Fundamentals of Investing

Disclaimers

- The information in this material is not intended as tax or legal advice. Please consult legal or tax professionals for specific information regarding your individual situation.
- The content herein was developed from sources believed to be providing accurate information.
- All investing is subject to risk, including the possible loss of the money you invest.
- All final investment and planning decisions are the discretion of the client.

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Course Pre-Requisites

We encourage completion of the Eustace Advisors Financial Education offerings listed below before completing this Course.

1. Create a Balance Sheet and Income Statement
2. Create a Budget

We also recommend students review the Terms and Definitions contained herein before the class session.

Course Objective

To prepare course participants to follow an educated, process-driven approach to investing.

At the completion of this course, participants should be familiar with basic investing terminology, understand a process to make investment decisions aligned with their goals and situation, and be prepared to better manage their personal investment portfolio.

For participants new to investing, we hope this course helps build confidence to establish your initial investment portfolio. If you already have an investment portfolio, this course may be helpful to improve your investment process.

Other classes and education resources will be offered to go into more detail on specific investment types and strategies.

Discussion Topics

1. Purposes of Investing
2. Terms and Definitions
3. Interesting Facts
4. Our Recommended Investing Process
5. Initial Steps – Getting Organized
6. Next Steps – Do Your Research and Take Action
7. Ongoing Maintenance - Monitoring and Adjusting Your Portfolio
8. Three Investment Funds – Emergency, Intermediate Goals, Long-Term
9. Bonus Topics
   A. The Investment Policy Statement, in more detail.
   B. The Benefits of Time and Compounding re: Investing.
   C. How to Analyze a Mutual Fund or ETF.
10. Resources
11. Questions / Discussion

Purposes of Investing

1. Achieve Financial Security / Confidence.
2. Fund significant purchases (Home, Car, RV, Vacation).
3. Take advantage of employer matching.
4. Education funding.
5. Retirement security.
6. Trust Management.
7. Estate Growth for Beneficiaries.

Terms and Definitions - General

1. Saving: the act of setting money aside for future use and not spending it immediately.
2. Investing: the act of allocating resources (i.e., money), with the expectation of generating an income or profit. Investing differs from saving in that the money is put to work with a risk that the related project or investment may fail, resulting in a loss.
3. Financial Plan: a document that details a person's current financial circumstances, insurance and estate plan status, their financial goals, and planned steps to achieve the stated goals.
4. Investment Policy Statement: a written statement defining an investor's goals, risk tolerance, acceptable investment types, timeline, underlying assumptions re: market and economic factors, and monitoring.
5. Investment Time Horizon: how long an investment is expected to be held until the money is needed.
6. Compounding: the increasing value of an asset due to the interest earned on both the original investment and accumulated interest.
7. Yield (Rate of Return): the projected change in value of an investment over a particular period.
8. Risk: the likelihood that an investment's value will decline. In investing, risk and return are related; low risk generally means low expected returns, while higher returns are usually accompanied by higher risk.
9. Volatility: a measurement of the uncertainty of changes to an asset's value. Higher volatility indicates an asset's value will vary more widely vs. its mean value over a certain period.

Terms and Definitions – Returns and Taxes

10. Dividends: corporate earnings that are paid to eligible shareholders.

11. Capital Gains: the increase in an asset's value <u>that is realized when the asset is sold</u>.

12. Interest: the charge for borrowing money (loan and credit card interest) or the payment received for lending money (investment account interest), generally expressed as a percentage of the amount borrowed or invested.

13. Income Tax: a government-imposed tax levied on an individual's wages, salaries, and other types of income.

14. Taxable Accounts: funded with investments that have already been taxed. All earned interest, dividends and capital gain distributions are taxed as income in the year in which they are earned. Ex: savings and checking accounts; taxable brokerage accounts.

15. Tax-Deferred Accounts: funded with investments that have not been taxed. The original investment amount and all earned interest, dividends and capital gains are taxed as they are withdrawn ("distributed") by the investor, typically after being invested for a minimal # years or until the investor reaches a certain age. Ex: 401Ks and Traditional IRAs.

