Financial Empowerment for Women
Fitness ✦✦Foundation ✦✦Fluency

presented for

The Christopher Wren Society

by

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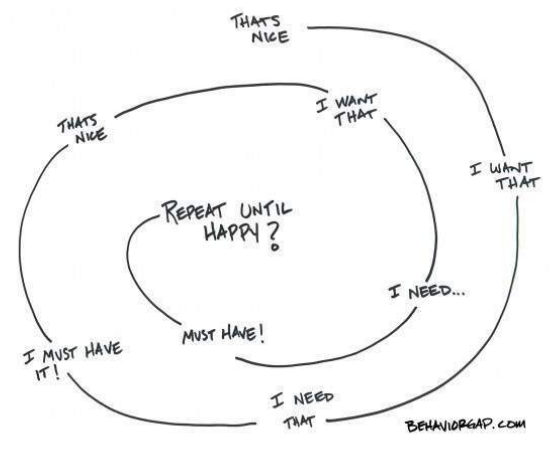
Recap From Last Week

- Sherri
  - Fitness
  - Financial Archetypes



- Ben
  - What is Money?
  - Income Statement / Balance Sheet
  - Risk / Reward

- Questions?

Homework Assignment

- How’d it go?

- Budgeting is like a…

Investing 101 – The Five Things

- Cash
- Real Estate
- Commodities
- Stocks
- Bonds

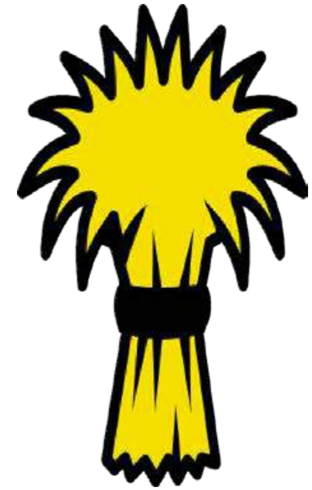
Cash

- What is it?
  - Checking/savings
  - Cash in wallet
  - Certificates of Deposit
- Why is it good?
  - Safe, FDIC insured
  - Liquid
  - Quickly accessible
  - Universally accepted
- Risks
  - Inflation

Real Estate

- What is it?
  - House, rental property
- Why is it good?
  - You can live in it
  - You can improve it to make it worth more
  - Other people can live in it and pay you
- Risks
  - Disaster
  - Market
  - Liquidity

Commodities



- What is it?
  - Oil, corn, wheat, coffeebeans
- Why is it good?
  - Stuff you consume
  - Typically keeps pace with inflation
  - Prices don’t fluctuate with the market
- Risks
  - Disaster
  - Currency
  - Geopolitical

Stocks

- What is it?
  - Ownership (equity) of a company
- Why is it good?
  - S&P 500 is the best place you could have invested over the last 100 years
  - Traded all day – very liquid
- Risks
  - Headline risk
  - Market risk
    - Systematic
    - Nonsystematic

Components of a Stock

- Price – How much does one share *cost?*
  - NOT necessarily what one share is *worth*
  - Disagreement over true "value" creates market
- Dividend
  - Cash paid to shareholders for owning shares
- Underlying financial data
  - Earnings (profits)
  - Revenues (sales)
- Price-to-Earnings ratio (price divided by earnings/profit per share)
  - Current stock price / earnings per share
  - Oranges-to-oranges comparison tool
  - Market average = about 20
- Other ratios
  - Price-to-sales (price, divided by revenue instead of profit)
    - <1 = potentially good value
  - Price-to-book (price, divided by assets minus liabilities)
    - Value investors look for P/B <1
  - PEG (PE, divided by annual earnings growth rate)
    - 1 = "fair"
    - What growth rate? 5-year expected? Next 12 months expected? Historical average?
- Beta
  - How similar is stock fluctuation to entire market fluctuation?

Type of Stock	Preferred Stock	Common Stock	Live Stock
Capital Structure?	After bonds, before common stock	Dead last	Moo
Dividend?	Higher, paid first	Lower, paid after preferred	Baah
Volatility?	Somewhat less	Greater	Oink

