# Building Your Portfolio Terminology –

**Sudweeks** MBA620/Fin 418 Day 16

**After-tax return**. This is your return after you pay taxes. It is calculated as: after-tax return = before-tax \* (1 – marginal tax rate) and your marginal rate includes both your federal, state and local (if any) taxes.

**Distributions.** These are distributions of interest, capital gains, and dividends by a mutual or index fund while you own the underlying shares. Even though you have not sold the shares, you are responsible to pay taxes on this distributions because the mutual fund is a pass-through vehicle and the taxes on these distributions are paid at the shareholder level.

**Education investment vehicles**. These are investment vehicles with the purpose to help you save for your children’s education, i.e., Education IRA, 529 plans.

**Free money**. This is money that is made available by a company, generally on a matching basis, to encourage greater participation in company sponsored retirement plans, i.e., 401k, Roth 403b, Keogh, etc. It is also money made available through education tax benefits, i.e. 529 plan contributions deductible from state taxes.

**Initial target portfolio**. This your first goal for a target dollar amount as you begin building your portfolio. It is calculated by taking your emergency fund goal and dividing it by your percentage in bonds and cash.

**Investment vehicles**. The investment vehicle is the tax-law defined framework that has specific tax advantages, i.e., 401k, 403b, Individual Retirement Account (IRA), SEP IRA, Roth IRA, Roth 401k, etc. Investment vehicles have different benefits, i.e., due to matching (free money), tax elimination, tax deferral, or just tax-efficient and wise investing. Investment vehicles are like shopping carts in the grocery store, they are the things you put your groceries, or financial assets, into.

**Investment/financial assets**. Investment or financial assets are the securities that are invested in by the investment vehicles, i.e., stocks, bonds, mutual funds, REITs, MMMFs, CDs, etc. They are like the groceries you put in your shopping cart, which is your investment vehicle.

**Long-term capital gains**. These are federal taxes on gains held more than 366 days. It may be taxed at a preferential rate depending on your marginal tax rate.

**Marginal tax rate**. This is your taxes on each additional dollar of earnings. If you made $1 more this year, at what rate would it be taxed.

**Ordinary dividends**. These are stock dividends earned from holding a stock an insufficient number of days within a specific period to be reported as qualified dividends. Ordinary dividends are taxed at a federal marginal or ordinary tax rate.

**Priority of money**. This is an educational tool to help individuals determine the order of which they should utilize investment vehicles to achieve their personal and family goals.

**Qualified dividends**. These are stock dividends earned from holding a stock a minimum number of days within a specific period. Qualified dividends are taxed at a federal preferential tax rate depending on your marginal tax rate.

**Retirement vehicles**. These are investment vehicles to help you save for retirement. These include for private businesses: 401-k, Roth 401-k plans; non-profit tax-exempt businesses: 403-b/Roth 403-b plans; State and municipalities: 457 plans; Individual retirement accounts: IRA/Roth IRA; and small business plans: SEP IRA, SIMPLE IRA;

**Short-term capital gains**. These are federal taxes on gains held less than 366 days. It are taxes at your ordinary or marginal tax rates.

**Tax-advantaged money**. This is the process of using investment vehicles that have specific advantages. There are two types: Tax deferred and tax-eliminated vehicles.

**Tax-deferred money**. This money has the ability to be invested before-tax, with principle and earnings taxed only at retirement (IRA, SEP IRA, etc.). This money converts long-term capital gains into short-term income for tax purposes.

**Tax-efficient and wise investments**. This is money that is invested tax-efficiently and wisely, consistent with the principles of successful investing discussed earlier.

**Tax-eliminated money.** This money can be used at retirement (or for education) without penalty and without taxes, i.e., a Roth IRA/410k/403b for retirement, and 529 Funds and Education IRA for education. You pay the taxes upfront, and then pay not taxes on earnings or capital gains when you take it out at retirement.