

MoneyWise Module 3

Saving and Investing: The Road to Financial Independence

Personal Finance Essentials:
8 Financial Priorities

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Saving and Investing:
The Road to Financial Independence

Module 3

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Discussion Topics

1. Perspectives: Spiritual matters
2. Investing Basics: Before you start
3. Investment Vehicles: The shopping carts
4. Investment Assets: The groceries
5. Investing Steps: The process

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1. Perspectives: Spiritual Matters

- Money teaches gospel principles
 - Money is a tool to teach us many things, including the principles of sacrifice, discipline, law of the harvest and work
 - Learning to manage money wisely can increase our freedom, bring peace and happiness into our lives, and teach us eternal gospel principles
 - President Ezra Taft Benson said: "The Lord desires his Saints to be free and independent in the critical days ahead. But no man is truly free who is in financial bondage." ("Prepare Ye," Ensign, Jan. 1974, p. 69).

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2. Investing Basics: Before you start


- Saving is how you acquire assets for your goals
- Investing is how your savings are put to work!
 - A goal of investing is to increase value and stay ahead of inflation
 - \$1 million today is worth only \$355,383 in 35 years (i=3%)
 - Rule of 72 (when years * rate = 72 then the amount doubles)

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Investing Basics: Key factors


- Investing is a function of five factors:
 - Factors under your control
 - 1. How much you save—rule of thumb for your savings rate:
 - 0-4% savings = high risk of wipeout
 - 5-9% savings = better but probably paycheck to paycheck
 - 10-20% = moderate to extremely comfortable lifestyle
 - 2. How long your investments are in the market
 - 3. Your asset allocation or investment mix—your risk level
 - 4. The expenses and taxes you pay
 - Factors outside your control
 - 5. Your returns on your investments



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Investing Basics: Taking Risks



http://www.youtube.com/watch?v=OV9mo_TuG9g

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Investing Basics: The importance of starting early

- **Bill—age 25**
 - Assumes a 7% return
 - Invests \$4,500 a year for 10 y
 - Total invested is \$45,000
 - Has \$62,174 by age 35
 - Stops contributing at age 35
 - He has \$337,445 at age 60
- **Phil—age 25**
 - Waits 10 years to start investing
 - Invests \$4,500 a year for 25 years
 - Total invested is \$112,500
 - He has \$284,621 at age 60
 - Phil has \$52,825 less than Bill at retirement




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Investing Basics: Before you invest

■ If you can answer these four questions with a “yes”, you are ready to begin investing!

- 1. Are your priorities in order and are you square with the Lord?
- 2. Do you have “adequate” life and health insurance?
- 3. Are you out of high-interest rate credit card and consumer debt?
- 4. Do you know your personal goals, live on a budget and have a written investment plan?


See an example of an [Investment Plan](#).

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3. Investment Vehicles: The shopping carts

- What are investment vehicles?
 - They are tax-law defined frameworks that may have tax advantages to help you save and invest
- There are three main types:
 - 1. Tax-eliminated vehicles (Roth IRA, Roth 401k, Roth 403b)
 - You put money in these after tax, and pay no tax when you take the money out at retirement (you pay taxes now)
 - 2. Tax-deferred vehicles (traditional IRA, 401k, 403b)
 - You pay no taxes on the investment when you put the money in, but must pay taxes on it when you take it out at retirement
 - 3. Taxable vehicles (normal brokerage or bank accounts)
 - You get no tax advantages now or when you take the money out at retirement




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Investment Vehicles: Key shopping carts

Plan Name	Tax Status	2015 Annual Maximum Contribution	Intended For
401(k) Roth 401(k)	Tax-deferred Tax-eliminated	\$18,000 \$24,000 if over age 50	Employees who are offered a company retirement plan
403(b) Roth 403(b)	Tax-deferred Tax-eliminated	\$18,000 \$24,000 if over age 50	Employees of non-profits and tax-exempt organizations
Traditional IRA	Tax-deferred subject to income limitations	\$5,500 per person \$6,500 if over age 50	Individuals
Roth IRA	Tax-eliminated, but earnings are tax-free after 5 years in the plan	\$5,500 per person \$6,500 if over age 50	Individuals
529 Plan	Tax-eliminated	\$416,000 per child (Utah)	Individual Education



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4. Investment Assets: The groceries

