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Quick Guide

This quick guide was prepared by Truebridge.

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CAUTION: This guide is intended to introduce some of the basic issues and steps involved in investing. It is not intended to be all-inclusive. There are many issues and topics to be addressed in making investments, and working with a qualified professional is strongly recommended.

Basics of Investing

This section introduces you to some basic investment concepts and general information related to making investment decisions, whether it be for money inside a retirement plan, such as an IRA or 401(k), or for money outside a retirement plan. When you sign up for a 401(k) plan, you choose from among investment vehicles offered by the plan. Which vehicles you choose should be partly dictated by your age.

If you are age 35 or younger and have started to build your retirement nest egg, time will enable you to take advantage of investment vehicles with long-term growth potential. You will have the ability to ride out the market's peaks and valleys, and take advantage of growth potential.

If you started saving for retirement towards the middle of your working life, or are age 35 to age 50, you can easily enjoy a middle of the road strategy with your retirement investments. You can strike a comfortable balance between growth funds and fixed-income funds to work toward your goal.

If you are currently age 50 or older, it's time to get more conservative. Concentrate on preserving your capital. Less risky investments will be less likely to drop in value.

Your Retirement Investment Goals

Getting clear on your goals helps you focus on what you really need to do to save for your retirement. So, setting a financial goal for your retirement investment strategy should be your first step. To help pursue this goal, consider the following questions:

1. How long will it be until you need the money to start producing an income for you? This is your ***time horizon***.
2. Do you feel comfortable with the day-to-day ups and downs in the value of your retirement savings? This is your ***risk tolerance***.
3. Do you know how fast you want your money to grow? This is called ***rate of return***.
4. Do you know the risks and opportunities associated with different investments? This is ***investment knowledge.***
5. How regularly do you plan on contributing to your retirement plan?

The investment strategy you develop to work toward your retirement goal depends on the answer to all five questions, but your tolerance for risk is one of the most important factors determining the investments you choose.

Risk Tolerance

In setting your objective, make sure you take into account your risk profile. That is, how much risk are you willing to take? Think of investment and risk as running across a spectrum, with investments with low risk at one end and high risk at the other. With lower-risk investments, safety of principal and minimal or no fluctuation in the value of your account is critical. As a trade-off, you are willing to accept a lower rate of return. Your tolerance for risk is usually lower when your time horizon is short-term. Typical investments are bank accounts, certificates of deposit, and money market funds (cash and/or cash alternatives.)

With higher risk tolerance, your goal is growth in your portfolio. You are seeking higher returns. You are willing to accept greater volatility over the short-term because your time horizon is long-term. Typical investments are growth stocks and growth mutual funds, international stocks and international or global mutual funds, and real estate or real estate mutual funds.

IMPORTANT NOTE: One of your basic objectives should be to achieve a long-term rate of return that is at least 3% above the long-term inflation rate. Keep this in mind as you think about your retirement goals. Both stock and mutual fund investing involves risk, including loss of principal. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

Investment Return

Historically, different investments or asset classes have achieved different rates of return over different time periods. Although past performance does not guarantee future results, when you compare the returns on common stocks, bonds, and cash, common stocks have had a competitive rate of return over a long period of time.

When you work on your retirement investment strategy, one of the key issues is the rate of return you expect to earn on your money.

Cash and/or cash alternatives, which may provide safety of principal and pay interest, have provided the lowest long-term rates of return. If your risk tolerance is low, you'll need to assume a relatively low rate of return on your investments when you do your planning.

Likewise, if your risk tolerance is higher and you have a long-term time horizon, investing in common stocks or stock mutual funds will offer the potential of a higher rate of return.

IMPORTANT NOTE: All performance referenced is historical and is no guarantee of future results. No strategy assures success or protects against loss. Stock and mutual fund investing involves risk, including possible loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will likely decline as interest rates rise and bonds are subject to availability and change in price.

Understand Risk

There are several kinds of risk. The two that we will discuss here and that you need to consider are market risk and inflation risk.

Market Risk

Cash-type accounts (bank accounts and money market funds*) are designed to provide safety of principal. You put a dollar in—you get a dollar back with some interest. The value of your account increases because your principal earns interest and your interest earns interest.

Bonds, or notes (less than ten years to maturity), are designed to pay you a fixed rate of interest over the life of the bond. They typically pay a higher return than cash accounts. When the bond comes due (matures), you get your principal back in full (assuming it doesn't default). However, prior to maturity the value of the bond can go up or down depending primarily on the direction of interest rates.

