SAVING AND INVESTING

WELCOME AND INTRODUCTION

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Most people want to achieve financial security. Although how "financial security" is defined will differ from person to person, one thing is true for all – saving and investing is the key to building wealth and achieving financial success.

Starting Early

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How much wealth is enough? How much should a person save each month or year? What is a good goal? A few years ago the head of the Social Security Administration suggested that the average middle-aged person today will need at least one half million dollars of their own money in order to retire comfortably (in additional to social security benefits and any employer-provided pensions). Are you on track to reaching half a million dollars by the time you retire? Did you know that the earlier you start to save and invest, the less you need to put away? Let's get right to work on the importance of starting early by looking at an example.

A 25-year old investor would have to invest $79.00 per month at a rate of return of 10%, a total out-of-pocket expense of $37,920, in order to have half a million dollars at age 65. If the investor delayed starting for 10 years, at age 35 a monthly amount of $221 would need to be invested, a total out-of-pocket expense of $79,560, in order to get the same half million at age 65. What if the investor delayed until age 45? He or she would have to invest $658 each month, a total out-of-pocket expense of $157,920 in order to get a half million by age 65 (all examples assume a 10% long-term rate of return, with taxes deferred.)

What does this example show? The earlier in life you start to invest, the less you have to save each month. This is the "magic" of compound interest and time. The sooner you begin to put money aside, the longer your money will be working for you. This is so important that it is almost impossible to overemphasize. Just like the key to building wealth is saving and investing, the keys to successful investing are pretty simple: start early in life, be consistent and disciplined, and let compound interest and time work for you.

It is possible to become a millionaire on a military paycheck. Today's investment marketplace offers many advantages to the small investor. This module explores how you can achieve financial freedom. It starts with a discussion of the basics, like using compound interest and time to your advantage, and includes savings uses and tools. Then it goes on to talk about stocks, bonds, and mutual funds, some basic investing techniques, and finally ways to continue to gain knowledge.

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THE EFFECTS OF COMPOUND INTEREST AND TIME

Compound Interest and Time: Rate of Return = 10%

Compound interest, simply defined, is when the money that your money makes, makes more money. Take a look at the handout, "Compound Interest and Time: Rate of Return = 10 Percent". This form shows four different Plans to grow money.

- In the first column, Plan A, $3,000 is put away each year for six years (a total of $18,000 out-of-pocket) starting at 21 years old. Without ever saving another cent, if the money were left to grow at 10% per year with no withdrawals, the plan would amount to over $1 million by age 65.

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- Plan B shows the result of a ten year delay in the same investment. Rather than investing $3,000 for six years starting at age 21, this scenario starts at age 31. For the same out-of-pocket expense the total will end up being $403,898. That ten-year delay cost $600,000!

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- Plan C shows what the investments would add up to if, at the 31 year point, the investor put away $3,000 a year every year up to age 65, a total out-of-pocket expense of $105,000. Will it equal Plan A? No, the return in this scenario would be $894,380.

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- Plan D shows investment of a $30,000 lump sum over three years ($10,000 per year), starting at age 36. The growth would amount to a total of $477,335.

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Some service members object to these projections. Objections include, "But I'll be dead by the time I'm 65!" Actually, financial planners are planning out to 100 years of age these days. Another common objection is, "You can't get 10% anywhere that I know of!" Again, this is not true. Reasonable investment returns and where to get them will be discussed later in this program.

Earlier, a figure of $500,000 might have seemed impossible. After looking at these scenarios and how invested money, through the "magic" of compound interest and time, can grow into substantial sums, it is clearly possible (and easy if you start early) to reach twice that figure!

THE FINANCIAL PLANNING PYRAMID

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The Financial Planning Pyramid

Building wealth can be easy if you follow a few simple steps. Remember to keep first things first. What is the first thing to do? The Financial Planning Pyramid provides a simple and organized approach to achieving your financial goals.

The Financial Planning Pyramid suggests that the foundation of any good financial plan be made up of adequate compensation (meaning not just your pays and allowances, but taking advantage of ALL of the benefits that come with being in the Navy), and some method for controlling spending – a budget or spending plan – which includes the wise use of credit. In addition, everyone needs some insurance protection (life, health, property, disability and/or liability). Please note two things about insurance: first, it is not designed to make you rich but to keep you from becoming poor in the event of an accident or disaster. Second, insurance is meant to protect you against financial loss, not to directly help you build wealth. (In other words, if you need protection, buy insurance, but if you need to build wealth, buy an investment product!)

