SAVING AND INVESTING FOR WEALTH

Hard Core Boot Camp
Content Session #1
SAVING AND INVESTING: WHAT’S THE SAME AND WHAT’S DIFFERENT?
VIDEO: THE PROS AND CONS OF SAVING AND INVESTING

http://www.youtube.com/watch?v=2DBdWeTXXeU&feature=related (ING Tutorial)
WHY PEOPLE INVEST

- To achieve financial goals, such as purchase of a new car, down payment on a home, or a child’s education
- To increase current income (e.g., retirees)
- To build wealth over time
- For financial security and peace of mind
- To have funds available during retirement years
## INVESTMENT CHARACTERISTICS

<table>
<thead>
<tr>
<th>Type of Investment</th>
<th>Safety</th>
<th>Risk</th>
<th>Income</th>
<th>Growth</th>
<th>Liquidity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stock</td>
<td>Average</td>
<td>Average</td>
<td>Average</td>
<td>High</td>
<td>Average</td>
</tr>
<tr>
<td>Preferred stock</td>
<td>Average</td>
<td>Average</td>
<td>High</td>
<td>Average</td>
<td>Average</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>Average</td>
<td>Average</td>
<td>High</td>
<td>Low</td>
<td>Average</td>
</tr>
<tr>
<td>Government bonds</td>
<td>High</td>
<td>Low</td>
<td>Low</td>
<td>Low</td>
<td>High</td>
</tr>
<tr>
<td>Mutual funds</td>
<td>Average</td>
<td>Average</td>
<td>Average</td>
<td>Average</td>
<td>Average</td>
</tr>
<tr>
<td>Real estate</td>
<td>Average</td>
<td>Average</td>
<td>Average</td>
<td>Average</td>
<td>Low</td>
</tr>
</tbody>
</table>

*Source: Garman/Forgue, PERSONAL FINANCE, Fifth Edition*
INVESTMENT RETURNS

- **Rent** - payment received in return for use of your real estate, such as a building

- **Interest** - “rent” for the use of your money

- **Dividend** - portion of a company’s earnings that the firm pays out to its shareholders

- **Capital Gain** - occurs only when investment is sold; results from increase in value of initial investment.

[http://www.aarp.org/money/investing/investment_return_calculator/]
Measure of your profit before taxes and fees

Formula:

Gain or loss in value + investment earnings

Examples:

- $1 per share dividend + $5 increase in share value = $6 per share TR before expenses

- $1 per share dividend + $5 loss in share value = <$4> share TR before expenses

http://www.ehow.com/how_6500173_calculate-total-returns.html
Illustration assumes an 8% average annual return.

**TIME + MONEY = “MAGIC”**

**INVESTING UNTIL AGE 65**

<table>
<thead>
<tr>
<th>Age</th>
<th>$2,000 Annually</th>
<th>$4,000 Annually</th>
<th>$8,000 Annually</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>$372,204</td>
<td>$744,409</td>
<td>$1,488,817</td>
</tr>
<tr>
<td>40</td>
<td>$157,909</td>
<td>$315,818</td>
<td>$631,635</td>
</tr>
<tr>
<td>50</td>
<td>$58,649</td>
<td>$117,297</td>
<td>$234,594</td>
</tr>
<tr>
<td>60</td>
<td>$12,672</td>
<td>$25,344</td>
<td>$50,687</td>
</tr>
</tbody>
</table>
INVEST FOR LONG-TERM GOALS

http://njaes.rutgers.edu/money/pdfs/goalsettingworksheet.pdf

Source: Garman/Forgue, PERSONAL FINANCE, Fifth Edition
INVESTMENT PRE-REQUISITES

- Adequate emergency fund
- Adequate insurance
- No or low consumer debt balance
- Written financial SMART goals
- An “investor’s mindset”
Even small amounts invested regularly grow impressively over time

- Time + Money = MAGIC!

