Developing a Financial Plan

What should my long-term financial goals be?

The first step is to figure out a realistic financial goal for yourself and your family. Talk with your loved ones to ensure that everyone has the same goals in mind. Clearly not all families will have the same end goal - figure out what is important to you, whether it is early retirement, financial comfort, children's education, travel, taking care of elders, or your children.

Are there simple guidelines to follow towards a comfortable retirement?

Someone starting their savings in their early 20s can save 10% of their income and have a sufficient nest egg, while someone starting in their 40s may have to bump that number up more towards 20%. This is all dependent on the time of your life that you choose to start, the size of your current nest egg, and the amount of money that you will need to retire comfortably.

It is always a good idea to contribute as much as possible to retirement plans, to take advantage of tax deferral and employer matches.

Generally people need around 80% of their pre-retirement income after they have retired for the first few years and then learn how to live on less. This will greatly depend on the expenses that you plan on having:

- Is the mortgage already paid off?
- Do you have car payments?
- Are you sending your children through school?

Another strategy worth following is to always have an emergency fund of at least 6 months of expenses. Considering your situation and the situations of the people that you depend on or depend on you, you can adjust the number of months accordingly, but 6 is a good ballpark number. This will also depend on how many bills you need to pay.

What should I take into account when I start investing?

- Risk vs. Return
- Asset Allocation
- Diversifying
- Monitoring Progress

Risk vs. Return

The first step in the investment process is to figure out what sort of Return on Investment (ROI) that you are seeking and to determine what level of risk that you are willing to take.

The risk that you are willing to take and the size of the ROI that you receive are correlated. In order to take a higher risk, you must have a reasonable chance of a higher return. The size of the risk will be affected by many factors in the market, and it is recommended that you consult trusted professionals.

These professionals will have ideas and recommendations for your investment portfolios, but never invest more aggressively than you feel comfortable with.

Asset Allocation

Asset Allocation is the selection of assets from across the asset classes: stocks, bonds, and mutual funds. This is a way to minimize risk. It ensures that if one of these groups takes a drastic downturn, you still have investments in the other sections and hopefully won't take large losses. It is recommended to allocate through at least 5 types of classes.

Diversification

Diversification is similar to asset allocation, but within the asset class. For instance, diversification would be buying 15 or 20 different stocks, with the same purpose in mind as asset allocation, to minimize risk and to make sure that if something tanks, it doesn't take your entire portfolio down with it.

Monitoring Progress

You can start by examining your trading records and ensuring that all of the trades went through at the prices that you instructed and with the correct commissions. Make sure to keep a good paper trail of all the transactions that occur in your portfolio just in case you ever need to contest anything.

Keep tabs on how your assets are performing. If they seem to be underperforming, you may want to change your investments to some that may be more lucrative. You may want to also check to make sure that the investments that you own are in line with your current investment strategy. Your strategy may change over time. Be sure to compare your investments to your current situation.

What risks will I be exposing myself to by investing?

There are definite risks to investing, but educating yourself can drastically limit your exposure to these risks.

- When the rate of return is great, the risk usually is as well. Depending on the situation, you may put yourself at risk to lose all of your initial investment.
- There is a great difference in the liquidity of assets. Some can be sold in moments, and some may take quite a bit of time - take this into consideration when buying. Some may also have penalties for selling early or maturation dates.
- Investing in a company with little or no history is much riskier than those with a proven track record.
- The previous performance of a stock doesn't necessarily mean that the stock will follow that pattern.
- Pay attention to news that pertains to the companies that you hold, information that is released about the companies in the news can seriously affect the values of the investments you hold.

How can I avoid taking unnecessary risks?

- Always trade through your brokerage firm.
- Never make purchases from phone solicitations offering the next hot stock.
- Never send personal checks to a sales rep, always to the company.
- Always receive your monthly statements to double check that everything is correct and that there are no irregular charges.
- If any sales representatives attempt anything that seems out of place, contact the branch manager of the company.

What factors should I consider before making a stock investment?

- Is this investment too risky for me?
- Do I feel comfortable with this investment?
- Do I have any moral conflict with what the business provides?
- Is this investment registered with the SEC?
- What sorts of fees are associated with this investment? Does it have a load that could possibly cancel out the earnings that you would receive?
- How liquid is the investment? Could I sell this quickly?
- What would need to happen in order to profit from this investment?

What factors should I consider before making a mutual fund investment?

- How has this fund performed previously?
- Is there a load? What fees are associated?
- How often will they produce statements?

- What does the fund invest in?
- Are there any specific risks related to this investment?

What investment pitfalls should I be on the lookout for?

