Investor & Financial Literacy Guide

Strategies for Investing Wisely & Avoiding Financial Fraud

A PUBLICATION OF GEORGIA SECRETARY OF STATE
SECURITIES DIVISION

Regulating securities activity statewide and protecting against investment fraud and promoting financial literacy.

Georgia investors:

Please enjoy our *Investor & Financial Literacy Guide: Strategies for Investing Wisely & Avoiding Financial Fraud*. We are providing this resource to the people of Georgia so you can invest wisely and set yourselves on the path to financial security.

Since day one, I have sought to provide as many financial resources as possible for the Peach State. Shortly after taking office, I created the She Leads financial empowerment and education program. Through She Leads, my office provides regular programming featuring financial leaders discussing everything from personal financial management strategies to how to build and grow a small business. You can access all of our past programs and sign up for future ones on the Secretary of State's website at https://sos.ga.gov/she-leads.

Both the She Leads program and this guide are provided through the Securities Division of the Secretary of State's office. The Securities Division is focused on protecting the people of Georgia from financial fraud and scams. As the state's chief financial regulator, my office works to ensure no one takes advantage of the people of Georgia.

In addition to the many useful investment tips below, this guide can also help you spot scams ahead of time. You can find additional tips and report a scam on my website at https://sos.ga.gov/page/investor-alerts-and-outreach.

This guide can be an incredible resource for the people of Georgia. I hope it will help lead you to financial stability and success.

Sincerely,

Brad Raffensperger

Brad Raffensperger
Secretary of State

Investor & Financial Literacy Guide

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Introduction

Investors have more responsibility than ever for achieving their financial goals.

When it comes to retirement, the days of corporations managing pension plans for their workers are dwindling, and have been for a long time. Social Security is expected to replace less and less of the income a retiree earned while working. Instead, workers increasingly have had to fend for themselves by setting up their own retirement accounts or participating in the retirement plans offered by employers, such as 401(k), 403(b), 457, and thrift savings plans.

This shift in responsibility requires us to know a lot more about making investments, yet too few of us really feel equipped to make informed decisions about our financial future.

A Library of Congress report found that many investors "lack essential knowledge of the most rudimentary financial concepts," such as the differences between stocks and bonds, the role of the stock market, and the value of portfolio diversification.

Nor do investors appreciate how badly investment fees erode their long-term returns—or how to minimize those fees.

When it comes to financial fraud, investors are consistently attracted to shiny new things—very risky investments that promise to earn them big, big returns. And they don't pay enough attention to the alarm bells ringing in their heads before putting their hard-earned money into one of the ever-evolving types of fraud.

The *Investor & Financial Literacy Guide* was written to help investors—beginning and more experienced—understand precisely these topics. And if you decide to seek a financial adviser, the *Investor & Financial Literacy Guide* will help you ask the right questions and do the necessary research to increase your chances of finding a financial professional you can trust.

To begin, let's address a basic question: Why Invest?

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PART 1

Why Invest?

Why invest? The answer can be summed up in three points:

1. You won't meet your financial goals unless you invest, or use the money you have to earn more money. You invest so you can buy a home, send your children to college, start your own business, or expand your horizons by continuing your own education or traveling.
2. Your most important goal is likely to be enjoying a secure retirement. You help make that possible by investing regularly. Investing supplements your savings and helps you cover your day-to-day costs, including healthcare expenses, over what could be a decades-long retirement.
3. Investing helps provide financial security for your family, and for the people and organizations that depend on your generosity.

All investing carries some degree of risk, however, so it pays to learn the investment basics before you get started.

BEFORE INVESTING, DEVELOP A PLAN FOR FAMILY MONEY MANAGEMENT

As you begin thinking about investing to meet future goals, you'll want to review the way you're managing the money you have now. A good place to start is by evaluating whether you're living within your means. Basically, you want to be sure that your monthly income is enough to cover your monthly expenses. If not, you risk being burdened by increasing debt that will make it hard to meet your current obligations and future goals.

If you find yourself short of cash at the end of every month, if you skip paying bills, and you're carrying large outstanding balances on your credit cards, you need to solve those problems first. There are two choices: increase your income or reduce your spending, or perhaps do both. Though they can be difficult, they are worth the effort.

Besides reducing debt, families should try to build an emergency savings fund that would pay for at least three to six months of living expenses. This fund can help cover the cost of unexpected events, such as unemployment, repairs or replacement of a car or major appliance, prolonged illness of a family member, medical expenses not covered by insurance, and property taxes.

A publication from the Federal Reserve Bank of Dallas, *Building Wealth: A Beginner's Guide to Securing Your Financial Future*, can take you step by step through the process of family budgeting, including building credit, controlling debt, preparing a spending plan, calculating your net worth, and knowing which types of insurance are needed to protect yourself from major financial losses. *Building Wealth* is free. Find out more at www.dallasfed.org/educate.

THE TIME VALUE OF MONEY

The $1 you have in your pocket today is worth more than that same $1 will be worth next month or next year. That's the time value of money: The more time that goes by, the less value your money has.

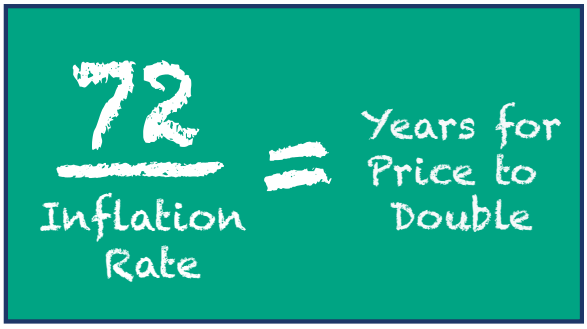
Money loses value—or buying power—as a result of **inflation**. Almost anything you buy now costs more than it once did—and often more than you expect. Inflation is a big part of the reason it will cost you more to live in the future than it costs now. What makes things worse is that over the past 40 years the average inflation rate as measured by the **Consumer Price Index (CPI)** has risen much faster than people's average **disposable personal income (DPI)**. That means you have lost a lot of buying power during that time.

Inflation also does real damage to your savings, especially if the inflation rate is higher than the interest rate you're earning. If that's the case, your savings are actually losing rather than gaining value.

So what's the solution? You'll need a source of income in the future that will outpace inflation and close the gap between what things will cost and what you have to spend. Investments can provide that income.

THE RULE OF 72

The Rule of 72 shows how inflation can erode your income. Here's how it works: You divide 72 by the **annualized** inflation rate, which has averaged 3% since 1926. Since 72 ÷ 3 = 24, you can expect your living expenses to double every 24 years.



That's an eye-opening number, since there's nothing unusual these days about a retirement lasting 24 years. It's critical, then, to have more income as time goes by. Keep in mind, too, that in some years inflation is higher than 3%. If inflation jumped to 6%, or soared past 12%, as it did in the late 1970s, then the damage to your long-term financial security could be severe.

The Rule of 72 is also a quick and accurate way to estimate how quickly the money you invest will double in value.

> **For example**, if your investment portfolio provided a 6% annualized return, you could expect your account to be worth twice what you invested after 12 years (72 ÷ 6 = 12). That's even if you don't invest another cent—though ideally you would continue to add money to your portfolio every year.

One word of caution, though: No rate of return is guaranteed. The estimates provided by the Rule of 72 depend on assumptions about the rate of inflation and the rate of investment return, both of which could differ significantly from historical averages or your expectations.

INVESTING FOR GROWTH

If the value of your investment portfolio increases more quickly than inflation causes prices to rise, you'll increase your **net worth** and be more financially secure. One way to do this is to invest for growth, or to try to achieve an annualized rate of return on your investments that is higher than the annualized rate of inflation.

Investing for growth is different from putting your money in **certificates of deposit (CDs)**. With bank or credit union CDs, your money is safe because deposits are federally insured and the return is guaranteed. The rate of return, however, is generally lower than the rate of inflation. In fact, in the past several years, CD returns have been about as low as they have ever been and typically less than half the average rate of inflation. Some investors have probably felt that, except for the federal deposit insurance, they would have made out as well by putting their money under their mattresses.

The sooner you start to invest, the more time your money has to grow. Just as the $1 you have today is worth more than the same $1 next year, so the $1 you invest today has greater potential for growth than the $1 you invest next year.

But investing at any age helps you financially.

INVESTING FOR GROWTH	
ALICE	**DAVE**
• Invests $400 a month from age 25	• Invests $400 a month from age 40
• Realizes average annual tax-deferred 6% return	• Realizes average annual tax-deferred 6% return
• At 65 her account is worth **$766,785**	• At 65 his account is worth **$271,832**

As this comparison shows, starting a tax-deferred retirement account at age 25 paid off for Alice. Her account ends up being worth almost three times as much as Dave's, who started a similar account at age 40.

In fact, even if Alice had stopped putting money into her account when she turned 35—after just 10 years—and she continued to achieve a 6% annualized return, she would have accumulated $440,390. She'd still have more in her account than Dave, even though he invested over 25 years. (Neither example takes into account investment costs.)

By investing early, you benefit from the power of **compounding**. With compounding, you earn a return not only on the amount you invest but on the earnings you accumulate. That gives you a bigger base on which future earnings can grow.

WHY PEOPLE DON'T INVEST

The arguments against investing are valid—to a point. Investments aren't insured, and your earnings aren't guaranteed. In some time periods, you will have to stomach the fact that the value of your investments has shrunk. You'll also need to avoid locking in your losses by selling in a panic.

The counterargument is that over extended periods of time—several decades, not one year or five years—you have a chance to achieve a much stronger rate of return, and much greater protection against inflation than CDs and money market accounts can provide.

> **For example**, between 1926 and the end of 2020, the compound annual growth rate was 10% for large company stocks, 12.1% for small company stocks, 5.5% for U.S. Treasury bonds, and 3.3% for U.S. Treasury bills. (Remember inflation has averaged 2.9% annually over this 95-year period.)

Those figures cover more than nine decades, though, and no one except the exceedingly optimistic plans to invest money for that length of time. There is no guarantee—in fact, probably very little likelihood—that your returns over 10 or 20 years of investing will closely track those historical returns. But since you have the potential for a rate of return that's higher than the rate of inflation, you may decide it's worth investing your assets in a mix of stocks and bonds.

Some people are understandably concerned that they don't know how or where to start investing, or simply don't have enough money. The best remedy is to learn more about investing and how it works, which is what the *Investor Guide* is designed to help you do.

PART 2

Making Investments

It's tough to start investing when you're unfamiliar with the different types of investments you might make, and when changes in the investment markets sometimes seem irrational. But if you're willing to put in the time to learn the basics, you'll be much more comfortable taking the plunge.

The place to begin is by recognizing that every investment belongs to what is known as an *asset class*—a group of investments that have important features in common. What's more, most investors can focus on just four of these classes to help achieve their financial goals. There are more asset classes, of course, but these are a good starting point.

ASSET CLASSES

What you need to know first is that each asset class puts your investment dollars to work in a different way, provides a different level of long-term return, and exposes you to different types of risk. Much of the time, each asset class reacts differently from the other classes to what's happening in the financial markets and the economy in general. For example, in a year when equities are increasing in value, fixed-income may be flat or even losing value. In a different year, it could be the other way around.

Equities | Fixed Income | Cash & Equivalents | Real Estate

Equities

When you make an equity investment, you buy shares of stock in an individual corporation or shares in a **mutual fund** or **exchange traded fund** (ETF) that owns stock in a number of corporations.

You can make money with equity investments in two ways. They may pay dividends, or income, or they may increase in value because the share price increases. Sometimes both things happen.

If the share price increases, you can sell your investment for more than you paid for it and reinvest the money. Or you can keep the shares. Either way, the value of your portfolio increases.

You may also be entitled to share in a company's or fund's profits. A corporation has the right to decide whether or not to pay a **dividend**, or a portion of its earnings. But a mutual fund must pass along to its shareholders the income it earns from its investments and the profits it makes from selling its holdings, after first subtracting its fees and expenses.

The risk with equity investments, particularly individual stocks, is that the prices may be **volatile**—or change significantly in a short period of time—and neither their **market price** nor the income they may provide is guaranteed. This means you could lose some or all of your money in an equity investment if its price dropped suddenly and you sold your shares.

Fixed Income

When you buy a bond, you are making what's known as a fixed-income investment. You are effectively lending money to the issuer of the bond, whether it is a corporation, a government, or a government agency. The issuer of the bond pays you a predetermined—or fixed—amount of interest on a scheduled basis, and then pays the principal of your investment back to you at the bond's maturity date.

The U.S. Department of the Treasury issues bonds on behalf of the federal government. A city or state may issue bonds to help pay for new roads, schools or other public infrastructure. Corporations sell bonds to increase cash flow or to fund expansions into new markets.

Buying a bond can be a straightforward transaction. Let's say you buy a 10-year U.S. Treasury Note with a face value of $5,000 and an interest rate of 3%. If you hold the bond to maturity, you would earn interest payments of $150 a year and then receive your $5,000 principal back at the end of 10 years.

Bonds are often bought and sold before maturity, however, so it's important to understand the impact of interest rates on the bond market. For instance, if interest rates rise, the market value of a bond that you already own will fall, meaning you would get less for it if you decided to sell it before maturity. That's because investors won't pay as much for a bond with a lower interest rate when they can buy a new bond with a higher rate.

Conversely, when interest rates fall, bond prices rise. A bond with a 3% interest rate is going to be more attractive to investors when new bonds are being issued with, say, a 2% interest rate.

Profit on a fixed income investment, or bond, includes the interest you earn and perhaps a **capital gain** if you sell it prior to maturity for more than you paid originally. Inflation, on the other hand, is the bane of bond investing, because inflation eats into the purchasing power of the fixed interest payments that bonds make over time.

Two types of government bonds can help protect investors from the effects of inflation: I-Bonds and TIPS.

I-Bonds are inflation-adjusted U.S. Savings Bonds. They earn interest based on the combination of a fixed rate and an inflation rate that usually adjusts twice a year. You can earn interest for up to 30 years, and cash out the bonds after five years with no penalty. You can also redeem these bonds after one year, but you pay a penalty of three months' interest.

The interest I-Bonds earn will always equal the rate of inflation, so the amount you invested will never decrease.

An investor can purchase up to $10,000 in I-Bonds in one year, and because of how the interest and principal are taxed, it's often preferable to hold these bonds in taxable accounts instead of **individual retirement accounts (IRAs)** or other accounts that defer the payment of taxes until the money is withdrawn.

TIPS are Treasury Inflation-Protected Securities, but they shouldn't be confused with conventional Treasury bonds. TIPS pay interest every six months at a fixed rate, but the principal invested in TIPS is adjusted to reflect the rate of inflation as measured by the **Consumer Price Index (CPI)**. The interest payments, then, vary with the adjusted principal. Higher inflation results in higher interest payments. In the event of deflation, the interest payment decreases.

TIPS are issued in terms of 5, 10, and 30 years. When a TIPS matures, an investor receives the adjusted principal or the original principal, whichever is greater. You can also buy TIPS in a mutual fund or ETF.

The interest rate paid by TIPS has been near rock bottom for years, just as yields from other Treasuries have been at historically low levels. The prospect of 1% annual interest may not interest a lot of investors, but because TIPS are indexed to inflation, they provide income and protection from inflation—a rare comfort for investors who are averse to risk.

TIPS are best held in tax-advantaged retirement plans because of the method used to tax their returns.

Bond mutual funds. You can also buy mutual funds or ETFs that invest in a portfolio of fixed income securities, including municipal or corporate bonds, Treasury bonds, or TIPS. Unlike individual bonds, however, a bond mutual fund doesn't guarantee a particular interest rate, mature on a specific date, or promise the repayment of your principal. Rather, its performance, and your income or potential profit or loss, reflects the collective performance of the bonds the fund owns.

The benefit of bond funds is the broad diversification within the bond market they provide. Many investors lack the capital, time, or experience to research and assemble their own diversified basket of individual bonds. Bond funds offer a solution. In addition, profits distributed from the funds can be automatically reinvested for investors who want to build their fixed-income stakes.

Generally, it's safer to invest in a bond mutual fund that owns many different types of bonds—such as corporate, U.S. Treasury or municipal—instead of buying a small number of individual bonds on your own. Investing in just a handful of individual bonds exposes you to greater risk that one of the entities that issued your bonds will run into financial trouble, endangering its ability to repay you.

Cash and Its Cousins

Cash is the coins jingling in your pocket, the paper currency folded in your wallet and the daily balances in your checking and savings accounts. A cash equivalent, on the other hand, is any short-term investment that's both highly **liquid**, meaning it can quickly be converted into actual cash, and safe, meaning there's minimal risk of a loss of **principal**. Investments considered cash equivalents include short-term bank certificates of deposit, U.S. Treasury bills, and money market mutual funds.

As you begin to educate yourself as an investor, you may come across the old maxim that "cash is trash" because of the low interest rates cash and cash equivalents earn. Ignore it. There are many good reasons to hold cash or cash equivalents, the most important being that life never unfolds completely as planned. You should try to build a cash reserve to cover at least several months of expenses. You may lose your job or crash your car. You or a loved one may get hit with big out-of-pocket medical bills.

Aside from just serving as a bulwark against the vagaries of life, a healthy reserve of cash or its equivalents will help you sleep better at night during the inevitable periods of stock-market turmoil. In addition, a reserve provides a resource you can deploy in the wake of such periods, to swoop in and pick up bargain-priced investments that less far-sighted investors have dumped in a panic.