Once the needs at the base of the Pyramid are met, an effective and systematic savings plan should be implemented. If you need to take care of some of the foundation issues, attend "Developing Your Spending Plan," "Credit Management," or any of the other financial education courses offered on base. You can also visit with your Command Financial Specialist or Fleet and Family Support Center Financial Educator for some assistance.

The Savings Level

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Once your management "tools" are in place, there is another level to work on before you start investing … you need to establish savings. Not until savings are established, especially emergency savings, should you move on into the investment levels.

The Financial Planning Pyramid shows that a sound savings plan consists of three components. These don't need to actually be three separate accounts (although some people find it easier to keep the money separate that way) but should be three separate "accountings".

- Emergency Fund - These are cash reserves set up in a safe, easy-to-access savings account to provide money for unexpected financial emergencies like emergency leave to visit a sick parent, repairs on the car, etc. The amount in the emergency fund is an individual decision, but a commonly used guideline for military members is to have one to three months of expenses set aside.

- Reserve Fund - Money should be available in savings to cover those expenses which are predictable but which do not occur on a monthly basis, such as car insurance, regular maintenance, taxes, birthdays, anniversaries, and holiday spending. Calculate the annual expense and divide it by 12, and put that amount aside monthly.

- Goal-Getter Fund(s) - The purpose of this fund is to provide savings for short-term goals (money needed in less than 5 years) such as buying a car, putting a down payment on a house, or financing a special vacation.

THE TOOLS OF SAVING

What do you put your money "in" when you are filling up your savings funds? Typically you will use some type of savings tool. Before discussing the different types available, though, it is important to understand the three main factors used to evaluate the appropriateness of a saving or investing tool (or "product"). These factors are safety, liquidity, and yield.

- **Safety.** This is the uncertainty that when you save and/or invest one dollar you will get at least your dollar back. Is the account insured? How safe is the principal? Some products guarantee you'll get your money back, others do not … you could lose some or all of what you invested.

- **Liquidity.** This is how quickly and easily you can get to your money. Some money is available immediately, such as money in a savings or checking account. Other money could take a long time to get at, such as equity in a real estate investment.

- **Yield (or Rate of Return).** This is how much money your money earns (what the rate of return is). Some financial tools, like a savings account, usually have a low rate of return, while others, like a growth stock, have the potential for high returns.

When considering the **"S-L-Y"** factors it is important to know that you can never have all three factors working in your favor – there will always be a trade-off. Which trade-off you are willing to settle for will depend on what your goals and your timeframe are for the money you have. For example: for your emergency fund, safety and liquidity will be most important, so you will have to sacrifice some yield.

There are four options for savings: savings accounts, certificates of deposit, money market accounts, and U.S. Savings Bonds. Each should be evaluated in view of safety, liquidity, and yield.

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Regular Savings Accounts or Share Savings Accounts

- Safety - Guaranteed up to $100,000 (per Social Security Number) if federally insured.
- Liquidity - No restrictions on withdrawals.
- Yield - Generally carry lowest rates of interest. (*Check for current rate ___________*).

Go to your local credit union or bank to open a regular savings or share savings account.

Certificates of Deposit (CDs) or Time Deposits: A deposit of a fixed sum of money for a fixed period of time.

- Safety - Guaranteed up to $100,000 if federally insured.
- Liquidity - Funds are invested for a fixed period, usually six months to five years. CD's may be liquidated at any time, but if it is prior to the maturity date some interest may be forfeited.
- Yield - Higher than savings deposits; the longer the term, the higher the yield (*Check for current rate ___________*).

Minimum deposits (usually at least $500) are required. Often called share certificates at Credit Unions.

Go to your local credit union, bank or brokerage to purchase a CD.

Money Market Accounts (MMA): An interest-earning savings account offered by FDIC-insured institutions, with limited transaction privileges.

- Safety - Safe, but may not be federally insured, depending on where the account is maintained. A money market deposit account at a bank or credit union should be insured up to $100,000 per account. A money market account held at a brokerage or through a mutual fund will typically not be insured at all.

- Liquidity – Generally, there are no restrictions on withdrawals. May be a large minimum deposit required, a required minimum balance, fees for withdrawals, and/or limited check-writing privileges.
- Yield - Generally low, but higher than regular savings. Varies with changes in interest rates. May be attractive if rates are rising rapidly. (*Check for current rate ___________*).

Go to your local credit union, bank, or a brokerage to open a money market account. Remember that many brokerages may help you open a money market FUND account, which will not be insured. For savings purposes, an insured money market ACCOUNT is appropriate.

