INVESTING FUNDAMENTALS

TIME VALUE OF MONEY

The concept of the Time Value of Money is that money available now is worth more than that same amount of money in the future because of its potential to earn interest. Let's say you have the choice between receiving a lump sum of $10,000 today versus receiving it 3 years from now. Because you could earn interest on that lump sum starting now, it will be worth more in 3 years after the interest is added than the same lump sum would be in the future. The bottom line? Invest your money as soon as possible!

HOW DOES YOUR MONEY GROW?

To invest is to expend money with the expectation of achieving a profit or material result. There are three elements or components that influence the growth of your money in an investment. They are your **input**, **the rate of return,** and the **length of time the investment works**. Which of these do you suppose has the greatest potential impact on its future growth?

This chart assumes a basic investment of $300 per month for 20 years with a 6% rate of return. Note: The chart does not consider fees, taxes, or other expenses.

	Input	Rate of Return	Time	Amount Saved
	$300/month	6%	20 years	$136,800
Change Input	**$600/month**	6%	20 years	$273,600
Change Rate of Return	$300/month	**12%**	20 years	$276,000
Change Time	$300/month	6%	**40 years**	**$575,100**

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What is most important?

If you invested $300 a month in this hypothetical account with a rate of return of 6%, how much would you have in 20 years? $136,800. What happens if you could double the input to $600 per month? You'd have $273,800, not surprisingly twice as much. Let's say you were lucky enough to find an account that would pay you double the rate of return at 12%. You'd have $276,000…a little over twice as much.

But what are the chances you can double the input or the rate of return? The input, maybe. The rate of return, not likely. You don't have much control over either of those. But what do you really have control over? You can control when you start investing! If you double the length of time that this investment works, you could have $575,100, over four times as much as the original investment.

With **compound interest**, when we put money in savings the account holder not only pays us interest on what we put in, but they pay us interest on what they put in too! As time goes by, the interest can really accumulate.

So, of the three factors—Input, rate of return, time—time is most important in the future growth of your money, i.e., the sooner you start investing, the greater the opportunity for growing your money. Consequently when is the best time to start investing? Right now!

SAVING VS. INVESTING

Sometimes the terms "saving" and "investing are used interchangeably, but they are different. The key difference is risk.

Savings are the part of consumer's disposable income that is not used for current consumption but is retained for future use and available when we need it.

Investing is the creation of wealth in such forms as growth in capital, interest, earnings, dividends, etc. Investing is intended to provide for financial security and to finance long-term goals, such as our children's college fund or retirement.

The biggest difference between saving and investing is the risk versus the reward. Saving generally allows you to earn a lower return but with little risk. Investing allows you to earn a higher return but with the possible risk of loss.

Savings is the first step in accumulating wealth. But savings by itself cannot cover the cost of future and long-term financial goals and needs because it only accumulates funds. To create wealth, savings must be put to work and into productive use. This is where investing comes into play.

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It is important to review your goals to determine whether saving or investing is best for you. However, engagement in both saving and investing is recommended for funding your financial goals and securing your financial future.

KEYS TO INVESTING

The concept of investing is pretty simple, but there are some basics a person needs to know:

- The strongest component for multiplying dollars is time, but it's on your side ONLY if you start as soon as possible.
- No investment is guaranteed or foolproof. You CAN lose money! As a general rule, the higher the potential return, the higher the risk. That's the risk/reward ratio, and you must understand your own risk tolerance. Just because you have time on your side does not mean that you can disregard risk, but it helps. Another thing that helps reduce risk is to diversify your holdings so that all your eggs aren't "all in one basket."

EQUITY INVESTMENTS

Where do we find higher rates of return and diversified portfolios (any combination of stocks, bonds and cash), and where can we invest for a long time? Equity investments are the key to reaching long-term goals.

Equities are shares of ownership in a company. Equity is just another word for stock. The terms "stock markets" and "equity markets" are often used interchangeably.

If you invest in equities, you will more likely realize greater gains than if you place your money in a traditional savings account or a fixed-return account.

