passions and strengths – fulfilling work that fits your lifestyle goals.

6. Entrepreneurship

Entrepreneurship is an investment of time, energy, and money which can yield excellent returns. While it's not for everyone, working for yourself can be rewarding and lucrative. Creating a business around your passions might provide a few hundred dollars of supplemental income, or become your main income source. Your own business can be a fun project to help you stay active. At the end of the day, we're all business owners. We're in the business of building brighter and better futures for ourselves.

Starting a business is an investment, and you must manage risk. Don't invest more than you can afford to lose.

Lesson Activity: Retirement Income

Estimate your retirement income from each source. If you don't know exact amounts now, just make your best estimate, and do further research on your own to get accurate figures. Then add up the figures to project your total income at retirement.

Lesson Activity: Retirement Income		
Estimate your income at retirement age.	Social Security	\$ _____
For any area about which you're	Assets	\$ _____
unsure, just try to make your best estimate.	Annuities	\$ _____
	Employment	\$ _____
	Entrepreneurship	\$ _____
	Other	\$ _____
Total Estimated Income at Retirement		\$ _____

Net Worth

When you build up a large enough net worth to live your desired lifestyle, you can live life on your own terms. Net worth is the measure of your net economic position.

You can calculate your current net worth by totaling your assets, then subtracting your liabilities.

	Assets	(investments, real estate, savings, etc.)
LESS	Liabilities	(debt, liens, etc.)
EQUALS	Net Worth	

For example, let's say you have \$65,000 in savings but you owe \$6,000 on personal loans and have credit card debt of \$10,000. In this example, your net worth would be \$49,000.

\$ 65,000
– 6,000
– 10,000
<u>\$ 49,000</u>

Visit www.financialeducatorsCouncil.org/calculator/access/NetWorth.html to access the NFEC's Net Worth Calculator.

Net worth is important to give you a good idea of your financial starting point. The chart of **Assets and Liabilities** on the next page provides examples of assets and liabilities that are important to consider.

Retirement Income

ASSETS

Home. Use the current value of your home to calculate its worth as an asset.

Other Real Estate. The value of any other real estate you may own.

Automobiles. The total value of all automobiles that you own. Do not include leased vehicles.

Metals. The value of gold, silver, or other precious metals in your possession.

Retirement Accounts. The current total balance of your retirement accounts. Include IRAs, 401(k) savings, SEP IRAs, variable annuities, and any other retirement savings accounts.

Bonds. If you own any Treasury, municipal, or commercial bonds that are not part of your retirement accounts, include them in the Assets column.

Stocks. Any individual stocks that are not part of your retirement accounts.

Mutual Funds. Any mutual funds that are not part of your retirement accounts.

Cash Value of Life Insurance. Some life insurance policies, such as whole life and universal, have cash value. Term life policies, on the other hand, have no cash value.

Savings Bonds. Count any savings bonds that are not included in your retirement accounts as assets.

Checking and Savings Accounts. The current total balance of your checking and savings accounts.

Cash.
Include any cash on hand.

LIABILITIES

Home Mortgage Principal. This is the current principal balance remaining on your mortgage — that is, the amount you would have to pay to own your home free and clear.

Other Mortgage Principal. The current principal balance for any other real estate mortgages you have. Include mortgages on rental property, undeveloped land, commercial property, or any other real estate.

Credit Card Debt. Your total credit card debt.

Auto Loans. Total amount currently outstanding on your auto loans.

Student Loans. Total amount, if any, that you currently owe in college or student loans. Enter the total outstanding amount even if your student loans are currently deferred.

Other Loans. Total amount of any other loans.

Lesson Activity: Net Worth

Follow the directions from the instructor to complete your net worth worksheet.

Assets	
Personal Residence	
Rental & Other Properties	
Physical Metals (Gold, Silver, etc.)	
Jewelry, Art, etc.	
Automobiles	
Other	
US Government Bonds	
Corporate Bonds	
Municipal Bonds	
Bond-Based Mutual Funds	
Other	
Stocks	
Stock-Based Mutual Funds	
Variable Annuities	
Other Annuities	
Life Insurance with Cash Value	
Business Partnership Interest	
Other	
Savings Account	
Checking Account	
Money Market Account	
Certificate of Deposit	
Other	

Liabilities	
Real Estate Mortgages	
Retirement Loans	
Student Loans	
Credit Card Debt	
Payday Loans	
Personal Loans	
Auto Loans	
Life Insurance Loans	
Margin Account Loans	
Other	
Other	
Other	
Other	
TOTALS	
Total Assets	
Total Liabilities	
Assets minus Liabilities = Net Worth	

Lesson Questions

1. To what level are Social Security payments predicted to drop by the year 2033?
 - a. 10 cents on the dollar.
 - b. 50 cents on the dollar.
 - c. 77 cents on the dollar.
 - d. 85 cents on the dollar.
2. What is net worth?
 - a. Total assets minus total liabilities.
 - b. Checking balance minus savings balance.
 - c. Annuities minus bonds.
 - d. Mortgages plus cash on hand.
3. A mutual fund is an example of a(n)..
 - a. Principal
 - b. Debt
 - c. Liability
 - d. Asset

Essential Questions

What are four potential sources of retirement income

1. _____
2. _____
3. _____
4. _____

How is a person's net worth calculated?

Retirement Planning & Taxes

Warm-up Activity:

Do you think the tax rate will increase or decrease over the next ten years?

Explain why you think the tax rate will increase or decrease.

Retirement Planning

Retirement planning should include tax planning as a critical component. Many financial products and strategies exist to help you retain more of the money you earn. Some investments that may provide tax benefits include 401K plans; IRAs; home ownership; starting a business; and municipal bonds. Here are two important points to consider:

1. Do not base your entire financial plan on the current Tax Code. The Tax Code can change at any time, and politicians are regularly trying to adjust the code.
2. Find a highly qualified tax planner.
 - Locate a tax planner who's available for year-round questions.
 - Before you make any financial decisions, always consult your tax advisor.
 - It is also suggested that you connect your financial team with your tax planner so your entire team is in the loop on your financial decisions.

There are financial products and strategies that allow you legally to pay fewer taxes, and locating a qualified tax planner is essential to your long-term success. A good tax planner will

Retirement Planning & Taxes

help you use tax laws to your advantage and play an instrumental role in your overall financial team.

Even once you've established a relationship with a tax planner, there are four pieces of information from the Tax Code that are critical for you to know about:

1. **INTEREST.**

Typically, interest earnings that can be derived from a savings account, bond, CD, and other types of interest-bearing investments are taxed as ordinary income.

2. **CAPITAL GAINS.**

Profits from the sale of a property or investment are called capital gains and will be taxed. Assets held less than 12 months are usually taxed as ordinary income, while assets held over 12 months are usually taxed at a 15% federal income tax rate.

3. **PRIMARY RESIDENCE.**

If you sell your home, you may be able to avoid a capital gains tax.

4. **DIVIDENDS.**

Currently, income derived through dividend-paying stocks is taxed at 15%; however, many political leaders are calling for this tax to increase.

All tax policies can change at any time and this course is for educational purposes only; not specific tax advice. That's why it's critical for any individual to have a trusted and highly-qualified tax planner.

■ Tax Benefit Plans

There are three types of tax benefits offered through investments: tax-deferred, tax-deductible, and tax-free.

1. **TAX-DEFERRED.**

Taxes are paid later with tax-deferred investments. You are able to invest the money that the government would have taxed. This can improve your overall returns. Tax-deferred investments can include 401(k) plans, 403(b) plans, and IRAs. With tax-deferred plans, you will not pay taxes until you withdraw the money. For some, this may provide an extra benefit if the tax rate you pay at retirement is less than your current tax rate.

2. **TAX-DEDUCTIBLE.**

This feature allows a person to deduct the amount invested from their gross income, lowering a person's overall tax liability. Tax-deductible investments can include 401(k) plans, 403(b) plans, Simplified Employee Pension Plans (SEP), Keogh, and IRAs.

3. **TAX-FREE.**

Tax-free investments provide returns that are free from federal income tax and, in some cases, state tax. Roth IRAs, municipal bonds, and 529 plans – assuming monies are used for schooling – are all examples of tax-free investments.

Qualified Retirement Plans (Pension Plans)

Employee-sponsored retirement plans (or pension plans) can help people reach their retirement goals. A “qualified” retirement plan (or pension plan) is for employees (and/or their beneficiaries), and is eligible to receive certain tax benefits from the IRS. There are two types of qualified retirement plans:

1. **DEFINED CONTRIBUTION PLAN** provides an income source that depends upon the employee’s contribution and investment performance. The money in the plan is tax-deferred and the employee often has some control over how much he/she contributes and where the money is invested.
 - The money in the plan is tax-deferred.
 - Benefits are based on the amount contributed by employee and any gain, loss or expense.
 - Participants have their own individual accounts and often have to make the investment decisions. Participants have some control over how much they contribute; however, there are some guidelines they must follow. They also have control over their investment performance.
 - Participants do not receive a guaranteed retirement benefit. Rather, the benefit depends on their contributions and investment choices.
 - Mandatory distributions start at age 70½.
2. **DEFINED BENEFIT PLAN** provides income at retirement typically based on the employee’s salary and the number of years they were involved with the plan. These plans are professionally managed and the employee has no control over the investments. These plans provide tax-deferred savings.
 - The employer provides the retirement benefits.
 - These plans provide tax-deferred savings.
 - The plan is professionally managed, and may be insured through Pension Benefit Guaranty Corporation (PBGC). PBGC insured pensions for 44 million Americans and benefits for 1.5 million whose pensions failed (according to their website in 2012).
 - Participants do not select the investments made.
 - Participants may or may not need to contribute monies, depending on the plan.
 - Plan benefits are often calculated based on participant’s salary and years of employment.

- Participants typically receive benefits in accordance with their vesting. Vesting is the amount of time necessary to receive benefits; vesting requirements differ from plan to plan.
- Participants do not have an individual account in their name.
- Some plans offer inflation adjustments.
- Typically, participants cannot receive lump sum payments.
- Benefits are typically not payable until the participant reaches retirement age; mandatory distributions start at age 70½.

Although not a third type *per se*, there are also hybrid plans that combine features from both defined contribution and defined benefit plans.

■ FYI – Investment Vehicles

You probably have already heard about IRAs and 401(K) plans. Here's a quick FYI on what you need to know. You can also refer to the table for a summary of the various types of investment vehicles and their features.

401(K) Plan

A 401(K) is an employer-sponsored retirement plan in the United States and some other countries which allows a worker to save for retirement while deferring income taxes on the saved money and earnings until withdrawal.

Individual Retirement Account (IRA).

An IRA is a retirement plan account that provides some tax advantages for retirement savings in the United States. There are a number of types of IRAs, which may be either employer-provided or self-provided plans. The types include:

- A **ROTH IRA** differs from most other IRAs. Contributions are made with after-tax assets, so all transactions within the IRA have zero tax impact and the withdrawals are tax-free.