Common stocks offer the potential for even a higher rate of return; but the value of your investment is subject to even greater volatility over the short-term. The stock's volatility is subject to market conditions and the financial well-being of the company you've invested in.

To sum up, market risk is the measure of how much the value of your investment can vary.

History shows us that investing in common stocks means that risk in the short term is greater than risk in the long term. It suggests to those who need their money soon not to invest in stocks.

*Money market funds are neither insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although they seek to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund.

IMPORTANT NOTE: Stock investing involves risk, including possible loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will likely decline as interest rates rise and bonds are subject to availability and change in price.

Inflation Risk

Previously, we talked about inflation. It is your enemy, and it reduces your purchasing power. Your goal should be to increase your purchasing power—and we recommend that you do this by investing to beat inflation by at least 3%.

Basic Strategies

There are two basic strategies that can help you reduce the risk in your retirement portfolio: diversification and dollar-cost averaging. These two strategies can be accomplished by simply saving on a regular basis through a 401(k) plan—you contribute money gradually (dollar-cost averaging) through payroll deductions, and you have the opportunity to invest in different investment funds (diversification).

Diversification

Diversification means don't put all your eggs in one basket. Investment experts say it's smarter to invest in a number of different vehicles. You want to have your money in many different kinds of investments, so that if anything happens to any one of them, it won't be a disaster. Being diversified spreads your risk across various types of investment products.

IMPORTANT NOTE: There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

Dollar-Cost Averaging

The strategy of systematically investing a fixed dollar amount over time is called dollar-cost averaging. For example, if you have $1,200 to invest in your retirement program this year, you would invest $100 per month instead of investing the whole $1,200 at the beginning of the year. The benefit of dollar-cost averaging is that it reduces the risk of buying shares at the wrong time—when stock prices are high. The theory is that you buy fewer shares when the price per share is higher and more shares when the price per share is lower. Dollar-cost averaging works in your favor because the average price per share that you end up purchasing is typically lower than the average price of the stock during the same period. This is the principle used when you make regular contributions to your 401(k) plan.

IMPORTANT NOTE: Regular investing does not guarantee a profit or protect against loss in a declining market. This plan involves continuous investments in securities regardless of fluctuating price levels, and you should consider your ability to continue through periods of low price levels.

Investments

It is crucial that you don't invest in something that you don't understand. Let's take some time to understand some basic investment alternatives that are commonly used when investing for retirement.

Individual Stocks

Before mutual funds came along, investors wanting to invest in a company or a few companies had to buy shares of stock in those companies. The value of the investment in a particular company is dependent upon the performance of that one company.

Average investors buying individual stocks will typically invest in just a handful of companies because the price of more established, blue chip stocks can be high. Because they own shares of stock in only a few companies, their risk remains higher than if they could own the shares of many companies.

IMPORTANT NOTE: Stock investing involves risk, including possible loss of principal.

Company Stock

As a 401(k) plan participant, you may have an option to invest all or a portion of your regular contribution in your company's stock. Many participants choose to put a good portion of their savings into the company's stock fund. But investing in an individual company's stock usually carries more risk than investing in mutual funds. As with all stock, your company stock may go up and down as market conditions change and the company's earnings fluctuate.

However, buying shares of company stock while also investing in other funds can substantially reduce your short-term volatility and possibly increase your long-term investment performance.

Look at your company's past performance. Past performance does not guarantee future results, but it can certainly tell you how it has done compared to other types of investments over the same time period.

IMPORTANT NOTE: Stock investing involves risk, including loss of principal.

Mutual Funds

By investing in a mutual fund, your dollars are invested in a large number of shares of many companies all at once, and your investment risk is spread out over many stocks, not just one. With mutual funds, your potential for risk is less. The ups and downs in the value of your investment are potentially less with a mutual fund than with an individual stock because you are more diversified.

Nearly all 401(k) plans offer some type of mutual funds because mutual funds provide instant diversity of investments.

Mutual funds make it easy for you to invest in stocks and bonds. There are potentially two main advantages of investing your money in mutual funds:

1. You receive professional money management.
2. You are able to truly diversify your holdings even when investing a small sum of money.

You can buy open-end or closed-end funds. Open-end funds issue and redeem shares based on the flow of money in and out of the funds. Open-end funds are typically what you think of when you think of mutual funds.

Each mutual fund has one or more fund managers who are skilled in the principles of money management. They also have access to a huge database of research.