US Savings Bonds—EE and I

- Safety—Guaranteed by the US Treasury.
- Liquidity—Can be redeemed after 12 months, but receive a 3-month interest penalty if held for less than 5 years.
- Yield for Series EE bonds: A fixed rate of return determined twice a year. (*Check for current rate ___________*).
- Yield for I-bonds: Yield is indexed for inflation and has two parts -- a fixed rate of return and a variable, semi-annual inflation rate. (*Check for current rate ___________*).

Series EE Savings Bonds are an easy, convenient and disciplined way to begin your investing. The S-L-Y trade-off is that the yield is relatively low. If you are going to invest in savings bonds, make it a ***part*** of your investment plan, but not ***all*** of it. Features of Series EE U.S. Savings Bonds include:

- Minimum investment is $25.00.
- Purchase for half of their face value, and the value of the bond builds up over time to achieve full face value ("Original Maturity"). For example, an EE Bond with a face value of $100 is purchased for $50. It is guaranteed to reach its face value in 20 years. (Note: I-bonds are purchased at their full face value, and the value is adjusted for inflation.)
- Risk is lower than most investments because the principal (amount you invested) and interest (amount your money earned) are backed by the full faith and credit of the United States Government.

- Convenient to purchase via allotment from military paycheck, from a bank or credit union, or directly from the government at www.savingsbonds.gov.
- There are no commissions or fees.
- Interest earned on savings bonds is exempt from state and local taxes, and federal taxes are postponed until you cash them in.
- Interest earned on bonds purchased by a person aged 24 or older and used to pay certain qualified education expenses may be excluded from gross income. In other words, these can be an important element of an education savings plan for a child. (Bond must be issued in the parent's name, not the child's, to get this tax benefit.)
- Savings Bonds earn interest for 30 years. They can be cashed in as early as 12 months after purchase, but if cashed in within five years of purchase there is a 3-month interest penalty. Rates of interest change every six months.
- If the bond hasn't reached face value within 20 years, the government will automatically make an adjustment to get it to face value.

SAVING VS. INVESTING

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What is the difference between saving and investing?

After working on the Management Level of the Financial Planning Pyramid, Savings becomes the next critical step towards financial security. Don't start an investment plan until you have a solid emergency fund for a safety net. However, for long-range goals it is important to get a better rate of return than is available with savings tools, and it is here that we move up the Pyramid to look at investment options.

How does investing differ from savings? They differ in the time-frame in which the money is needed, in the higher risk associated with investment tools, in the impact of inflation and taxes on investment earnings, and in the significant effect of compound interest and time.

Time Frame

As discussed earlier, it is most appropriate to use savings tools for short-term financial goals – money to be used in five years or less. If the money is needed for a goal in five or more years, investment tools that offer the potential for a higher yield are the best option. This is because in the short term, money that is placed in investment tools is subject to market fluctuations and the investor has a higher risk of losing money. The longer your investment horizon is (the distance from making the investment to using the investment), the better your ability to lower some of the risk of market fluctuations.

Risk

There is risk involved in ***every*** type of investment tool. These risks differ, depending on what investment product is used. Many people never invest their money because they are afraid of losing any of it – they don't want to take on any risk whatsoever – so they keep all their money in a low-earning savings tool. Unfortunately, doing that may mean they will never achieve their financial goals because they never take advantage of the bigger earnings available in the investment market.

Some risk can be minimized through diversification (not putting all your money in one investment type), which will be addressed later. Some risk can also be minimized by investing for the long term, as discussed above. In fact, the riskiest thing you can do with your money is to do nothing at all. Risk is not something to be feared, but to be managed. Knowledge of investing will help you manage it.

Among the most common types of risk are:

- *Physical Risk:* Theft, loss of principal.
- *Market Risk:* The ups and downs of the stock market. This is what most people think of when they consider the risks of investing. If an investment goes down in price, you have lost money at that point (assuming you have sold). However, market risk is often reduced when money is in a sound investment over long periods of time. Savvy investors will often invest more of their money when the market is "down" in value, because they see it as a big sale, and what could be a better time to buy than when a sale is in progress?
- *Interest Rate Risk:* The price of some investments fluctuates with changes in interest rates, particular fixed-income investments.
- *Inflation Risk:* Probably the greatest risk to your money over the long term. In order to keep ahead of inflation in your long-term savings/investments, you will need to accept a greater degree of other risks. An annual inflation rate of only 3.5% will cut the value of your money in half in 20 years.