Why is that? An equity investment is ownership, and ownership is the best way to stay ahead of inflation in the long run. It's the best way to make sure that your money is working for you. But ownership involves some risk. It is a matter of weighing the risk and the reward.

UNDERSTANDING THE STOCK MARKET

The stock market is made up of stock or security **exchanges**. A stock exchange or securities exchange, which can be a physical place or virtual, is an exchange where stockbrokers and traders can negotiate and buy and sell stocks, bonds, and other financial securities. The three primary stock markets or stock exchanges in the U.S. are the New York Stock Exchange (NYSE), the American Stock Exchange (AMEX), and the National Association of Securities Dealers Automatic Quotation System (NASDAQ), but there are fourteen others that also handle stocks.

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To raise money to grow their business, companies list shares of their stock on an exchange through a process called an initial public offering, or IPO. Investors buy and sell these stocks among themselves. The exchange tracks the supply and demand of each listed stock and with this information determines the price for each security.

Market Indexes
Investors use market indexes to gauge the performance of their portfolios and to help them make stock trading decisions. When you hear that the stock market is up or down, or closing up or down, the reference is to one of the major market indexes, such as the Dow Jones Industrial Average, the Nasdaq composite, or the S&P 500. Since it is difficult to track every single stock, a market index tracks the performance of a group of stocks, which either represents the market as a whole or a specific sector of the market, like technology or retail companies. The performance of this group of stocks is viewed as representative of the entire market. Consequently, when the comment is made that the stock market is up or down, it means that stock market indexes have moved up or down, and therefore the stocks within the index have either gained or lost value as a whole.

The composition of each market index varies. The Dow Jones Industrial Average (DJIA), also known as the "the Dow," is one of the most well-known and frequently used indexes, and includes stocks of 30 of the largest and most influential of U.S. companies. The S&P (Standard & Poor's) 500 includes stocks of 500 of the top United States companies. The Nasdaq is the stock exchange on which technology stocks are traded. The Nasdaq Composite Index, also called "the Nasdaq," is a measure of all stocks traded on that exchange, which include some non-technology companies and some companies not based in the U.S.

Bull Market vs. Bear Market
What is the difference between a bull market and a bear market? The market choses the bear as an indication of fear and something that we would not like to face. Consequently, when stock prices start dropping across all the market indexes, this is called a bear market. As a result, the trading of securities slows down and so does the economy. On the other hand, during a bull market, investors are confident and are trading, which means economic growth. Generally, the average bull market outlasts the average bear market. This means that in the long term you can grow your money by investing in stocks.

How Inflation Affects the Stock Market
Inflation is an increase in prices, which reduces consumer purchasing power and increases the cost of materials and labor. Ultimately, companies' earnings and growth will decrease. Since the price of stocks is proportional to a company's performance, stock prices will drop. The value of bonds will also be affected as a result of interest rate changes. The market value of a bond will fall for two reasons: 1) higher overall prices cause investors to worry that the return from the bond they own won't keep up with inflation, and 2) if the Fed raises interest rates to slow inflation, bond values fall because new higher-yield bonds become available.

