Course Manual

A Course in Personal Finance

BYU MARRIOTT
SCHOOL OF BUSINESS

Bryan L. Sudweeks | PhD, CFA | September 2019 | 12th Edition 2019-2020

Introduction by the Dean

Welcome to the BYU Marriott project on personal finance. A solid understanding of basic financial principles and the ability to manage finances wisely are important factors in the well-being of individuals and families. This project is one of our many efforts to increase the financial literacy and self-reliance of our students as well as of families and friends outside the University.

As you work through this course, I hope you will take the time to do three things.

First, read and study the material. Each chapter offers valuable information that will enrich your understanding of personal finance. The chapters have been carefully reviewed by the faculty and staff at BYU Marriott. We think they are informative and clearly written. They are organized to be useful to young people with little financial knowledge, people who have extensive experience in financial matters, and everyone in between.

Second, as you read, focus on the principles taught in the course. We emphasize principles because principles don't change over time. Types of financial assets, investment vehicles, and even financial theories may change, but principles do not. This focus will help you stay on course as you make financial decisions for yourself and your family over time, even as the financial environment around you changes.

Finally, apply these principles to your life by developing your own "Personal Financial Plan." Spencer W. Kimball has counseled, "To be sure your life will be full and abundant, you must plan your life" (*Ensign*, May 1974, 86). Think through and write down your vision and goals, the things you want to achieve in life. Develop a financial plan to help you accomplish your goals and then work to implement your plan. Such planning may be the most important tool for achieving your personal and financial goals.

Thank you for your interest in this course. May this be the start of even greater learning and understanding as you work toward greater financial self-reliance.

Sincerely,

Brigette C. Madrian
Dean and Marriott Distinguished Professor
Brigham Young University Marriott School of Business

Author's Note

Welcome to this manual and the accompanying website at http://personalfinance.byu.edu on Personal Finance. We have compiled information on what we consider the most important areas of personal finance for students, individuals, and families. We have developed a principles- and applications-based framework that we hope is clear and concise, and that applies the best practices used in the industry. While there may be differences of opinion as to what are the best practices in the areas discussed, this platform was developed to facilitate review and discussion of those practices.

The ideas presented in this manual were written for a Christian audience with membership in The Church of Jesus Christ of Latter-day Saint; however, the principles taught can be extended to members of any Christian faith. Readers who are not of the this faith may encounter a few unfamiliar terms within this text. While these terms may provide valuable insights to members of the Church of Jesus Christ, a thorough understanding of these terms is not required to understand the financial principles taught here. If you have questions about any of these terms, feel free to contact me at personalfinance@byu.edu, or visit The Church of Jesus Christ of Latter-day Saints' website (http://ChurchofJesusChrist.org/topics) for more information.

This manual and website are updated every year for new information, changes to tax laws, improvements in teaching methodologies, etc. As such, I would appreciate feedback to help make the manual and website better and more useful. While I have tried to present the material in as fair and balanced a framework as possible and am incorporating changes as they become apparent, there may be errors of omission or commission. While this personal finance manual and the website have been approved by Brigham Young University's Marriott School of Business for distribution, they remain the work of the author. Any errors are solely my responsibility and are not the responsibility of the Marriott School of Business, the faculty, or Brigham Young University.

Bryan L. Sudweeks, Ph.D., CFA

August 2019

How This Course Is Different

Dave Ramsey, a nationally syndicated radio talk show host, commented, "Personal finance is more personal than it is finance: it is more behavior than it is math" (KNBR, May 23, 2007). Learning about personal finance requires more than learning the languages of finance and math and more than just a change in spending habits—it requires a change in behavior. The four characteristics that make this course different from other courses on personal finance can help effect this change in behavior.

First, we take a different perspective on personal finance. Perspective—the way we look at things—influences our financial self-reliance because it influences the choices we make. Concerning perspective, the historian Will Durant wrote, "We need 'to seize the value and perspective of passing things. . . . We want to know that the little things are little, and the big things big, before it is too late; we want to see things now as they will seem forever—'in the light of eternity.'"[1]

Our perspective in this manual is unique. It is that personal finance is not separate from our Christian lives. Rather, personal finance is simply part of our Christian lives, and part of living the gospel of Jesus Christ. In this course, our perspective on personal finance is based on a long-term view of what truly matters, which will guide you as you make financial choices.

Second, we take a principles, doctrines and applications-based approach to personal finance. This helps us change our perspective on what we are doing. Unlike investment theory, investment vehicles, and financial assets, principles and doctrines never change. A sound understanding of the correct principles and doctrines of personal finance will act as a compass to guide you as you work toward achieving your personal and family goals. Richard G. Scott commented:

> [The] inspired statement, "I teach them correct principles, and they govern themselves," still applies. The Lord uses that pattern with us. . . Your consistent adherence to principle overcomes the alluring yet false life-styles that surround you. Your faithful compliance to correct principles will generate criticism and ridicule from others, yet the results are so eternally worthwhile that they warrant your every sacrifice.[2]

In this course you will learn how principles, doctrines and application relate to every aspect of your personal finances. Understanding correct principles and doctrines helps increase our motivation to act and makes it easier to follow and apply the concepts discussed in this manual and website to our personal lives.

Third, we don't just talk about what you can do, we give plans and strategies to help you in creating your own personal plans in 16 important areas. Seeing what others have done and are doing in specific areas can give you ideas and strategies on how you can create your vision in those areas.

Finally, we take an applications-based or creative approach to personal finance. Application is an invitation to learn and create. We discuss the creative process in terms of how we are all creators of our vision, goals and lives. It is not enough to know what you want to do in our lives and families—we must do it. Accordingly, the final difference is that we apply the things learned in this manual in the creation of your individual or family Personal Financial Plan. This is part of Ezra Taft Benson's advice to "Plan your financial future early, then live your plan."[3]

To help you apply your learning and planning, we offer a multi-disciplinary companion website at http://personalfinance.byu.edu. As one of the advanced lessons, it includes this book,

PowerPoint presentations, learning tools, videos of personal finance classes taught at BYU, and other personal finance manuals compiled and developed by the faculty and staff at Brigham Young University. These tools will help you catch your vision, set goals, and develop plans and strategies to help you create a budget, work toward getting out of debt, evaluate different investments, buy a house or a car, invest wisely, save for retirement, and more. You will also receive extensive instructions for developing your own Personal Financial Plan, including helpful examples of completed financial plans.

We believe that by changing your perspective, learning the doctrines, principles and applications that support successful financial management, giving examples of visions, goals and strategies in each key area, and then having you apply this knowledge to your own life in creating your own personal Financial Plan with the tools we've provided, will increase your financial literacy and motivation, and will help you achieve the vision and goals that are most important to you and your family. If you do this thoughtfully, carefully and prayerfully, it will help change behavior. Best of luck to you as you begin this wonderful journey to increased financial self-reliance.

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[1] *The Story of Philosophy*, New York: Simon and Schuster, 1927, 1
[2] "The Power of Correct Principles," *Ensign*, May 1993, 32
[3] Ezra Taft Benson, "To the Elderly in the Church," *Ensign*, Nov 1989, 4.

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1. Building a Strong Foundation: Another Perspective on Wealth[1]

Introduction

Personal finance. These two words can bring either fear or excitement into the heart of the reader. Why such varied responses to a simple two-word phrase? There are many different reasons.

One of the most prevalent is a lack of education. It is hard to make important decisions when you feel you are in unchartered territory. Other responses have been due to "misguided" information. Some individuals and companies have used personal finance as a tool to earn huge commissions on selling insurance and investment products without regard to the needs of the investors they supposedly serve, resulting in poor performance for the investors and uncertainty over missed goals. Still others have made unwise decisions based on solely acquiring assets and investments, but to the detriment of their spouses, families, and real success. While they may have acquired financial security, they have lost the things that will bring them what they desire most: happiness and joy. Others have learned how to bring Christ into their finances, learned their available options, determined the key doctrines, principles and applications, applied them in a creative process to their financial habits and goals, and have accomplished the vision and goals that they have set for themselves and their families, including happiness in this life and eternal life in the world to come. The purpose of this manual and the accompanying website is to help you come to understand the process of personal finance or financial planning for yourself and those you love, and to apply it in your lives.

Objectives

A. Understand how to bring Christ into your finances.
B. Understand the importance of perspective and our perspective for this course.
C. Understand our framework for learning: doctrines, principles and application.
D. Understand the implications of that learning framework.
E. Remember that "Life is Good."

Understand how to bring Christ into your finances

As we have read and studied scriptures, it is apparent that Jesus Christ wants to be a greater part of our lives and finances. He will not barge in and tell us what to do; He cannot, as He will not violate our moral agency. But He will plead, exhort, counsel and guide us back to our Father if we will allow Him more into our lives and finances.

Why do we want to bring Christ more into our finances? M. Russell Ballard reminded us: “In my judgment, we never will have balance in our lives unless our finances are securely under control.”[2] Christ can help us bring balance and control into our lives and finances. How do we bring Christ more into our lives and finances?

Seek to learn and love the Savior and His atonement more. We study, pray, learn more about Him, and contemplate His amazing atonement and what it means in our lives. Christ knows us by name and loves us perfectly, and has designed a detailed, individual, and customized curriculum (called life) exactly tailored to our needs, mission and destiny. Managing our finances is one of the pieces of that curriculum, and personal finance is simply part of the gospel of Jesus Christ.[3]

Strive to change daily and become more like Him. God’s grace, repentance and the atonement of Jesus Christ are perfect tools to help us change and to become more like our Savior. He has given us everything we need to become more like Him. He has taught through His servants that “a” pattern to change behavior is to understand doctrines and principles, and have them confirmed by the Spirit.[4] Boyd K. Packer said: “True doctrine, understood, changes attitudes and behavior. The study of the doctrines of the gospel will improve behavior quicker than a study of behavior will improve behavior. . . That is why we stress so forcefully the study of the doctrines of the gospel.”[5] However, it is not enough to know the doctrines—we must understand them as well. David A. Bednar commented, “President Packer did not teach that simply knowing true doctrine changes us. Rather, doctrine must be understood. . . Thus, true doctrine confirmed in the heart as true by the witness of the Holy Ghost changes attitudes and behavior.[6] He also reminds us “The answers are always in the doctrines and principles, and the doctrines and principles need to be in us.”[7]

Learn to apply His words and create our lives more closely with Him. As we strive to develop and grow, application is an invitation to learn and create.[8] As we do, we become creators with God of ourselves, our families and our lives. We learn important lessons from the creation[9] that we can use in our lives as we remember that “Creation is a spiritual gift.”[10] We were born creators, and had our first lessons in creation when as pre-existent spirits we helped create the earth we live on.[11] We create each day in our prayers, families, the environment in our homes, budgets, goals and our lives. We are all creators, and learn best when we learn and follow the Master Creator, even Jesus Christ. Not only does He know the way, He is the way.[12]

Always remember Him. We need Christ’s inspiration and guidance daily if we are to return with our families to His presence. We already covenant to “always remember Him” each week in the Sacrament. We must strive to keep those and our other covenants. We must remember that our conduct on our journey is as important as our final destination.[13] We must, like the pioneers, make “a covenant and a promise to keep all the commandments and statues of the Lord”[14] as we daily remember the Savior and follow the covenant path.

To bring Christ more into our finances, we must bring Him more into our lives. If we want to have balance in our lives, we must bring our finances securely under control. We can do this best with Christ's help. We bring Christ into our finances as we seek to learn and love the Savior and His atonement more, work to change and become more like Him, learn to apply and create with the Creator of the World, and always remember Him. Then with His help, we can accomplish all things.

Understand the Importance of Perspective and Our Perspective for this Course

The dictionary defines *perspective* as "one's point of view, the choice of a context for opinions, beliefs, and experiences."[15] The historian Will Durant wrote of the human need "to seize the value and perspective of passing things. . . We want to know that the little things are little, and the big things big, before it is too late; we want to see things now as they will seem forever—'in the light of eternity.'"[16]

The challenge then is to see things in a consistent perspective--as they will be forever. Neal A. Maxwell wrote of those without this perspective, "Living without God in the world brings a functional lack of consistent perspective. If there were no eternal truths, to what principles would mortals look for guidance? If not accountable to God, to whom are we ultimately accountable?"[17]

Our perspective—how we look at things—makes a difference in the choices we make. Do we recognize our difference in perspective as we look at the world around us? Do we recognize the implications of our differences in outlook, the differences of our eternal perspective as we go about our daily lives? Neal A. Maxwell commented:

> We see the world and the people in it differently, because, as C. S. Lewis observed, it is by the light and illumination of the gospel that we see everything else. . . The gospel is like the lens of a cosmic kaleidoscope that, instead of showing life, man, and the universe as senseless, unconnected fragments, shows us pattern, beauty, and purpose! It is this vision that can give us a special sense of proportion about the things in life that matter most. . . This perspective can make so many differences in so many ways that, unintentionally, we may be unconscious of the implications of our difference in outlook.[18]

The purpose of this section is to articulate "another" perspective on wealth, an eternal perspective. This perspective is critical for us to understand, and it has a major influence on how we make choices.

In this manual and website, we take a different view from the world. We disagree with the belief that "money buys happiness." The media continues to bombard us with the illusion that we have to spend money to be content or that to be happy, a person must be beautiful, sexy, thin, rich, or whatever it is they are selling at the moment.

Most of us are not conscious of the effects of our perspectives on our everyday lives. When we have a proper perspective on life, there is pattern, beauty, and purpose instead of senseless, unconnected fragments. Along with that knowledge of the purpose of life, it is important that we understand correct principles so that we can make good choices.

On the subject of choices, Spencer W. Kimball said:

> We hope we can help our young men and young women to realize, even sooner than they do now, that they need to make *certain* decisions only *once* . . . We can make a single decision about certain things that we will incorporate in our lives and then make them ours—without having to brood and re-decide a hundred times what it is we will do and what we will not do.… My young brothers [and sisters], if you have not done so yet, *decide to decide*![19]

The purpose of this series is to help you in your understanding of perspective as it relates to personal finance and then to help you "decide to decide" to be wise in the management of your personal finances. When we have an eternal perspective, we understand things differently, view events differently, and make choices differently with respect to our families, friends, work and finances.

Our perspective is simple: *Wise money management is simply living the gospel of Jesus Christ*. It is putting Christ first in our lives, not our pocketbooks. "But seek ye first the kingdom of God, and his righteousness; and all these things shall be added unto you".[20] It is the temporal application of eternal principles.

Understand our Framework for Learning: Doctrines, Principles and Application

Our learning framework for this class is unique. We use the framework for learning used by David A. Bednar in his book "Increase in Learning." It is based on doctrines (the whys"), principles (the "whats"), and application (the "hows"). It brings balance to the things we do. Bednar calls it, "A flexible tool that can be used to enhance our gospel learning and can be a useful aid as we apply the principles of prayerful inquiry and the pattern of asking, seeking, and knocking."[21]

Too often when we encounter problems in life, we are drawn to application as the way to make life better. But is it the best way? Bednar writes:

> Somehow we seem to be drawn to application as the primary way to 'fix" things, to make life better. . . And far too often we emphasize application without the necessary understanding and divorced from the doctrinal content. . . Whatever the reasons, emphasizing the application to the exclusion of fundamental doctrines and principles does not produce spiritual power, protection, and direction. . . Appropriate applications are necessary but can never stand alone. What is needed is a balance among doctrines,

> principles and application. . . *The answers always are in the doctrines and principles*. And the doctrines and principles need to be in us.[22]

This learning framework is unique. It asks three critical questions that can lead us to learning and life. They are:

> 1. Why should we *learn and become better at personal finance*? (this is a "why" or doctrine question).
>
> 2. What are the principles on which how we *learn and become better at personal finance are based*? (this is a "what" or principles question).
>
> 3. How do we *learn about and become better at personal finance*? (this is a "how" or application question).

Doctrines or "Whys" of Personal Finance

Doctrines are the truth about ourselves, our lives, our history, and our relationship to our Father in Heaven and his Son Jesus Christ. Boyd K. Packer said, "True doctrine, understood, changes attitudes and behavior. The study of the doctrines of the gospel will improve behavior quicker than a study of behavior will improve behavior. . . That is why we stress so forcefully the study of the doctrines of the gospel."[23]

David A. Bednar reminds us,

> President Packer did not teach that simply knowing true doctrine changes us. Rather, doctrine must be understood. The word understanding in the scriptures frequently is linked to and associated with the heart and refers to a revealed result or conclusion. Thus, true doctrine confirmed in the heart as true by the witness of the Holy Ghost changes attitudes and behavior. Knowing true doctrine is necessary but is not sufficient.[24]

Why should we learn doctrines? Doctrines are critical as they give us the perspective, motivation and strength to do the right things even when they are difficult.

We have been counseled to understand the "why" or doctrines of the gospel of Jesus Christ. Dieter F. Uchtdorf said:

> Seek out the majesty, the beauty, and the exhilarating joy of the 'why' of the gospel of Jesus Christ. "The 'what' and 'how' of obedience mark the way and keep us on the right path. The 'why' of obedience sanctifies our actions, transforming the mundane into the majestic. It magnifies our small acts of obedience into holy acts of consecration.[25]

Before we can decide more about wise money management, we must understand and answer the question, "Why should we learn and become better at family finance?"

While there are likely many different "whys", let me share a few thoughts on doctrines of why we believe God wants us to learn personal finance. Since perspective is so important, this question must be addressed from many different perspectives. Possible perspectives include spiritual, temporal, family, and personal. While there are an innumerable number of perspectives, these four seem to be important and will be addressed here.

Spiritual: Personal finance can help bring us to Christ. From a spiritual perspective, the ultimate purpose of everything we do, and God does, is to bring us to Christ. Because God's work and glory is to bring to pass the "immortality and eternal life of man"[26] and the only way we can have eternal life is through Jesus Christ[27], then the purpose of all mortal experience is to bring us to Christ, who then brings us to the Father. Learning to manage our finances according to gospel principles will help us grow spiritually as well as help build up our families and the kingdom of God.

C. Max Caldwell said:

> Whatever the problem may be in a person's life—failure to pay tithing, breaking the Word of Wisdom, casual church attendance, [or, I add, poor financial habits, the]—real issue is faith in Jesus Christ. If we can help people obtain the gift of faith in Christ, good works will follow. The end purpose of any law of God is to bring us to Christ. And how well will the law work? It depends on what we think of the Author of the law.[28]

We have also been commanded by prophets and the scriptures to be financially wise.

> [We] have been counseled for many years to prepare for adversity by having a little money set aside. Doing so adds immeasurably to security and well-being. Every family has a responsibility to provide for its own needs to the extent possible . . . If you have paid your debts and have a financial reserve, even though it be small, you and your family will feel more secure and enjoy greater peace in your hearts. May the Lord bless you in your family financial efforts.[29]

Perspective also adds significantly to motivation. Whether we view this counsel on being financially wise as a nice thing to do or a commandment of God will provide a great difference in our motivation to do these things.

Temporal: Personal finance can help us become wiser stewards. From a temporal perspective, managing resources is a skill that Heavenly Father wants us to develop during mortality. "For he who is faithful and wise in time is accounted worthy to inherit the mansions prepared for him of my Father."[30]

Personal finance helps us learn to be wiser financial stewards over the things with which God has blessed us. Joe J. Christensen said, "Our resources are a stewardship, not our possessions. I am confident that we will literally be called upon to make an accounting before God concerning how we have used them to bless lives and build the kingdom."[31]

I believe a critical question at judgment day from our Savior will not be, "How much money did you make?" Rather, it will be, "How well did you use the resources I blessed you with in the service of your family and fellow men?"

Family: Personal finance can help us return with our families back to Heavenly Father's presence. The third perspective is family. An eternal perspective on finances helps us keep our priorities in order. David O. McKay reminded us, "No other success can compensate for failure in the home."[32]

We show our love for our Savior as we pay our tithes and offerings. We are examples to our children as we put the Lord first and sacrifice through service, hard work, church and temple attendance. We build our communities and nation as we seek opportunities for service to our family, friends and fellowmen.

We will be disappointed in life if we gain the world's riches and lose our spouses and families. We must learn to better apply personal finance in the Lord's way, using His plan and obeying His commandments. In short, an eternal perspective on finances can prepare us for eternal marriage, strengthen existing marriages, and be a conduit for positive parenting.

Individual: Personal finance can help us prepare for and accomplish our divine missions. The fourth perspective is individual. We all have divine missions to perform here on earth, and personal finance can help us learn the lessons and develop the skills we need to accomplish those missions. Many of our missions will required material resources. Gene R. Cook said, "I bear testimony of the fact that if you keep the commandments, He nourishes you, strengthens you, and provides you means for accomplishing all things necessary to faithfully finish your divine mission here on earth."[33]

We are all at an important time in our lives, regardless of our age. Ask yourself, "Do I really believe that I have a mission here on earth to perform and am I performing it?"

Clearly, perspective is important, and by looking at many different perspectives we can understand more fully "why we should learn and become better at family finance."

So if money management is part of the gospel of Jesus of Christ, are there principles upon which wise money management is based? Let me propose a few principles that are the foundation upon which this perspective is based. I call these my "Principles of Finance."

Principles or "What's" of Personal Finance

Principles are fundamental laws or doctrines, which, if understood, will allow us to live or act according to truth. Richard G. Scott commented:

> [The] inspired statement, "I teach them correct principles, and they govern themselves," still applies. The Lord uses that pattern with us. You will find correct principles in the

> teachings of the Savior, His prophets, and the scriptures. While easy to find, true principles are not easy to live until they become an established pattern of life . . . Yet, as you resolutely follow correct principles, you will forge strength of character available to you in times of urgent need. Your consistent adherence to principle overcomes the alluring yet false life-styles that surround you. Your faithful compliance to correct principles will generate criticism and ridicule from others, yet the results are so eternally worthwhile that they warrant your every sacrifice.[34]

What are those principles or "what's" to which we must adhere whose results are so eternally worthwhile that they merit our every sacrifice? Let me propose a few principles that relate to understanding and using wealth wisely.

Principle 1: Ownership. Everything we have is the Lord's. The Psalmist wrote, "The earth is the Lord's, and the fullness thereof; the world, and they that dwell therein."[35] The apostle Paul, writing to the Corinthians, stated the same message, "For the earth is the Lord's, and the fullness thereof."[36]

We know from scriptures that the Lord was the creator of the earth[37], the supplier of our breath[38], the giver of our knowledge[39], the provider of our life[40], and the giver of all we have and are.[41]

Nothing we have is our own—it is all God's. As such, there should be no feeling of pride for the things we have or are. These things do not belong to us, but are on loan from a loving Heavenly Father and His Son, Jesus Christ. These blessings should encourage us to demonstrate greater obedience to God's commandments. As we realize that all we have and all that we have become are gifts from a generous Heavenly Father and Son, we will find gratitude and obedience rather than pride.

Principle 2: Stewardship. We are stewards over all that the Lord has, is, or will share with us. A steward is one who actively directs the affairs of another. The apostle Paul stated, "Let a man so account of us, as of the ministers of Christ, and stewards of the mysteries of God. Moreover it is required in stewards, that a man be found faithful."[42] The Lord stated, "It is expedient that I, the Lord, should make every man accountable, as a steward over earthly blessings, which I have made and prepared for my creatures."[43]

Being blessed with material things in life should not be seen only as a blessing but also as a responsibility. We will be required to give an account of our stewardship to Heavenly Father. In order for us to be wise stewards, it is our responsibility to learn everything we can about our stewardship so we can manage it to the best of our abilities. The purpose of this manual and website is to help you understand and manage your stewardship better as it relates to personal finance.

Principle 3: Agency. The gift of "choice" is man's most precious inheritance. President Thomas S. Monson taught, "When we came to the earth, we brought with us that great gift from God—even our agency. In thousands of ways we are privileged to choose for ourselves."[44]

The prophet Joshua counseled the people about agency when he said, "Choose you this day whom ye will serve; . . . but as for me and my house, we will serve the Lord."[45]

David O. McKay wrote, "Next to the bestowal of life itself, the right to direct that life is God's greatest gift to man . . . Freedom of choice is more to be treasured than any possession earth can give.[46]

We should do everything in our power to thank God for this wonderful right to choose, and then use that agency as wisely as we can.

Principle 4: Accountability. We are accountable for every choice we make, including our financial choices. We have been blessed with the gift of agency, but we will also be held accountable for its use. The Lord counseled, "For it is required of the Lord, at the hand of every steward, to render an account of his stewardship, both in time and in eternity."[47]

The blessing of agency is an unconditional gift of God, and how we use that gift shows how much we love Him and His Son Jesus Christ. The first three principles outlined above are God's gift to us. The fourth principle is our gift to God. We can, through our wise choices, show our Heavenly Father how much we love Him by obeying His commandments and covenants and striving to become more like His Son.

These four principles establish a spiritual foundation for understanding wealth that is based on our dependence on God and our need for financial self-reliance to fulfill His purposes.

Neal A. Maxwell put things of this world into a correct perspective when he taught:

> The submission of one's will is really the only uniquely personal thing we have to place on God's altar. The many other things we "give," brothers and sisters, are actually the things He has already given or loaned to us. However, when you and I finally submit ourselves, by letting our individual wills be swallowed up in God's will, then we are really giving something to Him! It is the only possession which is truly ours to give![48]

Everything we have is God's, and the things we receive are all blessings from Him. They are not ours, but they have been given to us as a stewardship for which we can make choices. We should choose well, as we will be held responsible for what we choose and do.

Application or the "How's" of Personal Finance

Once we understand the doctrines and principles of finance, it is important to understand how to apply what you are learning to your daily lives. I call this application or the creative process. Question 3 then becomes "How do we learn about and become better at family finance?"

In 2019 we took 24 BYU students to Europe for a Global Finance Investment Internship. One of the companies we visited in Germany was a large sport and apparel manufacturer. I was impressed with their marketing slogan "Calling all Creators."[49] Their point was we all are

creators, which we truly are.

On the importance of creation, Elder McConkie said, “The three pillars of eternity, the three events, preeminent and transcendent above all others, are the creation, the fall, and the atonement.”[50] Why is it so important that we understand the creation? I believe it is because this knowledge will help us to be better creators ourselves. Let me share eight lessons that I have learned from the creation. You will likely have your own lessons from your reading and study.

God is creative. The creation shows that Heavenly Father and His son are very creative beings. We are taught in the scriptures that we are created in the image of Heavenly parents and in Their likeness. As such, we should also very creative beings. We were meant to create, and this capacity is God-given.

Christ worked under the direction of the Father. The restored gospel has helped us to know that Jesus Christ created the heavens and the earth under the direction of the Father. Likewise when we create, we should be under the direction of the Father as well. To really accomplish all we need to in this life, we will need His help.

The earth was created from existing matter. The earth was created, not from nothing, as many suppose; rather, it was organized from existing matter.[51] Likewise, when we create, we are not starting from nothing. We take our existing vision, education, talents, skills and abilities, and match those with the resources and materials we have in our home, neighborhood, community or nation.

Creation is a two-step process. The Lord speaking to Moses said, “For I, the Lord God, created all things, of which I have spoken, spiritually, before they were naturally upon the face of the earth.”[52] Once He created things spiritually, then came the physical creation of everything on the earth. We likewise must create things spiritually through our vision, goals and plans, and then we can create it physically—and we can create with confidence.

There is an order in creation. Notice that there is an order in creation, first the world was organized, and then light came into the world. Next the waters were divided. Clearly there is order in creation and in the universe. Likewise, there is order in our creative processes, and we must learn what that order is.

Creation takes time. The creation of the earth did not happen overnight, but took six creative periods. How long those periods were has not been revealed, but we do know it was a long time. Likewise, when we create, we should realize that this is a time-consuming process.

Creation was a planned event. The creation was planned from the beginning under the direction of Heavenly Parents. The creation, fall and atonement of Jesus Christ were all part of the Father’s plan, “to bring to pass the immortality and eternal life”[53] of His children. We should make sure, as we go through our lives, that we to have a plan on how we will live our lives, so that we can, under the direction of the Father, support His same work and return to His presence.

We create every day of our lives. Some do not think they create; however the reality is that we create every day of our lives. Perhaps a few creations can help make the point.

Prayer. David A. Bednar commented on our spiritual and physical creation of each day. On the subject of prayer, he said,

> We learn from these verses that the spiritual creation preceded the temporal creation. In a similar way, meaningful morning prayer is an important element in the spiritual creation of each day—and precedes the temporal creation or the actual execution of the day. Just as the temporal creation was linked to and a continuation of the spiritual creation, so meaningful morning and evening prayers are linked to and are a continuation of each other.[54]

Family. We are co-creators with God in the creation of our families. We work with Him as creators of our marriages and in which our children are raised. We should make sure, as we work to create the environment in our marriages and in which our children are raised, that we do it as co-creators with Heavenly Father. We are reminded to always, "Create homes filled with love and serenity. Relieve suffering. Create enduring testimonies of eternal truths in ourselves and others."[55]

Vision and Goals. When we set and work toward our vision and goals, it is again the spiritual creation followed by the physical creation. Alma uses different words to describe this spiritual creation, such as "Do you exercise faith," "Do you look forward with an eye of faith," and "Can you imagine to yourselves."[56] God's ultimate goal for us is to learn both the spiritual and physical creation process so we live in such a way as we, with our families and through the Savior's atonement, can return to live with Him eternally.

Finances. Regarding our finances, the preparation of our budgets can be envisioned as the spiritual creation first, followed by the physical creation second as we spend the money. President Kimball said" "Every family should have a budget."[57] Living on a budget does not mean that you do not spend money; rather, you spend money on things that are planned for (the spiritual creation) and that are important to you.

Ourselves. Finally, the reality is that we create ourselves in every day and in everything we do. Our life then is the sum of each of our daily individual creations. As such, we recognize the importance of our daily creations in the creation of our overall lives.

Creation is a wonderful subject for additional study. We were born creators, and had our first lessons in creation when as pre-existent spirits we helped create the earth we live on.[58] David O. McKay taught, "Sculptors of life are we, with our uncarved souls before us. Everyone of us is carving a soul."[59] That we might help create and carve ours and other souls well is our prayer for each of you.

The application or the creative process is how we go from the spiritual creation to the physical

creation. It entails five steps. Each of these steps is important to the process, and this process can be applied to all areas of our lives. While it is possible to create without thinking through the creative process and many do exactly that, if we understand and apply this process it can help us to accomplish more and to be even more creative in our lives and our finances.

The Lord speaking to Joseph Smith said, "I will give you a pattern in all things, that ye may not be deceived."[60] David A. Bednar reminds us,

> Interestingly, the Lord gave us "a" and not "the" pattern for all things. I do not believe the Lord is suggesting with the language "a pattern in all things" that He has only one pattern to be used in every situation. Rather, the Lord's way includes a variety of patterns that can be employed to achieve different spiritual objectives.[61]

Let me share one possible pattern.

The Creative Process

Vision: We Catch our Vision. The scriptures teach "Where there is no vision, the people perish."[62] Why is vision so important? Vision is a critical precursor to effective goals, planning, writing, and accomplishing our personal and family goals. The best vision is from the longest perspective. Patricia T. Holland said, "Our prayers ought to be to see as God sees, to adjust our minds so we may see things from an eternal perspective. If we listen too often to the voices of the world, we will become confused and tainted. We must anchor ourselves in the spirit and that requires daily vigilance."[63]

Goals: We Develop our Goals. Goals are tools to help us keep us focused on our vision. Robert D. Hales gave advice on your choice of goals. He recommended:

> I would like to suggest a few of the most important goals in life that will give you joy as you fulfill your mission on this earth—eternal goals that will help you return with honor to your Father in Heaven. They include: Marry in the temple and cultivate eternal family relationships by prayerfully balancing the many facets of life, such as family, occupation, continuing education, hobbies, and entertainment. Faithfully and obediently live your religion and be true to the baptismal and temple covenants, always treasuring up the good things of life. Hold on to the eternal perspective, remembering that the things of the kingdom are eternal and the things of the world are temporal or temporary. Remember to give dedicated service throughout your life and always care for the needy who may require your love and other support.[64]

Plans and Strategies: We Make our Tactical Plans and Strategies. He continued and said, "Making these goals is not enough; we must make a plan to carry them out."[65] Goals are the destination, where we want to be, and our plans are the process by which we will get from where we are now to where we want to be. We need to be detailed in our plans to accomplish our goals and hence our vision.

Constraints: We Determine our Constraints. Whereas goals are the clear objectives for what you want to accomplish, and your plans are how you will accomplish those goals, then your constraints are given conditions or circumstances that your solution must satisfy. These are things that must be taken into account as these constraints can have a major impact on your ability to accomplish your goals and vision.

Accountability: We Share our Vision with Accountability Partners Who Can Help. Accountability is the process by which we make known our vision, goals and plans to others. This could be for three reasons.

- It may be because we need their moral or personal help to accomplish our goals and vision. Sharing your goals with your spouse and children is a good way to get help in accomplishing your goals. Having others help you be accountable for your goals is a great motivator.

- It also may be because they are part of our creative process and necessary to help us accomplish our goals. Mentors and friends can help when we fall short and help us know what to do to improve.

- As we share our vision with others, we give others permission to catch their own visions.

Regardless of the reason, accountability is an important part of the creation process.

For example, Heavenly Father's vision is the happiness and exaltation of his children. His goal is to "bring to pass the immortality and eternal life of man."[66] His plan is the Plan of Salvation or the Plan of Happiness. He has no constraints as his plan is for all people, and He communicates his plan with His children through prophets, apostles and scriptures. Just as He has a vision, goal, plan, constraints, and accountability, so we should too.

The manual will share concrete ideas and experiences on how you can apply the creative process to the personal finance area, how you can create your vision of what you want to become, set goals, develop a plan, work on constraints, and then communicate it to help you accomplish your vision. This process is applicable to all areas of your Personal Financial Plan.

Ezra Taft Benson reminded us to "Plan your financial future early, then live your plan."[67] As part of planning your financial future, you will develop your own Personal Financial Plan (PFP). Your PFP includes 16 different Plans, including your:

- Plan for Life (Vision, Goals, and Plans)
- Saving, Income and Expense Plan (Budget)
- Tax Plan
- Cash Management Plan
- Credit Plan
- Consumer Loans and Debt Plan

- Insurance Plan
- Family Financial Plan
- Investment Plan
- Retirement Plan
- Advance Plan
- Mission Plan
- Education Plan
- Housing Plan
- Auto/Toy Plan
- Individual/family Giving Plan

Our Conduct on the Journey is as Important as our Destination

As Anne and Bryan Sudweeks were driving home from our service in Nauvoo this year, they were listening to the book "Revelations in Context" and the section on D&C 136. Brigham Young was with the vanguard company in Winter Quarters, Iowa, and was praying for inspiration to get the Saints to the west. This section was guidance by the Lord on how to organize the Saints for their trip from Nauvoo to the Great Salt Lake.

As they thought about this inspired document, they wondered if there was more to this section than a standard organizational chart. Did it have a greater meaning that extended beyond the lessons for 1847? Chad M. Orton wrote:

> Some have assumed that the revelation is a simple how-to guide for organizing pioneer companies and have underestimated the role it played in refocusing Brigham Young and the Church. By helping the Saints remember that their conduct on the journey was as important as their destination, the revelation helped transform the westward migration from an unfortunate necessity into an important shared spiritual experience.[68]

Could the Lord be not only letting us know what Brigham needed to do, but also giving us a pattern that we can use in our financial lives as well?

Some have said, "The end justifies the means," meaning that "a desired result is so good or important that any method, even a morally bad one, may be used to achieve it."[69] Here in D&C 136 the Lord is saying that the means is as important as the end.

Brigham Young's vision and goal was simple, namely the largest single migration of an entire people, institutions, and culture in the history of the United States. To do this, the Lord inspired Brigham to organize the Saints "into companies, with a covenant and promise to keep all the commandments and statues of the Lord" (v. 2). Organization into companies was not new and had been discussed by the prophet Joseph. However, that combined with the covenant of righteousness was an inspired addition. Orton continued, "Brigham came to understand that

rather than simply blazing a trail that others would follow, the 1847 vanguard company was establishing a covenant path."[70] He knew that thousands would be following their path and direction, so inspiration was crucial. As the Saints kept their covenants and walked in the ordinances of the Lord, they had the help of heaven as they worked toward their destination.

Likewise, how we conduct ourselves on a day-to-day basis in our finances is as important as the final destination of financial self-reliance or saving money. The important thing is what we learn and become from our experiences with our finances, not just the amount saved, and the inspiration of heaven is critical. Our challenges may not be as daunting as Brigham's, but they are important. As we work toward our vision and goals of greater financial self-reliance, we should likewise be organized and prepared, as well as make that same covenant that we will "keep all the commandments and statues of the Lord" (v. 2) and "walk in all the ordinances of the Lord" (v. 4). As we do these things, we too can have heaven's help as we go along our journey to our financial and other goals.

What should our conduct entail? Thankfully, the Lord shared three important points.

<u>Follow the prophets and stay on the covenant path</u>. As soon as Brigham received this revelation, he and the other apostles worked to ensure that the Saints knew what the Lord expected of them. The results were instructive and impressive. Hosea Stout observed that following the revelation would bring needed calm and unity in the face of unexpected trials; it would "put to silence the wild bickering" that had complicated the journey across Iowa.[71] Richard E. Bennett noted that as they followed the prophet, the exodus became "the most carefully orchestrated, deliberately planned, and abundantly organized hegira [migration] in all of American history."[72]

As the pioneers kept all the commandments and statutes of the Lord (v. 2), followed the prophets (v. 3), and walked in all the ordinances of the Lord (v. 4), the Lord blessed them that they would be able to get to their destination. Likewise, as we keep the commandments and statues, listen to the prophets and stay on the covenant path, we too will get to our destinations, whether it is budgeting, investing, retirement planning, or other activities.