16. Tax-Free Accounts: funded with investments that have already been taxed. All earned interest, dividends and capital gains are exempt from tax if the investor defers withdrawals for a minimal period or until after reaching a certain age. Ex: Roth IRAs and Roth 401Ks.

17. Emergency Fund: taxable account used for unexpected short-term expenses (car/home repairs, medical costs, etc.).

Terms and Definitions - Strategies

18. Dollar-Cost Averaging: the practice of investing equal amounts of money at regular intervals, regardless of the price of a security. By buying regularly in up and down markets, investors buy more shares at lower prices and fewer shares at higher prices, which can reduce the overall impact of price volatility and lower the average cost per share. DCA is often promoted as an alternative to making large lump-sum investments and is appealing to investors who believe an investment will increase in value over time.

19. Asset Allocation: a broad strategy that determines the mix of assets to hold in a portfolio for an optimal risk-return balance based on their Investment Policy Statement.

    A. Buy-and-Hold Strategy: a long-term passive strategy where investors keep a relatively stable portfolio over time, regardless of short-term fluctuations. Buy and hold investors typically defer capital gains taxes and have low trading costs; however, their portfolio mix may get misaligned with their IPS over time if certain asset classes significantly outperform others.

    B. Strategic Asset Allocation: a portfolio strategy whereby the investor sets target allocations for various asset classes based on their IPS and rebalances the portfolio periodically when the original allocations deviate significantly from the IPS constraints due to differing returns. Similar to Buy-and-Hold, this strategy will better maintain the asset allocations established in the IPS but will have higher trading costs and potential tax impacts vs. Buy-and-Hold.

    C. Tactical Asset Allocation: a portfolio strategy whereby the investor makes short-term adjustments to their asset allocations based on market conditions and expected outperformance of certain asset classes over others. This tends to be an active management approach, with higher trading costs and potential tax impacts than Buy-and-Hold or SAA.

20. Rebalancing: the process of returning a portfolio's asset allocations to the levels defined in the Investment Policy Statement. Since different asset classes perform differently over time, a portfolio's allocation may diverge from the IPS objectives. Rebalancing involves buying or selling assets in a portfolio to regain the IPS's defined level of asset allocation.

Terms and Definitions – Investment Types

21. Fixed Income Investment: a security that pays investors fixed interest or dividend payments until the maturity date. At maturity, investors are repaid the principal amount they had invested. In general, these are conservative investments with relatively low-risk. Ex: Savings/Checking/Money Market Accts, Certificates of Deposit, Bonds.

22. Equities: shares in the ownership of a company; also referred to as stocks.

23. Mutual Funds: a financial vehicle that pools assets from shareholders to invest in securities like stocks, bonds, and other securities. Mutual funds are operated by professional money managers, who allocate the fund's assets per guidelines defined in the fund's prospectus. Mutual funds offer investors a simple means to invest in a diversified set of companies and industries, with automated investing options.

24. Exchange Traded Funds: an alternative to the mutual fund is the exchange-traded fund (ETF). ETFs often follow similar strategies as Mutual Funds but are structured differently to allow ETFs to be traded on stock exchanges, sold short and purchased on margin. ETFs also typically carry lower fees than the equivalent mutual fund and offer tax advantages vs. mutual funds. ETFs do not offer automated trading options like Mutual Funds.

25. Target Date Funds: a class of mutual funds that automatically rebalances asset class weights to optimize risk and returns over a predetermined time frame. The asset allocation of a target-date fund is typically designed to gradually shift to a more conservative profile as the target date approaches.

26. Alternative Investments: a financial asset that does not fit into the conventional equity and fixed income categories. Ex: private equity or venture capital, hedge funds, real estate, commodities, and collectibles.

Terms and Definitions – Investor Protection

27. Prospectus: Related to investments and securities, a prospectus provides details about the security. A mutual fund or ETF prospectus will include information on the fund's objectives, strategy, fees, management and risks. The Securities and Exchange Commission requires security issuers to file a prospectus when offering investment securities to the public.