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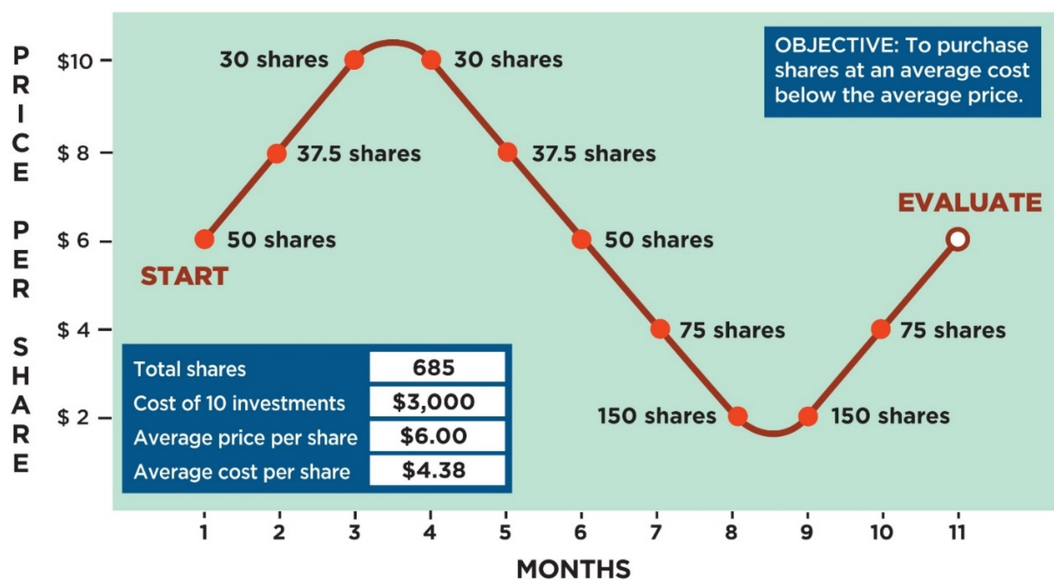
The Consumer Price Index (CPI) is the most common indicator of inflation. It constantly examines the cost of a “basket” of goods and services, such as transportation, food, and medical care. Changes in the CPI are an indicator of the effect of inflation on the economy.

DOLLAR COST AVERAGING

Dollar cost averaging is one strategy to minimize risk on a long-term investment; it is investing the same dollars regularly, regardless of the fluctuating price. It is a technique for buying shares at an average cost below the average price.

This chart illustrates how dollar cost averaging can work.



For example, let’s say we invest $300 a month for 10 months, and evaluate our progress in the 11th month. In this case, shares start at $6 each, go up to $10, down to $2, and back to $6. This up and down cycle is representative of one of many cycles we have seen in the stock market in past years. Our total investment is $3,000, and we purchased 685 shares over that time. At the 11th month our investment is worth (685 x $6) = $4,110.

The average price per share is $6, but what was our average cost per share? $6.00? No. $3,000 divided by 685 shares is $4.38 per share, not $6. What happened? We bought fewer shares as the price went up and more when the price was down. When is the best time to buy stocks? When they’re on sale! Can you predict when they go on sale? Usually not. If we could, we’d all be very rich and wouldn’t need this information.

Dollar cost averaging uses the fluctuations of the market and your discipline to accumulate shares at a lower cost than the average. This is a great strategy for the long-term investor.

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However, dollar cost averaging does not assure a profit and does not protect against a loss in a declining market. Since dollar cost averaging involves continuous investments in securities regardless of fluctuating price levels, investors should consider their financial ability to continue their purchases through periods of low price levels. Rates of return and investment performance cannot be predicted.

TRADITIONAL INVESTMENT OPTIONS

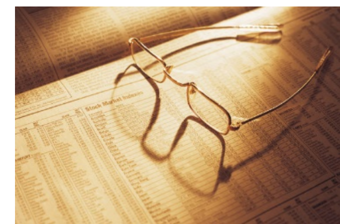
The most common investment options are bonds, stocks, and mutual funds.

Bonds

Bonds are debt securities, i.e., IOUs issued by corporations or governments. An investor loans money to an entity that needs funds for a defined period of time at a specified interest rate. In most cases bond issuers agree to repay the loans by a specific date (date of maturity) and to make regular (usually annual or semiannual) interest payments to the investors until that date.

If you hold the bond until it matures, you'll get back all the money you paid for it, unless the issuer defaults. Bonds have different maturity periods. They can be short (less than 5 years), intermediate (5-10 years), or long term (more than 10 years).

However, a bond's market value is directly related to interest rates. As interest rates go up, the market prices of bonds go down and vice versa. Until a bond matures, its price on the secondary market constantly changes in response to changes in interest rates.



The gain on bonds issued by governmental entities often is exempt from income taxes, which can make them attractive for those who need a steady tax-qualified income supplement, like retirees.