Each fund also has a particular objective. That objective is defined in the fund's prospectus. The objective could be long-term growth, current income, or a combination of income and growth. For example, the objective of XYZ fund is long-term growth. To accomplish the fund's objective, the fund manager invests the money received from its shareholders by purchasing shares of many individual companies (or leaving a small portion in cash). Some stock mutual funds can own shares of stock from a few hundred companies, thereby limiting its holdings in any one company to no more than 5–6% of all the assets in the mutual fund. This is true diversification, and your risk is less than if you invested in just one or two individual stocks.

Retirement plans may use many types of mutual funds. Some invest primarily in stocks, others mainly in bonds, while still others, known as balanced funds, invest in both stocks and bonds. Some are limited to investing in securities in the U.S., while others invest in foreign securities.

IMPORTANT NOTE: The monies in your retirement plans are growing on a tax-deferred basis (or tax-free* if in a Roth); that is, the earnings are not being taxed while they are in the retirement plan. Since you're already getting a tax-deferred benefit, you may not want to invest any of your funds in tax-exempt investments. It may be better to invest in a higher yield taxable investment. In addition, stock and mutual fund investing involves risk, including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will likely decline as interest rates rise and bonds are subject to availability and change in price. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

*federally tax-free, may be subject to state and local taxes

Guaranteed Investment Contracts (GICs)

A GIC, or guaranteed investment contract, may be one of the investment options in your 401(k) plan. The main reason why so many 401(k) participants have selected GICs is that GICs offer a fixed rate of return, typically guaranteed for periods up to a year or so. Also, the account value does not fluctuate with changes in market conditions, as with stocks and bonds. If the guaranteed rate is 5% for the current period, you can expect that your account will increase in value by 5% by the end of that period. While your return may only be 1-2% higher than money market funds, GICs eliminate the ups and downs associated with other fixed-income investments, e.g., government and corporate bonds.

But GICs may not be as safe as the name suggests. It's important to know the institution(s) that is (are) guaranteeing your funds. Most GICs are usually guaranteed by insurance companies, so it's important to know the financial rating of the company (they should be rated A+ or better by AM Best). Some GICs may be guaranteed by banks that are federally insured. Your employer can provide you with this information.

One more thing on GICs: They are not designed to provide you with long-term growth, as stocks are. Investing in safety is appropriate for the short-term but can jeopardize your long-term investment results.

IMPORTANT NOTE: Stock investing involves risk, including possible loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will likely decline as interest rates rise and bonds are subject to availability and change in price. Government bonds are guaranteed by the US government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. The market value of corporate bonds will fluctuate, and if the bond is sold prior to maturity, the investor's yield may differ from the advertised yield.

Asset Allocation

Asset allocation is a method of diversifying your investments to help you work toward the highest rate of return for the amount of risk you are willing to accept. Since no one can predict what will happen tomorrow, you need a way of investing your money to pursue your long-term goals. Rather than focusing on current market conditions and the short-term outlook, you need a strategy that is based on what stage of life you are at and how many years you are from starting your retirement.

Asset allocation is based on two simple concepts. First, different asset classes—stocks, bonds, and cash—react differently under the same economic conditions. For example, stocks tend to do well when inflation is low and interest rates are dropping. Bonds tend to perform well when the economy is slowing down and the price of stocks may be falling. And cash, while not a growth asset, can act as an anchor when both stocks and bonds are performing poorly.

Second, certain asset classes perform better over time than others. As you know by now, stocks and stock funds have historically outperformed over the long-term, but have the highest degree of short-term volatility. Bonds or bond funds with short-term maturities typically show less price volatility to changing interest rates than bonds with longer maturities.

Here's the basic point: By selecting a combination of stock and bond funds, you smooth out the short-term volatility—the ups and downs of the markets—while seeking to achieve your long-term results. Since each asset class has historically achieved certain rates of return over certain periods of time, we can assume certain combinations—ratios of stocks, bonds, and cash—will produce certain long-term results based on past performance, although actual results will vary and cannot be guaranteed.

IMPORTANT NOTE: Although asset allocation strategies seek to minimize short-term volatility, they do not protect against loss in a declining market. Past performance is no guarantee of future results. Stock and mutual fund investing involves risk, including possible loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will likely decline as interest rates rise and bonds are subject to availability and change in price.

Managing Your Investments

Evaluating Performance

Now that you have invested your money and have taken the time to carefully select the investments that fit your goals and risk tolerance, did you think your job was finished? It is your responsibility to manage your portfolio for the long term.

