

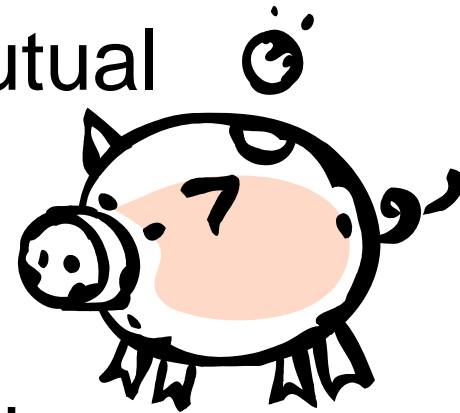


INVESTMENTS

101

Investing Means Making Choices.


- You can put money in a bank or under the mattress.
- You can buy stocks, bonds, or mutual funds.
- You can buy real estate or invest in a small business.



Investments Have Risk.



- Security prices go up and they go down. You may lose money.
- Inflation will lower the value of today's dollar.
- Taxes will reduce your returns.
- If you want your money to grow faster than inflation and taxes, you have to take some risk.

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- Investment risk is the uncertainty of achieving a desired return. Risk is represented by the volatility of returns -- up 15% one year, down 15% the next year, etc. One measure of investment risk is called the standard deviation of returns.
 - No one can predict how well the economy and financial markets will do in the future.

“There are only three kinds of financial prognosticators: those who don't know, those who don't know they don't know, and those who know they don't know but who get paid big bucks to pretend they know.”

-Burton Malkiel

Stocks, Bonds

- Stocks represent ownership. You own a “share” of a company. Some companies prosper; others go out of business.
- Successful companies prosper. Their stocks pay dividends and/or may grow in value.
- Bonds represent “loanership.” When a company or government borrows money from an investor, it issues an IOU, a bond. Bonds pay interest.
- Bond holders ordinarily do not share in the growth of the company.

What Is The “Market?”

Popular Indexes

- Dow Jones Industrial Average - most popular gauge of the U.S. Stock Market. 30 U.S. companies.
- Standard & Poor's 500 - most commonly used benchmark for the overall U.S. stock market .
- Russell 2000 – smaller stocks.
- Morgan Stanley EAFE – international companies. Europe, Australasia, Far East.
- Morgan Stanley Emerging Markets. Latin America, Southeast Asia.


Risk and Return

- Risk and return are two sides of the same coin.
- Over the long term, stocks have historically outperformed all other investments.
- From 1926 to 2004, large company stocks returned an average annual 10.4 percent gain. Long-term government bonds returned 5.4 percent.
- In general you can get a higher return (dividends plus appreciation) as a stockholder, but stocks are more volatile in the short term.
- On Oct. 19, 1987, stocks experienced the worst one-day drop in stock market history -- 22.6%.

“A bad year for bonds is like a day at the beach when compared to the kinds of losses suffered by stock investors.”

-Burton Malkiel

- In 1994, the worst year for bonds in recent history, intermediate-term Treasury securities (with maturities of 7 to 10 years) fell just 1.8 percent, and the following year they bounced back 14.4 percent.
- By comparison, in the 1973-74 crash, the Dow Jones industrial average fell 44 percent. It didn't return to its old highs for more than three years.
- Bonds are less volatile, but they can go down in price (when interest rates go up.) Occasionally bond issuers default on their IOUs.

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- When interest rates go up, bond prices fall, because bond buyers won't pay as much for an existing bond with a fixed interest rate of 5 percent as they will for a new one that is paying, say, 6 percent or more.
 - When interest rates fall, bond prices go up.
 - The effect is strongest on bonds with the longest term, or time to maturity. That is, long-term bonds get hit harder than short-term bonds when rates climb, and gain the most when rates fall.



Types of Investments

- Cash, money in the bank, Money Market Mutual Funds
- Stocks, stock mutual funds
- Bonds, bond mutual funds
- Real Estate (Office Buildings, Shopping Centers)
- Commodities (Oil, Gas, Cattle, Aluminum, Copper)

Inflation

- Inflation is an increase in the general level of prices.
- Increases in the cost of living mean the “purchasing power” of money is reduced.

Inflation and Purchasing Power

Inflation Rate	10 Years	25 Years
2%	-18%	-39%
4%	-32%	-62%
6%	-44%	-77%
8%	-54%	-85%



Types of Stocks

- Common, Preferred
- Large Capitalization, Small Capitalization
- United States, International
- Growth, Value
- Defensive, Cyclical



Types of Bonds

- Treasury, Corporate, Municipal
- Short-term, Long-Term
- Zero Coupon
- High Yield (“Junk Bonds”)
- TIPS (Treasury Inflation-Protected Securities)



Mutual Funds

- Pooling your money with other investors.
- Stock mutual funds (also known as equity funds) invest primarily in stock issued by U.S. or foreign companies.
- Bond mutual funds invest primarily in bond or debt instruments.
- Money market mutual funds invest mainly in short-term U.S. government and U.S. agency securities and seek to maintain a \$1 per share net asset value.
- Real Estate Investment Trusts, Commodities



Stock Mutual Funds

- Open-End
- Closed-End
- Active, passive
- Exchange-Traded Funds
- Sectors (Technology, Healthcare, Financial)
- Socially Responsible



INVESTING ADVICE

The preceding was factual.