The most common types of bonds are:

- Corporate bond—a bond issued by a corporation
- Municipal bond—a bond issued by state, city, or local government to finance operations or special projects. Generally, the interest earned is tax free.
- Treasury bond—a bond issued by the U.S. government, considered a safe investment because it is backed by the taxing authority of the U.S. government. Terms are for twenty to thirty years.
- Treasury note—same as treasury bond except that the note is issued for a shorter time period. It is typically issued in maturities of from one to ten years.
- Treasury bill—another instrument issued by the U.S. government. Maturities range from a few days to one year.
- U.S. Savings Bond—government-issued and -backed debt instruments that make periodic interest payments. Series EE and Series I bonds are zero coupon bonds (defined below).

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Series H/HH bond provide payments as current income. Series E and H/HH bonds are no longer issued but are still in circulation.
- Zero coupon bond—bond with no periodic interest payments. Investors receives one payment, which includes principal and interest, at maturity.

Factors to consider before buying bonds include:

- Issuer—Bonds are issued by the U.S. Treasury and other U.S. government agencies, state or local governments, and corporations. The issuer influences the credit risk (defined below) which, in turn, affects the price.
- Maturity—The date when the issuer agrees to repay the principal (face value) of the loan. The longer it takes the bond to mature, the more it will fluctuate with changes in interest rates. Short-term is more predictable and less risky than long-term.
- Credit Quality—A bond's quality is measured by the issuer's ability to pay interest and repay principal in a timely manner. Treasury bonds have the highest credit quality, and corporate high-yield ("junk") bonds have the lowest credit quality.
  - Call Risk-Occurs when an issuer opts to pay off some or all of its bonds before the maturity date, forcing the investor to find a new source of income in a lower interest rate environment. Not all bonds are callable.
  - Credit Risk-Occurs when an issuer defaults (fails to pay principal and/or interest) on the bond.
  - Interest Rate Risk-Rising interest rates will reduce the value of a bond. This applies if the investor plans to sell before maturity.

There are advantages and disadvantages to buying bonds.
- Advantages:
  - Bond prices tend to be more predictable than those of other investment securities.
  - Bonds provide a more reliable source of fixed income for a defined period of time. They generally offer higher income than cash investments, such as money market funds, CDs, etc., and they generally produce more income than stocks because stocks tend to focus more on capital appreciation than income generation.
  - Having bonds in your portfolio provides diversification, which reduces overall volatility.
  - Income from some bonds is tax exempt.
- Disadvantages:
  - Some bond risk comes from interest rate changes. Interest rates and bond prices move in opposite directions. When interest rates rise, bond prices fall; when interest rates fall, bond prices rise. For example, if you buy a $10,000 bond with a coupon (return) rate of 6% and interest rates rise, the issuer may offer a new bond with a 7% coupon rate. Since this means someone can earn more interest by purchasing the new bond, the value of the original bond is reduced. If you want to sell your bond, you would have to discount the price to make up for its lower interest rate. On the other hand, if interest rates rise a new bond may offer only a 5% coupon rate. If that happens, the original bond becomes more valuable and is said to be trading at a premium.

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- During periods of falling interest rates, issuers may call their loans (bonds) before maturity so they can reissue them at a lower rate. The investor must reinvest the principal sooner than planned, possibly at a lower interest rate.
- Investors can lose money if the bond issuer defaults.
- The value of the interest income can be eroded by inflation.
- Mergers, leveraged buyouts, and other corporate restructuring can adversely affect credit quality or market value of a bond.

Stocks

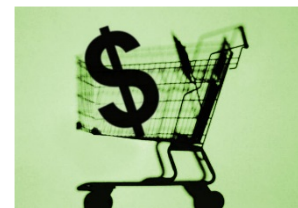
Stock represents ownership in a company. There are two types of stock: common and preferred. Common stock owners elect a board of directors, which hires the day-to-day managers of the business. Owners vote on issues at the stockholders' meetings. The board of directors determine what is done with any profits.