For example, if you wanted to invest \$1,000 of your earned income, and you are in a 20% tax bracket, you would have \$800 to put toward your Roth IRA. Assuming you invest this amount for 5 years, that would give you a total investment of \$4,000. Over 20 years at 10% return (a higher-than-average return used for ease of math), your investment would grow to \$26,909 of tax-free money. You could withdraw that and have the entire \$26,909.

- A **TRADITIONAL IRA** often has tax-deductible contributions so the money is taxed only when it is withdrawn at retirement.

Current Retirement Situation

With a traditional IRA you're able to invest pre-tax dollars, so you would invest the entire \$1,000 of your earned income. If you invest this amount for 5 years, that would give you a total investment of \$5,000. As in the example above, if you keep your investment over 20 years at 10% return, your investment would grow to \$33,736. However, you would be required to pay taxes on this amount. Assuming you are in the 36% tax bracket, you would net \$21,527.

	Simple IRA	401(K)	430(B)	Roth IRA	IRA
Tax Benefits	Tax-deferred growth and pre-tax contributions.	Contributions are pre-tax; distribution taxed as ordinary income.	Tax-deferred growth and pre-tax contributions.	Tax-free growth and withdrawals.	Tax-deferred growth.
Eligibility	Participant has min of \$5,000 earnings in any two preceding years, and is expected to earn \$5,000 in curr year.	Some income limits.	Designed for employees of public schools and tax-exempt orgs. like hospitals, public welfare orgs., etc.		
Contribution	Up to 100% of compensation with limits of \$11,500 (\$14,00 if over 50).	401(K) and Roth 401(K) combined with a limit of \$17,000 each year for those under 50. Restrictions also apply to the combined employee/ employer contributions.	Varying amount limitations; cannot exceed 100% of annual compensation. Those over age 50 can make additional contributions.	2012 max of \$5,000 (\$6,000 over age 50); not tax deductible. Contributions made with after-tax monies.	2012 max of \$5,000 (\$6,000 over age 50). Tax deductibility depends on MAGI (Modified Adjusted Gross Income).
Important Dates	Must wait two years before making any moves (rollover, withdrawal, etc.)		Immediately vested with their own contributions.	Deadline April 17 th .	Deadline April 17 th .
Withdrawal	Tax-deferred investment. Investor pays taxes at withdrawal.	Tax-deferred investment. Investor pays taxes at withdrawal.	Tax-deferred investment. Investor pays taxes at withdrawal.	Contributions are withdrawn tax-free. Earnings federally tax-free after 5-yr aging requirement and one other condition: 59½; qualified home purchase; disability; or death.	Withdrawals (contributions and earnings) are taxable when distributed.
Penalties	If under age 59½, 25% penalty for distributions made within first 2 yrs, reduced to 10% after two years.	10% early withdrawal penalty with exceptions. Principle withdrawal not allowed.	10% early withdrawal penalty with exceptions before age 59½.	10% unless exception applies: 5-year aging; 59½; qualified home purchase; disability; or death.	Withdrawal before 59½ may receive 10% penalty.
Minimum Distribution Requirements (MDR)	Age 70½.	Age 70½.	Age 70½.	N/A	Age 70½.

Lesson Activity: Retirement Planning

Think about what you would like your future financial life to be like. Write down what you would like or where you would like to be in each stage of your life below. Look at the samples to help you, and listen to the instructions provided by your instructor.

Start the activity at your current age range. Your first age range should be the most detailed.

GUIDELINES

Investments: Write about the type of investments that interest you, and how much time you will devote to study.

Net Worth and Cash Flow: Indicate how much you will have (net worth), and how much money will come from cash flow.

Lifestyle: List things you will have; things you'll experience during this time; how you feel about your money situation; and how you picture your day-to-day life.

SAMPLE: BETWEEN AGES 40—50

Investments: *My main investment will be in my education. I will begin to study about the investments I am interested in making and building a team that can advise me. I also plan to increase my savings by \$200 each month by reducing my expenses.*

Net Worth and Cash Flow: *By the time I reach 46, I want to have \$30,000 saved and invested. I also will have my employer-sponsored retirement plan fully funded each year.*

Lifestyle: *I will stay focused on doing what I know I like now – travel, meeting new people, experiencing new cultures. I will pay for these activities by reducing my overhead and expenses on areas that aren't as important to me.*

BETWEEN AGES 21—30

Investments: _____

Net Worth and Cash Flow: _____

Lifestyle: _____

BETWEEN AGES 31—40

Investments: _____

Net Worth and Cash Flow: _____

Lifestyle: _____

BETWEEN AGES 41—50

Investments:

Net Worth and Cash Flow:

Lifestyle:

BETWEEN AGES 51—60

Investments:

Net Worth and Cash Flow:

Lifestyle:

Lesson Questions

1. What are capital gains?
 - a. A portion of one's gross annual employment income.
 - b. One's net worth minus investments.
 - c. Profits from the sale of a property or investment.
 - d. A tax advantage on a defined benefit plan.
2. Which type of qualified employer-sponsored pension plan allows participants control over how their money is invested?
 - a. Defined contribution plan.
 - b. Defined benefit plan.
 - c. Municipal bond.
 - d. Guaranteed retirement benefit.
3. Which type of Individual Retirement Account (IRA) has zero tax impact when the money is withdrawn?
 - a. Defined benefit plan.
 - b. Self-directed IRA.
 - c. Roth IRA.
 - d. Traditional IRA.

Essential Questions

What are the four basic concepts in the tax code with which I should be familiar?

1. _____
2. _____
3. _____
4. _____

What are the three types of investment tax benefits?

1. _____
2. _____
3. _____

What are the two primary investment vehicles for retirement income?

1. _____
2. _____



Investments





Investments

In this unit you will gain an understanding of what investing is. Within these lessons you will learn about a variety of investment strategies and techniques to increase long-term financial security.

Why People Invest

Warm-up Activity

What does the word investing mean to you?

Why People Invest

Ask yourself: Is it better to bury your money in the ground where it could lose value due to inflation, or to invest your savings and potentially see your dollars grow for you?

Investing makes sense. It's all about making your money work for you, instead of the other way around. Best of all, if you take the time to become an investing expert, you may see your money double, triple, and quadruple. The earlier you begin investing, the more you can increase your original investment – at least in theory. So start studying now.

Imagine being able to earn money while you sleep, vacation, study, or shop. You can be making money all day, every day. This is possible when you earn profit and income by investing your savings in the stock market, bonds, real estate, entrepreneurial endeavors, and other investments. There are many good reasons why people choose to invest their money.

- **FINANCIAL SECURITY.**

Many people decide to learn about investing because they want to become financially secure. They don't want to worry about bills or being able to afford things they want.

- **LIFESTYLE.**

Earning money through investments helps you afford your desired lifestyle. Investing gets your money working for you, instead of you having to work for every dollar. And investments can provide you more free time to enjoy life.

Why People Invest

- **RETIREMENT.**

Most people today rely on Social Security (SSI), a social welfare program that provides monthly payments to people over the age of 65; and Medicare, a program that provides medical insurance coverage to seniors; for their retirement incomes. SSI and Medicare have been projected to be bankrupt by 2033, so you should put an alternative plan in place.

- **BEAT INFLATION.**

Inflation is defined as “too many dollars chasing too few goods.” Inflation drives prices up. Putting your money to work for you through investing can help you become financially comfortable and give you the freedom to live the lifestyle you choose. There are two ways to achieve financial comfort:

- Build up your net worth; and
- Build up your cash flow.

It is also important to understand the meaning of “cash flow” and “net worth.”

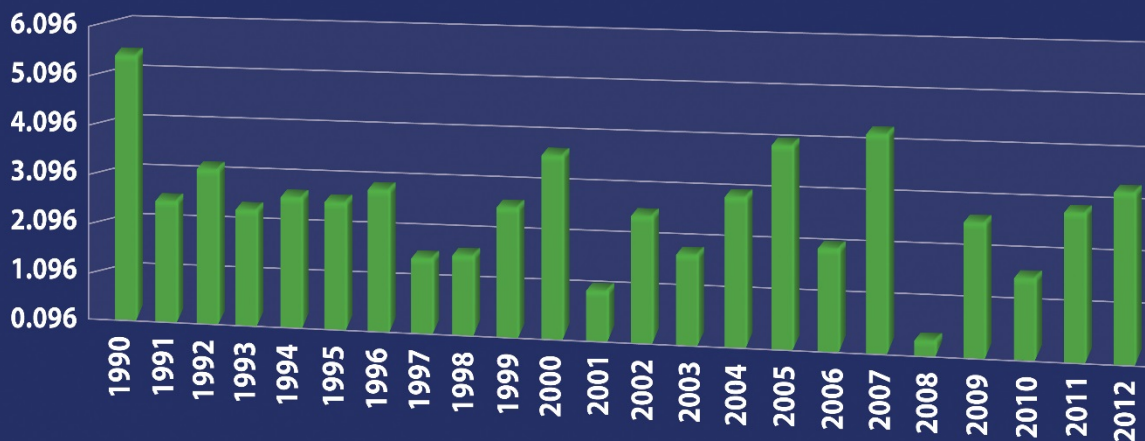
- **NET WORTH** is the measure of your net economic position – how much money you have left after your liabilities are subtracted from your assets.
- **CASH FLOW** is the amount of money you have coming in on a regular basis from investments or other sources.

Look at the **Inflation Charts** on the following page to see how inflation has affected the purchasing power of the dollar over the years.

How Much Will You Need To Have The Purchasing Power of \$10,000?



Historic Inflation Rates



The Effects of Inflation on Purchasing Power



Why People Invest

Historical US Inflation Rates									
Year	Percent	Year	Percent	Year	Percent	Year	Percent	Year	Percent
1921	-11.1	1941	11.3	1961	0.7	1981	8.4	2001	1.1
1922	-0.6	1942	7.6	1962	1.3	1982	3.7	2002	2.6
1923	3.0	1943	3.0	1963	1.6	1983	4.2	2003	1.9
1924	0.0	1944	2.3	1964	1.0	1984	3.5	2004	3.0
1925	3.5	1945	2.2	1965	1.9	1985	3.9	2005	4.0
1926	-2.2	1946	18.4	1966	3.5	1986	1.5	2006	2.1
1927	-1.1	1947	10.2	1967	3.6	1987	4.0	2007	4.3
1928	-1.2	1948	1.3	1968	4.4	1988	4.7	2008	0.03
1929	0.0	1949	-2.1	1969	6.2	1989	5.2	2009	2.63
1930	-7.0	1950	8.1	1970	5.3	1990	5.7	2010	1.63
1931	-10.1	1951	4.3	1971	3.3	1991	2.6	2011	2.93
1932	-9.8	1952	0.4	1972	3.6	1992	3.3		
1933	2.3	1953	1.1	1973	9.4	1993	2.5		
1934	3.0	1954	-0.7	1974	11.8	1994	2.8		
1935	1.5	1955	0.4	1975	6.7	1995	2.7		
1936	2.2	1956	3.0	1976	5.2	1996	3.0		
1937	0.7	1957	3.6	1977	6.8	1997	1.6		
1938	-1.4	1958	1.4	1978	9.3	1998	1.7		
1939	-0.7	1959	1.0	1979	13.9	1999	2.7		
1940	1.4	1960	1.7	1980	11.8	2000	3.7		

Lesson Activity: Inflation Quiz

If you are earning 1% in a savings account and inflation is at 3%,
will you be able to purchase more or less next year?

