Module 4

INVESTMENTS AND AVOIDING "THE BIG MISTAKE"

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Introduction

- So far, we have discussed what is important to you, organizing your finances, and creating actionable goals
- Now, we shift our focus from the "what?" to the "how?"
- How can we use various investment vehicles to help achieve our goals?

Module Outline

- Section 4.1: The Big Mistake
- Section 4.2: The Market
- Section 4.3: Stocks, Bond, Mutual Funds and ETFs
- Section 4.4: Greedy When Others are Fearful

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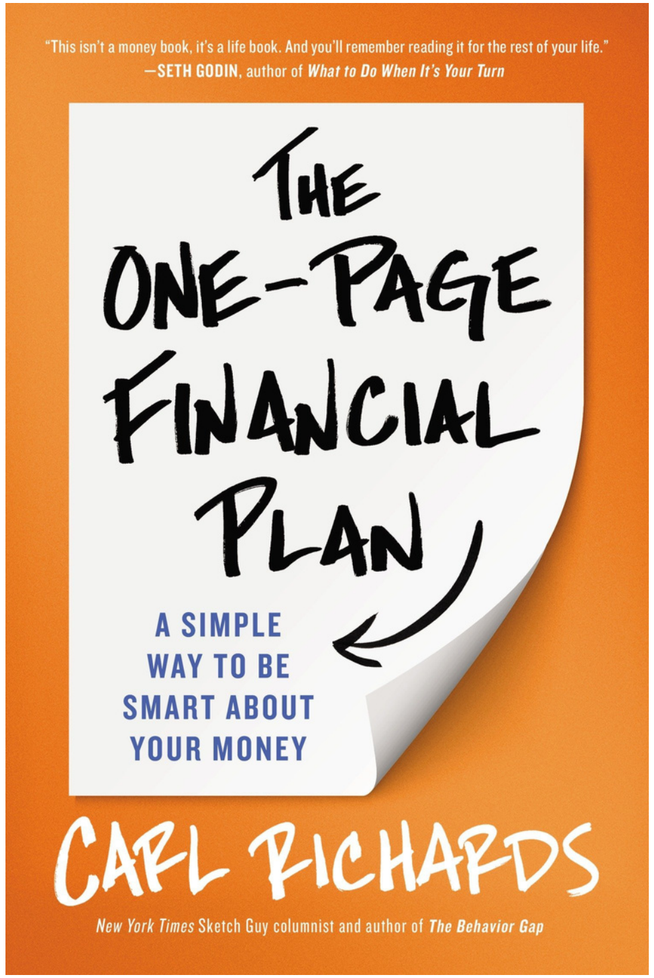
Let's get started!

Section 4.1

The Big Mistake

- Coined by Carl Richards in his book, "The One-Page Financial Plan"
- Buying when the market is at a high and selling when the market is low
- Likely the biggest mistake that you can make as an investor



Section 4.1

The Big Mistake

- What causes The Big Mistake?
- Emotional investing and lack of a clear plan
- Attempting to "time" the market
- Neglecting to think about your investments as an asset

Section 4.1

The Big Mistake

Purchase Price: $250,000
Selling Price: $300,000

Net Gain: $50,000

- Consider buying a home
- The value of your home fluctuates over time
- This is heavily effected by the overall housing market
- A homeowner with positive equity would be in a good position to sell their home at a profit

Section 4.1

The Big Mistake

Purchase Price: $250,000
Selling Price: $190,000

Net Loss: ($40,000)

- Consider a situation in which your home is worth less in the current market than what you originally paid for it
- Obviously, it would not likely make financial sense to sell your home in this situation
- Despite your fears about the market, you would be very unlikely to sell your home

Section 4.1

The Big Mistake

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Bottom line:

Treat your long-term investments
as you would your home

Section 4.1

The Big Mistake

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How do I avoid "The Big Mistake?"

- Use what you've learned so far in this course to create a plan that matches your goals and adheres to your "Why"
- Time *in* the market, not *timing* the market
- Avoid emotional decision making

Section 4.2

The Market

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- What do we mean when we talk about, "the market"?
- What is a market index?
- Are the market and the various indexes relevant to my investments?

