

Building a Foundation for Investing Success



What You Need to Know About Stocks, Bonds, and Mutual Funds

Featuring excerpts from these full-length booklets, available at investorprotection.org:

- The Basics for Investing in Stocks
- 5 Keys to Investing Success
- Mutual Funds and ETFs: Maybe All You'll Ever Need
- Getting Help With Your Investments
- A Primer for Investing in Bonds

WHEN I'M 



Written by the Editors of *Kiplinger's Personal Finance*



Introducing **WHEN I'M**

When I'm 65 is a national public television documentary, produced by Detroit Public Television, and engagement program exploring how our financial and lifestyle choices today will affect our quality of life in retirement. **When I'm 65** was created with the generous support of the Investor Protection Trust and the Investor Protection Institute.

Using case studies, engaging animations, and lively expert interviews, **When I'm 65** looks at how aspirations and financial planning for retirement have changed. The program's multi-generational approach examines how each generational cohort is looking at and planning for retirement.

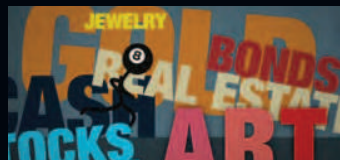
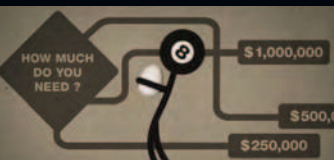
When I'm 65 addresses:

- How long life expectancies are changing how we define “retirement”
- Practical, hopeful planning tips for the new “DIY” retirement market
- Different priorities for Millennials, Gen Xers and Baby Boomers
- Planning financially for 20 or more years of life after a full-time career
- Alternative housing and support services
- Bipartisan support of retirement policy changes

“When I'm 65 offers jargon-free explanations and can-do action plans for all ages — Millennials, Gen Xers and Baby Boomers alike.”

— Don Blandin, CEO and President of Investor Protection Trust

Look for **When I'm 65** to air in key markets across the PBS system, and at workshops and conferences across the country. The full documentary and engagement videos are available at www.WI65.org, where you can also register for updates and learn more about the program.



A Foundation for Investing Success

Millions of Americans understand that the key to long-term financial security is using varying investment vehicles to generate high returns. If you're one of them, this booklet can provide some valuable guidance.

Start with the premise that it makes sense to build a portfolio on a solid foundation of different asset classes. For most people, four of the primary options are: stocks, bonds, mutual funds and exchange-traded funds (ETFs). Without these four cornerstones in place, the foundation may collapse or suffer damage, often due to fluctuations in the marketplace.



Accordingly, this booklet includes information on each of these basic investments, explaining how they work, what to do to invest and which potential pitfalls to avoid. Along the way, we will unlock the five keys to investing success that may help you minimize risk while maximizing profit. Finally, our overview concludes with a discussion about finding the best professional advisers for your personal situation.

If you haven't done so already, begin building your investment foundation today. Keep reading.

The Basics for Investing in Stocks

When you buy stocks, you are purchasing ownership shares in the company that issues them. Stocks are one of the most well-known asset classes, but their inherent volatility makes many risk-averse investors shy away. That's why it's important to understand that over the long run, stocks have beaten the performance of any other major asset class by a wide margin. Since 1926, stocks have returned nearly 10% per year, on average.

Stocks come in a variety of “flavors”:

- **Growth stocks** are shares of companies that consistently generate above-average revenue and growth.
- **Income stocks** pay out a relatively high ratio of their earnings in the form of dividends.
- **Value stocks** describe stocks that are cheap in relation to a fundamental measure, such as profits, sales or the value of a company's assets.
- **Small company stocks** over time have generated better returns than stocks of large companies, but they are often riskier.
- **Foreign stocks** add a valuable diversification benefit to a purely domestic stock portfolio. They provide exposure to foreign

currencies, economies and business cycles.

Stocks deserve a prominent place in any long-term investment plan, such as a retirement account. But because stocks are volatile in nature — meaning their value can rise and fall depending on a company's performance and demand for its shares — invest in them cautiously. Ideally, stocks should be held to meet only medium- and long-term goals. In other words, money invested in stocks should not be money that you might need in three to five years.

Diversifying your collection of stocks also can help lessen risk. The idea is to avoid a situation in which your investments are concentrated in so few holdings that big declines in the value of just one or two of them hurt your portfolio. If you buy individual stocks, you probably need a minimum of 20 to 30 companies from a variety of different industries for sufficient diversification. The idea is that when one stock in your portfolio is down, another may be up, thereby reducing your risk.