To be clear, the interest rate you earn on cash is low. The interest rate on cash equivalents is generally better but still might not exceed the rate of inflation in some periods. When it falls short of inflation, you'll have a negative real return. A real return is return minus the impact of inflation. So if you earn a 2% return on your cash or cash equivalent investment and inflation is 3%, your real return is negative.

Cash on hand brings tangible benefits and peace of mind, but you also should be aware your reserve won't garner much in the way of investment returns. Only you can determine how big a reserve fund you're comfortable with, but calculating your average expenses over a six-month period is a good way to start thinking about it.

Cash equivalents expose you to limited investment risk. Bank CDs are insured by the Federal Deposit Insurance Corporation (FDIC) if the institution issuing the CD is FDIC-insured. (The FDIC insures accounts in banks and savings and loan institutions

for up to $250,000 per depositor, and the National Credit Union Association does the same for depositors in credit unions. Different types of accounts, such as retirement, trust, individual, and joint accounts are insured separately.)

U.S. Treasury bills are backed by the full faith and credit of the U.S. government. Money market funds invest to maintain their value at $1 per share but are usually not insured and the $1 value is not guaranteed. That's an important way these funds differ from bank money market accounts, which are FDIC-insured.

Real Estate

By investing in real estate, we don't mean flipping houses or buying rental properties, or even making improvements to your own home. You can invest in commercial real estate—office buildings, apartment complexes, shopping malls, warehouses, or other developments—by buying shares of a publicly traded **Real Estate Investment Trust (REIT)**.

The more varied a REIT's properties are, either by type or geography, the greater the protection it has against downturns in the real estate market. Owning shares in a REIT is a type of equity investment. But a REIT is different from individual stocks, stock mutual funds, or stock ETFs since it must distribute at least 90% of its taxable income to its shareholders. However, that income isn't guaranteed and could be less than expected.

In addition, the return on a REIT is not necessarily correlated with the return on other equity investments. That's because real estate stocks may respond differently to changes in the financial markets or the economy as a whole than the stocks of companies providing other products and services. For example, equities often lose value as inflation increases while REITs may gain value because the properties that REITs hold can raise rents as prices increase.

While a REIT has the potential to provide significant income, that income is taxed at a higher rate than the rate that applies to dividend income from most stocks. For that reason, many people choose to hold REIT investments in tax-deferred retirement accounts.

INVESTING THROUGH MUTUAL FUNDS AND ETFS

Mutual funds and ETFs are similar in that they both invest in a basket of underlying investments, in most cases concentrating on a single asset class. And there are mutual funds and ETFs that invest in just about every major asset class in the world, including domestic and international stocks and bonds, REITs, and commodities. As a result, they provide an opportunity to invest more widely than you could otherwise do by buying individual securities.

COMPARING COSTS

You can't avoid fees altogether. What's more, the fees on some types of funds are generally higher than the fees on other types. The fees on actively managed funds that invest in small companies tend to be higher than the fees of funds that invest in large, well-known companies. That's because identifying appropriate small companies takes more time and research.

Similarly, the fees on international funds that invest in countries around the world tend to be higher than the fees on funds that invest exclusively in U.S. securities. However, it can be smart to own small-company and international funds to diversify your portfolio.

Mutual Funds

A mutual fund is formed by an investment company that typically offers a group, or family, of mutual funds. Each fund has a specific objective, such as providing long-term growth, current income, or sometimes a combination of the two.

Once a fund is created, it sells shares to investors. You may be able to purchase shares online or by contacting a company representative. Fund companies have made it a lot easier to buy shares this way. You may also buy shares through salespeople at banks and brokerage firms or by participating in an employer-sponsored retirement savings plan that includes the fund as one of its investment options.

Mutual funds also make it easy to invest. Initial minimum investments are relatively low and you can make additional investments of $50 or $100 on a regular basis—or any time you want. A mutual fund will also buy back any shares you want to sell based on the fund's price at the close of the business day. The price is called the **net asset value**, or NAV. That price may be higher or lower than the price you paid to purchase the shares.

Each fund pools the money it raises from its shareholders to make what are known as underlying investments. The more shares the fund sells, the more money it has to build a broadly diversified portfolio—much larger and more diversified than you as an individual investor could afford. The varied portfolio of some mutual funds makes them less risky than buying individual stocks and bonds.

> **For example**, a total U.S. stock market fund typically holds shares in the thousands of companies publicly traded on the major stock exchanges. Or, a stock fund might focus on one sector of the market—say, large-company stocks, as represented by the **S&P 500 Index**—or it might invest primarily in smaller companies it expects to grow rapidly.

International stock funds hold equities in non-U.S. companies, either by owning companies in developed markets such as Germany, Japan, and Australia, or in emerging markets like India and Mexico.

A bond fund might own a particular category of bond, such as municipal bonds, or a variety of corporate or government debt. Or, it may own bonds with a specific term, such as long or short. Total bond market funds typically own all those types of debt.

Actively Managed Funds vs. Index Funds

One other significant way in which mutual funds differ, however, is whether a fund is actively or passively managed. In an actively managed fund, a professional manager makes the decisions about which underlying investments to buy and when to sell them. In a passively managed fund, better known as an index fund, the underlying investments are determined by the index the fund tracks.

An actively managed fund tries to provide a stronger return than the benchmark index for the type of investments it makes. For example, a fund that invests in large-company stocks typically wants to outperform the S&P 500 Index. The fund's manager and his or her team research companies, choose investments in keeping with the fund's objective and trade its underlying investments to achieve high returns. These factors increase the fund's costs, which are passed on to shareholders as fees.

TYPES OF FUNDS	
ACTIVELY MANAGED FUND	**INDEX FUND**
• Manager invests to outperform a specific benchmark index (e.g. S&P 500)	• Fund invested to replicate performance of a specific benchmark index
• Higher fees than index funds	• Lower fees than actively managed funds
• Over time, most funds underperform their benchmarks	• Over time, more consistent performance relative to their benchmarks than individual actively managed funds

An index fund invests to replicate the performance of the index it tracks, not to beat it. If the fund tracks the S&P 500, for instance, it owns the 500 stocks in that index. If a stock drops out of the S&P 500, the index fund drops that stock as well and buys whichever stock replaces it. Similarly, if a fund tracks an index of small-company

stocks, as does the Russell 2000, the fund drops and adds stocks once a year as the underlying index changes.

An index fund, then, does not have to pay a manager to choose investments. And there are few trading costs because the portfolio changes only when the index changes. The result is lower fees for the fund's shareholders.

Index funds almost always provide stronger returns than actively managed funds over the long term, in part because of their lower costs.

An actively managed fund might do significantly better than its benchmark in one, three, or even five years, but it almost never does so consistently over the long term. One of the biggest traps investors fall into is picking an actively managed fund based on its recent track record of beating its index. Mutual funds that post stellar short-term returns rarely post equally strong returns over longer periods. In fact, funds that are the best performers one year usually fall from the top of the heap fairly quickly.

Fee Overview

There are two categories of mutual fund fees that apply to both actively and passively managed funds. Shareholder fees include any sales charges, or loads, you pay to purchase shares and redemption fees if you sell within an restricted period that the fund sets. You can avoid these fees if you buy only no-load shares and avoid premature redemptions.

Operating expenses, which include management, administrative, and marketing fees, apply in all funds and are expressed as an expense ratio, or a percentage of the fund's net assets. These fees vary by fund issuer and by fund type, and may vary from 0.05% to 2.5%. For example, the average expense ratio of actively managed equity funds is 0.52% Index funds making similar investments tend to have expense ratios closer to 0.07%.

You can find an explanation of a fund's fees in a table in its prospectus. That information lets you compare the costs of different funds making similar investments. The only expenses that are not reported are the transaction costs the fund pays to a brokerage firm to buy and sell its underlying investments.

Exchange Traded Funds (ETFs)

Exchange traded funds (ETFs) are equity investments that resemble stocks in some ways and mutual funds in others. You purchase shares of an ETF, which is listed on a stock exchange, through a brokerage account. What your purchase buys you is access to the performance of the securities included in the

ETF in the same way that your purchase of a mutual fund buys you access to the performance of its underlying investments.

ETFs trade throughout the day, as stocks do. The price changes to reflect supply and demand and other market forces. It is not reset at the end of the trading day based on its net asset value (NAV) as the price of a mutual fund is. However, when an ETF is actively traded, its market price and NAV tend to be closely related.

Most ETFs are index funds. That means an ETF portfolio is determined by the stocks or bonds included in the index it tracks. For example, an ETF named SPDR S&P 500 holds all the stocks in the S&P 500 index. Index ETFs are transparent, which means the current list of the fund's holdings is always available on the fund provider's website.

There are several advantages to investing in ETFs. Their expense ratios tend to be low. They allow you to diversify broadly across asset classes and subclasses as well as domestically and internationally more easily and more economically than you otherwise might be able to do. In addition, ETFs do not redeem shares that investors want to sell, as mutual funds do. This reduces turnover, limiting short-term capital gains, and can have other tax advantages.

But there are differences among ETFs that may make some more appropriate for your investment portfolio than others. Some ETFs tracking a specific index have higher expense ratios than others tracking the same index. Those that track a broad market, such as the S&P 500 or the Russell 2000 tend to be more liquid and more diversified than ETFs that track a narrower or niche market. So, as with other investment products, it pays to determine your objective and investigate your alternatives before making a decision to buy or sell.

MUTUAL FUNDS	ETFS (EXCHANGE TRADED FUNDS)
• Portfolio of securities selected to meet fund objective or that reflects index being tracked	• Portfolio of securities that reflects index being tracked
• Price determined by NAV (net asset value) at end of day	• Price determined by market trading throughout the day
• Shares in fund purchased from fund or through a broker or adviser	• Shares bought and sold like stocks through a broker or adviser
• Fund must buy shares to accommodate shareholder redemptions, with potential tax consequences	• ETF does not redeem shares a shareholder wishes to sell, enhancing tax efficiency

ESTABLISHING AN ACCOUNT

When you're ready to invest you can get started with a few simple steps. Contrary to what you may think, it's not that complicated. It may even be easier than figuring out your cable bill. But it will take some time and it does require some decisions on your part.

✓ **Step 1** is opening an account through which you'll purchase your investments. Mutual fund companies, banks and brokerage firms offer a variety of investment accounts.

For retirement investing, many corporations and other businesses offer **401(k)** plans. Public sector organizations may offer **457** plans, and nonprofit organizations and schools, **403(b)** plans. If your employer doesn't offer a retirement plan, you can open an **individual retirement account (IRA)** and save for retirement on your own. Or you can participate in an employer's plan and contribute to an IRA at the same time.

✓ **Step 2** is choosing investments, which may be your biggest challenge given the large number of investment products available. But you can start slowly, perhaps by opening an account at a mutual fund company and choosing a fund or two. You can broaden your investment base from there.

✓ **Step 3**—reinvesting—is the easiest. As your investments provide earnings, you use that income to buy additional shares instead of spending the money. The reinvested amounts help build your account value. Since you can often reinvest automatically, especially with mutual funds, you won't miss the money you don't see.

✓ **Step 4** is continuing to invest, contributing new money to your account every month or quarter. One of the easiest and most effective ways to do that is by arranging for direct deposit from your paycheck, bank, or credit union account directly into your mutual fund or brokerage account.

If you're investing in an employer-sponsored plan that's available through your job, you defer a percentage of your salary each pay period. Once you get used to the idea, it's another easy way to invest without missing the money you don't see.

PART 3

Principles of Investing

Investing is a balance between risk and return.

Return, in this context, means *investment return*, which is based on two things: change in investment value plus any earnings the investment produces. If you sell an investment for more than you paid for it, you'll have a gain, or positive return. But if you sell it for less than it cost you, you'll typically have a negative return, or loss.

EXAMPLE	
You buy 100 shares @ $20 per share	$2,000
You sell 100 shares @ $22 per share	$2,200
Profit ($2,200 – $2,000)	= $200
Company pays dividend of $0.25 per share	+ $ 25
RETURN ($200 profit + $25 dividend)	**= $225 (or 11.25%)**

Of course, you could have had a negative return if the share price when you sold was less than $20 a share.

The bottom line is that the higher your average annual return over time, the more likely you are to meet your financial goals.

Risk is the potential for losing money instead of making it, or making less than you had expected. Risk is also the possibility that the value of your return will be undermined by inflation, reducing your buying power.

Understanding the risk/return relationship is essential to making rational investment decisions. The more risk you're willing to take, the greater the potential for a substantial return, but also for experiencing a loss. On the other hand, if you take no risk, you'll have minimal return, if any.

> **For example**, if you put $1,000 in a five-year bank CD paying 2% compounded annual interest, your return will be $104, giving you $1,104. But if you bought shares of a stock mutual fund providing a 6% annual return, your return over the same five-year period would be $338—more than triple the return from the CD—giving you a total of $1,338.

While certain investments provide minimal return, the tradeoff is that they keep your principal safe. You can be confident that you'll be able to withdraw your $1,000 investment in the CD at the end of the term. But at any point, your mutual fund could be worth far less than $1,000. And if you sold it once it declined, you'd have a loss.

KEEP IN MIND

If you're rattled by the thought of losing money in a short period of time—with investing, five years is fairly short—then you may not be ready to invest. But keep in mind that it's entirely possible—though not guaranteed—that an investment that loses value at some point will regain its value over time and may be worth substantially more than you invested. The longer you can hold onto your investments, the better your chances for success.

INVESTMENT RISK

The risk associated with investing typically fits into one of two categories: market risk or specific investment risk.

Market risk results from what's happening in the financial markets as a whole. If the economy is extraordinarily weak, as it was in 2008 and 2009, the markets can be extremely volatile—which means prices change dramatically over short periods of time. When that happens, investors tend to lose confidence in the markets and in investing in general. They stop making new investments and sell off the ones they own. This, in turn, helps to create a more severe downturn.

Investment risk, on the other hand, occurs when an individual investment loses value for one reason or another that's directly related to the investment itself.

> **For example**, investment risk may result from poor management that reduces a company's earnings and drives its stock price down. Or sometimes a company crushes its competition by introducing a product that runs away with the market, reducing the value of the competitor's stock. Mutual funds, although generally not as risky as investing in individual stocks, can sharply decline in value if they hold stocks in one narrow sector of the market or if the overall market falls.

INVESTMENT RISK

STRATEGIES TO MANAGE RISK

While neither market nor investment risk can be entirely eliminated, there are strategies to help you manage the risks you face in investing. Three of the most effective are asset allocation, diversification, and cost control.

These strategies don't guarantee success or protect you from losses in a serious market downturn. But they can help you mitigate risk while maintaining the potential for a strong return.

Asset Allocation

Using asset allocation, you divide your investment principal among several different types of investments, or asset classes, on a percentage basis, rather than putting all of your proverbial eggs in one basket.

As we noted in **Part 2: Making Investments**, different asset classes—equities, fixed income, cash equivalents, and real estate—generally react differently to what's happening in the economy at any given time. You can take advantage of this phenomenon by investing in several different asset classes at the same time.

Asset allocation lets you offset losses in one class with gains in another. There's no guarantee that comes with allocation—in a severe market downturn, all asset classes can decline sharply—but putting all your money into one asset class is much more likely to produce a major loss than spreading it across several classes. What's more, asset allocation helps you position your portfolio to take advantage of the ever-changing markets—not by investing all your money in this year's hot class, but by having some investments in every asset class every year.

If you invested only in large-company stocks in the decade of the 2000s, you would have posted an annualized return of negative –1%. (The decade's returns weren't helped by a whopping negative –37% return in 2008 alone—a free fall that had many panicky investors pressing the "sell" button near the *bottom* of the market.)

Balanced portfolios would have fared better during the same time period. A portfolio of 70% stocks and 30% bonds would have produced an annualized return of 2.1%, and a 50/50 stock-bond split would have returned 3.9%. Those are modest returns, but they are in positive territory and at or above the inflation rate at the time.

A long time horizon is important for investing because returns from all asset classes can vary widely.

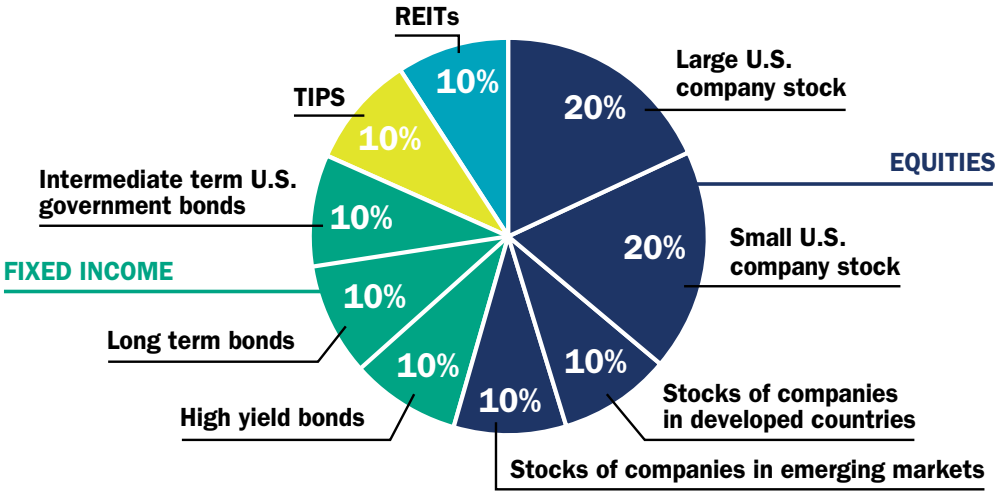
Diversification

Asset allocation helps you manage market risk. You can help manage investment risk by diversifying, or investing in several investments within each subclass of an asset class. For example, a large-company stock and a small-company stock are both equities, but belong to different subclasses.