Inflation

Inflation is an increase in the cost of goods and services. Inflation means that what costs a dollar today will cost more than a dollar in the future; for example, $100 in 1982 had the same buying power as $215 in 2007.

The current inflation rate is *(Look up rate __________)*. Historically, the annual rate of inflation also referred to as the "CPI" or Consumer Price Index, has averaged 3.4% over the last 93 years.

Taxes

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Along with risk and inflation, taxes become a bigger consideration when working with investment tools, and therefore provide another difference between saving and investing. Taxes are calculated differently depending on the type of investment account opened and the length of time the investment is held.

Regular Savings and Investment Accounts: There are three different types of accounts that have an affect on taxes. The first is a regular saving or investment account that has no special tax treatment associated with it. Money earned on these accounts is taxed as follows:

- *On Savings:* Earnings on your savings are taxed each year. If you earn interest or dividends on your savings and/or checking account, you will receive a statement from the bank or credit union at tax time indicating how much you earned. You must include it as unearned income on your 1040 and you will be taxed on it at what is called your Marginal Income Tax Bracket (MITB), which is usually 15% or 25% for most military taxpayers. Typically taxes on savings are minimal, because earnings are minimal.
- *On Investments:* Earnings on your investments come in a couple of forms – dividends and capital gains. At the end of each year, tax statements are sent out noting the earnings on investments and these earnings need to be included on tax returns. Here is an example of how taxes on investment tools can work.

One share of stock is purchased for $50 and sold for $60. The difference between a purchase price and a higher selling price is called a "capital gain". In this example, the capital gain of $10 will be taxed based on how long the investment was held and the investor's income tax bracket. Taxes are only due if there is a capital gain. If the investment is sold for less than what the purchase price was, the difference is called a "capital loss". In some circumstances, these types of losses can be used to offset gains when paying income taxes.

Mutual Funds, on the other hand, pass capital gains on to the investor every year, regardless of whether shares are sold. This will be discussed further later in this program. For now, be sure to keep all financial statements in order to correctly calculate taxes due.

The law regarding capital gains taxes is subject to change. In the 2006 tax year:

- Short-term capital gains (investment held 12 months or less) are taxed at the investor's Marginal Income Tax Bracket (MITB) up to 35%.
- Long-term capital gains (investment held more than 12 months) are taxed at 5% for taxpayers in the 10 and 15% MITB, and 15% for taxpayers in the 25, 28, 33 and 35% MITBs.

13 *Tax-Deferred Accounts:* These accounts allow the investor to delay paying taxes on any earnings. They are typically used for retirement planning. Tax-deferred accounts include the military Thrift Savings Plan, a civilian retirement plans like a 401K, and a regular "deductible" Individual Retirement Account or IRA. An immediate benefit of these accounts is that the contributions made to them are deducted from paychecks BEFORE income taxes are calculated, so taxable pay is reduced. Special withdrawal rules apply to these types of accounts and the money earned on them is taxed when it is withdrawn. Tax rates are the investor's MITB at the time of withdrawal.

The Roth IRA Account: The Roth IRA is a type of after-tax account. The money put into a Roth IRA cannot be deducted from income before taxes, so the contribution is considered an "after-tax" contribution. All withdrawals (contributions and earnings) made after a specified time period are not taxed.

For more information on retirement plans, attend a "Retirement Planning" workshop at your local Fleet and Family Support Center, or visit your Command Financial Specialist.

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Compounding

The only way to overcome taxes and inflation is to put the power of compound interest and time to work with a long-term, disciplined investment plan.

Here is one more example of how much money can grow over time. $100 saved monthly with no interest will equal $36,000 over thirty years. The same amount accumulating at 5% will grow to about

$83,673. This amount with a 10% rate of return grows to over $228,033. This example, along with earlier examples, shows again that the greater the rate of return and the longer your money works for you, the more you will eventually earn. Compound interest is a powerful force.

There is a difference, however, between what an investment can do on 15
paper and what investors do in real life. Unfortunately, when some people see their money begin to add up they feel a temptation to spend. Using the above example, what if after five years of saving the investor decided to use the approximately $7,800 that had grown (at 10%) to buy a car? Continued investing at the same rate would only grow to $133,889 instead of the $228,033 if ALL the money had been left to grow. In other words, you could say that the car didn't cost you $7,800, but $94,144 when you account for the lost growth.

The message? Save regularly and leave it alone to grow.

THE TOOLS OF INVESTING 16

So far this program has considered the magic of compound interest and time, the management and savings levels of the financial planning pyramid, the differences between saving and investing, and some characteristics of both saving and investing tools, namely safety, liquidity and yield. Moving up the pyramid to the investment levels, one can see that various tools are available to help us achieve our investment goals. Let's now explore some of the more popular and useful tools available.