HOW TO PICK STOCKS

There are numerous ways to pick individual stocks, some of them quite complex. In general, though, investors

look for companies that deliver solid earnings growth or those whose share prices are cheap relative to the perceived value of the company.

It's crucial to understand how stocks are valued. Here are some key approaches:

● **Price-Earnings Ratio.** The P/E ratio is perhaps the best-known and most widely used yardstick to assess a stock's value. The numerator, P, is a stock's current price. The denominator, E, is a company's earnings per share. The P/E ratio tells you how much investors are willing to pay for each dollar a company earns.

● **Price-to-Book-Value Ratio.** Book value, also known as shareholder equity, is a company's assets minus its liabilities. Price-to-book value (P/B) can come in handy for evaluating stocks when P/E ratios don't make sense. This may be the case if a company has no earnings (you can't divide P by zero), negative earnings (that is, the company loses money), or its earnings are temporarily distorted in either direction.

● **Price-to-Sales Ratio.** Price-to-sales ratios (the current share price divided by the company's sales) are also useful in valuing companies whose earnings are negative or erratic. That's because sales are more stable than earnings and because it's more difficult

for a company to use accounting techniques to manipulate revenues than earnings figures.

● **Dividend Yield.** Yield is the amount of dividend a company pays to shareholders annually expressed as a percentage of the stock's price.

WHEN TO SELL

The decision of when to sell a stock is as important as deciding which stocks to buy in the first place.

Among possible reasons to sell:

- The fundamentals change. Suppose you bought a stock because you had high expectations for a new product. If the product turns out to be a dud, sell.
- The dividend is cut. It's a sign the company may have problems.
- You reach your target price. Many investors set specific price targets, both up and down. A good target, for example, is to sell after you double your money, or after you lose 20%.



For more information, see the full-length booklet, *The Basics for Investing in Stocks*, available at www.investorprotection.org.

5 Keys



For more information, see the full-length booklet, *5 Keys to Investing Success*, available at www.investorprotection.org.

1

MAKE INVESTING A HABIT

The best chance to acquire measurable wealth lies in developing the habit of adding to your investments regularly and putting the money where it can do the most for you.

Here's why: Imagine that you put \$5,000 in a savings account where it earns a safe 2% rate of interest, compounded annually. Twenty years later, you'll have only \$7,430.

But suppose your goal is to build a substantial retirement nest egg? If you add \$100 a month to your original \$5,000 investment and earn an average return of 4% per year, after 20 years, you'll end up with almost \$50,000. But if you add \$250 per month and earn 8%, you'll accumulate almost \$175,000.

2

SET EXCITING GOALS

Vaguely defined investment goals can lead to half-hearted efforts to achieve them. Better to set goals you can grab onto, goals that excite you. Instead of working toward "financial security," why not aim for "\$500,000 net worth by age 60?" Instead of securing a "comfortable retirement," consider building "an investment portfolio that will yield \$2,000 a month to supplement my Social Security."

to Investing Success

It's well known that there are no guarantees in the investment world. But that doesn't mean you can't tip the odds in your favor. By following these five tried-and-true principles, you stand a much better chance of surviving the inevitable ups and downs of the markets and realizing your main goals.

3

DON'T TAKE UNNECESSARY RISKS

A key question for investors is: What is a prudent risk?

The answer depends on your goals, your age, your income and other resources, and your current and future financial obligations. A young single person who expects his or her pay to rise steadily over the years and who has few family responsibilities can afford to take more chances than, say, a couple approaching retirement age. The young person has time to recover from market reversals; the older couple may not.

4

KEEP TIME ON YOUR SIDE

Understanding the time value of money is central to making solid investment decisions. To understand this concept, consider the question: Would you rather have \$10,000 today or \$10,000 a year from today?

Of course, you'd choose to take the money now. Not only is a bird in the hand worth two in the bush, but \$10,000 you have to wait a year for could be worth less due to the effects of a year's worth of inflation. And you will have lost a year's worth of earnings you could otherwise have captured.

5

DIVERSIFY TO LOWER RISK

Simply put, diversifying means not putting all your investment eggs in one basket. No investment performs well all the time; when one thing is down, another thing tends to be up. By spreading your investments around, you're likely to increase your overall return and reduce your risk at the same time.

A Primer for Investing in Bonds

Stocks and bonds are often viewed as a portfolio's nuts and bolts. Essentially, that means your investment will work better if you have both in your portfolio. Yet even sophisticated investors may not understand how bonds work and how much they really pay.

WHAT EXACTLY IS A BOND?