Preferred stock owners are paid before any dividends are paid to common stockholders. Like common stock, preferred stocks represent ownership in a company, although preferred stock shareholders do not enjoy any of the voting rights of common stockholders. Also unlike common stock, preferred stock pays a fixed dividend that does not fluctuate, although the company does not have to pay this dividend if it lacks the financial ability to do so.

As with bonds, there are advantages and disadvantages to buying stocks.

- Advantages:
  - Stocks have higher potential growth, thus higher potential reward, than a cash investment such as a CD, money market account, or a fixed investment like a bond. This is because the investor is willing to assume some of the risk of ownership in a company.
  - Historically, the long-term capital growth of stocks has outplaced the interest paid on fixed investments.
- Disadvantages:
  - Stocks have higher risk than fixed investments, some of which are backed by the FDIC, or even government bonds, which pay a known rate of return and are backed by the full faith and trust of the government.
  - A single stock investment is especially risky because it lacks diversification, which is the strategy of investing in a variety of assets expected to react differently to changes in market conditions.

Mutual Funds



A mutual fund is a regulated investment company, run by a manager or team of managers, that pools money from many investors and buys and sells stocks, bonds, cash (fixed savings), or a combination to achieve a stated investment objective, which is found in its prospectus. A prospectus is a document that advertises or describes a commercial enterprise, in this case the fund offering.

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The usual investment objectives are:

- Aggressive Growth—These primarily stock funds invest in higher-risk investments that offer potential for higher returns. The goal is rapid growth of capital. These funds often invest in small or emerging companies that may see rapid growth.
- Growth—The goal is increasing capital. Income for the present is not considered, nor is it seen as a secondary consideration. Growth companies are usually more mature and have established a strong, even dominant, market position in their industry.
- Growth and Income—These funds pursue both increase in capital and current income. Growth potential and the ability to pay dividends are both factors used in selecting investments for this objective.
- Balanced—These funds invest in a combination of stocks and bonds. The allocation percentages are usually fixed, and these funds generally have at least 25% of their assets in fixed-income securities. They seek both income and capital growth.
- Income—Funds with this objective exclusively seek income from interest and dividends generated by their investments in fixed-income securities, like bonds, bills, or cash.

Mutual funds are generally categorized by size, investing style, and market.
A fund's prospectus will include information about all three.
Size—These definitions are a frame of reference; they may vary from one mutual fund tracking service to another.

- Small-cap stocks are typically defined as those of companies whose market capitalization (company value) is less than $1 billion.
- Mid-cap stock companies have market capitalization between $1 billion and $10 billion.
- Large-cap companies are those with over $10 billion market capitalization.

Investing Style—The two main investing styles are growth and value, which can rotate in and out of favor.

- Growth investing is a strategy of buying stock with increasing earnings with the hope that the earnings will drive the stock prices higher. Growth stocks are usually more volatile than value stocks but have delivered similar returns over the past 20 years.
- Value investing is the strategy of buying stock at a price below what the investor thinks it is actually worth, with the expectation that the price will go up and the investor will sell at a profit.

Market—A mutual fund may be classified according to where the majority of its assets are invested. Many funds have holdings from multiple markets. Classification is based on where most of the fund's assets are registered.

- Domestic, which includes stocks or other securities registered in the United States.
- Foreign, which include securities registered outside the U.S.

Evaluating a Mutual Fund

Mutual fund **value** is determined at the end of each trading day by calculating net assets. Net assets are divided by the number of shares outstanding to determine the net asset value (NAV) per share, which is announced every business day. The NAV is the price investors would get if

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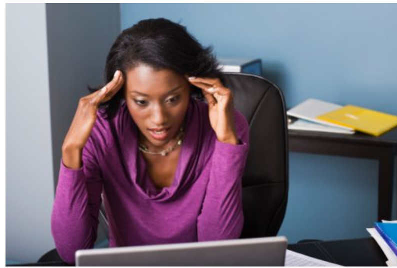
they sold shares that day. The offering price in the paper may be the same or higher, depending on sales charges.