<u>Be wise stewards over all the Lord has freely given you</u>. The Lord reminded the saints that they were His agents and the blessings they had received were from Him and should be used to prepare for what and who were coming later (v. 7, 9). They were to use their intellect, resources and property to help others (v. 10), be honest in their dealings, not covet (v. 20), return things borrowed (v. 25), return what they find to their rightful owners (v. 26), and be diligent in preserving what they have (v. 27). They were counseled against contention, pride (v. 19), taking the name of the Lord in vain (v. 21), speaking evil one with another (v. 23), drunkenness, and unedifying conversations (v. 24). As they did these things with pure hearts, they were promised "Ye shall be blessed; you shall be blessed in your flocks, and in your herds, and in your fields, and in your houses, and in your families" (v. 11). Likewise, as we are wise stewards over our financial resources and work to avoid contention, we too will be blessed in the things we are striving to achieve.

Remember the poor and needy on your journey. While the Saints were to be wise stewards, they also had a covenant responsibility to share an equal proportion for taking care of the poor, widows, and fatherless (v. 8). Likewise, as we work toward our financial goals, we also must remember our covenant responsibility to remember the poor and the needy along our way and to bear our "equal proportion" through our fast and other offerings and helping and serving others.

Because of both organization and righteous conduct, the pioneers were able to make the journey to the west. They established not only a physical but a covenant path as well, a path we can follow today. The Lord reminded the Saints that their conduct on the journey was as important their destination. Likewise, how we do the things we need to do as we work toward our financial goals is as important as what we do.

The Lord then shared what that conduct should include. They must follow the prophets and stay on the covenant path, be wise stewards over all the Lord has freely given, and remember the poor and needy on their journey. As the Saints followed this inspired guidance and improved their conduct, they made progress toward their ultimate goal in the west. Likewise, that guidance has relevance to us today. As we remember the importance of our conduct and these same three areas of concern, the Lord will likewise help us in our financial vision, goals and destinations.

By emphasizing the importance of what we do, our conduct, and what we have, our blessings, we tie everything, including our finances, back to the gospel of Jesus Christ. Moreover, we transform our finances from an unfortunate necessity to an important shared spiritual experience as we work together with our spouse and families to accomplish our financial vision and goals.

Understand the Implications of this Learning Framework

This learning framework is important for six specific reasons.

1. This framework helps us ask the important questions about our lives and our finances, such as "What doctrines and principles, if understood, would help me:
    - "Change my attitudes and behaviors toward my finances to become better at them?"
    - "Teach my children the place of money in our lives, instead of just the world's ways?"
    - "Better live the commandments to live on a budget, spend less than I earn, and be more exact in my record keeping?"

Understanding doctrines and principles can help us ask important questions that can be used to enhance our learning as we ask and seek deeper answers to the difficult questions of life.

2. This framework reminds us where the answers really are. Bednar reminds us, "Appropriate applications are necessary but can never stand alone. What is needed is a balance among doctrines, principles and application. . . The answers always are in the doctrines and principles. And the doctrines and principles need to be in us."[73]

3. This framework allows us to lift our perspective and vision, which can help us gain greater motivation. By finding our higher purpose (or doctrines) in what we are doing, we gain greater motivation to do the things that we need to do. Ted Callister reminds us "With increased vision comes increased motivation."[74]

4. This framework encourages us to take a long-term eternal perspective rather than a checklist approach. Paul declared "In the dispensation of the fullness of times [God] might gather together in one all things in Christ."[75] How do we gather together in one all things and how does this framework help?

David A. Bednar wrote, "The principle of gathering together in one can aid us in changing the conventional checklist [of family finance] into a unified, integrated, and complete whole in receiving the transforming power of the gospel of Jesus Christ in our lives."[76] For most of us our lives revolve around the checklist of things necessary for us to do including living on a budget, getting out of debt, saving for long-term goals, etc. These things are often considered separately, rather than in relation to each other and in relation to our overall lives. As we gather together in one, we put all these things together and see that these things, including our finances, are simply part of the gospel of Jesus Christ and hence we know what is necessary for us to do. We must "obey the commandments."[77] "bridle all our passions,"[78] "perform every word of command with exactness,"[79] "strip ourselves of all pride,"[80] "offer [our] whole souls as an offering unto Him,"[81] and "endure to the end."[82]

5. This framework reminds us of the importance of Christ and our daily conduct. It is not enough to know these things and even to have a testimony of their truthfulness, we must do them every day. It is crucial that we daily stay on the covenant path daily and we will achieve our destination.

6. Finally, this framework helps change our thinking. While principles and application keep us on the right track, understanding the doctrines and principles allows us to transform those hourly and daily mundane acts of obedience we must do in our finances into the majestic purposes that our Heavenly Father has planned for us. It magnifies, as Dieter F. Uchtdorf says, "our small acts of obedience into holy acts of consecration" to our Savior Jesus Christ.[83] Louise Y. Robison reminds us, "If we only half do our work we will have no pleasure, if we do it from a sense of duty we will have no joy, but if we feel . . . that our Father in Heaven has felt us to be worthy . . . and that we can carry this work when it is here to do, then we will have joy.[84]

Summary

We must strive to bring Jesus Christ more into our lives and finances. To do that, we must seek to learn and love the Savior and His atonement more, strive to change daily and become more like Him, learn to apply His words and create our lives more closely with Him, and always remember Him. Our learning framework supports each of those activities.

Perspective is important in studying personal finance. Our perspective is that personal finance is simply living the gospel of Jesus Christ; it is putting Christ first in our lives. Our view of the Savior, the way we look at life, at others and ourselves will have an important impact on how we utilize the blessings we have been given by God. It is critical that we have a correct perspective with our lives and finances, as perspective influences our choices.

We shared our important learning framework of doctrine, principles and application. Doctrines are revealed truth. The first critical question was “why should we learn and become better at family finance? Four key concepts constitute the doctrines, each related to a different perspective.

1. Spiritual- To bring us to Christ
2. Temporal- To help us become wiser stewards.
3. Family- To help us return with our families back to Heavenly Father’s presence.
4. Individual- To help us accomplish our divine missions.

Principles are guidelines for the proper use of agency. The second question was “what are the principles on which how we learn and become better at personal finance are based? Four key concepts constitute the principles or “what’s” on which this perspective is based. They are:

1. Ownership- None of what we have is ours.
2. Stewardship- We are stewards over all God has blessed us with.
3. Agency- The gift of choice is one of God’s most precious gifts.
4. Accountability- We will be accountable for all our choices, including our financial choices.

Application is how we accomplish what we need. The third question was “how do we learn about and become better at personal or family finance? This application or the creative process is critical to our accomplishing all we need to in life. The five key concepts are:

1. Vision- Our vision is what we want to become or how we want to live our lives. It is our ultimate destination and what we want to be like.
2. Goals- Goals constitute our destination or where we want to get to become our vision.
3. Plans- Plans are our tactical strategies or plans that will allow us to accomplish our goals.
4. Constraints- These are the conditions or circumstances that are critical for us to accomplish our goals.
5. Accountability- Finally, accountability is how we let others know what we are trying to accomplish and how we enlist their help in our process.

In summary, our learning framework was designed to help us bring Christ into our finances.

- We must seek to learn and love the Savior and His atonement more. As we do, we realize the personal finance is simply part of the gospel of Jesus Christ.

- We strive to change daily and become more like Him. We know that doctrines and principles, confirmed by the Spirit, change behavior.
- We learn to apply His words and create our lives more closely with Him. For we know that application is an invitation to learn and create.
- We always remember Him. As we do, we remember our conduct on our journey is as important as out destination.

It is our responsibility to be financially wise and use the resources we have been blessed with in blessing the lives of our families and others. We do that best when we daily bring Christ more into our lives and finances. The purpose of this manual and accompanying website, PowerPoints and learning tools is to help you accomplish that purpose.

Assignments

Financial Plan Assignments

Think about the things we have discussed regarding the doctrines ("why's"), principles ("what's"), and application ("how's") of personal finance. Why is this learning framework different? What things will this framework help us understand? These are the reasons we should be learning this material and we have a process on how to do it. With this framework we can change, as Dieter F. Uchtdorf states, "our small acts of obedience into holy acts of consecration."[85] With this understanding, we can avoid the problems that come with the world's different perspectives on wealth – generally incorrect ones. To become truly wealthy, we must first have a correct perspective and understand the key doctrines and principles for using wealth wisely. The scriptures state, "For God so loved the world, that he gave his only begotten Son, that whosoever believeth in him should not perish, but have everlasting life."[86] This is the true kind of wealth. Think about what is necessary to have this correct perspective on wealth.

Read and discuss the following three important chapters that help us with perspective on wealth and our understanding of its key principles: 1 Timothy 6, Jacob 2, and Doctrine and Covenants 6. These chapters are available online at http://scriptures.ChurchofJesusChrist.org/.

As you begin your PFP, start by filling our your PFP Introduction Template (LT01-01). What will happen if you don't prepare carefully this PFP? What will happen if you do? Think through the benefits of putting together a thoughtful Plan.

Learning Tools

The following Learning Tool will also be helpful as you prepare your Personal Financial Plan:

Personal Financial Plan (PFP) Table of Contents (LT01)

This is a recommended table of contents for your Personal Financial Plan. It includes the 16 separate plans which make up your PFP.

Review Materials

Terminology Review

Accountability. This is a principle is that states we are accountable for every choice we make. We do not make choices with no consequences or accountability; rather, we will be held accountable for the decisions and choices we make.
Agency. This principle is that we have choice in our lives. We are agents of will, who can make choices consistent with our beliefs and values. Moreover, the gift of "choice" is man's most precious inheritance, and we should protect it carefully.
Application. Application is the "how' of how we do things. It is how we apply the doctrines and principles in our lives.
Constraints. Constraints are given conditions or circumstances that must be satisfied in order to enable us to accomplish our goals.
Accountability. Accountability is the process of letting others know what your vision, goals, plans, and constraints are to enlist your help in the creative process. It can also be enlisting others in helping accomplish your goals as you need their help for certain specific parts of your plans and strategies.
Creative Process. It is the way we get from an idea or vision to its eventual accomplishment. It has five critical areas: vision, goals, plans, constraints, and accountability.
Doctrines. Doctrines are the reasons behind why we do things. They answer the "why" questions of our lives, which are generally the most difficult questions to answer.
Goals. Goals are tools to help us keep our vision in focus. They are intermediate stepping stones that will take us to our eventual vision of what we are trying to accomplish.
Ownership. This is the principle that everything we have is the Lord's, and we do not own the things we have and are. It is based on scripture and helps us to see our blessings as gifts on loan from a loving Father in Heaven.
Perspective. Perspective is how we look at things. It is important because it influences choice. We can take many different perspectives in our view of different aspects of our lives, with the best perspective being the perspective that last the longest—an eternal perspective.
Plans. Tactical plans are the roadmaps by which we will accomplish our goals. It is how we will get from where we are now to where we want to be to accomplish our goals.
Principles. These are doctrinally based guidelines for how we should live our lives. Whereas doctrines answer the 'why" questions, the principles are the "what" questions, i.e., what are the things and guideline we should be following and doing.
Stewardship. This is the principle that we are stewards over all that the Lord has, is, or will share with us. This view helps us realize the things we have are a gift and we should take care of them.
Vision. This is the act or power of seeing or imagination, where we come to solidify in

our minds who we are and what we can accomplish. It is a creative work through which the power of thought, imagination, and effort combine to help us thoughtfully consider possible future events that may come to pass.

Review Questions

1. Why is it important to "decide to decide" now? What problems can it help us avoid?
2. Why does God want us to learn wise money management?
3. What is our perspective and why is it important?
4. What are the four key principles on which that perspective is based? Why are they important? What can we do to incorporate these principles into our lives now?
5. Some have asked, "If wealth is so bad, should we seek for riches?" What did Jacob say about this question in Jacob 2:18–19? What should we seek for first?
6. What are the benefits of this doctrines, principles and application learning framework?

Case Studies

Case Study 1

Data

Brenda came from a family that had few worldly goods, but there was a lot of love in the home. She has come to talk with you about her finances because she respects you for the wonderful example you have set at work.

Application

She asks you, "What is the purpose of wealth in our lives?"

Case Study 1 Answers

You have lots of good ideas, but you share the following: Jacob shared with us one view of the purpose of wealth in our lives. He counseled us that if we seek wealth, we should do it for the right reasons, and it is OK to do so only *after* we seek the kingdom of God. The purpose of wealth is not to build ourselves up, and its possession does not allow us to think we are better than other people. Rather, it is to help us bless our families, serve our fellow men, and build the kingdom of God.

Case Study 2

Data

Brenda continues to ask you questions regarding your perspective and principles for using wealth wisely. She asks if there are principles that you know and have lived that have made a difference in your life.

Application

Share the four key principles for using wealth wisely discussed in this chapter. Why is each principle important? What can we do now to incorporate each principle into our lives now?

Case Study 2 Answers

There are several good answers for these questions. You might respond with:
Our perspective is that personal finance is simply living the gospel of Jesus Christ. That perspective is based on four key principles:

1. Ownership: Everything we have or are is a gift from God.
    - It is important because the things we have are not ours but are on loan from a loving Father in Heaven.
    - We can incorporate this principle into our lives by learning that when we share with others, we are only giving back to God what was His in the first place.
2. Stewardship: We are stewards over the things the Lord has blessed us with.
    - It is important because we must learn to be better stewards over our blessings because we will be held accountable for what we do with these blessings.
    - We can incorporate this into our lives by learning as much as we can about the things we need to do so we can become the best stewards we can over the blessings our Heavenly Father shares with us.
3. Agency: The gift of "choice" is man's most precious inheritance.
    - It is important because we need to use this gift wisely so we can return and live with God eternally.
    - We can incorporate this into our lives by studying all areas of our decisions and decision-making processes so we can have the information needed to make the best decisions possible.
4. Accountability: We are accountable for our choices, including our financial choices.
    - We are the final decision-makers in life.
    - It is important because we must learn to choose wisely.
    - We can incorporate this into our lives by setting good goals and then by making wise choices to help us attain those goals—goals that our Heavenly Father would have us seek.

Case Study 3

Data

Brenda was concerned as one of her friends was blessed with material riches, and made poor choices which caused him to lose his testimony. She asks: "If wealth is so bad, should we seek for riches?"

Application

What did the prophet Jacob in Jacob 2:18-19 say about this question? What should we seek for first?

Case Study 3 Answers

The prophet Jacob said seeking for riches is OK "if" we first seek the Kingdom of God, and if we seek riches for the right intent--for righteous purposes.
But before ye seek for riches, seek ye for the kingdom of God. "And after ye have obtained a hope in Christ ye shall obtain riches, if ye seek them; and ye will seek them for the intent to do good-to clothe the naked, and to feed the hungry, and to liberate the captive, and administer relief to the sick and the afflicted (Jacob 2:18-19).

First, we should seek for the Kingdom of God and doing His will. Then we can seek for riches—but with the intent to do good. Gordon B. Hinckley said: "The Lord will love us, I think, to the degree to which we lift and bless those in distress. I believe that with all my heart, mind, and soul. The accumulation of means is not a bad endeavor when those means are used to bless the needy of the earth."[87]

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2. Intermediate Investing 1: Principles

Introduction

The previous chapters have been successful if they have helped you put personal financial management into perspective. These chapters have taught you the “why’s,” “what’s”, and “how’s” of personal finance and the creative process of how to live on a budget, keep track of where your resources are going, manage your cash and cash equivalents wisely, protect yourself from loss by owning insurance, and make big-ticket purchases wisely. Now we begin a discussion on long-term investing.

Please be aware that this class approaches the subject of investments differently than other textbooks approach this subject. Most books take an asset-based approach: in other words, they talk about stocks, bonds, mutual funds, and other assets. These assets will change over time as new assets are developed and sold. I take a principles-based approach to discussing investments because the principles will not change over time.

Objectives

When you have completed this chapter, you should understand the key aspects of investing including:

A. Understand what to do before you invest and the investing factors you control
B. Understand the principles of successful investing
C. Understand asset classes
D. Understand what makes a good mutual fund
E. Understand and select your investment vehicles

Know What to Do Before You Invest

Once you have some basic information, there are some other important questions to ask yourself before you start investing in financial securities. This is important as there are things we should do first before we begin investing for retirement and other goals.

- Are there bills or debts you should pay before beginning your investment program? Are there covenants we have made which help us realize our financial priorities?
- Are there certain products or services you feel you should never do without? Should you have health and life insurance before you begin investing?
- What should you do about your high-interest debts such as credit cards and consumer loans? Does it really make sense to earn 6 percent annually on an investment when you

are paying 24 percent annually for credit cards and other forms of debt?
- How does investing fit in with your personal vision, goals, plans and budget? Do you have a plan for investing? What is that plan?

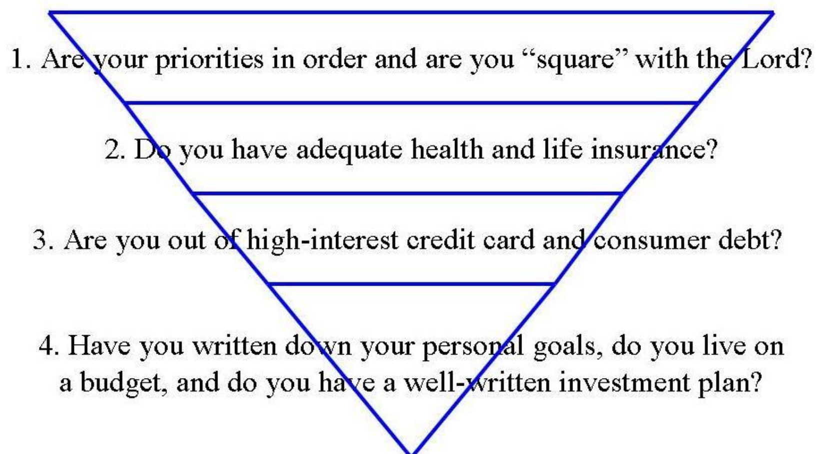
As I have worked with families and students, I have developed a helpful framework for teaching investing. I call this framework "the investment hourglass." This tool helps relate priorities and risks to the goals you want to accomplish.

The investment hourglass is divided into two parts: the top of the hourglass, which represents questions you should consider before you invest, and the bottom of the hourglass, which represents how you should invest.

The hourglass is designed to help you prioritize your goals and objectives. Since investing is a means to an end—and not an end in itself—you should base your investment decisions on your vision, goals and plans. If you can answer each of the questions listed in the top of the hourglass affirmatively (see Picture 2), you are ready to invest. If you cannot answer affirmatively with any of these statements, you have other important things to do before you begin your formal investing in securities markets.

The top of the hourglass teaches about priorities. What are your most important priorities, and how do we make sure we put first things first? First and foremost, your most important priority is being "square" with the Lord, who I believe is your most important creditor. Before you invest, ask yourself if you have paid your tithes or other contributions to your local church or religious organization consistent with your belief in God and desire to obey His commandments.

Picture 2. Top of the Investment Hourglass—Before You Invest



Your second priority is your family. If something were to go wrong with your health, or if you were to die, who would take care of your family? Make sure you have adequate life insurance

and health insurance in place before you begin investing. Disability or death is not a valid excuse to stop providing for the needs of your family.

Your third priority is yourself. Personal responsibility has two parts: the first involves getting out of credit card and consumer debt. When there is no guarantee that you will make a return on your investments in the stock market, it does not make sense to pay 24 percent interest on credit cards. The second part of personal responsibility involves knowing your vision, goals and plans, including living by your budget and Investment Plan. Figuratively speaking, before you drive to a new location, you must understand where you are, where you want to be, and how to get there. Your budget represents where you are, your vision represent where you want to be, and your Investment Plan represents how to get there.

If you can answer "yes" to each of the questions from the top of the investment hourglass, you are ready to invest. This hourglass can help you keep your priorities in order: God first, family second, and personal responsibility third.

Factors Controlling Investment Returns

Reinhold Niebuhr in the Serenity Prayer wrote, "God grant me the serenity to accept the things I cannot change; courage to change the things I can; and wisdom to know the difference"[1] (see Picture 3).

Picture 3. Serenity Prayer

Jim Seaberg reminds us of the six factors that control investment returns.[2] Five of those factors are within your personal control, while only one is outside of your control. The five factors you control are

- How much you save,
- How long your investments grow,
- Your mix of investments, i.e., your asset allocation,
- How much you pay in expenses, and
- How much you pay in taxes.

The only factor you do not control is

- Your investment returns.

If you want to do well on your investing, spend your time and efforts on the things you can control!

Focus on:

- Saving money each week or month by reducing your spending and sticking to your budget.
- Keeping your investments in the market at your acceptable risk level. This will allow your investments to compound over time.
- Understanding your risk level, and then keeping your asset allocation, your stock and bond mix, consistent with that risk level.
- Being wise and keeping fees, expenses, and transactions costs at the lowest possible level.
- Being wise and investing so that you minimize taxes and maximize after-tax returns.

Successful investors spend their time on the areas that are within their personal control while spending a minimal amount of time on areas outside their personal control. In the area of investment returns, we recommend the use passive management/indexing as an investment strategy to minimize risk and give some control over their of investment returns. On the other hand, many novice investors spend their time on areas they cannot control and fail to be concerned with areas they can control.

Once you have a basic understanding of investing and the things you can and cannot control, it is necessary to understand how most investors have done and the principles of successful investing.

Understand and Follow the Principles of Successful Investing

The purpose of principles is to give us guidelines to help us manage and accomplish our personal and family vision and goals. If you understand the "correct principles" that relate to successful investing, you will be able to "govern," or manage, your investment portfolio better. Dallin H. Oaks said:

> We live in a complex society, where even the simplest principle can be exquisitely difficult to apply. I admire investors who are determined not to obtain income or investment profits from transactions that add to the sum total of sin and misery in the

> world. But they will have difficulty finding investments that meet this high standard. Such complexities make it difficult to prescribe firm rules. *We must rely on teaching correct principles*, which each member should personally apply to govern his or her own circumstances.[3]

Once you are ready to invest, you must recognize that there is not just one right way to invest. There are multiple methods of investing, depending on your vision, goals, budget, and Investment Plan. The key to successful investing is to know yourself and what you are trying to accomplish.

How have Most Investors Done?

An important question to ask about investing is "how have most investors done?" By answering this question, it can help us to see if the current methods used by most investors have been successful in helping them attain returns in excess of their benchmarks—what they could accomplish with an indexing strategy.

Table 1. Historical Analysis of Equity Investor's Return (Dalbar 2015-2019)

Year	Investor Period	Investor Returns	Benchmark Returns	Difference
2015	1995–2014	5.2%	9.9%	-4.7%
2016	1996–2015	4.7%	8.2%	-3.5%
2017	1997–2016	4.8%	7.7%	-2.9%
2018	1998–2017	5.3%	7.2%	-1.9%
2019	1999–2018	3.9%	5.6%	-1.7%

Table 2. Historical Analysis of Fixed Income Investor's Return (Dalbar 2015-2019)

Year	Investor Period	Investor* Returns	Benchmark Returns	Difference
2015	1995–2014	0.8%	6.2%	-5.4%
2016	1996–2015	0.5%	5.3%	-4.8%
2017	1997–2016	0.5%	5.0%	-4.5%
2018	1998–2017	0.4%	4.6%	-4.2%
2019	1999–2018	0.2%	4.6%	-4.4%

Table 3. Historical Analysis of Asset Allocation Investor's Return (Dalbar 2015-2018)

Year	Investor Period	Investor Returns*	Benchmark Returns**	Difference
2015	1995–2014	2.5%	8.4%	-5.9%
2016	1996–2015	2.1%	7.0%	-4.9%
2017	1997–2016	2.3%	6.6%	-4.3%
2018	1998–2017	2.6%	6.2%	-3.6%
2019	1999–2018	2.9%	9.7%	-2.3%

* DALBAR 2015– 2019 ** Estimate of 60% equity and 40% fixed income

To understand how most equity investors have done in investing, you must compare their returns to their benchmarks or indexes. A benchmark is a yardstick to see how a group or portfolio of assets

have performed. One of the longest surveys of how investors have done is provided by Dalbar (Dalbar.com). Each year DALBAR puts out an annual survey called *Quantitative Analysis of Investor Behavior* (QAIB), which discusses how the average investor in equities, fixed income and asset allocation funds have done compared to his or her benchmarks over the past 20 years. It covers returns over the past 20 years and it is updated every year.

Interestingly, with all the information available at our fingertips via the internet and with our abilities to buy and sell stocks instantaneously, most investors have not had very high returns in comparison to their benchmarks (see Table 1). Realize that the negative sign is the shortfall per year, not the shortfall over the 20 year period, and it is significant.

Have bond investors done any better in comparison to their bond benchmarks? Sadly, the returns were even less and the difference between the average bond investor's return and the bond benchmarks was even greater (see Table 2).

What about those who participate in an asset allocation strategy (actively moving between equity markets and bond markets based on which seems most attractive)—how have they done? Again, the results are not encouraging (see Table 3).

As the saying goes, "If you do what everyone else does, you will get what everyone else gets."[4] Based on the DALBAR studies, it seems that whatever people are doing regarding investing is not working very well for equity or fixed income investors compared to benchmarks. Perhaps there are better ways to invest than what others have done in the past or are doing now.

How have most actively managed mutual funds performed compared to their benchmarks? If they have performed better, we could conclude that the active managers are adding value over and above the return that an investor could receive by investing in a low-cost, tax-efficient index fund or ETF.

In general, most actively managed mutual funds have not beaten their benchmarks over the long term (see Chart 1). While in some years actively managed funds outperform their index fund counterparts, the support for actively managed funds for longer periods of time is low.

Another paper that examined mutual fund performance on both a total return and after-tax basis reported:

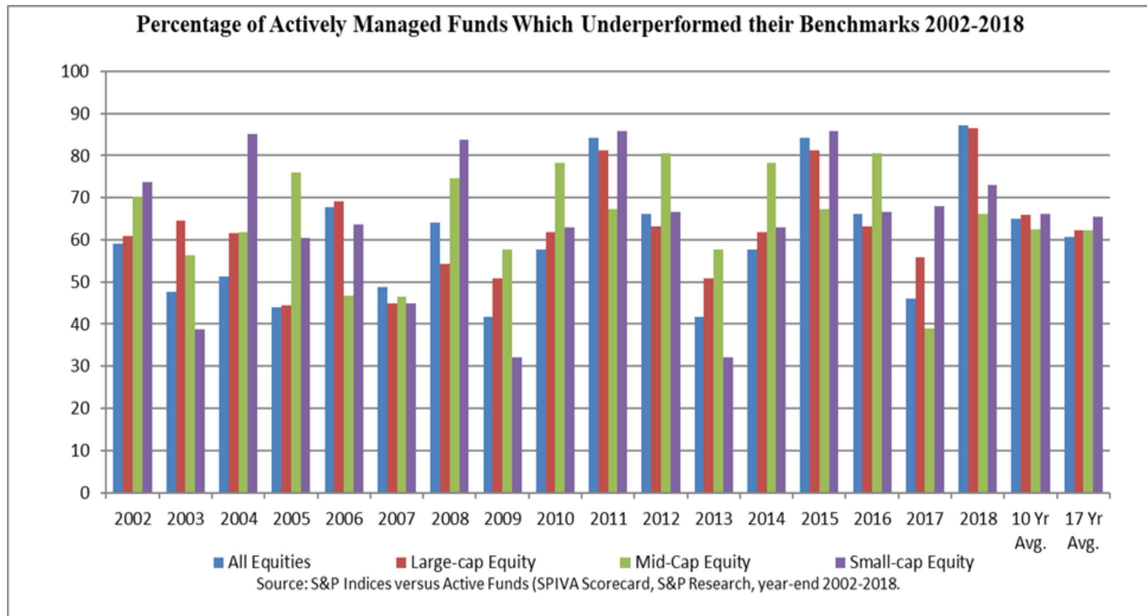
> In general, we find that index funds outperform actively managed funds for most equity and all bond fund categories on both a total return and after-tax total return basis, with the exception of actively managed small company equity and international funds. These results should be viewed with caution, however, as there is evidence that actively managed funds outperform the index funds during periods when the economy is either going into or out of a recession.[5]

Recent experience is not much different. In the last 10 years, the percentage of actively managed funds that failed to beat their benchmarks was in excess of 60-65%, depending on asset class (see

Chart 2).

Whatever you decide to invest in, and whatever phase of investment you are in, it is critical that you adhere to correct principles. Following are the principles that I believe, if followed, will help you to minimize that difference between investor returns and benchmarks and will likely help you to have a successful portfolio.

Chart 1. Percentage of Actively Managed Funds That Failed to Beat Their Benchmarks[6]



1. Know Yourself, your vision, goals and plans. Investing is not an end in itself; rather, it is a means of reaching your vision and your personal and family goals. Consequently, you need to know yourself as an investor. You should have well-written and well-thought-out vision, goals and plans. Goals are critical because they help you determine what you want to accomplish with your investment program. For help on writing your goals, see Chapter 2. Creating Your Personal Financial Plan and Setting Personal Goals.

You also need to know your budget. A critical part of successful investing is having a well-planned budget; a percentage of your income should be earmarked for savings and investment. You cannot invest without funds, and you should not invest with borrowed money. For help on budgeting, see the chapter on budgeting.

You also need to understand your ability to tolerate risk. You want to develop a “sleep-well portfolio”—a portfolio that is planned so that even when investments go wrong, as they often do, you can still sleep well at night.

Beware of overconfidence in your portfolio. One sign of overconfidence is frequent trading. A study found that men trade 45 percent more often than women trade and that men's annual returns were, on average, 2.7 percent lower than women's annual returns. The study also found that single men trade 60 percent more often than single women trade and that single men's annual returns were 1.4 percent lower than single women's annual returns.

You must be especially wary of overconfidence when trading online. The same study showed that the same group of investors beat the market by 1.9 percent before online trading. However, when the same group of investors switched to online trading, the group underperformed by 3.6 percent. [7] While online trading may appear to give you more control, it can result in lower overall returns if it leads to greater overconfidence and more frequent trading.

1. **2. Seek, receive and act on the Spirit's guidance**. This includes seeking diligently through study and prayer, living worthy of the Spirit's guidance, and then acting on it once it is received. Carlos E. Asay said,

> When the Spirit is with us, we can think thoughts we've never thought before, we can say words we've never said before, we can perform beyond our natural abilities. That power is related to truth, to the scriptures, to the stirring of the Spirit within. And the power won't come unless we're actively courting the influence of the Holy Ghost.[8]

3. Understand the key areas of investing and especially risk. Risk is inherent in all investment activities. Some risks include inflation, business, interest-rate, financial, market, political and regulatory, exchange-rate, call, and liquidity risks. The key to managing risk is to understand the different types and to invest at a risk level that is comfortable for you. Often, taking a risk tolerance test will help you discover the level of risk that is right for you. One such test is included in the Learning Tools section of the website A Risk-Tolerance Test (LT16).

4. Stay Diversified. Diversification is your best defense against risk. Diversification does not mean simply investing in 10 different banks; rather, to be properly diversified, you should invest in different companies, industries, and perhaps even countries that won't be subject to the same economic factors or risks. Make sure you understand the risks of each of your investments.

Many people review the portfolio returns from various asset classes over the last 10, 20, or 50 years to get an idea of an asset class's performance history. However, these people often invest in only one or two single assets instead of in a portfolio of 500 or more stocks and are often disappointed when they do not get the returns they expected. Remember, the returns from asset classes are from portfolios of hundreds of assets—not

from individual assets. To see the effects of diversification, see Historical Return Simulation for Asset Classes (LT23).

5. Make Low-Cost and Tax-Efficient Investments. Watch your investment costs carefully, including costs for transaction fees, management fees, and taxes. Remember that when investing, a dollar saved is worth more than a dollar earned.—you have to pay taxes on every new dollar you earn, but every dollar you save is already taxed and can earn interest on income. Be aware that frequent trading incurs significant transaction and tax costs; avoiding this will help you keep your costs low.

Defer or eliminate taxes as much as possible. Mutual funds are required by law to distribute 90 percent of all capital gains, dividends, and interest to their shareholders each year. That means you must pay taxes on the distributions from your mutual funds each tax season, even though you may not have sold a single share. Mutual funds are pass-through accounts for tax purposes, which means that the tax consequences of the mutual fund are paid by the investor, not the mutual fund. The portfolio manager's decisions can have a significant impact on your tax bill.

Make tax-efficient investments to avoid paying more taxes than necessary. Remember, it is not the amount of money you make but the amount of money you keep after taxes and inflation that makes you wealthy.

6. Invest for the Long Run. Invest for the long run; this is how you will achieve your goals. There are no "get-rich-quick" schemes that work.

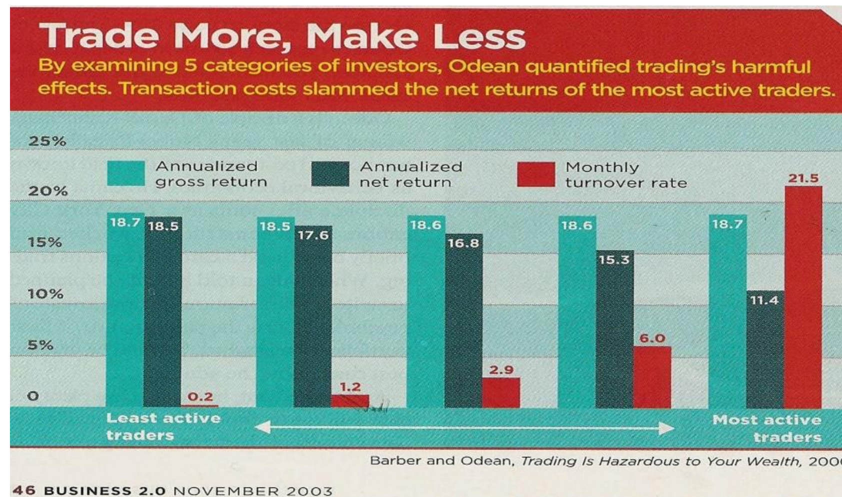
Avoid short-term trading. Short-term trading is expensive and incurs transaction costs and taxes. Be sure to keep at least part of your funds in the market for the long run—taking money out of the market may not only slow your progress but could stop it altogether. A recent study found that those who traded more often, using the turnover ratio as a proxy for trading, had lower returns than those who traded less often and used a buy-and-hold strategy (see Chart 2).[7]

7. Use Caution If You Are Investing in Individual Assets (which I do not recommend). If you want to invest in individual assets (which is not necessary for a successful portfolio), do your homework and know what you are investing in and who you are investing with. Learn about the company, its financial statements, its management, its short- and long-term strategies, its domestic and global industry, and its competition. It takes many hours of diligent, careful research to investigate a company thoroughly. Do not take others' word for it: do the research yourself. Of course, finding a great company is not enough—the stock must also be priced right. A great company whose stock is overpriced can still be a lousy investment.

If you do not have time to research individual companies, invest in mutual or index funds that contain many individual assets. If your mutual fund has 10 stocks, you need to know

those 10 stocks well. However, if your mutual fund has 500 or more stocks, you do not need to know those 500 stocks as well because each stock has such a small impact on your total portfolio.

Chart 2. Trade More, Make Less



If you want to try to beat the market, try for a short period of time and compare your returns after taxes to your benchmarks. Do not waste too much time and energy trying to beat the market because you will be able to match the market return with little or no effort through no-load, low-fee index mutual funds or exchange traded funds (ETFs).

If you feel you must trade actively, try to trade efficiently in terms of taxes. Trade in tax-deferred or tax-eliminated retirement accounts such as a 401(k), Roth IRA, or traditional IRA accounts so your taxes are eliminated or deferred until you take the money out at retirement.

8. Monitor Portfolio Performance against Benchmarks. Thomas S. Monson stated, "Where performance is measured, performance improves. Where performance is measured and reported, the rate of improvement accelerates."[9]

How can you know how your investments are doing if you do not monitor their performance? To understand the performance of your investments, you will need to learn how to use benchmarks. Benchmarks are passively managed portfolios of financial assets that indicate how well your financial assets are performing. Set your own portfolio benchmarks and then monitor your portfolio performance on a monthly, quarterly, and annual basis.

If you choose to invest in actively managed mutual funds, compare the assets' after tax performance against the benchmarks you have set. If the return on these assets is consistently lower than the benchmarks, consider investing in no-load (no sales charge),

low-fee index funds, which are discussed later in this course. The returns on index funds are generally more consistent in matching the performance of selected benchmarks than actively managed funds.

9. Do Not Waste Too Much Time and Energy Trying to Beat the Market. It is difficult, expensive, and time-consuming to try to beat the market, or gain returns in excess of the returns on the major asset classes. While it may be possible on a short-term basis, it is difficult to consistently beat the market on a long-term basis. You are competing against hundreds of thousands of professional money managers with much more time, money, and access to information than you have.

10. Invest Only with High-Quality, Licensed, Reputable People and Institutions. When you need help, do not be afraid to ask for it. However, be sure to get help from good people whose actions and beliefs are consistent with the principles discussed in this chapter. Good help from qualified, licensed, and experienced financial planners, financial advisors, and brokers may help you with your Investment Plan.