Asset Classes 17

There are three main types of asset classes available to investors. An asset class is a group of securities that have similar characteristics, behave similarly in the marketplace, and are subject to similar laws. The three are equities (stocks), fixed-income (bonds), and cash equivalents (money market instruments). Everything else is a combination of these three

When you invest in equity – when you buy a stock – you become an owner. When you invest in fixed-income – buy a bond – you become a lender. Often fixed-income securities are also referred to as "debt" securities, but this is good debt, the kind where people owe YOU money, not the other way around. A well-planned financial portfolio will have a combination of equities, fixed-income and cash, depending on investment goals, time-frame, and risk.

The Financial Planning Pyramid lists some of the better known forms of equity and debt: stocks (equity), bonds (fixed income or debt), mutual funds (explained below), hard assets (things you can touch) such as real estate, gold or silver, and collectible items, and a few others. Several of these are worthy of a more detailed discussion because they are the best investment tools for sailors and their families.

18 **Fixed Income: Bonds**

Companies and governments issue bonds to fund their day-to-day operations or to finance specific projects. When you buy a bond, you are loaning your money for a certain period of time to the issuer, be it General Electric or Uncle Sam. In return, bond holders get back the loan amount plus interest payments, which are usually distributed twice a year.

- Bonds represent money owed to the investor -- an IOU.
- Companies and governments, i.e., cities, states and federal governments, issue bonds.
- Bonds can be very safe (guaranteed by the full faith and credit of the U.S. Government), have a high risk of default (if a company is heading towards bankruptcy, etc.), or fall somewhere in between. The investor needs to research the "rating" of a bond to ensure you only buy ones that match your risk tolerance.
- Bond returns have averaged 3.7 – 5.5% over the past 81 years.
- Bonds are moderately liquid—chances are you won't get money out of a bond the same day you need it.
- Bonds have a fixed interest payment, so they usually provide a reliable stream of income.
- Bonds are typically purchased through a brokerage.

19 **Equity: Stocks**

Common stocks are the classic equity investment. You can buy stocks in U.S. companies, foreign companies, large companies, small companies, companies that analysts think will grow (growth), and companies that analysts think are currently selling at a bargain (value).

- Common stocks represent ownership in a company.

- Returns come from dividends and/or an increase in stock prices; dividends represent profits passed on to shareholders.

- Stocks have averaged an annual return of 10—12% for the past 81 years.

- Stocks can be purchased through a brokerage (on-line or in person), through an employer investment plan, or even directly from the company that sells the stock through a dividend reinvestment plan (DRIP).

- Developing an individual stock portfolio takes research and time. Financial experts suggest having 10 to 30 different stocks in a portfolio in order to be well-diversified.

- Stocks normally are the best long-term way to beat inflation and represent the best opportunity for long-term growth of your money.

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The Lessons

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What should you be learning from this discussion of asset classes?

1. It should be clear that an investor can have higher potential earnings by putting money in the stock market than by putting it in bonds or in a savings product.

2. There is always the S-L-Y trade-off to consider. The higher the potential yield of an investment, the higher the risk (lower the safety). We already said you should always be prepared to lose money, but you should also expect a decent rate of return if you have done your homework.

3. A well-balanced portfolio will contain a combination of asset classes (stocks, bonds, cash), and the stocks and bonds chosen should be diverse as well.

4. Assets are neither good nor bad, but there are good and bad uses. Which investment is best for an investor depends on the time horizon, objective, risk tolerance, and age.

5. For young people starting to invest, over long periods of time it is usually better to be an owner rather than a lender. Stocks have a higher return over extended periods of time than bonds and will provide the greater opportunity for long-term growth.

6. Use bonds to receive a stream of income (very useful for those in retirement.)

7. This investing thing can be complex! It can be, but it doesn't need to be … there are several investment options that make investing easy almost to the point where it takes care of itself!

22 **Mutual Funds**

Mutual Funds provide an easy alternative to selecting individual stocks or bonds. A mutual fund is a company that pools money from many investors and invests in the different asset classes or some combination of them. The combined holdings the mutual fund owns are called its portfolio. Each share represents an investor's proportionate ownership of the fund's holdings and the income those holdings generate.

Mutual funds make money for shareholders in several ways:

- The investments the fund owns may pay dividends (stocks) or interest (bonds).
- When the manager sells an investment for a profit, there will be a capital gain.
- There will be an increase in share price (Net Asset Value or NAV) if the fund performs well.