Asset subclasses tend to differ from each other in some important ways, though they all share the core characteristics of their class. For instance, a large-company stock and a small-company stock tend to increase in value at different rates, react differently to changes in the economy, and expose you to different levels of investment risk.

Similarly, bonds have different **terms**, different **ratings**, and different interest rates. They also have different issuers: the U.S. Treasury, various cities and states, and corporations large and small.

In the diversified portfolio shown below, each asset class—such as equities and fixed income—includes mutual funds that make different types of investments.



It may be easier to understand diversification by understanding what it's not:

- You're *not* diversified if you own just a handful of stocks, or shares of a mutual fund that is concentrated in the financial sector or some other specialized corner of the market.
- You're *not* diversified if the only bonds you own are issued by the state in which you live or by the same U.S. government agency.

ALLOCATING YOUR PORTFOLIO

There are many factors to think about when you begin investing and are deciding on an initial allocation for your portfolio. How old are you? How long will it be before you retire? What are your financial obligations, such as debt and dependents? What is your risk tolerance—meaning, how would you react if a market downturn sapped a large percentage of your investment assets? If the answer contains the word "panic," you may want to stick mainly to safer investments, such as fixed income, and go easy on equities.

Your asset allocation is a personal decision that depends on many factors unique to your financial situation, your family circumstances, and your temperament. Don't allow yourself to be pushed into something that you don't understand or that exceeds your tolerance for risk.

What's right for your brother-in-law, or for someone selling financial products, may not be right for you. There's nothing wrong with listening to someone's opinion, but ultimately you must do your own research and make your own decisions.

There's no allocation that's right for everyone or that works perfectly in every market environment. But a handful of mutual funds that invest in different asset classes provide adequate diversification so that when one part of your portfolio falls in value it doesn't sink the ship. Once you consider the following factors and open an account with a mutual fund company or brokerage firm, it's easy to find the funds you need to start building your portfolio.

FACTORS TO CONSIDER IN MAKING INVESTMENT DECISIONS

- **The length of time you have to achieve the different goals for which you're investing.** Investing to buy a home within the next five years is a lot different from investing for a retirement that will start in 30 years.
- **The amount of risk you are comfortable taking.** Even if you expect to work 30 or more years before retirement, you may not be able to stomach the risk that exists even in a diversified portfolio. "Sleeping well" was the investment criterion of the late Paul Samuelson, American's first Nobel laureate in economics.
- **Other investments or expected sources of income.** This includes Social Security, which provides lifetime benefits and therefore represents a significant financial asset for most Americans. You may also have earned a pension, or have a small business or income from family business interests. The amount of these assets can greatly influence the amount of risk you feel comfortable taking.

SAMPLE PORTFOLIO ALLOCATIONS

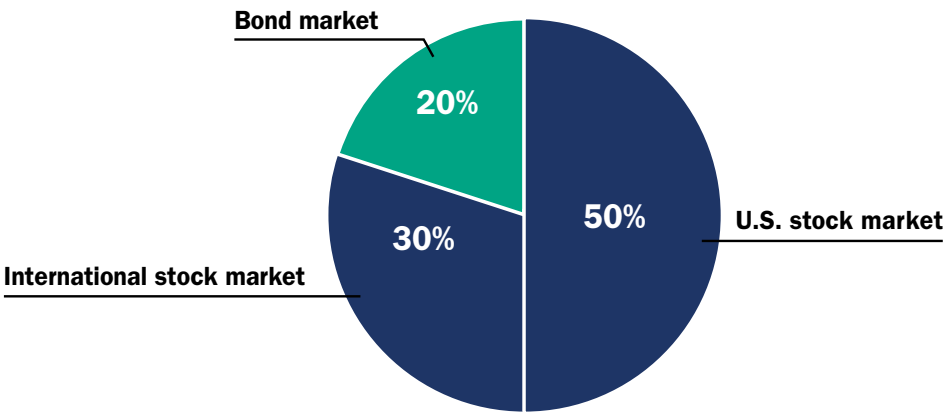
The following pie charts show four portfolio allocations. The appropriate split between stock and bond holdings will typically reflect an investor's financial situation, age, and tolerance for investment risk. Remember, these allocations are just models. The allocation that is most appropriate for you may be somewhat different from any one of these models.

Aggressive Portfolio

50% U.S. stock market

30% International stock market

20% Bond market



This portfolio has allocated 80% of its holdings to U.S. and international stocks. The U.S. stocks are diversified across industries through index and other mutual funds. A relatively small percentage is allocated to fixed income.

The allocation may be appropriate for investors who:

- Have a long time to reach their financial goals so can withstand the ups and downs of the market over time.
- Have enough current income and savings to meet everyday expenses as well as unexpected financial obligations.
- Have other sources of fixed income for the long term, such as a generous pension.
- Have a relatively high tolerance for investment risk, take a long-term view of investing, and don't panic when market prices drop.

Moderate Portfolio

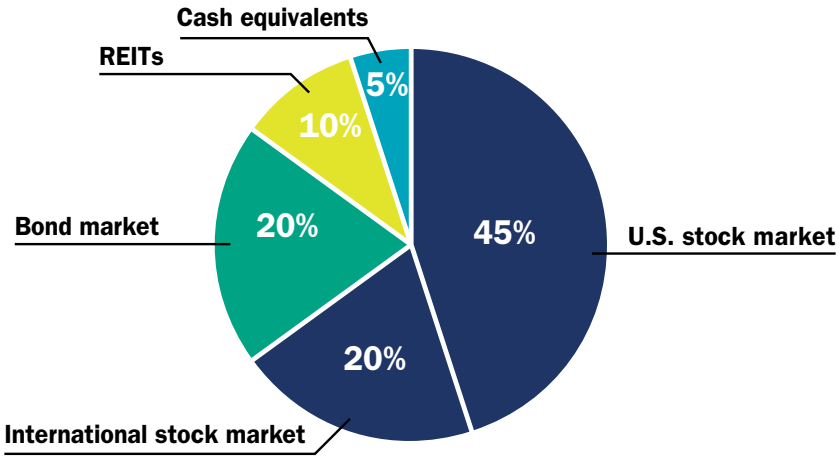
45% U.S. stock market

20% International stock market

20% Bond market

10% REITs

5% Cash equivalents



This portfolio has allocated 65% of its holdings to U.S. and international stocks, 20% to fixed income investments, and 10% to REITs.

This allocation may be appropriate for investors who:

- Have many years to reach their financial goals and can withstand the ups and downs of the market over time. However, they also want a cushion should market prices be down when they need the cash to meet expenses.
- Can afford to risk potential short-term losses in the equity markets and have sufficient cash equivalent investments to avoid having to sell their equity holdings when the market is down.
- Are approaching retirement but have other reliable sources of income.
- Have a moderately high tolerance for investment risk, take a long-term view of investing, but want to mitigate investment risk by allocating a portion of the portfolio to cash equivalents and fixed income.

Balanced Portfolio

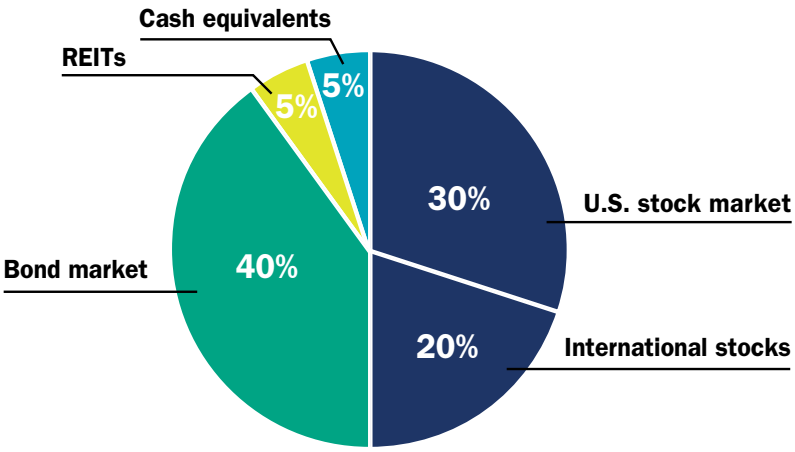
30% U.S. stock market

20% International stock

40% Bond market

5% REITs

5% Cash equivalents



This portfolio strikes a balance between diversified stock mutual funds that account for 50% of the holdings, 40% allocated to fixed income, and 5% to REITs.

This allocation may be appropriate for investors who:

- Have achieved some of their financial goals, but still have others to reach.
- Want to capitalize on the potential upside of the markets while providing income from bond investments as a cushion against market downturns should they need cash to meet unexpected expenses.
- Have a moderate tolerance for investment risk and want to balance more stable, fixed income investments that preserve their earnings with the greater upside potential of equity investments, despite the higher risk.

Conservative Portfolio

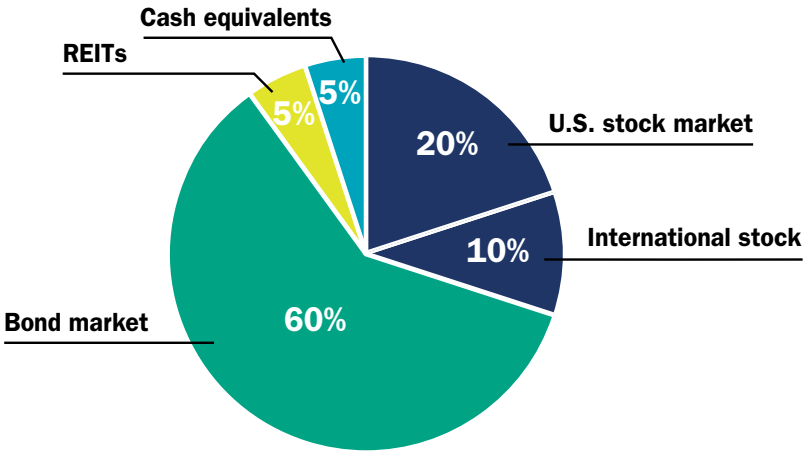
20% U.S. stock market

10% International stock

60% Bond market

5% REITs

5% Cash equivalents



This conservative portfolio has an allocation of 30% in equity investments and 60% in fixed income investments, with a smaller percentage in REITs and cash holdings.

This allocation may be appropriate for investors who:

- Are approaching retirement and want to preserve some of their earnings while retaining their equity holdings as a hedge against living many years in retirement.
- Want to balance income and lower risk fixed-income investments with some upside potential from equity holdings despite the downside risks.
- Have a relatively low to moderate tolerance for investment risk and wish to preserve their capital while holding some equity investments to outpace inflation.

PORTFOLIO RETURNS

It might be helpful to review the long-term returns of some established portfolios that substantial numbers of investors use as a starting point—but only a starting point—for deciding how to allocate their assets. The portfolios use between two and four mutual funds, making them easy to assemble.

The returns are **real returns**, meaning they are adjusted for the rate of inflation. If a mutual fund returns, say, 8% in a year, and inflation during that time was 2%, the real return is 6%. Real returns give you the most accurate picture of what your investments are truly earning.

ALLOCATION USING LOW-COST MUTUAL FUNDS	ANNUALIZED RETURNS 1970 – 2019
Classic 60/40 Split	
60% U.S. Stock Market	**6.1%**
40% Bond Market	
Three-Fund	
40% U.S. Stock Market	**5.8%**
20% International Stock Market	
40% Bond Market	
William Bernstein (investment adviser and author)	
25% Large-Company Stocks	**6.4%**
25% Small-Company Stocks	
25% Developed International Stocks	
25% Short-Term Treasuries	
Rick Ferri Core Four (investment adviser and author)	
48% U.S. Stock Market	**6.8%**
24% International Stocks	
20% Bond Market	
8% Real Estate Investments Trusts (REITs)	

SOURCE: PortfolioCharts.com/portfolios. Returns assume the portfolio is rebalanced annually.

MAKING CHANGES

The old adage that the only constant in life is change certainly applies to investing. Once you've carefully allocated your investment portfolio across diverse asset classes, you've taken a big step toward gaining some control over your financial future. But you're not finished. Two concepts are extremely important to keep in mind: **reallocating** and **rebalancing**. You should embrace both.

Reallocating

Reallocating is the process of adjusting your asset allocation as your circumstances change. The allocation you picked as a single 25-year-old is likely too aggressive when you're 50 and facing the prospect of sending a kid to college. You may want to trim the amount you have in equities and other more volatile investments and add more stable fixed income and cash equivalents.

Regardless, you should periodically take stock of your financial goals and life circumstances, and then reallocate your portfolio accordingly.

Other factors may affect how and when to reallocate your portfolio as well. For example, conventional wisdom suggests that, as you approach retirement, you concentrate your portfolio more on fixed income investments and less on equities.

But as people live longer and enjoy fuller, more active lives in retirement—often accompanied by increased expenses—the traditional move to a more conservative allocation model may no longer be appropriate for everyone.

That's why some financial advisers now recommend that investors nearing or in retirement shift their allocation to fixed income investments at a slower rate, keeping more in equities well into retirement. This approach would apply especially to those who have other sources of fixed or earned income to meet everyday expenses as well as unexpected emergencies or changes in their financial situation.

Rebalancing

Rebalancing is the more regular process of adjusting your portfolio to account for swings in the financial markets. If one asset class has been doing either particularly well or particularly poorly over the past six months or year, it likely has skewed your portfolio away from your preferred allocation.

For instance, if you opt for an allocation of 60% equities and 40% bonds for your portfolio, over time the markets will alter that allocation. Stock market gains may increase your equity holdings to 70% and negative factors affecting the bond market may reduce your bond holdings to 30%. In that case, you should consider selling stocks and buying bonds in order to rebalance your portfolio back to your targeted percentages.

Alternatively, you could simply designate all of your new investment money to bonds until you have restored your 60%/40% balance. The benefits of rebalancing are significant. For one, the process helps provide you with the framework and discipline to sell high and buy low. In the above example, rebalancing by selling some of your booming equities stake will allow you to lock in solid stock market gains.

If you rebalance by buying more of an asset class after it slumps, you'll lower your average cost in the investment and potentially set yourself up for future gains.

Rebalancing is also important because it restores your investment portfolio to the level of risk you decided you were comfortable with when you first established your asset allocation. In general, you should consider rebalancing when your allocation drifts about 10% from your targets.

Rebalancing isn't easy on the psyche—everyone wants to stay with a winner. Yet selling holdings that have soared in value and buying assets whose prices have declined is one way to bring your portfolio back into balance.

TARGET DATE FUNDS

If allocating assets, and rebalancing and reallocating your portfolio, seems complicated, or you've never rebalanced or reallocated the investment accounts you have, you may want to consider a target date fund (TDF).

If you contribute to a retirement plan at work, you probably have that option since employers are rapidly adding target date funds to their 401(k) investment choices. You can also select these funds for a college savings account, an individual retirement account (IRA), or a taxable investment account.

An investor selects a TDF pegged to his or her expected year of retirement or the year in which a child goes to college. If the expected year of retirement is between 2038 and 2042, for example, the investor would select a 2040 TDF. The fund starts with a portfolio mostly in stocks and then shifts over time to increase the percentage of fixed income. In theory, the fund becomes less risky as retirement or college entrance approaches. The pace and timing of the reallocation is known as the fund's **glide path**—a reassuring term that implies a smooth landing.

Target date funds have a lot of advantages, and they are promoted, with some justification, as one-stop shopping for investors who are perplexed by what can seem

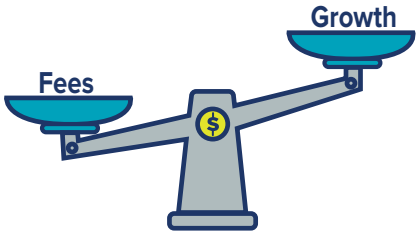
like an overly complex financial marketplace. But they also expose you to potential risks, as all investments do.

TDFs that share a target date—a 2040 retirement fund, for example—can have different allocations and different glide paths. So, in choosing a target date fund, it's important for investors to determine whether the allocation is appropriate for their goals and their tolerance for risk, rather than just picking one based on a certain year.

As with mutual funds in general, fees on some target date funds cost more—a lot more—than fees on others, resulting in a big difference in the returns they pay.

Many investors also have dangerous misconceptions about target date funds. A survey conducted for the Securities and Exchange Commission found that nearly half of target date fund owners didn't understand that the funds *do not guarantee income* in retirement. These investors didn't realize that TDFs are funds of fund, including a TDF, that invest in other mutual funds. The value of any mutual fund or fund of funds depends on the performance of its underlying investments during the period in which they're invested. That performance can't be predicted.

HOW INVESTMENT COSTS AFFECT YOUR RETURN



In addition to market risk and investment risk, you have to consider what you pay to buy and own investments, since these costs directly reduce your investment return.