Make sure you invest with mutual fund companies that have a tradition of meeting the needs of their investors. Work with good companies that offer good products. Be careful with your money and invest it wisely.

Use the best resources available to help you invest, but be aware of how much you pay to use those resources. In addition, make sure your advisors are licensed to counsel you on the broad range of investment assets you are (or should be) considering. Work only with licensed and registered advisors. In some circumstances, fee-only financial planners or advisors may be a better choice than financial planners or advisors that are paid on commission.

11. Develop a Good Investment Plan and Follow It Closely. Develop a good Investment Plan that is consistent with your goals, your budget, and the principles discussed in this chapter. Follow this plan closely. An Investment Plan is a detailed road map of your investment risk and return, constraints, investment strategy, and reporting and evaluation methodology. For an example of an Investment Plan, see Investment Plan Example Template (LT05A).

Your Investment Plan should outline the amount of return you are seeking and the risk level you are comfortable with for investments. This plan documents constraints—such as taxes, liquidity, and time horizon—that affect your portfolio. It details which asset classes you will or will not invest in and includes your view on active versus passive management. It lays out your plan for the percentage of gross income you will invest each month, the amount you will invest in each of your chosen asset classes, the maximum percentage of your assets that you will invest in any single new investment, and the ways your strategy will change as you get older. Finally, your Investment Plan

details how often you will rebalance your portfolio and how often you will report the portfolio performance to others.

Think of your Investment Plan as a road map to successful investing. Your plan should be consistent with the principles discussed in this course.

Finding Balance

As you work on understanding and developing your how you will investment, finding balance among doctrines, principles and application is important in helping you become better investors. We have shared some ideas for principles, although you can find others. Below are a few ideas for doctrines on which the principles are based. As you strive to increase your ability and effectiveness in investing wisely, I recommend you study and ponder the doctrines and principles supporting this application.

Principles	Doctrines
Know yourself, your goals, vision and budget	Identity
Seek, receive and act on the Spirit's guidance	Obedience
Understand risk – there is lots of it	Stewardship
Stay diversified	Accountability
Invest low-cost and tax efficiently	Stewardship
Invest long-term	Stewardship
Know what you invest in	Accountability
Monitor performance versus benchmarks	Accountability
Don't waste time trying to beat the market	Stewardship
Invest with good people and firms	Stewardship
Develop a good Investment Plan (IPS) and follow it	Stewardship

From Obedience to Consecration

From the principles and doctrines, we can see that we are not just working on being wise with our liquid assets, which is an application. From a higher perspective, or increased vision,

> We are children of the Creator (identity), striving to live worthy of the Spirit (obedience), learning to understand ourselves and our risk tolerance (agency), and learning to understand financial markets and instruments (accountability). We are developing our investing talents carefully (stewardship), so we can invest our resources carefully and wisely (agency), to accomplish our personal missions and our individual and family vision and goals.

If you plan wisely and invest accordingly, you will save yourself from heartache and problems in the future, and you will likely achieve your personal and family goals.

Understand Asset Classes

We have already shared that asset classes are broad categories of investments with specific (and similar) risk and return characteristics. Asset classes are distinguished by characteristics specific to particular groups of securities, such as type of financial instrument, market capitalization, maturity, geographic location, etc. The major asset classes are cash and cash equivalents, fixed income, and equities.

Always be diversified in your investing—don't put all your financial assets or "eggs" in one basket. What this means is to invest in many different asset classes in your portfolio such as equities: large cap, small cap, international, emerging markets, etc.; bonds: taxable, tax-free; short-, med-, and long-term corporates; short- and long-term governments, etc.; and cash: money market, CDs, savings, MMMFs, etc.

Investing entails risk, which means different things to different investors. Risk could mean the possibility of losing all your money. It could also mean the possibility of losing principal. Risk could also entail the possibility of not achieving a specific holding-period return.

Risk is measured in many different ways. In the past, the main risk of investing was considered "default risk," or the risk that a company would not be able to pay back an investment due to default or bankruptcy. Government securities were considered risk-free investments because investors knew the government could always print money.

In more recent years, analysts began to use variance, or standard deviation, to better measure risk; using this measurement, they found that even government securities are risky. This measure of risk is not concerned with the possibility of default but with the volatility of the investments—the risk that the investment's return may be lower than expected. Currently, investors also use a metric known as "beta," which measures the way a specific stock moves in relation to a specific market or benchmark.

Generally, most investors prefer to use variance or beta to measure risk. Both are measures of how volatile a stock is—how much it moves both up and down. In the case of beta, risk is also measured by how much the stock moves in comparison to a specific benchmark. A lower variance indicates that the price does not move very much. A higher variance indicates that the price moves a lot in comparison to the benchmark. A beta higher than one indicates that the stock is more volatile than the market; a beta less than one indicates that the stock is less volatile than the market; a beta of exactly one indicates that a stock moves with the market. When you look at a stock's returns, you should always look at the variance of the stock as well. Generally, higher returns carry higher risks because investors must be compensated for taking on additional risk.

There are a few important concepts you should understand related to risk:

- *Investment risk* is the probability of not achieving some specific return objective.
- The *risk-free rate* is the rate of return that will definitely be obtained through an investment in a short-term government security.
- The *risk premium* is the difference between the expected return and the risk-free rate.

- *Risk aversion* is the reluctance of an investor to accept risk.

The Importance of Asset Classes

Understanding asset classes is critical if you are to invest. You should invest at a level of risk that you are comfortable with and that will help you to achieve your personal and financial goals. The way you manage risk is by managing the amount of your portfolio in the respective asset classes (or baskets of investments).

Asset classes are broad categories of investments with specific and similar risk and return characteristics. They are distinguished by characteristics specific to particular groups of securities, such as type of financial instrument, market capitalization, maturity, geographic location, etc. The major asset classes are cash and cash equivalents, fixed income, and equities. We will discuss each asset class simply to help you understand the benefits and risks of the specific asset class.

Cash and Cash Equivalents. The major goal of this asset class is liquidity and to preserve capital. This asset class includes Certificates of Deposits (CDs), money market funds, T-bills, and commercial paper, etc. For an individual investor, it would also include your savings, checking account, money market deposit accounts. It offers a fixed rate of return.

Cash includes money market funds which seek to preserve the value of your investment and still offer a somewhat competitive return. Short-term interest-bearing investments include Treasury bills and Savings Bonds, loans to the U.S. Government, and commercial paper, loans to corporations.

The advantages of cash and cash equivalents is liquidity and stability of principal. You can turn these securities into cash quickly and easily. They are generally low risk. There is little risk of losing principal since the borrowers have good credit and loans are for short periods of time. These are good investment assets for money you plan to use in less than 3-5 years and don’t want to take risks with losing principle.

The disadvantages is that they are less attractive as medium-to-long-term investments (> 5 years) as returns on cash and cash equivalents are unlikely to keep up with taxes and inflation. Cash assets are generally fully taxable—make sure you take taxes into consideration.

Fixed Income (or Bonds). The major goal of fixed income is to provide income and to hopefully earn returns in excess of inflation. There are many different types of fixed income assets including taxable bonds include U.S. Treasuries, corporate bonds and agency issues (bonds issued by U.S. government agencies, like Ginnie Mae); tax-free bonds include revenue or general obligation bonds issued by local or state governments and agencies. Such bonds are generally free from federal and state taxes on income.

Short-term bonds (or short term bond mutual funds) include bonds that mature in less than five

years. Short-term bonds are less vulnerable to interest rate risk than long-term bonds as there is a shorter time period before the bonds mature. Short-term bonds are generally considered good investments for anyone needing a dependable stream of income (dividends) in an environment where interest rates are not likely to rise.

Intermediate-term bonds/bond funds are bonds with a maturity of 3–10 years. Because of their longer maturity, they are more susceptible to interest rate risk, the risk that interest rates rise during the period you own the bonds.

Long-term bonds (or junk bonds or bond mutual funds) are bonds with a maturity of 10 or more years. These bonds generally have the highest yields, but are the most vulnerable to interest rate volatility.

Inflation protected securities are securities whose yield is linked to the rate of inflation as measured by a specific inflation index. These bonds have the benefit that when interest rates rise, the yield on the bond rises as well.

The U.S. Government also sells savings bonds to investors whose earnings fall within specific income limits. I Bonds (or inflation linked bonds) have their interest rate linked to inflation that changes every six months. EE Bonds pay a fixed interest rate over a specific period of time.

Bond mutual funds are different from buying individual bonds. Mutual funds buy and sell bonds before they mature. Investing in a bond mutual fund means you are buying a share in thousands of different bonds in a changing portfolio, and so you are more diversified than in buying an individual bond. The income from a fixed-income mutual fund fluctuates as mutual funds buy and sell bonds. The market value of the mutual fund changes depending on whether the fund is selling bonds at a loss or gain. The longer the maturity of the bonds (see the average maturity) the more dramatically your principal will gain or lose value as interest rates change.

The advantages of fixed income investments is that they offer greater potential return than cash, but at greater risk. They are a good diversification tool when holding a diversified portfolio of assets, as bonds generally move differently than stocks.

The disadvantages are that returns have been historically lower than stocks. They are very susceptible to interest rate and other risks. Generally, fixed income assets alone are not good long-term investments because they don't provide enough growth to beat inflation over long periods of time. They should be part of an overall diversified portfolio.

Equities (or Stocks). The major goal of this asset class is to provide growth and earn returns in excess of inflation. Over long periods of time, the stock market historically has been the only major asset class to consistently outpace inflation.

An equity share is ownership in a businesses' earnings and assets. You get a proportionate share of the profits by receiving dividends, and also benefit from increases in the company's share

price as well. Mature companies are a likelier source of dividends (rapidly growing companies often prefer to reinvest profits).

Equity asset classes are generally delineated by market capitalization (which is shares outstanding multiplied by the stock's current market price), type of company (growth versus value), or geographic area. The benchmarks for each asset class tend to change over time, but equity asset classes can be generally defined as follows:

Market capitalization is one measure of the size of a company. It is calculated by multiplying the market price of the stock by the number of shares (i.e. ownership pieces) outstanding. The greater the capitalization, the larger the company. It is used to weight companies in various benchmarks by the size of the company, i.e. large-capitalization (or large cap), mid-capitalization (or mid-cap), or small-capitalization (or small-cap) firms.

Large caps are stocks with a market capitalization greater than $10 billion in the US, and smaller capitalizations for international companies. These are the generally the largest, most well established companies in the US, with a history of sales and earnings as well as notable market share which has allowed them to grow and expand. Traditionally, large cap was synonymous with "dividend-paying company," but this is no longer a standard for classification. These are generally mature corporations with a long track record of steady growth and dividends.

Mid-cap or mid-capitalization stocks are stocks with market capitalization between roughly $2 billion and $10 billion. These stocks tend to grow faster than big cap companies, and are generally less volatile than small cap companies. Mid-caps generally perform somewhere between small-cap and the large-cap asset classes. For asset-allocation purposes, mid-caps are generally not considered a major asset class.

Small-cap or small capitalization stocks are companies with a market capitalization less than $2 billion. These are smaller, sometimes newer, US and global companies that are still developing and may have a smaller market share than their large-cap counterparts. Small-cap stocks are subject to greater volatility and may fail more frequently than companies in other asset categories, but are generally expected to grow faster than bigger companies.

Within the equity stock categories are three separate types of stocks: growth, value and blend.

Growth stocks are companies whose earnings are expected to grow very rapidly. Frequently these are companies developing new technologies or new ways of doing things.

Value stocks are companies which are inexpensive in terms of the market (in terms of low PE and low P/BV ratios). These are companies that have potential for good long-term return through both appreciation and dividends.

Blend stocks are stocks that include part of both value and growth components.

International/Global/Emerging Market stocks are stocks of companies based entirely outside the U.S. or throughout the world. These can be of any size (small-cap, large-cap), any type (value, growth) and from any part of the world. Funds that contain a mixture of U.S. and foreign holdings are called global funds.

International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, political instability, foreign taxes and regulations, and the potential for illiquid markets.

Stock mutual funds are funds that own stock in specific groups or types of companies. When you but a mutual fund, you are buying a share in multiple companies which change over time depending on the fund manager's decisions. You are responsible for paying taxes on all distributions by the mutual fund, which are taxed at your level—not at the mutual fund level.

Mutual funds are delineated by investment objective, which can be any of the equity asset classes discussed above.

The advantages of equities is that when purchased as part of a diversified portfolio they offer highest return of the major asset classes. Growth and value stocks tend to perform in alternating cycles—it makes sense to own both types. A portfolio of diversified stocks have generally been a good investment for long-term investing—they have consistently beat inflation over the long-term.

The disadvantages of equities are they offer less stability of principal than other asset classes, and subject to short-term price fluctuations. Equities are risky for short-term investments. If you're investing for less than 3-5 years, only a small portion (if any) of your investments should be in stocks due to their volatility.

Understand Asset Class Risk and Return History

It is important to understand how the various asset classes have performed historically. Remember that an asset class is a group of financial assets with similar risk and return characteristics. From a historical analysis, we can learn much about a particular asset class (see Chart 3).

I believe it is important to study history, including the history of investments and investment returns. Some have questioned the importance of learning an asset class's performance history because they reason that the future will not be like the past. Gordon B. Hinckley stated the following regarding this notion, "All of us need to be reminded of the past. It is from history that we gain knowledge which can save us from repeating mistakes and on which we can build for the future." [10]

What have been the characteristics of risk and return historically? Chart 4 and Table 4 show that from 1926 to 2018 (90 years), large-capitalization stocks (as represented by the S&P 500) have

yielded a return of about 9.0 percent per year and have a standard deviation of 19 percent. Small-capitalization stocks have yielded a return of about 11.0 percent per year and have a standard deviation of 29 percent. *T-bonds* have yielded a return of 5 percent per year and have a standard deviation of 9 percent. *T-bills* have yielded a return of about 3 percent per year and have a standard deviation of about 1.0 percent, while inflation has increased 3 percent with a standard deviation of 2%. Note that while different asset classes have different risk and return relationships, there is generally a positive relationship between risk and return (see Chart 3). Moreover, these numbers will change every year.

Chart 3. Asset Class Returns

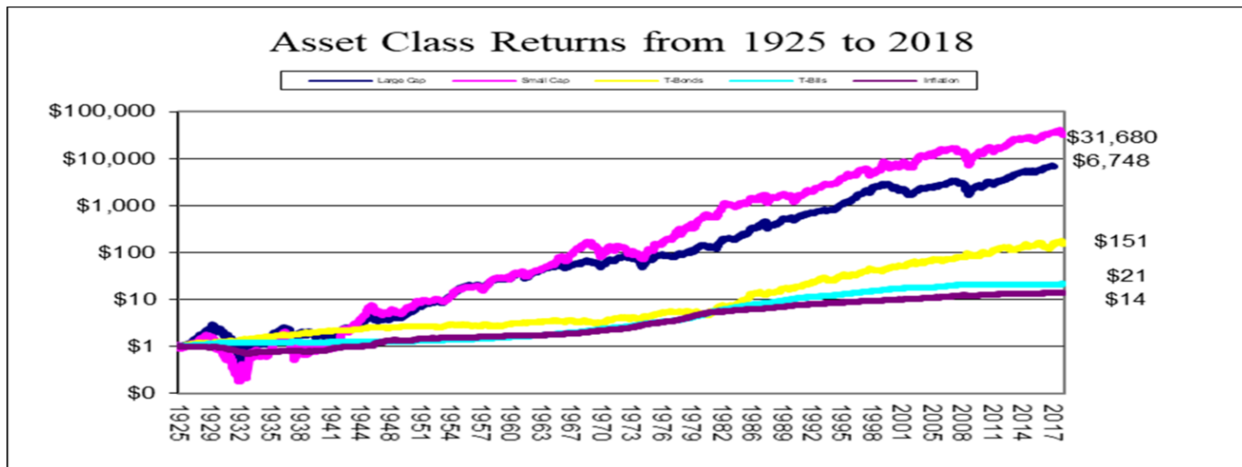


Chart 4. Annual Risk versus Return

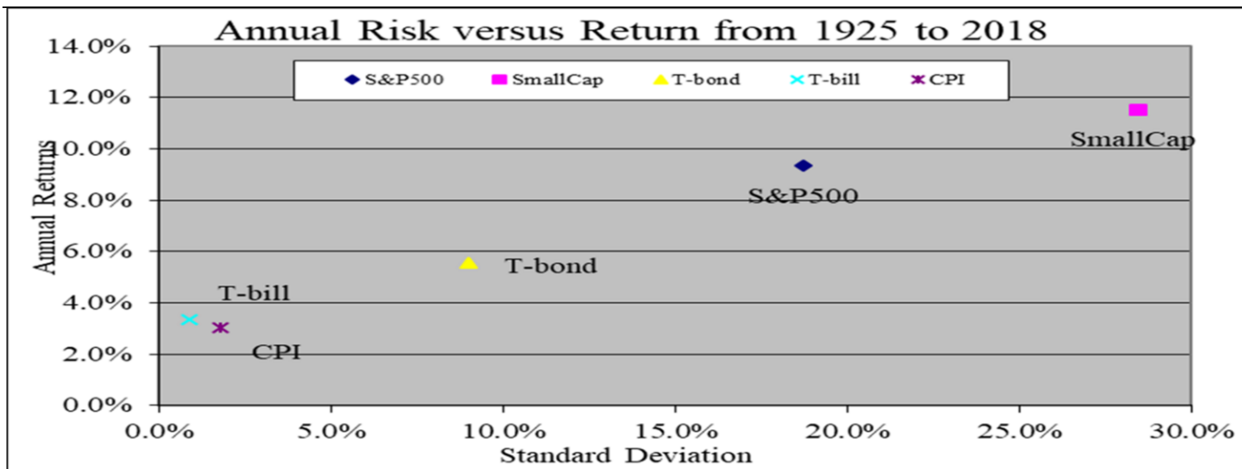


Chart 5, which shows the S&P 500 annual return since 1926, shows that the annual return appears to be very volatile—there are many years of high returns and many years of negative returns. However, looking at the return in terms of 5-year periods instead of 1-year periods shows that there are only a few major periods of time which had a negative return. If you follow

the return trend over a 10-year period, you will likewise see that there have been very few times when the 10-year return was not positive (see Chart 7).

We will now look at risk, or standard deviation. Table 4 shows the *geometric return* and the standard deviation for each of the major asset classes. As you look at the large-cap (the Standard and Poor's 500 Index) return and risk, note that over 5, 10, 25, 50, 75, and 90 years, the return was volatile, yet over longer periods has been around 7 to 10 percent. The standard deviation has ranged from approximately 15 percent to 20 percent.

Chart 5. S&P 500 Annual Returns

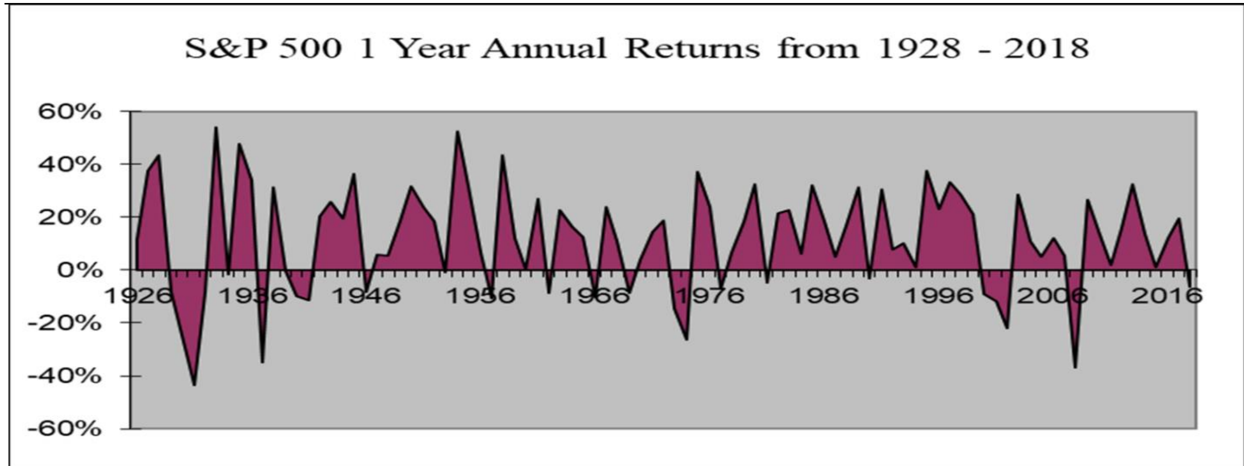
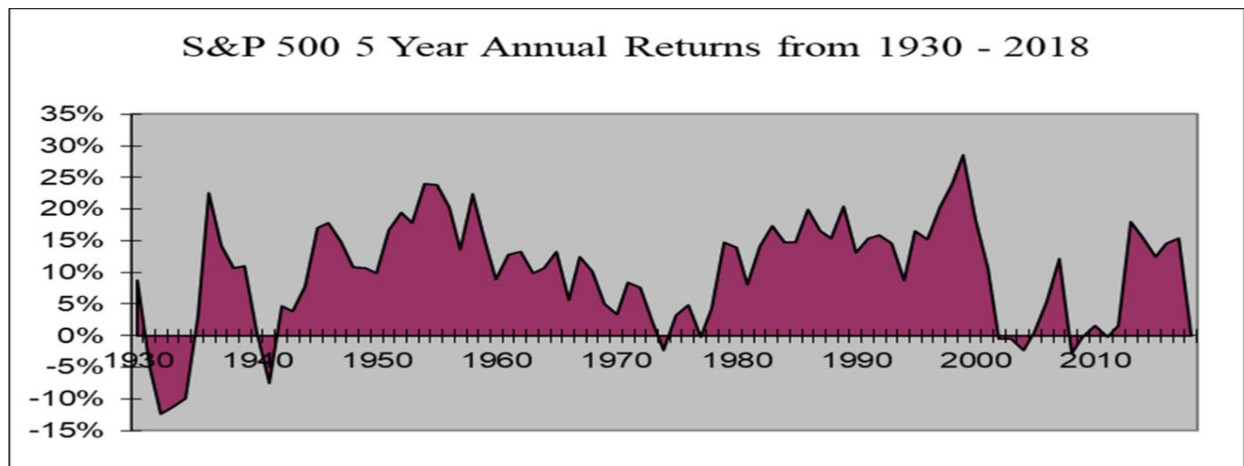


Chart 6. Five-Year Annual Returns

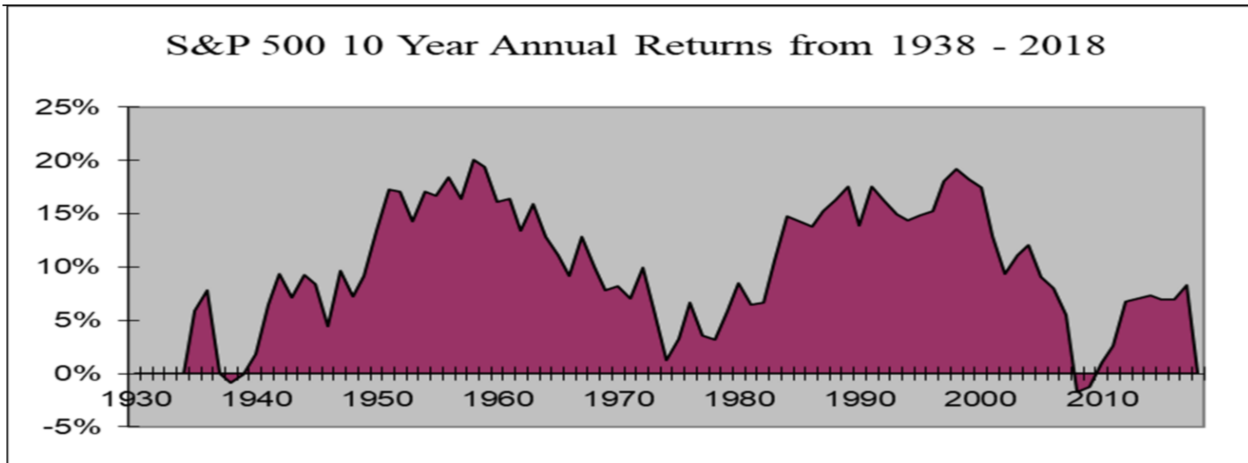
If you look at small-cap returns over the same periods of time, you will see that same volatility, particularly in recent years. Though over longer periods the return has been between 10 to 14 percent, notice that the risk levels of small-cap returns (the standard deviation) are between 20 percent and 30 percent.



If you look at fixed-income investments (T-bonds), you will see that they have, on average over longer periods, yielded a return ranging from 5 percent to 9 percent; the variance for T-bonds during this time period was between 8 percent and 12 percent.

If you look at T-bills on the chart, you will see that they have yielded a range of approximately 0.1 to 5 percent interest over the various periods of time; T-bills have had a standard deviation of between 0.1 and 0.9 percent.

Chart 7. 10-Year Annual Returns



Inflation (as measured by the CPI) has been between 1.5 and 4.1 percent with a standard deviation of between 0.5 and 1.9 percent.

Table 4. Geometric Return and Risk over Specific Time Periods

Total Returns For the Periods Ending December 31, 2018

	1 Year	5 Years	10 Years	25 Years	50 Years	75 Years	90 Years
S&P500							
Compound Return	-6.2%	7.6%	12.7%	8.9%	9.7%	11.2%	9.3%
Standard Deviation	14.7%	10.9%	13.6%	14.4%	15.0%	14.2%	18.7%
SmallCap							
Compound Return	-12.2%	3.5%	12.7%	10.3%	11.0%	13.6%	11.5%
Standard Deviation	18.5%	15.2%	18.9%	20.1%	21.2%	19.9%	28.5%
T-bond							
Compound Return	11.6%	6.2%	4.3%	7.0%	8.0%	5.8%	5.5%
Standard Deviation	21.7%	15.2%	14.1%	11.6%	11.3%	9.6%	9.0%
T-bill							
Compound Return	1.9%	0.6%	0.3%	2.4%	4.7%	3.9%	3.3%
Standard Deviation	0.1%	0.2%	0.2%	0.6%	1.0%	0.9%	0.9%
EAFE (International)							
Compound Return	25.6%	8.4%	2.4%	6.9%			
Standard Deviation	4.3%	11.7%	18.5%	16.0%			
Emerging Markets							
Compound Return	37.8%	4.7%	2.0%	8.0%			
Standard Deviation	6.7%	12.3%	22.7%	22.4%			
REITs							
Compound Return	5.1%	9.3%	7.4%				
Standard Deviation	6.8%	15.0%	39.1%				
CPI							
Compound Return	2.1%	1.5%	1.8%	2.2%	4.0%	3.6%	3.0%
Standard Deviation	0.0%	0.8%	1.0%	1.1%	1.3%	1.5%	1.8%

Inflation (as measured by the CPI) has been between 1.5 and 4.1 percent with a standard deviation of between 0.5 and 1.9 percent.

In order to invest successfully, you must understand the risks and benefits of each of the major asset classes. This chapter has attempted to share some risk and return history over the past 85 years.

Source: Ibbotson Associates for large cap, small cap, T bond, T bill and Inflation up to 2014 with Bloomberg for 2015 and beyond, and Morgan Stanley Capital International for the remainder, 2015 and beyond.

Understand What Makes a Good Mutual Fund

You already determined the asset classes your portfolio should contain and the appropriate benchmarks for these asset classes in previous chapters**.** Therefore, you have already completed steps one and two. This chapter will discuss steps three and four; you will learn how to determine key parameters for evaluating mutual funds of specific asset classes, and you will learn how to use a database program to set those parameters and evaluate potential candidates.

There are a number of important criteria you should consider when selecting mutual funds. Seven of the key criteria include diversification, low cost, tax-efficiency, low turnover, low levels of un-invested cash, no manager style drift, and small (or positive) tracking error.

1. Wide Diversification

Diversification is your most important defense against market risk. Select mutual funds that include many different companies in each portfolio category. Avoid investing in sector funds or industry funds, individual stocks, or concentrated portfolios of any kind until you have sufficient education, experience, and assets. Even then, keep the percentage of these assets low in relation to the amount of your overall assets.

2. Low Cost

Investment returns are limited, and investment costs of all kinds reduce your returns. If you have two funds with the same return, the fund with the lower expense ratio will give you the higher actual return. Keep costs low!

I recommend you invest in low-cost, no-load (i.e., without a sales charge) mutual funds. You should rarely (if ever) pay sales charges of any kind. Because you are a long-term investor, it may be acceptable to invest in funds with back-end loads or funds with a sales charge for selling within a specific period of time, as long as that period of time is under 180 days. You should also minimize management fees as much as possible. Remember, a dollar saved is a dollar you can invest to earn more money.

3. Tax Efficiency

If you are investing in a non-retirement investment vehicle, taxes are another important expense you should analyze. Look at the tax cost ratio in the section entitled "Returns: Tax Analysis." Too many investors fail to account for the impact taxes will have on their returns: taxes typically reduce returns by about 25 percent each year.

When investing in taxable funds, choose funds with an eye to obtaining high returns while keeping taxes low. Taxes reduce the amount of money you can use for personal and family goals. Watch the historical impact of taxes for the fund because it is likely to be similar in the future. Remember, it is not what you earn, but what you keep after taxes that makes you wealthy.

4. Low Turnover

Look for funds with low turnover. Turnover is a measure of the amount of trading activity that takes place during a given period of time; turnover is shown as a percentage of the average amount of total assets in the fund. Calculate turnover by adding the fund's sales and purchases and dividing by two. High turnover, or excessive trading, increases the amount of taxes and transaction costs you will have to pay. Many costs associated with turnover are hard to quantify and are therefore not disclosed in the prospectus. Other costs that stem from high turnover include commissions, bid-ask spreads (the difference between what buyers are willing to pay and what sellers are asking for in terms of price), and market impact costs (a jump in price that occurs when a manager tries to buy a large block of shares). Remember that each transaction generates a taxable event, and the cumulative taxes can be very expensive.

5. Low Un-Invested Cash Low

Un-invested cash is cash the mutual fund has not yet invested in securities. High levels of un-invested cash are drags on a mutual fund's performance. For example, if the fund's portfolio has a small percentage of large-cap stocks and a large percentage of cash, the low rate of return on the cash will dilute the higher rate of return on the large-cap stocks. Look for funds that keep the percentage of cash in their portfolios low. Some mutual funds hold large amounts of cash to fund potential redemptions or to comply with their investment policy. Choose funds that are fully invested (95 to 99 percent, depending on the asset class and fund size) in the market segment you are targeting. Do not pay the mutual fund to manage cash. While it is acceptable for open-end mutual funds to have some frictional cash, this cash should comprise less than 5 percent of the fund.

6. No Manager Style Drift

The law requires that mutual funds have a prospectus available for individual clients to review. This prospectus states the investment objective of the fund (whether the fund will invest in large-capitalization stocks, international bonds, real estate, etc.). Manager style drift relates to the fund manager's style and the types of companies the fund will buy or sell. Over time, portfolio managers may change the types of companies they choose to invest in; this change is called manager style drift. Changes in the size, geographical location, or relative valuation of the

companies included in the fund can alter a manager's investment style. Since this investment style affects the performance of the fund, a portfolio manager should generally remain consistent in the types of companies he or she selects for the fund.

7. Small (or Positive) Tracking Error

Tracking error (or trailing return, as defined by Morningstar) is the difference between the return on the fund and the return on the fund's benchmark.[11] Tracking error should be small, meaning that the fund return should be very close to the benchmark return. Generally, the smaller the tracking error, the more consistent the performance of the fund is compared to its benchmark. If the tracking error is negative, the fund has yielded lower returns than the benchmark. Most people do not complain too much if the tracking error is positive, or in other words, if the fund has yielded higher returns than the benchmark.

Using Databases to Select Funds

Now that you understand the parameters you should adhere to when selecting mutual funds, you can set your criteria and then use a database to get a list of all the funds that meet your criteria. For example, you can use Morningstar and Using Morningstar to Select Funds (LT07) to set your criteria for stocks, bonds, and other financial assets. To aid you in your selection, we have created a Mutual Fund Selection Worksheet (LT07B) that includes the criteria discussed and where to find it on Morningstar.

While there are many different resources for finding mutual funds, the Premium Fund Screener from Morningstar is one of the better resources. You will need to set up an account and a password. The cost of using Morningstar on the Internet is $125 per year. This service is available for free for some college students, such at BYU.

Understand and Select Investment Vehicles Carefully

Before you can build a successful investment portfolio, you must understand the difference between investment vehicles and investment (or financial) assets. *Investment vehicles* are special types of investment retirement accounts that provide a tax-advantaged framework that allows you to invest in various financial assets. Tax advantages include the deferral of current taxes or the elimination of future taxes on earnings. These accounts are useful because they provide specific tax advantages that are not available when financial assets are purchased individually. Investment vehicles are like shopping carts in the grocery store.

Investment, or financial, assets are specific classes of financial securities in which you may invest, including stocks, bonds, mutual funds, real estate, money-market mutual funds, CDs, and so on. As you have learned, these financial assets are grouped into asset classes and are associated with different levels of risk. Investment assets are like the groceries you put in your shopping cart.

Table 1. Select Investment Vehicles for 2019 (Before Catch-Up)

Plan	***Tax-Deferred***	***Tax-Eliminated***	***Maximum Amount***	***For Employees of:***
401(k)	Yes		$19,000	Businesses w/ Plans
Roth 401(k)		Yes	$19,000	Businesses w/ Plans
403(b)	Yes		$19,000	Non-profit, tax-exempt
Roth 403(b)		Yes	$19,000	Non-profit, tax-exempt
457	Yes		$19,000	State/Municipalities
SEP IRA	Yes		$56,000	Small Businesses
SIMPLE IRA	Yes		$13,000	Small Businesses
IRA	Yes		$6,000	Individuals
Roth IRA		Yes	$6,000	Individuals
Education IRA		Yes	$2,000	Individual Education
529 Plans		Yes	$485,000 per child	Individual Education

There are many types of investment vehicles. Many investment vehicles are geared towards helping you build a retirement account and most are named after a specific line in the Internal Revenue Code. For example, a 401(k) plan is a retirement plan offered to employees of private companies, a 403(b) plan is a retirement plan offered to employees of public companies, a Simplified Employee Plan (SEP-IRA) is a retirement plan designed for employees of small businesses, and an Individual Retirement Account (IRA) is a retirement plan designed for individuals. Table 1 shows characteristics of select investment vehicles for 2018.

Understanding the process can help you identify the tax benefits and other benefits that different investment vehicles offer. The process is divided into three sections: free money; tax-advantaged money; and tax-efficient and wise investments. Understanding the process can help you determine which investment vehicles you should use first in working toward your financial goals.

Priority 1: Free Money

The first priority is *free money*: free money is the money provided by your company when you participate in a company-sponsored retirement plan or a reduction in taxes for investing in specific education vehicles for your children and family. Free money is often provided through a *matching plan,* in which your company offers to match a percentage of the money you invest in your retirement plan. A matching plan is used as an incentive to encourage employees to remain with the company and to invest in a retirement plan. Some states allow a tax deduction for your contribution to that state's 529 Plan for education, which is also a form of free money

Free money is your first priority because it is free and the percentage matched by the company is usually higher than any rate of return you could earn in the market. The risk of investing in a company-sponsored plan is that you are usually required to stay with the company for a certain number of years to become fully vested, or in other words, take full ownership of the free money.

Priority 2: Tax-Advantaged Money

There are two different types of tax-advantaged vehicles or accounts: tax-eliminated accounts and tax-deferred accounts. Your choice of which account is better mainly depends on your current tax rates and your estimation of your future tax rates. If you expect your tax rates to be higher in the future than they are now, you will save a greater amount for retirement if you choose a Roth retirement account versus a traditional, and pay the taxes now. However, if you expect your tax rates to be lower in the future than they are now, you will save a greater amount for retirement if you choose a traditional retirement account in which you pay taxes when you take the money out at retirement. To help you decide which type of IRA is more beneficial for you, see Roth versus Traditional: Which Is Better for You (LT28). It allows you to set an annual contribution, an estimate for a rate of return on earnings, and your current and future tax rates. By changing your future tax rates, you can determine if your balance in the future would be higher or lower, all other areas being held constant.

Tax-eliminated accounts: Tax-eliminated accounts require you to pay taxes on principal before you invest it; however, you do not have to any pay any taxes on the capital gains or earnings in the future. There are several different tax-eliminated investment vehicles and assets that can help you save for retirement (i.e., Roth IRAs or Roth 401(k)) or for education (i.e., 529 funds, Education IRAs and Series EE or I bonds when the principle and interest are used for qualified educational expenses). When tax-eliminated accounts are used for qualified purposes, withdrawals can be made without penalty and without taxes.

With a Roth IRA or a Roth 401(k), you pay taxes on the principal before you deposit the money into your retirement account. Once you reach age fifty-nine and a half, you can take both the principal and interest out of this retirement account without paying taxes on the money. By paying taxes beforehand, you eliminate taxes on all capital gains and earnings in this account. Roth IRAs have an additional advantage: if you need to use the funds in your account before retirement, you can withdraw the *principal* without penalty because you have already paid taxes on the principal. The disadvantage of a Roth IRA is that, like all retirement accounts, you cannot withdraw your *earnings* without penalty until you are at least fifty-nine and a half years old.