- ***Don't invest emotionally***. It is better to keep a moderate controlled approach to investing as opposed to constantly chasing the jackpot which can be dangerous.
- ***Don't trust tips***. If you aren't the head of a large investment firm, by the time a tip reaches you, it is probably too late.
- *Pay attention to your investments*. Stay involved with what your investments are doing, don't rely solely on others helping you.
- ***Reevaluate***. Your financial situation may change over the course of time, be sure that all of your investments are still appropriate.

How should I allocate my IRA investments?

IRAs are just like any other investment - you should take into consideration how much risk you are willing to take on and act accordingly.

For people who are more risk-averse, fixed short-term investments could be more fitting.

Be careful about investing in municipal bonds - by doing so you will sacrifice return that would convert tax free income into taxable income.

What are derivatives and options?

Derivatives are investments whose values derive from the security which they are based on. Options can be useful in making a portfolio less risky. Derivatives can also be futures contracts or swap agreements.

Stock options are a contract that allows one to sell or buy 100 shares of stock at a given price and in a specific time frame. These can be traded on numerous exchanges.

When an option is bought, an investor will buy a premium, which is the commission plus the price of the option. If an investor is to buy a "call" option, they are predicting that the price of the security will increase before the option period expires; on the other hand, if the investor buys a "put" option, then they are predicting that the price will decrease.

This can be a useful tool in an investment portfolio, but not recommended for beginners, if you are interested in trading options, be sure to do your homework.

What are the biggest mistakes investors make?

- Starting too late
- Paying high fees
- Investing Emotionally
- Using a one-size-fits-all plan
- Not taking taxes into consideration
- Overly Risky Investing

Starting Too Late

The time to start is now. The power of compound interest is astounding - the earlier you take advantage the more it will work for you. If you start out earlier, you can start with less, invest less and still end up making more than if you started out later.

Paying High Fees

Broker's commissions can negate all of the hard-earned interest that you have accumulated. Don't let this happen to you - pay attention to what you are being charged. The more you pay, the less you keep.

Investing Emotionally

Successful investing consists of planning and reason. Once emotion gets involved, it can ruin all of the planning and reason that you had used to construct your investment strategy. Keep using the strategies that have consistently made people rich over the years, don't look to follow the new and exciting strategies that haven't yet stood the test of time.

Using a One-Size-Fits-All Plan

Your individual needs should trump any ideas of blindly following any plan. Keep an account of how much risk you are willing to take, and what your time frame is. Your portfolio should match your needs.

Not Taking Taxes Into Consideration

The net profits from stocks are taxable as capital gains. Being in a tax-deferred investment account will stop this from eating away at your savings.

Overly Risky Investing

Being extremely risky can pay off big time, but it can also leave you with a diminished nest egg it you gamble wrong. There are many great investments that offer decent returns without putting your funds in excessive danger.

What is the difference between Cumulative vs. Annualized Return?

Annualized return is the return on investment received that year. Cumulative return is the return on the investment in total.

For instance, the money gained in the first year of an investment would be the annualized return. The total return of investment accumulated at the end of the second year would be the cumulative return.

What is the Rule of 72?

The rule of 72 is a quick way to calculate how long it will take your investments to double at different interest rates.

Take the rate of yearly return on your investment and divide 72 by that number. The result is the number of years it will take for you to double your investment.

What is significance of total return?

The total return is the amount of money that a fund makes after reinvesting and receiving dividends. This will deliver the most benefit from the compounding interest. The total return is a way to accurately gauge the real return on investment that you will get with a mutual fund.

What is a yield?

The yield is the amount paid annually by an investment. The yield is most commonly a percentage of the market price of an investment, which does not take into account the appreciation. Since money market funds and certificates of deposit don't fluctuate like stocks and bonds do, the yield would be the same as the total return.

What is an annuity?

An annuity is an insurance contract - the insurance company invests in stocks and bonds on behalf of the purchaser with the tax deferred money.

When the purchaser turns 65 the purchaser will begin to receive payments, which will fluctuate with the prices of the underlying securities. An annuity will guarantee that the purchaser will receive payments until their death.

Annuity contracts will often carry various charges which vary from one company to another, and would be worth reading before purchasing. Since these are not securities, they are not regulated by the SEC.

What do I need to beware of when investing in an annuity?

You will not be able to withdraw any of the money in an annuity during its tax deferred growth period without incurring large fees. You will be charged 10% for tax code and the insurance will usually charge "surrender charges" on top of that.

What types of annuity are available?