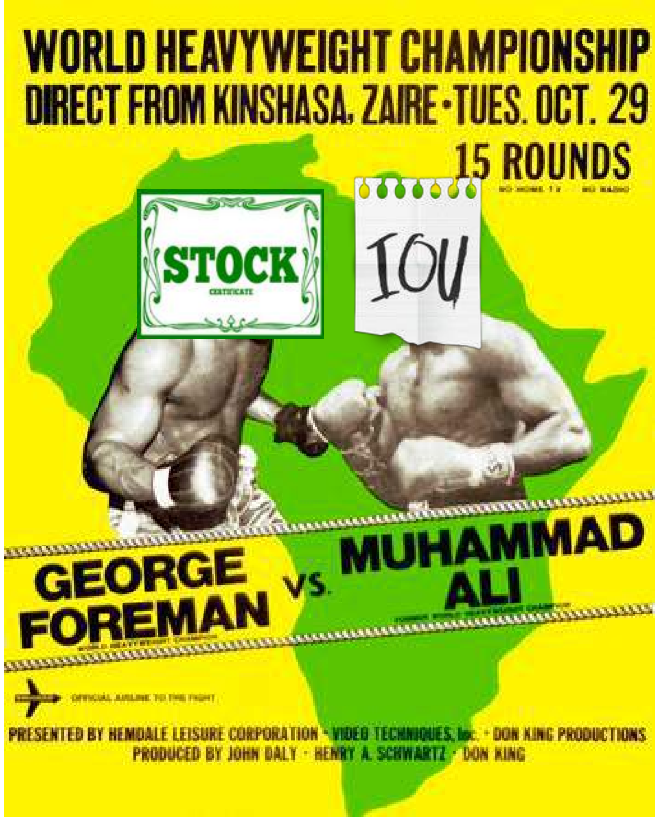
Bonds

- What is it?
  - Debt, either from a person, corporation, or government
- Why is it good?
  - Tend to be safe
  - Return of principal at maturity
  - Regular interest payments
- Risks
  - Credit risk / default risk
  - Interest rate risk

Components of a Bond

- Par value
  - $1,000
- Interest rate, or coupon
  - Total annual income you receive
- Current price
  - As it trades on the market
  - Fluctuates with prevailing interest rates…see-saw
- Yield
  - Coupon / current price
- Credit Rating
  - How likely will they default?
- Features
  - Call, sinking fund, balloon

Stocks vs. Bonds



- Bonds provide:
  - Ownership of debt in a company
  - Regular payments of interest for a fixed term
  - Return of principal at end of loan term
  - NO upside if company does well
- Stocks provide:
  - Ownership in a company
  - No guarantee that principal will be returned
  - Unlimited upside if company does well

Stocks tend to be riskier than bonds. Investors need to be compensated for this risk. Over the long-term, stocks tend to provide higher returns than bonds.

Alternative Strategies?

- Hedge Funds
  - Short-selling
  - Arbitrage
- Managed Futures
  - Commodities
- Currency
  - Exchange rates
- Private Equity
  - Securities not traded on the open market

BREAK!

IS NOW OVER

Taxing Matters

Taxing Matters

- Income Tax
  - Stocks = Dividends
  - Bonds = Interest
  - Added to other taxable income (Social Security, Pension, etc.)
  - Ultimate tax is based on marginal bracket
- Capital Gains/Losses
  - Tax on the profit realized from the sale of an investment, adjusted for the cost of acquisition.
  - Short-Term < 12 Months
  - Long-Term > 12 Months

Capital Gain Rules

1. ST & LT Gains are taxed at different rates
2. ST or LT Losses are netted against gains
3. $3,000 of excess ST or LT Losses can offset income
4. Excess Loss can be carried forward for use in future years, “Loss Carryover”

Tax-Loss Harvesting – At Year end, accounts should be reviewed for Realized Gains and look for opportunities to offset them with unrealized losses.

Taxing Matters

Filing Jointly	Marginal Rate	LT Capital Gains	Investment Income
$0 -- $18,450	10%	0%	0%
$18,451 -- $74,500	15%	0%	0%
$74,901 -- $151,200	25%	15%	0%
$151,201 -- $230,450	28%	15%	0%
$230,451 -- $411,500	33%	15%	3.8%
$411,501 -- $464,850	35%	15%	3.8%
$464,850+ Source: IRS.gov	39.6%	20%	3.8%

Capital Gain Example

		Example 1	Example 2	Example 3
Short--Term:	Capital Gain	$2,000	$5,000	$2,000
	Capital Loss	($5,000)	($2,000)	($9,000)
	Net Gain/Loss	($3,000)	$3,000	($7,000)
Long--Term:	Capital Gain	$5,000	$1,000	$5,000
	Capital Loss	($1,000)	($5,000)	($4,000)
	Net Gain/Loss	$4,000	($4,000)	$1,000
Net Result:	Long Term Gain Income Offset	$1,000	($1,000)	($3,000)
	Loss Carryover			($3,000)

Portfolio Components

- Individual Securities
  - Stocks & Bonds
  - Munis
- Mutual Funds
  - Passive or Active
- ETFs – Exchange Traded Funds
  - Passive
  - Active – just becoming available

Munis

- A municipal bond is a bond issued by a local government, or their agencies.
- Revenue & General Obligation
- A huge market: $3.7 Trillion (2011, SEC).
- Interest is federally tax-free, and if purchased in the resident state they are state tax-free.
- If purchasing a out of state bond they are still federally tax-free

Question: If I can buy a corporate bond with an interest rate of 6%, or a VA muni with a interest rate of 5%, which one offers the higher return?