With many 529 funds and Series EE and I bonds, you are investing with after-tax dollars. If you use your earnings to cover qualified educational expenses for your children, you do not have to pay taxes on the earnings. However, if you do not use the earnings for qualified educational expenses, you must pay a 10-percent penalty on your earnings, as well as federal and state taxes on the amount withdrawal as it is considered ordinary income for tax purposes.

Tax-deferred accounts: Tax-deferred accounts allow you to invest without first paying taxes on the principal; then, when you withdraw money from the account at retirement, you pay taxes on both the principal and the earnings. This type of account is advantageous because it allows you to invest a larger amount of money using a smaller percent of your net income. Examples of tax-advantaged investment vehicles include Individual Retirement Accounts (IRAs); 401(k), 403(b), and 457 plans; and Simplified Employment Plan Individual Retirement Accounts (SEP-IRAs).

Suppose your gross income last year was $50,000, and you invested $3,000 in a traditional IRA. Your adjusted gross income (the income on which you pay taxes) would be $47,000 ($50,000 less the $3,000 contribution). Contributing to an IRA reduces the amount you must pay in taxes today (the amount of your tax savings would be equal to $3,000 multiplied by your tax rate). However, when you retire after age fifty-nine and a half and take this money out of your retirement accounts, you are not only required pay taxes on your $3,000 investment, but you must also pay taxes on any earnings the IRA investment has produced as well. Note also that although your investments were long-term investments, both earnings and principle will be taxed at ordinary tax rates.

The risk of using tax-deferred investment vehicles is that you must be at least age fifty-nine and a half to make withdrawals. If you withdraw funds before you reach this age, you must pay taxes on the funds at your ordinary income-tax rate, and you must also pay a 10-percent penalty fee. Thus, if you make early withdrawals, you may lose up to 50 percent of your investment in taxes (a 10-percent penalty charge plus 40 percent in taxes if you have the highest marginal tax rate possible). Tax-deferred earnings that have remained in your retirement account for more than twelve months are still taxed as ordinary income, which is taxed at a higher rate than capital gains.

Priority 3: Tax-Efficient and Wise Investments

The third priority is tax-efficient, wise investments. Wise investors know they will have to pay taxes and transaction fees on any investment they make, so they work to minimize these costs as much as possible. They also monitor their investments' performances by comparing their returns after taxes and transaction fees to the appropriate benchmarks. The following are five important suggestions for investing tax-efficiently and wisely.

1. Know the impact of taxes. As an investor, you must be particularly concerned about the effects of taxes, because taxes are one of the largest expenses you will have to pay when you invest. Every dollar you pay in taxes is a dollar you will not be able to invest. To invest in a tax-efficient manner, you must understand how taxes influence your returns (capital gains, dividends, and interest). You can use the following formula to calculate your after-tax return:

$$\text{Return}_{\text{after tax}} = \text{Return}_{\text{before-tax}} * (1 - \text{marginal tax rate})$$

Your after-tax return is equal to your before-tax return multiplied by the result of one minus your marginal tax rate. Your marginal tax rate is the tax rate you pay on your last dollar of earnings. Your marginal tax rate encompasses your federal, state, and local taxes. It is important for you to know your marginal tax rate. Remember that different types of earnings are taxed differently. Bond interest is taxed at your marginal tax rate, stock dividends are taxed at preferential 15 percent (if your marginal tax rate is higher than 15%) or 0 percent (if your marginal tax rate is 15 percent or less), and more if you make taxable income over $400,000. Unrealized capital gains (the capital gains on assets

that have not been sold yet) are not taxed at all until the assets have been sold.

To understand the impact of taxes, you must calculate the estimated after-tax return of each asset you are considering.

2. Reduce taxes and defer earnings and taxes to the future. Capital gains are taxed at a much lower rate than ordinary income (15 percent if your marginal tax rate is 25 percent or more, or 0 percent if your marginal tax rate is 15 percent or less. Earn as much of your income as possible in the form of long-term capital gains.

Invest in your qualified and individual retirement plans. This way you are getting a tax break now, and will not have to pay taxes until retirement. You could also invest in Roth retirement vehicles where you pay taxes now, but never pay taxes on the investments ever again.

You can replace ordinary income with capital gains by using a buy-and-hold strategy when you invest. This strategy means that you hold on to your assets for as long as possible and do not trade in your accounts. By holding on to assets for extended periods of time, you defer earnings to the future and avoid paying taxes now.

3. Minimize turnover and taxable distributions. Minimize turnover on all assets and minimize taxable distributions on your mutual funds. Every time you sell an asset, you set up a taxable event (a transaction that has tax consequences). By using a buy-and-hold strategy, you minimize the impact of taxes and reduce your transaction costs as well.

The law requires that mutual funds distribute 90 percent of all capital gains and interest to shareholders annually. You will have to pay taxes and fees on these distributions, even if you do not sell your mutual fund. As an investor in a mutual fund, you must sometimes pay taxes because of the actions of the mutual fund's portfolio manager.

You can minimize turnover and taxable distributions by selecting your mutual funds wisely. Invest in funds that do not have a history of trading actively (i.e., funds that have low turnover or trading). These funds will reduce the amount you must pay in taxes each April.

4. Replace interest income with stock dividend income. Because of changes in the tax law in 2004, taxes on dividends from individual company stocks or stock mutual funds were reduced to 15 percent or 0 percent, depending on your marginal tax rate. However, interest earned on bonds or bond mutual funds is taxed at your ordinary income rate. If you put more emphasis on stock dividend income than interest income, you will potentially increase your portfolio's return and pay less in taxes as well. These steps should only be taken if they are appropriate for your risk-tolerance level.

5. Invest tax-free. If you are in a high marginal tax bracket, you can invest in assets that

do not require you to pay federal or state taxes. For example, municipal bonds are federal tax-free; they may also be state tax-free if you are a resident of the state that is issuing the bonds. Treasury bonds are state tax-free, and certain government savings bonds, such as Series EE and Series I bonds, are both federal and state tax-free if the proceeds are used solely for qualified educational expenses.

Using the Process

Some investment vehicles are preferred over others because they provide tax advantages and other advantages. Unfortunately, some of the investment vehicles that are high money priorities also have lower maximum contribution limits. For example, in 2018 the maximum amount you could contribute to a Roth IRA was $6,000, while there was no limit on how much you could invest in taxable individual financial assets.

Although some investment vehicles have limitations, it is still a good idea to adhere to the process discussed. You should first invest money in vehicles that are the highest priority on the list. When you have reached the maximum amount you can invest in these vehicles, or when you have invested as much money as your company is willing to match, then you should invest in the next highest priority. Continue to invest until you have utilized all of your available investment funds.

When selecting financial assets to include in your retirement account, remember that you will not have to pay taxes on the principal or earnings until you take the money out, or not at all. If you own financial assets that are actively traded or that generate a lot of income, these assets should be held in your retirement accounts; you will not have to pay taxes on the assets until you take them out at retirement, if at all. Assets that you may want to hold in your retirement account include actively traded accounts, taxable bonds, and high-turnover mutual funds.

Financial assets that you are managing with a buy-and-hold strategy should be kept in taxable investment accounts. Such assets include tax-free bonds, tax-efficient indexes and mutual funds, and other financial assets that you do not plan to sell for a long time. Although you may be required to pay taxes on these funds each year for dividends and other short-term distributions, it is usually tax efficient to hold these assets for extended periods of time. The taxes that you must pay on these funds will add little to your yearly tax bill.

Summary

I approach the topic of investments differently than other textbooks. Most books take an asset-based approach. I take a principles-based approach because the principles of good investing will not change over time. There are important investing principles that, if followed, will result in a quality investment plan and lead to a successful investment portfolio.

We must understand what we should do before we invest, which is to:

1. Be square with the Lord,
2. Have adequate health and life insurance to care for the needs of your family in the event that something were to happen to you,
3. Be out of high-interest credit card and consumer debt, and
4. Write down your goals, be living on a budget, and have a well-written and well-thought-out investment plan.

These steps help you prepare a "priorities-based" investment plan. There is no better way to start investing than to have your priorities in order.

We then discussed the factors you control in investing. We must understand the factors we control and work on those areas.

We shared the 10 principles of successful investing. These are critical if you are to achieve your goals. We shared how most investors have done with their investments, which isn't positive. That is why the principles are so important. They are:

1. Know yourself.
2. Understand risk.
3. Stay diversified.
4. Invest low-cost and tax-efficiently.
5. Invest for the long run.
6. Use caution if you must invest in individual assets.
7. Monitor portfolio performance against benchmarks.
8. Don't waste too much time and energy trying to beat the market.
9. Invest only with people and institutions that are high-quality, licensed, and reputable.
10. Develop a good investment plan and follow it closely.

Follow these principles and you will have a much better chance of having a successful portfolio.

Finally, we finished with understanding asset classes and how to use investment vehicles wisely for saving and investing.

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3. Intermediate Investing 2: Application

Introduction

You have an understanding of key investment basics, why you invest, factors you control, how most investors have done with their investments (performance has not been good compared to benchmarks). You understand what you should do before you invest, and you have reviewed the principles of successful investing. You understand asset classes and you have reviewed the risk and return characteristics of the various asset class. These principles we discussed are critical to understanding, developing, and implementing a successful investment portfolio. In addition, you have reviewed the investment hourglass, a learning tool to help you understand that investing is a means to an end, not an end in itself. Investing is a way to achieve your personal and family financial goals.

Objectives

When you have completed this chapter, you should be able to do the following:

6. Understand risk tolerance and determine your risk level
7. Set your asset allocation consistent with your risk
8. Create your investment plan
9. Carefully choose your mutual/index funds
10. Select your financial assets wisely, rebalance tax-efficiently, and hold your assets for 40 years

Understand Risk Tolerance and Determine Your Risk Level

One of the key challenges of investing is to invest at a risk level you are comfortable with. Different investors can accept different levels of risk as they work to achieve their personal and family goals. This view and understanding of risk is not an easy thing to determine.

If you choose to invest at lower risk levels, you will have a greater probability of not losing money, yet because of the lower risk, your returns are likely to be lower as well. There is a tradeoff between risk and return. If your risk level is too low, you will need to save more money for retirement and other goals as your returns will likely be less.

If you take too much risk in your investing, there are concerns as well. With higher risk, you have higher volatility and hopefully higher returns. However, if you invest at a higher risk level than you are comfortable with, you will be very concerned every time the market declines.

Interestingly, most investors are torn between “fear” and “greed.” When the financial markets

decline, the "fear" kicks in. We think we should take our investments out of the market, and that we will know and be able to put them back in before the market goes up again (this is called market timing). I personally know of no investor that can consistently time the market.

Likewise, when the markets are going up, the "greed" kicks in. We think we should put all our assets into one or two "sure things", which are anything but sure.

Our challenge then is to find a median point between fear and greed, so that we can build a portfolio that will give us the amount of risk that we are comfortable with and that will help us to achieve our goals. That is where risk tolerance comes in.

Risk Tolerance

Risk tolerance is an investor's willingness to accept risk. It is related to the holdings of the investor's investment portfolio or their expected holdings in their investment portfolio, particularly their asset allocation or asset mix. Generally, a higher risk tolerance indicates a willingness to take on more risk, while a lower risk tolerance indicates a willingness to take on less risk.

Your risk tolerance is determined in two main ways: 1. It can be derived from an investor's age and their current portfolio holdings, i.e., an implied risk tolerance, or 2. It can be estimated by an investor answering specific questions regarding investor demographics including age, characteristics, spending habits, history, and investment experience.

When we define risk in the determination of risk tolerance, risk in this case is generally considered the volatility of investment returns. Investors with a lower risk tolerance will have more assets in less risky or less volatile asset classes such as bonds and cash. Investors with a higher risk tolerance will have more assets is more risky or more volatile asset classes such as equities or stocks including small caps, international, REITs, etc.

Table 2. 90 Year Return and Volatility of Asset Classes from 1927 to 2018

Asset Class	Annual Return*	Standard Deviation*
US Small Cap	11.5%	28.5%
US Large Cap	9.3%	18.7%
Treasury Bonds	5.5%	9.0%
Treasury Bills	3.3%	0.9%
Inflation	3.0%	1.8%

Source: Calculated from Ibbotson Data 2016 and Bloomberg afterward. Note that each of these asset classes are portfolios of financial assets, not individual assets.

Some have wondered if risk tolerance is more an absolute number or a general category. For the purposes of this class and lecture, risk tolerance is considered more a general category. In this class, we divide risk tolerance into five general categories: very conservative, conservative, moderate, aggressive, and very aggressive.

The purpose of risk tolerance is to enable an investor to determine an appropriate asset allocation or investment mix based on the investor's willingness to accept risk. This allocation is critical because it determines the amount of risk an investor is willing to accept. A lower risk tolerance should lead to a lower risk portfolio, with more invested in bonds and cash. A higher risk tolerance should lead to a higher risk portfolio with more equities.

The challenge of risk tolerance is that it is not an exact science, and can mean different things to different people. Risk tolerance varies from one individual to another.

Please note that there are many different risk tolerance tests and categories that may lead to slightly different results. There are lots of different risk tolerance tests available online, many of which are more to sell investment products than to really help people understand how they should invest their assets. Luckily, we are not selling anything with this manual or this website.

Take A Risk tolerance Test

To come up with your asset allocation, I recommend you take a risk tolerance test. There are a number on the internet, but for the ease of use, we will use our risk tolerance test from the website. A Risk-Tolerance Test (LT16) is a tool we developed to help students understand and determine their asset allocation and risk tolerance. The process is:

1. Read through the entire test to familiarize yourself with what you are doing (it is included below).
2. Review each of the 8 questions and answer each of the questions carefully based on your views, experience and opinions.
3. Then add up your points from each question. There are five potential responses to each question, worth 1 to 5 points.
4. Add up the point next to the correct response and sum your total points from each of the 8 questions.
5. From your total points, we will have recommended actions for your asset allocation.

Question 1: Demographics. What is your age currently?

1. 65 and over
2. 45 to 64
3. 35 to 44
4. 25 to 34
5. 24 and under

The younger you are generally, the more willing you should be to tolerate risk and the longer time horizon in which to grow assets. If you are younger, should think about taking a little more risk.

Question 2: Time Horizon. What is your investment time horizon for this money?

1. 1 year
2. 2-5 years
3. 5-10 years
4. 10-20 years
5. 20 years or longer

Your time horizon will impact on how much risk you take. You will have different time horizons for different “buckets” (remember that money in the stock market is subject to more risks). If your time horizon is less than 3-4 years, it may not be a good idea to invest in market, particularly equities.

Question 3: Investment Goals. What is your primary objective for this money?

1. Preservation of Principal
2. Current Income
3. Growth and Income
4. Conservative Growth
5. Aggressive Growth

Your goals will, to a degree, drive your willingness to take on risk and will make a big difference on where you invest. If your goal is safety, you should take on little risk. If your goal is aggressive growth, you should be willing to take on much more risk.

Question 4: Expected Personal Earnings: Regarding your current income, do you expect it to:

1. Decrease dramatically in the future
2. Decrease a slight amount in the future
3. Stay about the same
4. Increase with the pace of inflation
5. Increase dramatically

Income is an important driver of your investments. If you feel your income will decline, you will likely be much less willing to tolerate risk than if you think your income will increase dramatically. Expectations of your earning will have an impact on risk.

Question 5: Emergency Funds: What amount of money do you have set aside for emergencies? (This does not include borrowings or credit lines, but does include money you can access quickly)

1. None
2. Enough to cover three months of expenses
3. Enough to cover six months of expenses
4. Enough to cover nine months of expenses
5. Over twelve months of expenses

The larger your emergency fund, the more you are able to take on risk. Generally, with your first investments, you should take on very little risk. As your asset size increases, so should your willingness to increase risk.

Question 6: Investment Experience: What is your personal investment experience?

1. I have never invested any money in any financial market or instrument.
2. I am relatively new investor,--only a few years.
3. I have invested in IRAs and employer sponsored retirement plans (401 (k)) for some time, but now I am ready to develop additional investment strategies outside of that plan.
4. I have invested for quite some time and am fairly confident in my investment decisions.
5. I have invested money for years and have a definite knowledge of how financial markets work.

Generally, the more experience investors have with financial markets, the more risk they are able and willing to bear. However, this should be tempered by your willingness to accept risk.

Question 7: Investment Risk: Regarding your view of risk, which investment would you be more comfortable making?

1. I am comfortable investing in savings accounts, CDs, and other short-term financial instruments.
2. I invest in savings accounts/CDs, but I also own income-producing bonds and bond mutual funds.
3. I have invested in a broad array of stock and bond mutual funds, but only the highest quality.
4. I have invested primarily in growth stocks and growth stock mutual funds.
5. I like to pick out new and emerging growth companies and aggressive stock mutual funds.

What you own is an indicator of your risk level. If invested only in CDs/"safe" investments, you are likely risk averse. If in aggressive stocks/funds, you are willing to take on more risk.

Question 8: Investment Preference: Which investment would you be more likely to invest in? The investment has:

1. A 20-year average return of 0-1%, with infrequent downturns and no years of negative returns.
2. A 20-year average return of 2-3% with mostly positive returns but less than a year of negative returns.
3. A 20-year average return of 4-5% with a few downturns and more than one-year of negative returns.
4. A 20-year average return of 6-7% with several periods of negative returns

5. A 20-year average return of 8% or greater with several periods of substantially negative returns.

Higher returns require higher risk, If comfortable with lower returns, you can position your portfolio. If you want the higher returns (and risk), invest according to your risk level.

You should now have your total score. From your total score, it can help you understand what type of investor you are: Very conservative, Conservative, Moderate, Aggressive, and Very aggressive. Each score will have a recommended action regarding increasing or reducing risky assets (see Table 4).

Set Your Asset Allocation Consistent with Your Risk

Asset allocation it is the process of determining how the assets of a portfolio are divided, mainly into which asset classes. A well-diversified portfolio should have broad diversification across many asset classes to reduce overall portfolio risk. A broadly diversified portfolio is an investor's key defense against risk, a key to a "sleep-well portfolio," one that is not torn between fear and greed. Asset allocation is a three-step process:

Step 1: Set your initial bonds and cash allocation to equal your age as a percent of your overall portfolio allocation. For example, if you are 40 years old, you should have 40% of your portfolio in bonds and cash, and 60% in equities

Step 2: Take this risk tolerance test. Based on your results, you will adjust that allocation to take into account your individual risk tolerance and come up with an risk-appropriate asset mix. If you are more conservative you will increase your bonds and cash allocation and decrease your equity allocation. If you are more aggressive, you will do the opposite

Step 3: Determine your preferred asset classes based on risk within your major asset classes. If you are a conservative investor, you will likely have many different bond asset classes (short-term, long-term corporates, governments, municipals, etc.), but likely only large cap equities, and perhaps a small amount of other equity asset classes. If you are more aggressive, you will do the opposite, have more small cap, international, emerging markets, REITs, etc. and less allocation to bonds and cash.

Asset allocation is important for two reasons:

1. Research has shown that most of the returns from financial assets are mainly a function of returns from the specific asset class decision, and not from the individual stock selection decision. Asset class choice influences returns.

2. In the process of selecting your asset allocation, you are selecting your risk level for your overall portfolio. Selecting asset classes is selecting the risk or risk level for your

portfolio.

Table 3. 10 Year Return and Volatility of Asset Classes from 2007 to 2018

Asset Class	Annual Return*	Standard Deviation*
Other: US REIT	7.4%	39.1%
Equity: Emerging Markets	2.0%	22.7%
Equity: US Small Cap	9.1%	20.3%
Equity: International	2.4%	18.5%
Equity: US Large Cap	8.3%	15.0%
Government Treasury Bonds	5.6%	13.3%
Government Treasury Bills	0.3%	0.2%
Inflation	1.6%	1.3%

Source: Calculated from Ibbotson and Bloomberg. These are portfolios of financial assets, not individual assets.

While we cannot know which asset classes will be the most risky over the upcoming years, we can use historical data to determine the most risky asset classes over the past 90 years ending December 2018 in terms of volatility (or standard deviation). The higher the standard deviation the more volatile the asset class (see Table 2).

As you know, time periods change. What were the most risky asset classes over the past 10 years ending December 2018 (see Table 3)? Notice that generally the higher risk asset classes had the higher return, but it was not necessarily the case.

So if risk tolerance is important then the challenge becomes the process of determining your asset allocation. How do we do that?

The challenge is to get from your risk tolerance to your asset allocation. Table 4 below helps you do that. Match your beginning allocation, which is your age in bonds, with your recommended action. Once you perform the recommended action, you will have your asset allocation or asset mix consistent with your preferred level of risk.

Investors are free to shift between the cash and bond allocations without any change in effectiveness of the test. I personally prefer to always have, at minimum, a 1-5% allocation to cash.

So how does this scoring work? For example, if you scored 35 points, you would be considered an “aggressive” investor. This is your risk tolerance or type of investor you are.

To get to your asset allocation or asset mix, you need to start with your age in bonds. For example, assume you are age 40 so assume 40% in bonds.

Next, do what the Asset Allocation Recommendations suggest. For an “aggressive” investor, you would add 10% to equities and subtract 10% to your bond and cash allocations from the above

charts. Your asset allocation at age 40 would be 30% bonds and cash, and 70% equities.

Table 4. Asset Allocation Results from the Risk Tolerance Test

Investor Type Asset Classes:	*Asset Allocation Recommendations:*
Very Conservative	8 to 12 points
Cash	+5%
Bonds	+15%
Stocks	-20%
Conservative	13 to 20 points
Cash:	+0%
Bonds:	+10%
Stocks:	-10%
Moderate	21 to 28 points
Cash	0%
Bonds	0%
Stocks	0%
Aggressive	29 to 36 points
Cash	-5%
Bonds	-5%
Stocks	+10%
Very Aggressive	37 to 40 points
Cash	-5%
Bonds	-15%
Stocks	+20%

You are likely wondering if you can have two individuals with similar asset allocations yet with different risk levels? The answer is yes. This is due to their different ages. For example, three investors each have a 60% equity and 40% bond allocations. Investor A is age 50 and is Aggressive; Investor B is age 60 and is Moderate; and Investor C is age 40 and is Very aggressive. Their overall allocations of 60% equity and 40% bonds the same. However, their allocations within the equity and bond allocations will likely be very different. Aggressive investors will have more small cap, international, and other risk equity asset classes. Conservative investors will have more in savings accounts, bonds, government securities, and municipal bonds.

Creating Your Personal Investment Plan

The most important financial-planning document you will prepare, besides your list of personal

and family vision and goals, is your Investment Plan. In finance terms, your Investment Plan is also known as your investment policy statement. An Investment Plan is important because it creates a framework for every investment activity in which you will participate. It states what you will invest in, how you will invest, why you will invest, what percentage of your money you will invest, and so on. In short, your Investment Plan significantly affects your investment returns. Write this plan well and then follow it carefully. An example of an Investment Plan is found in the Learning Tools directory of the website under Investment Plan Example Template (LT05A). Your Investment Plan is a detailed description of all the major components of your investment strategy. It will help you to do the following:

1. Represent yourself: It explains your personal investment characteristics, such as your risk tolerance and your personal constraints, and how those relate to your asset allocation and targets.

2. Articulate what you will and will not do: This plan clearly states what you will and will not invest in and how you will invest. It also includes investment guidelines that will help you invest your money wisely and achieve your goals.

3. Provide an investment framework and guidelines for making wise investment choices: If you clearly think through and plan how you will invest now that you have few assets (and are not influenced by fear and greed), you will have an investment framework and guidelines to help you reason through decisions that could have a major impact on future financial goals and retirement. If followed carefully, your plan will help you avoid poor investment decisions that could have major repercussions for your financial life. But you must write your Investment Plan carefully and then follow it.

Your Investment Plan is divided into four separate categories:

1. Risk and return objectives
2. Investment guidelines and constraints
3. Investment policy
4. Portfolio monitoring, reevaluation, and rebalancing

1. Risk and Return Objectives

This category describes your expectations for returns on your investments. These expectations will, to a large extent, determine your asset-allocation decisions. In other words, these expectations will determine how you will distribute your investments among different asset classes. This category also addresses your expectations for risk and outlines how much risk you are willing to accept.

Expected returns: You should not invest without specific goals in mind. For your first goal, you should decide what return you expect your total portfolio to make over a specific time period. You cannot know with certainty what the actual returns will be before you invest. However, you can estimate an expected return, or a goal you hope to achieve during a certain period of time

(such as a week, a month, or a year). Be aware that your expected return will have a major impact on what your portfolio looks like.

- An expected annual return of 1 to 2 percent will likely be the result of a diversified, very low-risk portfolio.
- An expected annual return of 3 to 4 percent will likely be the result of a well-diversified, low-risk portfolio.
- An expected annual return of 5 to 6 percent will likely be the result of a well-diversified, moderate-risk portfolio.
- An expected annual return of 7 to 8 percent will likely be the result of a less-diversified, high-risk portfolio.
- An expected annual return greater than 9 percent will likely be the result of an undiversified, very high-risk portfolio that is heavily dependent on high-risk assets.

Note that you will determine your expected returns for two periods of time: before retirement and during retirement.

There are several ways to estimate your expected returns. To give you an idea of how to estimate your expected returns over a period of time longer than one year, it may be helpful to look at the long-term history of the asset classes you have selected. Look at Historical Return Simulation for Asset Classes (LT23).

Expected risk: Since a higher expected return requires you to accept more risk, it is important that you know your risk-tolerance level, or your willingness to accept risk. Where you are in your life, as represented by your age, will likely have a big impact on how much risk you are willing to take. In general, when people are younger, they are more willing to accept risk because their investments will have more time to grow and overcome losses. As people grow older, they usually become less willing to accept risk because they will need their investment funds sooner for retirement and other purposes. Investors that have a low tolerance for risk should typically devote the majority of their portfolios to bonds and cash because these investments are the least risky of all asset classes; however, these investments also have the lowest returns. Investors that are willing to accept more risk may allocate more of their portfolio to U.S. and international stocks versus investments in bonds and cash. The challenge of wise investing is to balance your risk and return expectations with your situation in life and your personal goals.

Defining risk in your portfolio is a challenge. Professional investors usually state an annual standard deviation as the acceptable risk level for their portfolios—for example, 12 percent. From a financial standpoint, this means that 66 percent of the time the investor’s risk will be within one standard deviation (plus or minus 12 percent) of his or her mean or average return. If an investor’s average return is 8 percent, this means there is a 66-percent chance that the

investor's returns will be between –4 percent (8 percent – 12 percent) and 20 percent (8 percent + 12 percent). While using a standard deviation to define risk may be helpful for some, this method will not work for everyone. I would like to propose a more simple way of defining risk: using investment benchmarks.

Instead of defining your risk-tolerance level in terms of a standard deviation, you can simply define it by deciding that you are willing to accept the risk of the benchmarks you have chosen for your portfolio. You can determine how risky a particular asset is by looking at your investment benchmark. If you have a small-capitalization stock mutual fund or asset that has had a return of 6.5 percent over the last 10 years and a standard deviation of 19.3 percent, you can compare this asset to an investment benchmark for small-cap stocks. From Table 4 in the previous chapter, note that small-cap stocks have yielded a 7.2 percent return over the past 10 years with a 20.6 percent standard deviation. Your mutual fund or asset has a slightly lower return than the benchmark (6.5 percent versus 7.2 percent), but with slightly lower risk than the benchmark (19.3 percent versus 20.6 percent).

You can also determine a portfolio's risk level by comparing the portfolio to weighted individual benchmarks. For example, if you choose a portfolio that is made up of 50 percent U.S. stocks, 20 percent international stocks, 25 percent bonds, and 5 percent real estate (all percentages should add up to 100), then your risk is equal to the risk defined by the benchmarks of each of these asset classes. In this case, your risk would be equal to the benchmarks of each element in a portfolio that contains 50 percent U.S. stocks (as measured by Standard and Poor's 500 Index, a major benchmark for large-capitalization stocks); 20 percent international stocks (as measured by MSCI Europe Australia, Far East Index (EAFE), a major benchmark for international stocks); 25 percent bonds (as measured by the Barclays Aggregate Index, a major benchmark for bonds); and 5 percent real estate (as measured by Standard and Poor's REIT Index, a major benchmark for real estate investment trusts). A list of the major benchmarks for a portfolio can be found in the Learning Tools directory of the website under Possible Benchmarks for Investment Plans (LT15) and Expected Return Simulation and Benchmarks (LT27). Asset class performance over the past 1, 5, 10, 25, 50, 75, and 85 years can be found in Table 4 in the previous chapter of this manual.

2. Investment Guidelines and Constraints

The second category of your Investment Plan is investment guidelines and constraints.

Investment guidelines: Your investment guidelines are the road map for how you will invest over your lifetime. These guidelines and constraints explain the ways in which you will invest differently at different phases in your life. Generally, most individuals have three stages of their financial life cycle. Most investors who are younger than age 55 are in stage one, or capital accumulation and growth. Investors who are approaching or in retirement are typically in stage two, where the main goal is investment preservation, or maintaining the value of investments. The choice of the number of stages is arbitrary. You can add more stages if you choose.

Your investment guidelines should provide you with a general road map for investing money at different stages of your financial life cycle. These guidelines should integrate all of your financial goals to give you a complete financial perspective.

Investment constraints: Once you have decided on your investment guidelines, you should identify your investment constraints, constraining factors that you must take into account as you manage your portfolio. Your Investment Plan should address a number of important constraints: liquidity, investment horizon, tax considerations, and any special needs.

Liquidity is the speed and ease with which an asset can be converted into cash. As you create your plan, consider how important it is for you to have the option of turning your assets into cash quickly. Ask yourself how much money you will need at different times in your life and how quickly that money needs to be available. Examples of liquidity constraints include paying for graduate school, making a down payment on a house, and sending a child to college. To pay for these expenses, you will need to convert assets into cash.

Investment Horizon is the amount of time you are planning to keep an asset to save for a particular purchase. Consider how soon you will need to use the funds from a particular investment. Examples of short-term investment horizons include saving for a new car or making a down payment on a house. An example of a long-term investment horizon would be saving for retirement or saving for your children's college educations.

Tax considerations take into account your current tax bracket and your current tax rates. Consider your tax position: are tax-free or tax-deferred investments more advantageous than taxable investments? You cannot simply compare the stated returns of particular assets; you must compare assets by taking into account that certain investments eliminate federal or state taxes and those other investments are tax-free. For example, if you are comparing government I and EE savings bonds versus corporate bonds, you must take into account that government I and EE savings bonds are state tax-free (and federal tax-free if principal and interest are used for college tuition costs), while corporate bonds have no tax advantages.

Special-needs are constraints related specifically to your family, your business, and other areas of life that are important to you. Do you have a child with a disability? This may impose specific requirements on your Investment Plan because you will likely need life insurance to provide funds for a disabled child in case of your death. Is a large part of your wealth tied up in your company? This imposes constraints such as the decision of how much you should invest in your company's employee stock-ownership plans. You may have other special constraints that will influence your investment decisions. It is critical that you understand your special needs before you begin investing.

3. Investment Policy

Your Investment Plan also includes your investment policy, which is a written statement of what you will and will not invest in, how you will allocate your investments, and how you will

distribute your assets. Your investment policy is divided into six sections:

- Acceptable and unacceptable asset classes
- Investment benchmarks
- Asset allocation
- Investment strategy
- Funding strategy
- New investment strategy

Acceptable and unacceptable asset classes: It is important that you decide which assets you will invest in before you begin investing so that others will not be able to convince you to invest in asset classes that are not suitable for you at your stage in the financial life cycle. Invest where you have a particular expertise or where the odds are in your favor. You should plan to invest in asset classes that have a history of delivering long-term returns, not just high returns over very short periods of time. For example, I recommend that investors invest in stocks, bonds, mutual funds, and cash and cash equivalents; I do not recommend investing in futures, options, foreign currencies, or precious metals. The investments I have recommended have long-term histories of consistent performance, while the investments I do not recommend lack a history of consistent performance.

Review the historical performance of various asset classes to roughly estimate future performance. After reviewing the historical performance of the various asset classes, it is likely you will decide to invest in stocks and mutual funds, bonds and cash equivalents, and real estate.

Once you have identified which asset classes you will invest in, you must also determine which asset classes you will not invest in. Asset classes on this list may include those in which you do not have expertise or those in which the odds are against you. For example, most investors should probably not invest in asset classes such as foreign currencies. The foreign currency trades are controlled by large international banks, which employ hundreds of very experienced men and women with PhDs in finance. These banks have billions of dollars invested in computers and computing power as well as real-time databases to alert them immediately to economic changes that may affect currencies. The odds are not in your favor: investing in foreign currencies is known as a “zero sum game.” This means that for every winner, there must be a corresponding loser. You do not want to be that loser. Other asset classes that typically require a great deal of expertise include commodities (especially commodity futures contracts, which have very high levels of implicit debt), precious metals, and art. Be cautious of investing in these areas unless you have specific expertise to support your investment decisions.

Investment benchmarks: are hypothetical investment portfolios that show how a specific set of assets performed over a specific period of time. These portfolios can help investors evaluate how their investments are performing versus how the benchmark is performing over the same time period. Unless you have a benchmark by which you can judge your investments’ performance, you cannot know how your investments are doing. For example, if you invest in a mutual fund of

large-cap stocks and your annual return is 6 percent for 2016, how do you know if this is a good or bad return? You cannot know if you do not have anything to compare this information with. But if you know that your benchmark for large-cap stocks, the Standard and Poor's 500 Index, rose 12 percent during 2016, then you know that your investment underperformed in that year. Your investment was up 6 percent for the period versus a 12 percent return for the benchmark.

Investors select benchmarks based on asset classes, size or capitalization, geography, issuer, and investment style. Investment benchmarks are covered more thoroughly in later sections of this course.

Asset allocation is the process of determining how much you will invest in each specific asset class in your portfolio. Research has shown that the decision of how to allocate your assets is the most important factor affecting your portfolio's performance.[1] As you write this section of your Investment Plan, you should answer these questions:

- How much will you invest in each asset class?
- What percentage of your total investments will you invest in each asset class?
- What is the minimum allocation of funds you will invest in an asset class at any point in time?
- What is the maximum allocation?
- What is the target allocation?

Your target asset allocation will probably vary throughout your life. Again, the younger you are, the more likely it is that you will be willing to invest in riskier asset classes. Likewise, the older you are, the less likely it is that you will be willing to invest in riskier asset classes.

In general, the first decision you should make when determining your asset allocations is between stocks and bonds. One time-tested way to decide how much you should invest in bonds is to use your age as the percentage for the allocation. The logic behind this starting point is that the older you are, the more you should invest in bonds because bonds are less risky than other investments. The remainder of your portfolio would be allocated to equities.

The second step you should make when you are determining your asset allocations is to understand your risk tolerance. I recommend that you take a number of different risk-tolerance tests to help you decide how to make allocations in your portfolio. One example of a risk-tolerance test is found in A Risk-Tolerance Test (LT16) in the Learning Tools directory of the website. Based on the results from this test, you may either decide to increase your equity allocation above the time-tested approach if the test indicates you are an "aggressive" investor or reduce your equity allocation if the test indicates you are a "conservative" investor. The amount you increase or reduce for different allocations should be based on your individual tolerance for risk.

After you have decided on your portfolio's allocations, you should add different types of stocks and bonds to deepen your portfolio. You might add some small-cap stocks or some international stocks if you want to take on more risk. Or you might add some federal tax-free municipal bonds

or state tax-free Treasury bonds if you want to reduce the risk of your portfolio. You can then broaden your portfolio by adding additional asset classes, such as real estate, emerging markets, and inflation-linked bonds.

Once you know the asset classes you want to invest in, it is important that you decide on a minimum allocation, maximum allocation, and target allocation for each asset class. Having a set minimum allocation preserves diversity in your portfolio. Diversification is an important tool for reducing risk. Since your allocations will change over time, reaching your maximum allocation will be a signal that it is time to rebalance your portfolio back to your target allocation, which is your ideal allocation, based on your current expectations and the current market conditions.

When you are determining minimum, maximum, and target allocations, you should take into account where you want to be throughout your entire investing life. It is likely you will have to make different allocations for the different stages of your financial life cycle—for example, newly married, kids in college, retirement, and so on.

Your investment strategy describes how you will invest your money. It clarifies how you will manage, prioritize, and fund your investment; it also describes how you will evaluate new investments. The following paragraphs explain some of the questions you should answer about your investment strategy.

Will you use active management or passive management? Active management is a strategy in which you try to outperform your benchmarks by actively buying and selling stocks and bonds. This strategy requires considerable time and expense to maintain. Passive management is a strategy in which you invest in index funds, or exchange-traded funds, instead of trying to beat your benchmarks: index funds, or exchange-traded funds, simply mirror the performance of your benchmarks. This strategy is much cheaper in terms of time and costs, and it is often more tax-efficient as well.

You may also choose to use a combination of active and passive management for your portfolio. For example, you may choose to use active management for your tax-deferred accounts (these accounts do not require you to pay taxes until retirement, when you withdraw the money) and passive management for your taxable accounts (these accounts require you to pay taxes each year). Your choices will depend on your goals, your objectives, and your investment style.

Will you invest in mutual funds or individual assets? Mutual funds are professionally managed portfolios that are composed of similar assets; mutual funds offer the benefits of diversification and economies of scale. Investing in individual assets, such as stocks and bonds, allows you to control what you invest in and when you will realize capital gains. While it is much more exciting to invest in individual assets, these assets also involve much more risk and instability. You may choose to invest in a mix of assets: a combination of mutual funds and individual stocks or bonds.