☐ More ☐ Less

What if you are earning 7% on a stock market investment with 3% inflation,
would you be able to purchase more or less next year?

☐ More ☐ Less

What if your bank offered you a CD at 4% but you had to keep your money in the CD for 5
years. What are the risks?

In Year #1 of the example above, if the inflation rate was 3% for all 5 years, would that give you more or less purchasing power? ☐ More ☐ Less

If inflation jumped to 8% in Year #2, would that investment still make sense for you?

☐ Yes ☐ No

CASE STUDY

The Federal Reserve is a company that acts as the central bank of the United States. It is not part of the government; however, the Federal Reserve is designed to work within the overall economic and financial policies established by the government. The Federal Reserve is primarily funded by interest on US government securities.

One of the Reserve's duties is to regulate money supply. In 2010, the Reserve increased money supply by \$600 billion. This is commonly referred to as "printing money," although nowadays they're able to create money electronically.

Knowing what you now know about inflation, what do you think happened to the inflation rate in 2010 : ☐ Increase ☐ Decrease

What do you think will happen to the purchasing power of the dollar:

Will you be able to purchase more or less with \$1.00? ☐ More ☐ Less

Lesson Activity: Budget at Retirement

This activity will help you estimate your budget when you reach retirement and plan ahead for the impact of inflation.

First, you will need to fill out the **Net Worth Chart**. List the current value of your assets and costs of your liabilities. Place the totals in the designated cells, then subtract the total cost of your liabilities from the total value of your assets to determine your net worth.

Why People Invest

NET WORTH CHART

Assets		Liabilities	
<input type="checkbox"/> Personal Residence		<input type="checkbox"/> Real Estate Mortgages	
<input type="checkbox"/> Rental & Other Properties		<input type="checkbox"/> Retirement Loans	
<input type="checkbox"/> Physical Metals (i.e., gold, silver)		<input type="checkbox"/> Student Loans	
<input type="checkbox"/> Jewelry, Art, etc.		<input type="checkbox"/> Credit Card Debt	
<input type="checkbox"/> Automobiles		<input type="checkbox"/> Payday Loans	
<input type="checkbox"/> Other		<input type="checkbox"/> Personal Loans	
		<input type="checkbox"/> Auto Loans	
<input type="checkbox"/> US Government Bonds		<input type="checkbox"/> Life Insurance Loans	
<input type="checkbox"/> Corporate Bonds		<input type="checkbox"/> Margin Account Loans	
<input type="checkbox"/> Municipal Bonds		<input type="checkbox"/> Other	
<input type="checkbox"/> Bond-Based Mutual Funds		<input type="checkbox"/> Other	
<input type="checkbox"/> Other		<input type="checkbox"/> Other	
		<input type="checkbox"/> Other	
<input type="checkbox"/> Stocks			
<input type="checkbox"/> Stock-Based Mutual Funds			
<input type="checkbox"/> Variable Annuities			
<input type="checkbox"/> Other Annuities			
<input type="checkbox"/> Life Insurance with Cash Value			
<input type="checkbox"/> Business Partnership Interest			
<input type="checkbox"/> Other			
<input type="checkbox"/> Savings Account		TOTALS	
<input type="checkbox"/> Checking Account			
<input type="checkbox"/> Money Market Account			
<input type="checkbox"/> Certificate of Deposit			
<input type="checkbox"/> Other			
		Total Assets	
		Total Liabilities	
		Net Worth (Assets minus Liabilities)	

Future Living Expenses

You need to calculate your possible living expenses in the future to create a solid retirement plan.

First, you need to determine an annual inflation rate. There is no crystal ball for determining an accurate rate; but gaining knowledge, keeping up-to-date with monetary policy, and having a trusted team of advisors can help you decide on an average figure.

Next, calculate your possible living expenses in the future. For example, if you think the inflation rate will be 3% and your expenses total \$2,000 per month right now, here's what you would enter into your calculator: **$\$2,000 \times 1.03 = \$2,060$**

That figure estimates your expenses to increase by \$60 at the end of the first year. To calculate inflation for 5 years, simply keep multiplying each new total by 1.03. For example:

Year 1	\$2,000	X 1.03	= \$2,060
Year 2	\$2,060	X 1.03	= \$2,121
Year 3	\$2,122	X 1.03	= \$2,185
Year 4	\$2,185	X 1.03	= \$2,251
Year 5	\$2,251	X 1.03	= \$2,318

Lesson Activity: Future Impact Calculator

Now, complete the Future Impact Calculator below, following these steps:

1. Add up all the items that will be adjusted by inflation;
2. Add up those items that will not be adjusted by inflation;
3. Multiply your inflation-affected expenses by the inflation rate;
4. Then add your non-inflated expenses to that total.

Why People Invest

FUTURE IMPACT CALCULATOR

Monthly Expense of Items

Not Affected by Inflation

Monthly Expense of Items

Affected by Inflation

Estimated Inflation Rate

Inflation-adjusted Expenses

Year

Year 10

Year 20

Year 30

Total Expense

Items Affected by Inflation +
Items Not Affected by Inflation

Year

Year 10

Year 20

Year 30

What steps will you take now to ensure that your income is enough to support your retirement lifestyle?

What expenditures will you reduce at retirement to ensure that your lifestyle goals are met?

Finally, complete the charts “Budget Now” and “Budget at Retirement”. If you has more liabilities than assets in your net worth calculation, you will need to include a monthly payment towards this “expense” to compensate. You can either include the detailed (year to year) effects of inflation on your expenses or simply take the average to help in your forecasting.

Investments

Budget Now

Money Coming In		
Employment Income	Current	Goal
Employment Income		
Federal Income Tax	-	
State & Local Tax	-	
Social Security/Medicare	-	
Tips		
Net Income		

Other Income		
Rental Properties		
Stock Market		
Entrepreneurial Endeavors		
Interest Income		
Other		
Total		

Total Income		
---------------------	--	--

Money for Savings		
Emergency Fund		
Retirement Plans		
Investments		
Short Term 'Fun' Savings		
Charities		
Total		

Total Income		
Total All Expenses		
Total Savings		
Money Left Over		

Expenses		
Living Expense	Current	Goal
Rent / Mortgage		
Taxes / Insurance		
Utilities: Electric /Gas		
Utilities: Water / Garbage		
Cable/Satellite		
Internet		
Phone		
Other		
Total		

Travel Expenses		
Car payment		
Insurance		
Registration		
Gas		
Maintenance		
Other		
Total		

Other Expenses		
Student Loan Debt		
Credit Card Debt		
Groceries		
Clothes		
Personal Items		
Entertainment		
Eating Out		
Additional Liabilities		
Total		

Total All Expenses		
---------------------------	--	--

Why People Invest

Budget At Retirement

Money Coming In	
Employment Income	Goal
Employment Income	
Federal Income Tax	
State & Local Tax	
Social Security/Medicare	
Tips	
Net Income	

Other Income	
Rental Properties	
Stock Market	
Entrepreneurial Endeavors	
Interest Income	
Other	
Total	

Total Income	
---------------------	--

Money for Savings +/-	
Emergency Fund	
Retirement Plans	
Investments	
Short Term 'Fun' Savings	
Charities	
Total	

Total Income	
Total All Expenses	
Total Savings	
Money Left Over	

Expenses	
Living Expense	Goal
Rent / Mortgage	
Taxes / Insurance	
Utilities: Electric /Gas	
Utilities: Water / Garbage	
Cable/Satellite	
Internet	
Phone	
Other	
Total	

Travel Expenses	
Car payment	
Insurance	
Registration	
Gas	
Maintenance	
Other	
Total	0

Other Expenses	
Student Loan Debt	
Credit Card Debt	
Groceries	
Clothes	
Personal Items	
Entertainment	
Eating Out	
Additional Liabilities	
Total	0

Total All Expenses	
---------------------------	--

Lesson Questions

1. How do you calculate your net worth?
 - a. Subtract your assets from your liabilities.
 - b. Total up your assets and liabilities.
 - c. Add up your income and expenses and adjust for inflation.
 - d. Subtract your liabilities from your assets.
2. Over the past five years, what has been the average rate of inflation in the US?
 - a. 1%
 - b. 3%
 - c. 6%
 - d. 12%
 - e. 25%
3. When the Federal Reserve increases the money supply, what happens to the purchasing power of the dollar?
 - a. It does not change
 - b. It goes up
 - c. It goes down
 - d. It goes up briefly, and then goes down
 - e. It goes down briefly, and then goes up
4. Precious metals (such as gold or silver) that you own are an example of:
 - a. An asset
 - b. A liability
 - c. An annuity
 - d. A bond

Why People Invest

Essential Questions

What is investing? _____

Why do people invest? _____

What is inflationary risk? _____

Introduction to Investing

Warm-up Activity:

What do each of the following quotes mean to you?

“When you’re making money doing what you love, you are already retired.”

“Many describe the new retirement as having the freedom to do what you want to do, when you want to do it.”

■ Preparing to Invest

The reason many people invest is to achieve financial freedom. The term “financial freedom” means something different to each person, but many define it as being able to have the lifestyle they want and knowing they can afford it financially. To work toward attaining this goal it’s important to get your money started growing for you instead of having to work for every penny.

Introduction to Investing

Here are some important terms that relate directly to your financial freedom:

- **CASH FLOW** is the difference between the money you have available at the beginning and end of an accounting period.
 - **Positive** cash flow: Cash coming in is greater than cash going out.
 - **Negative** cash flow: Cash going out is greater than cash coming in.
 - **Breakeven** cash flow: Cash coming in and cash going out are the same.
- **NET WORTH** equals Assets minus Liabilities.
- **ASSET** is any item of economic value owned by a person or corporation
 - **Tangible** assets include gold, real estate, stocks.
 - **Intangible** assets include copyrights, trademarks, brand recognition.
- **LIABILITY** is a loan and/or other obligation you have to pay.
- **RETURN ON INVESTMENT (ROI)**. This performance measure helps investors compare the return offered by one investment to returns on other investments. ROI is calculated by dividing an investment's financial yield by its cost. The result is expressed as a percentage or ratio.

Lesson Activity: Investment Definitions

1. CASH FLOW

You receive a **\$1,500** check from a tenant on a rental property that you own. That month, your mortgage, insurance, taxes, and other rental property- related expenses for that unit come to **\$1,300**. Complete the following statement:

In the example above, the rental property provides the owner a
[type] _____ cash flow of
[amount] \$ _____ per month.