Some investment costs are unavoidable. It costs money to handle transactions. It costs mutual funds to manage their funds. It costs brokers to maintain their offices and websites and provide research about investments. But there are ways you can avoid paying more than necessary:

- When investing in a mutual fund, always check its **expense ratio**. To pay for its operating and marketing expenses, a fund annually charges a percentage of your account balance. If the expense ratio is 1%, for example, you will pay $150 on an account value of $15,000. The fund may also impose sales charges, called **loads**, which aren't included in the expense ratio. Both are published in a fund's **prospectus** and on the fund company's website. Many fund companies will sell you shares in their funds directly, with no sales charge. The point is to choose the least expensive of comparably rated funds.
- Choose lower-cost investment accounts. You might open an online brokerage account, where there are no commissions on purchases. With this type of account, though, it's up to you to identify investments and choose the right times to buy and sell since your broker will not be making suggestions.

THE IMPACT OF FEES

Assume you invest $10,000 in a tax-deferred account, make monthly contributions of $250 for 25 years, and realize an annual 6% rate of return. (Assume for this example that taxes are deferred until withdrawal.)

The theoretical total you would accumulate is $212,813. However, the actual amount you end up with will depend on the investment fees and expenses charged by the fund in which you invest, as illustrated by the following fund choices.

	Fund 1	**Fund 2**	**Fund 3**
Value before fees and expenses	$212,813	$212,813	$212,813
Expense ratio	0.2%	0.8%	1.2%
Upfront sales charge	None	None	4.75%
Effect of fees and expenses	–$6,858	–$25,993	–$39,168
Accumulated value	**$205,955**	**$186,820**	**$173,645**

In this example, if you invested in Fund 1 you would end up with $205,955. But if you had invested in Fund 3, you'd have only $173,645. That's a difference of $32,310—a tidy amount that's better in your pocket than adding to a fund's revenues.

As you can see, the impact of fees and sales charges on your mutual fund investment return can be substantial.

Despite what you might think, and what a high-priced fund manager might tell you, study after study has shown there is absolutely no evidence that higher-cost investments produce superior returns. In fact, the opposite is true.

Keep in mind that the cost of investing may not stop with the expenses charged by the mutual funds themselves. If you invest in mutual funds and stocks through a brokerage account, you may commissions when you buy the funds, and you could pay additional fees for account maintenance.

You have no control over many investment variables—the direction of the market, the rate of inflation, or the tax rate on your earnings. But you do have control over one of the most critical variables—what you pay to buy and own your investments.

The lesson is clear: The higher a fund's expense ratio and the more you pay in sales charges, commissions, and other fees, the smaller your return will be. Every dollar counts when maximizing your investment return.

PART 4

Investing for a Secure Retirement

When you start thinking about retirement, one of the first things to consider is what it will cost you to live comfortably. That gives you a basis for determining the income you'll need.

Some things will probably cost less when you retire: You won't be commuting. Your mortgage may be paid off, or nearly so. Your children may be college graduates with jobs, not living in their old rooms. There may be other expenses that will drop as well.

On the other hand, certain things will probably cost more. Health insurance and out-of-pocket healthcare costs top the list. Real estate taxes and property insurance may go up. You may want to spend more on travel, hobbies, or other things you've been waiting to do until you had more time.

And you'll still be spending money on food, clothing, and other necessities.

The consensus is that in retirement you'll need at least 70% of your last working year's income to maintain your lifestyle after retirement. You will probably need more if you're single or the primary breadwinner in your family.

Inflation is a primary factor: Your costs will increase over time, some faster than others. Each year that you're retired you're likely to need more income than the year before.

If you're concerned that you've gotten off to a late start in building your retirement assets, there are ways to catch up. The good times begin when you turn 50 because you can save more in a traditional or Roth IRA as well as in a 401(k) or similar plan offered by your employer.

SIX PRIMARY SOURCES OF RETIREMENT INCOME

- A **pension** from a private company or public organization
- Social Security benefits
- An annuity—a contract between you and an insurance company—that provides guaranteed income for a certain period of time
- Income from tax-sheltered retirement accounts to which you have contributed over the years—these include an employer-sponsored **401(k)**, **457**, or **403(b)** plan, and an **individual retirement account (IRA)**
- Income from taxable investment accounts
- Income from a post-retirement job

RETIREMENT ACCOUNTS

Any investment we have discussed so far—stock, bond, mutual fund, ETF—becomes a retirement investment when you own it in a retirement account. A retirement account may, in turn, be part of a broader retirement plan, such as the one sponsored by your employer.

> **For example**, you can make retirement investments through an account in an employer-sponsored retirement savings plan, such as a 401(k), which is open to all eligible employees. If you participate, there is an account in your name in the plan. The money you put into the account is always yours, not the company's. You contribute to your account by deferring part of your salary, and you can allocate the money to any of the investments available through the plan—typically mutual funds.

Similarly, you may make investments through an IRA that you open with a brokerage firm, bank, or mutual fund company that serves as a custodian of the account. The custodian keeps track of your account, sends you regular statements, and follows your instructions for investing your contributions. In fact, the types of retirement investments you want to make are an important factor in choosing where you open your IRA. You will want a custodian that offers the range of investments you're considering for your retirement portfolio.

Since investments themselves don't distinguish a retirement account from a non-retirement account, what does? It's the way that earnings in the accounts—and sometimes the contributions made to them—are taxed.

In a taxable account, income tax is due on all earnings in the year you receive them, although different types of investment income are taxed at different rates. If you collect $100 in interest payments in a year, that $100 is added to your other ordinary income, including salary or wages, and is taxed at the same rate.

Long-term capital gains and **qualified dividends** are also taxed in the year you receive them, though at your lower, **long-term capital gains tax rate**. Interest on certain municipal bonds is tax free.

In contrast, with a **tax-deferred retirement account**, such as a 401(k) or an IRA, income tax is not due on your investment earnings until you withdraw them from the account—typically over a period of years after you retire. If the contributions to the account were tax-deferred at the time you made them, as they would be with a 401(k) or an IRA for which you were eligible to deduct your contribution, tax is due on the full amount of every withdrawal, not just on the earnings.

The tax rate that applies to these withdrawals is the rate you pay on your ordinary income, though your rate in retirement may be lower than it was when you were working if your overall income is less.

PENSION PLANS

The amount you'll receive in pension payments depends on the years you worked, the compensation you received, and other provisions that are specific to your company's plan. You should check with your Human Resources department well in advance of your retirement about the plan details, including payout options and other decisions.

SOCIAL SECURITY

If you have worked and contributed to Social Security for the equivalent of 10 years, you can expect to receive benefits when you retire. How much you will receive depends on a number of factors, such as the number of years you participated, the amount you paid in to Social Security, and the age at which you start to collect.

As a rule, the longer you wait to begin collecting benefits, the higher your monthly payments. For people born in 1960 or later, 67 is considered full retirement age—the age when you start to collect full benefits. For people born between 1943 and 1954, the full retirement age was 66. For people born from 1955 through 1959, the age increases in two-month increments, from 66 and 2 months to 66 and 10 months.

Each year you wait until age 70, the bigger your benefit will be. If someone who is currently 62 waits until the full retirement age of 67 to claim benefits, he or she will receive a monthly benefit that is nearly 40% higher. If he or she waits until 70, the monthly benefit increases by another 25%. If you decide to take payments *before* the full retirement age, however, which you can do as early as age 62, your benefit amount will be permanently reduced based on your age when you began.

To help you determine at what age you should start taking your Social Security benefits, check the Retirement Estimator calculator and other information at www.socialsecurity.gov. You should also consult more comprehensive information about maximizing benefits. The Center for Retirement Research at Boston College (crr.bc.edu) publishes *The Social Security Claiming Guide*, and an increasing number of mutual fund companies and financial services firms offer free benefits estimators.

ANNUITIES

Another possible source of retirement income is an annuity, which is an insurance company contract intended to provide regular income payments, often for your lifetime. There are three basic types of annuities:

- An **immediate annuity** converts a sum of cash into a steady stream of income. You typically pay for an immediate annuity with a single, upfront payment before the payout phase begins.
- A **deferred annuity** is typically purchased by paying premiums to the issuing company during your working years. The accumulated value of your account provides a source of regular income after you retire. Any earnings in your account are tax deferred until you start withdrawals.
- A **longevity annuity** resembles an immediate annuity. You purchase it with a lump sum or transfer the money from your IRA or employer-sponsored plan balance. The difference is that instead of beginning to pay income right away, as an immediate annuity does, the start date for receiving income from a longevity annuity is a number of years in the future, based on the age you select. It just can't be older than 85.

Annuities can be complicated products with many different features and fees. While advocates point to the regular income that annuities guarantee, critics maintain that the costs eat into the benefits these products provide. And there's always the risk that the company providing the annuity will be unable to meet its financial obligation to its contract holders.

KEEP IN MIND

If you're planning to purchase an annuity, you should consult a knowledgeable fee-only financial professional to help you make appropriate decisions about annuities for your financial situation.

401(k) PLANS

When you participate in a traditional 401(k) plan, you defer pre-tax earnings to your account every pay period, typically by designating a percentage of what you earn. The deferred earnings aren't included in the gross income your employer reports to the IRS, so contributing to this type of 401(k) actually reduces the income tax you owe for the years you contribute.

Some employers also offer a tax-exempt Roth 401(k) account. You defer after-tax, not pretax, income to a Roth 401(k) so your taxable income is not reduced for the years you contribute. But everything you withdraw from the account, typically after you retire, is totally tax-free provided you are at least 59½ and the account has been open at least five years.

There is an annual cap on 401(k) contributions imposed by the federal government. The limit is $20,500 in 2022, plus a catch up contribution of $6,500 if you are 50 or older. You can usually contribute any amount up to the limit. If you have a choice of

traditional and Roth accounts, you can choose one or the other or divide your annual contribution between the two.

Since the salary deferral is handled automatically, making the contribution is easy—at least when you get used to the idea of trading off a bit less in your paycheck for more retirement savings for the future.

The harder part is selecting the investments for your account. Most employers provide a number of investment options, which are typically mutual funds, but may also include company stock or annuities. It's generally your responsibility to select from among those choices, which requires evaluating your investment strategy and the level of risk you are comfortable taking.

There are compelling reasons to contribute to a 401(k) plan:

- Your employer may match a percentage of the money you contribute, perhaps even dollar for dollar, up to a certain limit. That's free money—always a good thing.
- Your contributions to a traditional account reduce your current taxable income and the income tax you owe.
- Investing regularly helps you build your account balance.
- Tax deferral on your contributions and earnings allows your savings to compound faster than they would in a taxable account since you don't have to withdraw money to pay taxes.

In addition, 401(k) plans allow a substantially higher contribution than an IRA. That's a major selling point, especially if you can afford to contribute the maximum.

On the potentially negative side, the menu of investment choices may be limited, making it difficult to achieve the degree of diversification you would prefer. It may also be difficult to determine how much you are paying in fees and other expenses. The higher those costs, the more they will reduce your return.

403(b) PLANS

A 403(b) plan is similar to a 401(k) retirement savings plan. It is for employees of not-for-profit organizations, including charities, public school districts, universities, foundations, and other public-sector entities. Some plan providers offer a Roth 403(b) as well as a traditional tax-deferred account. You can choose the traditional or the Roth and may be able to split your contributions between the two as long as you don't exceed the annual limit. As with a Roth 401(k), you contribute post-tax rather than pretax income. Earnings accumulate tax-deferred, but withdrawals when you retire are free of federal income tax provided your account has been open at least five years.

But while the mechanics of a 403(b) plan are much the same as 401(k) plans, including the possibility of a Roth account, 403(b)s have some important distinguishing characteristics.

The assets in 403(b) plans for public school district employees may be heavily concentrated in fixed and variable annuities. In fact, the 403(b) plan is sometimes known as a tax-sheltered annuity (TSA) or tax-deferred annuity (TDA) because when Congress created the 403(b) in 1958, only annuities were allowed in the plan.

Even though mutual funds have been allowed in 403(b) plans since the 1970s, the perception may linger with some employees that the plan was designed for annuities. This continued bias toward annuities may have another cause: Sales agents have more of an incentive to sell them because the commissions are often higher.

Newer 403 (b) plans and those offered by different institutions may offer a broader range of investment alternatives more in line with those typically available in a 401(k). It pays to review the plan documents and discuss your options with the plan administrator and perhaps an independent financial professional before you decide on how to invest for retirement.

Like private-sector 401(k) plans, 403(b)s allow employers to match participant contributions. But if they do, they lose a federal regulatory exemption, subjecting them to greater oversight. As a result, comparatively fewer 403(b) plans offer employer matches than 401(k)s do. As an alternative to a 403(b), school employees may want to establish a traditional or Roth IRA. While a 403(b) has a higher contribution limit than an IRA, the IRA may offer lower costs and greater investment choices.

KEEP IN MIND

Required minimum distributions (RMDs) from employer plans and IRAs were suspended for calendar year 2020 for account holders who would otherwise have been required to take them. However, RMDs are required for tax years 2021 and 2022 for anyone who is 72 or older. Special rules apply to inherited IRAs.

IRAs

If you receive a salary, wages, commissions, or other income for work that you do, you can contribute to an individual retirement account, or IRA. What you may not realize is that you can contribute to an IRA in addition to participating in a 401(k), 403(b), or other employer-sponsored retirement plan. Or you can choose an IRA instead of those plans, or if you don't qualify to participate in an employer plan.

With an IRA, earnings in your account are tax deferred, and no tax is due as those earnings compound. You choose your own custodian—a mutual fund company, bank, credit union, brokerage firm, or other financial services company—and then select investments from among those the custodian makes available. If you invest with a mutual fund company, you will likely have more choices than a typical employer provides through a 401(k). You can buy and sell as often as you like without tax consequences, though you will pay trading costs.

Like employer-sponsored plans, IRAs have an annual contribution limit: In 2022 it is $6,000. And like a 401(k), there is a catch-up provision—in this case, $1,000—for a total contribution limit of $7,000 if you are 50 or older.

You can make a catch-up contribution every year you have earned income starting at 50 and make up a lot of ground in saving for retirement. For example, if you are 50 and have saved nothing for retirement, you can contribute $6,000 every year to an IRA, plus a $1,000 catch-up contribution. You could save even more if the annual contribution or the catch-up amount increases, as it sometimes does.

INDIVIDUAL RETIREMENT ACCOUNTS

IRAs	TRADITIONAL IRAs	ROTH IRAs

• Open to anyone with earned income
• Tax-deferred earnings
• You choose from available investments offered through custodians, who may be:
  • Banks
  • Mutual funds
  • Brokerage firms
• Annual limit on contributions, with catch-up after 50
	• Contribution may be deductible based on your income (MAGI)
	• Deductible amounts reduce current taxable income
	• Both deducted contributions and earnings taxed at withdrawal
	• Withdrawals mandatory after 72
		• Contributions never deductible
		• Eligibility to contribute based on MAGI
		• Withdrawals never required
		• Earnings can be withdrawn income-tax free if:
		  • You're at least 59½
		  • Account has been open 5+ years

Traditional IRA

In a traditional IRA, your earnings aren't taxed until you withdraw them from your account, usually after you retire. If you are at least 59½, there is no penalty for taking the money out, even if you are still working.

You may qualify to deduct your contribution to an IRA based on your **modified adjusted gross income (MAGI)**. In 2022 you can deduct up to $6,000 if you file as a single taxpayer or as a head of household and your MAGI is less than $68,000. If your MAGI is between $68,000 and $78,000, you can deduct a gradually decreasing percentage, until your eligibility phases out with a MAGI over $78,000. If you're married and file a joint return, you qualify for a full deduction up to a MAGI of $109,000, with gradually phased out eligibility until your MAGI reaches $129,000. Above that amount, you don't qualify to deduct.

You may also be eligible to deduct your contribution despite your MAGI if you are not covered by a retirement plan at work. However, there are limits if you're married, file a joint return, and your spouse is covered by a plan at work.

In years that you qualify, taking a deduction for your traditional IRA contributions will reduce your taxable income. But remember, those contributions will be taxable, along with your IRA earnings, when you begin making withdrawals.

With a traditional IRA, you must begin to take **required minimum distributions (RMDs)** when you reach 72, whether or not you need the money.

Roth IRA

A Roth IRA has the same contribution limits and provides the same tax-deferred earnings as a traditional IRA. But there are significant differences between the two.

As with any IRA, you can continue to contribute as long as you have earned income, even if you're in your 90s. But with a Roth IRA, you are not required to start making withdrawals at any age as you are with a traditional IRA.

Even better news is that you can withdraw your earnings tax free if you're at least 59½ and your account has been open at least five years. However, your contributions to a Roth IRA are never deductible. They're always made with **after-tax income**.

There are eligibility requirements for contributing to a Roth IRA, based on your MAGI. In 2022 as a single taxpayer you're qualified to make a full contribution if your MAGI is less than $129,000, and to make an increasingly smaller contribution until your MAGI reaches $144,000. The comparable limits if you're married and filing a joint return are $204,000 and $214,000.

EMPLOYER PLAN OR IRA

Saving for retirement, like everything in investing, is a matter of choice. You can choose to participate in a workplace plan such as a 401(k), or you can forgo the employer-sponsored plan and establish an IRA, either traditional or Roth.

An IRA is likely to have more investment choices than a 401(k), 403(b), or 457 plan, and IRA fees may be lower, based in large part on the investments you choose. And

while traditional IRAs, like a 401(k), 403(b), or 457 plan, require you to take withdrawals after you turn 72, you may have more control over managing how you take those withdrawals with an IRA than you do with an employer-sponsored plan.