Will you use leverage in your investing? Using leverage is the process of borrowing either

money or securities for your investment activities. Using leverage is not recommended. While leverage increases the potential for return on an investment, it also magnifies the potential for loss. Many investors have lost significant amounts of financial assets by using leverage. There are two types of leverage used by a few individual investors: buying on margin and short selling.

Buying on margin is borrowing to purchase a stock. The amount of borrowing you use is referred to as your "leverage." For example, you are sure the value of a stock you do not currently own will go up soon. You invest $10,000 of your own money and invest another $10,000 that you borrow from your broker—buying on margin. If the value of the stock goes up, you make a larger profit because you used leverage to invest more. However, if the value of the stock goes down, you incur a larger loss because you invested more, and you must still pay back the $10,000 you borrowed, regardless of the price of the stock. With leverage you can lose considerably more than the amount you put up of your own money.

Short selling is another type of leverage in which you borrow stock and then sell it immediately. For example, you are positive the value of a stock will go down. Before the stock goes down, you borrow a hundred shares of that stock from your broker and sell them. Again, you are borrowing, but this time you are borrowing stock instead of money. If the stock price goes down, you will be able to buy the shares back at a lower price; you make a profit by selling the borrowed shares at a higher price and buying them back at the lower price to replace the stocks you borrowed. However, if the value of the stock goes up, you will have to use your own money to buy back the more expensive shares; you must also repay any dividends paid during the period you borrowed the shares.

Using leverage is risky because you can lose much more than you originally invested. Do not take the chance. Joseph F. Smith stated the following:

> If there is anyone here intending to go into debt for speculation . . . I would advise him to hesitate, pray over it, and carefully consider it before he obligates himself by borrowing money and going into debt. In other words, keep out of debt if you can. Pay your debts as soon as you can.[2]

Funding strategy: You cannot invest without having the funds to invest, and you should not invest with borrowed money. Where will you get the funds for your investments? In a previous section, I recommended that you always pay the Lord first—that you pay tithes and other offerings before anything else—and then pay yourself a minimum of 10 percent, hopefully more (20 percent).

Most financial planners recommend that you save a minimum of 15 percent when you are young, and they recommend that this amount should increase as you get older. Once you have set aside the recommended 10–20 percent each month, invest this money wisely according to your personal Investment Plan. In this manual, I recommend that you save 20 percent of every dollar you earn after college.

How will you manage the funds for your various financial goals? One way to save for different financial goals is to set up different investment vehicles for each of your financial goals. You can use a 401(k) plan to save for retirement, a taxable account to save for your children's weddings, and 529 funds and Education IRAs to save for your children's educations. You can also set up investment accounts to save for an emergency fund, a house down payment, or a car fund. If you pay yourself at least 10 percent (hopefully more), you can divide this money among your financial goals; for example, you could allocate 5 percent to your 401(k) plan, 4 percent to your investment fund, and 1 percent to your 529 funds.

New investment strategy: How will you handle new investments? You need to decide the maximum percentage you will allocate to any new investment. Most experts advise that this amount should generally not be more than 10 percent of an investor's assets. Too often, people lose a great deal of money by putting all of their investments into one company or product that they think is a sure thing. There are no sure things. To avoid falling into this trap, decide now on the maximum amount you are willing to invest with a single investment: in other words, decide how much you would be willing to lose with a single investment.

You should also decide on the maximum amount of your company's stock that you will include in your 401(k) or other retirement account. For most people, this amount should not be more than 5 to 10 percent of the funds in their retirement account. Remember the principle of diversification. If your company does well, your job is secure and your retirement portfolio is strong. If your company does poorly, you may lose your job, and your retirement portfolio may be reduced substantially as well.

4. Portfolio Monitoring, Reevaluation, and Rebalancing

The final part of your Investment Plan is describing how you will monitor, reevaluate, and balance your portfolio. Monitor your performance. Compare the performance of each of your assets against benchmarks on a monthly, quarterly, and annual basis. How did your assets perform? Which assets had returns that were greater than their benchmarks, and which assets had returns that were less than their benchmarks?

Setting goals is not a one-time event. You should continually review and reevaluate your goals. Has your situation in life changed? Which goals need to be changed to accommodate your situation?

Finally, has your portfolio shifted away from your target asset allocations because of time or because of the performance of your assets? How will you rebalance your portfolio to regain your target allocations, while at the same time minimizing the tax effects of rebalancing? We will discuss the topic of rebalancing in more detail in later sections.

Final Thoughts on Your Investment Plan

To conclude our discussion on investment plans, I would like to offer a few final suggestions.

First, develop a good Investment Plan and stick to it. This plan is your road map to attaining your financial goals. Think it through, write it well, and follow it closely. An example of a good Investment Plan can be found in Investment Plan Example Template (LT05A). Feel free to copy this plan and personalize it based on your views of risk, return, constraints, investment policy, and portfolio monitoring and rebalancing. Instructions on filling this plan out are found in Investment Plan Example Instructions (LT5B).

Second, compare the performance of your assets to your chosen benchmarks on a monthly, quarterly, and annual basis. No one will watch your portfolio like you will.

Third, beware of following the investment crowd. It is unlikely that last year's best-performing asset classes will be this year's best-performing asset classes. In my experience with investing, I have found that winners rotate. Avoid chasing last year's winners.

Finally, remember that there are tax consequences for selling—try to minimize those tax consequences as much as possible. Beware of churning, or buying and selling too often. Rebalance your portfolio annually—perhaps even less often.

Carefully Choose your Mutual or Index Fund and Build Your Investment Portfolio

You already determined the asset classes your portfolio should contain and the appropriate benchmarks for these asset classes in previous chapters**.** Therefore, you have already completed steps one and two. This chapter will discuss steps three and four; you will learn how to determine key parameters for evaluating mutual funds of specific asset classes, and you will learn how to use a database program to set those parameters and evaluate potential candidates.

There are a number of important criteria you should consider when selecting mutual funds. Seven of the key criteria include diversification, low cost, tax-efficiency, low turnover, low levels of un-invested cash, no manager style drift, and small (or positive) tracking error.

1. Wide Diversification

Diversification is your most important defense against market risk. Select mutual funds that include many different companies in each portfolio category. Avoid investing in sector funds or industry funds, individual stocks, or concentrated portfolios of any kind until you have sufficient education, experience, and assets. Even then, keep the percentage of these assets low in relation to the amount of your overall assets.

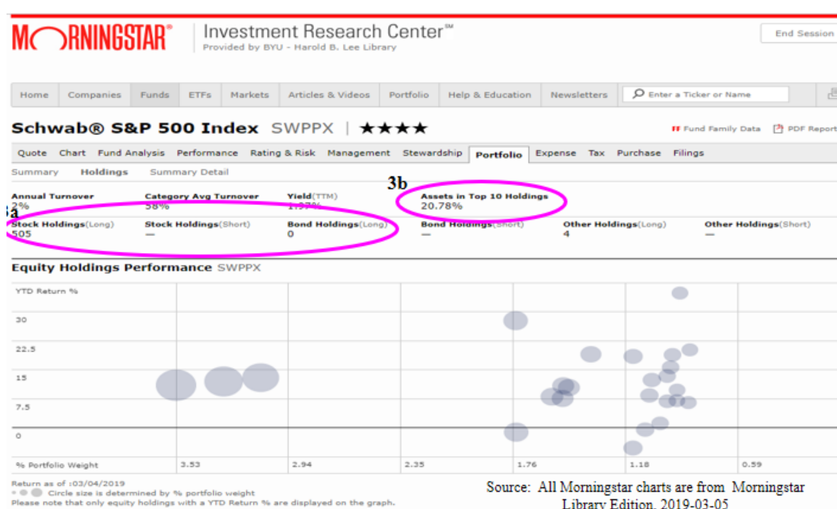
There are four main factors that determine whether a mutual fund is sufficiently diversified: numbers, concentration, types of assets, and location.

Numbers: What is the total amount of holdings, or securities, in the fund? You want to select a fund that holds many securities and industries. Check the number of holdings in the fund (see Table 1). If the fund has only 15 holdings, it is not very diversified and you should carefully

understand each of those 15 companies. If the fund has 504 holdings (as does the Vanguard 500 index fund), it is much more diversified. Since there are over 500 companies in the portfolio, and since no company is a significant portion of the portfolio, it is not as critical that you carefully understand each of the companies in the portfolio.

Concentration: What percentage of the fund is allocated to the top 10 holdings? If 50 percent or more of the fund is invested in the top 10 holdings, then the fund has a high concentration in these holdings. If only 17 percent of the fund is invested in the top 10 holdings, then the fund has a lower concentration in these holdings and your risk is most likely spread out over many companies.

Table 1. Morningstar Website: Diversification



Source: All Morningstar charts are from Morningstar Library Edition, 2019-03-05

In addition, by looking at the top 10 holdings of a mutual fund, you can see the percentage of net assets or of the value of the portfolio that the top 10 stock comprises. Generally, the lower the concentration in the top 10 holdings, the lower the risk of a problem with a single company, and the better for most investors.

Type of assets: What types of assets are in the fund? If the mutual fund is an equity fund or a bond fund, then all assets should be of the same asset class. However, if the fund is a balanced fund, an asset-allocation fund, or life-cycle fund, you should examine the percentage of the fund that is allocated to stocks, bonds, and cash. Again, the more diversified the fund is in terms of its holdings of different types of financial assets, the less volatile the fund will be.

Location: What is the location of the companies that are included in the mutual fund? The more diversified the locations, the less risk to the fund. Companies from different geographical areas are subject to different business cycles; hence, these companies should experience highs and lows at different times in the investment cycle.

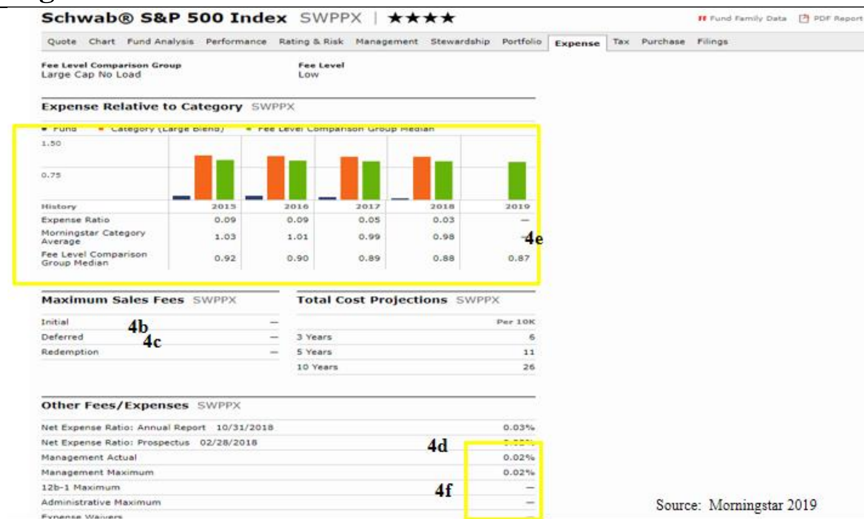
2. Low Cost

Investment returns are limited, and investment costs of all kinds reduce your returns. If you have two funds with the same return, the fund with the lower expense ratio will give you the higher actual return. Keep costs low!

I recommend you invest in low-cost, no-load (i.e., without a sales charge) mutual funds. You should rarely (if ever) pay sales charges of any kind. Because you are a long-term investor, it may be acceptable to invest in funds with back-end loads or funds with a sales charge for selling within a specific period of time, as long as that period of time is under 180 days. You should also minimize management fees as much as possible. Remember, a dollar saved is a dollar you can invest to earn more money.

Costs are explained in the mutual fund's prospectus (a document that describes all aspects of the mutual fund) in the section entitled "Fees, Management Fees, and Expenses" (see Table 2). This section details all administrative costs, management fees, 12b-1 fees, and other charges. The most important ratio listed in this section is the total expense ratio. This is the overall cost of the listed fees. Remember that the fund manager will reduce your investment by this amount every year. The lower this ratio, the more you will be able to earn for your personal goals. Note that the Vanguard Fund charges 0.16 percent a year for total expenses. Compare this to the average total expense of large-cap stocks, which is .92 percent. While you cannot change the management fee once you have invested in a fund, you can and should understand the management fee before you invest in any fund.

Table 2. Morningstar Website: Costs



Expense Relative to Category SWPPX

History	2015	2016	2017	2018	2019
Expense Ratio	0.09	0.09	0.05	0.03	—
Morningstar Category Average	1.03	1.01	0.99	0.98	—
Fee Level Comparison Group Median	0.92	0.90	0.89	0.88	0.87

Maximum Sales Fees SWPPX

Initial	—
Deferred	—
Redemption	—

Total Cost Projections SWPPX

	Per 10K
3 Years	6
5 Years	11
10 Years	26

Other Fees/Expenses SWPPX

Net Expense Ratio: Annual Report 10/31/2018	0.03%
Net Expense Ratio: Prospectus 02/28/2018	[illegible]
Management Actual	0.02%
Management Maximum	0.02%
12b-1 Maximum	—
Administrative Maximum	—

Source: Morningstar 2019

If you are investing in a non-retirement investment vehicle, taxes are another important expense you should analyze. Look at the tax cost ratio in the section entitled "Returns: Tax Analysis." Too many investors fail to account for the impact taxes will have on their returns: taxes typically reduce returns by about 25 percent each year.

3. Tax Efficiency

If you are investing in a non-retirement investment vehicle, taxes are another important expense you should analyze. Look at the tax cost ratio in the section entitled "Returns: Tax Analysis." Too many investors fail to account for the impact taxes will have on their returns: taxes typically reduce returns by about 25 percent each year.

When investing in taxable funds, choose funds with an eye to obtaining high returns while keeping taxes low. Taxes reduce the amount of money you can use for personal and family goals. Watch the historical impact of taxes for the fund because it is likely to be similar in the future. Remember, it is not what you earn, but what you keep after taxes that makes you wealthy.

Your tax-adjusted return is the estimated return after the impact of taxes. There are two ratios to watch: the tax cost ratio and the potential capital gains exposure (see Table 3).

The tax cost ratio is the percent of nominal fund returns that is taxable, assuming the fund is taxed at the highest rate, and is calculated as (1 + return) * (1 – tax cost ratio) – 1. If a fund had an 8 percent return and the tax cost ratio was 2 percent, investors in the fund took home 6.00 percent, or (1.08 * .98) – 1. The potential capital gains exposure is an estimate of the percent of the fund's assets that represent capital gains. If this number is high, there is a high probability that investors may receive gains as capital gains rather than as ordinary income.

Table 3. Morningstar Website: Tax Efficiency

Schwab® S&P 500 Index SWPPX | ★★★★

Quote | Chart | Fund Analysis | Performance | Rating & Risk | Management | Stewardship | Portfolio

Compare

Tax Analysis

	1-Mo	3-Mo	6-Mo	YTD	1-Yr	3-Yr	5-Yr	10-Yr	15-Yr	Since Inception
Pretax Return										
SWPPX	3.21	1.39	-3.07	11.46	4.63	15.20	10.58	16.57	8.26	7.61
Tax-adjusted Return *										
SWPPX	3.21	0.35	-4.06	11.46	3.56	14.41	9.86	16.00	7.71	7.07
% Rank in Category	48	44	38	48	27	15	8	11	13	—
Tax Cost Ratio										
SWPPX	—	—	—	—	1.02	0.68	0.65	0.48	0.51	—
Potential Cap Gains Exposure										
SWPPX	45.40									

(02/28/2019)

Currency is displayed in USD.
* Post tax returns are load adjusted.

4. Low Turnover

Look for funds with low turnover. Turnover is a measure of the amount of trading activity that takes place during a given period of time; turnover is shown as a percentage of the average amount of total assets in the fund. Calculate turnover by adding the fund's sales and purchases and dividing by two. High turnover, or excessive trading, increases the amount of taxes and transaction costs you will have to pay. Many costs associated with turnover are hard to quantify and are therefore not disclosed in the prospectus. Other costs that stem from high turnover include commissions, bid-ask spreads (the difference between what buyers are willing to pay and what sellers are asking for in terms of price), and market impact costs (a jump in price that occurs when a manager tries to buy a large block of shares). Remember that each transaction generates a taxable event, and the cumulative taxes can be very expensive.

A mutual fund's turnover is described under the prospectus heading "Annual Turnover" (see Table 5). You want a mutual fund that invests long-term, consistent with the principles of good investing. The more turnover a fund has, the more the investor will spend on transaction costs and taxes (which are not included in the total expense ratio). The more costs the fund generates, the higher the fund's returns must be to offset these expenses.

You should also look at the section entitled "Potential Capital Gains Exposure in the Returns: Tax Analysis." You should avoid mutual funds that have a high potential for earning short-term capital gains because they are taxed at the highest marginal tax rate.

5. Low Un-Invested Cash Low

Un-invested cash is cash the mutual fund has not yet invested in securities. High levels of un-invested cash are drags on a mutual fund's performance. For example, if the fund's portfolio has a small percentage of large-cap stocks and a large percentage of cash, the low rate of return on the cash will dilute the higher rate of return on the large-cap stocks. Look for funds that keep the percentage of cash in their portfolios low. Some mutual funds hold large amounts of cash to fund potential redemptions or to comply with their investment policy. Choose funds that are fully invested (95 to 99 percent, depending on the asset class and fund size) in the market segment you are targeting. Do not pay the mutual fund to manage cash. While it is acceptable for open-end mutual funds to have some frictional cash, this cash should comprise less than 5 percent of the fund.

The percentage of un-invested cash in a fund is listed in the "Asset Allocation" section of the prospectus (see Table 5). Remember that the amount of un-invested cash in a fund may change over time, so monitor this amount. The Vanguard fund has 0.4 percent un-invested cash.

6. No Manager Style Drift

The law requires that mutual funds have a prospectus available for individual clients to review. This prospectus states the investment objective of the fund (whether the fund will invest in large-

capitalization stocks, international bonds, real estate, etc.). Manager style drift relates to the fund manager's style and the types of companies the fund will buy or sell. Over time, portfolio managers may change the types of companies they choose to invest in; this change is called manager style drift. Changes in the size, geographical location, or relative valuation of the companies included in the fund can alter a manager's investment style. Since this investment style affects the performance of the fund, a portfolio manager should generally remain consistent in the types of companies he or she selects for the fund.

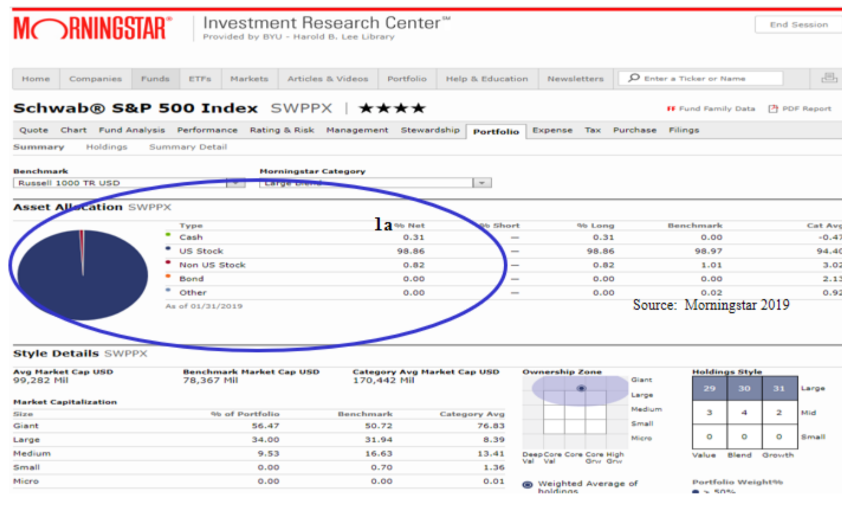
Table 4. Morningstar Website: Turnover

Source: Morningstar 2019

The fund's prospectus should clearly define the asset classes that will be included in the portfolio, the size of the target companies, and whether the portfolio has a growth or value tilt. A growth tilt means that the portfolio manager invests in stocks that have higher price-earnings and price-book ratios than the market and are likely to grow faster than the market. A value tilt means that the portfolio manager invests in stocks that are cheaper than the market and have lower price-earnings and price-book ratios than the market. A portfolio manager should not change the type of asset classes included in the fund. You are paying the manager to invest in the asset classes that are detailed in the prospectus, and this is what he or she should do. If you purchase a small company mutual fund, the fund manager should not purchase international or emerging market shares because these investments are not part of the fund's target asset classes. If you want exposure to these asset classes, you should invest in a mutual fund that specializes in international and emerging market shares.

The portfolio manager's investment style is described in the "Manager's Style" box in the section called "Portfolio: Style Box Details" (see Table 6). The diagram in the "Manager's Style" box lists the company valuation across the top and the company size on the side. The manager's style should not have changed over time. If you see that it has changed, find another fund where the style has remained consistent.

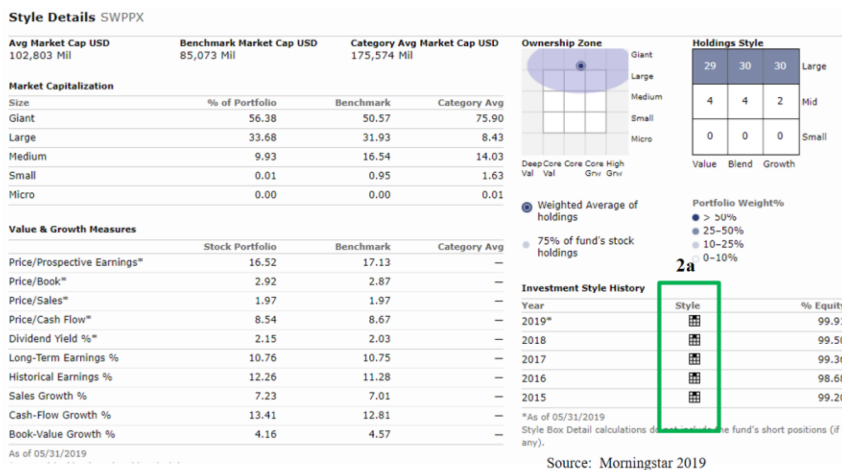
Table 5. Morningstar Website: Un-Invested Cash



7. Small (or Positive) Tracking Error

Tracking error (or trailing return, as defined by Morningstar) is the difference between the return on the fund and the return on the fund's benchmark.[3] Tracking error should be small, meaning that the fund return should be very close to the benchmark return. Generally, the smaller the tracking error, the more consistent the performance of the fund is compared to its benchmark. If the tracking error is negative, the fund has yielded lower returns than the benchmark. Most people do not complain too much if the tracking error is positive, or in other words, if the fund has yielded higher returns than the benchmark.

Table 6. Morningstar Website: Manager Style Drift



A fund's tracking error is usually listed in the prospectus section entitled "Tracking Error: Returns: Performance History" (see Table 7). You should look at three major parts of the section that deals with tracking error, "Tracking Error versus the Index," "Tracking Error versus the

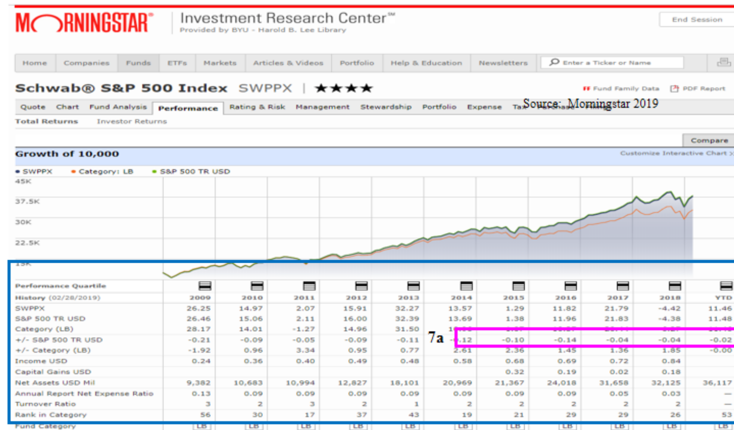
Category," and "Percent Rank in Category."

Tracking error versus the index (+/– index): This section shows the difference between the return on the fund and the return on the benchmark, or index. If tracking error is consistently small, it is likely you will consistently receive benchmark returns.

Tracking error versus the category (+/– category): Sometimes funds with similar objectives will have different benchmarks. This section combines all funds with similar objectives. This information indicates how well the fund performs in comparison with other funds in the same asset class (or category). A positive tracking error indicates that a fund has had higher-than-average returns as compared with other funds in the category.

Percent rank in category: This section shows the percentile in which a fund falls in a given category. A rank of 15 indicates that the fund is in the top 15th percentile of all funds; the lower the number, the better the performance of the fund compared to the performance of other funds in the category. Watch this percentage rank for consistency. A fund that is in the top-third of all funds year after year is a much better prospect than a fund that is the top performer one year and a mediocre performer for several years. Remember that winners rotate, and last year's best-performing fund is unlikely to be this year's best-performing fund. Consistency is a critical factor.

Table 7. Morningstar Website: Tracking Error



History (02/28/2019)	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	YTD
SWPPX	26.25	14.97	2.07	15.91	32.27	13.57	1.29	11.82	21.79	-4.42	11.46
S&P 500 TR USD	26.46	15.06	2.11	16.00	32.39	13.69	1.38	11.96	21.83	-4.38	11.48
Category (LB)	28.17	14.01	-1.27	14.96	31.50	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
+/- S&P 500 TR USD	-0.21	-0.09	-0.05	-0.09	-0.11	-0.12	-0.10	-0.14	-0.04	-0.04	-0.02
+/- Category (LB)	-1.92	0.96	3.34	0.95	0.77	2.61	2.36	1.45	1.36	1.85	-0.00
Income USD	0.24	0.36	0.40	0.49	0.48	0.58	0.68	0.69	0.72	0.84	
Capital Gains USD							0.32	0.19	0.02	0.18	
Net Assets USD Mil	9,382	10,683	10,994	12,827	18,101	20,969	21,367	24,018	31,658	32,125	36,117
Annual Report Net Expense Ratio	0.13	0.09	0.09	0.09	0.09	0.09	0.09	0.09	0.05	0.03	—
Turnover Ratio	3	2	3	2	1	2	2	2	2	2	—
Rank in Category	56	30	17	37	43	19	21	29	29	26	53
Fund Category	LB	LB	LB	LB	LB	LB	LB	LB	LB	LB	LB

Using Databases to Select Funds

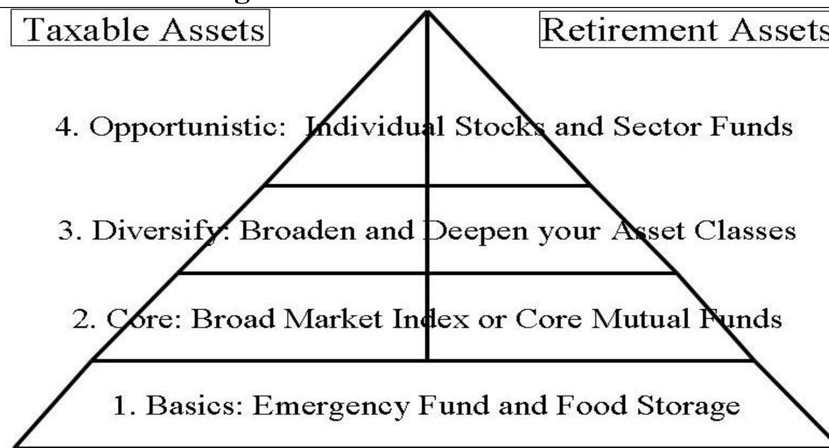
Now that you understand the parameters you should adhere to when selecting mutual funds, you can set your criteria and then use a database to get a list of all the funds that meet your criteria. For example, you can use Morningstar and Using Morningstar to Select Funds (LT07) to set your criteria for stocks, bonds, and other financial assets. To aid you in your selection, we have created a Mutual Fund Selection Worksheet (LT07B) that includes the criteria discussed and where to find it on Morningstar.

While there are many different resources for finding mutual funds, the Premium Fund Screener from Morningstar is one of the better resources. You will need to set up an account and a password. The cost of using Morningstar on the Internet is $125 per year. This service is available for free for some college students, such at BYU.

Building Your Investment Portfolio

Strategies for developing investment portfolios differ among individual portfolio managers and institutions. The strategy each investor prefers depends on the way he or she views the market; an investor's strategy also depends on his or her goals, budget, and experience in investing. It is impossible to discuss the strategies that every portfolio manager uses to build each portfolio; however, as I have reviewed successful portfolios, I have found that several critical phases of investment remain the same.

Chart 1: The Investment Hourglass Bottom



The top half of the investment hourglass detailed the steps you should take before you begin investing. Like the way we live our lives and decide on our goals, the way we invest should be based on our priorities.

The bottom of the investment hourglass contains a pattern of successful portfolios that I have seen in my experience as I have worked with students, families, and institutions (see Chart 1).

The bottom of the investment hourglass is divided into four levels, representing four phases of investment. The first level, or base, of the hourglass represents the phase in which you develop your emergency fund and food storage. I strongly recommend that you start this phase first. Generally, it is recommended that you have the larger of three to six months of income or expenses in very liquid cash or cash equivalents (i.e., savings accounts, internet savings accounts, money market mutual funds, short-term CDs, checking accounts, etc.) for your emergency fund. For information on cash management vehicles, see the chapter on Cash and Liquid Asset Management.

The second level represents the phase in which you develop your portfolio's core, or broad exposure. This level generally gives you exposure to the least risky of all the equity asset classes, mainly large-capitalization mutual funds. When you first begin investing, I strongly recommend that instead of purchasing individual stocks and bonds you follow the principles of investing discussed earlier and instead invest in low-cost, no-load index mutual funds. Doing so will give you broad diversification (I prefer a minimum of 500 securities per fund), market returns, and tax-efficient investments. For information on mutual funds, see chapter on Mutual Fund Basics.

The third level represents the phase in which you further diversify your portfolio by broadening and deepening your asset classes. If your core allocation is large-capitalization stocks, to deepen your portfolio you might include mutual funds which invest in small-capitalization or mid-capitalization stocks. If you were to broaden your asset classes, you might look to add no-load, low-cost, tax-efficient mutual funds which gave you exposure to new asset classes such as international (companies listed on stock exchanged located outside the United States), emerging markets (companies listed on stock exchanges located in the developing countries), or Real Estate Investment Trusts (portfolios of real estate investments that are developed and trade similar to mutual funds). There are many more other asset classes as well.

Finally, the fourth level represents the phase in which you develop your opportunistic assets, such as individual stocks and sector funds. Truthfully, you do not ever need to purchase individual stock or bond assets or sector funds.

Levels two, three, and four are also divided in terms of taxable assets and retirement assets. *Taxable assets* are assets on whose generated earnings you will need to pay taxes each year. *Retirement assets* are assets that you will not need until after you retire and on whose generated earnings you do not pay taxes ever or until you take the money out at retirement. The breakdown of your assets between your taxable and retirement accounts will depend on your personal goals and your available retirement vehicles.

The bottom of the investment hourglass illustrates three important principles.

First, it illustrates the importance of keeping risk in perspective. The base of the hourglass encompasses the least risky investments. As you move up the hourglass, you take on higher risk and, hopefully, higher returns.

Second, the hourglass teaches you the "how to" of investing. You should invest in lower-risk assets first and then expand your portfolio to increase its potential for greater risk and more return as the size of your assets increases.

Third, the investment hourglass separates taxable assets and retirement assets. The impact that taxes have on these two types of accounts is not the same, so retirement and taxable assets should be managed differently.

Why Index or Exchange Traded Funds

Index funds are mutual funds that hold the same proportions of specific shares as that held by a specific benchmark or index. Exchange-traded funds (ETFs) are mutual funds that are very similar to index funds, except that instead of being traded only once a day like a mutual fund, they can be purchased and sold at any time the market in which they trade is open. The goal of index funds and ETFs is to match the benchmark performance of a specific asset class. There are nearly 1,000 different index funds and over 500 different ETFs, and they all follow different indices or benchmarks related to geography, maturity, capitalization, and style.

Index funds and ETFs were created because some investors were concerned that actively managed funds were not always able to beat benchmarks after the effects of fees, taxes, and other expenses. By purchasing an index fund, investors stop trying to beat the benchmark: instead, they accept the benchmark's return and risk. Interestingly, index funds have tended to outperform most actively managed mutual funds over the long term.

ETFs were created because index funds trade only once per day at the fund's ending net asset value. Some investors wanted to trade index funds throughout the day. In addition, although the management fees on index funds were low, some people thought they should be even lower. Hence, many ETFs have lower management fees than many index funds. However, since ETFs trade on a market just like a stock, investors in ETFs need to factor in the additional cost of buying and selling the shares into the total cost calculation.

Active management tends to hurt a mutual fund's performance because excessive trading generates taxes and fees. Actively managed funds also have much higher management fees than index funds. (The average index fund charges 18 basis points, while the average actively managed mutual fund charges 80 to 200 basis points).

Index funds and ETFs use a passive investing strategy that requires very little time to maintain. Passive investment does not require you to know much about valuation, security analysis, or other company-specific information. You just need to be willing to accept the general market return for the asset classes included in your index fund or ETF. Although returns on index funds vary from year to year (just as returns on benchmarks vary from year to year), they still yield a consistent, respectable return. Jason Zweig, a senior writer for *Money* magazine, said the following about index funds:

> With an index fund, you are on permanent auto-pilot: you will always get what the market is willing to give, no more and no less. By enabling me to say "I don't know, and I don't care," my index fund has liberated me from the feeling that I need to forecast what the market is about to do. That gives me more time and mental energy for the important things in life, like playing with my kids and working in my garden.[4]

Index funds have become the standard against which other mutual funds are judged. If an actively managed mutual fund cannot perform better (after taxes and fees) than an index fund (index funds are very tax-efficient), then investors should lean toward purchasing the index fund. Warren Buffet wrote the following in 1993, and I believe his statement still applies today, "By

periodically investing in an index fund, the know-nothing investor can actually outperform most investment professionals. Paradoxically, when "dumb" money acknowledges its limitations, it ceases to be dumb."[5] He also said, "Doing reasonably well investing in stocks is very, very easy. Buy an index fund, preferably over time, so you end up owing good businesses at a reasonable average price. If you own a cross-section of American businesses, you are going to do well."[6]

In addition, the amount of time necessary to invest in index funds and ETFs is significantly less than the time needed to analyze, evaluate, value, and purchase individual stocks. In general, most actively managed funds and brokerage accounts tend to under-perform index funds in the long run after all taxes, costs, and fees. Invest accordingly.

The competition in stock-market research is intense and will get more competitive in the future. This will help make markets more efficient and indexing even more attractive. Market indexing or "passive investing" is a free ride on the competition; it takes very little time and contributes to a "sleep-well" portfolio.

Many dislike indexing because passive investing is boring, selecting stocks can be intellectually challenging, sharing investment "war" stories with friends is fun, and doing "nothing" about your investments is unnerving. Reasons to use index funds include immediate diversification, generally superior long-run performance, tax-efficient strategy, and time efficiency, which allows you to spend more time on the things that are important to you, such as family and friends, helping others, and doing well at work, instead of spending time analyzing individual companies.

Select Assets Wisely, Rebalance Tax-efficiently, and Hold your Assets 40 Years

Once you have done your research and have completed your Investment Plan, the process to pick YOUR mutual funds is simply:

1. Determine the asset classes needed for your Plan and choose the appropriate benchmarks. This you have already done.

2. Determine what makes a good mutual fund and which asset classes you need exposure. You have determined your criteria and know what makes a good mutual fund.

3. Using a database program (we use Morningstar in the class), set those criteria and evaluate each of the potential mutual funds.

4. Select the best mutual funds using Using Morningstar to Select Funds (LT07) and Mutual Fund Selection Worksheet (LT07B) (with hints on the "Filled in" tab).

5. Now put your Investment Plan together.

Assume your asset class was Large Cap, and you choose SWPPX for your fund. What next?

1. Go to Morningstar, and type the ticker "SWPPX" in upper right box
   - Where it says PDF Report (if available), print off this report. If there is no PDF Report, just print off the entire "Quote" Page. Include these in your Investment Plan as Exhibit III. Fund Support Exhibits. If you need help, see Mutual Fund Selection Worksheet (LT7B), Filled In for possible fund ideas and tickers
2. Download the Investment Process Spreadsheet (LT13)
   - For most, the first 4-10 asset tab will be sufficient.
   - Put in your Salary and emergency fund goal and percentage.
   - It will automatically determine your target portfolio fund size (your emergency fund amount divided by your bonds/cash percentage).
   - Assuming a salary of $60,000 and a 25% allocation to bonds and cash. Your target portfolio size would be $100,000.
3. Add data to the Investment Process Spreadsheet (LT13)
   - Put in your asset classes and benchmarks, and percentages in Panel I. Use the dropdown boxes for asset classes and benchmarks
   - Then put in the tickers and Fund names
4. Print off all your Exhibits

   Print off your filled in Exhibit I. Expected Return Simulation and Benchmarks (LT27)
   - Print off your filled in Exhibit II. Investment Process Spreadsheet (LT13)
   - Print off Exhibit III. Mutual Fund Pages from Morningstar. There should be a minimum of 4 funds from 4 different asset classes
   - Include these with your completed and filled in Investment Plan and you should be good.

Rebalancing Tax-efficiently

Portfolio rebalancing is the process of buying and selling assets to align your portfolio with the target asset-allocation percentages you determined in your Investment Plan. Over time, a portfolio can become unbalanced, or different from your target asset allocations, due to changes in asset and asset class performance, changes in your personal objectives or risk-tolerance level, and the introduction of new capital or new asset classes that you consider attractive.