Dividends and capital gains must be paid out regularly to the fund's shareholders. Many people choose to reinvest this money right back into their account. Whether they take the money or reinvest it, income tax must still be paid on the profits at the end of the year (unless the mutual fund is a tax-deferred account, which will be discussed later).

23 *Advantages:* Mutual funds offer a number of advantages.

- Professional management – An individual who invests in a mutual fund is actually hiring a professional money manager to research, select, and monitor the performance of the portfolio.
- Diversification – Mutual funds can offer automatic and immediate diversification. When you diversify, you put your money in a mixture of different individual securities; if one performs poorly, the others may make up for it. Diversification helps spread the risk and also the opportunity. This can be difficult to do for a new investor developing his or her own portfolio independently—it takes time, education, and larger investment amounts. Mutual funds make diversification easy and cost-effective.

- Liquidity – Shares can be redeemed at NAV (plus any fees and charges) at any time.
- Affordability – Some mutual funds accommodate investors who don't have a lot of money to invest by setting relatively low dollar amounts for initial purchases, subsequent monthly purchases, or both.

Disadvantages: There are also some disadvantages.

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- Costs despite Negative Returns – Sales charges, annual fees and other expenses must be paid annually whether or not the fund makes money. Also, there is the possibility of having to pay taxes even when the fund performed poorly, depending on when the shares were purchased.
- Lack of Control – The portfolio is determined by the manager, not the investor. The investor may not be able to determine the exact makeup of the portfolio at any given time.
- Price Uncertainty – NAV may not be computed until many hours after a redeem order has been placed. Mutual funds generally calculate their NAV after the major U.S. exchanges close.
- Not Insured – Mutual funds are not federally insured like deposits in a bank or credit union. You can lose your money.
- Complex Records – Mutual funds can be complex when it comes to tracking purchases, sales and earnings over long periods of time. Keep all end-of-year statements.

Types: Here are some of the common types of mutual funds.

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- Funds invested in the ***stock market***
- Funds invested in the ***stock market and bond market***
- Funds invested in the ***bond market***
- Funds invested in the ***money market***

Choosing a mutual fund: There are thousands and thousands of mutual funds out there – how do you choose one? You can narrow the field when choosing a mutual fund by looking at the following:

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- Your goals and objectives: The objective of the fund should match your objective. For example, if you just want your money to grow, go with a large "growth" fund.

- The fund's performance history: Although past performance is not an indicator of future performance, sometimes it is all you have to go on. Look for a fund with good one, three, five and ten year returns. The returns should be at least as good as other funds in its category and its benchmark index.

- Management: The manager's performance history and his or her length of time with the fund may help in the decision. The longer the manager has been with the fund, the more you can rely on getting the same returns the fund has gotten in the past.

- Costs: There are costs to buying mutual funds. You can buy "no-load" funds, where no commission is charged, or "loaded" funds.

    - A **"load"** is a sales commission you'll pay to the person who sold you the fund. Loads can be as high as 8.5%, and can be assessed when the fund is purchased (*front-load*), or redeemed (contingent deferred sales charge or *back-load*). If you are going to buy a mutual fund with a load, be sure you are satisfied with the services of the person who is selling you the fund.

    - Funds will also have **annual expenses** (you won't see them taken out of your account, but they affect fund performance.) All loads, expenses, and fees are disclosed in the fund prospectus.

- Services: Many mutual funds are part of a larger organization (called a "family" of funds) which will offer many funds with different investment objectives. Investors may be permitted to transfer money to a different fund at little or no charge as their goals or investment outlook changes. Some funds allow withdrawals by check writing. Other services may also be available.

- Buying a Mutual Fund – Mutual funds can be purchased through a full-service broker, discount broker, financial planner, a bank or credit union investment advisor, or directly and easily from a fund family via the phone and the mail. A financial service professional can provide both a prospectus and an annual report for a mutual fund. When dealing with a fund directly, the prospectus will be sent when you request information on the fund. It may also be helpful to consult additional sources of information on mutual funds prior to investing. A wide range of information is easily available and most of the information you need can be found by consulting rating services such as Morningstar or Lipper.

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What is "The Market"?

This would be a good time to discuss this term which is used a lot but maybe not completely understood. When you hear "the market" on TV, usually as in, "Today the market was …", what does the term refer to?