Volatility “comes with the territory” but not all investments are equally volatile

- Volatility = “peaks and valleys” of investment value

- Need an “investor’s mindset” to handle

The higher the potential rate of return, the greater the investment risk
INVESTMENT RISK PYRAMID

Summit
- Options
- Futures
- Collectibles

Middle
- Real Estate
- Equity Mutual Funds
- Large/Small Cap Stocks
- High Income Bonds/Debt

Base
- Government Bonds / Debt
- Money Market / Bank Accounts
- CDs, Notes, Bills, Bankers Accept.
- Cash and Cash Equivalents

High Risk
Low Risk
Historically, common stocks have out-performed other investments over long time periods BUT...it has not been a smooth ride!

<table>
<thead>
<tr>
<th>Year</th>
<th>S&amp;P 500 Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001</td>
<td>-11.90%</td>
</tr>
<tr>
<td>2002</td>
<td>-22.1%</td>
</tr>
<tr>
<td>2003</td>
<td>28.7%</td>
</tr>
<tr>
<td>2004</td>
<td>10.9%</td>
</tr>
<tr>
<td>2005</td>
<td>4.9%</td>
</tr>
<tr>
<td>2006</td>
<td>15.9%</td>
</tr>
<tr>
<td>2007</td>
<td>5.5%</td>
</tr>
<tr>
<td>2008</td>
<td>-37.0%</td>
</tr>
<tr>
<td>2009</td>
<td>26.5%</td>
</tr>
<tr>
<td>2010</td>
<td>15.1%</td>
</tr>
</tbody>
</table>
Diversification
- Putting your money, “your eggs,” into several “baskets” (e.g., stocks, bonds, cash, real estate)
  - http://www.investopedia.com/articles/02/111502.asp#axzz1rH9rDBUo

Dollar-Cost Averaging
- Investing regular amounts at regular intervals regardless of price
- Examples: $50 on the 1st of every month or 6% of your gross income every payday
- Lowers average share price cost over time
## Dollar-Cost Averaging Example

<table>
<thead>
<tr>
<th></th>
<th>January (Market High)</th>
<th>February</th>
<th>March</th>
<th>April (Market Low)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amount Invested</td>
<td>$200</td>
<td>$200</td>
<td>$200</td>
<td>$200</td>
</tr>
<tr>
<td>Share Price</td>
<td>$35</td>
<td>$28</td>
<td>$24</td>
<td>$20</td>
</tr>
<tr>
<td>Number of Shares Purchased</td>
<td>5.7</td>
<td>7.15</td>
<td>8.3</td>
<td>10</td>
</tr>
</tbody>
</table>

**Total Number of Shares:** 31.15 shares  
**Average Share Cost:** $25.68/share  ($800 ÷ 31.15)
Percentage of portfolio in different asset classes

Important factor in overall investment success

The more stock in portfolio, the more aggressive the asset allocation

- One guideline: 110 - age = % of portfolio in stock
- Conservative portfolio: less stock in portfolio

Conservative

Moderate

Aggressive
PORTFOLIO REBALANCING

- Get back to original asset class weights (percentages) to maintain same risk level

- Asset classes grow at different rates

- Two ways to do:
  - Sell assets in over-weighted asset class
  - Put new money in under-weighted asset class

- Forces you to “buy low, sell high”
INVESTMENT FRAUDS
The difference between a pyramid scheme and a Ponzi scheme is that a Ponzi schemer will only ask you to invest in something. You won’t be asked to take any action other than handing over money.