2. ASSETS

Which are more secure: _____ **tangible** assets or _____ **intangible** assets?

Why? _____

3. ROI (RETURN ON INVESTMENT)

Assume you purchased \$1,000 worth of stock. After a year, the stock is worth \$1,100.
What did you earn on the investment? \$_____ [*financial gain*]

Use the formula to determine the percentage of ROI.

$$\frac{\text{[Financial Gain]}}{\text{[Cost of Investment]}} = \text{[ROI]} \%$$

Lesson Questions

1. Having a *break-even* cash flow at the end of an accounting period means:
 - a. You had more cash going out than coming in.
 - b. You had more cash coming in than going out.
 - c. You had a net worth higher than your amount of assets.
 - d. Your cash going out and cash coming in were the same.
 - e. Your bank account is empty.
2. *Tangible assets* might include:
 - a. Real estate and stocks.
 - b. Net worth and liabilities.
 - c. Clothing and food.
 - d. Copyrights and trademarks.
3. ROI is calculated by:
 - a. Dividing net worth by investments.
 - b. Dividing tangible assets by intangible assets.
 - c. Dividing financial gain by the cost of the original investment.
 - d. Multiplying risk times potential return.
 - e. Multiplying assets times liabilities.

Introduction to Investing

Essential Questions

What is cash flow? _____

What is net worth? _____

What does ROI stand for and what does it mean? _____

[illegible]

Good Debt vs. Bad Debt

Warm-up Activity

What is good debt, and what is bad debt? Be sure to explain why.

Not All Debt is Bad

Good debt is the kind we use to buy assets—things like real estate, stocks, and businesses. The goal of good debt is to purchase items that we think will go up (appreciate) in value, so we increase our wealth over time. Bad debt is loans we use to purchase items that go down (depreciate) in value—things like cars. Good or bad, we should treat all debt with a healthy respect. Even loans used to purchase good investments can lead to financial problems if we don't have the proper knowledge base.

Good Debt

Investment Loans. For investment experts with high-level knowledge and a trusted team of advisors, investment loans can help gain leverage to earn higher return on investment.

Loans for Income-Producing Real Estate. This is considered good debt because when you rent the place to tenants to pay down your loan, you may earn income. If you purchased real estate in the right area at the right time, the property can increase in value.

Business Loans. For entrepreneurs looking to expand and grow their businesses, taking on a business loan may help.

Good vs. Bad Debt

Education Loans. Student loans and other investments that finance one's education can be good debt, depending on how well you plan. Since individuals with degrees tend to make more over a lifetime (typically around \$500,000 more) than those without higher education, this investment can be considered a good debt. However, student loans are bad debt if you drop out before finishing the degree. Also, if you choose an expensive school to study a profession that doesn't pay well, that debt also can be considered bad. Minimize student loan debt to avoid the stress associated with paying it back. Typically, not interest is accrued and no student loan payments are required while the student is in college.

Home Loans (for a property you live in). This may be considered good or bad debt, depending on your investment strategy. Purchasing a home may be a good investment because, in many locations, the value can increase over time. In other locations, home prices decline over time, and this bad debt causes people financial strain.

Bad Debt

Credit Cards. Essentially, any type of credit card is considered bad debt. Credit cards carry high interest rates and finance charges. Retail stores, banks, and other companies offer credit cards to consumers. Regardless of who issues a credit card, typically it is considered bad debt. However, a credit card can be good debt if you pay the money you borrow back in full each month; that helps increase your credit score and you incur no interest charges.

Personal Loans are cash loans from a bank or company. These types of loans are an unwise investment. Like credit cards, they carry high interest rates. While you may believe you need to access cash fast, this type of loan is not the best choice.

Payday Loans are similar to personal loans. However, in most cases you guarantee to pay the loan off with your next paycheck. Therefore the amount loaned is usually limited to the amount of your paychecks. They also hold high interest rates and allow the lender to deduct the amount of the loan from your next paycheck.

Car Loans. Since a car declines in value and offers no income, car loans are classified as bad debt. However, in today's age you often need a car to earn income; in that case the loan would qualify as good debt. To help ensure that your car purchase leans toward the good debt side, keep these tips in mind:

- purchase used cars (new cars lose up to 30% of their value immediately);
- shop for a good deal; minimize unneeded extras; and
- shop for the best car loan.

CREDIT MYTHS

- ☐ More income means a better credit score – credit represents your ability to pay your bills on time, not how wealthy you are.
- ☐ A cash-only money management system will help your credit score – In order to have a good credit score, you actually need to use credit responsibly.
- ☐ Closing down credit card accounts improves your credit score – This can be harmful if you carry too much of a balance on other credit cards.
- ☐ I don't need to check my credit report if all my bills are paid – Your credit report can contain erroneous information on it, from something as simple as incorrect dates to fraudulent accounts.
- ☐ Bad credit marks are removed after seven years – some information is removed but other information, like a chapter 7 bankruptcy, will stay for 10 year

Good vs. Bad Debt

Lesson Activity: Good Debt or Bad Debt

The best way to learn the difference between good debt and bad debt is to choose. Complete the chart by yourself or with a friend to figure out whether each situation generates good debt or bad debt.

1. Shelly wants to go to college but her family has no money for her to use toward expenses. She doesn't make enough money to pay for school and doesn't qualify for grants. She wants to take out a \$5,000 loan to pay for school.

<input type="checkbox"/> Yes, it's good debt	OR	<input type="checkbox"/> No, it's bad debt
because _____		

2. Daniel wants to buy his girlfriend an engagement ring. There are some rings in his price range but he found a really nice one that he can finance and pay only \$20 per month.

<input type="checkbox"/> Yes, it's good debt	OR	<input type="checkbox"/> No, it's bad debt
because _____		

3. George is short on cash until payday. His car broke down and will cost \$750 to fix. He has been saving for about a year and has \$1,000 in savings. He wants to use his credit card so he does not deplete his savings account.

<input type="checkbox"/> Yes, it's good debt	OR	<input type="checkbox"/> No, it's bad debt
because _____		

Lesson Questions:

1. Which of the following is most likely to be an example of a “good” debt?
 - a. Personal loan
 - b. Business loan
 - c. Payday loan
 - d. Car loan
2. Which of the following is most likely to be an example of a “bad” debt?
 - a. Investment loan
 - b. Payday loan
 - c. Educational loan
 - d. Home loan
3. A student loan is:
 - a. A good debt.
 - b. A bad debt.
 - c. Maybe a good debt, maybe a bad debt depending on many factors.



Good vs. Bad Debt

Essential Questions:

What is good debt? _____

What is bad debt? _____

What type of debt is a home loan considered, and why? _____

What type of debt is a credit card considered, and why? _____

Compound Interest

Warm-up Activity

“The most powerful force in the universe is compound interest.” *Albert Einstein*

What do you think this quote means? _____

Compound Interest

What if you had known when you were 18 years old that, if you just invested \$100 a month, you could become a millionaire by retirement age due to compounding interest?

Would you have been inspired to start saving and investing your money when you were younger? Most people would answer, “Yes!” Unfortunately, even today most people do not learn about money when they’re young. And too many of us learn about money at the “school of hard knocks.”

People who start investing \$100 a month before they turn 30 have a good chance of becoming millionaires.

It happens due to a principle called compound interest. Compounding interest allows money to grow off of itself, and the younger a person starts to invest, the larger that person’s money can grow. Understanding the principle of compounding interest will help you when you begin investing.

The beauty of compounding interest is that you make money **BOTH** on the money you deposit **AND** on the interest your investments pay you. So interest is calculated not only on the initial principal, but also on the accumulated interest your money generates over time.

Compound Interest

That's the definition of *compounding interest*: the process by which the value of an investment increases exponentially because it earns interest both on the principal and on the prior interest payments.

This may sound complicated. Don't worry too much about the definition. Here's what compounding interest would mean to someone who started investing at age 18:

Based on a 12% Rate of Return	
If you invest this much per month ...	You can be a millionaire at this age!
\$100	57
\$200	51
\$400	46
\$700	41

But no matter your age, you can still take advantage of compounding interest. There are various investment strategies to help you get better returns on your money. But do you see how just a simple savings plan and compounding interest can work in your favor?

Lesson Activity: A Penny a Day

Listen carefully to the business proposition put forth by your instructor who needs someone to work for him/her for one month. Here are your options:

1. On the first day, you will earn one penny. But your "salary" will be doubled each day for the entire 30 days.
2. You can choose to be paid a lump sum of \$100,000 for the entire month.

Consider your options carefully before choosing, then select the one you think will be most successful. Use the calendar grid provided to make your calculations based on the instructions.

Investments

Day 1	Day 2	Day 3	Day 4	Day 5	Day 6	Day 7
Day 8	Day 9	Day 10	Day 11	Day 12	Day 13	Day 14
Day 15	Day 16	Day 17	Day 18	Day 19	Day 20	Day 21
Day 22	Day 23	Day 24	Day 25	Day 26	Day 27	Day 28
Day 29	Day 30					

Compound Interest

Lesson Activity: Compounding Interest

Follow along with your instructor and use your calculator to come up with the correct results.

You invest \$10,000 that earns a return of 10% per year. At the end of one year, you will have made \$1,000: $\$10,000 \times .10 = \$1,000$

Now calculate your total account balance at the end of the year by multiplying $\$10,000 \times 1.1 = \$11,000$

Next calculate how much you would have in your account if you earned **10%** a year from your **\$10,000** investment for **15** years.

Round to the nearest dollar: \$ _____

■ The Rule of 72

The **Rule of 72** says that if you divide 72 by the non-decimal interest rate (10, not 0.1) you are receiving from an investment the answer tells you how many years it will take for that money to double. This principle helps illustrate that the earlier you start saving for retirement, the better the chances that your money will double.

EXAMPLE: If you have \$10,000 in savings and are earning a 10% interest rate, your money will double in 7.2 years. $72 \div 10 = 7.2$

Lesson Activity: Using the Rule of 72,

1. How long will it take to double your \$10,000 at %% interest? _____

2. If you put your \$10,000 in your piggy bank at 0% interest, how much will you have when you retire? _____

■ Preparing to Invest

The impending reduction and/or elimination of pension and SSI benefits make it critical that you become an educated investor.

The basic definition of investing is buying assets that you believe will increase in value.

Assets include purchases like real estate, stocks, precious metals, or businesses. Since assets do not always increase in value, every investment carries an element of risk.

1. **CONSISTENCY**

The first step to achieving financial success is following a consistent, long-term investment plan. Adopting a regular savings plan forms the foundation of your investing career. Your savings forms the backbone of a plan that provides you with money to invest on a regular basis.

Building wealth over time is all about taking the long view, and not getting bogged down in short-term gains. Building financial freedom takes time. But that doesn't mean you shouldn't get involved now. Success can come faster than you think!

By learning simple investment lessons you can begin making money while you sleep. If you start investing early and consistently, you'll harness the power of compounding interest.