- Most common starting investments
 - Cash instruments (e.g., savings, CDs, money markets, checking, MMDAs)
 - Mutual Funds (e.g., following bond, large and small cap asset classes)
 - Index, asset allocation, and target date mutual funds
- Investments to consider later
 - Stock mutual funds—represent ownership
 - Bond mutual funds—represent debt owed to you
 - Real assets/REITs—represent real property assets other than your home



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Investment Assets: Cash Management

- Low-risk and predictable—savings accounts.
 - Ideal for short-term goals and situations where little risk can be tolerated
 - These include checking and savings accounts, CD's, money market accounts, etc.
 - Have more long-term risk due to inflation!
- Know what fees, maturities, minimums, and withdrawal options exist
 - Bankrate.com is a good source for rate information and comparison



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Investment Assets: Low-cost mutual funds



- Most mutual funds are used for intermediate to long-range goals
- Pool your money with others to buy cash instruments, bonds, stocks and real estate
- Most funds would instantly diversify your money and provide professional management
- Watch fees, taxes, loads (sales commissions), strategy, liquidity, history
- Broadly diversified index, asset allocation, and lifecycle funds are often ideal mutual funds for the beginning investor

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Investment Assets: Building your portfolio


Steps and Goals	Investment Assets
Step 4. Add opportunistic investments if desired (<u>many successful investors never do this!</u>)	<u>Individual Assets:</u> These include specialized and sector funds, individual stocks and bonds, real estate, etc. (the most risky)
Step 3. Broaden and diversify your core portfolio (once you have your EF and a Core strategy)	<u>Mutual Funds:</u> Add more index / mutual funds following different asset classes, i.e., small cap, international, REITs, etc.
Step 2. Build a Core Strategy (for those starting out who already have their EF) to give access to your major equity / asset classes	<u>Mutual Funds:</u> Broad market US index funds (e.g. S&P 500, total market), target date or life-cycle funds
Step 1. Build your Emergency Fund (EF) and Food Storage	<u>Cash Instruments:</u> Savings, checking, CDs, MMMFs, etc

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Investment Assets: Your Emergency Fund

- Before you begin, your first investment priority is 3–6 months of living expenses in liquid assets
 - Suitable investments for your Emergency Fund are:
 - Bank or credit union savings, checking or money market account
 - Money market mutual fund
 - Look for low minimum initial investments
 - Internet MM accounts may pay higher interest rates
 - Unknown time horizon means you shouldn't take risk
 - These are short-term investments that can be accessed easily for emergencies



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Your Emergency Fund: Financial Priority 4

- Take two minutes to talk as a group or couple
 - What is the importance of your emergency fund?
 - How much of an emergency fund will you have? (generally 3-6 months is recommended)
 - What is your plan to save for your emergency fund?
 - Write these on your "Eight Financial Priorities" sheet

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Investment Assets: Food Storage

- Along with building your Emergency Fund, *begin* building your food storage
 - Use wisdom in your expenditures
 - Start to build your first aid and 72-hour kits
 - Start to build your food storage and other emergency essentials
 - Use wisdom while in school



www.providentliving.org
<http://www.lds.org/topic/self-reliance/>

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5. Investing Steps: The Process

1. Budget and save every month
 - You cannot invest without savings
2. Determine your investment needs and goals
 - Time horizon, risk tolerance, and investment vehicles
3. Select good institutions and people to work with
 - Invest low-cost with good people
4. Choose your investment vehicles and assets
 - Choose low cost, low tax, diversified assets
5. Get the match and automate investing
 - Make investing contributions automatic
6. Monitor your plan
 - Monitor your plan and re-evaluate as necessary

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Investment Step 1: Budget and Save

- Budget and Save
 - We recommend 10% to Tithing, 10-20% (10% minimum) to yourself, and 70-80% to your budget
- Turn saving into investing—prioritize your goals
 - Build your emergency fund
 - Pay off consumer debt
 - Save for specific purchases—house or car
 - Save for retirement
 - Save for children's college and mission funds

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Investment Step 2: Determine your investment needs for your goals

- What characteristics do you need?
 - Asset class (which baskets do you need?)
 - Time horizon (when will you need the money?)
 - Type of investment vehicles (which accounts will you use?)
 - Tax deferred (traditional) versus tax-eliminated (Roth)
 - Which vehicle will help you attain goals the fastest?
 - Risk tolerance (how much risk will you take?)
 - Conservative, moderate, aggressive
 - Many web sites offer a short risk tolerance test