On the other hand, employer-sponsored plans have much higher contribution limits, which allow you to build your retirement savings faster if you can contribute more than the cap on IRA contributions. Investing is probably easier with an employer-sponsored plan as well since all you need to do is sign up. Your contributions are automatically withheld from your pay and deposited directly into the investments you have chosen.

You have to do a little more upfront work with an IRA, including choosing a custodian, selecting investments, and arranging to have money from your paycheck or checking account transferred directly into your IRA on a regular basis.

Whichever retirement savings choice you make, you should not pass up this opportunity to save for retirement with tax-deferred earnings.

EMPLOYER PLAN OR IRA?

	Employer Plan	IRA
Investment choices	Choices determined by plan	More, sometimes better choices based on custodian
Fees	Depends on plan	Depends on custodian and investments
Contribution limits (2022)	$20,500 + $6,500 catch-up	$6,000 + $1,000 catch-up
Withdrawal flexibility	Mandatory at retirement May roll over to IRA	Required after 72 in traditional but not Roth IRA

CASH-OUTS AND ROLLOVERS

If you participate in a workplace retirement account, the balance you've built up is a tempting source of ready cash. You can usually borrow from your account with favorable repayment terms. And when you switch jobs you can cash out, putting all the money in your pocket.

Increasing numbers of workers are doing one or more of those things, sabotaging their retirement planning. If an employee cashes out from an employer plan and does not roll the money into another qualified retirement account, he or she faces income taxes and potentially a stiff tax penalty. And any money withdrawn from a retirement account is no longer growing tax-deferred.

Similarly, public- and private-sector workers who participate in a pension plan don't always consider all the ramifications of withdrawing money from their pension accounts. Pension plans in solid financial shape can provide a monthly annuity payment for life—a valuable benefit available to fewer and fewer U.S. workers and one not to be surrendered lightly.

Pension benefits also attract unscrupulous investment salespeople who can reap a windfall in commissions and fees by convincing pension holders to roll over some or all of their money into other, supposedly higher-yielding investments. Pension holders run the risk of putting their money into an inappropriate, high-cost investment or, at worst, investing in a fraudulent investment program. As always, make sure you deal with a *registered* investment adviser and take the time to understand the fees and costs you may pay.

KEEP IN MIND

Before taking a loan from an employer plan, remember, too, that if you leave your job and have an outstanding loan balance, you must repay it in full within a strict time frame. Otherwise the amount that hasn't been repaid is considered a withdrawal. Taxes and perhaps a 10% tax penalty will apply.

Rolling over your plan assets to a new employer plan or IRA is one way to make sure your money continues to grow tax-deferred. Or, if you're comfortable with your former employer's plan, you may be able to keep your assets there. But cashing out will only damage your retirement savings.

PART 5

Avoiding Scams and Understanding High-Risk Investments

In 1906, American satirist Ambrose Bierce coined the word *incompossible*, as in, "Two things are incompossible when the world has scope enough for one of them, but not enough for both."

That word perfectly describes the kind of mindset that makes investors susceptible to fraud—reaching for the "incompossible dream" of high returns with very little or no risk.

THE WARNING SIGNS OF FRAUD

To safeguard against investment fraud, there are specific promotions to avoid and warning signs to heed:

Tips from those you know. Churches, community organizations, retirement communities—all are fertile ground for what's known as affinity fraud, where a con artist exploits an affiliation with a group as a way to win an investor's confidence. The crook may be a member of the group or may just pretend to be. A fraudulent investment scheme may spread quickly among the group's members and can often extend to trusting family members and friends.

Affinity fraud can turn into a Ponzi scheme, where early investors may—but not always—receive their promised returns with the money coming from later investors in the fraud.

Advertising—online and traditional. The explosive growth of social media, and online communications in general, has provided more avenues for fraudulent investment promoters to hawk their wares. It doesn't take much effort for a promoter to stake out a place on the internet and solicit funds for a fraudulent scheme. Investors should remember that the apparent sophistication of a promoter and the professionalism of a website or social media channel are meaningless when it comes to selling investments.

Traditional advertising hasn't gone away, however. Advertisements for investments that range from inappropriate and misleading to downright fraudulent are still common on the radio and in the print and online formats of newspapers and magazines.

Free lunch offer. Speaking of mail, if you're older than 50, you may receive a steady stream of invitations to supposedly educational "free lunch" and dinner seminars. It's less of a hassle to eat elsewhere. At best, these invitations are pure marketing. They can also serve as a sales pitch for a high-cost, unsuitable investment, and at worst they're a breeding ground for fraud.

Unsolicited calls. "Boiler rooms"—the term for a roomful of salespeople making unsolicited phone calls to try to hook investors—remain plentiful. The wonders of call screening make it easy to reject unsolicited offers. Hanging up works, too.

Junk mail. For mail solicitations, buy a shredder, and use it.

Pressure to act. Never be pressured into making hasty investment decisions—a legitimate investment isn't like a one-day-only sale at a department store or a short-term window to buy inexpensive plane tickets. If it's a good investment today it will still be a good investment when you've had time to evaluate it.

Things you don't understand. Never hesitate to ask hard questions if you are unclear about the investment offer, or if the responses to your questions are confusing or evasive. A salesperson may be able to make the most convoluted investment sound reasonable—even irresistible—while keeping the details vague. Ask yourself if you really understand how the investment works.

All talk, no documents. Financial promoters must explain the costs, risks, and obligations of the investment. No paperwork that provides that breakdown? Don't invest.

KEEP IN MIND

The best warning for investors is the old cliché: If an investment seems too good to be true, it probably is. And depending on your financial situation, even some legitimate investments should be avoided if they are not suitable for your financial goals.

You can defend yourself against crooks by being aware of the tactics they use, by carefully checking all the investment material they provide, and by investigating their credentials before you act. Ultimately, you are responsible for taking steps to avoid fraud, just as you are for the other investment decisions you make.

WHEN YOU SUSPECT FRAUD

If you suspect a violation of the law or believe you have received grossly inappropriate financial advice, you can contact your State Securities Regulator with general questions or you can file a formal complaint.

To make a formal complaint it's important to gather the following information:

1. The name of the account holder
2. The type of investment involved
3. The name of the salesperson or representative who sold you the product
4. A chronological list of events, starting with the initial contact made by the company
5. Copies of documents in support of the complaint, including statements, letters, forms, and applications
6. A description of how you want the company to rectify the situation

TOP THREATS TO INVESTORS

Certain types of investments raise red flags and always require careful scrutiny. While it's always important to read the contracts and offering documents carefully before you make any investment, it's especially important for complex investment strategies with which you may not be familiar. If an investment sounds too exotic or complex, or the salesperson promises big returns with minimal risk, consider just saying no.

Don't wager your savings on a "can't-miss" investment fairytale.

Threat: Unregistered Individuals

RISKS TO INVESTORS: If you buy an investment from someone who is not registered to sell securities in your state, chances are high you're putting your money into a fraud.

Remember, anyone acting as a sales agent for a company selling stocks, bonds, or other investments to the public must be registered to do so.

Registering with the State Securities Regulator involves qualifications testing, background checks, and periodic review.

WHAT TO DO: Always check to confirm that a person you are considering investing with is actually registered to sell investments. You can do this by visiting the State Securities Regulator's website. If an individual is registered, you can request a free background check on him or her.

Threat: Oil and Gas Offerings

RISKS TO INVESTORS: Private oil and gas offerings are highly speculative, complex, and full of unfamiliar, technical terms. It's very difficult to determine how much oil or gas will actually be produced or to assess the promises and background of the promoter.

You may be required to pay high commissions and other fees, significantly reducing the return on your investment.

Interests in these partnerships may be illiquid or not transferrable, so your money may be locked up for a long time.

WHAT TO DO: Be very cautious when considering all private oil and gas investment offerings.

Ask for and carefully review all documentation.

Check on the background of the promoter and all companies involved in the project. Make sure the promoter offering the investment is registered to sell securities.

Consult with an independent, registered financial professional as to the appropriateness and risk of the investment for your portfolio.

Threat: Cryptocurrency Offerings

RISKS TO INVESTORS: Cryptocurrency offerings are extraordinarily volatile—meaning risky—and almost impossible for a layperson to understand.

Investments tied to cryptocurrency hit everyone's radar in November 2021 when the price of one bitcoin reached a record high of $68,000, but by the following month had dropped in value by more than $25,000. Cryptocurrency prices continue to be in a constant cycle of boom and bust.

Promoters of these investments look to take advantage of people who are swayed by the idea of virtual currencies as a quick path to wealth.

Even seniors and retirees, who traditionally prioritize security over speculation, are being persuaded to invest in initial coin offerings (ICOs) and cryptocurrency mining pools.

WHAT TO DO: Do not invest in cryptocurrency offerings unless you can determine some basic facts about the company.

Make sure you can identify the principals of the company and its physical location. If you can't, you will be transferring funds to anonymous third parties at undisclosed locations. Also ask to see audited records or other financial information to back up any claims of high profits.

Most important, deal with *registered* parties. State registration requirements should apply equally to traditional securities and emerging securities, including products tied to cryptocurrencies.

Keep in mind that you will have little or no recourse if your money is stolen.

Threat: Promissory Notes

RISKS TO INVESTORS: Promissory notes are basically IOUs from companies and individuals who often have limited operating histories.

It's difficult for an investor without special expertise to analyze promissory notes that are broadly marketed to the public to fund projects such as oil and gas exploration or real estate, or as a way to buy interests in a business partnership.

Legitimate promissory notes are generally marketed to sophisticated or corporate investors who have the resources and expertise to evaluate the terms and conditions of notes and the companies behind them.

WHAT TO DO: If you are considering investing in a promissory note, first make sure the person selling the note is registered to sell securities.

Recognize that promissory notes are often marketed as high-yield, no-risk sources of income. They're intended to entice investors looking for an alternative to low yields on products such as certificates of deposit (CDs) and money market accounts.

Threat: Private Placement Offerings

RISKS TO INVESTORS: Private placement offerings are used to raise capital without having to comply with the registration requirements of securities laws.

This exemption from registration allows companies to raise money, but only from investors who meet the definition of accredited. That means having net worth of $1 million, excluding the value of the primary residence, or annual income of $200,000 or $300,000 If the investor is married or has what the SEC calls a spousal equivalent. Other individuals qualify as accredited based on measures of professional knowledge, experience, or certification defined by the SEC. For example, those who hold Series 7, Series 65, and Series 82 licenses qualify, as do state- and SEC-registered investment advisers.

Accredited investors may get pitched seemingly exclusive offers that are supposedly limited to sophisticated investors of means. But the pitches may be slim on important details, and the investments may turn out to be illiquid.

WHAT TO DO: Be cautious when considering these types of investments, even if you have a high net worth. Because private placement offerings aren't registered, there is always the potential they are unsuitable, or even fraudulent, investments.

Threat: Talking Heads

RISKS TO INVESTORS: It's easy to believe that someone who dispenses financial advice on the radio, online, or in books, has special expertise that can put you on the safe and secure path to wealth. But that's not usually the case.

The airtime for many investment radio shows is bought and paid for by the hosts, who may or may not have legitimate financial credentials. The content may not always be objective but slanted to benefit the host or guest speakers.

The internet is even more of an ethics-free zone for posting financial content, and there are many alleged financial experts who tout their books. One such book sounded particularly appealing: *Robbed With a Pen Again: A Guide to Protecting Your Assets*. The author was sentenced to 12 years in state prison for fraud in 2018.

WHAT TO DO: Listen to, and read, pundits with skepticism.

Some base their advice on risky investments that aren't suitable for most investors. Some don't disclose conflicts of interest and the fees they get for making certain recommendations.

A lot of pundit talk is just noise, and it's best to tune out anything that distracts you from sound investing principles.

Threat: Real Estate

RISKS TO INVESTORS: Depending on the structure of the real estate investment offering, risk factors may include:

- The illiquidity of the investment.
- The impact of changes in interest rates on the profitability of the investment or the ability to sell or refinance property.
- The potential effect of demographics, property valuation, and rental rates on the revenue generated.

Some promoters of fraudulent real estate investments also claim to have special expertise that guarantees investors unrealistically high returns on their investment.

Non-traded Real Estate Investment Trusts (REITs), invest in the same types of assets as publicly traded REITs but carry the following risks not found in REITs listed on the major stock exchanges:

- They are highly illiquid, long-term investments that must be held for 7 to 10 years on average.
- Some have limited redemption programs, but they are not required and may be suspended at any time.

- Significant front-end fees and commissions may be charged, reducing the amount of money that is actually invested in real estate.

WHAT TO DO: Be wary of claims that real estate investment carries minimal risk because it is backed by a "hard asset" such as a parcel of land or a home or commercial building.

Because non-traded REITs often require investors to meet minimum net worth and/or income standards, check the prospectus to make sure you meet those standards.

Threat: Alternative Investments for Self-Directed IRAs

There are many non-traditional investments you may consider for a self-directed IRA, but with these choices come greater risks.

RISKS TO INVESTORS: Investing for retirement usually means buying stocks, bonds, and mutual funds through a workplace plan, like a 401(k) or 403(b), or establishing your own individual retirement account (IRA).

If you want to buy alternative assets for a retirement account—such as precious metals, real estate, virtual currencies, and promissory notes—you will likely have to open a *self-directed IRA* account.

All IRAs provide investors with tax benefits for retirement savings, and all IRA accounts are held for investors by custodians.

The difference is that in a self-directed IRA, the custodian generally offers only limited protection against fraud.

WHAT TO DO: Avoid unsolicited investment offers, especially for riskier, alternative assets.

Always ask if the person offering investments for your self-directed IRA is licensed and if the investment is registered. Always check the answers with your State Securities Regulator.

Fraudulent promoters can misrepresent the responsibilities of self-directed IRA custodians and claim that the investments are legitimate or protected against loss. In fact, the custodians of self-directed IRAs generally do not evaluate the legitimacy of any investments in the account.

Threat: High-Yield Trading

RISKS TO INVESTORS: Active trading of stocks, bonds, foreign currency, and cryptocurrency is a tough way to consistently earn profits.

Foreign currency is a vast global market where prices are volatile, and losses can pile up in a few hours. There's a huge risk in buying into investment promotor promises that predict the prices of currencies and guarantee enormous profits with little or no risk.

Promoters often solicit investors with outsized claims of profitability—3% a week, or 30% a month—that may tempt investors to start counting their expected windfall.

WHAT TO DO: Make sure the trader and the firm are registered to sell securities, currencies, or commodities.

Currency traders, for example, must be registered with one or more federal regulatory agencies and in most cases licensed by the State Securities Regulator in the states where they operate.

Keep in mind the unusual complexity and skill involved in earning consistently high returns in the rapid trading of any asset.

Threat: Targeting the Elderly

RISKS TO INVESTORS: Older people sometimes accumulate substantial assets after a lifetime of working and saving. They may also be experiencing cognitive decline. That's the main reason con artists target them.

Cold calls remain a staple of investment fraud. The longer a caller can get someone to stay on the line, the greater the chances he or she can steal their money. Older people who welcome a chance to engage with others may be especially susceptible to this type of scam.

The U.S. Congress passed the Senior Safe Act in 2018 to provide legal immunity for financial firms that report suspected financial fraud involving senior citizens. According to the law, *senior citizen* is defined as a person who is 65 or older.

WHAT TO DO: Get a reality check from a trusted family member. Money is often a touchy topic within families, but for an older person a family support network is ideal.

No matter our age, most of us could use a trustworthy and informed friend or family member to give advice on large financial transactions or a change in

investment strategy. A financial professional could help, too, whether it's a certified public accountant, attorney, certified financial planner, or registered investment adviser.

Sometimes older people delay reporting fraud out of embarrassment, thinking it is an admission that they can no longer handle their own affairs. But it's important to report suspected fraud as soon as possible.

THE "GENIUS" TRADER

Who doesn't want to get rich quick? The genius trader promises he can make it happen.

Say an investment promoter promises you a return of 3% a week by trading foreign currencies on your behalf. All you need to do is invest $1,000 a month until you're 58 and you'll be…let's see, interest compounded biweekly, move the decimal point two places to the right, carry the "1"…a zillionaire!

That math doesn't make any sense. Neither do the investment pitches by promoters who promise huge returns from using arbitrage to trading in alternative products like forex, gold and silver and other commodities…the list goes on and on.

Conventional investing—for many people that means mutual funds—requires disciplined saving, knowing how much risk is tolerable, and a willingness to accept inevitable declines in the markets. It takes time. (See "Making Investments," page 5.) The genius trader typically promises investors a trifecta of quick results, unrealistic returns, and low risk. The genius' favorite terms are "no risk," "safe and secure," and "guaranteed."

You will, however, take an enormous risk investing with traders who say they can produce almost instant profits. That is an invitation to fraud.

CRYPTOCURRENCY OFFERINGS REACH MAIN STREET INVESTORS

The internet has been alive with the sound of cryptocurrency scams since late 2017, when the price of one bitcoin reached a record of $19,665, but within weeks had lost more than half its value. The price of bitcoin—and other major cryptocurrencies—has since followed a cycle of crash-rebound-repeat.

The only constant has been a steady stream of promoters looking to take advantage of investors who have been hearing about cryptocurrencies as a quick path to wealth.

As a result, cryptocurrency-related cases have become a staple of the State Securities Regulators' enforcement work.