2. **CHECK YOURSELF**

Emotions make us do things we wouldn't normally do. This is especially true with investing. The negative emotions most likely to affect people when they invest are greed and fear. Many people just chase the almighty dollar. They want more and more – yet when they start to lose money, they become scared and freeze up.

Another emotional crutch for some people is to fall in love with a stock, or a company, or a piece of real estate. Despite warning signs telling them to sell, they foolishly continue to hold on to it, even as it depreciates in value!

People who carry emotional baggage when they invest are likely to make bad decisions more often than people with a clear, relaxed business focus.

3. **CONTROLLING YOUR EMOTIONS**

Controlling your emotional responses to risk will be an important part of your investment plan.

"Get rich quick" schemes are a dime a dozen — someone calling you with a "hot" stock tip, or begging you to invest in a sweet deal. These types of salespeople are trying to stir up your emotions by selling you an improbable dream. Ponzi schemes, bank fraud, and the Enron collapse are some good examples of investment scams in which people lost millions. Don't let that happen to you. Gain the knowledge you need to make educated financial decisions for yourself.

When someone approaches me with an investment idea, the first question I ask is, "Do you invest in this yourself?" If the answer is "No," – which it often is – I thank them for their time and politely decline.

Compound Interest

It's good to listen to other people's investment ideas, but never let them convince you to get involved before doing your own research. Check out their claims by looking online, reading books, and talking to trusted advisors. The more you know about money matters, the more successful you'll be – and the more fun you'll have doing it!

Always continue to learn and think for yourself. Put your money on your mind, and keep your mind on the money. Soon you could be making \$10,000 a month in interest alone!

Lesson Activity: Preparing to Invest

Follow the instructor's directions to complete this activity. The checklist on the next page will be useful as you prepare to invest in your future.

Rate your current investment confidence level:

1 2 3 4 5 6 7 8 9 10

Low

High

Do you want to invest within the next few years?

☐ Yes

☐ No

PREPARING TO INVEST CHECKLIST

- ☐ Before you consider investing be sure to have six months' worth of expenses put away in your emergency fund.
- ☐ Be free of credit card debt and have a working budget in place that allows you to save money each month.
- ☐ Only use *risk capital* for investments. Risk capital refers to money that you can afford to lose without putting you in dangerous financial circumstances.
- ☐ Have a team of trusted advisors and mentors at your disposal.
- ☐ Create an overall investment plan and determine how the investment you are considering fits into your plan.
- ☐ Gain expert-level knowledge on each specific investment you are considering by conducting *due diligence* research. Due diligence means you educate yourself on the investment and do your homework before committing your hard-earned money.
- ☐ Determine the risk and potential reward. All investments have a certain amount of risk and reward. Ideally, you want to earn the highest return (reward) with the least amount of risk.
- ☐ Have an exit plan in place in case the investment doesn't go as planned.

Lesson Questions

1. According to the rule of 72, if you earn a 10% interest rate how long will it take for your money to double?
 - a. 1 year
 - b. 72 years
 - c. 7.2 years
 - d. It depends on the type of investment.
2. Interest earned both on an original investment of money and also on the interest the original money has accumulated is called _____ interest.
 - a. Simple
 - b. Nominal
 - c. Compound
 - d. Real
3. If you invest \$1,000 and earn 8% interest, to what amount will your investment have grown after 1 year?
 - a. \$1,800
 - b. \$920
 - c. \$1,080
 - d. It depends on the type of investment.
4. Compounding interest on your investments is beneficial because_____.
 - a. It protects you against investment risk.
 - b. It allows you to earn interest on the money you initially saved or invested, and then as you earn interest, the interest money earns interest as well.
 - c. It provides a way for you to diversify your investments.
 - d. You are able to calculate a return on investment (ROI).
5. How will the “Rule of 72” help you when you consider various investments?
 - a. It will let me know when my investment has increased 72%.
 - b. It lets me know when my investment will double.
 - c. It can reduce my risk.
 - d. All of the above.

Compound Interest

Essential Questions

What is compounding interest? _____

What does the Rule of 72 tell you? _____

What is a Ponzi scheme? _____

What are some ways to become prepared to invest? _____

Risk & Potential

Warm-up Activity

What does *financial risk* mean to you? _____

What are some events that might cause an investment to lose money? _____

■ Risk Management

Risk is the chance that an investment you make will lose money. There are ways you can manage risk, but a certain amount of risk will remain present in every financial decision you make. Consider the following examples:

Common investment risks include:

- **INFLATION RISK.** The value of an asset or income decreases due to the reduced value of the currency. The purchasing power of the investment return declines.
- **LIQUIDITY RISK.** This risk is commonly associated with real estate and refers to the inability to convert an asset to cash. With stocks that have a high trading volume, typically your liquidity risk is low – with the exception of when there is a significant market correction.
- **INTEREST RATE RISK.** When interest rates rise, the value of a fixed-rate investment will decline in value.
- **BUSINESS RISK.** The potential for a company in which you have invested (in a stock or bond) to go out of business, become bankrupt, or be unable to pay back their bond obligations. Enron, Blockbuster, and Wicks Furniture are a few examples of companies that are now out of business. Diversification (holding a variety of investments) helps minimize your business risk losses.
- **OPPORTUNITY RISK.** When you're presented with a better investment option than the one to which you've committed your money, that's called opportunity risk. Because you're already tied up in a project, you cannot act on the new opportunity and you potentially lose profits.

Risk & Potential

- **CREDIT RISK.** Credit risk is a specific risk for bondholders where the bond issuer cannot make interest or principal payments.
- **MARKET RISK (aka Systematic Risk).** The uncertainty and movement of financial markets is termed market risk. This type of risk affects all securities in the same asset class in a similar manner. Changes in interest rates, tax base, and other factors all affect your potential return on investment. Some events that can increase your market risk include: natural disasters, major policy changes, and events that can impact the overall market (like the collapse of Bear Sterns).
- **REINVESTMENT RISK.** This risk mainly applies to those bondholders whose bonds are coming due who are seeking a bond investment with equal or greater interest and the same amount of risk. If they're unsuccessful, their income can be reduced or they may have to invest in riskier bonds.
- **POLITICAL RISK.** Government action that might change the value of the investment is a risk that must be considered.

■ Importance of Noting Risk and Potential

Understanding your risks and their potential to alter your investment returns is extremely important. Planning, knowledge, sound advice, and due diligence are some ways to minimize investment risk.

Risk capital refers to money that you can afford to lose without putting you in dangerous financial circumstances.

- You should only invest risk capital.
- You should gain knowledge about each investment type you are considering.
- You should have a team of trusted advisors and mentors at your disposal.

BEFORE YOU INVEST ...

1. First build up an emergency fund in your savings account that would cover your expenses for a certain length of time (6-24 months) should you suffer a loss.
2. Gain knowledge about each investment type you're considering, and have a team of trusted advisors and mentors in place to help guide your decisions.
3. Create an overall investment plan and judge how well each new investment you consider fits into that plan.
4. Calculate the risk and potential reward of each investment; ideally you want to earn the highest return (reward) with the least amount of risk.
5. Conduct due diligence research on each specific investment you consider. Due diligence

means you educate yourself on each investment you're researching, and do your homework before committing your hard-earned money.

6. Finally, create an exit strategy in case an investment doesn't pan out as you've planned.

Evaluate the Pros and Cons

There are a lot of different investments out there, so make a list of possibilities and evaluate the advantages and disadvantages of each one. Weed out any investments with overwhelming "cons," and zero in on the best investments for your budget and goals.

Lesson Activity: How Much Can I Lose?

Consider each of the following situations and indicate how much you think you can lose in each:

1. You buy a piece of real estate for \$200,000 and make a \$20,000 deposit.

How much can you lose?

- ☐ Nothing
- ☐ Your investment of \$20,000
- ☐ More than your original investment

2. You invest \$3,000 to purchase 100 shares of a stock values at \$30 a share.

How much can you lose?

- ☐ Nothing
- ☐ Your investment of \$3,000 plus any trading fees
- ☐ ore than your original investment and trading fees

Lesson Questions

1. The inability to convert an asset into cash defines which type of risk?
 - a. Opportunity risk.
 - b. Political risk.
 - c. Market risk.
 - d. Liquidity risk.
2. Which of the following is a key method for managing risk in one's investment plan?
 - a. Investing as much of one's money as possible in the stock market.
 - b. Choosing investments with potential for the highest returns.
 - c. Using the Rule of 72 to determine how long your investment will take to double.
 - d. Conducting due diligence research on every investment one is considering.

3. You should only invest _____.
- a. Risk capital.
 - b. Money borrowed on a credit card.
 - c. In real estate.
 - d. Interest.

Essential Questions

What is a financial risk? _____

What are three different types of financial risk?

1. _____
2. _____
3. _____

What is risk capital? _____

What is due diligence? _____

Building A Team of Trusted Advisors

Warm-up Activity

What is a trusted advisor? _____

Building Your Team

As much as you need to think for yourself, nobody ever made a million dollars by working exclusively on their own. It takes teamwork. By establishing a winning team, you can be the best and invest.

Creating the right team of professional advisors is important to your success. It's important to work with trusted, reputable, and established professionals within any given field. Would you hire a computer programmer to fix your plumbing? Neither should you choose a financial advisor without any financial expertise.

Your financial team should include the following members:

- College planner – if you or your children are going to college this is a must.
- Tax planner – the tax code covers more than 15,000 pages.
(Either learn all the regulations, or find a professional to do your taxes.)
- Attorney
- Financial mentor
- Financial coach, advisor, or professional
- Insurance agent
- Realtor and mortgage professional

Each of these members will play an advisory role in your success. Just like researching an investment, do your homework before selecting team members. Ask your friends, family, and business associates for referrals. Do your potential advisors have references? Can you check their histories?

■ Your Rock-Solid “A” Team

- **FINANCIAL MENTOR.** A mentor could be someone you know who successfully manages his/her own money, someone whose advice you feel comfortable soliciting. The more knowledgeable, experienced people you have around you, the better decisions you will make.

But never take anyone’s advice without doing your own homework. You’re looking for a helpful guide, not a puppet master! Although some people may seem to know how to manage their money properly, appearances can be deceiving. Always do your own research as a backup. Perhaps one day you will become an experienced mentor yourself!

- **TAX PLANNER.** Having the right tax planner on your team will keep more money in your pocket when April 15 (Tax Day) comes around.

The complicated tax code is more than 17,000 pages long, so having a tax planning professional is critical. Boning up on basic tax knowledge doesn’t hurt, though, since about one-fourth to one-third of your income goes to paying taxes if you work for someone else.

Besides the questions listed below, ask your tax planner: “Are you available year-round for questions?” If you’re first starting out, your taxes will be pretty easy to manage, but we still don’t advise you to do them yourself. Hire a professional with whom you can grow as your investments and income grow.