28. FDIC: The Federal Deposit Insurance Corp. is an independent federal agency insuring deposits in U.S. banks in the event of bank failures. The FDIC insures deposits up to $250,000 per depositor, if the institution is a member firm. The FDIC covers checking/savings accounts, CDs, money market accounts, IRAs, revocable and irrevocable trust accounts, and employee benefit plans.

29. SIPC: The Securities Investor Protection Corporation protects investors from loss if their brokerage firms fail. Customers of SIPC-member institutions who lose money as a result of company liquidation are insured up to $500,000. The SIPC protects investments in stocks, bonds, mutual funds, options, Treasury securities, and CDs.

Interesting Facts

1. 30% of US households have a long-term financial plan.
2. Less than 25% of millennials have a basic understanding of finances and the need to save and budget.
3. 80% of millionaires are self-made.
4. 41% of Americans fear running out of money.
5. 62% of Americans acknowledge they don't have enough saved for retirement.
6. An April 2023 CNBC article highlights that 74% of Americans feel they cannot rely on social security benefits for their retirement.
7. Since 1960, the average inflation rate in the US was 3.8% per year. Recently: '22 - 8.0%; '23 - 4.1%; '24 – 2.9%.
   - A product or service that cost $100 in 1960 would cost ~$1,076 today.
8. Since 1960, the average return of the S&P 500 through 2023 was 10.26%.
   - $100 invested in the S&P 500 in 1960 was worth ~$64,000 as of Dec 31, 2024.
9. Between the 1960s and 2000, the U.S. <u>average</u> return on a 3-month CD was >5%; since 2000, it is <1.5%.
10. In Jan. 2025, the national average for bank savings/checking account annual yields is 0.41%/0.07%, respectively.
11. About 10,000 mutual funds and ETFs are offered to U.S. investors.
12. 16,000 individual stocks are traded on U.S. markets.
13. Only 41% of college students complete their Bachelor's degree in 4 years.

Cited from sources including Ramsey Solutions, U.S. Federal Reserve, Bureau of Labor Statistics, Fortune, CNBC, and others.

Our Recommended Investing Process

Assess your current financial situation.

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Define your financial goals.

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Establish your time horizon and risk tolerance.

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Learn about your investment options.

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Select what to invest in and how to allocate your investments.

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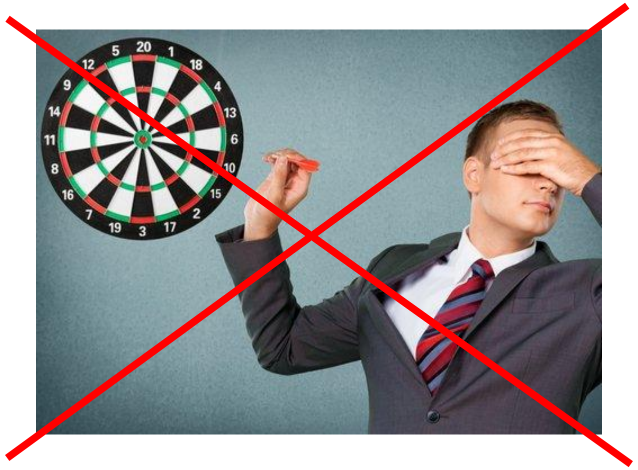
Periodically monitor and adjust your investments.



Initial Steps – Getting Organized

1. Assess Your Current Financial Situation ("current location").
   - This is defined via a Balance Sheet, Income Statement and Budget. These are covered in prior classes. See note
   - The information gleaned from these files will help you define the resources you have available to invest.
2. Define Your Financial Goals and Time Horizon ("destination").
   - These factors will be captured in an Investment Policy Statement (IPS), which defines suggested investment types and a recommended Asset Allocation %. See note
   - An IPS will define up to three general investment "buckets" based on time horizon:
     a. short-term needs (emergency fund),
     b. intermediate needs (saving for a goal such as a house, car or college education), and
     c. long-term (retirement and legacy).
3. Make an Honest Assessment of your Risk Tolerance and Investing Experience.
   - Risk tolerance will narrow down the set of acceptable investment types and Allocation %.
   - Investing Experience and Confidence will dictate if you collaborate with a Financial Advisor or take a DIY approach.