- ***Single-Premium Annuity***. This is where the investment is made all at once in a lump sum.
- ***Flexible-Premium Annuity***. This annuity can be funded with a series of payments.
- ***Immediate Annuity***. With this annuity, the payments begin back to the purchaser instantly.
- ***Deferred Annuity***. Payments will be redistributed back to the purchaser many years later. This is usually used as a vehicle to let the money gestate tax deferred.
- ***Fixed Annuity***. The company will invest your money into fixed investments such as bonds, and the principal is guaranteed for a minimum period of time.
- ***Variable Annuity***. With a variable annuity you are able to invest in either stocks, bonds, or cash equivalents. The principal is not guaranteed with this annuity.

How and when do I collect my annuity?

There are a few choices that you have when choosing to collect your annuity. Some people opt for a lump sum, even though it negates one of the major features of the annuity: payments until death.

The amount of the monthly payments that you receive depends on:

- The amount of money in your annuity contract
- The life expectancy of the annuitant
- The size of the minimum required payments (if any)
- Whether the payments continue after death or not

There are various different settlement options. Be absolutely sure when you choose, because the decision will be final when you make it.

- ***Fixed Amount***. With a fixed amount option, you will choose a monthly amount that you will receive until your annuity runs out. There is a possibility that your money may run out before you pass on, and also the chance that you may die before your money runs out. In that case, your beneficiary will receive your payments.
- ***Fixed Period***. The company will pay you for a fixed amount of time. If you are waiting for a retirement payment from another investment, it may be a good idea to get this fixed money until you start to receive payment from another investment. Again, if you are to pass before the money is fully paid, the remainder will go to your beneficiary.
- ***Lifetime Or Straight Life***. This plan will continue to pay you money until you die. This is the safest option to ensure that you receive payment until the day you die. Conversely, if you die early, there will be no payments to the beneficiary.
- ***Life With Period Certain***. With this plan you will receive payments until death - and for a period afterwards, your beneficiary will receive payments too. The longer the period, the lower the monthly payment.
- ***Installment***. This guarantees that if you die before you have exhausted your funds, the rest will be distributed to the beneficiary.
- ***Joint And Survivor***. In this option the payments are made to the joint annuitants. In the event of one's passing, the other will continue to receive a lesser amount.

How are the annuity payments taxed?

The tax rates will differ for qualified and non-qualified plans.

An annuity that is tax-qualified is one that funds a qualified retirement plan. When this qualified annuity is used it follows the same tax laws as these retirement vehicles, such as:

- Tax deferral during the gestation period
- The earnings will not be taxed until withdrawal

A non-qualified annuity is bought with after-tax dollars, but the benefit of tax deferred savings still applies.

What taxes will my annuity be subject to after death?

Annuity payments to beneficiaries are subject to the same taxes that would have been collected from you.

What should I take into consideration when shopping for annuities?

- ***Commissions***. Check the broker commissions - even though the insurer is the one who gives you the annuity, the broker may make anywhere from 3 to 8% which can substantially cut into your money.
- ***The Company***. Make sure that the company that you are buying the annuity from has a good track record. There is no agency (such as the SEC) that checks the procedures of these companies, so the reputation of the company is of the utmost importance.
- ***Compare and Contrast***. Check the amount of payments that you will receive from different companies. This may vary greatly from company to company - however, do not judge solely based on these numbers. Keep in mind the legitimacy of the company.

What hidden costs may be associated with the annuity?

- ***Commissions***. If the commission is paid in a front-end load, this can reduce the amount of your initial investment. A no or low-load annuity contract is preferable.
- ***Penalties***. The surrender charges usually only apply for the first 7 years, starting at 7% the first year, declining 1% per year until after the 7th year, when these surrender charges no longer apply.

What about other fees?

- Maintenance Fees
- Mortality Fees
- Investment Advisory Fees

These fees should be stated plainly in the prospectus.

Bonds FAQ

What is a bond?

A bond is simply a certificate which the borrower promises to repay within a certain time period. For the privilege of using the money, the government entity, municipality or company will agree to pay a certain amount of interest per year, usually an exact percentage of the amount loaned.

Bondholders do not own any part of the companies they lend to - they do not receive the benefits of dividends or the privilege to vote on company matters as stockholders would, and the success of the investment isn't related to that company's record in the market either. A bondholder is entitled to receive the amount that was agreed upon, as well as the principal of the bond.

Corporate bonds are generally issued in the denominations of $1000. This price is referred to as the face value of the bond - this is the amount that is agreed to be paid by the company at the time that it matures. Bond prices can differ from their face values, because the prices of the bonds are correlated to the current market rates. When these rates change, the value of the bond will as well. If one were to sell the bond before the time that it matures, the bond may be worth less than was initially paid. A callable bond is one that the issuer may choose to buy back at full face value before the maturity date.