- **COLLEGE PLANNER.** If you or your children are going to college, finding a talented college planner is a must. It will be important to determine your (or your child’s) return on investment for obtaining the college degree. How much will the education cost, compared to the increased earning potential with the degree?
- **ATTORNEY.** Legal questions often arise when you review contracts and other documents, so finding an efficient attorney is a good idea. Any time you need to sign a contract, hire an attorney who specializes in the relevant field. An inexpensive way to hire an attorney is through pre-paid legal companies, which typically offer several different plans. Choose the plan that best fits your needs.

Sometimes you might feel you don’t get straight answers from legal folks. Remember that they’re trying to limit their own liability. To avoid this problem and get better answers, consider reviewing all contracts yourself first, writing down any specific questions you have prior to asking the attorney for review. You’ll expand your knowledge and get a better grasp of the business side of investing.

- **REALTOR AND MORTGAGE PROFESSIONAL.** If you own or plan to purchase a home, the expert assistance of a realtor and/or mortgage professional will be critical to your advisement team. They can help you calculate the mortgage you can afford, obtain financing, and research and select the perfect property for your needs.
- **FINANCIAL ADVISOR.** Finding a trusted financial advisor can help you achieve your financial objectives and forms an important member of your investment team. Find an advisor who believes in furthering your education and who takes the time to truly understand your investment objectives.
- **INSURANCE AGENT.** Many people just choose insurance companies based on the cheapest rates. But choosing by price alone might actually cost you more in the long run. Pick an established insurance company with competitive rates, one that offers all types of insurance (auto, home, life) and that knows the business inside and out. Select an experienced agent who can address your unique situation.

Ask each professional you're considering as a member of your trusted advisor team the following basic questions:

- How many years have you been in your respective field?
- What are your fees and how do you get paid?
- What are your credentials?
- What professional boards do you belong to?
- Have you ever had any disciplinary action?
- What is your past experience?
- What other services do you offer?
- How many other people do you advise?

Choose people who not only are educated, but whom you like on a personal level. These relationships will be long-term, so you want to work with people you enjoy being around. If your financial planner, realtor, lawyer, or tax professional is a close trusted friend, and you know he or she has been successfully managing and investing money for years, that person may be an excellent resource.

While it's important to have a great team on your side, you shouldn't use your advisors as a crutch. Your financial decisions are ultimately your own. Your advisors just serve the purpose of informing you about all your available options.

Team of Trusted Advisors

Once you have the proper team in place, your advisors will support your efforts in ways you can't accomplish alone. You'll have more time at your disposal and the peace of mind you need to start building your fortune.

Lesson Activity: Investment Protection

Consider the following scenarios and write down your answers to the questions about each.

1. A mortgage broker recommends to a family that makes \$2,500 a month that they get a loan at payments of \$1,000 per month. What he doesn't tell the family is that,
 - in the second year, the payments increase to \$1,500;
 - in the third year payments will be \$2,000; and
 - by the fifth year payments will be \$3,000 per month.

This escalated payment schedule is mentioned in the 40 pages of legal disclaimers the family received, but they didn't read all those pages because the documents were confusing.

How could this family have protected themselves from getting a mortgage that was bad for their situation?

2. In 2008, one of the largest investment banking firms in the country was recommending that people purchase an investment while secretly betting that the investment would lose money. As a result, the investment firm made millions while the people lost millions.

How could the people who became prey to this scandal have protected themselves?

Lesson Questions

1. Which of the following are two professionals you should have on your team of trusted advisors?
 - a. College professor and health care professional.
 - b. Doctor and event planner.
 - c. College planner and tax planner.
 - d. Accountant and pastor.
2. What is the primary role of a financial advisor?
 - a. To make your final investment decisions for you.
 - b. To help you get a mortgage.
 - c. To protect you from banking fees.
 - d. To inform you about all the options surrounding a financial decision.
3. Which of the following is an important question you should ask a potential member of your team of trusted advisors?
 - a. What is your past experience?
 - b. How much do you earn?
 - c. Do you have any hot stock market tips?
 - d. Where did you go to school?
 - e. How many other people do you advise?



Team of Trusted Advisors

Essential Questions

What is a trusted advisor? _____

Why is it important to have trusted advisors in business?

What are three things I should ask a potential advisor?

1. _____

2. _____

3. _____

Investment Checklist

Warm-up Activity:

What steps should I take before I start investing?

▀ Becoming Prepared to Invest

You now know some very compelling reasons why you should begin investing to get your money working for you, instead of you having to work for every dollar. But before you dive into investments you also must take some important steps to become prepared.

Knowledge forms the foundation of your investment strategy and financial planning. Once you have gained a solid knowledge base about all the available investment options, your next most important step is to build a trusted team of advisors.

Another key component of investment preparation is freeing up risk capital to use for your investments. Before implementing any investment strategy you should build up an emergency savings fund that equals between 6 and 24 months' worth of your expenses. Then if your income source were to dry up (for example, if you lose your job), you could still meet your obligations for that number of months.

Once you have an emergency fund that would last you 6-24 months and a working budget that includes a good savings plan, you can start building up risk capital that you can afford to invest. Minimizing bad debt should be an important focus of your budget.

Investment Checklist

Finally, you need to develop an overall investment plan that aligns with your lifestyle goals and matches your risk tolerance. You should include an exit plan in case an investment doesn't perform as predicted. Don't forget to conduct due diligence research on every investment you're considering.

Lesson Activity: Investment Preparation Checklist

KNOWLEDGE

Circle the number that represents your current financial knowledge level. Then underline the number that represents the knowledge level to which you plan to improve your personal financial knowledge within one year.

1 2 3 4 5 6 7 8 9 10

Low

High

TRUSTED TEAM

Place a check mark next to those trusted team members you will have in place within one year.

- | | |
|---|--|
| <input type="checkbox"/> Tax planner | <input type="checkbox"/> College planner |
| <input type="checkbox"/> Attorney | <input type="checkbox"/> Financial mentors |
| <input type="checkbox"/> Financial advisors | <input type="checkbox"/> Insurance agent |
| <input type="checkbox"/> Realtor or mortgage professional | |

EMERGENCY SAVINGS

Depending on your qualification and ability to get a job, a 6- to 24-month emergency fund will prepare you for an unexpected event or job loss.

- ☐ I currently have ____ months in emergency savings.
- ☐ Within one year I will have ____ months of emergency money saved.
- ☐ I have a working budget in place. ☐

RISK CAPITAL

Once I build up my emergency fund, I will start to save risk capital. Risk capital is money that I can invest without risking dangerous financial circumstances. I will start saving risk capital to invest by [date]_____.

MINIMAL BAD DEBT

Many people pay 20% or higher credit card interest rates. Those people earn less on their investments.

If your investments are earning 6% and you're paying 24% interest on credit card debt, what action should you explore? Why?

If you owed \$20,000 on a credit card at a 0% interest rate and you received \$20,000, would it be better to pay off your credit card or to invest that money? Why?

PLAN

I will have solid ideas on my investment and retirement plan by the end of this coursework.

Check here ☐ if over the next 12 months you will take time to finalize your plan, even if you don't yet have enough money saved to risk yet.

DUE DILIGENCE

Check here ☐ if you will perform due diligence on the specific investments or companies in which you consider investing.

Lesson Questions

1. What is the first, most important step you should take before you start investing?
 - a. Conducting due diligence
 - b. Having a trusted team
 - c. Gaining knowledge
 - d. Borrowing money
 - e. Selling off assets

Investment Checklist

2. Why is minimizing bad debt important to an investment plan?
 - a. Bad debt carries high interest rates that will decrease the amount you earn on your investments.
 - b. Having bad debt looks negative on a budget.
 - c. Bad debt increases the brokerage fees you have to pay.
 - d. Having bad debt will interfere with your exit plan.
3. It's a good idea to start creating an overall investment plan even if you don't yet have enough money saved to risk investing.
 - a. True
 - b. False

Essential Questions

Name at least four important steps you should take to prepare for investing:

1. _____

2. _____

3. _____

4. _____

Types of Investments

Warm-Up Activity

Why should I learn about investments as part of my long-term financial planning strategy?

Investment Basics: Opportunity Cost, Risk, and Reward

When striving to reach a state of financial wellness, it is important that you have a solid understanding of the types of investments available and how each can fit into your long-term financial strategy.

Every time you choose to make an investment, you will have less money to put into other investments. That concept is called “opportunity cost.”

Each investment opportunity offers varying levels of risk and reward that should be calculated prior to taking any action.

In general, the higher the risk of a given investment, the higher its potential reward will be; and lower-risk investments have lower potential returns.



Types of Investments

Types of Investments

SAVINGS ACCOUNTS	
Returns	Are low, typically below inflation. In 2014, most savings interest rates are less than 1%.
Benefit	Include ability to access money quickly and safety of principal.
Risks	There is low risk of capital loss because banks are insured by the FDIC (credit unions, by the NCAU).
Liquidity	You can access your money instantly (although with larger amounts, you may experience some delay. Low cost to access money.
CERTIFICATE OF DEPOSIT (CD)	
Returns	are low, but often higher than savings accounts. The more money you have to invest in CDs, the larger return you can earn. In 2012, CD rates for one year were about 1%.
Benefit	Money Market accounts have similar qualities to CDs but are typically shorter in term, often with maturity dates of one year or less.
Risks	There is low risk of capital loss because CDs are insured by FDIC (banks) or NCAU (credit unions). The longer the term of a CD, the higher the risk that it will earn a return less than inflation.
Liquidity	CD liquidity varies. You may pay a fee to access the money. There will be minimal or no cost — <u>if you wait until the maturity date</u> . If you sell before the CD maturity date, you will probably pay penalties.
ANNUITY.	
Investors can opt to set up an annuity to provide income for a specific period of time, a term which can end during their lifetimes.	
Returns	Varies. Income is dependent on the amount of your investment, length of payments and performance, and what type of annuity you choose. Two common types of annuities are fixed annuity, which provides a guaranteed payout; or variable annuity, where income is determined by the performance of the annuity's underlying investments.
Benefit	Include the potential to generate a future income stream; some annuities offer capital protection.
Risks	Vary with type of annuity. Common risks include lack of liquidity and inflation risk. There is also a smaller risk that you'll lose your capital investment if the insurance company that insures the annuity fails.
Liquidity	Most annuities allow for some type of distribution penalty-free; however, you probably won't be able to access all your money immediately without paying penalties.

INDIVIDUAL STOCKS	
Returns	Varies depending on market conditions and investment strategies.
Benefit	Stocks have the potential to earn returns greater than the rate of inflation.
Risks	You can lose 100% of your money.
Liquidity	You can sell stocks any time the market is open. Many stocks can be traded after hours.
MUTUAL FUNDS	
Returns	Varies greatly depending upon type of mutual fund investment.
Benefit	Include the availability of a wide selection of mutual fund options that meet a variety of investment goals. The returns you can expect are tied to the amount of risk you're willing to take.
Risks	Risk varies greatly depending on the type of mutual fund in which you invest;, with some funds, you can lose your entire capital investment.
Liquidity	Most mutual funds are liquid and, like shares, can be sold the same or next day at Net Asset Value (NAV). There are different types of mutual fund classes that you can choose. Some penalize for early withdrawal.
COMMODITIES	
Returns	Varies greatly.
Benefit	Commodities may provide a hedge against inflation.
Risks	There is a risk of losing some or all of your money.
Liquidity	In most markets, you can access your money quickly.
EXCHANGE TRADED FUND (ETF)	
Returns	Varies depending on the type of ETF you choose.
Benefit	ETFs provide broad market exposure and typically have lower operating expenses than mutual funds. You can buy and sell ETFs when the market is open, compared to mutual funds which only allow sales at the close of market.
Risks	You can lose some or all of your money.
Liquidity	Most ETFs offer a high degree of liquidity.