- *The Dow:* The Dow Jones Industrial Average tracks the daily gains and losses of thirty stocks from the New York Stock Exchange that are consider to be key players in the market and the economy. In other words, the Dow is an index. An index is a tool for comparing your investment's performance against other similar investments. It is a measurement of the combined average performance of groups of similar securities. For the Dow, one could say they take the value of all thirty stocks, run a formula on it each day (like an average), and then track the changes in that number every day.
- *The NASDAQ:* The North American Securities Dealers Automated Quotation System. The NASDAQ is a computerized trading system on which stocks (typically smaller companies or high tech companies) are bought and sold. The NASDAQ doesn't exist anywhere—it is not a bricks and mortar place. Every day an average of all the stocks traded on the NASDAQ is computed, and the change in that index, the NASDAQ Composite Index, is reported daily.
- *The S&P 500:* The Standard and Poor's 500 is an index that tracks the large company stock population. S&P is a financial research and publishing company. The Index tracks 500 large American stocks. It is like the Dow, only includes more companies, and in fact the components of the S&P 500 can comprise from 70 to 75% of the economic base of this country.
- *The Wilshire 4500:* This is an index of small-company stocks that reflects the rest of the market not included in the S&P 500.
- *The Wilshire 5000:* This is an index of 5000 companies designed as a measure of the entire U.S. Stock market.
- *The Lehman Brothers U.S. Aggregate Bond:* This is an index designed to measure both government and corporate bonds.
- *The NYSE:* The New York Stock Exchange, is an actual building in New York City where stocks are bought and sold. Also, every day an index for all the stocks traded on the exchange is reported.
- *The AMEX:* The American Stock Exchange is another brick and mortar building where stocks are bought and sold, and there is also an index computed on it. It is the second largest options exchange market.

- *The Nikkei:* A place in Japan where stocks are bought and sold, and there is also an index computed on it.
- *The EAFE:* Computed by Morgan Stanley, this index tracks the performance of approximately 1200 non-US companies representing 21 countries in Europe, Australia, New Zealand and the Far East.

When you hear the term "The Market" it may be in reference to all of these taken together. However, when you hear, "For the last ten years the market returned …" generally it is in regard to the S&P 500, the broader U.S. market index.

Indexes like these can be a valuable way of determining how your investments are doing. For example, if you hold some stocks that are included in the S&P 500 and you want to see if your portfolio returns are keeping up with the market in general, you would compare your portfolio returns with the S&P 500 for the same period. If you held a mutual fund with technology stocks, you would be better to compare the return on your mutual fund to the NASDAQ, as that would be a better comparative index. If most of your stock or mutual fund investments are in foreign companies, you would compare the rate of return on your portfolio with that of the EAFE index.

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Putting it all together: The TSP Funds

A great way to understand how mutual funds and indexes relate to each other is to consider the Thrift Saving Plan funds. The TSP is a retirement savings and investment plan sponsored by the Federal Government. This plan allows for each member to invest a certain amount of money each month into one of 10 funds. These funds are in fact mutual funds, and the majority have a portfolio that is exactly the same as some of the indexes just discussed, because they invest in the exact same securities as the index.

Service members must sign up to participate and contributions are taken directly out of the paycheck before taxes. The purpose of the TSP is to provide a source of retirement income. It is ***not*** a savings account that can be withdrawn at any time. The TSP is a **tax-deferred account,** which means no taxes are due until the money is withdrawn.

For a complete understanding of the Thrift Savings Plan you should attend a Retirement Planning Seminar or Thrift Savings Plan brief given by your local Fleet and Family Support Center. For purposes of this module, only the types of funds available through TSP will be discussed.

The TSP Investment Options

G Fund	F Fund	C Fund	S Fund	I Fund	L Funds
•Government Securities •Especially Issued for TSP •2006: 4.93% •10 Yr: 5.31%	•Bonds •Based on LBA Index •2006: 4.40% •10 Yr: 6.25%	•Stocks •Based on S&P 500 Index •2006: 15.79% •10 Yr: 8.37%	•Stocks •Based on Wilshire 4500 Index •2006: 15.30% •10 Yr: 9.56%	•International Stocks •Based on EAFE Index •2006: 26.32% •10 Yr: 7.53%	•Combination of other Funds •Combination based on Time Horizon to Retirement

The above chart shows six funds offered through the TSP, including what the fund invests in, and what index, if any, the fund is based on. The F, C, S and I funds are all based on an index. The "L" Funds are not based on an index directly, but are some combination of all the other funds. In the "L" Fund category the investor has a choice of four funds that have a different asset mix. The combination of assets depends on the age of the investor and when the investor plans to retire (not military retirement, final retirement). The L Fund solves all the complications of picking individual stocks or mutual funds and the need to re-balance a portfolio as the investor nears retirement (for example, often as people near retirement they move money out of the riskier equity class and into the more stable, income-providing fixed-asset class.) The investor chooses when the money needs to be available, and matches the L fund up with that investment horizon. Couldn't be simpler!