To find out how your investments are performing, there are quite a few places you can go for information. Below are some reference sources:

- For stocks: Value Line Investment Survey
- For mutual funds: *Morningstar*
- For bonds: Moody's and Standard and Poor's
- *The Wall Street Journal*
- *Investor's Business Daily*
- *Barron's*

There are many magazines that investors can read, such as *Money Magazine, Kiplinger's Personal Finance,* and *Smart Money.*

This is a suggested reading list; it is not an endorsement of any of the above publications.

The Pitfalls of Trying to Time the Market

It's human nature to panic when you see your hard earned money invested in something that drops in value. Your heart sinks and you may kick yourself for thinking you made a poor decision. Prudent investors realize that the market will ebb and flow like the ocean tide.

Follow Performance

Although you shouldn't panic when the market fluctuates, don't make the mistake of investing in something and then ignoring changes in the business climate, the investment itself, or changes in your own life that would make it wise to sell. Smart investors will pay attention to the results of their portfolio. They reevaluate their portfolio from time to time, and are willing to make changes.

How often should you review your portfolio? You should review it every quarter. You also may want to review it when financial circumstances change, for instance, if you get a pay raise or bonus. Here is a list of some other circumstances that should prompt review:

- Substantial decline or rise in the stock market
- Change in tax laws
- Significant change in the price of a stock or bond

SUGGESTION: Don't be afraid to move out of a poor performer. When should you switch out of one investment and buy into another? That may sound like a simple question, but the answer is not so easy. There are no definitive guidelines—brokers and professional investors struggle with this on a daily basis. But keep this in mind—a fund that performs poorly in one or two consecutive quarters may be the hottest performer in the following quarters.

Avoid Following the Market Too Closely

Try not to watch all your investments fluctuate on a daily basis. People tend to become obsessive when they see their investments lose value. Don't succumb to your fears too easily. Remember that you are investing for the long-term, so don't move your money around constantly in an effort to stay ahead of the market.

Keep in mind that by dollar-cost averaging, you are benefiting from investing your money each pay period. Because you are buying investments at different price levels, you are compensating for the ebbs and flows of the market.

IMPORTANT NOTE: Dollar cost averaging involves continuous investment in securities regardless of fluctuation in price levels of such securities. An investor should consider their ability to continue purchasing through fluctuating price levels. Such a plan does not assure a profit and does not protect against loss in declining markets.

Keep an Eye on Results

Monitoring the performance of your investments is the key to maintaining a healthy portfolio. And as you know by now, growth is the key to successful retirement investing. Therefore, you need to make sure to take the time to analyze the results and make adjustments.

IMPORTANT NOTE: If the fluctuations in your investments are making you uneasy, you may not be in the right investments for you. That's why knowing your risk tolerance is so important.

Don't Get into More Investments than You Can Monitor

To diversify fully, you may be tempted to own too many investments. Remember that, sometimes, less can be more. Sticking with a few mutual funds may accomplish your goal of diversification and make monitoring easier. Investing in a host of individual stocks can make the most prudent investor crazy. Make your portfolio only as complicated as you can easily handle.

How Is Investing for Retirement Different from Other Investing?

It's not. Any investment program needs to consider the rate of return, your risk tolerance, and your time horizon. Young people investing for retirement have a long-term time horizon. Investing in stock mutual funds makes sense. When you are closer to retirement, more conservative investments such as bonds and cash may be more appropriate.

Not much different from saving for college—or saving for a house. The process is the same. What is your goal? What do you have to work with? When will you need the money? Getting clear about your goals always eliminates unwanted or unnecessary alternatives.

Steps to Follow when Investing in Funds in a 401(k) Plan

1. **Do your research**. Focus on the long-term track record of the fund and use the numerous services available that rate the funds. You may not be able to find your 401(k) fund(s) listed in the more popular rating services. If so, determine the 401(k) fund's objective (growth, aggressive growth, equity-income, etc.), and compare the fund's performance to the average three-, five-, and ten-year performance of other funds in that category.
2. **Request a prospectus for the various funds from your company.** The prospectus provides you with information regarding the fund's objectives, fees, composition, and allowable investments. Don't use the prospectus to assess performance of the fund—use an independent rating service.
3. **Decide on which fund to choose based on your risk tolerance, your investment goals, and your investment time horizon.** Basically, you need to know how much fluctuation in your portfolio you are comfortable with. ♦