Types of Investments

BONDS	
Returns	Varies widely based on type of bond. Bonds have a price and yield proportional to their risk. Returns on municipal bonds (issued by cities, counties, etc.) vary, depending on safety of investment, but can range from 2% to 5%. Returns on corporate bonds range by risk from 4% to as high as 20% for very high risk bonds, aka “junk” bonds.
Benefit	Bonds are typically less volatile than stocks, and are often used to stabilize portfolio value. Income is received at regular intervals. Some bonds have tax advantages.
Risks	Varies. If you choose a high-risk bond and the company that issued the debt goes bankrupt, you could lose your entire investment. This is known as business risk. There is also inflation risk. Bond prices have an inverse relationship with interest rates: when one rises, the other falls. So if you sell before the bond matures, you could lose money.
Liquidity	Typically bonds are less liquid than stocks. If a bond is downgraded or in default, you might have trouble getting out of the investment.
REAL ESTATE	
Benefit	Investing in real estate has several benefits: appreciation (property goes up in value); cash flow (rental and income producing properties); and potential tax benefits and leverage.
Risks	Depreciation, falling housing prices, and being unable to sell are risks of owning real estate. Most people get loans to buy real estate. If you lose your job or have financial hardships, you may not be able to pay back the loan. Then you might have to “short sell” the home (sell for less than the house is worth) or be foreclosed (the lender takes back the home). In both cases, you could lose more money than you’ve invested, plus it would hurt your credit rating.
Liquidity	In good real estate markets, you can sell within a few months. In bad real estate markets, it may take years to sell at a discount. Cost of sale is about 8% of the home sales price.

Lesson Activity: Opportunity Cost

Consider each of the scenarios described below, and write your thoughts about the best decision for each situation.

1. You are looking to purchase a rental property in six months. You have \$25,000 in your checking account that is not earning any interest. You would like to see the \$25,000 working for you.

What investment(s) would you consider with this scenario?

2. You are looking for an income stream when you retire. You have calculated exactly how much you need to live, and you don't have any extra money to make riskier investments.

Which investment sounds right to you in this situation?

Types of Investments

3. You are young and willing to take educated investment risks that earn high returns.

What investment options may be best for you?

4. You need to access your money in a month. Where could you put your money?

5. You want to save money to eventually purchase a home. You plan to buy a home within five years but will do so sooner if your money earns good returns.

What are the types of investments to consider in this situation?

Lesson Questions

1. What is opportunity cost?
 - a. The liquidity of an investment.
 - b. The idea that when you choose an investment option, you will have less money available to invest in other options.
 - c. The risk of losing one's capital.
 - d. The cost of buying a stock.
 - e. The benefit an investor receives from taking a higher risk.

2. When choosing investments, the relationship between risk and reward is best stated as:
 - a. The higher the risk, the lower the potential reward.
 - b. The lower the risk, the higher the potential reward.
 - c. The higher the risk, the higher the potential reward.
 - d. The higher the reward, the easier it is for the investor to calculate risk.
 - e. There is no relationship between risk and reward.

3. In investing, the term *liquidity* refers to:
 - a. How quickly the investment can be turned into cash.
 - b. The value of the investment in whole dollars.
 - c. The ability of the investment to keep pace with inflation rates.
 - d. The perceived ability of the investor to pay back his or her debts.
 - e. The value of the investment according to the consumer price index.

Types of Investments

Essential Questions

Name four types of investments currently available.

1. _____
2. _____
3. _____
4. _____

What is opportunity cost?

What is the relationship between risk and reward when making investments?

The Stock Market

Warm-Up Activity

What is a stock? _____

What does diversification mean? _____

What Is the Stock Market?

You may have heard stories about the millions of dollars made by people who owned stocks or shares in Microsoft, Google, and Wal-Mart. There are many different types of financial markets: stock, bond, option, and futures markets are just a few. The stock market is one piece of the overall U.S. financial market. The stock market is a market for trading the stock of companies and other financial securities. A stock is genuine partial ownership in a company. For example, if you owned 10,000 shares of a company that has 1,000,000 outstanding shares, you would own 1% of that company.

The stock market offers investors the opportunity to reap rewards, but there is also a risk. For example, have you ever heard of Enron? How about WorldCom? (Hint: both had their stocks drop to \$0 in value). Although any investment carries risks, education, experience, and a trusted team can help you achieve successful returns on your investments.

The stocks of companies are listed and traded on *stock exchanges*. The stock of companies in the United States is listed on several different exchanges; for example, the New York Stock Exchange (NYSE) and the NASDAQ.

During trading, stocks are bought and sold by bidding. When the **bid price** (price at which buyer is willing to buy) and **ask price** (price at which seller is willing to sell) match, a sale takes place. This means that prices can fluctuate day-to-day and the worth of the stock you own can change, depending on demand for the company's stock. The stock market moves based on prices at which people are offering to purchase a stock. You can make a consistent, steady return using index investing, no matter which way the market moves.

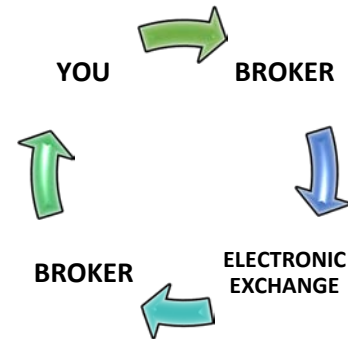
The Stock Market

How Buying & Selling Works

Let's break it down. A stockbroker is the middleman. He sells or buys stock on your behalf. The reason is that stock transactions must be made between two members of the exchange – you can't just walk into a stock exchange and start trading stocks. So you're going to be using a broker to invest in stocks.

In addition, stockbrokers may also offer financial advice to their clients on which stocks to buy. (Bear in mind, they're on commission – everyone's after your hard-earned money!) Therefore, a basic *stock market transaction* works like this:

YOU ➡ BROKER ➡ ELECTRONIC EXCHANGE ➡ BROKER ➡ YOU



HINTS FOR SUCCESS: A FEW IMPORTANT LESSONS

- ☐ **Don't listen to "hot stock tips."**
Most of the time, they are wrong and move people away from their overall investment strategy. You've probably already received bogus stock tips in your email spam. That's where these tips belong – in your junk folder!
- ☐ **Don't invest in individual stocks unless you are highly-educated or have a trusted team.** It can be trick to pick a winner out of a bag of hundreds or thousands of stocks.
- ☐ **Be careful who you take advice from.** Wall Street is full of conflicts, and everyone wants a piece of your money.

Lesson Activity: Auction Game

Follow the instructions provided by your instructor. During the game, you will have an opportunity to bid on an item against your classmates.

Basic Principles of the Stock Market

SUPPLY AND DEMAND

This is a fundamental rule of economics. The stock market runs according to this rule.

- **Supply** is the quantity of stock shares available for sale.
- **Demand** is the number of stock shares investors are willing to purchase at a given price.
- If supply is greater than demand, in the case of stocks, then the price will naturally fall. If supply is less than demand, the price will go up.

This principle explains why stock prices go up and down, but the reason for greater interest (or lack of interest) in a stock is more related to the company's performance, gossip about the company's future, and/or technical factors.

RISK AND RETURN

Just like supply and demand, risk and return are correlated (or they should be if you're getting a good deal).

- If an investment is low risk, you probably can't expect high returns.
- In high-risk ventures, you can expect higher returns in exchange for risking your money.

For instance, if you invest in a brand-new company with no track record, you're taking a high risk. What if the company goes out of business? You would lose everything. Or if it's successful, you could make a lot of money.

Once you have a solid savings account and a lot of knowledge about choosing individual stocks, it's okay to allocate a small portion of your portfolio to riskier investments. But not before!

OWNERSHIP

Owning a stock makes you co-owner of the company. Ownership gives you a voice in the company's business. You can vote at meetings and take a real interest in the inner workings of the company you've invested in. You can vote at meetings and take a real interest in the inner workings of the company. You act through an appointed group of individuals called the Board of Directors. This board acts in your interest while the company's management acts in the company's best interest. The company's management (CEO and other executive staff) answer to the Board of Directors.

STREET TALK

You've probably heard the word on the street. Now learn the lingo of Wall Street.

- **Share** — A share is an ownership unit of a company issued to shareholders.
- **IPO** — Initial Public Offering (IPO) is the first sale of a corporation's common shares to public investors. The main purpose of an IPO is to raise capital for the corporation.
- **P/E Ratio** — The price/earnings (P/E) ratio represents a stock's present price in relation to its per share earnings from the past year.
- **Moving Averages** — Technical investors look at charts and evaluate the stock price in relation to the average of a stock's closing price for a specified number of previous closing prices. This can indicate whether stock is moving up or down – which is important for analysis because once a stock starts moving in a particular direction, it tends to gain strength and continue moving in that direction.
- **Volume** — equals the daily number of shares of a security that are traded. This is another indicator. Increased volume on increasing prices shows accumulation. Increased volume on lower prices shows distribution. Price/volume relations can determine which way a stock will move.
- **Consolidation** — occurs when a stock pulls back after a move up or down, and temporarily trades in a narrower range on lower volume.
- **Odd Lot** — order to buy or sell less than 100 shares of a stock.
- **Stop Loss** — This is a sell order placed under current stock price to limit losses in case a stock price goes down. For example, your stock is currently at \$20. You want to sell if it drops to \$18, so you would simply put a Stop Loss order in at \$18. The stock is sold automatically once it reaches that level.

Approaches to Trading

There are different approaches for finding the “best” stocks. For example, fundamental investors look at things like *earnings per share* (EPS), *book value*, and *P/E ratio* (*price/earnings*). There are also technical investors who avidly read charts to determine trends. In the same way, there are different styles of trading and investing in stocks.

- **DAY TRADERS** usually try to profit from short-term price conditions, so they like to connect with fast, impulsive sellers and buyers. These traders often place several trades to several hundred trades per day.

- **SHORT-TERM INVESTORS** are keen to buy a stock. Then if the stock moves up, they get their money (and profit) back out quickly. If the stock moves down, they cut their losses and sell.

Those short-term profits that traders and short-term investors generate can be tempting, but unless you're extremely experienced, it's wiser to adopt a long-term mentality.

- **LONG-TERM INVESTORS** are often called "buy and hold" investors. They purchase stock in hopes of generating large gains over a period of time.