Our recommended method to complete these steps is to create a Balance Sheet, Income Statement, Budget and Investment Policy Statement. See note

Note: Eustace Advisors can provide templates for these files

Next Steps – Research, Plan and Act

1. Research investment options that align with your IPS ("show me some routes").
   - For Mutual Funds and ETFs, review the prospectus, compare key attributes against comparable funds/ETFs, and ensure you understand all fees.
   - For CDs, savings/checking accounts and money market accounts, assess interest rate paid and CD term.
2. Draft an Investing Action Plan, as part of a General Financial Plan ("pick a route").
   - This defines the <u>specific</u> steps to take to build a portfolio in line with your IPS, based on your research.
   - Examples:
     a. *Open Vanguard VTSAX mutual fund with $1,000, and schedule $100 per month automatic investments.*
     b. *Transfer funds from credit union money market to Vanguard VMRXX to increase yield on emergency savings account.*
3. Establish the appropriate financial accounts and invest per the Plan ("start route").
   - The big investment firms (Vanguard, Fidelity, Schwab, Blackrock) have excellent online access and customer support.
   - If you aren't comfortable opening an account or trading on-line, they will help you over the phone.

<u>The best way to summarize your research, plan your next steps and track completion is to create a written Financial Plan.</u> See note

Note: Eustace Advisors can provide a template example.

Ongoing Investment Management

1. Once an Investment Policy Statement and Financial Plan are established, they need to be monitored and updated on a regular basis.
2. Most Financial Advisors suggest assessment of an investment portfolio 1-2x per year, and rebalancing of the portfolio every 1-2 years. A significant life event should also prompt an assessment of the plan and investment portfolio and adjustments as warranted.
3. The Key Factors to Monitor:
   A. Your portfolio performance vs. industry benchmarks and your investment goals.
   B. Your actual portfolio allocation vs. IPS allocation guidelines (equities vs. fixed income, market and sector exposure, etc.). Over time, the allocation of the investment portfolio may get skewed due to out-performance of certain allocation categories vs. others. An example is the out-performance of equities vs. fixed-income investments over the past decade.
   C. Is the Portfolio allocation aligned with the defined investment timeline? The longer the investment timeline, the higher the % of the allocation that should be invested in equities.
   D. The impact of taxes on your investment returns.
   E. Are you on track to meet your defined investment goals?
4. Make decisions and adjustments that align with your Investment Policy Statement.
   A. Don’t overreact to daily news; stay focused on your plan.
   B. Use advisor resources and/or on-line investing tools as needed to simplify the analysis and adjustment process.

Short-Term Needs – Emergency Fund

1. How much do I need? 3-6 months of critical* living expenses, per your budget.
2. What Criteria Should These Investments Meet?
   - Protect savings -> ultra-safe investments.
   - Immediate access to funds -> no volatility or time commitment.
3. Suggested investment types: high-yield bank accounts and money-market accounts.
   - Tip: most mutual fund money market accounts pay higher interest rates than banks and credit unions.
   - On-line banks such as Ally and Marcus offer much higher savings account yields than most banks and credit unions.
4. Automate your investing to make regular contributions until $ goal is met.
   - Most Money Market mutual funds offer automated investment features to allow monthly purchases.
5. Money-Market and High-Yield Savings options to consider (data as of January 31, 2025):

Fund	Ticker	Exp. Ratio	Average 7-day SEC yield	Minimum investment
Vanguard Cash Reserves Federal MM Fund	VMRXX	0.10%	4.30%	$3,000
Fidelity Government MM Fund	SPAXX	0.42%	4.03%	N/A
Schwab Government Money Fund	SNVXX	0.35%	4.09%	N/A
Marcus Saving Account (Goldman Sachs)	N/A	N/A	3.9% APY	N/A

* Expenses such as dining out, clothing, entertainment are NOT considered critical, as they can be reduced if necessary.