On the other hand, a pyramid schemer will offer you an opportunity to make money yourself by recruiting new “investors” into the “franchise” similar to a multi-level marketing firm.
## Pyramid Schemes

<table>
<thead>
<tr>
<th>Levels</th>
<th>Number of Participants</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>2</td>
<td>36</td>
</tr>
<tr>
<td>3</td>
<td>216</td>
</tr>
<tr>
<td>4</td>
<td>1,296</td>
</tr>
<tr>
<td>5</td>
<td>7,776</td>
</tr>
<tr>
<td>6</td>
<td>46,656</td>
</tr>
<tr>
<td>7</td>
<td>279,936</td>
</tr>
<tr>
<td>8</td>
<td>1,679,616</td>
</tr>
<tr>
<td>9</td>
<td>10,077,696</td>
</tr>
<tr>
<td>10</td>
<td>60,466,176</td>
</tr>
<tr>
<td>11</td>
<td>362,797,056 - more than U.S. Population</td>
</tr>
<tr>
<td>12</td>
<td>2,176,782,336</td>
</tr>
<tr>
<td>13</td>
<td>13,060,694,016 - more than double World Population</td>
</tr>
</tbody>
</table>
“PUMP AND DUMP” SCAMS

- Promoter urges you to “buy now or lose out”
- Price rises sharply
- Fraudsters sell at peak
- Price drops when the hype stops
- Investors lose money

http://www.sec.gov/answers/pumpdump.htm
AFFINITY FRAUDS

- Target members of a group
  - Race
  - Profession
  - Religion
  - Age

- Recruit group leader to spread the word

- Key to scheme: trust

How to avoid: Ask questions!
IS IT TOO GOOD TO BE TRUE?

- High yield often means high risk
- Watch out for “guaranteed” returns
- “Red Flag” words: “limited time offer,” “safe as a CD,” “risk-free”
- Beware of exotic, unusual products
  - Don’t invest in anything you don’t understand or feel comfortable with

Warning:

If it sounds too good to be true, it probably is!
INVESTMENT RESOURCES
INVESTING FOR YOUR FUTURE
HOME STUDY COURSE
(COOPERATIVE EXTENSION)

- Free of charge and downloadable
- 11 units; do at your own pace
- Designed for beginning investors
- Monthly investment messages

www.investing.rutgers.edu
Free of charge and downloadable

11 content modules

Designed for beginning investors

Used for library investor education programs

http://www.finrafoundation.org/resources/education/modules/
INVESTMENT RISK TOLERANCE QUIZ

Rutgers Cooperative Extension

http://njaes.rutgers.edu/money/riskquiz/

Investment Risk Tolerance Quiz

Want to improve your personal finances? Start by taking this quiz to get an idea of your risk tolerance—one of the fundamental issues to consider when planning your investment strategy, either alone or in consultation with a professional. Choose the response that best describes you—there are no “right” or “wrong” answers. Just have fun!

When you're done, click on the "View Results" button to see how you're doing.

Note: This quiz was developed by two university personal finance professors, Dr. Ruth Lytton at Virginia Tech and Dr. John Grable at Kansas State University. By taking this quiz you will be contributing to a study on measuring financial risk tolerance. Your results will be recorded anonymously. We are not collecting any identifying information.

Investment Risk Tolerance Quiz

1. In general, how would your best friend describe you as a risk taker?
   - A real gambler
   - Willing to take risks after completing adequate research
   - Cautious
   - A real risk avoider

2. You are on a TV game show and can choose one of the following. Which would you take?
   - A. A real gambler
   - B. Willing to take risks after completing adequate research
   - C. Cautious
   - D. A real risk avoider
TWENTY STEPS TO SEVEN FIGURES

- Set measurable (SMART) financial goals
- PYF starting today
- Diversify portfolio
- Invest regularly (DCA)
- Buy and hold stocks for the long term
- Take prudent investment risks
- Choose quality stocks
- Minimize investment expenses
- Take advantage of tax breaks
- Invest cash windfalls
- Live below your means
- Develop a spending plan
- Work hard
- Increase your “human capital”
- Grow your net worth
- Practice stability
- Take care of yourself (good health habits)
- Believe in yourself
- Pass the “Wealth Test”
  - Age x Income ÷ 10 = Adequate Net Worth
- Be patient

Slides: http://rci.rutgers.edu/~boneill/presentations/index.html
CONTENT SESSION 1
ACTIVITIES
BREAK TIME!