Munis

Tax-Equivalent Yield

$$\frac{\text{Interest Rate of Muni Bond}}{(1 - (\text{Federal Marginal Tax Rate} + \text{State Tax Rate})}$$

Example: 20 year Virginia Bond , 5% Interest Rate, Federal Tax Rate 28%, State 5.75%

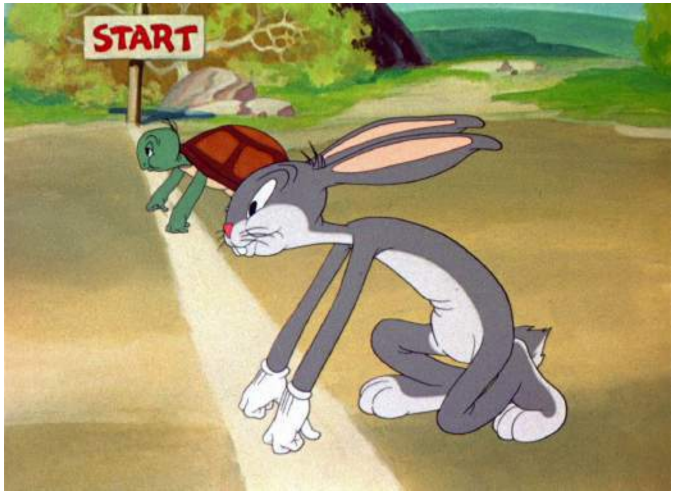
$$\frac{.05}{1 - (.28 + .0575)} = .0755 \sim 7.6\%$$

Even better if you purchased MD Bond, out-of-state

$$\frac{.05}{1 - (.28)} = .0694 \sim 7.0\%$$

Active vs Passive Management

Active	Passive
Focus on individual trades and transactions	Typically tracks a given market index – which is a representation of a greater whole
Try to “beat the market” by picking winning and losing stocks.	Believe that markets are efficient and that the prices we observe are fair
Try to forecast when to jump in and out of the market – market timing or tactical management	It is extremely difficult to consistently outperform the market
Can generate higher costs from more active trading	Cheaper because more of a mechanical process



Mutual Funds & ETFs

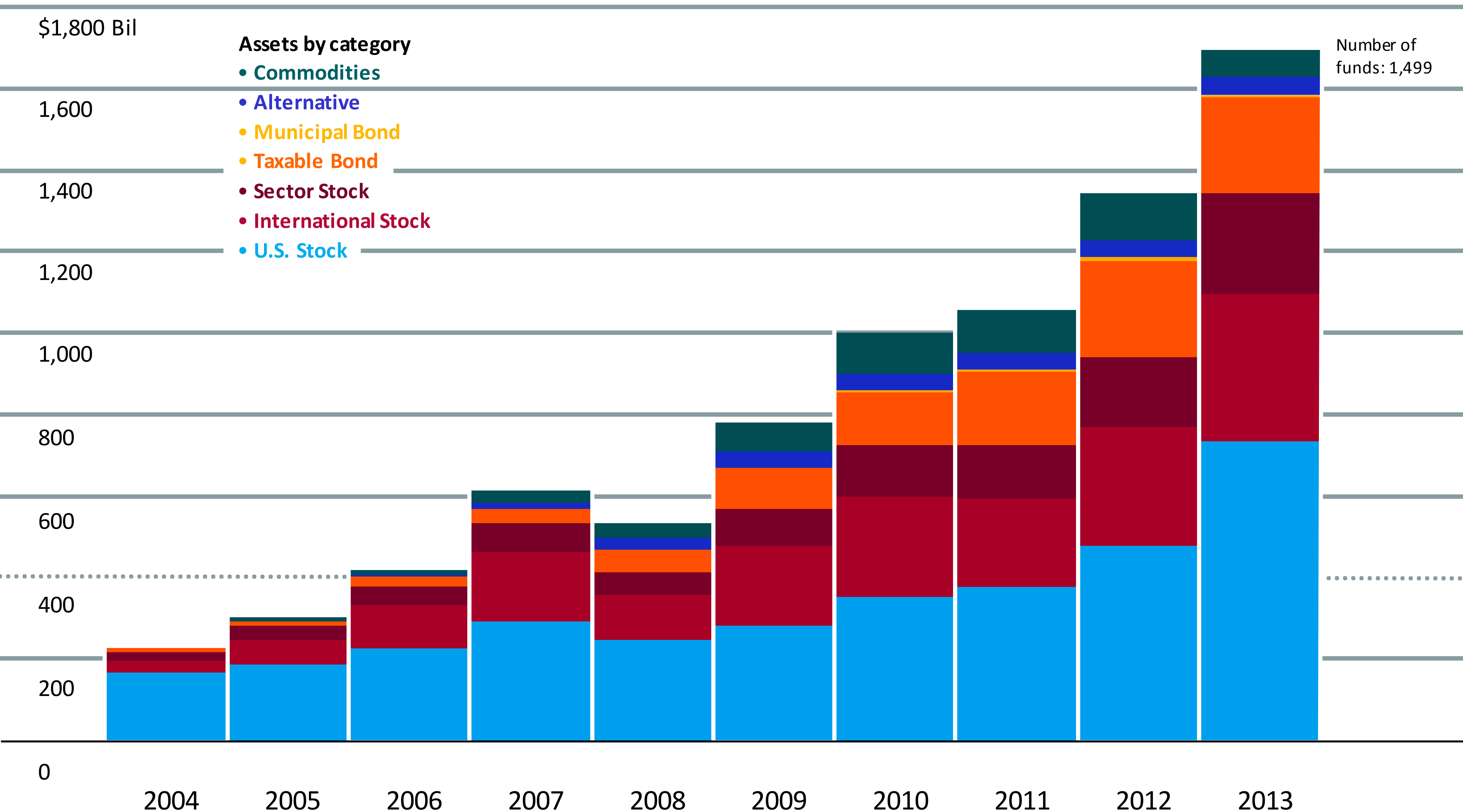
	Mutual Funds		
	Actively Managed	Passively Managed -Index	ETFs
Ownership	Purchased directly from the fund	Purchased directly from the fund	Purchased on the exchange
[redacted]	[redacted]	[redacted]	[redacted]
Pricing	Once per Day after Market Close May require a minimum initial purchase	Once per Day after Market Close May require a minimum initial purchase	Traded throughout the trading day
[redacted]	[redacted]	[redacted]	[redacted]
Transparency	Holdings generally disclosed monthly or quarterly	Holdings generally disclosed monthly or quarterly	Underlying holdings disclosed daily
[redacted]	[redacted]	[redacted]	[redacted]