Now for my opinions on successful investing.

There Is No Free Lunch

- Beware of investments that sound too good to be true.
- Do not buy any investment you do not understand or cannot explain to a smart 12 year old.

"As a general rule of thumb, the more complexity that exists in a Wall Street creation, the faster and farther investors should run."

- David Swensen



Diversification

- Placing a significant amount of your savings in one or a handful of stocks is risky, particularly if the companies are in the same type of industry.
- Diversification is a way to reduce the investment risk of a portfolio by including a variety of assets and/or maturities.
- You can spread the risk of your overall holdings by using different mixes of equity, bond, aggressive, and conservative investments, depending on your personal situation.

Keep Costs and Taxes Down

- High up-front or back end commissions (with B shares of mutual funds) will kill your returns.
- Short-Term Capital Gains (investments held for a year or less) are taxed at your ordinary income tax rate. Long-term capital gains are taxed more favorably.
- The average U.S. stock mutual fund has an operating expense of 1.4% per year.

"The only factor reliably linked to future mutual fund performance is the expense ratio charged by the fund."

-Burton Malkiel


Load Versus No-load Funds

- Mutual fund shares can be sold with a sales charge, or "load," which can range from 4% to 8%.
- There are a variety of load types, including front-end loads, contingent deferred load (load fee is spread over the investment period) and back-end load fees (redemption fees).
- Some mutual funds also have distribution fees (also known as 12b-1 fees). These fees are paid out of the assets of the fund to cover the costs of advertising and marketing.
- A true no-load fund does not charge any commissions or 12b-1 fees, so all of the investor's money is put directly into the investment.



Wall Street Is Not Your Friend.

- Stock analysts have conflicts of interest, if their employers also do investment banking business for the companies the analyst is following.
- Stockbrokers often get more training in sales than in portfolio management.
- Stockbrokers get higher commissions on some investments that might not be the best alternatives for investors.
- Brokers will not tell you about lower-cost alternatives.



“Well-informed investors avoid lining brokers' pockets with unproductive fees and enjoy higher expected returns from buying no-load funds.” -David Swensen

“Make no mistake about it, you are engaged in a brutal zero-sum contest with the financial industry. Every penny of commissions, fees, and transactional cost they extract is irretrievably lost to you.” -William Bernstein

Conclusions:

Avoid load funds, expensive wrap accounts and other high commission products such as Variable Annuities and Limited Partnerships.

Can You Beat the Market?

- Academic research and decades of experience point to an “efficient market.”
- Many investors analyze information about companies. If investors think that a stock is overpriced, they sell it or don't buy it. If investors believe a stock is under-priced, they buy it or hold what they already own.
- Because of the competition among many investors, the price of a stock generally reflects what people think it is worth. Only new and unexpected information causes prices to change.
- It is very difficult to beat the market. And it is very difficult to select money managers who will beat the market.
- When a money manager has beaten the market, it is difficult to know if it was caused by skill or luck.

Rules To Remember

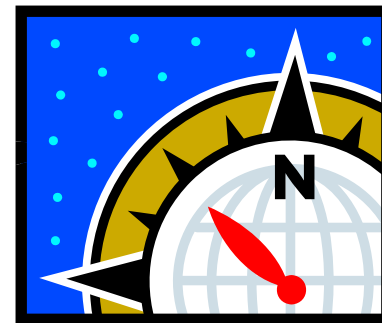
- Don't trade excessively.
- Don't try to time the market.
- Don't let emotions influence you.
- Don't buy what's hot.


“Don't let short-run fluctuations, market psychology, false hope, fear, and greed get in the way of good investment judgment.”

-John Bogle

Conclusions

- Have a long-term plan and stick with it.
- Diversify among different asset classes.
- Don't panic.
- Stay the course.





“Investors must understand that a superior portfolio will underperform from time to time. If they are prepared for this disconcerting reality, they are less likely to find themselves abandoning their superior portfolio in favor of Wall Street's deal of the day.” -Frank Armstrong

“Discipline is the key to success for the long-term investor. He or she must not fall into the trap of managing holdings by newspaper headline, sound bites, mindless prediction, gut feelings, or the last time period's results.” -Frank Armstrong



Disclaimer

- Mutual funds are subject to risk.
- Diversification does not ensure a profit or protect against a loss in a declining market.
- Past performance is not a guarantee of future results.