Bonds are IOUs issued by domestic and foreign corporations, state and city governments or their agencies, the federal government and its agencies, and foreign governments. They are issued for periods as short as a few months to as long as 30 years, or occasionally even longer.

When you buy a bond, you become the issuer's creditor. That means the issuer owes you the face amount of the bond, plus interest.

You get a fixed amount of interest on a regular schedule — every six months, in most cases — until the bond matures. At that time, you are paid the bond's face value. If the issuer goes broke, bondholders have first claim on the issuer's assets, ahead of stockholders.

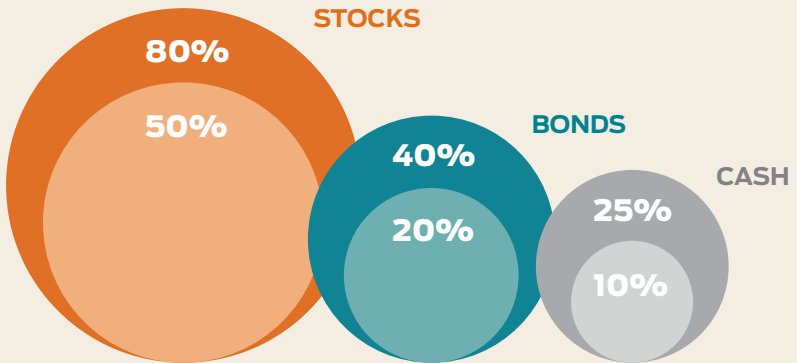
After bonds are issued, they can be freely bought and sold by individuals and institutional investors in what's called the secondary market, which works something like a stock exchange.

Many different types of entities issue bonds. Among them:

- Corporations may issue secured bonds, which are backed by a lien on some portion of a corporation's assets. Or they may issue debentures, which are unsecured bonds, backed only by the general ability of the corporation to pay its bills.
- Municipal bonds are issued by state or city governments, or their agencies. Interest paid on municipal bonds is generally exempt from federal income taxes and usually exempt from the issuing state's income taxes. General obligation bonds are backed by the full taxing authority of the issuing government. Revenue bonds are backed only by the receipts

HOW TO DIVERSIFY

Think in terms of ranges rather than fixed percentages when deciding how to divvy up your investments.



from a specific source of revenue, such as a bridge or highway toll.

- U.S. Treasury debt obligations are backed by the full faith and credit of the federal government. Interest from Treasuries is exempt from state and local (but not federal) income taxes.
- Agency securities are issued by various U.S. government-sponsored organizations, such as the Tennessee Valley Authority. Although they are not technically backed by the full faith and credit of the U.S. Treasury, they are widely considered to be moral obligations of the federal government.
- Treasury inflation protected securities, or TIPS, are Treasury bonds that adjust with changes in consumer prices.

HOW MUCH DOES A BOND REALLY PAY?

When a new bond is issued, the interest rate it pays is called the coupon rate, which is the fixed annual payment expressed as a percentage of the bond's face value. A 5% coupon bond pays \$50 a year interest on each \$1,000 of face value, a 6% coupon bond pays \$60 and so forth.

One of the most important things you need to know about bonds is that as interest rates rise, bond prices fall; as interest rates fall, bond prices rise. Because of this relationship, the actual yield to an investor depends in large part on where interest rates stand on the day the bond is purchased. So the vocabulary of the bond market needs more than one definition for yield.

- **Current yield** is the annual interest payment calculated as a percentage of the bond's current market price.
- **Yield to maturity** includes the current yield and the capital gain or loss you can expect if you hold the bond to maturity, which is the date when the bond must be paid in full.

HOW TO REDUCE THE RISKS IN BONDS

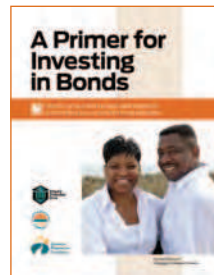
Inflation and rising interest rates are two of the biggest risks bondholders face. Inflation erodes the value of fixed payments to the bondholder. If inflation is accelerating, investors are likely to demand higher interest rates to lend money.

How can you reduce these risks?

- Don't buy long-term bonds when interest rates are low or rising.
- Stick to short- and intermediate-term issues. Maturities of three to five years will reduce the potential ups and downs of your bonds.
- Acquire bonds with different maturity dates to diversify your holdings.

Another risk is default — the chance that the issuer won't be able to pay off bondholders. To guard against this risk:

- Check the rating of any bond you consider purchasing. Ask a broker for the rating or check online at sites such as www.standardandpoors.com or www.moody.com. Look for a rating of BBB (Standard & Poor's) and Baa (Moody's), or better.
- Spread your bond holdings across several different issuers, whether corporate or municipal.