Mutual Funds Expenses

	Mutual Fund Share Class			
	A	C	I or Y	ETF
Expense:	Large up-- -front charge Low annual cost	No up--front charge Higher annual cost	No up--front charge Low annual cost	Similar transaction cost to purchasing stock Low annual cost
Good for?	Long-- -term investors*	Short-- -term investors*	Mega--investors, +$1M purchase Advisory clients	Tax--efficiency, low cost, passive investment
Bad for?	Short-- -term investors	Long--term investors	Nobody?	Investors who want active management
Expense:				
Front--End Charge	5%+	0%	0%	Transaction Fee
Annual Management Fee	.75% -- 1.5%	.75% -- 1.5%	.5% -- 1.0%	.05% -- .5%
Annual 12b--1	.25%	1.25%	0%	0%
CDSC	0%	1.0%	0%	NA

ETFs Are a Fast-Growing Investment Vehicle

Assets by category 2004–2013



Types of Accounts

- Transactional or Retail Accounts
  - Accounts that are not tax-advantaged.
    - Taxes are paid annually on interest earned, dividends received and any short or long-term gains that are realized.
  - Examples include checking accounts, savings accounts, investment brokerage accounts, etc.
- Retirement Accounts
  - Tax deductible accounts or Roth Accounts
  - Include IRAs, 401k plans, 403b plans, 457 plans, etc.
  - For funds that will not be needed until at least age 59 ½

Tax Deductible Savings Accounts
401k & 403b plans, Traditional IRAs

- Funds are contributed to the account on a **pre-tax basis**
  - You get **a tax deduction** for the amount of the contribution
- So long as funds are in the account, all growth and earnings on the funds is **tax-deferred**.
- Income taxes are paid when the funds are distributed from the account.
  - **All distributions are taxed at ordinary income tax rates**.
- Funds cannot be accessed without a **10% penalty** until age 59 ½.
- You must begin to distribute funds once you turn 70 ½. These are known as Required Minimum Distributions (**RMD**).

Qualified Roth Accounts

- Funds are contributed to the account on an **after-tax basis**.
  - **No tax deduction** is received in the year the contribution is made.
- Funds growth **is tax-deferred** and **distributions are tax-free** so long as certain criteria is met.
  - Funds must remain in the account for a minimum of 5 years;
  - Earnings cannot be withdrawn until at least age 59 ½;
- There are **no minimum distribution** requirements.
- **Contributions may be limited** because of income levels.
- There are **no income limits to converting** a traditional IRA to a Roth IRA.