Section 4.2

The Market

- In regards to your investments, "the market" generally refers to two key stock exchanges
- New York Stock Exchange
- Nasdaq

Section 4.2

The Market

- The exchanges act as a primary marketplace for buying and selling stocks, bonds, commodities, etc.
- When a company decides to issue stock, they will often list on one of the exchanges as an "initial public offering" or IPO
- Stocks can also be bought and sold outside of the exchanges but this is where all of the action begins

Section 4.2

The Market

- In general, stock market indexes display the current prices of the stocks that they track in real time
- Different indexes track different stocks
- The three most followed indexes are the S&P 500, Dow Jones Industrial Average, and the Nasdaq Composite

Section 4.2

The Market

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- Whether or not an index is relevant to you depends entirely on what you are invested in
- For example, if you own predominately large U.S. companies, then the S&P 500 may be a good benchmark to compare yourself to
- While the indexes can provide you with an idea of how the economy, and therefore your investments, are doing, you should rely on your own plan and investment strategy for guidance

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Stocks, Bonds, Mutual Funds, and ETFs

- What exactly is a stock?
- Simply put, a stock is a small ownership stake in a large corporation
- These small pieces of large companies are called, "shares"
- Price for a share of a company fluctuates daily depending on demand for that company's stock

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Stocks, Bonds, Mutual Funds, and ETFs

- Why do companies issue stock?
- In order for a large business to grow, they need capital or they need to "spend money to make money"
- There are two ways to do this:
  - Take out debt
  - Sell stock

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Stocks, Bonds, Mutual Funds, and ETFs

Benefits of Issuing Stock

Pro's	Con's
• Obtain the capital necessary for growth • Avoid taking on additional debt • Further raise awareness for your company	• Dilutes your ownership • Risk of losing control of the business • Beholden to your shareholders and subject to annual shareholder meetings • Increased scutiny by the authorites, general public, and financial regulators alike

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Stocks, Bonds, Mutual Funds, and ETFs

Benefits of Owning Stock

Pro's	Con's
• The opportunity to participate in the growth of the company • The right to make your voice heard at shareholder meetings • Potential to receive dividends depending on the company	• You also participate in the company's losses • Risk of the company going bankrupt and your shares becoming worthless • Exposure to economic, legislative, and business risk

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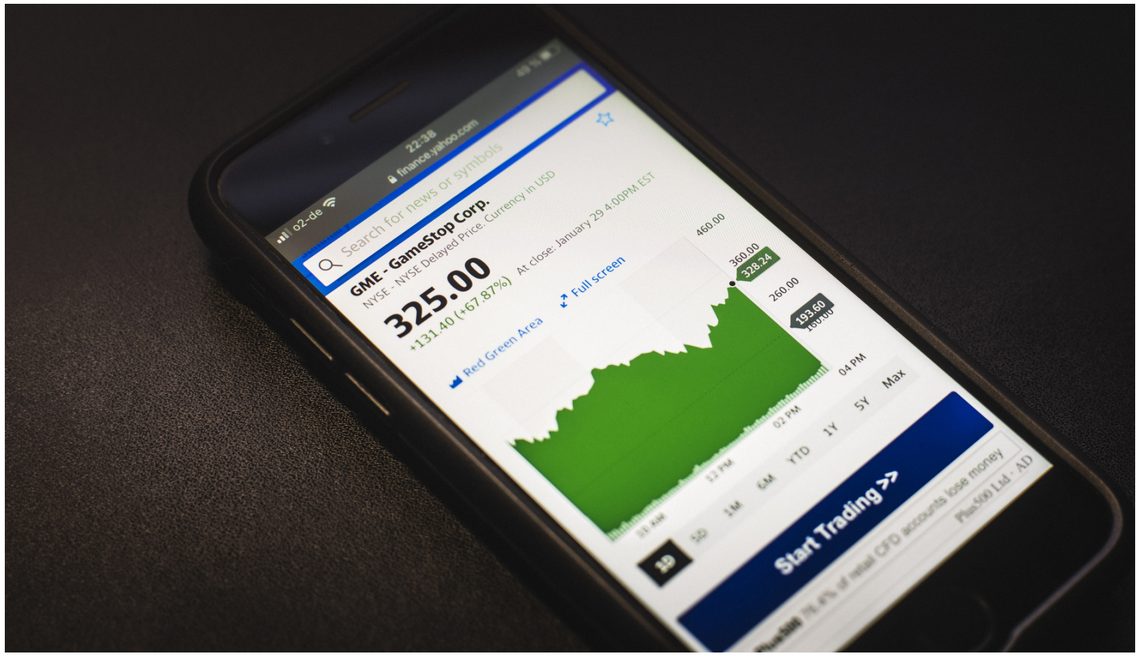
Stocks, Bonds, Mutual Funds, and ETFs



- Where can I buy stock?
- Individual shareholders trade their shares in the "secondary" market
- Third party trading platforms offer trading services online
- Financial professionals can help you research and make trades