Intermediate Goals Fund

1. How much do I need?   Use a calculator* based on your goal.
2. What Criteria Should These Investments Meet?
   - Protect savings -> safe investments with conservative growth potential (i.e., beat inflation).
   - Short-term access to funds -> low volatility and <6-month time commitment.
3. Suggested investment types: CDs, money-mkt or short-term bond funds, balanced funds.
   - Tip: look at building a Brokered CD ladder for better rates than Bank CDs and very low risk.
4. Automate your investing to make regular contributions until $ goal is met.
5. Options to consider (data as of January 31, 2025):

Fund	Ticker	Exp. Ratio	Rate or 5-yr return	Minimum investment
Vanguard Wellesley Income Fund Investors	VWINX	0.23%	3.94%	$3,000
Schwab Brokered CD – 6-month term	N/A	0%	4.35%	$1,000
Fidelity Asset Manager® 40%	FFANX	0.51%	4.79%	N/A
Vanguard Wellington Fund Investors	VWELX	0.26%	8.15%	$3,000

* https://www.nerdwallet.com/article/finance/savings-goal-calculator

Long-Term – Retirement/Education Funds

1. Basic presumption: Long-term investment horizon (at least 10 years).
2. How much do I need? Use a simple calculator* based on your plan or talk to an Advisor.
3. What Criteria Should These Investments Meet?
   - Tax Deferral or Tax Free, Low expenses, Diversification, Long-term returns in line with broad stock market indexes.
4. Recommended investment types: Target-date Mutual Funds; simple 2- or 3-Fund portfolio.
5. Suggestions:
   - To the extent possible and allowable, invest in tax-deferred or tax-free investments.
   - Leverage your employer's investment programs, especially matching contributions and ESPP.
   - Leverage 529 Savings plans and HSAs as applicable for their taxation benefits.
   - Automate your investing to make regular contributions and leverage Dollar Cost Averaging.
     - Most employer retirement plans are set up for automated payroll deductions.
     - Most IRA mutual funds offer automated investment features to allow monthly/quarterly purchases.
   - Start with a <u>SIMPLE, diversified</u> portfolio.
     - Target Date Funds offer diversification and automatic rebalancing.
     - Implement a customized 2-Fund or 3-Fund portfolio, such as those documented separately by Eustace Advisors.

* https://investor.vanguard.com/tools-calculators/retirement-income-calculator
* https://digital.fidelity.com/stgw/digital/planning/retirement/retirement-income-calculator/

Investment Policy Statement

All investors should have an IPS in place, whether they use an investment advisor or DIY.

Purposes of an Investment Policy Statement:

A. Summarize, in writing, the factors that will influence an investor's decisions and actions.
B. Establish unique criteria for each general portfolio category (emergency fund, intermediate-term, long-term).
C. Define the key participants in the investing activity.
D. Define allowable investment types and recommended allocation %.
E. Establish the techniques to monitor performance, and how often this will be assessed.

Key attributes of an Investment Policy Statement:

A. Must be in writing.
B. Must be realistic.
C. Should have a long-term perspective.
D. Must be clearly defined, using measurable criteria whenever possible.
E. Clearly defines responsibility for specific actions (investor, advisor, both).

An important role of the IPS is to guide actions to be taken during periods of market disruption when emotional or instinctive responses might otherwise lead to less prudent actions.