For more information, see the full-length booklet, *A Primer for Investing in Bonds*, available at www.investorprotection.org.

Mutual Funds and ETFs: Maybe All You'll Ever Need

Mutual funds combine the money of many investors and then invest in stocks and bonds (as well as other types of assets, such as gold). Some mutual funds accept as little as \$250 to open an account, and most funds have many thousands of investors. This can add up to hundreds of millions, or even billions, of dollars to invest. Thus, funds can afford to invest in dozens or even hundreds of securities, and that reduces risk.

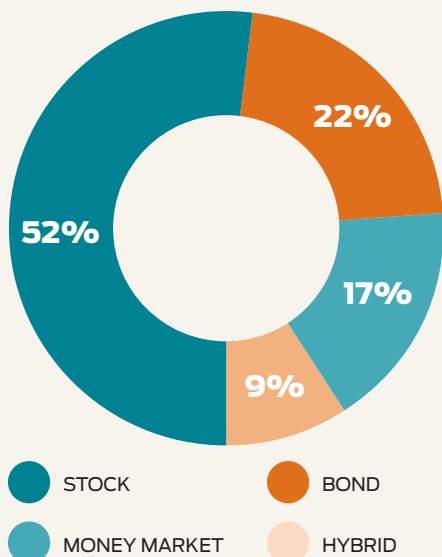
DIFFERENT TYPES OF FUNDS

Before we discuss all the different things funds invest in, let's look at the three main forms of mutual funds:

- **Index Funds.** These are relatively simple funds that aim to track indexes, or broad baskets, of different securities. They are not actively managed by experts trying to beat the market. Instead, their goal is to match the market.
- **Actively Managed Funds.** These funds employ professionals who continuously monitor thousands of securities, so they can assess which ones to buy, hold or sell in an attempt to deliver the best possible results.
- **Exchange Traded Funds.** ETFs are a cross between index funds and stocks. Like index funds, ETFs hold baskets of securities that follow indexes. ETFs trade just like stocks, throughout the trading day. Because you can buy as little as a single share of an ETF, the minimum investment for owning an ETF is typically far less than for owning a mutual fund.



MUTUAL FUNDS: WHERE THE MONEY IS



Source: Investment Company Institute, 2015.

Now let's look at funds by what types of securities they invest in:

• **Money Market Funds.**

Money market funds have very low risk and are commonly used by investors to keep cash on hand and earn some interest.

• **Stock Funds.** This is the most popular type of mutual fund, measured by the number of funds and the amount of money

invested in them. Stock funds usually invest in one type of stock, such as large company U.S. stocks, small company U.S. stocks or foreign company stocks.

• **Bond Funds.** The main securities that bond funds invest in are U.S. government bonds, corporate bonds, and municipal bonds, which are exempt from federal income taxes. Another popular category is high-yield corporate bonds. These bonds are issued by companies with low credit ratings. But with the higher risk of default, comes the potential for higher yields.

HOW TO CHOOSE FUNDS

You can use many strategies when choosing funds. To start, funds charge various fees and annual expenses, and you should always try to minimize these. The more you pay in fees, the less that's left for you.

You should also study past performance, but don't go overboard. Look for funds with good long-term

records of at least five years, though a record of at least 10 years is best.

You should also check fund management when it comes to actively managed funds, because a fund's record is only as good as the manager who compiled it. Since managers come and go, check to see how long the manager of a fund you're considering has been at the helm.

ASSEMBLING A PORTFOLIO

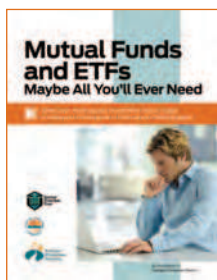
The most important decision you'll make as an investor isn't which fund to buy. More important is how you split money among different types of assets — mainly between stock funds and bond funds. This asset selection will have the most effect on the two things you want to control most in your portfolio: potential return and level of volatility.

So how do you assemble a portfolio that will reduce risk and meet your goals? Well, you can do it yourself, or you can choose a fund that is pre-assembled with many different types of funds.

Target-date retirement funds are the most common



of these diversified funds. As these funds approach the target date (or the year of your expected retirement), it becomes more conservative, typically lowering the percentage of assets invested in stocks in favor of more bonds and cash. The idea is to reduce the likelihood of big losses as you get closer to needing the money.



For more information, see the full-length booklet, *Mutual Funds and ETFs*, available at www.investorprotection.org.