No investing style is necessarily better than another; but until you have a lot of education and experience, it's probably best to focus on long-term investments.

- **ACTIVE VS. PASSIVE PORTFOLIO MANAGEMENT.** You also can weigh the pros and cons of active vs. passive management of your stock portfolio. Active management is considered an art: stock picking and market timing. Passive management is more of a "buy and hold" approach.

What suits you best? Many new investors start off passively, looking for long-term steady gains until they have a better understanding of how the market operates.

If you've done your homework, you've covered your bases and covered your backside.

■ Diversification

Diversification is defined as spreading investments among many different securities or sectors to reduce the risk of owning any single investment. For example, if you put money into a SPY (A&P 500 Index ETF), you literally own a fractional interest in every one of the 500 stocks that make up that index. If one stock in the S&P 500 has bad news and drops 50% of its value, you're only invested in 1/500th of that stock, and you won't see too much negative effect from that. In comparison, if you just owned that stock by itself, you would have lost 50% immediately.

Lesson Activity: Diversification

PART I

- **Person A** invests \$100,000 of his money in a startup company that many people think will take off.
- **Person B** invests \$10,000 of his money in the startup mentioned above; \$30,000 in real estate; and the remaining in a few different mutual funds.

The Stock Market

If the startup company's stock price skyrockets, who will make the most?

☐ Person A

☐ Person B

If the startup company fails, who will lose the most?

☐ Person A

☐ Person B

In what ways can **Person A** generate a positive return on investment? _____

In what ways can **Person B** generate a positive return on investment? _____

PART II

- All of a family's investments are held in mutual funds. They decide to invest in an individual stock. Which of the following describes this action?
 - ☐ Diversification BETWEEN asset classes
 - ☐ Diversification WITHIN an asset class.
- A family owns a home and decides to invest in an ETF and some physical gold. Which of the following describes this action?
 - ☐ Diversification BETWEEN asset classes
 - ☐ Diversification WITHIN an asset class.

How can having a diversified portfolio benefit you?

What are the possible drawbacks of having a diversified investment portfolio? _____

Types of Funds

- **Mutual funds** are funds operated by an investment company. The money is pooled together from various shareholders and then invested in different stocks, bonds, options, commodities, or money market securities. Mutual fund managers buy and sell stock on a regular basis and try to deliver returns that beat the overall market performance.
- An **index fund** is a type of mutual fund whose portfolio is designed to track the components of a market index and can give investors increased diversification, broad market exposure, and low operating expense. Examples: the S&P 500, the NASDAQ 100, the Wilshire 5000, and the Dow Jones.
- An **ETF (exchange-traded fund)** is a security that tracks a basket of assets like a commodity, sector, index, or other area. It acts similarly to an index fund but trades like a stock. Examples include an S&P 500 ETF called Spiders (SPY) and a Wilshire 5000 ETF called Vipers (VTI).

SCENARIO

There was an investor who wanted to invest in technology stocks. He had a good idea about which stocks he was interested in, and this is what he found:

Technology stock 1 \$300 per share

Technology stock 2..... \$50 per share

Technology stock 3 \$150 per share

Technology stock 4 \$100 per share

If he wanted to invest in each of these stocks, it would cost him \$600 plus trading fees.

He also found a mutual fund that owns the exact stocks he was interested in trading. The investor could also choose to purchase the mutual fund.

Mutual funds offer a cost-efficient way for educated investors to allocate and diversify their monies. There are several types of mutual funds:

There are thousands of mutual funds, and most fit within a smaller subset of categories.

- **Aggressive Growth Funds** — try to maximize capital gains, may leverage their assets by borrowing money, and may trade in stock options.
- **Growth Funds** —are similar to aggressive growth funds, but usually do not leverage their investments (borrow money) or use stock options.
- **Growth Income Funds** — The goal is to generate dividend income and growth.
- **Income Funds** — The main focus is on generating dividend income.
- **International Funds** — hold stock of companies around the world.
- **Asset Allocation Funds** — don't just invest in stocks; they also may have bonds, real estate, metals, and money market and other mutual funds.
- **Sector Funds**— invest in a specific sector of the stock market. For example, a technology fund would buy tech stocks.
- **Bond Funds** — invest in corporate and government bonds.
- **Money Market Funds** — are mutual funds that invest solely in short-term debt instruments.
- **Equity Fund** — Essentially, this is a mutual fund with a portfolio consisting primarily of stocks, as opposed to a mix of bonds and other commodities. There are several different types of equity funds.

- **Growth**— These are stocks believed to be the fastest-growing companies in the market. On the other hand, they rarely provide dividend income and are considered higher risk.
- **Income** —Investing in securities that pay interest or dividends to provide income.
- **Growth & Income** — A combo of the two above, providing both growth and income.
- **Value** — Investing in large or mid-sized companies that may be undervalued.
- **Small, Medium & Large** — Based on size, these funds invest in emerging (small), mid-sized (medium), or established (large) cap.
- **Sector** — Stocks in a single market sector carry more risk than investing across many sectors; however, the potential rewards are greater. Sector funds may include funds that just invest in computer chip companies or telecom companies.
- **Fixed Income** and **Money Market** — These are low-risk funds that earn much lower returns, on average. They work as interest-bearing investments with reduced risk, compared to equities. If you're a long way from retirement, you probably won't need these low-risk funds in your portfolio yet. If you're closer to retirement, you may want to consider these funds.
- **Balanced** — As the name implies, a mutual fund that invests into the money market, bonds, preferred stock, and common stock.

A “sales”, “charge” or “load” is levied on the purchase or sale of mutual fund shares. Common load types include:

- **Front-end load** — paid when shares are purchased (Class A shares).
- **Back-end load** — paid when shares are sold (Class B shares).
- **Level load / low load** — paid annually (Class C shares).
- **No-load fund** — no sales load is paid up front or on the sale; however, fees like exchange fees, account fees, etc., are paid (Class C shares).

■ The Joy of Index

An index is a group of stocks that collectively represents a larger group. Index funds basically allow investors to buy a bunch of stocks that mimic the performance of the entire stock market, in the hope of replicating a successful trend. Since you're investing in the overall performance of the market, the risk of investing in a single stock can be reduced.

Broad market indexes allow you to generate investment returns similar to overall market performance. When you invest in the *S&P 500* broad market index, you are actually purchasing

The Stock Market

a fraction of all the 500 stocks in that index. Broad market indexes that closely match the overall return of the stock market earn higher returns for investors than the average mutual fund. The smallest broad-based index is the *Dow Jones Industrial Average*, with 30 industrial stocks. The largest is the *Wilshire 5000*, with over 5000 stocks in one fund.

- **The Dow Jones Industrial Index**

The Dow is an average of the 30 most significant stocks traded on the New York Stock Exchange (NYSE). This is the oldest and one of the most observed indexes in the world. Companies whose stock is traded on the Dow include McDonald's, Home Depot, Verizon, Coca-Cola, Microsoft, and American Express.

- **The Standard & Poor's 500.**

The S&P is a basket of 500 stocks from leading companies in leading industries. The performance of the S&P gives a broad snapshot of the performance of the overall US equities market. This is one of the best broad-based indexes for beginning investors. Amazon, Johnson & Johnson, Disney, Motorola, Office Depot, and Wells Fargo are among the stocks that make up the S&P index.

- **NASDAQ 100.**

One hundred of the largest domestic and international non-financial companies are on the NASDAQ stock exchange. This exchange is heavily weighted with technology stocks.

- **Wilshire 5000.**

These are all publicly traded companies in leading industries, representing the broadest index for the US equity market. It has grown from 5,000 to more than 6,500 stocks.

Investing in mutual funds, index funds, or ETFs is something you should only do when you have some knowledge and the guidance of professional, trusted advisor. You can see that you have a lot of choices in the stock market.

▀ So Where Do You Invest?

There are more than 10,000 mutual funds. And having too many choices can be overwhelming, which definitely won't help your decision process. *Keep it simple*. If you don't understand an investment, don't buy it.

Choose investments that suit your age, risk tolerance level, and financial goals. Each person is different and it's important to have a clear investment strategy before putting money at risk. For instance, some people may be able to invest more conservatively as they approach

retirement age; others who are behind on their retirement savings may need to be more aggressive.

Choose an overall investment strategy and investments that suit you.

Dollar Cost Averaging

If you were to invest \$100 per month, you would own 131 shares after one year. Your investment would have increased in value by \$376. In comparison, if you did not follow a dollar cost averaging plan, and purchased \$1,200 worth of shares at once, in 2013 your return would be \$240. You would own 120 total shares (\$1,200 investment divided by \$10 per share = 120 total shares).

A SAMPLE PLAN

	Monthly Investment	Cost per Share	# Shares Purchased
Jan	\$100	\$10	10
Feb	\$100	\$9	11.1
Mar	\$100	\$8	12.5
Apr	\$100	\$9	11.1
May	\$100	\$7	14.2
Jun	\$100	\$6	16.6
Jul	\$100	\$8	12.5
Aug	\$100	\$10	10
Sep	\$100	\$12	8.3
Nov	\$100	\$13	7.7
Dec	\$100	\$11	9.1
Jan	\$100	\$12	8.3
TOTAL SHARES:			131.4

Lesson Activity: Dollar Cost Averaging

Listen to the instructor's explanation about how dollar cost averaging works, and follow along using the sample plan below.

To create a dollar cost averaging plan, there are two key elements:

1. Budget the exact amount of money you can invest.
2. At set specific intervals — weekly, monthly, or quarterly — invest that amount of money into the investment.

The Stock Market

What are your thoughts about dollar cost averaging? _____

What benefits do you see in developing a dollar cost averaging plan?

Describe a situation where following a dollar cost averaging plan would earn you a lower return than investing a lump sum: _____

Lesson Questions

1. A stock is ...
 - a. A type of bond.
 - b. An example of the relationship between risk and return.
 - c. An investment method.
 - d. A share in a company, representing partial ownership of that company.
2. Which of the following best describes the principle of supply and demand?
 - a. If supply is greater than demand, the price will go down.
 - b. If demand is greater than supply, the price will go down.
 - c. If supply goes up, the demand will fall.
 - d. If demand increases, the supply will increase.
3. What is the main purpose of investment diversification?
 - a. To spread the returns over a longer period of time.
 - b. To reduce the risk of owning any single investment.
 - c. To help budget one's investment dollars more wisely.
 - d. To identify different types of asset classes.
4. What are the two key elements of dollar cost averaging?
 - a. Budgeting the amount you have to invest and investing a set amount at specific intervals.
 - b. Choosing an asset class and trading stocks.
 - c. Developing a quarterly plan and diversifying your portfolio.
 - d. Day trading and maximizing long-term gains.

The Stock Market

Essential Questions

What is a stock? _____

What are the two basic principles of supply and demand? _____

What is the difference between day traders, short-term investors, and long-term investors in the stock market? _____

How can having a diversified portfolio help me? _____

What are the possible drawbacks of having a diversified portfolio? _____

What is dollar cost averaging? _____