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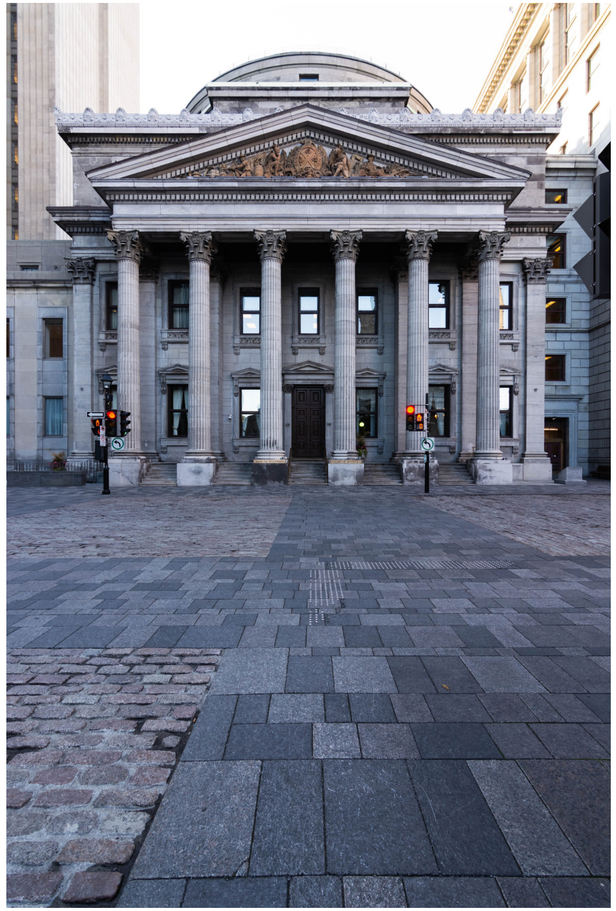
Stocks, Bonds, Mutual Funds, and ETFs

- What is a bond?
- The second way in which companies raise capital is by issuing bonds
- Essentially, this is when a company borrows money to fund their endeavours
- The Federal, state, and local government also issues bonds for various purposes



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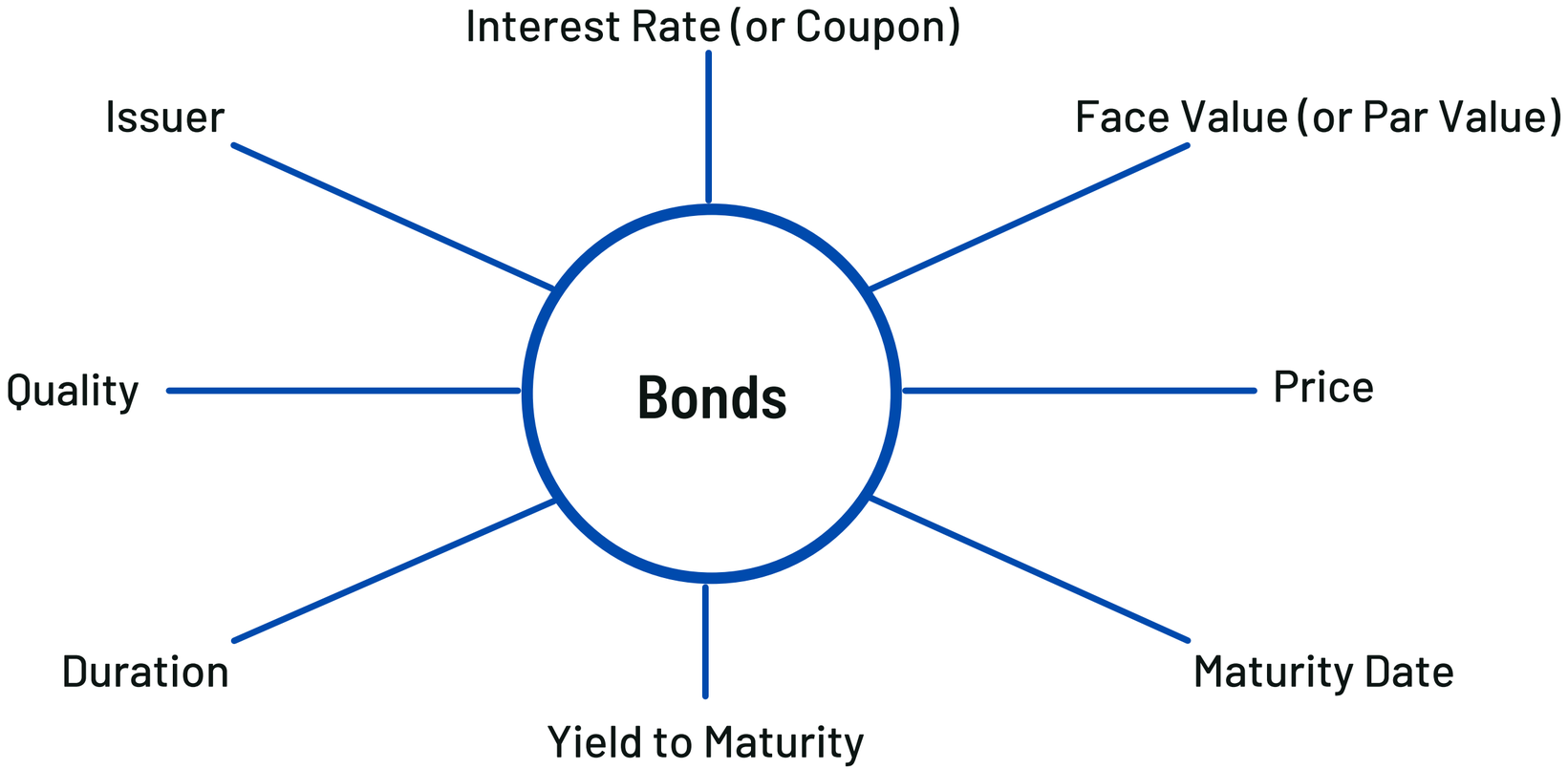
Stocks, Bonds, Mutual Funds, and ETFs