Performance is measured by calculating the gain or loss in net asset value from the start of the measurement period to the end of the period. **It is important to remember that a fund's past performance is NEVER a good predictor of its future performance.** There are too many variables that can affect future performance. However, you can get a feel for how the fund has historically reacted to various ups and downs in the market.



Mutual fund **distributions** include capital gains and income dividends, which may be taken in cash or reinvested in additional shares. Capital gains distributions are the prorated share of net gains realized by the fund on securities sold that year. Income dividend distributions are the prorated share of interest and dividends earned on securities in the portfolio after expenses have been deducted. At the end of January each year, shareholders of non-tax-qualified accounts receive various statements from the mutual fund company that report fund earnings paid as distributions during the previous year.

Mutual funds also have advantages and disadvantages.

- Advantages:
  - Because mutual funds hold many stocks, bonds, and cash vehicles in their portfolios, they provide immediate diversification and asset allocation (described below).
  - Mutual funds can use their size to advantage to buy and sell holdings at lower costs than the average investor.
  - Mutual funds can be sold at NAV on any day the markets are open.
  - Professional managers select and monitor the securities so investors don't have to.
  - Buying a mutual fund is easy, and the minimum investment is small, sometimes as low as $50 a month. Also, mutual funds are highly regulated to protect investors from fraud.
- Disadvantages:
  - Mutual fund returns are not guaranteed or insured, and do not protect against loss in a down market.
  - Because they require professional managers, there are fees involved in investing in mutual funds.
  - Mutual funds typically have some "cash" in their portfolio, depending on their investing style, to allow them to meet withdrawal requests and retain flexibility in investing. Cash is not working as hard as money actually invested.
  - It's possible to have too much diversification by investing in too many mutual funds with similar investment objectives. Also, because funds have relatively small holdings in many stocks, a high return from a particular stock may have a disproportionate effect on the fund's return.
  - Fund managers do not consider your personal tax situation when making decisions about fund activities.

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- Market risk—the risk that the market can lose value, (also known as systematic risk)—can be caused by many things: politics, natural disasters, war, terrorist attacks, etc. While diversification can reduce the impact of a single company's failure, it does not eliminate the risk that stock or bond markets will go down in value over time.
- Non-systematic risk normally affects only one company or sector of the market. Diversification helps here too.
- Interest rates directly affect bond performance, therefore mutual funds heavily invested in bonds will be affected by changes in interest rates.

An **Index Fund** is a particular type of mutual fund that emulates a financial market index such as the Standard & Poor's (S&P) 500, the Nasdaq Composite, or others. It can allow a person to invest in a portfolio similar to a market index, usually at a relatively low cost. Because they are constructed to match an index, they do not require much management; in fact the stocks are not actively traded to meet a particular investment objective other than to follow the index.

Some advocates say they can outperform actively-managed funds because of their lower cost. On the other hand, they can never "beat" the market index they are based on, and because of their fees will always trail its performance.

Exchange Traded Funds (ETFs) are also constructed and managed to emulate a particular market index, but they can be bought and sold throughout the day like a stock, while an Index Fund can only be bought and sold at the end of the day at the established daily price.

INVESTMENT DECISION FACTORS

Before you start investing, you need an investment strategy. Do you need income today, or are you looking for financial growth to fund your future retirement? As we saw, different investment vehicles are better at some things than others, so you need to know why you're investing before you put money into it.

How do you feel about risk? Are you a risk taker, or a risk avoider, or somewhere in the middle? There are investments to meet all needs. Remember though that the longer your time frame before you need the money, the more aggressive you can (and may have to) be. You can download a no-cost *Investment Risk Comfort Level* worksheet from the FCEF website at https://www.fcef.com/wp-content/uploads/Investment-Risk-Comfort-Level.pdf to help you determine your comfort level. This worksheet is a pdf and therefore the website does not store any of your personal information.