Through investigations and enforcement actions, they have identified how many promoters of fraudulent cryptocurrency investments lure unwary investors into their schemes:

- Promoters emphasize guaranteed, secure profits while concealing basic facts, such as the names of their principals and even the physical address of their office. In these instances, investors are transferring funds to anonymous parties operating from undisclosed locations—and they will have little recourse if their money is stolen.
- Technology can create the illusion of professionalism, expertise, and success. Promoters manipulate video to falsely show they maintain cutting-edge facilities, use stock photographs to fictitiously represent company officials, and spoof email to represent that established businesses are recommending their securities offering.
- In the riskiest cryptocurrency-related offerings, promoters do not provide audited records or other financial information to back up their claims of extraordinarily high profits.
- Promoters' claims of secure cryptocurrency-related investments and guaranteed profits should be approached with caution: Cryptocurrencies tend to be extremely volatile and investors may be unable to quickly liquidate products tied to them.

PART 6

Finding a Financial Professional You Can Trust

At some point you may turn to a financial professional for help with investing decisions, particularly if you're trying to achieve different goals—such as retirement, children's education, and buying a home. Before you can begin the search for someone you can trust, you need to identify the type of help you need. To do that, it pays to understand the distinction between two basic types of financial professionals—**investment advisers** and **brokers**.

INVESTMENT ADVISERS

Investment advisers help you make investment decisions and manage your portfolio, and have a **fiduciary duty**, or legal requirement, to act in your best interest, not for their own personal gain. Investment advisers (IAs) may work as sole practitioners or, more commonly, at advisory firms that employ a number of advisers. (Investment advisory firms are also called **registered investment advisers**, or RIAs, and the advisers who work for them are known as investment adviser representatives, or IARs.)

Unlike brokers, who typically earn a commission on trades they make on your behalf, investment advisers charge a fee for their services, sometimes based on a percentage of the money they manage, sometimes on an hourly basis, and sometimes on a retainer basis for a package of services.

In selecting an adviser, be sure to do your homework. Advisers must provide you with key information, such as their credentials, years and type of professional experience, the services they provide, how they are compensated, and any conflicts of interest that may apply. You should also ask about a prospective adviser's work with other clients whose financial situation may be similar to your own.

Investment advisers are required to be registered with one of two regulatory authorities, depending on the size of their business:

- Investment advisers who manage up to $100 million in total assets—referred to as assets under management or AUM—must be registered with and inspected by the State Securities Regulator in the state or states where they operate.
- RIAs with more than $100 million in assets under management must register with the U.S. Securities and Exchange Commission (SEC).

FORM ADV: ESSENTIAL ADVISER INFORMATION

Registered Investment Advisers (RIAs) are required to provide their background information on **Form ADV**, which has three parts.

Part 1, which has two sections, identifies the firm and its business practices, the owners, executive officers, and the employees who provide investment advice. It also discloses any disciplinary actions involving the firm or its advisers.

Part 2, which also has two sections, is in narrative form and serves as the primary disclosure document for investment advisers. It contains information about:

- The RIA's business practices and any significant changes the firm has undergone recently
- Fees and compensation
- Multiple costs folded into a wrap fee charged to clients
- Conflicts of interest that the firm has or may have in representing a client
- Firm's social media accounts
- Types of clients the firm has
- Disciplinary information, if any, about the firm and its employees
- When and how the firm reviews client accounts
- Financial information about the firm

Part C, which was added in 2020, is a relationship summary, called Form CRS. It contains information specifically for retail investors, including how to obtain additional information about the firm. Form CRS explains:

- The types of relationships the firm has with its clients
- The services it provides
- Its fees and other costs
- Any potential conflicts of interest
- The Standard of Conduct to which the firm and its employees adhere
- The disciplinary history of the firm and its advisers

Investors should thoroughly review Parts 1, 2, and 3 of Form ADV before doing business with an investment adviser. The firm is required to provide its clients with this information and update it annually. You can also find a firm's Form ADV at the SEC's Investment Adviser Public Disclosure website at **www.adviserinfo.sec.gov**.

BROKERS

The terms **broker** and **broker-dealer** are legal terms that refer to the individuals and brokerage firms who are in the business of buying and selling securities on behalf of customers.

Individual salespeople employed by brokerage firms are called stockbrokers and are officially referred to as **agents** or **registered representatives**. But these individuals use other unofficial titles, too, including financial consultant, financial adviser, and investment consultant. In recent years, brokerage firms have offered a broader range of investment planning services in addition to trading securities.

Many brokers' compensation is based on the commissions clients pay each time they buy or sell a security—a potential conflict of interest that could mean investors end up paying more than they should if brokers illegally trade excessively or if they sell products for which they receive exceptionally high commissions.

Historically, brokers have not had a fiduciary relationship with their clients but have been required to recommend only those assets that were suitable for a particular client. In its Regulation Best Interest (Reg BI), which took effect in June 2020, the SEC changed that standard. While still not fiduciaries, brokers must take each client's best interest into account and provide investors with the same Form CRS that is Part 3 of Form ADV described on the previous page.

Retail investors should take particular interest in the potential conflicts of interest that might arise, the circumstances in which those conflicts might occur, and how they will be addressed.

Brokers may be required to be registered with more than one regulatory authority, depending on where they live, to whom they offer securities, and the type of business they operate. Brokers engaged in the offer and sale of securities are required to register with the State Securities Regulator in states where they operate. These brokers may also be subject to the oversight of FINRA.

It's not a common occurrence, but it will sometimes take months or years for both investment advisers and brokers to report disciplinary actions and other red flags, such as customer complaints, civil court cases, and bankruptcies. Failure to report relevant information in a timely way, which generally violates securities regulations, means potential investors don't have all the information they need when considering hiring an adviser or broker.

DEALING WITH REGISTERED BROKERS AND ADVISERS

Be sure to investigate any financial professional you are considering working with until you're satisfied that he or she is legitimate. Most importantly, deal only with registered salespeople or advisers.

Generally, anyone wanting to sell securities must be registered to do so—a fact many investors don't realize. An unregistered person or company selling investments is likely violating the law.

REGULATION BEST INTEREST (REG BI)

Investor protection against fraudulent investments and the inappropriate and sometimes illegal behavior of investment professionals is a primary concern of several federal and state regulatory agencies.

Over the past few years, some agencies have been developing new regulations to help ensure that certain investment professionals are putting the interests of their clients first.

However, the phrasing of the rules, the type of protection they provide, and how strictly they govern the behavior of stockbrokers—who work on a commission-bases sales model—has been extensively debated.

The SEC rule, commonly referred to as Reg BI (Regulation Best Interest), mandates that professionals provide advice and recommendations that are always appropriate to and in the best interest of the investor. One recurring issue is how a professional who has a potential conflict of interest in recommending securities or an investment strategy must explicitly disclose that conflict to the investor.

Effective as of June 30, 2020, Reg BI requires broker-dealers to provide Form CRS to clients. Among other things it should:

- Disclose all material conflicts of interest associated with a recommendation.
- Have procedures to identify and disclose, or eliminate, all conflicts of interest associated with recommendations.
- Have a reasonable basis to believe, based on potential risks, rewards, and costs, that the recommendation is in the best interest of the customer and doesn't place the broker-dealer's interest ahead of the customer's interest.

Some regulators argue that serving a client's best interest will remain a weaker standard than taking fiduciary responsibility, as investment advisers must do. As more brokers call themselves financial advisers, the difference between best interest and fiduciary responsibility can get muddled.

Regardless of how the debate plays out, it's important to know what you can expect from a financial professional with whom you plan to work. Remember that investor protection starts with you, the investor. When considering a potential investment adviser or broker you should always ask the questions described on page 59. That will help you determine if those individuals or firms will be providing appropriate financial advice and recommendations that are in your best interest, not in their own.

RESEARCHING A BROKER

To research a broker, start with the Financial Industry Regulatory Authority's BrokerCheck, a database that holds licensing and registration information for registered representatives and securities dealers and brokerage firms in the United States. The BrokerCheck report will tell you about a dealer's or agent's track record, including:

- Employment history for the past 10 years
- Disciplinary actions that have been taken by federal, state, and self-regulatory organizations
- Whether the broker or agent holds other professional designations such as a Certified Public Accountant or Certified Financial Planner
- Civil judgments and arbitrations in securities disputes
- Pending written complaints
- Criminal convictions or indictments
- Bankruptcy filings
- Outstanding liens and judgments

The BrokerCheck report may not be a complete record, however. It relies on self-reporting by registered firms and individuals, not all of whom submit to FINRA every document they should. It also does not include certain disclosures that are more than 10 years old, including bankruptcy, customer complaints, and lawsuits.

ROBO-ADVISERS

Investors who are comfortable handling financial matters online have another option for help: a robo-adviser that provides automated but still personalized investment guidance.

You can start the process of enlisting a robo-adviser by filling out an online questionnaire on the website of one of the dozens of firms that offer this service. You'll be asked

to detail your financial goals, income, assets, risk tolerance, short- and long-term goals, and investing time horizon.

Using a variety of high-tech tools—including advanced software and algorithms—your robo-adviser then crunches the data you've provided and churns out what it determines to be the most appropriate mix of assets for your portfolio.

Robo-advisers can handle single accounts, such as an Individual Retirement Account, as well as multiple portfolios of taxable accounts, college savings accounts, or other categories of investment accounts.

Fees for robo-advisers typically are substantially less than those charged by traditional advisers because the service is largely automated. In addition, robo-advisers use low-cost index funds and ETFs to build portfolios.

Since not everyone is comfortable getting all their advice online, some robo-adviser services have expanded to offer a dose of human interaction. The cost of the expanded service varies, depending on whether you want to talk to someone online or on the phone, and how often.

For example, you may be comfortable with a robo-adviser most of the time but want to speak with a human expert to discuss strategy during periods of market turmoil.

One thing you should make sure you're clear on is how often your robo-adviser rebalances assets in your account to ensure that the overall mix of investments doesn't significantly differ from your target allocation. But rebalancing more than once a year may be excessive and can result in higher than necessary trading costs.

Rebalancing, which involves selling some assets and buying others to keep your portfolio aligned with your investment strategy, can also affect your taxes. For example, if the robo-adviser updates your portfolio frequently, you could have large short-term gains that are taxed at the same rate as your regular income rather than at the lower rate that applies to long-term gains. To qualify for a long-term gain, you must hold an asset for more than a year before selling it.

Finally, be sure to consider a robo-adviser's approach to investing before signing up. Just like their human counterparts, robo-advisers have varying investing styles and offer different investment products. The final decision on how to allocate assets in your portfolio is up to you.

FINANCIAL PLANNERS

Unlike the terms investment adviser and broker, *financial planner* is not a legally defined term. It generally refers to someone who develops, and may also implement, comprehensive financial plans for clients based on their long-term goals.

Firms that offer robo-advisory services are typically registered with either the Securities and Exchange Commission or a State Securities Regulator. Robo-advisers are required to file the same Form ADV as investment advisers.

Form ADV requirements, which include a detailed breakdown of fees, are explained on **page 50**.

A financial plan typically covers such topics as estate planning, tax planning, insurance needs, and debt management, in addition to more investment-oriented objectives, such as retirement and college planning. But you'll want to be sure to ask about a planner's experience and credentials before you sign a contract to work with him or her.

ALPHABET SOUP OF DESIGNATIONS

A financial professional may use various titles, whether or not he or she is registered or licensed with a regulatory authority. The problem is that there are at least 150 designations in use. According to an investor bulletin from the SEC and the North American Securities Administrators Association: "The requirements for obtaining and using [professional designations] vary widely, from rigorous to nothing at all."

Some designations fit no one's idea of rigorous. The Chartered Senior Financial Planner designation, for example, requires limited professional experience, a three-day course, and one exam.

To become an Accredited Retirement Adviser, an applicant can buy a study guide for a 100-question, multiple choice test. There's no coursework, and no way to check disciplinary actions or submit a complaint.

There are, of course, many designations that require extensive testing and continuing education, and whose oversight body may impose disciplinary sanctions. Earning the

KEEP IN MIND

Regardless of the type of financial professional you choose to help you, there is one absolutely critical step to take beforehand: ***Read the contract.*** That sounds like obvious advice, but it's advice that some investors do not heed. Knowing the precise terms of the contract can forestall misunderstandings, disagreements, and even lawsuits down the line. Clear up any questions with the prospective financial professional ahead of time, and if necessary, consult with a lawyer, accountant, or trusted third party to review the contract terms.

Chartered Financial Analyst (CFA) designation requires hundreds of hours of study to pass three six-hour exams, and four years of work experience. Earning the Certified Financial Planner (CFP) designation requires the completion of seven courses and three years of financial planning experience.

Investors need to look beyond the acronym or designation to determine what's behind it: the exams, ethical standards, and oversight body, as well as the continuing education required to maintain the designation.

One resource is FINRA's "Understanding Professional Designations," which provides a snapshot description of more than 200 designations. The site is not comprehensive, does not allow a comparison of the designations, and does not evaluate the designations. But it's a good place to start.

The proliferation of "senior adviser" certifications targeting elderly clients is a growing problem, according to the U.S. Consumer Financial Protection Bureau (CFPB). There are more than 50 such designations in use, with many of the titles practically identical. That's confusing for investors, on top of the typically wide variance in training and education these professionals receive.

If a financial professional tells you that he or she has a certain credential, ask some direct questions:

- Who awarded you the credential?
- What are the training, ethical, and other requirements to qualify for this credential?
- Do you have to take a course and pass a test?
- Does the designation require a certain level of work experience or education?
- To maintain the designation, are you required to take refresher courses?
- How can I verify your standing with this organization?

KEEP IN MIND

As a reminder, investment advisory firms are required to provide their clients with a brochure about their employees in Form ADV. If an employee claims to have a professional title, the brochure supplement must include an explanation of the minimum qualifications for the title. This is not the case with brokerage firms or financial planning firms.

QUESTIONS TO ASK

Once you've researched prospective investment advisers and brokers, it's time to ask questions. In ***The Little Book of Safe Money*** (Wiley & Sons Inc., 2009), author Jason Zweig, personal finance writer for ***The Wall Street Journal***, recommends you sit down with the candidates and ask these questions:

- What made you want to become a financial adviser?
- Do you focus primarily or exclusively on asset management, or do you also have expertise in taxes, retirement, and estate planning, as well as budgeting and debt management? What education, training, experience, and licenses do you have in these practice areas?
- What is your philosophy of investing? Do you rely mainly on lower-cost index mutual funds? (If the answer is "No," ask to see evidence that the alternatives actually have worked as well or better.)
- How high an annual return on my investments do you think is feasible? (Anything above 10% suggests the adviser is either delusional or dishonest. Answers below 8% start to make sense.)
- How do you manage risk?
- What needs and goals does your typical client have?
- How many clients do you have, and will you personally manage my account? How much time should I reasonably expect you to devote to me over the course of a typical year?
- Describe something you achieved for a client that makes you proud.
- What's the worst mistake you've made with a client?
- How do you go about resolving conflicts with clients?
- Describe the process you have in mind for helping me to achieve my goals. How will you monitor our progress?
- Would any investments you recommend create a potential conflict of interest between doing what's best for me and doing what benefits you?
- When recommending investments, do you accept any form of compensation from any third party? Why or why not?

QUESTIONS TO ASK (CONTINUED)

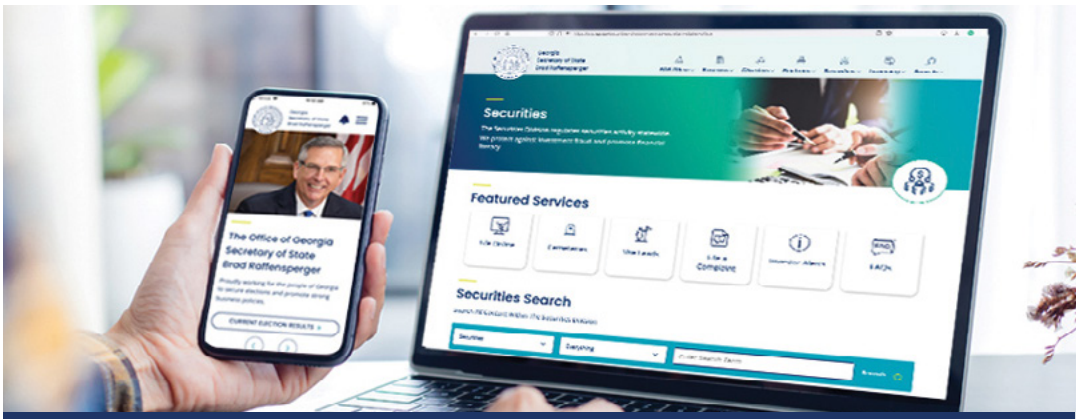
- What are your services likely to cost me in a typical year? What percentage of my assets will you charge in annual fees? How do you report your fees and commissions?
- May I see a sample account statement, and can you explain it to me clearly?
- Can you provide me with your resume, both parts of your Form ADV, and at least three references?

As you ask these questions, take written notes not just on how the adviser seems to respond to your queries but also on how the answers make you feel. Do you sense that this person is trustworthy? You should come away feeling that you would have no concerns about sharing a close secret with this person—because sooner or later, you probably will. If you have any doubts, find another adviser.

You, in turn, should be prepared to openly and honestly answer questions from financial advisers:

- Why do you think you need a financial adviser?
- How knowledgeable are you about investing and financial matters, and how confident are you in your knowledge?
- What does money mean to you?
- What are your biggest fears? What are your fondest hopes?
- How much time and energy are you willing to invest in any financial plan we develop?
- What would it take for you to feel our working relationship is successful?
- When someone presents you with evidence that your opinions may be mistaken, how do you respond?
- How do you deal with conflicts or disputes?