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Investment Step 3: Select a reputable company

- For company retirement plans (i.e., 401k, 403b, Roth 401k, etc.)
 - Your firm has already chosen the company
- For investing outside of company plans:
 - We recommend using no-load mutual funds
 - Use no-load, low cost, and tax efficient index funds
 - Some of the larger Fund Companies are

■ Vanguard	(800) 662-7447	
■ Fidelity	(800) 544-7272	
■ T Rowe Price	(800) 638-5660	

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Investment Step 4: Choose investment vehicles and assets carefully

- Choose your vehicles carefully
 - Taxable account: No tax benefits
 - Tax deferred: Traditional IRA, 401K, 403b
 - Tax eliminated: Roth IRA, Roth 401k, Roth 403b
- Choose your assets carefully
 - Do not borrow to invest
 - Stay diversified (don't put all your eggs in one basket)
 - Invest low cost and tax efficiently--limit turnover and transactions costs (control your costs)
 - Do not invest in individual assets and sector funds until your asset size is greater than \$500,000 (if at all)

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Investment Step 5: Get the match and automate

- Find out if your company provides a match for retirement saving
 - It is free money - get this money first!
- Set your savings goal and then use your institution's automatic features to make it happen
 - Dollar-cost average—set dollar amount to invest regularly over set period—i.e. \$100 month. This lowers your average cost of investing!
- If your company does not have a retirement plan, automate a monthly transfer to your favorite mutual fund company
 - Index, target date or lifecycle funds are good Funds to start out
 - Diversification is your key defense against risk

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Investment Step 6: Monitor your plan

- Monitor performance versus benchmarks
- Review investments on regular basis—at least annually
- Ensure your investments still match your goals (i.e., time frame, and risk tolerance) and rebalance as needed
- Follow the principles of successful investing
- Work to minimize taxes and expenses



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Save for Long-term Goals: Financial Priority 5


- Take two minutes to talk as a group or couple
 - What is the importance of saving for retirement?
 - What are your plans to save for your retirement and perhaps mission and education costs for your children?
 - What can you do to start now?
 - Write these on your "Eight Financial Priorities" sheet

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Case Scenario *

*Lots of assumptions here—including rates of return. Be careful in applying this to your situation



John

- 25 years old, married with 1 child
- New job—\$36,000 a year (nets \$30,000 a year, or \$2,500/month)
- Has 401k — 3% company match
- 10% saver, with \$1,000 saved
- Goals in order of importance =
 - Emergency Funds (\$7.5k)
 - House Savings (\$10k)
 - Retirement (\$1mn), and
 - Child's Education (\$65k)

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Case Scenario *

*Save 10%, accomplish goals 1 & 2. Save 15%, accomplish goals 1 & 2 & 3. Save 20%, accomplish all goals

Goal 1 = \$7,500 Emergency Savings, 5 years
 * \$100/month @ 3% = \$6,465, add 1k saved = **\$7,465**

Goal 2 = \$10,000 House Savings, 7 years
 * \$100/month @ 4%, 7 years = **\$9,675**

Goal 3 = \$1 Million Retirement Savings, 40 years
 * \$196 + \$90 match = \$286/month @ 8% = **\$998,428**

Goal 4 = \$65,000 Education Savings, 18 years
 * \$100/month, 18 years @ 8% = \$48,008
 * \$100/month, 10 years @ 8% = **\$18,295**
\$66,303

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Saving and Investing Take Aways

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Resources and FHE Suggestions

***All Resources are Online at <http://personalfinance.byu.edu>

Readings

- Reading 3.1 Charles E. Davis, "A Banker's Dozen: Guidelines for Wise Investing" Ensign, Sept. 1991, 64.
- Reading 3.2 John W. Hardy, "Recognizing—and Avoiding—Bad Investments," Ensign, Sept. 1983, 55.
- MoneyWise Reference Manual (online), Chapters 18, 19, and 17

Tools

- Exhibit 3.1 Couples Case Study
- Exhibit 3.2 A Risk Tolerance Test
- Exhibit 3.3 Roth versus Traditional - Which is Better?
- Exhibit 3.4 Retirement Planning Needs

Websites

- BYU Personal Finance Website: <http://personalfinance.byu.edu>
 - Intermediate Course: Intermediate Investing
 - Advanced Course: Advanced Investing
- Mutual Fund Research, <http://morningstar.com>

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