When you've answered the above questions, you can better decide on your investment strategy. Investment strategy is a set of rules or procedures used to guide the makeup of an investment portfolio. There are several investment strategies, including investing for income, growth, preservation of capital, tax avoidance, and others. Your investment strategy may be

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influenced by many factors, including your goals, your age, your investment experience, your family responsibilities, your education, your annual income, and your risk tolerance.

Those who are retiring soon will likely focus on an investment strategy of generating current income, so they may want to concentrate on bonds and stocks that pay reliable dividends. Those who have many years before they need their investments can concentrate on growth, so they may want to buy stocks in companies expected to grow over the years. Some investors seek preservation of capital, which attempts to protect the money they have by investing in insured or fixed-income investments such as Treasury securities, high-yield savings accounts, money market accounts, or certificates of deposit that promise to return the principal. However, while this may sound like a smart strategy, over time the constant avoidance of investment risk will probably lead to returns that may not keep up with inflation.

ASSET ALLOCATION

We have all heard the adage, "never put all your eggs in one basket." In the investment industry this phrase applies because to minimize the impact of any one security in their portfolios, investors should spread their investments among different categories (also known as asset classes). This strategy is commonly known as **diversification.**

Asset allocation is an investment technique that aims to balance risk and create diversification by dividing investments among major categories, such as cash, bonds, stocks, real estate, and derivatives. The theory is that each asset class will perform differently over time and in different market conditions, and by investing in different asset classes investors can minimize a major loss should things ever go amiss in a particular investment class. Asset allocation's purpose is to balance risk and reward by apportioning an individual's portfolio assets according to their goals, risk tolerance, and investment horizon.

Some financial advisors recommend subtracting an investor's age from 100 to determine how much should be invested in stocks. For example, a 40-year old would be 60% invested in stocks. Variations of the rule recommend subtracting age from 110 or 120 given that the average life expectancy continues to grow. As individuals approach retirement age, portfolios should generally move to a more conservative asset allocation to help protect assets that have already been accumulated.

Asset Classes

The three main asset classes are equities, fixed-income, and cash and equivalents. They each have different levels of risk and return and perform differently over time. Cash is the most conservative; it barely keeps up with inflation. Bonds, as we saw earlier, are primarily for those who need an income stream, and their advantages and disadvantages depend on the issuer

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and type of bond. We know that stocks are a bit more aggressive, depending on their investing style and market, and are better for longer-term investments. Real estate, foreign currency, natural resources, and precious metals investments are the most aggressive of all because much of their appeal is to speculators, not true investors.

Asset Allocation Mutual Funds
Asset allocation mutual funds are diversified mutual funds that invest in a mix of asset classes, such as stocks, bonds, and cash. The balance of assets remains relatively fixed and are meant to achieve a certain financial goal. These funds allocate a specific amount to various asset classes depending on the fund's target goal. The funds usually allow for some deviation from the stated target allocations but will regularly rebalance back to the target allocation basis, such as monthly or quarterly. Asset allocation mutual funds are an easy way for an investor to gain access to a well-diversified portfolio. An example of asset allocation mutual funds are the funds found in some retirement savings plans, like the target date funds in a 401(k) plan or the Thrift Savings Plan lifecycle funds used in the military's Blended Retirement System.

RISK VS. RETURN
The risk/return tradeoff is the core of asset allocation. To maximize return and minimize risk, you need to know the risk/return characteristics of the various asset classes. The chart shown compares the risk and potential return of some of the more popular asset classes.

Stock equities have higher potential return, but also higher risk. Government treasury instruments have lower risk since they are backed by the government, but they also provide lower potential return.

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It is due to the risk/return tradeoff that diversification through asset allocation is so important to minimize losses. Since different asset classes have different risks and experience different market fluctuations, proper asset allocation protects your investment portfolio from the ups and downs of one single class of securities. While part of your portfolio may contain more volatile securities, other assets may remain stable.