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Stocks, Bonds, Mutual Funds, and ETFs

	Corporate	Government
Financial backing?	The issuing corporation	Full faith and credit of the United States government
Taxes?	Interest is taxed as ordinary income	Interest may be tax free
Types?	Debentures, Convertibles, High Yield	General Obligation, Municipal Bonds, Treasury Securities

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Stocks, Bonds, Mutual Funds, and ETFs

- Stocks represent an ownership stake in a company
- Bonds represent your right to receive interest as a result of a loan
- Stocks and bonds enjoy an inverse relationship in regards to market volatility

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Stocks, Bonds, Mutual Funds, and ETFs

- What are mutual funds and ETFs?
- Both are similar in that they are diversified portfolios managed by professional investment managers
- They are also similar in that each fund has a stated investment objective
- They differ in how they are traded, how they are managed, and how much they cost the investor

Section 4.3

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Stocks, Bonds, Mutual Funds, and ETFs

- A mutual fund is a pool of money collected from numerous investors, to invest in stocks, bonds, and other assets
- Managed by professional managers with stated investment objectives
- Shares are NOT traded on the open market. They are bought and redeemed directly with the fund company
- Management expenses depend on the share class

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Stocks, Bonds, Mutual Funds, and ETFs

- Share classes include:
  - A Shares
    - Up-front sales charge and a ongoing management fee that is less than C shares
  - C Shares
    - No up-front sales charge but a larger ongoing fee for management of the fund
    - Also have a back-end fee should you decide to sell your shares within a year of purchase
  - I, F, R, Adv, etc.
    - No sales charge and lower ongoing expenses
    - Used primarily by corporate retirement plans and financial advisors

Section 4.3

Stocks, Bonds, Mutual Funds, and ETFs

- ETF stands for Exchange Traded Fund
- Like mutual funds, they manage diversified portfolios of investment assets for various objectives
- Unlike mutual funds, they ARE traded on the open market
- Buying shares in a company vs. buying shares in a portfolio

Section 4.3

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Stocks, Bonds, Mutual Funds, and ETFs

	Mutual Funds	ETFs
Management	**Predominately Active**	**Predominately Passive**
Expenses	**Depend on share class but can range from 0.5% to 5.75%**	**Much lower expenses sometimes reaching 0.25% or less**
History	**Mutual funds have been around longer and thus have longer track records**	**ETFs are newer to the scene and thus have shorter performance history**
Purchase	**Purchased and redeemed with the fund company. Trades placed are effected at the end of the trading day**	**Shares are bought and sold in the market in real time. Purchases and sales are made immediately**

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Stocks, Bonds, Mutual Funds, and ETFs

- Active Management vs Passive Management
- Active management involves the judgement and decision making of an investment professional to make prudent changes to a fund
- Passive management or index investing is the act of purchasing every company in an index with the intent to "buy and hold"
- Passive management is utilized primarily by ETFs

Section 4.4

Greedy When Others are Fearful

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"Be fearful when others are greedy and greedy when others are fearful"

- Warren Buffett

Section 4.4

Greedy When Others are Fearful

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- Don't get swept up in irrational exuberance
- Don't panic when the world is panicking
- Do stick to your plan and make investment decisions based on sound decisions not emotion!!!

Section 4.4

Greedy When Others are Fearful

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3 Questions

1. Why am I considering this decision?
2. Does this decision agree with my financial plan?
3. What effects could this decision have on my future finances?

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Conclusion

- By this point, you should have a better understanding of the financial markets and the common types of investments that you are most likely to come across.
- You should also be able to define the “Big Mistake” and understand the importance of avoiding it
- You are now ready to move on to the next module, “Types of Investment Accounts”

Congratulations on Completing Module 4!

Disclosures

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