It is important to rebalance your portfolio to ensure you continue moving toward your personal goals at an acceptable level of risk. The challenge of rebalancing is that each time you sell a security, you incur transaction costs; if the account is taxable, you also create a taxable event.

Portfolio Rebalancing Strategies

There are many different strategies for rebalancing a portfolio. In this chapter we will discuss two strategies: periodic-based rebalancing and percent-range rebalancing.

In **periodic-based rebalancing** (also called calendar-based rebalancing), you must decide how often you will rebalance your portfolio—monthly, quarterly, or annually. After each designated period of time, you will rebalance your portfolio to make it consistent with the target asset-allocation percentages listed in your Investment Plan. Allowing longer periods of time to pass between each rebalancing entails lower transaction costs but higher tracking error (the difference between the return you actually receive and the return you would have received if your portfolio had been at its target asset allocations).

The advantage of periodic-based rebalancing is that it is a simple method. The disadvantage is that it does not account for current market performance, which influences overall portfolio performance.

In **percent-range rebalancing** (also called volatility-based rebalancing), you rebalance your portfolio every time the portfolio's target asset-allocation percentages stray a predetermined percentage from your target percentages (e.g., plus or minus five percent). A higher percentage will reduce transaction costs but raise tracking error, while a smaller percentage will reduce tracking error but raise transaction costs.

The advantage of this method is that it is easy to implement because asset performance will indicate when you should rebalance. The disadvantages include that it is difficult to set an ideal range and that assets with higher target percentages and more volatility will have to be rebalanced more often than assets with lower target percentages and less volatility.

New money/donations (NMD) addendum: Regardless of which rebalancing strategy you use, I recommend you also consider using an NMD addendum. Since most of you pay yourselves monthly, donate to charities on a monthly basis, and use caution in your selection of assets, you are in a strong position to combine the aforementioned strategies with an NMD strategy.

An NMD addendum may be used when the following situation applies: in the process of rebalancing, you may find that you need to sell assets on which you have large capital gains. If this is the case, you may want to use the NDM addendum to donate the appreciated asset instead of selling the asset and paying taxes on the capital gains.

You can donate appreciated assets to churches and other qualified charities tax free. For members of the Church of Jesus Christ of Latter-day Saints, you can donate to tithing, fast offerings, missionary fund donations, and almost any other type of donation listed on the ward donation slips. This may be the same for other churches as well. The "donation-in-kind" of an appreciated asset can take the place of your tithing, fast offerings, or other charitable contributions. Then, since you have paid your tithes and offerings through donated securities, you can use the cash you would have paid for your contributions to buy securities to rebalance your portfolio back to your asset-allocation target percentages. (For more information on how to

donate appreciated assets to the Church of Jesus Christ of Latter-day Saints, please see the website at ChurchofJesusChrist.org.) Within about four to six weeks of donating an asset to the Church, you will receive a donation-in-kind receipt (see Tithing Share Transfer Example (LT08)). Keep this receipt as well as a copy of the *Wall Street Journal* to verify the value of the assets on the day you made your donation. You can then use these two documents to report a charitable donation on your tax return next year.

The key to rebalancing is minimizing market impact, transaction costs, and taxes due. By donating assets "in-kind," you eliminate capital gains taxes on your donated assets, minimize transaction costs and market-impact costs, contribute to a reputable charity (the charity must be a 501(c)(3) organization), and get a tax deduction.

Which rebalancing method is best? For most people, the strategy that is easiest for them will likely be the strategy that is most useful for them. A combination of periodic-based rebalancing and percent-range rebalancing usually works well, especially for smaller portfolios. These strategies can also be combined with the new money/donations addendum to minimize tax implications.

Hold Assets for 40 Years

As you choose good mutual or index funds, and rebalance tax-efficiently, the final point is to hold them for 40 years. The purpose here is two-fold. First, it is to encourage you not to buy and sell on every hiccup of the market. Fortunes are lost on transactions costs for those who buy and sell a lot. Second, if you take a buy and hold strategy, you will be paying much less taxes on your transactions. Finally, as you hold your assets for a long-time, particularly index funds that offer exposure to your various asset classes, you will enjoy to power of the market to help you achieve your personal and family goals.

Summary

We took a risk tolerance test which helped you to understand which type of an investor you are: very conservative, conservative, moderate, aggressive, and very aggressive. This test had two purposes: to help you understand what type of investor you are and to help you understand a recommendation for your asset allocation, how risk is brought into your portfolio. The riskier the assets in your portfolio, the riskier the portfolio.

We then, based on your age and risk tolerance, helped you to determine your risk tolerance. We also shared how different people with different ages and risk tolerance can have similar portfolios.

We shared how you put together an Investment Plan that details how you will invest, your objectives, constraints, strategies and evaluation. Those who carefully put together their investment plan will find a greater ability to weather the ups and downs of the market.

We discussed how you build an investment portfolio using the bottom of the investment hourglass. As you begin to save and invest, review the bottom of the investment hourglass. Start with the basics: build your emergency fund and food storage, then work up the pyramid. As you go up the pyramid, you will be adding risk to your portfolio. When you build your portfolio, it is critical that you take risk into account.

We discussed how you select financial assets for your portfolio. We discussed why it is a poor idea to buy individual stocks and bonds initially, especially when your portfolio is less than a $500,000. Easier and wiser investments would be no-load, low-cost index and mutual funds which offer immediate diversification, low cost, low taxes, and generally good performance.

We finished with some final cautions. Don't go into debt to invest. This includes borrowing against your home equity, buying on margin, or selling short. Don't move assets from one vehicle to another, i.e., take money from your 401(k) to buy a cash value insurance policy. Be careful of people selling assets—make sure they are licensed and the products are registered. If it sounds too good to be true, it likely is.

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[1] Robert G. Ibbotson and Paul D. Kaplan, "Does Asset Allocation Policy Explain 40, 90 or 100 Percent of Performance?", *Financial Analyst Journal*, Jan./Feb. 2000, 2633.
[2] Conference Report, Oct. 1911, 128–29
[3] http://library.morningstar.com/Education/MLE_Glossary_T_Z.html#TrailingReturnCategory
[4] "Indexing Lets You Say Those Magic Words," *CNN Money*, Aug. 29, 2001.
[5] *Letter to Berkshire Hathaway Shareholders.*
[6] "Warren Buffet: Top 3 Investment mistakes to Avoid," USA Today, October 26, 2013.

Personal Finance Glossary

% Rank in Category. This is the number the fund ranks in its category or versus the benchmark. It is the top percentile, i.e., the lower the number the better.

12-b1 fees. These are fees paid by the shareholders to market the fund to other possible shareholders. These are just marketing fees. Avoid them.

401k Plans or Roth 401k Plans. These are defined contribution plans where employees contribute a percent of salary up to a specified amount. Employers may contribute a matching amount (free money) to encourage participation.

403b Plans or Roth 403(b) Plans (also called Tax Sheltered Annuities). These are defined contribution plans, and are the same as 401k but for non-profit tax-exempt companies and institutions (i.e., schools).

457 Plans. These are defined contribution plans, the same as 401k plans but for state and municipal workers and tax-exempt organizations.

529 Prepaid Tuition Plan. This is an education plan where you can prepay tuition for a child and you know tuition will be covered, regardless of raises in costs of tuition. May be useful if you think your children will not be eligible for financial aid.

529 Savings Plan. This is an education plan where you can put money aside after tax and it grows tax free if principle and earnings are used for qualified educational expenses. Control of the funds resides with the contributor, who chooses the assets within options provided.

60% Solution budgeting method. A process of budgeting where you determine your gross salary each month, take 60% of that amount and only spend that amount each month. Do not spend beyond that amount. This leaves 20% of your salary for long-term goals and 20% of your salary for taxes at year-end.

Account maintenance fees. These are fees for maintaining your account.

Account Transfer Fees. These are charges for moving assets either into our out of an existing account.

Account Transfer Fees. These are charges for moving assets either into our out of an account.

Accountability. This is a principle is that states we are accountable for every choice we make. We do not make choices with no consequences or accountable; rather, we will be held accountability for the decisions and choices we make.

Accumulation Stage (of retirement). This first stage of retirement begins when you first begin to work and is the time where you accumulate assets which you will later use for retirement needs.

Accumulation strategies. These are possible strategies to use while you are in the accumulation stage of retirement. They could include to save 20% of every dollar you earn after school, with 10% into the company 401k (or Roth 401k), 5% into the taxable account for retirement , and 5% into children's mission and education funds; save 20% of every dollar, with the priority of maxing out the Roth IRA for both yourself and your spouse, 3% into education IRAs for kids, etc.; or convert funds from traditional 401k and IRA accounts into Roth accounts with a minimum tax impact if financially viable.

Action Plan. This is your plan to accomplish our individual and family goals.

Active management. Active management is the process of trying to beat market returns by the active buying and selling of mutual funds and stocks.

Active portfolio management. It is the process of using publicly available data to actively manage a portfolio in an effort to beat the benchmark after all transactions costs, taxes, management, and other fees. However, to do this successfully you must do this consistently year-after-year, and not just from luck.

Actively managed funds. These are funds where the portfolio managers try to beat the performance of a benchmark through the active purchase and sell of securities in their asset class. Actively managed funds generally have higher management fees which must be overcome through higher returns

Adjustments. Adjustments are deductions from total

income allowed by the IRS to get your Adjusted Gross Income (AGI). These include (among others):qualified medical savings contributions (flexible spending accounts), contributions to individual retirement accounts (IRA), contributions to Health Savings Accounts (HSAs), student loan interest and tuition and fees deduction (IRS 970) (within limits), one-half self-employment tax, etc. Losses include net capital losses (up to $3,000), sole proprietorship losses, and active participation real estate losses

Advanced Health Care Directive. This document, also known as a living will or personal or advance directive, is a legal document where a person specifies what actions should be taken for their heath care if they are no longer able to make decisions for themselves due to illness or other reasons.

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.

Agency bonds. Bonds issued by government agencies which were authorized by Congress including the Federal National Mortgage Association (FNMA), Federal Home Loan Banks (FHLB), and Government National Mortgage Association (GNMA).

Agency. This principle is that we have choice in our lives. We are agents of will, who can make choices consistent with our beliefs and values. Moreover, the gift of "choice" is man's most precious inheritance, and we should protect it carefully.

Annual Percentage Rate (APR). The APR is a rate that is generated from a precise calculation specified in Regulation Z. It only takes into account the fees going into the loan and does not take into account the time value of money.

Annuities. These are financial products developed and sold by insurance companies designed to accept and grow funds, and then, upon annuitization, pay out a stream of payments for a specified length of time. Annuities can be structured many different ways, such as payments for life for annuitant or spouse (i.e., for life of both), duration of payments (i.e., 20 years certain or life, whichever is longer), the type of payments (i.e., fixed or variable), etc. The different ways in which annuities can be structured (they are insurance products) provide the flexibility to construct an annuity contract to be meet your needs. However, it also increases expenses.

Annuitization. The process of determining what percent of retirement assets should be annuitized to ensure sufficient funds for the recipient's life.

Annuity types. These are the different types of annuities.

Application. Application is the "how' of how we do things. It is how we apply the doctrines and principles in our lives.

Appreciating assets. These are assets which may or which have historically appreciated in value.

Asset allocation funds. These are mutual funds which rotate asset classes among stocks, bonds, and cash for the best return. Asset allocation funds invest the fund's assets in the asset classes expected to perform the best over the coming period of time.

Asset allocation. This is the process of managing risk in your investment portfolio. Asset allocation is the process of allocating assets between various asset classes. It determines the risk of the portfolio and is the percentage allocated to each of the different asset classes.

Asset backed bonds. Bonds backed by specific holdings of the issuing company, such as equipment or real estate.

Asset classes. Asset classes are broad categories of investments with specific (and similar) risk and return characteristics. Asset classes are distinguished by characteristics specific to particular groups of securities, such as type of financial instrument, market capitalization, maturity, geographic location, etc. The major asset classes are cash and cash equivalents, fixed income, and equities.

Assets under management. This is another way an investment advisor is paid. It is calculated as a percentage of your assets under management, i.e., if you have $500,000 with an advisor and their fee is 1.0% per year, you will pay them $5,000 per year.

Assets. These are things that you own that have value.

Auto Loans. Auto loans are consumer loans that are secured with an automobile. Because they are secured, they have a lower interest rate than an unsecured loan or credit card. They normally have a maturity length of 2 to 6 years. The risk is that you

will often be left with a vehicle that is worth less than what you owe on it.

Automobiles and Other Vehicles. These are depreciating assets, such as cars, trucks, and RVs that normally must be inspected and licensed.

Average Amount Borrowed. This is the average amount borrowed over the life of the loan. In leasing, it is the (Net capitalized cost + residual)/2.

Average compensation. The average of the years of salary considered in making the defined benefit calculation.

Average Daily Balance (ADB): A common way of calculating interest to charge. Computed by adding each day's balance for a billing cycle and then dividing by the number of days in the cycle.

Average Indexed Monthly Earnings (AIME). The average lifetime earnings indexed for inflation is your top 35 highest earning years up to age 60. It entails adjusting each year's earnings total to reflect its value in the year in which eligibility is requested.

Average Monthly Interest Rates. This is the Annual Percentage Rate (APR) divided by 12.

Average tax rate. This is the average amount of every dollar you earned that was paid for federal income taxes. It is generally calculated at income taxes paid divided by AGI or Total income.

Baby bonds. A bond with a par value of less than $1,000.

Balance sheet (personal). This is a financial snapshot of your financial position on a given date.

Balanced funds. These are mutual funds which purchases both stocks and bonds generally in a specific percentage or relationship, i.e. 60% stocks and 40% bonds. Their benefit is that they perform the asset allocation, stock selection, and rebalancing decision for the investor.

Balloon loans. These are loans which payments including interest and principle are not sufficient to pay off the loan at the end of the loan period, but require a large "balloon" payment at some point in the future to fully pay off. This type of loan is not recommended.

Balloon Mortgages. These are mortgage loans whose interest and principal payment won't result in the loan being paid in full at the end of the term. The final payment, or balloon, can be significantly large. These loans are often used when the debtor expects to refinance the loan closer to maturity.

Bankruptcy Chapter 13. This process prepares a repayment plan in which the court binds both the debtor and the creditors to terms of repayment. The debtor retains property and makes regular payments to a trustee out of future income to pay creditors over the life of the bankruptcy plan.

Bankruptcy Chapter 7. This process liquidates assets and uses them to pay creditors according to precedence in the Bankruptcy Code. It is the quickest, simplest and the most frequently selected (75%) kind of bankruptcy filing. Certain debts cannot be waived by Chapter 7 bankruptcy such as child support, student loans, drunk driving fines, etc.

Basic Health Insurance. This is basic health coverage which covers hospital, surgical and physician expense insurance. It covers hospital insurance, which is hospitalization expenses including room, board, nursing, and drug fees; surgical insurance, which is the direct costs of surgery including the surgeon's and equipment fees; and physician expense insurance, which covers physicians' fees including office, lab, X-ray, and fees for other needed tests.

Bearer bonds. Bonds with coupons attach that pay interest only to the bearer upon surrender of the coupons.

Behavioral finance. Behavioral finance is an upcoming field of financial theory that attempts to further understand securities prices through understanding investor behavior. It came about because the assumptions which Finance makes, that people make rational decisions and people are unbiased about their predictions of the future are not always valid. Behavioral finance tries to incorporate "personal behavior" in an effort to extend finance beyond its narrow assumptions.

Benchmark. This is the relevant index for the specific category tracked by Morningstar or other fund monitoring company.

Bend Points. Calculating your PIA from AIME is divided into three calculations called "bend points" because the formula, when graphed, appears as a series of line segments joined at these amounts. These bend points change year to year.

Beneficiaries. The people who receive the property or assets.

Bidding and the Winner's Curse. Bidding may lead to a suboptimal result when you bid your fair value. Assuming everyone else has the correct value, if you won you overpaid.

Blend stocks. These are stock that are a part of both value and growth.

Bond interest and bond fund distributions. These are taxed at your Federal and state Marginal Tax Rate.

Bond mutual funds. Bond mutual funds are funds which invest a majority of their assets in bonds of specific types of companies or institutions. These funds generally have a specific objective, i.e. "corporate," "government", "municipals," "growth," etc. which relates to the types of bonds the mutual fund invests in. In addition, most have a specific maturity objective as well, which relates to the average maturity of the bonds in the mutual fund's portfolio.

Bond rating companies. A private sector company that evaluates the financial condition of the bond issuing company, its revenues, profits, debt, and other critical areas, and gives the company a rating which indicates the relative safety of the bond. They only rate corporate and municipal bonds. They include: Standard & Poor's, Moody's, and Fitch's.

Bond ratings. Bond ratings are measures of the riskiness of a company. Ratings run from "AAA" (Standard & Poor's) or "aaa" (Moody's) for the safest to "D" for the extremely risky. Ratings categorize bonds by default risk, the risk of the company being unable to repay the bond

Book-entry bonds. Bonds which are registered and stored electronically, similar to stock purchases.

Breakeven Analysis. This is a form of loan analysis that does not take into account the time value of money, but is simple to calculate. You calculate all new costs and fees for the new loan, and savings in principle and interest over the old loan. You then divide all new costs by monthly savings which will give you your breakeven point in months. If your breakeven point is less than 4 years, it may be a good idea, 5-7 years, it might be considered, or greater than 7 years, be careful. You may likely move before 7 years.

Budgeting Process. These are the steps you take to create your budget. It includes: 1. Know what you want to accomplish, 2. Track your spending (your expenses), 3. Develop your cash budget, 4. Implement your budget, 5. Compare it to actual expenses, then make changes where necessary to achieve your goals.

Budgeting the Better Way. This is a budgeting process where you pay the Lord first, and yourself second, then pay your bills. This makes paying yourself a higher priority.

Budgeting the Old Way. This is a budgeting process where whatever was left at the end of the month went into savings. The challenge is that there is never anything left at the end of the month.

Business risk. Risk that the bond's value will decline due to problems with the company's business.

Buyer's broker. This is a realtor that works specifically for the buyer and is paid by the buyer. The have a fiduciary responsibility to the buyer and not the seller which is different from the traditional buyer seller broker relationship.

Buying on margin. Buying on margin is borrowing money to invest. You borrow money from your broker and use it to purchase financial assets. If the stock goes up and you sell the stock, you make a profit due to leverage. Be careful as you can lose much more than your original investment.

Calendar Effects. The impact of tax and reporting is not consistent with theory. Behaviorists point out that returns are a function of cash flows, which tend to be concentrated around calendar turns. Institutions tend to "window dress," i.e., sell unwanted and buy desired stocks for period-end reports.

Call provision. A provision that allows the issuer to repurchase the bonds before the maturity date. Deferred calls provide more protection.

Callable bonds. Bonds which can be called, i.e. redeemed, before maturity at the option of the issuer.

Capital gains taxes. Capital gains are realized earnings from selling a financial asset at a profit. It is the sale price less the purchase price, and are divided into short-term and long-term. Short-term capital gains are gains from the sale of an asset where the asset was held for less than 366 days and is taxed at your marginal tax rate. Long-term capital gains are gains on the sale of an asset where the asset was held for more than 366 days and is taxed at a preferential federal rate. These are taxes you pay on assets held a specific period of time.

Capital gains. Capital gains are the best type of earnings as capital gains at the share level are not taxed until you sell your mutual fund shares. You decide when to be taxed. This is the difference between what you paid for the bond and what you sold it for, or the par value if you held the bond to maturity.

Capitalized cost reduction: Any reductions in capitalized cost, such as rebates, down payment, dealer incentives, trade-in, etc.

Capitalized cost: The cost to which you agree or negotiate when purchasing a vehicle.

Captive brokers. These are brokers whose company is part of a group which owns a mutual fund company. These brokers may be encouraged to sell company mutual funds which may not be the best fit for the investor but are in the interest of the company.

Carelessness. A reason for debt. We understand its costs, but we become lazy.

Cash accounts. This is money with the broker which you use to pay for purchases or receive any cash. There is a specific time between notification of purchases and when the purchases must be paid.

Cash Advance: Using a credit card to obtain cash, such as through an ATM or over the counter at a bank. This is an extremely expensive way to borrow, and carries several pricy fees.

Cash and Cash Equivalents. Cash and cash equivalents is an asset class whose major goal is liquidity and to preserve capital. Cash includes CDs, money market funds, T-bills, and commercial paper, etc. It also includes short-term interest-bearing investments such as treasury bills and savings bonds, loans to the U.S. government, commercial paper, and loans to corporations. It is a good investment asset class for money you plan to use in less than 3-5 years and don't want to take risks. It is less attractive as medium-to-long-term investments (> 5 years) as returns on cash and cash equivalents are unlikely to keep up with inflation.

Cash Dividends. Theory has shown that dividends are irrelevant in the absence of taxes and transactions costs. Behaviorists suppose that dividends can be justified by "mental accounts" which increase current income at the expense of "higher self-control" equity accounts. Older high-net worth investors value dividends more highly and concentrate in high income securities (preferred habitat) theory.

Cash-Balance Plans. A type of DBP in which provides specific annual employer contribution (generally 4-7%) each year, plus a low but guaranteed rate of investment earnings. Accounts grow at a predetermined rate, regardless of how much is in the account. Employees do not make any investment decisions.

Category. These are all funds in the same category as established by Morningstar.

CD Laddering: the process of getting a higher interest rate by buying longer term CDs and purchasing them more often. For example, 1 month CD rates are too low, but you like 6 month rates. Take the amount of money you want to invest, divide it by 6 (or any number), then invest 1/6 of your money every month in a 6 month rate. You are creating a ladder of CDs, and every month you have money coming in. You would then reinvest that in another 6 month CD.

Child's Benefit. Any child who is under 18 (19 if still in high school), is eligible for a benefit of 50% of the retired workers PIA, subject to a family maximum. Child's benefits terminate at age 18, marriage, or death. The dependent child of a fully or currently insured worker will receive a benefit of 75% of the worker's PIA (subject to family maximum) if the child is under age 18 (or age 19 is a full-time high school student), or is over age 18 and has been disabled since before age 22, and is not married.

Children's Trustee. The person who manages the assets for the children.

Children's Trusts. Trusts specifically for underage children.

Class A Shares: These shares commonly have a front-end or back-end load to compensate for the sales person's commissions. Because of the front-end loads, they usually have lower management fees.

Class B Shares: These shares commonly only have a back-end load that is paid only when the shares are sold. This load traditionally declines over time. Class B shares generally have higher expense ratios when compared to Class A shares.

Class C Shares: These shares generally have a lower front- and back-end load fees, but higher management fees.

Class R Shares: These shares are generally for

retirement purposes. Check the loads and management fees which may be substantial.

Class Y Shares: These are shares with very high minimum investments, i.e., $500,000, but which have lower management fees and waived or limited load charges. These are generally for institutional investors.

Class Z Shares: These are shares only available for employees of the fund management company.

Closed-end mutual funds. These are mutual funds with a specific number of shares outstanding. Individuals must purchase shares from existing shareholders, and shares may trade at a premium to (more than) or discount (less than) the underlying Net Asset Value (NAV). These premiums or discounts may be based more on investor demand than the underlying share value.

CLUE Report. A report, prepared by insurance companies that keep a record of all payments by insurance companies to individuals and institutions. Under the FACT Act (Fair and Accurate Credit Transactions Act of 2003) you can obtain the following Comprehensive Liability Underwriting Exchange (CLUE) reports each year: CLUE Auto: A 5-year loss history report of your automobile claims (if a loss was filed against your automobile insurance policy and if the insurance company reported the information to CLUE); and CLUE Personal Property: A 5-year loss history report of your homeowners claims.

Codicil. A document which institutes minor changes in the original will. Must be signed, witnessed, and attached to the original will.

Collateralized mortgage obligations (CMOS). More complex and specialized versions of mortgage backed bonds.

Commission costs. These are the cost associated with trading of bonds. While all bond trades incur commission costs, some newly issued bonds are sold without commission cost as the issuer absorbs the costs. Most trades however, incur commission costs, which are paid to the broker who arranged the trade.

Commissions. Commissions are the way a broker or investment advisor is paid. It is either a percentage of every buy or sell order (e.g., 20 bps per trade), or a specific charge for a trade (e.g., $9.99).

Community Property. A form of ownership is equal and only between partners. Lifetime control is shared by both spouses, consent from both is required to sell, income is shared between owners, and testamentary control in the one-half interest is unlimited unless property has right of survivorship feature (applicable in some states).

Compulsiveness. A reason for going into debt. We lack the self-control to discipline our purchases.

Computer Software budgeting method. This process uses commercially available budgeting software such as such as Mint.com (free), Quicken, Mvelopes, or others. Determine your gross salary and take home each month after taxes and other deductions, determine spending by category, and budget each category. Work to within your budget for each spending category. You will obtain receipts and credit card information directly via internet from financial institutions.

Conventional loans. These are loans that are neither insured nor guaranteed. They are below the maximum amount set by Fannie Mae and Freddy Mac of $424,000 in 2018 (single family). They require Private Mortgage Insurance (PMI) if the down payment is less than 20%.

Convertible bond. Bond which gives the holder the right to convert the bond to company stock instead of getting the cash repayment.

Convertible loans. These loans begin as a variable-rate loan and can be locked into a fixed-rate loan at the then current interest rate at some predetermined time in the future (for a specific cost).

Cooperation and Altruism. The process where we work with others and are concerned about them, not just ourselves and what we want. Cooperation may be a viable investment strategy. People's motives may lead to actions different than conventional rationality, i.e. individual selfishness, would suggest.

Corporate Bonds. (1)Bonds secured corporate debts by collateral or real property liens. (2) Debt instruments issued by corporations to fund the requirements of the companies.

Cost. These are the fees and expenses you pay to own a mutual fund or asset. Invest low cost. In a world where investment returns are limited, investment costs of any kind reduce your returns. We recommend you invest in no-load mutual funds to reduce costs.

Counseling: non-profit credit counseling agencies. These are agencies set up specifically to help people reduce the credit-card debt load in their lives. The non-profit companies have arrangements with many of the credit companies. Working with them, they can reduce or even eliminate your interest payments with specific creditors.

Counseling: For-profit credit counseling agencies. These are companies whose goal is to make money through helping people get out of debt. They often consolidate debt into a single loan with a lower rate, or get homeowners into an interest-only home loan and use the excess cash to pay down debt.

Coupon interest rate (or interest rate). The percentage of the par or face value that will be paid annually to the holder in the form of interest.

Covenants, Conditions and Restrictions (CCRs). These are legal documents that can affect what you can do with any potential homes. These can be quite restrictive as to what you can and cannot do with your home including exterior, landscaping, and other requirements. If you cannot live with the CCRs, don't buy there.

Credit Bureau: Private organizations which maintain credit information on individuals, which it allows subscribers to access for a fee. The three major credit bureaus to know are: Equifax, Experian, and Trans Union.

Credit Card: A financial instrument that allows the holder to make purchases through an open line of credit.

Credit Counseling Agencies (CCAs). These may be either non-profit or for-profit agencies to help you get out of debt. You should use these with caution.

Credit Limit: The maximum amount that one can borrow on a single credit card. This amount is often influenced by one's credit score.

Credit Report: Information collected by credit bureaus from subscribers, creditors, public court records, and the consumer.

Credit Score: A numerical evaluation of your credit based on specific criteria determined by the credit scoring company.

Credits. Credits are dollar for dollar reductions in your taxable liability. Credits are worth significantly more than deductions.

Current ratio. This is your monetary assets divided by your current liabilities. This ratio tells you how many times you could pay off your current liabilities with your liquid cash on hand.

Current Yield. It is the ratio of annual interest payments to the bond's market price.

Currently Insured Status. To be "currently insured", you must have at least 6 quarters of coverage in the previous 13 quarter period. Currently insured is adequate for eligibility for survivor benefits paid to children and for a surviving spouse caring for a qualifying child. Eligibility for other benefits generally requires fully insured status or 40 quarters of coverage

Custodial Accounts (UGMA/UTMA). These are investment vehicles that are managed for the child until the child turns a certain age. They can be invested in all types of financial assets, stocks, bonds, mutual funds, etc. UTMA (Uniform Gift to Minors Account) has fewer restrictions and may include real estate. These can be used for any educational or other expenses, including missions. The risks are there are no tax advantages and it is considered the child's money as soon as the child is of age—it cannot be taken back by the issuer. I prefer a tax-efficiently invested account.

Custody (or annual) fees. These are fees the brokerage house charges to hold the mutual funds or ETFs in your account. May be a minimum amount for small accounts ($15 per year), a specific charge per holding (8 basis points per security), or a percentage of assets for large accounts (25 basis points on assets under management).

DALBAR. DALBAR is a private company that does research on investor returns. It puts out an annual survey in a book titles "Quantitative Analysis of Investor Behavior." It discusses how average equity fund investors have done versus benchmarks over the past 20 years in the equity, fixed income, and balanced categories.

Day orders. These are orders to buy and sell securities which are good only until the end of the trading day.

Day trading. It is the process of an individual giving up all his spare time in an area in which he has little or limited competence, in an attempt to consistently beat the market and other professionals after taxes, costs and fees.

Debenture. A long-term unsecured bond. It can have a hierarchy of payment, with unsubordinated and subordinated debentures. These are bonds backed by the credit of the issuing company.

Debit Card: Unlike credit cards, debit cards act like a personal check. When used, money is taken straight from the connected account to pay for the purchased item.

Debt Cycle. It is the process of why and how we go into debt.

Debt Elimination: Expensive Debt First. This is one of the personal strategies. The logic is to pay off your most expensive debts first.

Debt Elimination: Smallest Debt First. This is one of the personal strategies. The logic is to pay of the smallest debts first. Then take the money saved to pay off all your other debts. You have success early on as you pay off the smallest debts first.

Debt Obligations or Back-end Ratio. This housing affordability ratio calculates what percent of your income is used for housing expenses plus debt obligations. It should not exceed 36% of your monthly gross income. The formula is: Monthly PITI and other debt obligations/ monthly gross income < 36%. Debt obligations include mortgage payments, credit card, student loan, car, and other loan payments. PITI = Principal, interest, property taxes, and property insurance

Debt ratio. This is your total liabilities divided by your total assets. This ratio tells you whether you could pay off all your liabilities if you liquidated all your assets. This represents the percentage of your assets financed with borrowing.

Debt Reduction Strategies. These are strategies for reducing debt. It is a six-step process: 1. Remember perspective, the "why's" and "what's." Accept that you have a debt problem; 2. Write down your goals so you know where you want to be. Stop incurring new debt; 3. See where you are by making a list of all your bills and debts. Admit the need to change your habits and lifestyle if being debt free is important; 4. Look for one-shot ways of reducing debt; 5. Organize a debt repayment Plan; and 6. Follow through on the Plan until total debt elimination.

Debt. It is the process of borrowing something with the expectation to pay it back in the future with interest.

Deductions. Deductions are IRS allowed reduction amounts (standard deduction) or taxpayer determined amounts (itemized deductions) to get taxable income from your Adjusted Gross Income.

Deep-discount and on-line brokers. These are brokers who are even cheaper than discount brokers. They do only trading, but at a 90% discount to full-service brokers. On-line can even be cheaper with other services.

Deferred. Payments are deferred until the specified time the investor elects to begin receiving the payments.

Defined Benefit Pension Plans. A Defined Benefit Pension Plan is a DBP where payments are based on a benefit payout formula. The formula is based on your salary, years worked and a company determined factor to calculate how much you will get each year. Employees do not contribute and bear no risk.

Defined Contribution Plan (DCP). A retirement plan where the employer contributes a specific amount to the employee's retirement funds while the employee is working and then has no responsibilities once the employee retires. Employer contributes to a fund, and then has no additional obligation when the employee retires. Employee may also contribute to the fund. Pension is determined by how much is invested by both the employer and employee, and how fast it grows.

Delayed Retirement Credit. Delaying payment beyond full retirement age results in a benefit increase for each year of delay. With a delay the worker's PIA is not increased and the benefits to family members is not increased.

Dental and Eye Insurance. This is insurance which covers only dental work and expenses relating to the eyes and teeth. Generally, it is only partial costs of eye exams, glasses, contact lenses, dental work, and dentures. Know your coverage, as the amount covered varies by plan provider. These plans are generally expensive, unless they are provided as part of an employer plan.

Depreciating assets. These are assets which depreciate. Often, the minute you take ownership of these assets, i.e. drive these assets off the car lot, they drop in value.

Direct PLUS Loan. These are loans available for parents of undergraduate, dependent students to help with school-related expenses, and the parent is

responsible for interest during school. Repayment begins six months after student graduates, discontinues, or drops below half time, and the parent is the borrower.

Direct Subsidized Loans. These are loans direct from the Federal government. The government pays interest while student is enrolled in school at least half-time, and repayment begins 6 months after student graduates or drops below half-time enrollment.

Disability Benefits. Workers who qualify for disability benefits are entitled to 100% of PIA until the earliest of the following: disability ends: benefits are terminated in the second month after the end of disability, or the workers dies: benefits are terminated in the month prior to the month the worker dies. If the worker attains full retirement age: disability benefits convert to retirement benefits.

Disabled Child. The disable child of a retired or disable worked is entitled to benefits past age 22 if the disability began before age 22.

Discount bonds. A bond that is sold at a discount to its par value. Generally, upon maturity the accrued interest and original investment add to the bond's par value.

Discount Points: These are payments made by the lender to reduce the interest rate on the loan. They are somewhat similar to prepaid interest. You pay more upfront in points but you will pay less on interest costs in the future. Your challenge is to minimize your overall interest costs, i.e., your effective interest rate.

Discount-service brokers. These are brokers who only perform trading, but usually at a 50% to 70% discount to full-service costs.

Discretionary accounts. These are accounts where you authorize a broker or investment advisor to make trades for you and your account. Exercise caution with this as the broker can buy and sell securities at will and you are responsible for all taxes and commission costs.

Discretionary contribution plans. Retirement plans where contributions are at the employer's discretion. These include profit sharing plans, stock bonus or ESOP plans, and money purchase plans.

Distribution Options. This is the decision as to how a distribution or payout is to be received. Make sure you understand the tax consequences of any payout or distribution option chosen.

Distribution/disposition/decumulation Stage (of retirement). This stage begins after you have retired. This is your plan as to how best take distributions from your remaining retirement and taxable accounts to minimize taxes and maximize the availability of your assets.

Distribution/disposition/decumulation strategies. These strategies help you set up a framework where you will not outlive your assets. Recommendations include taking out maximum distribution of 3.6% of total assets each year; only taking out maximum earnings from investments of previous year; or during your later years which income is less, i.e., during missions, transfer money from your tax-deferred to tax-eliminated accounts.

Distribution/Payout Options. These are options as to how you will take the benefits over your retirement.

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.

Diversification. Diversification is the process of allocating your assets so they are not concentrated in a single asset class. It is "not putting all your eggs in one basket". Having a diversified portfolio in many different asset classes is your key defense against risk

DNAH-ial Budgeting Method. This is a method many people use. It stands for DNAH ial - Do nothing and hope. It is not recommended.

Doctrines. Doctrines are the reasons behind why we do things. They answer the "why" questions of our lives, which are generally the most difficult questions to answer.

Down payment. This is the amount that you pay on the house to reduce the cost of the loan. Generally, lenders like a significant down payment as that indicates that the borrower is not likely to walk away from the loan. Different loans require different down payment amounts, i.e Conventional loans – 20 % recommended (but you can get in with 5%), FHA loans – 3.5%, and VA loans – 0% down payment

required.

Downgrade. A situation where a bond rating company reduces the bond rating of a bond generally due to a deterioration in the company's financial condition.

Dread Disease and Accident Insurance. This is a special insurance to cover a specific type of disease or accident. Generally it provides only for 'specific' illnesses or accidents on the "covered" list, and it provides a set maximum dollar amount of reimbursement. This insurance is generally expensive, unless included in your company's total health plan. Generally, concentrate on making your health coverage as comprehensive as possible.

Durable power of attorney. This provides for someone to act on your behalf in the event you should become mentally or physically incapacitated. This document is separate from the will and goes into effect before death. This document should be very specific as to which legal powers it transfers.

Earnings multiple approach. This is one approach for determining the amount of life insurance required. The goal is earnings replacement. The earnings multiple approach seeks to replace the annual salary stream of a bread winner for X years, normally 10 – 15 times gross salary.

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.

Education IRA. An Education IRA, also called a Coverdell ESA, is an investment vehicle for planning for the future cost of a child's education. The plan allows after-tax contributions each year for each child until age 18. Contributions and their subsequent earnings are tax-free when withdrawn to pay for qualified secondary and post-secondary education expenses.

Education Savings Account (Coverdell or Education IRA). The investment vehicle is similar to a Roth IRA where you invest in this account with after tax dollars, and if you use the proceeds for qualified educational expenses, distributions are tax-free. You choose your investments and the proceeds can be used for eligible elementary, secondary and post-secondary education expenses.

EE Bonds: US government savings bonds where the interest rate is set every 6 months and tied to current market interest rates.

Effective Interest Rate. This is the precise interest rate you are paying, after all costs and fees (regardless whether they are paid in the loan or out of the loan). The goal of a good loan is to have the lowest effective interest rate, which takes into account the time value of money.

Effective marginal tax rate. This is the average amount of every dollar you earned that paid for all local, state, and federal income taxes.