ASSET ALLOCATION PORTFOLIOS

To make the asset allocation processes easier for clients, many investment companies offer model portfolios that consist of different proportions of asset classes. Each portfolio of different proportions satisfies a particular level of investor risk tolerance and investment goals. The portfolios usually range from conservative to very aggressive. The chart shown reflects where these portfolios may fall in terms of risk (low to high).

Conservative	Allocates large percentage of portfolio to lower-risk securities such as fixed income and money market securities. Primary goal is to protect assets.
Moderately conservative	Asset composition is divided almost equally between fixed-income securities and equities. Goal is to provide a balance of growth and income.
Moderately aggressive	Higher level of risk than conservative portfolio. Used with a longer time horizon and medium level of risk tolerance.
Aggressive	Mainly consists of equities. Primary goal is long-term growth of capital.
Very aggressive	Consists almost entirely of equities. Primary goal is capital growth over a long time horizon. For those with high risk tolerance.

The next chart provides sample portfolio asset allocations for the previously mentioned risk levels and the percentages of each asset class the portfolios might hold. You can see that more conservative portfolios contain more fixed income securities and cash than the more aggressive portfolios, which contain more equities.

Type of Portfolio	% Fixed-income securities	% Equities	% Cash
Conservative	70%-75%	15%-20%	5%-15%
Moderately conservative	55%-60%	35%-40%	5%-10%
Moderately aggressive	35%-40%	50%-65%	5%-10%
Aggressive	20%-25%	65%-70%	5%-10%
Very aggressive	0%-10%	80%-100%	0%-1%

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SELECTING AN ASSET ALLOCATION STRATEGY

You need to build your investment portfolio for your current financial situation, your investment goals, and your risk tolerance. For example, the amount of cash and short-term investments in your portfolio will depend on the amount of liquidity and safety you need. If you do not have liquidity concerns and have a higher risk tolerance, you will want a smaller portion of cash and short-term investments and more with higher risk and longer time frames. Clarify your current situation and your future needs for capital, as well as your risk tolerance, to determine how your investments should be allocated among the different asset classes.

REBALANCING YOUR PORTFOLIO

Investment companies occasionally rebalance their portfolios to ensure they meet their intended needs. As investment instruments change in response to the market, or as new ones are created, investment companies sell those that no longer meet their needs and buy others to take their place. Rebalancing an asset allocation portfolio will restore the portfolio to its target allocations, keep risk in check by limiting exposure to each asset type, provide a disciplined process of selling high to buy low, and can be based on the calendar and/or tolerance thresholds.

You will want to maintain the most effective risk/return ratio in your portfolio. For the same reasons that an investment company will rebalance its portfolios, you should monitor and periodically rebalance your own. If one asset class in a portfolio has gone up in value while another has gone down, the proportion of that class may be higher than the desired level. Investors should periodically (usually quarterly) evaluate the progress of their portfolio and make necessary modifications. An investor's risk tolerance usually decreases when the time horizon in which to make up losses decreases. Make sure you don't jeopardize your retirement by becoming too conservative.

RULE OF 72

A useful tool in evaluating your investments is the **Rule of 72**. This allows you to estimate how long it would take to double your money, given a particular rate of return, or to estimate what rate of return would be required to double your money in a particular time period.

For example, let's say you invest $10,000 and want to see how long it would take to become $20,000 at 6% rate of return. To do so you divide the number 72 by 6. The result is your money would double in 12 years.

Using this rule a different way, if you need your $10,000 to double in 9 years, what rate of return would you need? If you divide 72 by 9, you will discover that you would need an 8% rate of return.

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SUMMARY

Investing can look complex, but don't be afraid of it. if you want to get ahead in your finances, you must invest. If you need assistance, ensure you consult a qualified financial professional.

Remember that:

- Different investment vehicles play different roles in an investment portfolio
- Dollar cost averaging can allow investors to buy shares at a discount
- Asset allocation reduces risk by combining investments with low return correlations
- Asset allocation encourages disciplined investing
- Rebalancing maintains target asset allocation over time
- You can lose money in an investment
- The best time to invest is…RIGHT NOW!

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