Invest time in picking a good financial adviser. It will be one of the most important decisions you make and one of the most significant relationships you ever have.



Resources

The mission of the Georgia Secretary of State Securities Division is to protect Georgia investors by encouraging a safe and healthy financial services sector that promotes capital formation in Georgia. The Securities Division is providing this information and resource guide as part of its mission to provide investor education and for fraud prevention.

KEY INVESTOR EDUCATION AND FRAUD PREVENTION INFORMATION WEBSITES:

North American Securities Administrators Association (NASAA)

Organized in 1919, the North American Securities Administrators Association (NASAA) is the oldest international organization devoted to investor protection. NASAA is a voluntary association whose membership consists of 67 state, provincial, and territorial securities administrators in the 50 states, the District of Columbia, Puerto Rico, Canada, and Mexico. In the United States, NASAA is the voice of the 50 state securities agencies responsible for efficient capital formation and grass-roots investor protection. The ASC is an active member of NASAA and recommends their website as an excellent source for investor education and securities industry regulatory information.

Securities and Exchange Commission (SEC)

The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation. The SEC oversees the key participants in the securities world, including securities exchanges, securities brokers and dealers, investment advisors, and mutual funds. Here the SEC is concerned primarily with promoting the disclosure of important market-related information, maintaining fair dealing, and protecting against fraud. The SEC's Office of Investor Education and Advocacy provides a variety of services to address the problems and questions faced by investors.

Office of Investor Education and Advocacy (SEC)

The SEC Office of Investor Education and Advocacy offers you a variety of services to attend to the problems and questions that you might have as an investor. They cannot advise you as to what investments to make, but will be able to instruct you about how to invest wisely and avoid frauds.

La SEC en Español: Información para los Inversionistas (SEC)

La Oficina de Educación y Asistencia a los Inversionistas (Office of Investor Education and Advocacy) de la SEC le ofrece una variedad de servicios para atender los problemas y preguntas que usted pudiera tener como inversionista. No podemos aconsejarle qué inversiones realizar, pero sí podremos instruirle acerca de cómo invertir sabiamente y evitar los fraudes.

Investor.gov

The Securities and Exchange Commission's Investor.gov website has additional resources, including sections devoted to investing, financial tools and protecting investments.

Financial Industry Regulatory Authority (FINRA)

The Financial Industry Regulatory Authority (FINRA), is the largest non-governmental regulator for all securities firms doing business in the United States. Created in July 2007 through the consolidation of the National Association of Securities Dealers (NASD) and the member regulation, enforcement and arbitration functions of the New York Stock Exchange, FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services. The FINRA Investor Education Foundation, formerly known as the NASD Investor Education Foundation, supports innovative research and educational projects that give investors the tools and information they need to better understand the markets and the basic principles of saving and investing.

WHEN YOU SUSPECT FRAUD

If you suspect you are a victim of fraud, suspect that a violation of the securities laws has occurred or believe you have received grossly improper financial advice, the Division is here to assist you as best it can.

- You can contact the Georgia Secretary of State Securities Division at (470) 312-2640 or at registrations@sos.ga.gov with general questions or to file a formal complaint.
- The SEC maintains a Tip, Complaint, and Referral system to allow members of the public to report suspected investment fraud. This TCR system can be found at sec.gov/TCR

- Through its Complaint Program, FINRA investigates complaints against brokerage firms and their employees. FINRA is empowered to take disciplinary actions against brokers and their firms. Go to: https://www.finra.org/investors/need-help/file-a-complaint

ADDITIONAL RESOURCES

The resources listed below will help you find information on investing and personal finances. The Division does not endorse, nor is it responsible for, any companies, products, or services featured at the websites or publications listed in this resource guide.

Investing

- FINRA's BrokerCheck (brokercheck.finra.org) gives you a snapshot of a broker dealer and a broker dealer's employment history, regulatory actions, and information on their investment-related licensing, arbitrations, and complaints.
- Easy public access to information about investment advisor firms and investment adviser representatives on the Investment Adviser Public Disclosure (IAPD) website adviserinfo.sec.gov
- PAUSE is the SEC's list of soliciting entities that have been the subject of investor complaints.
- The Internal Revenue Service (irs.gov) has a guide that compares traditional IRAs and Roth IRAs.
- The National Endowment for Financial Education's site (Smartaboutmoney.org) has free guides that explain stocks, bonds, and mutual funds.
- The National Association of Investors Corp (betterinvesting.org) has information about the stock market through online classes, webinars, and research reports.
- The Federal Reserve Bank of Dallas has a guide: *Building Wealth: A Beginner's Guide to Securing YourFinancial Future*. dallasfed.org/microsites/cd/wealth

Personal Finance

- Investment turorial from the nonprofit Women's Institute for a Secure Retirement ("WISER"). wiserwomen.org
- Check your credit score. You can check your credit report with the three credit bureaus—Experian, TransUnion, and Equifax—for free once a year. To request your reports, go to annualcreditreport.com.

- Get estimates of your Social Security and pension benefits. You can get an estimate of your future Social Security benefits and a record of your lifetime earnings history at ssa.gov
- It's important to estimate how much money you will need for retirement. A good place to start is the online Ballpark Estimate calculator from the Employee Benefit Research Institute's site, choosetosave.org.
- Partnering with the Investor Protection Trust, the Secretary of State is making available the helpful and handy "Financial Field Manual: The Personal Finance Guide for Military Families." This free financial resource is designed to help service members and their loved ones understand how to maximize personal finance opportunities and avoid financial hazards. The manual includes comprehensive information on a range of critical issues, such as need-to-know changes to the military retirement system, how to recognize financial fraud, and what financial steps to take before and after your service. https://sos.ga.gov/sites/default/files/2022-01/Military_Financial_Field_Manual_2020.pdf

- When I'm 65 (wi65.org) is a public television documentary and engagement program that explores the changing realities of retirement and provides toolkit materials including action guides and videos customized for various age groups.
- National groups of financial planners offer searchable databases with contact information include:
  - The National Association of Personal Financial Advisors (napfa.org)
  - The Financial Planning Association (onefpa.org)
  - The Certified Financial Planner Board of Standards (CFP.net)
  - Garrett Planning Network (garrettplanningnetwork.com)
  - Financial Planning Association of Georgia (fpaga.org)
  - Association for Financial Counseling and Education (afcpe.org)

SHE LEADS

Launched in 2019, She Leads was the first program of its kind for the State of Georgia hosted by Georgia Secretary of State Brad Raffensperger as part of his financial literacy platform. sos.ga.gov/she-leads

She Leads monthly webinars are free and open to all Georgians. Free registration can be completed online at sos.ga.gov/she-leads.

2020 Teleconferences

- Relief and Resources for Small Business in GA (May 5, 2020)
- Financial Scams: COVID-19 & Beyond (May 21, 2020)
- Making Money Moves (June 3, 2020)
- Rebuilding & Recovering Financially: A pathway for small businesses (July 29, 2020)
- Mission Readiness: Helping military families protect their finances from coronavirus challenges (September 15, 2020)
- Finding Funding: How to fund your business during a pandemic and beyond (Oct 29, 2020)

2021 Webinars

- Funding Your Business: How to get a piece of the pie (Feb 10, 2021)
- Building Wealth (Feb 25, 2021)
- Smart Money Moves: Side hustle, small businesses and investing (Gen Z & Millennial Edition-April 29, 2021)
- A Financial Mindset: The secret sauce to success (May 6, 2021)
- The Juggling Act: Managing competing financial priorities (June 24, 2021)
- Securing Capital: Navigating the process (July 27, 2021)
- Get Back on Track: Rebuilding your personal finances and small business post pandemic (August 25, 2021)
- The Art of StartUps: Funding options demystified (Sept 22, 2021)
- The Art of StartUps Part 2: More to explore (Oct 27, 2021)
- The Pandemic Pivot: Surviving & thriving (December 7, 2021)

2021 Webinars

- **4-Part Virtual Financial Literacy Workshop Series**
  - Part 1: Maximizing Profit Though Selecting Optimal Revenue Models (April 7, 2022)
  - Part 2: Business Financial Planning Essentials (April 21, 2022)
  - Part 3: Pricing Your Products and Services (May 5, 2022)
  - Part 4: Developing Your Fundraising Strategy (May 19, 2022)

LET'S READ

- Alboher, Marci. *The Encore Career Handbook: How to Make a Living and a Difference in the Second Half of Life*.
- Bernstein, William J. *The Investor's Manifesto: Preparing for Prosperity, Armageddon, and Everything In Between*.
- Bogle, John. *Common Sense on Mutual Funds*.
- Collamer, Nancy. *Second Act Careers: 50+ Ways to Profit From Your Passions During Semi-Retirement*.
- Farrell, Chris. *Purpose and a Paycheck*.
- Ferri, Richard. *All About Asset Allocation*.
- Hannon, Kerry. *Great Jobs for Everyone 50+: Finding Work That Keeps You Happy and Healthy and Pays the Bills*.
- Hannon, Kerry. *Money Confidence*.
- Hannon, Kerry. *Never Too Old to Get Rich: The Entrepreneur's Guide to Starting a Business Mid-Life*.
- Kobliner, Beth. *Get a Financial Life: Personal Finance In Your 20's and 30's*.
- Kotlikoff, Lawrence, Moeller, Philip, Solman, Paul. *Get What's Yours: The Secret to Maxing Out Your Social Security*.
- Morris, Virginia B., and Kenneth M. Morris. *Guide to Money & Investing*.
- Morris, Virginia B., and Kenneth M. Morris. *Paying for College*.
- Olen, Helaine, and Harold Pollack. *The Index Card: Why Personal Finance Doesn't Have to Be Complicated*.
- Singletary, Michelle. *Spend Well, Live Rich*.
- Stanley, Thomas J. and Sarah Stanley Fallaw. *The Next Millionaire Next Door*.
- Tobias, Andrew. *The Only Investment Guide You'll Ever Need*.
- Zweig, Jason. *The Little Book of Safe Money*.

Glossary of Terms

401(k) retirement savings plan

A 401(k) plan is an employer-sponsored retirement savings plan to which the employee, the employer, or sometimes both employee and employer contribute to an account set up in the employee's name. The contributions go into investments offered by the plan, and all earnings on those investments accumulate tax deferred.

With a traditional 401(k), you defer pretax income, which reduces the income tax you owe in the year you make the contribution. You pay tax on all withdrawals at your regular rate, determined by your filing status and tax bracket.

If you change jobs, 401(k) plans are portable, which means that you can move your accumulated assets to a new employer's plan, if the plan allows transfers, or to a rollover IRA.

With a Roth 401(k), which some but not all employers offer, contributions are made with after-tax income. Withdrawals are required at retirement, but no tax is due provided you are at least 59½ and the account has been open at least five years.

403(b) retirement savings plan

A 403(b) plan is an employer-sponsored retirement savings plan for employees of not-for-profit organizations, such as public school districts, colleges, hospitals, foundations, and cultural institutions.

Some employers offer 403(b) plans as a supplement to—rather than a replacement for—defined benefit pensions. Others offer them as the organization's only retirement plan.

Your contributions to a traditional 403(b) are tax deductible, and any earnings are tax-deferred until withdrawn. Contributions to a Roth 403(b), which some but not all employers offer, are made with after-tax dollars, but the withdrawals are tax free if the account has been open at least five years and you're 59½ or older.

If you change jobs, 403(b) plans are portable, which means you can move your accumulated assets to a new employer's plan if the plan allows transfers or to a rollover IRA.

457 retirement savings plan

The tax-deferred retirement savings plans known as 457 plans are available to state and municipal employees.

Like traditional 401(k) and 403(b) plans, the money you contribute and any earnings that accumulate in your name are not taxed until you withdraw the money, usually after retirement. If your 457 plan offers a Roth account, you contribute after-tax income but withdrawals are tax free if you are at least 59½ and your account has been open at least five years.

The contribution levels are set each year at the same level that applies to 401(k)s and 403(b)s, though 457s may allow larger catch-up contributions.

You also have the right to roll your plan assets over into another employer's plan, including a 401(k) or 403(b), if the plan accepts transfers, or an individual retirement account (IRA) when you leave your job.

Accredited investor

An accredited investor is a person or institution that the Securities and Exchange Commission (SEC) defines as being qualified to invest in unregistered securities, such as privately held corporations, private equity investments, and hedge funds.

To be an accredited investor you must have a net worth of more than $1 million excluding the value of your primary residence, or a current annual income of at least $200,000 or $300,000 if you're married or have what the SEC calls a spousal equivalent. Other individuals qualify as accredited based on measures of professional knowledge, experience, or certification defined by the SEC. For example, those who hold Series 7, Series 65, and Series 82 licenses qualify as do state- and SEC-registered investment advisers. So do certain organizations.

Asset allocation

Asset allocation means dividing your assets on a percentage basis among different broad categories of investments, called asset classes. Stocks, bonds, and cash are examples of asset classes, as are real estate and commodities.

Most financial services firms suggest particular asset allocations for certain categories or groups of clients and fine-tune those allocations for individual clients.

The asset allocation model—specifically the percentages of your investment principal allocated to each investment category you're using—that's appropriate for you at any given time depends on many factors, such as the goals you're investing to achieve, how much time you have to invest, and your tolerance for risk. Asset allocation may help protect your portfolio against market risks without significantly reducing your return. But it does not guarantee a profit or protect against losses in a falling market.

Broker

A broker acts as an agent or intermediary for a buyer or a seller, or, less commonly, for both in return for a commission. The buyer, seller, and broker may all be individuals, or one or more may be a business or other institution. For example, a stockbroker works for a brokerage firm, and handles client orders to buy or sell stocks, bonds, and other investments.

Broker-dealer (B/D)

A broker-dealer (B/D) is a brokerage firm that holds a license granted by the Securities and Exchange Commission (SEC) to act as a broker, or agent, to buy and sell securities for its clients' accounts. The firm may also act as principal, or dealer, and trade securities for its own inventory.

Some broker-dealers act in both capacities, depending on the circumstances of the trade or the type of security being traded. For example, your order to purchase a particular security might be filled from the firm's inventory provided you are notified that this has happened.

Capital gains

A capital gain is the difference between the purchase price and the sale price of a capital asset when the sale price is higher than the purchase price. For example, if you buy 100 shares of stock for $20 a share and sell them for $30 a share, you realize a capital gain of $10 a share, or $1,000 in total.

If you have owned the stock for more than a year before selling it, you have a long-term capital gain. If you hold the stock for less than a year, you have a short-term capital gain. Long-term gains on many capital assets are taxed at a lower rate than your ordinary income, and short-term gains are taxed at the same rate as your ordinary income.

Certificates of deposit (CD)

Certificates of deposit (CDs) are time deposits with fixed terms, typically ranging from three months to five years. On traditional bank CDs, you earn compound interest at a fixed rate, which is determined by the current interest rate and the CD's term. Adjustable-rate and market-rate CDs may also be available, though specific terms and conditions apply. When you purchase a CD from a bank, your account is insured by the Federal Deposit Insurance Corporation (FDIC) up to the per depositor limit.

You usually face a penalty if you withdraw funds before your CD matures. With a bank CD, you often forfeit some or all of the interest that has accrued up to the time of the withdrawal.

Certified Financial Planner (CFP)

Certified Financial Planner (CFP) is a professional designation that identifies financial planners who have met rigorous professional standards, including specialized education, set by the CFP Board. Planners entitled to use the CFP designation have agreed to adhere to the principles of honesty, integrity, competence, and diligence when working with their clients and are subject to oversight by the CFP Board.

Compounding

Compounding occurs when your investment earnings, such as dividends or interest, are

added to your principal, forming a larger base on which future earnings may accumulate.

As your investment base gets larger, it has the potential to grow faster. And the longer your money is invested, the more you stand to gain from compounding.

For example, if you invested $10,000 earning 8% annually and reinvested all your earnings, you'd have $21,589 in your account after 10 years, including earnings of $11,589.

If instead of reinvesting you withdrew the $800 in earnings each year, you would have collected $8,000 over the 10 years. The $3,589 you didn't earn represents the benefit of 10 years of compound growth.

Consumer Price Index (CPI)

The Consumer Price Index (CPI) is compiled monthly by the U.S. Bureau of Labor Statistics and is a gauge of inflation that measures changes in the prices of basic goods and services, such as housing, food, clothing, transportation, medical care, and education.

The CPI is used as a benchmark for making adjustments in Social Security payments, wages, pensions, and tax brackets to keep them in tune with the buying power of the dollar. It's often incorrectly referred to as the cost-of-living index.

Disposable personal income (DPI)

Disposable personal income (DPI) is the amount that's left after income taxes, FICA taxes, and other required amounts are withheld from gross income.

DPI is the money you have available to spend on your essential and discretionary household expenses, to save, and to invest.

Diversification

Diversification is an investment strategy. When you diversify, you spread your investment dollars among different sectors, industries, and securities within a number of asset classes.

A well-diversified stock portfolio, for example, might include small-, medium-, and large-capitalization domestic stocks, stocks in six or more sectors or industries, and international stocks. The goal is to protect the value of your overall portfolio in case a single security or market sector takes a serious downturn.

Finding the right diversification mix for your portfolio depends on your age, your assets, your tolerance for risk, and your investment goals.