Emerging Market stocks and emerging market mutual funds. These are stocks or mutual funds of companies that trade in the countries not considered develop by the IMF. These are often smaller companies in smaller markets. International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, political instability, foreign taxes and regulations, and the potential for illiquid markets.

Employee Contribution (or Salary Reduction Plans). These are defined contribution plans where employees contribute before tax dollars reducing their taxable income and earnings accumulate tax deferred. The major plans are Roth or Traditional 401k and 403b plans and 457 plans. Employees direct the funds into different financial asset options provided by the company including mutual funds, index funds, fixed income, equities, money market funds, and GICs (guaranteed investment contracts). Companies have their list of approved investment assets. Employees choose where to invest their assets subject to the company list, and employees are not allowed to invest outside of approved investment assets.

Employer Qualified Retirement Plans. These are retirement plans, established by a company, that have specific tax and other benefits to both the company and the employee. Benefits include competition, tax shelters, personal retirement for the owners, and personal retirement for the employees. They can be either defined benefit or defined contribution plans.

Employment. This is working during college to help offset the cost of educational expenses.

Endowment Effect. Sometimes we perceive that an asset's value increases by virtue of our ownership. Once you own something, its value hasn't increased or changed.

Envelope budgeting method. A process of budgeting where you prepare divide spending each month into categories, create envelopes for each category of spending, and once a bill comes, take the money from the corresponding envelope and pay the bill.

Equities (or Stocks). Equities are an asset class that provides growth and earns returns in excess of inflation. Over longer periods of time, the stock market historically has been the only major asset class to consistently outpace inflation. Equity ownership is ownership in a businesses' earnings and assets. Equity asset classes are delineated by market capitalization (which is shares outstanding multiplied by the stock's current market price), type of company (growth versus value), and geographic area. The benchmarks for equity asset classes can be generally defined as capitalization: Large, mid, and small; type: Growth, blend, and value; or geographic area: US, international, global and emerging markets. Equities have offered the highest return of the major asset classes historically and have been a good investment for long-term investing—they have consistently beat inflation over the long-term. However, they offer less stability of principal than other asset classes, and subject to short-term price fluctuations (so very risky for short-term investments).

Equivalent Taxable Yield: This is the yield you would need to earn on a fully taxable security to give the same after-tax return that you receive on a tax advantaged security, i.e., a security that has specific tax advantages (i.e., tax free for Federal or State or both).

Estate planning. The process of anticipating and arranging for the disposal of your resources to accomplish your personal and family goals after you pass away.

Estate Taxes. These are taxes, paid to the government, due on passing of an individual. Estate taxes are equal to the gift-adjusted taxable estate multiplied by the appropriate tax rate. To determine the net tax owed, calculate the total tax owed and subtract the unified gift and estate tax credit.

Estate transfer. This is the process that property interests are legally transferred from one to another, either during the person's lifetime or at death

Euro Bonds. Bonds issued by U.S. companies and sold outside of the U.S. in U.S. dollars.

Exchange rate risk. Risk that changes in exchange rates will impact profitability for firms working internationally.

Exchange traded funds (ETFs). These are portfolios of stocks similar to mutual funds which trade on organized exchanges. ETF's trade like stocks, are purchased with all the transaction/custody costs, are priced throughout the day (rather than at day's end like mutual funds), and can be sold short and purchased on margin. ETFs can be either in a unit investment trust (UIT) format or an open-end mutual fund structure. The UIT structure does not allow for reinvestment of dividends.

Excise "sin taxes" and state sales taxes. These are taxes imposed when goods are purchased.

Exclusion Amount. This is the amount of estate value that is excluded from the estate tax.

Exclusive Provider Organization (EPO). These are similar to an HMO, but operates through an insurance company. It is funded through an insurance company, with health care provided by contracted providers. Only care received from contracted providers is covered (unless in an emergency situation).

Executor or personal representative. This is the person who is responsible for carrying out the provisions of the will.

Exemptions. An exemption is an amount of money set by the government that you can deduct for each qualifying person in your household.

Expenses. This is where your money goes. There are two types of expenses: fixed expenses, which are expenses you don't directly control; and variable expenses, which are expenses you can control.

Family Giving Plan. A family plan which states how the family will give, to whom it will give to, as well was what the family will or will not do or give to.

Family Money. This refers to the use of personal savings and help from parents or other family.

Fee for-service (or traditional indemnity plans). These are health care plans where the doctor bills the patient directly, and the patient is reimbursed, to a specific percentage, by the insurance company. They provide the greatest flexibility for choosing doctors and hospitals, they define the percent of each claim the policy will cover, and they define the amount the insured must pay before a claim is eligible for reimbursement. Generally these plans are more

expensive and require more paperwork.

FHA Loans. These are Federal Housing Administration (FHA) Insured Loans. The FHA does not originate any loans, but insures the loans issued by others based on income and other qualifications. There is lower PMI insurance, but it is required for the entire life of the loan (1.5% of the loan). While the required down payment is very low, the maximum amount that can be borrowed is also low.

FICO Score: This is the most commonly used credit score. It ranges from 300 to 850.

Fill or kill orders. These are orders which must be either filled or canceled immediately. Most often these are market orders.

Financial assets/instruments. These are different types of securities that are sold in financial markets.

Financial Goals. Financial goals are personal goals with a cost attached.

Financial markets. Markets in which financial securities or assets are bought and sold.

Financial Planning. This is the process of helping yourself and others to use their resources more wisely to achieve their personal and family goals. It should help determine where you are, where you want to be, and how you will get there.

Financial Ratios. These are ratios that can help you to analyze your spending.

Financial risk. How the firm raises money could affect the financial performance of the firm and the value of the bonds.

Fixed contribution plans. These are defined contribution plans where contributions are fixed by the employer. Examples are thrift and savings plans and target benefit plans.

Fixed Income. Fixed income is an asset class that attempts to provide income and to earn returns in excess of inflation. There are two different types of fixed income assets: Taxable bonds. Taxable bonds include U.S. Treasuries, corporate bonds and agency issues (bonds issued by U.S. government agencies, like Ginnie Mae). Tax-free bonds include revenue or general obligation bonds issued by local or state governments and agencies. Such bonds are generally free from federal and state taxes. Fixed income includes short-term bonds/bond funds, intermediate-term bonds/bond funds, and long-term bonds/junk bonds/bond funds issued by governments or corporations. Fixed income offers greater returns than cash, but with greater risk. It offers good diversification tool when holding a long-term stock portfolio, as bonds move differently than stocks. However, returns have been historically lower than stocks, they are very susceptible to interest rate and other risks, and generally, fixed income assets alone are not good long-term investments because they don't provide enough growth to beat inflation over long periods of time.

Fixed rate mortgages (FRMs). These are mortgage loans with a fixed rate of interest for the life of the loan. These are the least risky from the borrower's point of view, as the lender assumes the major interest rate risk above the loan rate. These are the most-recommended option for new home buyers.

Fixed. Payments are a fixed amount, and are made to the investor until the end of the contract, usually till the investor dies.

Fixed-rate loans. Have the same interest rate for the duration of the loan. Normally have a higher initial interest rate as the lender could lose money if overall interest rates increase. The lender assumes the interest rate risk, so they generally add an interest premium to a variable rate loan

Floating rate bond. Bond whose interest payments fluctuate according to a specific benchmark interest rate.

Free Application for Federal Student Aid (FAFSA). This is the application form for obtaining government student aid.

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.

Free Money. This is money you do not physically work for and is not paid back. It includes scholarships and grants.

Full Retirement Age (FRA). This is the age at which a retiree will receive 100% of their entitled benefits. Receiving benefits prior to FRA will result in a reduction in benefits. Receiving benefits after FRA will result in an increase of benefits.

Full-service brokers. These are brokers who will give you all the tools, research and other advice to help you trade and invest.

Fun. Sometimes we trade for fun and entertainment instead of financial performance. This is OK, but make sure your fun money is no more than 5% of the value of your portfolio—that way you don't lose too much.

General Obligation bonds. Bonds backed by the taxing power of the issuer.

Generation-Skipping Tax. This is a tax on revenue lost when wealth is not transferred to the next generation, but to a succeeding generation. It is a flat tax, in addition to the regular estate tax, imposed on any wealth or property transfers to a person two or more generations younger than the donor.

Gift and estate taxes. These are taxes imposed when assets are transferred from one owner to another.

Gift Tax Exclusions. A gift tax must be paid on all transfers to others (other than a spouse) that are in excess of the maximums specified. The maximum specified is your exclusion.

Gift-Adjusted Taxable Estate. This is equal to your taxable estate plus any taxable lifetime gifts, which is the cumulative total of all gifts over the annual limit.

Giving Plan. A plan on your thoughts on your personal and family giving. It discusses how you will handle both your institutional (through Church and other institutional contributions) and personal (personal and family contributions and service) giving.

Global stocks and global stock mutual funds. These are stocks or mutual funds of companies that contain a mixture of U.S. and foreign or international holdings. International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, political instability, foreign taxes and regulations, and the potential for illiquid markets.

Goals. These are things we would like to accomplish. They are often divided by time, i.e., short-term, in the next 12 months; medium-term, from 2-10 years; and long-term, beyond 10 years. They may also be divided by type, i.e., identity, integrity, and temporal goals. They will take effort and resources, but are things that are important to us and are what we want to accomplish.

Good Faith Estimates (GFE). This is an estimate from each lender (not just a Summary) of the likely costs you will likely pay as you complete the loan process. I recommend you get GFEs from each potential lender and compare them.

Government-Sponsored Health Care Plans. Government-sponsored health care plans are insurance plans which are sponsored either by the state or the federal government. These plans fall under three headings: Workers' Compensation, Medicare, and Medicaid.

Grace Period: The amount of time given by a credit card company to pay a due balance before interest starts to accrue. Normally 20 to 25 days, excluding cash advances. It does not apply if the card already carries a balance.

Grad PLUS Loan. These are loans available for graduate students to help with school-related expenses. The student is responsible for interest during school, repayment begins six months after student graduates, discontinues or drops below half time, and the graduate student is the borrower.

Grants. Money given to individuals for education on the general basis of need.

Gross Estate. This is the value of all your assets, including life insurance, pensions, investments, and any real or personal property.

Gross Income. Gross income for tax purposes is all income, unless specifically excluded or deferred.

Gross Savings Ratio. This is your income for savings divided by your gross income. This ratio tells you what proportion of your total income is being saved.

Growth stocks. These are fast-track companies whose earnings are expected to grow very rapidly. Frequently these are companies developing new technologies or new ways of doing things.

Guardian. The person who cares for minor children and manages their property.

Health Care Coverage. Health Care Coverage is divided into four areas: basic health insurance, major medical expense insurance, dental and eye insurance, and dread disease and accident insurance.

Health Care Providers. These are the major providers of health care. They fall into three types: Private health care plans, which are either fee-for-

service (or traditional indemnity plans) or managed health care (HMO, PPO); Non-group (individual) health care plans, or Government-sponsored health care plans.

Health care proxy. A health care proxy designates someone to make health care decisions should you be unable to do so for yourself.

Health Maintenance Organizations (HMOs). HMOs are prepaid insurance plans which entitle members to the services of specific doctors, hospitals and clinics. They are the most popular form of managed health care, due to their costs, which are roughly 60% of fee-for-service plans. They provide a system of doctors and hospitals for a flat fee, and emphasize preventive medicine and efficiency, and subscribers pay a relatively small co-pay for services rendered. They provide little choice of doctors and hospitals. As such, service may be less than at other facilities and referrals sometimes difficult to get.

Hedge funds. Hedge funds are less-regulated mutual funds which take much more risk than normal with the expectation of much higher returns. Generally they can take both long positions (where they buy assets) and short positions (where they short-sell assets, i.e., borrow assets and sell them). They hope to later buy back the assets at a lower price before they must return them to the borrower.

Holographic Will. A will and testament that is entirely handwritten and signed by the testator. Traditional wills require signatures of witnesses as well as the testator's signature and intent. Holographic wills are treated equally with witnessed will and need only to meet minimal requirements in order to be probated

Home Equity Lines of Credit (HELOC). Home equity lines of credit are basically second mortgages which use the equity in your home to secure your loan. These are generally adjustable rate notes that have an interest only payment, at least in the first few years of the note. Interest rates are variable and are generally interest only in the first few years. They have lower rates of interest than other consumer loans.

Home Equity Loans. This is a personal debt strategy. You take out a home equity loan, which is a loan against the equity in your home (the difference between what the home is worth and how much you owe on it) to pay off your debts. Home equity loans are basically second mortgages which use the equity in your home to secure your loan. Normally can borrow up to 80% of your equity in your home.

Home Inspection. This is a service, usually paid for by the buyer, to alert them to potential problems with the home. Many of these problems should be fixed by the seller prior to purchase and so these problems need to be discovered and disclosed. Don't buy someone's problems.

Housing Expenses or Front-end Ratio. This is a housing affordability ratio that calculates what percent of your income is used to make mortgage payments. Housing expenses should be less than 28% of your monthly gross income. The formula is: monthly PITI*/monthly gross income <28%. PITI = mortgage principle, mortgage interest, property taxes, and property insurance.

Housing. These are appreciating tangible assets, such as land, dwellings, vacation home, or rental property used for personal goals or capital income.

Housing Ratios. As Christians, we have other important obligations that we also pay, i.e., tithing and paying ourselves, i.e., savings. As such, should have smaller houses (at least less expensive), because we pay the Lord first and ourselves second. For a spreadsheet that takes into account the fact that we pay the Lord first and ourselves second within this front-end and back-end ratio framework, see: Maximum Monthly Mortgage Payments for Christian Savers Spreadsheet (from the website).

I Bonds: Inflation linked US government savings bonds, where the rates on the bonds are tied to inflation.

Identity goals. These are goals that relate to our long-term view of who we are and how we see ourselves. These goals help us be better in our long-term view of who we are and what we want to become.

Ignorance. A reasons for going into debt. We don't understand interest and its costs.

Immediate Annuity Distribution. You can use your defined contribution plan to purchase an immediate annuity, either from your retirement Plan provider or from others outside the Plan.

Impound/escrow/reserve accounts. These accounts are that portion of a monthly payments held by the lender or servicer to pay for: Taxes, Hazard insurance, Mortgage insurance, Lease payments, and

Other items as they become due. These are for payments for items above which are over and above your monthly mortgage payments of principle and interest. These may or may not be required by your lender.

Inactivity/Minimum balance fees. These are fees because you did not have account activity during the period or because you failed to keep a minimum balance in your account.

Inactivity/Minimum balance fees. These are fees imposed because you did not trade or have account activity during the period or because you failed to keep a minimum balance in your account.

Income Statement (personal). This is a financial record your inflows and outflows of cash. It is on a cash basis. The statement is based entirely on actual cash flows, not accruals.

Income Taxes. Income taxes are a progressive tax meaning that the more you earn the more you pay.

Income-consuming assets. These are assets which require a constant infusion of cash to keep operative.

Income-generating assets. These are the best type of assets. These assets generate income or capital gains which may eventually allow you to have income without your having to work.

Indenture. A document that outlines the terms of the loan agreement.

Independent brokers. These are brokers whose company is not part of a major chain or who own a captive mutual fund company. They may be inclined to give unbiased advice as they do not sell specific mutual funds.

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Index funds. Index funds are mutual funds designed to match the returns of a specific index or benchmark. Different Index funds may track many different benchmarks, including the S&P500 (Large-cap stocks), Russell 5000 (small-cap stocks), MSCI EAFE (international stocks), Barclay Aggregate (corporate bonds), DJ REIT (Real estate investment trusts), etc. Index funds are tax efficient since they do little in buying and selling of securities, and their goal is to match the return of their relative benchmarks.

Index funds. These are mutual funds or ETFs which hold specific shares in proportion to those held by a specific index, i.e., the S&P 500 or Russell 2000. Their goal is to match the benchmark performance. Index funds have become the standard against which other mutual funds are judged.

Individual Biases. The brain does not work like a computer. Instead, it processes information through shortcuts and emotional filters to shorten the analysis time. These filters and shortcuts lead to predictable errors in investing. We must be wise to these prediction errors so we can be better investors and better stewards over our resources.

Individual Development Accounts (IDA). These are matching resources from local and other sources to encourage saving for specific goals including education. They must be used for education, or home purchase, or to start a business, you must be in the program for 12 to 36 months maximum, and must attend a basic money management class (Fin418 counts), reside in Utah, be 18 or older, have income to save and meet needs criteria.

Individual Retirement Accounts. These are retirement account created with the Taxpayer Relief act of 1997. While there are over a dozen different individual retirement accounts, the three major types of Individual Retirement Accounts are Traditional IRA, Roth IRA, and Education IRA, which is also called a Coverdell Education Savings Account (ESA).

Individual Retirement Annuity: An IRA set up with a life insurance company through purchase of annuity contract.

Inflation risk. Risk that a rise (decline) in inflation will result in a decrease (increase) in the bond's value.

Inherited IRA: An IRA acquired by the non-spousal beneficiary of a deceased IRA owner.

Initial public offerings (IPOs). These are the very first shares ever issued by a company. Investment bankers serve as underwriters or intermediaries for these IPOs

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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.

Installment Loans. Installment loans are loans which are repaid at regular intervals and where payment includes both principal and interest. These are normally used to finance houses, cars, appliances, and other expensive items. These loans are amortized, which is the process of the payment going more toward principal and less toward interest each subsequent month. These may be secured or unsecured loans, variable-rate or fixed-rate loans.

Insurance. Insurance is a tool help you achieve your personal and family goals. It is a product that transfers the risk of certain types of losses or events from an individual to another institution. By transferring risk, it can help the individuals achieve specific goals if they die, get sick or become unable to work. But it is a tool that needs to be understood and used wisely.

Insured Worker. A worker is only entitled to receive benefits if that worker is fully insured. Workers are considered fully insured if they have worked forty quarters of work (a quarter is three months) and earned a specific amount of money per quarter.

Integrity goals. Integrity goals relate to the characteristics and standards you want to achieve in the work and service you provide. These goals relate to how we will work and live, what we will and will not do, and characteristics and skills we wish to attain.

Interest only Option loans. These are FRMs or ARMs with an option that allows interest only payments for a certain number of years, and then payments are reset to amortize the entire loan over the remaining years. Some will take out an interest only loan to free up principal to pay down other more expensive debt. Once the interest-only period has passed, the payment amount resets, and the increase in payment can be substantial. These are generally not recommended.

Interest or finance costs. This is the average amount borrowed times the monthly interest rate. In calculation form, it is the (Net capitalized cost + residual value) / 2 times your average interest rates which is the APR/12.

Interest rate risk. Risk that a rise (fall) in interest rates will result in a decline (rise) in the bond's value.

Interest. The cost of using borrowed money. Interest must always be paid.

Interest/coupon payments. These are payments received as part of the contractual agreement to receive interest payments from a bond. Bonds which have preferential interest tax treatment, i.e., muni's and Treasuries, must still pay capital gains taxes.

Intermediate-term bonds. Bonds with a maturity of 2 to 10 years.

Internal Rate of Return (IRR). This is a form of loan analysis to determine whether you should refinance or not. The process is to calculate all costs and fees for the loan, calculate the monthly savings, determine the number of months of savings, and set the number of months on the new loan equal to the number of months remaining on the old loan so you are not extending the loan! If your IRR is greater than your risk-free rate, then refinance.

International Bonds. Bonds issued by international companies and sold internationally in various currencies.

International stocks and international mutual funds. These are stocks or mutual funds of companies based entirely outside the U.S. These can be of any size (small-cap, large-cap), any type (value, growth) and from any part of the world outside the US. International investments involve additional risks, which include differences in financial accounting standards, currency fluctuations, political instability, foreign taxes and regulations, and the potential for illiquid markets.

Intestate. The process whereby the state essentially writes the will for a person because they did not prepare a will during their lifetime.

Investment advisor. A person or an organization that helps makes the day-to-day decisions regarding a portfolio's investments for investors.

Investment Assets. These assets include stocks, bonds, mutual funds that are invested for the future. These are also income-producing assets used to accumulate wealth to satisfy specific goals.

Investment Benchmarks. An investment benchmark is the standard by which to judge your asset performance. You never choose an asset without choosing an investment benchmark. Use your

investment benchmark to determine how well you are doing.

Investment Constraints. These are specific needs you have which will constrain how you will invest your portfolio.

Investment Guidelines. Your investment guidelines are the general road map on how you will be investing your assets over your life cycle. It integrates your personal goals and your financial goals into a complete financial perspective.

Investment Horizon. This is when will you sell the investment.

Investment Plan (also called and Investment Policy Statement). Your Investment Plan is the most important document you will prepare in regards to your investing activities. It sets the plan and framework on every investing activity. It states what you will do: what you will and will not invest in, how you will invest, why you will invest, what percentages you will invest, etc. In short, it is the key document that will impact your investment returns most for the rest of your future.

Investment risk. This is the risk of who takes responsibility for the investment outcome, the insurance company or the insured.

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.

IRA Rollover distribution (Be careful and don't touch the funds). You can roll over your distribution into an IRA. The benefits are you can defer taxes until you withdraw the funds, you can direct investment to different assets and asset classes, and you can continue to enjoy tax-deferred growth. The risks are that there is no guarantee that funds will last a lifetime and you must begin withdrawals at 70½ or 50% penalty is incurred.

Irrevocable Living Trust. A trust that cannot be changed by the owner once established, because the trust becomes another legal entity which owns all the assets contained in the trust and pays taxes on the assets and gains they produce. The assets are not subject to estate taxes since they are not part of your estate and assets in the trust do not pass through probate.

Issue. These are children.

Issuer. The corporation or government agency that issues the bond.

Itemized Deductions. These are allowable deductions (if you itemize) and include: charitable contributions (cash, in kind, and/or mileage), home mortgage interest, medical expenses (>10% AGI), un-reimbursed qualified job expenses (> 2% AGI), casualty and theft expenses (> 10% AGI), etc.

Jensen's Alpha. This is a risk-adjusted performance measure. This is the ratio of your portfolio return less CAPM determined portfolio return, or alpha = rp - [rf + ßp (rm – rf)] where ap = alpha for the portfolio, rp = average return on the portfolio, ßp = Weighted average Beta, rf = average risk free rate, and rm = average return on market index port. It is portfolio performance less expected portfolio performance from CAPM model.

Joint and Survivor Annuities (percent relates to the amount the spouse receives). You receive payment for as long as you live or for a certain guaranteed period, whichever is longer, and your spouse, after you die, receives that percent of your payment for as long as they live.

Joint Tenancy with Right of Survivorship (JTWROS). Ownership is shared equally and lifetime control is shared, income is shared between owners, testamentary control is absent, and then right of survivorship is key.

Jumbo loans. These are loans in excess of the conventional loan limits and the maximum eligible for purchase by the two Federal Agencies, Fannie Mae and Freddy Mac, of $424,000 in 2018 (some areas have higher amounts). Some lenders also use the term to refer to programs for even larger loans, e.g., loans in excess of $500,000.

Junk Bonds. Bonds with very low bond ratings, a

higher interest rate and default rate, and are almost always callable.

Keogh Plan. This is a small business retirement plan set up by a sole proprietor or partnership (not incorporated) which allows employers to make tax-deductible payments to retirement plans, similar to pension or profit-sharing plans. Plans can be either a defined benefit or defined contribution, but most commonly are DC profit sharing or money purchase plans. Contributions are tax deductible, earnings grow tax-deferred, and employers may borrow from the Plan

Large-cap (capitalization) stocks. Large caps are stocks with a market capitalization greater than roughly $10 billion in the US, and smaller capitalizations for international companies. These are the generally the largest, most well established companies in the US, with a history of sales and earnings as well as notable market share. These are generally mature corporations with a long track record of steady growth and dividends.

Lease cost: The total cost of a vehicle's lease.

Lease term: The number of months the vehicle is leased.

Lease: A contractual arrangement calling for the lessee (user) to pay the lessor (owner) for the use of an asset.

Leverage. The decision of using debt to invest. It is not recommended.

Liabilities. This is what you owe to others. Liabilities come in two major forms: current liabilities, liabilities that must be paid-off within the next year, and long-term liabilities, liabilities that extend beyond one year.

Liability Coverage. Liability is the financial responsibility one person has to another in a specific situation. Liability results from the failure of one person to exercise the necessary care to protect others from harm. Personal liability coverage protects the policyholder from the financial costs of legal liability or negligence. There are two major forms of liability insurance: the liability portions of homeowners and auto insurance and an umbrella liability coverage.

Life Annuities (guaranteed for the "certain" period). You receive benefits for as long as you live or for a certain guaranteed period, whichever is longer.

Life insurance. This is insurance that provides compensation to your beneficiaries should you die prematurely. It transfers the economic loss of death from an individual to an insurance company by way of a life insurance contract. It can help us take care of our own and extended families should we die.

Life-cycle funds. These are funds which change their allocation between stocks and bonds depending on investor age. As an investor ages, life cycle funds reduce their allocation to stocks and increase their allocation to bonds, more consistent with the goals and objectives of an older investor.

Lifetime transfers. Methods of transferring property including the sale or gifting of one asset to another.

Limit orders. These are orders to sell or buy a specific number of shares at a specific price or better. This is generally the best method in working with brokers.

Limited Partnership Basis. A process of teaching children about finance based on their age and consistent with their ability to learn.

Liquidity risk. Risk that investors will be unable to find a buyer or seller for a bond when they need to sell or buy.

Liquidity. This is the speed and ease with which an asset can be converted into cash.

Living Trust. A trust where assets are placed in the trust while you are still living. You can take them out and move them according to what you want to do before you die.

Living will. It is a legal document that details your end-of-life wishes for health care. It is used when you are still alive but unable to make health care decisions for yourself. A living will states your wishes regarding medical treatment in the event of a terminal illness or injury

Loads. Loads are sales charges to compensate the sales force for selling the fund. Loads directly reduce the amount of money invested by the amount of the load. Loads can either be front-end or back-end, depending on when the mutual fund company takes out the load or sales charge. Generally, research has found that the performance of load funds and no-load funds is identical. When the sales charges are included, no-load funds significantly outperform load funds. (Matthew R. Morley, "Should You Carry a Load? A Comprehensive Analysis of Load and No-Load Mutual Fund Out-of-Sample Performance,"

Journal of Banking and Finance, vol. 27, nu. 7 (2003), pp. 1245-71.)

Loan term. This is the duration of the loan. It can be 10, 15, 20 or 30 years depending on your goals and your cash flow situation.

Local income taxes. These are uncommon; but some larger cities, for example, New York City, impose such a tax.

Long-term bonds. Bonds with a maturity of greater than 10 years.

Long-term capital gains. These are capital gains where the Fund has owned the assets for more than a year (366 days). These are taxed at a rate dependent on your taxable income.

Long-term Debt Coverage ratio. This is your income available for living expenses divided by long-term debt payments. This ratio tells how long you could make monthly payments on your debt based on the amount of money you have available for living expenses (which is wages less taxes). The inverse of this ratio is the Debt Service ratio.

Loss Aversion. Often losses are given more weight in our minds than potential gains in any position. These weights are more than utility theory would suggest. We should give gains and losses equal weight in your analysis. It is the gains and losses of the overall portfolio that are important, not individual securities.

Low Income Filer. This is a single filer with provisional income below $25,000 or married filing jointly (MFJ) with income below $34,000. None of the benefits are taxable.

Lump Sum Benefit. A lump sum of $255 is available to the surviving spouse, nonresident spouse, or to children eligible for the monthly benefits (for 2018).

Lump Sum Distribution. This is taking the entire retirement account at retirement. You are responsible to ensure this amount lasts your entire life. The benefits are you can take the money out as you need it, and can invest/gift/use it elsewhere. The risks are that plans only allow distributions every 3 months, taxes are incurred immediately, and if you do not plan well, may not have sufficient money for retirement.

Lump-sum. You receive a single payment of all principal and interest at retirement that you are responsible to manage.

Maintenance margin. This is money you put up to buy on margin. If your maintenance margin falls below a specific level, you will be required to put up more money. If not, your position will be closed out.

Major Medical Insurance. This is major coverage of medical costs over and above the basic health insurance coverage. It covers medical costs beyond the basic plan. These normally require a co-payment and/or a deductible. There is a stop-loss provision, which limits the total out-of-pocket expenses incurred by the insured to a specific dollar amount and a life-time cap for the insurance company, which limits the total amount the insurance company will pay over the life of a policy.

Managed health care providers. These are insurance companies which provide pre-paid health care plans to employers and individuals. There are four main types of managed care: i. Health maintenance organizations (HMOs), Preferred provider organizations (PPOs), POS Plans (POS), and Exclusive Provider organization (EPOs). They pay for and provide health care services to policy holders and they provide the most efficient payment of bills. However, they limit choices to the doctors and hospitals that participate and they require policy holders to pay a monthly premium and share the cost of care.

Management fees. These are fee charged by the advisor to a fund generally on the basis of a percentage of average assets under management, i.e. 75 basis points or .75% a year.

Manager Style Drift. This is a check on the management style. Make sure the manager's investment style remains constant. Investment fund managers have no authority to change the asset class. If you purchase a small cap fund, the manager should purchase small cap shares. The fund's prospectus should clearly define the market size, company, and portfolio style tilt.

Margin accounts. These are accounts where you borrow from the brokerage firm to purchase financial assets. This is debt, and can amplify both gains and losses.

Margin call. This is a call by the broker to put up more money when your margin declines below a certain level. I recommend you do not buy on margin. It is using debt to invest and you can lose more than

your original investment doing this.

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.

Market capitalization. It is one measure of the size of a company. It is calculated by multiplying the market price of the stock by the number of shares (i.e. ownership pieces) outstanding. The greater the capitalization, the larger the company. Market capitalization is used to weight companies in various benchmarks and to determine certain classes of companies, i.e. large-cap, mid-cap, small-cap, etc.

Market orders. These are orders to sell or buy a specific number of shares at the currently available or market price. Be careful as the market can move quickly and dramatically between when you place the order and order execution time.

Markup. This is the difference between the buying price and the calculated selling price.

Maturity date. The date when the bond expires and the loan must be paid back.

Maximum Family Benefit. When benefits are payable to more than one family member, a family maximum applies. This includes all benefits paid to the family. For disability, the family maximum is the lesser of 150% of the workers disability benefit or 85% of the AIME used to calculate the benefit, but is not less than the benefit paid to the worker. When the worker is living, and benefits exceed the family maximum, the worker's benefit is not adjusted; rather, the reduction is made in other beneficiaries' payments.

Mean Reversion. Prices tend to correct themselves as investors correct for overreaction. Long-term prices tend to revert to the mean.

Medicaid. Medicaid is a medical assistance program, operated jointly by the states and federal government, to provide health care coverage to low income, blind, or aged persons. Medicaid payments may be used to offset the premiums, deductibles, and co-payments incurred with Medicare. There is no guarantee that this plan will be around in its present form.

Medicare Benefits. Medicate hospital insurance (HI) portion of Medicare, also known as Part A, is largely funded by the 2.9% HI tax on earnings. Part A is compulsory. Individuals at least age 65 and eligible for Social Security retirement benefits on their own behalf are entitled to coverage under Medicare Part A. If the individual has applied for Social Security (SS) retirement benefits, no separate application is required.

- Medicare Part A is compulsory and covers all hospital related expenses, such as bed and board, operating room costs, and lab tests. Patient pays a deductible and coinsurance payment.
- Medicare Part B is voluntary, with a monthly charge. It covers doctors' fees and other outpatient treatment. Patient pays a premium, deductible, and 20% of approved charges.
- Medicare Part C (Medicare Advantage) provides three program alternatives: coordinated care plans, private fee-for-service Medicare, and health savings accounts (HSAs).

Medicare. This is a health care insurance program for elderly and disabled. Medicare insurance provides medical benefits to the disabled and to those 65 and older who are covered by Social Security. Its cost is covered through Social Security taxes. Individuals can get insurance through Medicare that would be prohibitively expensive through other channels, however, it doesn't cover all the costs and expenses and individuals must pay certain amounts. In addition, there are limitations to the coverage, such as out-of-hospital prescription drugs and limitations to the number of days in skilled nursing facilities. Medicare is divided into three parts: A, B, C.

Mental Accounts. Often investors keep mental accounts rather than viewing individual assets as part of a total portfolio. We do this to try to save ourselves from ourselves.

Mid-cap or mid-capitalization stocks. These are stocks with capitalization between roughly $2 billion and $10 billion. These stocks tend to grow faster than big cap companies, and are generally less volatile than small cap companies. Mid-caps generally perform similar to the small-cap asset class. For asset-allocation purposes, mid-caps are generally not considered a major asset class.

Middle Income Filer. This is a single with income from $25,000 to $34,000 and MFJ with income from $32,000 to $44,000. Up to 50% of social security benefits are taxable.

Minimum purchase amount. This is the minimum

amount the mutual fund company will allow you to purchase in their funds to begin investing.

Mission Statement. This can be your individual and family purpose and passion. It can also include other things such as family mottos, family mission statements, what you stand for, etc.

Modified Adjusted Gross Income. This is your adjusted gross income adding back certain items such as foreign income, foreign-housing deductions, student-loan deductions, IRA-contribution deductions and deductions for higher-education costs.

Monetary (or Current) Assets. This is cash or other assets that can be easily converted into cash. These may be also income-producing assets. They provide necessary liquidity in case of an emergency.

Money factor: A way of expressing interest rates, calculated by taking the APR and dividing it by 24.

Money Market Account or Money Market Deposit Account: A non-financial account that pays interest based on current interest rates in the money markets. They typically require a higher minimum balance to avoid monthly fees and typically have a higher rate of interest.

Money market mutual funds. Money market mutual funds are funds which invest the majority of their assets in short-term liquid financial instruments such as commercial paper and government treasury bills. Their goal is to obtain a higher return, after fees and expenses, than traditional bank savings or checking accounts.

Money Purchase Plans. These are defined contribution plans where the employer contributes a percentage of employee salary each year, not dependent on company profits. Employees do not contribute.

Monitor performance. The process of understanding and reviewing the performance of a portfolio. Unless you monitor performance, you will not know how you are doing in working toward accomplishing your objectives. You need to know how every asset you own is performing, and performing versus its benchmark, so you can determine how well you are moving toward your goals.

Month's Living Expenses Covered ratio. This is your monetary assets divided by your monthly living expenses. This ratio tells you how many months you could survive in the event of the loss of all current income. Your living expenses do not include charitable contributions, taxes or savings.

Mortality risk. This is the risk that the insured dies outside the contract period and is therefore not covered by insurance.

Mortgage-backed bonds. Bonds backed up by a pool of mortgages.

Mother's or Father's Benefit. The surviving spouse of a fully or currently insured worker is eligible to receive a benefit of 75% of the worker's PIA if they are caring for a child who is under age 16 or who was disabled before age 22 (subject to family maximum).

MSRP: The price the manufacturer hopes to get for the sale of a product.

Mutual fund returns. Mutual fund returns include distributions of dividends, capital gains, and interest, and any NAV appreciation. Your total return: (ending NAV–beginning NAV)+ distributions / beginning NAV. Mutual Fund after-tax returns is your return after all taxes are taken out. Mutual fund before-tax returns is your return before taxes.

Mutual fund share classes. These classes of shares vary depending on the loads and management fees paid. While there are differences in classes of shares among investment management companies which charge loads, they generally are:

Mutual fund supermarkets. Mutual fund supermarkets i.e., Fidelity Funds Network, Charles Schwab, or Jack White, allows you the benefits of the mutual fund company while you get access to a whole range of mutual fund companies (but not all of them). Mutual fund companies rebate part of their management fees back each month to the "mutual fund supermarkets" to have them included in their list of funds.

Mutual fund. It is a way of holding financial and real investments. It is an Investment company that pools money from investors to buy stocks, bonds, and other financial investments. Investors own a share of the fund proportionate to the amount of their investment divided by the total value of the fund.

Necessity. One of the reasons for going into debt. It is we truly cannot feed our families.

Needs Approach. This is an approach for determining the amount of life insurance that is required. It determines the total needs of the

beneficiaries which includes immediate, debt elimination, transitional, dependency, spousal life income, education, and retirement needs. It is the most detailed of the approaches.

Negative Amortization Mortgages (NegAm). These are mortgage loans in which scheduled monthly payments are insufficient to amortize, or pay off the loan. Interest expense that has been incurred, but not paid is added to the principal amount, which increases the amount of the debt. Some NegAm loans have a maximum negative amortization that is allowed. Once that limit is hit, rates adjust to make sure interest is sufficient to not exceed the maximum limit.

Net capitalized cost (also called **adjusted capitalized cost**): The final amount paid. Found by taking the capitalized cost and subtracting capitalized cost reduction.

Net worth or equity. This is the difference between your assets, the things you own of value, and your liabilities, what you owe to others.

New investor bias. New investors dilute the value of existing investor's shares. Since new money comes into the fund at Net Asset Value, and since this money must be invested (at roughly 0.5% on average in the U.S.), existing investors are subsidizing new investors coming into the fund

NMD (New Money / Donations) Addendum. This is a way to rebalance using either of the rebalancing methods. Rebalance as determined previously, but pay your charitable donations using appreciated assets, and use the money you would have spent on charity to purchase the "underweight" assets, so you do not have to sell and incur transactions costs or taxable events.

No-load mutual funds. Mutual funds that are sold without a sales charge and are redeemed without a charge as well.

No-Load Shares: These are shares sold without a commission or sales charge. Generally, these shares are distributed directly by the investment management company, instead of going through a sales channel. They may have higher management fees to compensate for the lack of a front- or back-end load.