The Benefit of Time and Compounding

1. Start saving and investing as EARLY as possible, to leverage the benefit of compounding.

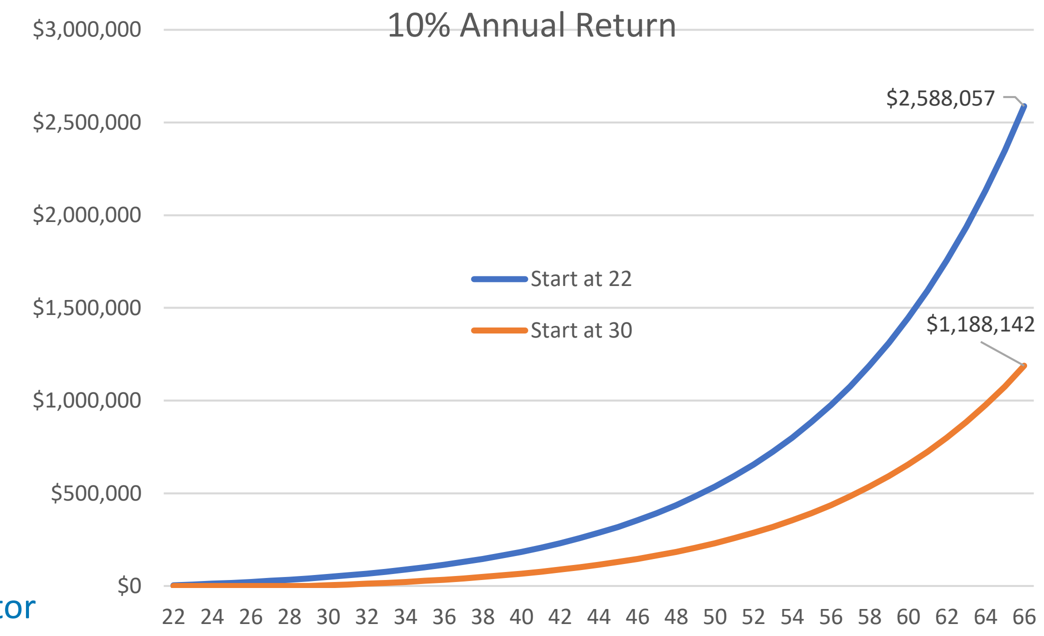
   Compounding is the investment gains that are achieved on previous investment gains. Successful investors will leverage compounding to their benefit, by reinvesting interest and dividends.

   Example: if a \$100 investment earns 5% per year, then 5% will be earned on \$105 in the 2nd year, on \$110.25 the 3rd year, etc.

3. ~40% of the historic gains of the S&P 500 is due to the dividends paid.

In the graph shown to the right, each investor invests \$3,600 per year and achieves the long-term average S&P 500 return of 10%.

All gains are reinvested; the impact of taxes on the investment gains are not reflected.



For additional examples, see https://www.eustaceadvisors.com/blog/advantage-time-investor

Mutual Fund / ETF Analysis

A general comparison of funds is a good starting point; you should review the prospectus before investing in any mutual fund or ETF, particularly for Actively-Managed funds and ETFs.

General Criteria

1. Fund Strategy and Asset Composition. Does the fund fit within your IPS guidelines?
2. Active vs. Passive Management. Higher fees and turnover vs. Index alignment.
3. Restrict options to funds accessible from established investing accounts? Simpler account management.

Head-to-Head Comparison

1. Fees. The impact of a 0.5% or greater difference in fees over 25-35 years is dramatic (see Vanguard example at https://investor.vanguard.com/investment-products/mutual-funds/low-cost).
2. Historic Performance vs. Benchmark and Peers. Passive funds should correlate to benchmarks.
3. Fund Turnover. This has a significant impact on capital gain related taxes for non-qualified mutual fund accounts.

Examples: https://markets.ft.com/data/funds/us/compare

1. Total Market Equity Funds: VTSAX, FSKAX, SWTSX
2. Target Date 2055 Funds: LIVAX, VFFVX, FHAOX, RRTVX (highlight impact of expenses over 32 years).

Resources

1. www.investopedia.com – this is a great resource for financial, tax and estate related topics.
2. Kaplan College for Financial Planning AAMS® Course Study Material.
3. https://corporatefinanceinstitute.com/resources/wealth-management/investing-beginners-guide/
4. https://investor.vanguard.com/tools-calculators/investor-quick-start-tool
5. High yield savings accounts:
   - https://www.marcus.com/us/en/savings/high-yield-savings
   - https://www.ally.com/bank/online-savings-account/
6. Opening an investment account:
   - Vanguard: https://personal1.vanguard.com/mmx-move-money/funding-method
   - Fidelity: https://www.fidelity.com/open-account/overview
   - Schwab: https://www.schwab.com/open-an-account
7. Info on 3-Fund Portfolios and Target Date Funds:
   - https://www.clevergirlfinance.com/3-fund-portfolio/
   - https://www.fool.com/the-ascent/buying-stocks/articles/heres-why-investors-love-the-3-fund-portfolio/
   - https://www.investopedia.com/articles/retirement/07/life_cycle.asp.

Questions?