Diversification may help protect your portfolio against certain market and management risks without significantly reducing the level of return you realize. But it does not guarantee you will realize a profit or insure you against losses in a market downturn.

Dividend

A dividend is a portion of a corporation's earnings that the board of directors may pay out to shareholders as a return on investment.

These dividends, which are often declared quarterly, are usually in the form of cash, but may be paid as additional shares.

You may be able to reinvest cash dividends automatically to buy additional shares if the corporation offers a dividend reinvestment program (DRIP) or direct purchase plan (DPP).

Dividends are taxable unless you own the investment in a tax-deferred account, such as an employer-sponsored retirement plan or IRA. This rule applies whether you reinvest the dividends or take the money.

Equity

In the broadest sense, equity is ownership. If you own stock, you have equity in the company that issued the stock even if your stake is very small. Equity also refers to the difference between an asset's current market value—the amount it can be sold for—and any debt or claim against it.

Exchange traded fund (ETF)

Exchange traded funds (ETFs) resemble open-ended mutual funds but are listed on a stock exchange and trade like stock through a brokerage account.

You buy shares of the fund, which holds a portfolio of stocks, bonds, commodities,

or other investment products. You can use traditional stock trading techniques, such as buying long, selling short, and using stop orders, limit orders, and margin purchases.

The ETF doesn't redeem shares you wish to sell, as a mutual fund does. Rather, you sell in the secondary market at a price set by supply and demand. ETF prices change throughout the trading day and are not reset at the end of each trading day, as mutual fund prices are.

An ETF's net asset value (NAV) is determined by the total market capitalization of its portfolio holdings plus uninvested cash, minus expenses, divided by the number of outstanding shares the fund has issued.

Expense ratio

An expense ratio is the percentage of a mutual fund's, ETF's, or variable annuity's total assets deducted to cover operating and management expenses.

Those expenses include employee salaries, custodial and transfer fees, distribution, marketing, and other costs of offering the fund or contract, but not trading costs or commissions.

For example, if you own shares in a fund with a 1.25% expense ratio, your annual share is $1.25 for every $100 in your account, or $12.50 on an account valued at $1,000.

Expense ratios vary widely from one fund company to another and among different types of funds. Typically, international equity funds expense ratios are higher, and index funds are lower than average.

Fiduciary

A fiduciary is an individual or organization legally responsible for managing assets on behalf of someone else, usually called the beneficiary. The assets must be managed in the best interest of the beneficiary, not for the personal gain of the fiduciary.

However, the concept of acting responsibly can be broadly interpreted, and may mean preserving principal to some fiduciaries and producing reasonable growth to others.

Executors, trustees, guardians, and agents with powers of attorney are examples of individuals with fiduciary responsibility. Firms known as registered investment advisers (RIAs) are also fiduciaries.

Financial adviser

Financial adviser is a generic designation for someone who provides financial advice. There is no credential or accreditation associated specifically with the term. However, people who describe their services as providing financial advice may have some other credential, such as registered representative (RR), certified financial planner (CFP) or similar designation, or they may work for a registered investment advisory firm (RIA).

Glide path

Glide path is the approach a target date fund takes in reallocating its portfolio as time passses.

Each fund company's glide path varies somewhat from those of its competitors, based on the company's investment strategy and risk profile.

What is similar is that all target date funds have a specific time horizon. They invest to achieve growth in the early phases of their life span, gradually reallocating to produce income and protect principal as their target dates approach. What differs is the rate and timing of the reallocation, in particular how much of the fund remains invested for growth at the target date.

Target date funds are often retirement investments, using target dates such as 2025 or 2040. Or they may be used in 529 college savings plans, where they are described as age-based tracks.

Individual retirement account (IRA)

Individual retirement accounts are one of two types of individual retirement arrangements (IRAs) that provide tax advantages as you save for retirement.

Everyone with earned income may contribute to a tax-deferred IRA. Those whose modified adjusted gross income is less than the annual cap for his or her filing status qualifies to contribute to a Roth IRA.

There are annual contribution limits, catch-up provisions if you're 50 or older, and restrictions on withdrawals before you turn 59½. Tax-deferred IRAs have required minimum distributions (RMDs) after you turn 72.

Earnings withdrawn from a traditional IRA are taxed at the same rate as your ordinary income. So are the contributions if you are qualified to deduct them for the year they were added to your account.

Contributions to a Roth IRA, in contrast, are not tax-deductible, but the withdrawals from Roth accounts are tax-free provided you are at least 59½ and your account has been open at least five years.

Initial coin offering (ICO)

In an ICO, an entity issues virtual coins, often called tokens, to raise capital. A token sale is distributing a new cryptocurrency to investors, who typically pay for tokens in bitcoin or another established cryptocurrency.

Investment adviser

An investment adviser is a financial professional who provides guidance to investors to help them make investing decisions. The adviser may also manage an investor's portfolio.

Load

A load is the sales charge, or commission, you may pay if you buy mutual fund shares through a broker or other financial professional.

If the sales charge is levied when you purchase the shares, it's called a front-end load. If you pay when you sell shares, it's called a back-end load or contingent deferred sales charge. With a level load, you pay a percentage of your investment amount each year you own the fund.

Long-term capital gain

A long-term capital gain is the profit you realize when you sell a capital asset that you have owned for more than a year at a higher price than you paid to buy it.

Unlike short-term gains, which are taxed as ordinary income, most long-term gains are taxed at rates lower than the rate that applies to your ordinary income.

You can subtract any long-term capital losses you realized in the same tax year from your long-term capital gains to reduce the amount on which potential tax may be due.

Modified adjusted gross income (MAGI)

Your modified adjusted gross income (MAGI) is your adjusted gross income (AGI) plus any tax-exempt interest income and certain adjustments you may have taken to reduce your AGI.

If your MAGI is less than the maximum levels set by Congress for your filing status, you qualify for various tax adjustments, deductions, and credits. Some of these include the right to subtract student loan interest, take a deduction for your contributions to a tax-deferred IRA, make contributions to a Roth IRA, and take the American Opportunity, Lifetime Learning, and adoption tax credits.

Money market mutual fund

Money market mutual funds invest in stable, short-term debt securities, such as commercial paper, Treasury bills, certificates of deposit (CDs), and other short-term instruments.

The fund's management tries to maintain the value of each share in the fund at $1.

Unlike bank money market accounts, money market mutual funds are not insured by the Federal Deposit Insurance Corporation (FDIC).

However, since they're considered securities at most brokerage firms, they may be insured by the Securities Investor Protection Corporation (SIPC) against the bankruptcy of the firm. In addition, some funds offer private insurance comparable to FDIC coverage.

Mutual fund

A mutual fund is a professionally managed investment product that sells shares to investors and pools the capital it raises to purchase investments.

A fund typically buys a diversified portfolio of stock, bonds, or money market securities, or a combination of stock and bonds, depending on the investment objectives of the fund. Mutual

funds may also hold other investments, such as derivatives and cash.

A fund that makes a continuous offering of its shares to the public and will buy any shares an investor wishes to redeem, or sell back, is known as an open-end fund. An open-end fund trades at its net asset value (NAV).

Net asset value (NAV)

Net asset value (NAV) is the dollar value of one share of a mutual fund or exchange traded fund (ETF).

NAV is calculated by totaling the value of the fund's holdings plus money awaiting investment, subtracting operating expenses, and dividing by the number of outstanding shares.

A fund's NAV changes regularly, though day-to-day variations are usually small. With a mutual fund, the NAV is reset at the end of each trading day, while with an ETF, the NAV changes throughout the day.

The NAV is the price per share an open-end mutual fund pays when you redeem, or sell back, your shares. With no-load mutual funds, the NAV and the offering price, or what you pay to buy a share, are the same. With front-load funds, the offering price is the sum of the NAV and the sales charge per share and is sometimes known as the maximum offering price (MOP).

Net worth

To figure your own net worth, you add the value of the assets you own, including but not limited to cash, securities, personal property, real estate, and retirement accounts, and subtract your liabilities, or what you owe in loans and other outstanding obligations.

If your assets are larger than your liabilities, you have a positive net worth. But if your liabilities are more than your assets, you have a negative net worth.

Pension

A pension is an employer plan that's designed to provide retirement income to employees who have vested, or worked enough years to qualify for the income.

Defined benefit plans promise a fixed income, usually paid for the employee's lifetime or the combined lifetimes of the employee and his or her surviving spouse.

The employer contributes to the plan, invests the assets, and pays out the benefit, which is typically based on a formula that includes final salary and years on the job.

Tax is due on your pension income at your regular rate, so a percentage is withheld from each check. If the state where you live taxes retirement income, those taxes are withheld too. But, pension income is not subject to Social Security or Medicare withholding.

Principal

Principal can refer to an amount of money you invest, the face amount of a bond, or the balance you owe on a debt, distinct from the finance charges you pay to borrow.

A principal is also a person for whom a broker carries out a trade, or a person who executes a trade on his or her own behalf.

Prospectus

A prospectus is a formal written offer to sell stock or bonds to the public. It is created by an investment bank that agrees to manage the offering.

The prospectus sets forth the business strategies, financial background, products, services, and management of the issuing company, and information about how the proceeds from the sale of the securities will be used.

The prospectus must be filed with the Securities and Exchange Commission (SEC) and is designed to help investors make informed investment decisions.

Each mutual fund and variable annuity provides a prospectus to potential investors, explaining its objectives, management team and policies, investment strategy, and performance. The prospectus also summarizes the fees and analyzes the risks you take in investing.

Qualified dividends

A qualified dividend is a dividend that is taxed at a taxpayer's long-term capital gains tax rate

rather than at the rate that applies to his or her ordinary income.

A dividend is generally qualified if two conditions are met. First, it must have been paid on stock issued by a U.S. corporation or eligible non-U.S. corporation. However, certain dividends are never qualified, including those paid by real estate investment trusts (REITs) and regulated investment companies.

Second, the person who owns the stock on which the dividend has been paid must have owned it for at least the minimum holding period. The holding period in most cases is at least 61 days during the 121-day period that began 60 days before the ex-dividend date.

Real Estate Investment Trust (REIT)

A real estate investment trust (REIT) pools investors' capital to invest in a variety of real estate ventures.

There are three types of REIT: Equity REITs buy properties that produce income. Mortgage REITs invest in real estate loans. Hybrid REITs usually make both types of investments.

REITs may be publicly traded corporations. In that case, after the REIT has raised its investment capital, it trades on a stock market. Other REITs are nonlisted investments available to qualified investors who wish to be limited partners. Nonlisted REITs may be public or private.

All REITs are designed to be income-producing investments, and by law 90% of a REIT's taxable income must be distributed to investors. This means the yields on REITs may be higher than on other equity investments although the income is not guaranteed. REIT income distributions are taxed as ordinary income.

Reallocating

Reallocating, in the context of an asset allocation strategy, means to change the percentage of investment assets assigned to specific asset classes.

You reallocate to reposition a portfolio to improve the potential for meeting a particular goal. For example, you might reallocate in response to a major change in the economy or if you married, divorced, or had a child.

You might also reallocate as you get closer to retirement and wish to put greater emphasis on producing income and less on seeking growth. In that case, you might increase your allocation to fixed-income investments and income-producing stock and decrease your allocation to small-company stock, stock mutual funds, and stock ETFs.

Real return

Real return adjusts the percentage return on an investment or investment portfolio to account for the impact of inflation.

For example, if the return on a stock investment is 6% in a year that the rate of inflation is 2%, the real return is a positive 4%. But if the return on an investment is 3% in a year the rate of inflation is 4%, the real return is a negative 1%.

Real return is useful in evaluating whether or not your investments are providing returns that increase your purchasing power or at least keep it stable. Flat or negative real returns are a major argument against investing too conservatively for the long term. Any investment can produce negative real returns in a flat or falling market.

Rebalancing

Rebalancing, in the context of an asset allocation strategy, means to bring an investment portfolio's current asset allocation back into line with the portfolio's intended allocation.

You might rebalance, for example, after a period of strong stock market performance that has increased the percentage of your portfolio invested in stock and decreased the percentage invested in bonds.

When the actual allocation of your portfolio deviates too much from your intended allocation, you may be exposed to more risk than you are comfortable with or assume less risk than may be required to produce the return you seek. Those are the situations in which rebalancing may be required.

Registered investment adviser (RIA)

A registered investment adviser (RIA) is a firm that is paid for providing investment advice, registers with the Securities and Exchange Commission (SEC) or a state securities agency, and is generally subject to regulation by states or the SEC, depending on how much money the firm manages.

Firms registered with the SEC have more than $100 million under management. Firms with assets up to $100 million register with the state securities agency in the state or states where they operate.

An RIA's employees, called investment adviser representatives (IARs), are bound by a fiduciary standard in recommending securities to their clients. They may manage clients' investment portfolios and earn a fee, or sometimes a fee plus commission, for their advice.

An RIA must file a three-part Form ADV. Part 1 provides basic information about the firm. Part 2 is a detailed narrative explanation, in Plain English, about how the firm operates, how it does its analysis, what it charges, and any material disciplinary actions. Part 3, known as Form CRS, focuses on client relationships and services, conflicts of interest, and the firm's Standard of Conduct.

Registered representative (RR)

Registered representatives are licensed to act on investors' orders to buy and sell securities and to provide advice relevant to portfolio transactions.

They may be paid a salary, a commission—usually a percentage of the market price of the investments their clients buy and sell—or in some cases by fees figured as a percentage of the value of a client's account.

Registered reps, commonly known as stockbrokers, work for a broker-dealer that operates in the market where the trades are handled. The reps must pass a series of exams administered by FINRA to qualify for their licenses and are subject to FINRA oversight. FINRA is the acronym for the Financial Industry Regulatory Authority, the self-regulatory organization for the securities industry.

Regulation best interest (Reg BI)

Regulation Best Interest (Reg BI) is a Securities and Exchange Commission (SEC) standard of conduct for broker-dealers and their employees to follow when they recommend to a retail customer any securities transaction, the use of various types of investment accounts, or an investment strategy involving securities. The rule specifies that these recommendations be in the customer's best interest and that any conflicts of interest or financial incentives that would benefit the broker-dealer or its employee(s) be disclosed.

Return

Your return is the profit or loss you have on your investments, based on income and change in value, typically on a one-year basis.

Return can be expressed as a percentage and is calculated by adding the income and change in value and dividing by the initial principal or investment amount. You can find the average annual return by dividing the percentage return by the number of years you have held the investment.

For example, if you bought a stock that paid no dividends at $25 a share and sold it for $30 a share, your return would be $5. If you bought on January 3, and sold it the following January 4, that would be a 20% annual percentage return, or the $5 return divided by your $25 investment.

But if you held the stock for five years before selling for $30 a share, your average annual return would be 4%, because the 20% gain is divided by five years rather than one year.

Robo-Adviser

A robo-adviser is a digital platform that gathers personal and financial data from its clients to create and automatically rebalance algorithm-driven investment portfolios appropriate to meeting the client's goals. In most cases, the investments are index mutual funds and ETFs.

Fees are low, often 0.2% to 0.5% of the account balance, and the required minimum investment is often in the $5,000 range, making the opportunity to invest available to a wider range of people. A robo-adviser typically offers several levels of potential interaction with a human adviser, with the cost depending on the level of access.

Standard & Poor's 500 Index (S&P 500)

The Standard & Poor's 500 Index, referred to as the S&P 500, tracks the performance of 500 widely held large-cap U.S. stocks in eleven sectors of the economy.

Target date funds

A target date fund is a fund of funds that allows you to invest in a portfolio with a set time horizon, such as your planned retirement date.

In fact, each target date fund characteristically has a date in its name, such as Fund 2025, Fund 2030, or Fund 2040. You choose one whose date is closest to the date you plan to retire.

A target date fund aiming at a date in the somewhat distant future tends to have a fairly aggressive asset allocation, with a focus on equity funds. As the target date approaches, the fund is reallocated to become more conservative to preserve the assets that have accumulated and provide income. The pace of that reallocation is known as the fund's glide path.

Tax-deferred retirement account

Tax-deferred means that any tax that may be due is postponed until a later date.

For example, a tax-deferred retirement savings account, such as a traditional 401(k) or 403(b), allows you to postpone income tax that would otherwise be due on employment income you contribute to the account and any earnings on those contributions until some future point.

Then tax is due on amounts you withdraw, at the same rate you pay on your regular income. The balance remaining in the account continues to be tax deferred.

A big advantage of tax deferral is that earnings may compound more quickly, since no money is being withdrawn. But in return for postponing taxes, you agree to limited access to your money before you reach 59½.

U.S. Treasury Bills

U.S. Treasury bills are the shortest-term government debt securities. They are issued with a maturity date of 4, 8, 13, 26, or 52 weeks. The par value is $100, as is the case with Treasury bonds and notes.

The interest a T-bill pays is the difference between the purchase price and par value, which is repaid at maturity.

T-bills are described as risk-free investments. Because they are backed by the full faith and credit of the U.S. government, they pose virtually no credit risk. And, because their terms are so short, they pose little or no inflation risk.

U.S. Treasury Bonds

U.S. Treasury bonds are long-term government debt securities with 20- or 30-year terms. These bonds, like other Treasury issues, are considered among the world's most secure investments since they are backed by the full faith and credit of the U.S. government.

U.S. Treasury Notes

U.S. Treasury notes are intermediate term debt issues, with terms of 2, 3, 5, 7, or 10 years. The yield on the 10-year note is the benchmark for other interest rates, including mortgage rates.

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