Non-deductible IRA. Individuals may contribute to a non-deductible IRA. The benefits are that money is contributed after-tax, and investment earnings grow tax-deferred. No taxes are paid on the investment earnings until the earning are withdrawn at retirement. Accurate record keeping is required to pro-rate the nondeductible portion of any subsequent distribution.

Non-group Coverage Plans. These are health insurance plans which cover individuals on a case-by-case basis and are traditionally the most expensive type of coverage. They provide a custom insurance policy to the purchaser. They are expensive, usually 15% - 60% more expensive than a group policy and may require subscribers to pass a medical exam.

Non-probate transfers. These are "will substitutes," and include state law, right of survivorship, beneficiary designations, and gifts causa mortis.

Non-refundable credits. Non-refundable credits include child tax, child and dependent care, elderly and disabled, adoption, hope learning, and lifetime learning and are only good up to the amount of taxes owed.

OASDI – HI (Old Age, Survivors, and Disability Insurance and Hospital Insurance). This is payment for Social Security and Medicare taxes. The employee and employer each pay (assuming your Adjusted Gross Income (AGI) is less than $250,000: Social security tax (OASDI) of 6.20%, Medicare tax (HI) of 1.45%, for a total of 7.65% each. Self-employed individuals pay the whole 15.30%. OASDI-HI taxes are on taxable wages including wages, salaries, bonuses, commissions, value of employer provided meals/lodging, sick pay during first 6 months, employer paid group life insurance premiums in excess of $50,000, salary reduction from 401k, 403b, 457 plans, non-qualified deferred compensation no longer at risk, non-qualified stock options, vacation pay, and severance pay.

Open orders (GTC: good till canceled, GTD: good till date specified). These are orders which are good until filled or canceled. Be very careful with open or GTC/GTD orders. If you fail to cancel specific orders, you might have orders filled that you forgot to close out.

Open-end mutual funds. These are mutual funds that can be purchased and sold each day at the fund's Net Asset Value, which is the fund's assets less liabilities, divided by the number of shares outstanding.

Option Adjustable Rate Mortgages (Option

ARMs). This is an ARM where interest rate adjusts monthly, and payments annually, with “options” on the payment amount, and a minimum payment which may be less than the interest-only payment. The minimum payment option often results in a growing loan balance, termed negative amortization, which has a specific maximum for the loan. Once this maximum is reached, payments are automatically increased and the loan becomes fully amortizing after 5 or 10 years, regardless of increase in payment and must be repaid within the 30 year limit. These are not recommended.

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.

Organized Exchanges. These are areas used to facilitate trading of financial instruments.

Origination fees: These are the costs and profits made by the mortgage broker for originating the loan.

Overreaction. Many investors assign a probability to asset returns based on past theory. Appropriate reaction to a negative event is to update a prior probability to the most recent event. Overreaction is when they assign too high a value.

Over-the-Counter (OTC) Market. This is an electronic network of dealers used to execute trades without specialists or middle-men.

Ownership. This is the principle that everything we have is the Lord’s, and we do not own the things we have and are. It is based on scripture and helps us to see our blessings as gifts on loan from a loving Father in Heaven.

Par value. The face value or amount returned to the holder of the bond at maturity.

Passive management. Passive management is the process of accepting average returns through purchasing index funds rather than trying to beat the market. It is much cheaper and more tax efficient.

Passive portfolio management. It is the process of buying a diversified portfolio which represents a broad market index (or benchmark) without any attempt to outperform the market or pick stocks. Since most active managers fail to outperform their benchmarks, especially after costs and taxes, investors have realized that if you can’t beat them, join them, so they buy low-cost passive funds which meet their benchmarks consistently and minimize taxes.

Payday Loans. These are short-term loans of 1-2 weeks secured with a post-dated check which is “held” by the lender and then cashed later. These have very high interest rates and fees, APR > 720%. Typical users are those with jobs and checking accounts but who have been unable to manage their finances effectively.

Pell Grant. A type of government grant to help students attend college.

Percentages. We sometimes move in and out of asset classes and stocks instead of keeping specific asset class percentages relatively constant (within our minimum and maximum amounts from our Investment Plan). We get lower returns from increased trading costs and may have more risk than we want.

Percent-range-based rebalancing. This is the process of rebalance the portfolio every time actual holdings are +/-5% (or +/-10%) from target ratios. Rebalance whenever you are outside this range. It is easy to implement and wider ranges will reduce transactions costs (at the expense of higher tracking error).

Performance evaluation. It is the process of evaluating a portfolio’s performance with the goal of understanding the key sources of return.

Periodic Payments distribution. With this distribution, you can plan for regular payments at regular intervals, and can ensure that payments are available for a specific period of time. However, there is no assurance of lifetime income, and your tax rate may be high due to the amount of money withdrawn.

Periodic-based rebalancing. This is the process of rebalancing where you specify a time period, i.e. bi-annually, annually, etc. After each time period, rebalance the portfolio back to your original asset allocation targets. It is the most simple of the methods, and longer periods have lower transactions and tax costs (but higher tracking error costs).

Permanent insurance. Permanent insurance is an insurance contract that is purchased for the entire life of the policy holder with premiums divided between death protection and savings. Provides insurance that cannot be cancelled, may be used for estate

retirement, and savings. It is complex, expensive, and not transparent, and unless premiums are paid, it can expire worthless. Please note that certain permanent products are not permanent, i.e. they can lose money.

Personal Financial Plan. This is a document that contains all critical areas of your personal financial life. It is your individual and personal roadmap for achieving your personal and family goals. It entails 6 steps: 1: Decide What You Want, 2: Evaluate Your Financial Health, 3: Define your Personal and Financial Goals, 4: Develop a Plan of Action, 5: Implement Your Plan, and 6: Revise Your Plan as Necessary.

Personal Property. These are depreciating tangible assets, such as boats, furniture, clothing, etc.

Personal Representative (Executor). This is the person who fulfills the requirements of the trust or will.

Perspective. Perspective is how we look at things. It is important because it impacts choice. We can take many different perspectives in our view of different aspects of our lives, with the best perspective being the perspective that last the longest—an eternal perspective.

Piggyback loans. These are two separate loans, one for 80% of the value of the home and one for 20%. The second loan has a higher interest rate due to its higher risk. The second loan is used to eliminate the need for PM Insurance. With a piggyback loan, PMI is not needed, but these are much harder to get now.

Point of Service Plans (POS). These plans have attributes of HMOs, PPOs, and indemnity plans. The point at which benefits are received determines the amounts of benefits paid. POS may include HMO, PPO, and indemnity type programs, and the POS may also have a gatekeeper.

Points. Points are fees for a loan. 1 Point is one percent or one hundred basis points of the loan. This money is pre-paid interest, money paid to the mortgage broker (not the lender). It is deducted from the loan proceeds (you still must pay it back), and is essentially another fee for helping you arrange the loan (minimize points). Lenders charge points to recover costs associated with lending, to increase their profit, and provide for negotiating flexibility. You will like have to pay origination points, but buy-down points (to reduce the interest rate on the loan) are purely optional.

Political or regulatory risk. Unanticipated changes in the tax or legal environment will have an impact on a company's bonds.

Portfolio attribution. It is the process of separating out portfolio returns into their related components, generally attributable to asset allocation, securities selection, industry, and currency.

Portfolio evaluation. The process of monitoring financial asset performance, comparing asset performance to the relevant benchmarks, and determining how well the fund is meeting its objectives.

Portfolio management. It is the development, construction, and management of a portfolio of financial assets to attain an investor's specific goals.

Portfolio rebalancing. It is the process of bringing portfolios back into given target asset allocation ratios. Changes in allocation occur due to changes in asset class performance and investor objectives or risk, or introduction of new capital or new asset classes.

Portfolio reporting. The process of reviewing portfolio performance with the necessary participants, i.e. your spouse or your investment advisor.

Potential Cap Gains Exposure. This is an estimate of the percent of a funds asset's that represent capital gains. If this is high, the probability is high that these may come to the investor as capital gains.

Pre-approval. Pre-approval is the process whereby lenders have pull your credit score, looked at your tax records and approve you for a specific amount of a loan. Get pre-approved for your loan by a number of lenders (with mortgage loans, you can have multiple loans requested within a 90 period and it's counted as one loan request). You can borrow up to this pre-approved amount without a problem. Remember however that you do not need to borrow that amount. I recommend you borrow less than that amount.

Preferred Provider Organizations (PPOs). PPOs are insurance plans which are essentially a cross between the traditional fee-for-service and an HMO. PPOs are organizations where in-plan provider's fees are covered, and out-of-plan providers results in higher fees. Insurers negotiate with a group of doctors and hospitals to provide care at reduced rates, while giving insurers the ability to go to non-plan doctors. PPOs provides health care at a discount to

fee-for-service plans. They provide a group of doctors which work at reduced costs to the participants, while assessing an additional fee if the participant uses a non-member doctor or center. PPOs are more expensive than HMOs and use of non-PPO providers results in higher out-of-pocket costs.

Prepayment Penalties. These are penalties enforced by the lender for prepaying a loan too soon. Prepayment penalties have a stated period of time, i.e., 1, 2, or 3 years the prepayment penalty is in effect, a maximum pay down percentage (MPP), i.e., 6% of the principal per year, and a prepayment penalty if you sell it before, i.e., 6 months interest. With a soft prepayment you cannot within the stated period of time without penalty, refinance at all, sell the loan to family members, or pay down more than your MPP each year. The only way to get out of a soft prepayment penalty is to sell the property to an unrelated party. With a hard prepayment, you cannot within the stated period of time without penalty refinance at all, sell the loan to anyone, or pay down more than your MPP each year. There is no way to get out of a hard prepayment penalty before the defined period without paying the penalty.

Prepayment. Prepayment is the process where you repay the loan early, either through paying off the loan or selling the house and the new buying paying off the old loan.

Pre-qualified. Pre-qualified is a process where lenders estimate your credit based on information you tell them. I recommend you get pre-approved, not pre-qualified.

Price. The price that the bond sells for.

Pride. A reason for going into debt. How we look to others is more important than how we look to God.

Primary and Secondary markets. Primary markets are markets for trading newly issued securities. Secondary markets are for trading already issued shares of stocks, bonds, and other securities. Secondary markets consist of organized exchanges and over-the-counter or electronic markets where existing shares are traded.

Primary Insurance Amount (PIA). Your PIA is the basic unit used to express the amount of a worker's benefit if they received benefits at their full retirement age (FRA). The calculation of PIA is based on the workers AIME, which is split into three segments and multiplied by specific percentages for each segment and summing the parts.

Primary markets. These are markets for trading newly issued securities.

Principles. These are doctrinally based guidelines for how we should live our lives. Whereas doctrines answer the 'why" questions, the principles are the "what" questions, i.e., what are the things and guideline we should be following and doing.

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.

Private Alternative Loans. These unsubsidized loans are much more expensive than federal unsubsidized loans, interest starts immediately and accrues, and you must begin paying the loan back immediately. The student is the borrower. These have higher up-front fees and may require a cosigner. Read the fine print VERY CAREFULLY.

Private Health Care Plans. These are health care plans sold by private insurance companies to individuals and employers as part of a benefits package.

Private Mortgage Insurance. Insurance paid for by the borrower to ensure that the lender is made whole should the borrower default. If equity in the home is greater than 20%, PMI is not required for conventional loans or VA loans (but is required by FHA loans for the life of the loan).

Probate. Probate is the process of distributing an estate's assets after death. Probate is a matter of state law. It is the matter of administering the portion of the person's estate that is disposed of in either by will provisions, for those with a valid will, or by intestate succession, for those who die without a will.

Profit Sharing Plans. These are defined contribution plans where employer contributions vary year-to-year depending on firm profitability (it may be zero if the firm is not profitable in that year).

Psychological biases. These are views on how the brain works and affect our investment decision making process. Poor investment decisions caused by psychological biases affect your wealth, so we need to learn to recognize and avoid poor investment decisions which come from those psychological biases.

Q-TIP (Qualified Terminable Interest Property) Trust. A Q-TIP Trust is a testamentary trust which provides a means of passing income to the surviving spouse without turning over control of the assets. These trusts ensure that assets will be passed to your children upon the death of the surviving spouse.

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.

Qualified stock dividends. These are payment of cash to the Fund by the companies owned where the company owned the shares for a specific length of time. These are taxed at a preferential rate depending on your taxable income.

Real estate and property taxes. These are taxes imposed annually or semi-annually on assets owned.

Real Goals. These are goals you really want to accomplish, and are willing to work hard and seek Heavenly Father's help in accomplishing them.

Realtor or Real Estate Broker. This is a person supposedly trained in the process of selling and buying real estate. You want a realtor that know the market in the area you are looking at. Remember that realtors are paid by the seller, so remember that in your associations. Sellers divide the sales commission (usually 6-8%) between the listing realtor and the buying realtor.

Redemption. The process of redeeming a callable bond before its maturity date.

Refinance. The process of getting another mortgage loan on your home and repaying the old loan with a goal to reducing your interest and other costs overall.

Refundable Credits. These are credits paid to the taxpayer even if the amount of the credits exceeds the tax liability.

Required minimum distributions. For tax deferred retirement plans, the government requires that a certain percentage of assets must begin by April 1st of the year following age 70½. The distribution is the account balance on Dec. 31 of the previous year (age 69) divided by the life expectancy from the table below. There is a 50% penalty on minimum distributions not taken.

Required Minimum Distributions. This is a legal requirement of many tax-deferred retirement vehicles which require savers to distribute a specific amount each year after age 69 of total plan assets. It is calculated by dividing the total amount in accounts by a specified number given.

Residual value: Expected value of a vehicle at term end. Often used as purchase price after a lease has ended.

Retirement Benefits. Retirement benefits can either be reduced or increased depending on your PIA, your FRA and the date when benefits begin. You can begin receiving benefits as early as age 62. Benefits that begin 3 years before FRA will be reduced by a maximum of 20% (or 5/9% of 1% per month for each month benefits begin before FRA or 6.67% per year). Additional reductions of 5% per year are effective when FRA exceeds age 65.

Retirement Payout Options. These are the types of annuity distribution payouts available at retirement. Investors and spouses jointly determine the types of payments at retirement.

Retirement plans. These are income-producing assets, such as pensions, IRAs, 401K, Roths, SEPs. etc. by you or employer used to accumulate wealth for retirement.

Retirement vehicles. These are a specific type of investment vehicles which are related to retirement. These include qualified retirement plans such as both traditional and Roth 401k, 403b, and 457 plans; Individual retirement plans such as Roth and traditional IRAs; and small business plans such as SEPs, Simple, and Keogh plans.

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;

Retirement/Annuitization Stage (of retirement). This stage begins when you retire. It is your plan on how your assets will be distributed at retirement. Your goal should be to have sufficient assets for your lifetime to enable you and your spouse to live like you want in retirement.

Retirement/Annuitization strategies. These are strategies to use while you are in the retirement stage. They might include: calculate a minimum acceptable level of retirement income, and annuitize that

amount; take out on a specific percentage of assets each year in retirement, etc.

Revenue bonds. Bonds backed by the revenues of a specific project.

Reverse Mortgages. These are mortgage loans whose proceeds are made available against the homeowner's equity. Financial institutions in essence purchase the home and allow the seller the option to stay in the home until they die. Once they die, the home is sold and the loan repaid, generally with the proceeds. These are typically used by cash-poor but home-rich homeowners who need to access the equity in their homes to supplement their monthly income at retirement.

Revocable Living Trust. It is the most common type of living trust. It is a trust which allows for unlimited control by the trust's owner, because the owner retains title to all the assets in the trust. They do not pass through probate. They provide greater ease and privacy of distribution upon death.

Risk of Downgrading. Should a bond's rating be downgraded, the seller would need to reduce the price of the bond (resulting in a lower yield to the seller and a higher yield to the buyer) to make up for the increased risk.

Risk pooling. It is the process where individuals transfer or share their risks with others to reduce catastrophic losses from health problems, accidents, lawsuits, etc.

Risk. Risk is the possibility of having a return different from what was expected, whether it is losing all your money, losing principle, or not achieving a specific rate of return. There are many different types of risk including: inflation, business, interest rate, financial, market, political and regulatory, exchange rate, call, and liquidity risk.

Risk-adjusted Performance. It is the process of determining performance after adjusting for the risk of the portfolio.

Rollover IRA: A traditional IRA set up to receive a distribution from a qualified retirement plan.

Roth Conversion. This is the process of converting a traditional individual retirement account to a Roth account.

Roth IRA. This is an individual retirement account which provides no deduction for contributions but provides that all earnings and capital gains are tax free upon withdrawal after retirement. You are actually investing more with a Roth, since your investments are after-tax, and contributions can be withdrawn tax/penalty free. Earnings grow tax-free if the Roth IRA is in place for at least 5 years, and you are 59½ years old.

Savings Bonds: Bonds issued by the US government with tax advantages to encourage savings.

Savings Ratio. This is your income for savings divided by your income available for living expenses. This ratio tells you what proportion of your after-tax income is being saved.

Scholarships. Money given to promising students because of their shown abilities in specific areas. There are many scholarships available, but you have to find and apply for them individually.

Seasoned new issues. These are new shares being issued by a company that is already publicly traded.

Secondary markets. These are markets for trading already issued securities. Secondary markets trade previously owned shares of stocks, bonds, and other securities. Secondary markets consist of organized exchanges and over-the-counter or electronic markets where existing shares are traded.

Secured Credit Card: Similar to a standard credit card, but is tied to a checking or savings account. The card cannot be used once the money in the account is gone, until more funds are added. Useful for building credit.

Secured loans. Secured loans are guaranteed by a specific asset, i.e. a home or a car, and typically have lower interest rates.

Securities markets or organized exchanges. These are areas used to facilitate trading of financial instruments.

Securities markets. Securities markets are where securities, i.e., financial assets, are traded. The two different types of securities markets are primary and secondary markets.

Seeking Solace (abdicating responsibility). Sometimes we follow newspaper/newsletter advice which we know has been shown to under-perform. We prefer to take other's advice rather than doing our own homework. That way if the performance goes bad, we can blame others (we don't have to take responsibility).

SEP-IRA. The Simplified Employee Pension (SEP-IRA) is an Individual Retirement Account which allows a small business employer to contribute to the retirement of the employees. Employer contributes the same percentage to all employees, and no required annual contribution. Contributions are tax deductible, earnings grow tax-deferred, and employees own the plans.

Series EE and Series I Bonds. US savings bonds with the special tax advantage that earnings on the bonds are tax-free if used for paying tuition and fees

Sharpe Index. This is a risk-adjusted performance measure. It is the ratio of your "excess return" divided by your portfolio standard deviation, i.e., your (rp – rf)/sp where rp = Average return on the portfolio, rf = your riskfree rate, and sp = Standard deviation of portfolio return. The Sharpe Index is the portfolio risk premium divided by portfolio risk as measured by standard deviation.

Shortfall. This is the difference between what you have now saved for retirement and what you think you need for retirement.

Short-sell. A short-sell is where a lender allows a property to be sold for less than the amount owed on a mortgage and takes a loss. A short sell allows the borrower to avoid foreclosure, which involves hefty fees for the bank and poorer credit outcome for the borrower, and the lender to make "less" of a loss on the property and to not enter foreclosure. A short sell does not necessarily release the borrower from the obligation to pay the remaining balance of the loan.

Short-term bonds. Bonds with maturity usually a year or less.

Short-term capital gains. These are capital gains where the Fund has owned the assets for less than 366 days. These are taxed at your Federal and state "ordinary" or "Marginal Tax Rate (MTR)"

SIMPLE 401k. This is a small business qualified retirement plan that provides some matching funds by the employer. Employees can have no other qualified plan, and may contribute up to the specific amount each year. Contributions are tax deferred and grow tax-free, and there is a penalty for early withdrawal. The employer is "required" to either contribute at least 2% or to match employee contributions, usually 1-3%

SIMPLE IRA. This is one of the SIMPLE retirement plans where Employees can participate. Contributions are tax deductible, it is easy to set up and administer (compared with a traditional 401(k)). A small business qualified retirement plan that provides some matching funds by the employer.

SIMPLE Plans. These are Savings Incentive Match Plans (SIMPLE) that provides matching funds by the employer. It can be established as an IRA or as part of a 401k plan. Employees can have no other qualified plan, and can contribute up to 100% of compensation to a maximum limit each year. The employer is "required" to either contribute at least 2% or to match employee contributions, usually 1-3%.

Single payment (or balloon) loans. These are loans that are repaid in only one payment, including interest. These are generally short-term lending of one year or less, sometimes called bridge or interim loans, often used until permanent financing can be arranged. These may be secured or unsecured.

Sinking fund. Money set aside annually to pay off the bonds at maturity.

Small-cap or small capitalization stocks. Small-cap stocks are companies with a market capitalization less than $2 billion. These are smaller, sometimes newer, US and global companies that are still developing and may have a smaller market share than their large-cap counterparts.

Smart Card: Similar to a debit card, but rather than being connected to a certain bank account, they magnetically store a certain amount of money linked to the card itself.

SMARTER Goals. SMARTER is an acronym for helping you as you strive to set effective goals. It is: S = specific, M = measurable, A = assignable, R = realistic, T = time-bound, E = evaluated, and R = reassessed.

Social Security or FICA. Social security is a government provided retirement, survivor, and disability benefits. Franklin D Roosevelt signed the Social Security Act in 1935 to Aid the displaced and out of work. Social Security is a pass-through account, which means that FICA taxes being paid by current workers provided the money for benefit payments to current retirees.

Sole ownership. Ownership where ownership and control is absolute in one individual. Income belongs to sole owner and testamentary control is absolute.

Special Joint and Survivor Annuity (if there is a death in the marriage the benefit decreases). You receive payment for as long as you live or for a certain guaranteed period, whichever is longer, and your spouse, after you die, receives a percentage of that payment for as long as they live.

Spousal IRA. A Spousal IRA is an IRA contribution for a non-earning spouse. If one spouse is an active participant, the non-earning spouse can contribute to a Spousal IRA. Limits are the same as the traditional and Roth IRA.

Spouses benefit. A fully insured worker's spouse age 65 (FRA) is eligible to receive a retirement benefit of 50% of the worker's PIA subject to the family maximum. This benefit is reduced by 25/36% of 1% for each of the first 36 months that the spouse is under FRA (25% for 3 years). Once the FRA > 65, a reduction of 5/12 of 1% is imposed for each month beyond 36 months the spouse is under the FRA. The reduction of benefit from early retirement will not affect the amount of the spouses benefit. Disability benefits for spouses are 50% of the worker's PIA, reduced if the spouse is under FRA, subject to a family maximum amount.

Spreadsheet budgeting method. Using a computer and spreadsheets, determine your gross salary and take home each month after taxes and other deductions. Determine spending by categories (rows) and dates (columns), and budget for each category. As bills come in, input the spending on each date (column) and row (category).

Sprinkling Trust. A Sprinkling Trust is a testamentary trust that distributes assets on a needs basis rather than according to some preset plan to a designated group of beneficiaries.

Standard Family trust. This is a testamentary trusts which hold the assets of the first spouse to die until the second spouse dies. The spouse has access to income from the trust, or the trust principal, if necessary. They reduce the estate of the second spouse so that the estate taxes can be reduced.

State taxes. Most states impose an income tax; however, some, like Texas and Nevada do not. Alaska actually pays you to live in that state

Status Quo Bias. Sometimes individuals prefer the status quo over a new, more preferable position. There is an aversion to change, even if the change is for the better.

Stepped Up Basis. This is the process of the value of an asset being stepped up, or changed from the original value when purchased, to the current value when the person dies and it is transferred to heirs.

Stewardship. This is the principle that we are stewards over all that the Lord has, is, or will share with us. This view helps us realize the things we have are a gift and we should take care of them.

Stock Bonus Plan. These are defined contribution plans where employer contributions are made with employer shares of stock. Employee stock ownership plans (ESOPs) and leveraged ESOPs (LESOPs) are the most common.

Stock dividends. Stock dividends are dividends received from a company from the ownership of the company shares. Stock dividends are of two types, qualified or ordinary/not qualified. A qualified dividend is a dividend paid by a U.S. corporation where the investor held the stock for more than 60 days during the 121-day period that begins 60 days before the ex-dividend date (see Teaching Tool 32). An ordinary dividend is a dividend that is not qualified, i.e., you have not held the stock for a long enough time period to get the Federal preferential tax rate.

Stock Market Secrets. These are supposed short-cuts or secrets that only the professionals know, but they will share them with you for a price. Don't get taken.

Stock mutual funds. These are stock mutual funds are funds which invest a majority of their assets in common stocks of listed companies. These funds generally have a specific objective, i.e. "large-cap," "small-cap", "value," "growth," etc. which relates to the types of stocks the mutual fund invests in.

Stockbroker. A stockbroker is a person who is employed by and solicits business for a commission house or merchant.

Stop (or stop-loss) orders. These are orders to sell a specific number of shares if the stock price falls below a certain price or buy a specific number of shares if the stock price rises above a certain price. These are used to set prices to safeguard against major fluctuations.

Student Loans. These are loans with low, federally subsidized interest rates used for higher education. Examples include Federal Direct (S) and PLUS Direct (P) available through the school; Stafford (S)

and PLUS loans (P) available through lenders. Some are tax-advantaged and have lower than market rates. Payment on Federal Direct and Stafford loans deferred for 6 months after graduation.

Style analysis. It is another way of obtaining abnormal returns is by analyzing the investment style pf the portfolio. You can decompose returns by attributing allocation to style, and style tilts and rotation are important active portfolio strategies.

Subordinated bond. Bond that will be paid after the other loan obligations of the issuer are paid.

Subsidized Loans. Loans where another party pays the interest while the student is in school. Interest begins 6 months after the student graduates or drops below half-time enrollment.

Subsidized University Loans. These are loans offered by the university to students attending school.

Successor Trustee. This is the person to succeed the trustee should the trustee not be able to manage the trust.

Supplemental medical insurance. The SMI portion of the Medicare program (Part B) is financed by premiums paid by participants and by federal government funding. Participation in Part B is voluntary.

Survivor Benefits. Deceased worker must had had fully insured status; other survivor benefit (mother's or fathers' child's lump sum) will be paid to eligible survivors of a fully or currently insured worker

Target Benefit Plan. These are defined contribution plans that establish a required contribution level to meet a specific target level of benefits at retirement.

Tax Considerations. These are how taxes will impact your investment decisions, including your tax position, specifically your marginal and average tax rate; and how tax-free investments may fit into your plan, i.e. municipal versus corporate bonds.

Tax Cost Ratio. This is the percent of nominal Fund return attributable to taxes, assuming the fund is taxed at the highest rate. If a fund had an 8.0% return, and the tax cost ratio was 2.0%, the fund took home (1 + return) * (1 – tax cost ratio) -1 or (1.08*.98)-1 or 6.00%.

Tax Efficiency. Invest in taxable funds with an eye to obtaining high returns while keeping taxes low. Taxes reduce the amount of money you can use for your personal and family goals. Watch the historical impact of taxes, for it will likely continue. Remember it is not what you earn, but what you keep after taxes that makes you wealthy.

Tax Freedom Day. This is the day you stop working for the government and begin working for yourself.

Tax Tables. These are tables to help you calculate how much taxes you owe.

Taxable accounts. There are investment vehicles without tax advantages.

Taxable bonds. Taxable bonds include U.S. Treasuries, corporate bonds and agency issues (bonds issued by U.S. government agencies, like Ginnie Mae).

Taxable Estate. This is equal to the gross value of your estate, less estimated funeral and administrative expenses, debts, liabilities, taxes and any marital or charitable deductions.

Tax-adjusted Return. This is your return after taxes

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 no taxes on earnings or capital gains when you take it out at retirement.

Taxes (automobile) (also called government costs). It is the tax on the usage and interest in a lease. It is calculated as (Usage + Interest) times your tax rate.

Taxes on Distributions. These are taxes on your distributions which must be taken into account to get the true return of your portfolio but which are not noted on your monthly reports.

Taxes on mutual funds. Mutual funds are pass through vehicles, which means that taxes are not paid at the Fund level but are passed through to the individual shareholders who must pay the taxes. Mutual fund taxes are mainly capital gains, stock dividends and interest/coupon payments. They are handled the exact same way as the taxes for stocks and bonds discussed earlier.

Taxes. These generally are your largest single annual expense. These may include personal, income, business, transportation and other taxes. Taxes can further be divided into Federal taxes, or taxes we pay the Federal government; State taxes, or taxes we pay the state government, and local taxes, which are taxes we pay the local government.

Tax-free bonds. Tax-free bonds include revenue or general obligation bonds issued by local or state governments and agencies. Such bonds are generally free from federal and state taxes.

Teaser Rates: Very low introductory interest rates used to attract new customers to a certain credit card. They increase soon after the card is in the user's hands.

Temporal goals. These are goals that relate to the temporal measures of success. It could be money, title, fame, positions at work or in industry, include influence, rank or power, or assets, investments, or possessions.

Tenancy by the entirety. Ownership is shared equally and limited to spouses, lifetime control is shared by both spouses, consent from both is required to sell, income is shared between owners, testamentary control is absent, and the right of survivorship is key.

Tenancy in Common. Ownership is shared, with each owning an undivided fractional interest that may be unequal, lifetime control is unlimited, income is shared between owners in relation to fractional interest, and testamentary control is unlimited.

Term Insurance. Term insurance is insurance protection for the insured over a specific term or time period. They may be renewable or non-renewable policies. It is the least expensive form of insurance and the death benefit coverage is only for a specific term.

Term or Bond Maturity. The maturity of the bond.

Testamentary transfers. Methods by which property is transferred at death.

Testamentary Trust. The process where assets are placed in trust after you die. The trust is created after probate according to your will.

Thrift /Savings Plans (TSP). These are defined contribution plans where the employer matches a percentage of employee contributions to a specific amount (i.e., free money). This program is for employees of federal civil service.

Total Costs Analysis. This is a form of loan analysis that does not take into account the time value of money, but is simple to calculate. To do this, calculate your total new costs and fees from the loan until it is paid off, your total current monthly principal and interest costs remaining without refinancing, your total refinance monthly principal and interest costs. If you will be paying less overall, think about it, if it is equal or less, it likely does not make finance sense.

Total expense ratio. This is the total percentage of assets that are spent each year to manage the fund including management fee, overhead costs, and 12b-1 fees.

Tracking Error. This is the return on the fund less the return on the benchmark. This tracking error should be small versus your benchmark. Tracking error is the historical difference between the return of a fund (i.e. a mutual fund) and its specific market/sector benchmark or index. The smaller the tracking error, the better the performance of the Index fund relative to the benchmark. However, you won't complain if the tracking error is positive (i.e., your fund had higher returns than the index or benchmark).

Traditional IRA. An individual retirement account in which an individual can contribute up to a specific amount annually which is tax-deferred. Eligibility and amounts depend on the contributor's income level and whether they have other retirement plans. The contribution is tax deductible and earnings grow tax-deferred.

Transaction costs. These are costs of the fund buying and selling securities, which are not included in other costs. Mutual funds which turn over the portfolio often, i.e. buy and sell a lot, will have higher transactions costs. A good proxy for this is the turnover ratio.

Treasury Bills. A short-term debt obligation issued

at a discount and redeemed at face value upon maturity in 3, 6, or 12 months.

Treasury Bonds. A long-term debt obligation issued at or near par and interest is paid semiannually.

Treasury Notes. An intermediate-term debt obligation issued at or near par and interest paid semiannually.

Treynor Measure. This is a risk-adjusted performance measure. This is similar to Sharpe but it uses the portfolio beta instead of the portfolio standard deviation, or (rp – rf)/ ßp where rp = average return on the portfolio, rf = average risk free rate, and ßp = weighted average b for portfolio. It is the portfolio risk premium divided by portfolio risk as measured by beta.

Trust Grantor. The person who created the trust.

Trustee. The person who will manage the trust.

Trusts. A trust is a legal contract. When you create a trust you are simply creating another legal entity. Trusts avoid probate and are more difficult to challenge than wills. They may reduce estate taxes, allow for professional management, provide for confidentiality, can be used to provide for children with special needs, can be used to hold money until a child reaches maturity, and can assure that children from a previous marriage will receive some inheritance in the future.

Turnover ratio. This is a measure of trading activity during the period divided by the fund's average net assets. A turnover ratio of 50% means half the fund was bought and sold during the period. Turnover costs money and incurs taxes.

Turnover. This is the amount of the portfolio that is bought and sold during a specific period. Keep turnover low, as turnover is a proxy for fund expenses and taxes. The costs associated with turnover are hard to quantify and may not be disclosed in the prospectus. These costs include commissions, bid-ask spreads, and market impact.

Types of Mutual funds. The types of mutual funds generally follow the major asset classes, i.e., money market, stock, and bond mutual funds.

Underwriting. Underwriting is the process whereby the borrower fulfills the requirement of the lender and the lender funds the loan. It also includes the lender selling the loan and the loan being syndicated and sold to investors.

Un-invested Cash. This is the amount of cash in the portfolio. High cash levels in the portfolio are drags on performance so keep un-invested cash low.

Unique Needs. Unique needs are special needs that may impact your investing decisions.

Unlimited Marital Deduction. There is no limit on the value of an estate that can be passed tax-free to a U.S. citizen spouse. This does not apply to non-U.S. citizen spouses. The tax-free maximum gift per year to non-citizen spouses is specified.

Unsecured corporate debts. Bonds not secured by collateral, and pay a higher return.

Unsecured loans. Unsecured loans require no collateral, are generally offered to only borrowers with excellent credit histories, and have higher rates of interest – 12% to 28% (and higher) annually.

Unsubsidized Federal Loans. These are loans for both grads and undergrads where the student responsible for interest during school, repayment begins six months after student graduates, discontinues, or drops below half-time enrollment for a continuous 6 months. The interest is not subsidized.

Upfront costs. These are cost due at the signing of the loan which include closing costs and points, down payment (3-20 percent of the loan amount), and other closing costs including points (3-7 percent).

Upgrade. A situation where a bond rating company improves the bond rating of a bond due generally to an improving financial condition.

Upper Income Filer. These are singles with income above $34,000 and MFJ with income above $44,000. 85% of Social Security benefits are taxable.

US Savings EE Bonds. Savings bonds issued by the US government that pay a fixed rate of interest with is reset every 6 months.

US Savings I bonds. Bonds issued by the U.S. government, and tax deferred until maturity. They are not marketable, but can be redeemed from local banks. Bonds sold at face value, with interest paid at maturity, with the interest rate set to inflation with a fixed component.

Usage (automobile) (also called depreciation). This is the amount of the value of the vehicle that is used over the lease life. It is calculated at the Net capitalized cost – residual value.

VA Loans. These are Veterans Administration (VA)

Guaranteed Loans. These loans are issued by others and guaranteed by the Veterans Administration. They are only for ex-servicemen and women as well as those on active duty. Loans may be for 100% of the home value.

Value stocks. These are inexpensive (in terms of low PE and low P/BV ratios), companies that have potential for good long-term return through both appreciation and dividends.

Values Statement. These are the values you will live by to help you accomplish your vision and mission.

Variable or Adjustable Rate Mortgages (ARMs). These are mortgage loans with a rate of interest that is pegged to a specific index that changes periodically, plus a margin that is set for the life of the loan. Generally the interest rate is lower compared to a fixed rate loan, as the borrower assumes more of the interest rate risk. The may have a fixed rate for a certain period of time, then afterwards adjust on a periodic basis.

Variable-rate loans. Have an interest rate that is tied to a specific index (e.g., prime rate, 6-month Treasury bill rate) plus some margin or spread, i.e. 5%). Can adjust on different intervals such as monthly, semi-annually, or annually, with a lifetime adjustment cap. Normally have a lower initial interest rate because the borrower assumes the interest rate risk and the lender won't lose money if overall interest rates increase

Vesting period. This is the period required before the promised benefits are considered yours.

Vision Statement. This is your vision of what it is you want to become. It is seeing or visualizing with your mind's eye what you will be in the future.

Widow(er)'s Benefits. A benefit of up to 100% of the deceased, fully insured PIA will be paid to the surviving spouse who is at least age 60 and who was married to the worker for 9 months. The surviving spouse is generally eligible if he or she is not remarried and is not entitled to retirement benefits (due to his or her covered employment) of at least the amount of the deceased workers PIA. A widowers benefits terminates at death or at eligibility for an equal or greater retirement benefit.

Will. A legal declaration by which a person provides for the disposition for their property and other assets at death.

Winning by Losing. Sometimes we actively trade stocks instead of buying index funds or ETFs which we know are lower cost and take a lot less time to invest. We know index funds generally outperform the actively managed funds, but we try to invest actively anyway.

Workers' Compensation. Workers compensation is state insurance program that insures against work-related accidents and illness. Workers' Compensation provides insurance to workers injured on the job, regardless of whether they have other health insurance or not. It only covers work-related accidents and illnesses, and coverage is determined by state law and varies state by state.

www.charitynavigator.org. a website on information about various charities which file Form 990 with the IRS. However, they do not include religious organizations listed as "church or convention or association of churches" which are exempt from filing Form 990.

Yankee Bonds. Bonds issued by international companies and sold in the U.S. in U.S. dollars.

Yield to Maturity. This is the true yield received if the bond is held to maturity, which assumes that all interest payments can be reinvested at the same rate as the bond itself.

Yield. The annual interest on a bond divided by its price.

Zero-coupon bonds. A discount bond which pays no interest until maturity.

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