There are three major features of bonds:

- Issuing Organization
- Maturity
- Quality

Short Term Bonds mature in two years or less and long term bonds mature in ten or more. Intermediate is between two and ten years.

What is bond quality?

Bond quality is the rating of the creditworthiness of an issuing organization. There are organizations that specialize in judging bond quality. The higher the rating, the lower the risk of the investment. The rating system uses letters A through D. The only bond considered to be risk free is the U.S. Treasury Bond.

How does the bond rating system work?

Highest Quality	Moody's	Standard & Poor's
High Quality	Aaa	AAA
Good Quality	Aa	AA
Medium Quality	Baa	BBB
Speculative Elements	Ba	BB
Speculative	B	B
More Speculative	Caa	CCC
Highly Speculative	Ca	CC
In Default	-	D
Not Rated	N	N

How do interest rates affect bond prices?

Generally bond prices and interest rates have an inverse relationship - as interest rates drop, bond prices rise and vice versa.

How does maturity affect bond prices?

Bond prices are heavily influenced by maturity - the longer the maturity, the greater the change in price for a change in interest rates. If interest rates rise, it would make a larger difference in the 20 year bond, as opposed to a 10 year bond. Because of this, bond fund managers will attempt to change the fund's average maturity to anticipate changes in interest rates.

What is a bond call provision?

A "call" is when the issuer of the bonds has an opportunity to redeem the bonds after a certain specified amount of time has passed. This doesn't guarantee a continuation of a high yield after the call date - it limits the appreciation of the bonds, and it makes the investment more risky. These call provisions can be complex, so it is best for investors that don't have strong knowledge to avoid bonds with a call feature.

Should I buy bond funds directly or go through a mutual fund?

A bond mutual fund has within it multiple bonds, and for that reason it is impossible to lock in the payment rate or the principal, which you would be able to do if you were directly buying a fund.

A bond mutual fund is an investment company which manages a portfolio of individual bonds. The investors buy ownership in the company, and each share represents ownership in all of the company's holdings. Managers will use these investments to buy and sell bonds that align with the objective of the fund.

Because a bond fund manager has more resources to deal with, they can invest in a vast array of bonds - many more than could any individual investor. There are also certain investments that cost tens of thousands of dollars a share - a bond fund costs far less.

Liquidity plays a major role in bond buying. If you purchase a bond individually and wish to sell it, you must find a buyer for your bond, but if you are invested in a bond fund, that fund has to buy your shares back at any time you wish.

What are the different issuing organizations?

- Municipal bonds are offered by local governments, states and cities. The interest of these bonds is not subject to federal income tax, and if the bondholder lives in the jurisdiction of the governing authority, the interest is exempt from state and local tax. Because of all of these tax advantages, the interest rates paid on these bonds is usually lower than others.
- Like municipal bonds, the U.S. government also issues these securities. Since they are issued by the U.S. Government, they are considered to have the best safety of all bonds.
- Treasury bills can be bought through a broker or directly from the Federal Reserve.

Mutual Funds FAQ

How are mutual funds taxed?

All mutual funds distributions should be reported as income, whether you reinvest or not. Taxable distributions come in two forms, ordinary dividends and capital gains. The distributions of ordinary dividends represent the net earnings of the fund and are paid out periodically to the shareholders. Since these payments are considered to be dividends to you, they must be accounted for accordingly.

Capital Gain Distributions are the net gains of the sales of securities in the fund's portfolio and will be taxed at a different rate than that of ordinary dividends. Yearly, your mutual form will send you a form, called the 1099-DIV, which will have a detailed breakdown of all of these.

Can I avoid tax by reinvesting mutual fund dividends?

Funds will generally give you the opportunity to automatically reinvest in the fund. This does not prevent you from paying tax on your assets, but this reinvestment will prevent you from paying more "buy" fees to get into the fund, so it is advantageous.

What taxes apply to my return-of-capital distributions?

Mutual funds sometimes will distribute back to shareholders monies that haven't been attributed to the funds earnings. This is a non-taxable distribution.

Stock FAQ

How does stock trading work?

Stocks are traded in quantities of 100 shares, called round lots. Any quantity of stock under 100 shares will be considered an odd lot.

What is the difference between Preferred and Common Stock?

Most stocks are common stocks. However, there is another type (known as preferred) which gives certain advantages regarding dividends. Generally, preferred stock holders do not have the same voting rights that the holders of common shares do. Common stocks are based on company performance, while preferred stocks will usually have a stated dividend.

How can I invest in foreign stocks?

It is fairly easy to invest in foreign corporations, because these corporations need to register these securities with the SEC. These companies are subjected to the same rules as U.S. companies.