THE TECHNIQUES OF SAVING AND INVESTING

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Pay Yourself First

Make sure you have adequate income to pursue a savings and investment plan, and that you are adequately insured. Save from the top of your spending plan versus the bottom (don't save whatever is left after all of your expenses are paid; make your savings and investments a regular expense, too.) Set up a savings allotment—you won't miss it if you don't see it—or join the TSP.

Participate in the Military Saves Campaign

This program is sponsored by the Consumer Federation of America through an agreement with the Department of Defense. It is designed to encourage you to set your savings goals and provide suggestions and information on how to make that happen. The goal of the program is to help service members and families become financially prepared and put them on the path toward financial freedom. Contact your CFS, Fleet and Family Support Center, or www.militarysaves.com to enroll.

Maximize any Tax-Deferred Investment Opportunities

When you have all the necessary savings funds in place, decide how much money you can invest regularly and how much of that amount will go into retirement accounts. Put the maximum amount possible into any tax-deferred opportunities. These would include the Thrift Savings Plan (TSP), a 401k, and an IRA. However, once money is put into retirement accounts it cannot be withdrawn without a penalty. Therefore, it is wise to put some of your available dollars into retirement accounts and some into regular, taxable accounts.

Thinking About Investing

Investing Resources

Make Regular, Steady Investments

Earlier in this discussion, an example was used that showed the impact of spending money that had accumulated in an investment account. Even if you continue investing at the same rate, you will never catch up to what you could have had if you hadn't withdrawn your money early. Keep in mind that investment performance isn't the same as investor performance. The stock market could be posting a return of 25%, but if you aren't investing regularly, you won't see your investments grow.

If you have a lump sum of money to invest, research the options, consult a professional, and invest it in an appropriate investment tool for your goals, timeframe and risk tolerance. But if you are like most small investors, you don't have a large sum of money and are investing a smaller amount on a monthly basis … keep at it, and don't stop the flow of money into your investments.

SUMMARY AND CONCLUSION

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Take Action

The investment markets have never been friendlier to small investors. Employer-provided retirement plans like the TSP, the internet, and mutual funds make investing easy and effective. Remember, the riskiest thing you can do with your money is to do nothing at all … inflation will guarantee that you will move away from building wealth as the value of your money erodes. So keep first things first, and put your money where it can grow for you.

- *Determine Financial Goals:* Set both short and long-term goals and determine which types of investments are appropriate for the time horizons associated with each.
- *Review your Budget:* Cut expenses, pay down your debt, and determine how much you can put into savings and investments each month. Pay yourself just like you would pay any other bill – except pay yourself first!
- *Save Money You Don't Have … Yet!* Commit a portion of every future raise to your investment plan. You don't have it now, so you won't miss it when you invest it.
- *Establish emergency, reserve and goal-getter savings funds:* Goals should include having three months of expenses in emergency savings and putting aside about 10% of net income for long-term goals.
- *Get help if you need it.* Talk to trusted family, friends and co-workers and ask how they invest their money. Make an appointment to see your Command Financial Specialist or Fleet and Family Support Center Financial Educator for additional information. Explore the possibility of hiring a financial professional (like a Certified Financial Planner) to help you with your plan if you need it.
- *Build an investment portfolio.* Maximize tax-deferred opportunities. Choose a mutual fund or the stock of a company you have researched. Interview and hire a financial professional if you prefer to have assistance.
- *Keep learning.* New information is available all the time and the investment environment changes frequently. Read books and magazines, attend classes, talk to fellow investors, start an investment club. Even if you plan to work with a broker, financial planner, or other investment advisor, it will still help if you improve your knowledge about what you

plan to invest in; no one is as interested in your family's financial future as you are.

A course on investing at a local community college or adult education center can be interesting as well as informative. Free seminars, given by individuals and organizations in financial services as a way to attract potential clients, can also be useful as long as you remain on guard for the sales pitch. Scan the internet; visit the local library, read some financial magazines and newspapers.

- *Keep At It!* Finally, once you get started—keep at it! Continue saving for both short and long-term goals. It takes time to produce virtually anything worthwhile. Never take money out of your TSP, IRA or other long-term investments for short-term objectives—that's why you have established a goal-getter or emergency fund.