Getting Help With Your Investments

The road to financial success may be “paved with potholes,” but you don’t have to dodge them alone. By enlisting the services of competent professionals, you increase the likelihood you’ll achieve the desired results. The information below can help you understand how to choose advisers and what to do if you encounter any problems.



UNDERSTANDING YOUR CHOICES

Your first step in getting the help you need is to find an adviser whose specialties match your particular situation. Here are some of your options:

• **Registered Representatives**

are people who are familiarly but no longer widely known as stockbrokers. They are your first point of contact if you simply want to buy and sell stocks.

• **Certified Financial Planners**

(CFP®) have met experience requirements and taken qualifying examinations to prepare them to take on a variety of assignments, from analyzing your retirement funds to setting up a schedule of cash distributions when you get a lump sum of money at retirement.

• **Accredited Financial**

Counselors (AFC®) also have met experience requirements. The AFC certification, however,

emphasizes communication skills that help advisers provide financial behavior guidance.

• **Registered Investment Advisers**

(RIA) actively manage or invest money on your behalf for a fee. You may elect to give RIAs the authorization to make trades in your accounts and determine your investment strategy.

Note that you can find more detailed explanations for how these and other professionals can help you in the full-length booklet, *Getting Help With Your Investments*, mentioned on the next page.



MAKING A SELECTION

In every metropolitan area, there are thousands of men and women who are eager to give you advice and handle your money. Even in smaller cities and towns, you’re likely to have multiple options. With so many choices available to you, how can you make an informed decision?


For more information, see the full-length booklet, *Getting Help With Your Investments*, available at www.investorprotection.org.



A good strategy is to ask for referrals from friends, colleagues and professional acquaintances. Next, review each potential adviser's website carefully. You'll also want to conduct a Google search on each candidate and verify each candidate with your state securities regulator (see more about regulators below).

Now you're ready to schedule introductory meetings with a few top candidates! Here are five important questions to ask during those interviews: What is your training and experience? What is your investment philosophy and record? Can I have a copy of your regulatory disclosure forms? How will our relationship work? How much do you charge?

DEALING WITH PROBLEMS

 Working with an adviser, it is important to be on the lookout for unethical or illegal activity such as unsuitable recommendations, misrepresentation of risk, unauthorized trading, outright fraud or theft, and overinvestment in one asset type (contrary to your instructions).

If you do encounter these kinds of problems, you can receive help from

a number of regulatory organizations. These include the Securities and Exchange Commission (www.sec.gov/complaint.shtml) and the Financial Industry Regulatory Authority (www.finra.org).

State Securities Regulators

are another helpful resource. For more than 100 years, these regulators have worked within state governments to protect investors and maintain the integrity of the securities industry. Your regulator can provide the following:

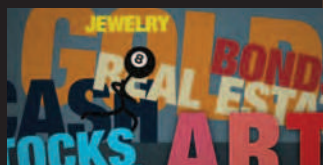
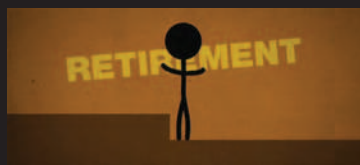
- Verification that a broker-dealer or investment adviser is licensed
- Notice of any prior complaints and disciplinary or enforcement actions
- Listings of educational background and previous work history
- Websites, phone numbers or addresses where you can file a complaint
- Noncommercial investor education and protection materials.

Find your State Securities Regulator on the North American Securities Administrators Association (NASAA) website. Visit www.nasaa.org and click on "Contact Your Regulator."

WHEN I'M

The retirement landscape in the 21st century is changing dramatically. **When I'm 65** is a groundbreaking public television documentary produced by Detroit Public Television with a community engagement program that examines the choices all Americans must make today to plan for a financially secure future.

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ABOUT THE INVESTOR PROTECTION TRUST



The Investor Protection trust (IPT) is a nonprofit organization devoted to investor education. More than half of all Americans are now invested in the securities markets, making investor education and protection vitally important. Since 1993 the Investor Protection trust has worked with the States and at the national level to provide the independent, objective investor education needed by all Americans to make informed investment decisions. For additional information, visit www.investorprotection.org.

ABOUT THE INVESTOR PROTECTION INSTITUTE



The Investor Protection Institute (IPI) is an independent nonprofit organization that advances investor protection by conducting and supporting unbiased research and groundbreaking education programs. IPI carries out its mission through investor education, protection and research programs delivered at the national and grassroots level in collaboration with state securities regulators and other strategic partners. IPI is dedicated to providing innovative investor protection programs that will make a meaningful difference in the financial lives of Americans in all walks of life and at all levels of sophistication about financial matters. For additional information, visit www.ilinvest.org.