Investing 101 —what every investor needs to know –what to teach your children
Bob Adams
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Successful Investing 101—

(What every investor should know—and what to teach your children)

Investing Choices:
the good - the better – or the expensive

Bob Adams
bob-adams@comcast.net
www.bob-adams.net

10-1-09

Who is offering this information?

- Puget Sound Chapter of *Better Investing*
  - Non-profit
  - Volunteer driven
  - Goal: Teach you how to invest
- Who am I?—a volunteer
- www.betterinvesting.org/puget
- contact@puget.betterinvesting.net
- 206-935-0861

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Investing 101--

- 1- General Money Tips
- 2- Investing Vehicles—pros and cons
- 3- Why Expenses are Important
- 4- Basics of Investing
- 5- Company Analysis
- 6- Are you beating the market

4

General Investing tips --teach your children

- Equities outperform other investments
  - Bonds
  - Real Estate
  - Precious metals and gems
- Invest for the long term
  - Short term = high risk
  - Long term = low risk
- Save 10% of your paycheck

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General Money Tips --teach your children

Pay off credit cards monthly
- Keep balance below 10% of credit limit
- Don't close credit card accounts – Why?

(Ok to close if you have a zero balance on all cards)
- Keep older cards

Pay bills on time
- Credit score killers—
  - 1 missed car payment: - 100 points
  - Too many credit applications can damage your score
    - Cell phone – New Credit Card – Utilities

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General Money Tips --teach your children

Slide not in handout

New credit card rules—February 2010
- Prohibited: Free incentives to students for a card application
- Parent or adult must co-sign for any applicant under 21
- Student must show proof of ability to pay debt on their own

Limit is 20 percent of the student's income

If you can't make payments—negotiate!
Councling help: www.nfcc.org
(National Foundation for Credit Counseling)

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Your Debt—warning signs
Compare to gross income

- Total monthly payments should be < 36%-48%

  % = Payments / Gross Income

- Debt is excessive if:
  - 1) <u>Monthly car payments</u> and average <u>new charges to credit card</u> exceed 20%
  - 2) <u>Monthly mortgage</u> (including taxes & insurance) exceeds 28%

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Your Debt—warning signs

- Total owed on home <u>no greater than 80%</u>
  - Includes second mortgage – equity credit line, etc.
- ARM*: add 6% to introductory rate
  - Calculate monthly payment (<u>maximum payment</u>)
    - Ask Realtor or Broker – OR

www.mortgage101.com/mortgage-calculators
www.NASDAQ.com click on *Personal Finance*
[credit card and debt information]

* Adjustable Rate Mortgage

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Your Debt— guidelines

- Set aside 8 months living expenses for emergencies
- Don't take out auto loan for more than <u>36 mo</u>.
  - Can leave you "Upside-Down"
- Loans are Sub-Prime if FICO score less than:
  - 600 for car loan
  - 700 for home mortgage
  - Result: higher interest rates

FICO (Fair Isaac Corp.)

- Data from Consumer Reports article July 2008

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FICO Score: What's that?
Financially—THE most important 3 digit number

- It impacts your interest rate on ***<u>loans</u>*** & ***<u>insurance</u>*** premiums
  - Car
  - Home
  - Any loan – any insurance

- One <u>free</u> credit report each year
- Get one from each credit agency

<u>www.annualcreditreport.com</u>
(some banks offer free access to your FICO)

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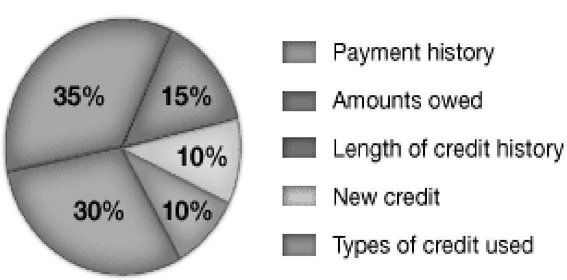
FICO Score: What's that?
What's in your score:



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FICO Score: What's that?
A three digit number:

- Range: 300-850

  >750 receive "Best" credit rates
  >700 = "Good" credit rates
  <650 = Sub prime

Estimate your FICO score – www.bankrate.com

http://www.bankrate.com/calculators/credit-score-fico-calculator.aspx

Free Credit Information Booklet –www.myfico.com
http://www.myfico.com/crediteducation/brochures.aspx

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FICO Score: What's that?

30 Year Fixed Rate Home Loan

FICO® score	APR [?]	Monthly payment
760-850	4.620%	$1,542
700-759	4.844%	$1,582
680-699	5.023%	$1,615
660-679	5.240%	$1,655
640-659	5.675%	$1,736
620-639	6.227%	$1,843

Location: Washington — Loan amount: $300,000 — Recalculate

http://www.myfico.com

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Another thing...

The future of dating?
...Wanna come up and see my FICO score?

- "The least romantic date"
  - Have a "credit report" conversation
  - Print your credit report, bring it to dinner—and share it (Full disclosure)

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Guidelines...

Next: Part II
Investing Vehicles

Investing Vehicles

1) Investing in managed mutual funds
2) Investing in index funds
3) Investing in ETFs (Exchange Traded Funds)
4) Investing in equities (stocks)

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What is a Managed Mutual Fund?

- Pooled money from many
- Managed for you
  - Expenses are high >1.5%
- Good diversification
- Available in any type at any broker
  - Over 100,000 funds

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What is an Index Fund

- Pooled money from many
- Managed for you
  - Expenses are low <.2%
  - Good diversification
- Available in various types at any broker
  - Easily cover all aspects of the market
    - Large companies -- 500 Index Fund Inv
    - Medium companies – Mid-Cap Index Fund Inv
    - Small companies – Small-Cap Index Fund Inv
- Vanguard www.vanguard.com

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What is an ETF
(Exchange Traded Fund)

- Pooled money from many (a type of mutual fund)
- Managed for you
  - Expenses are low .15 to .2% + trading fee
  - Good diversification
  - Buy & sell shares at any time at a known price
  - High turnover (3,600-6,000%)
- Available in various types at any broker
  - Easily cover all aspects of the market
    - Large companies
    - Medium companies
    - Small companies

    Industries
    Foreign and Domestic

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What is an Individual Acct.

- Your money held separately from others
- You decide what and when to buy/sell
  - Expenses are low (You control expenses)
- Available through any broker—discount
- What do you buy
  - A "Share" of a company

Next: Pros & Cons of each type

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Managed Mutual Funds—pros/cons

- Pros:
  - Convenient
  - Easy
  - Automatic investing
- Cons:
  - Under perform the market
  - *Expensive* – 1.5% annual fee <u>average</u> + + +
  - Short term Capital gains taxed at your rate
    - High turnover

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Managed Mutual Funds
What does "expensive" mean?

- 16 year study by *John Bogle* (Vanguard)
- Investors in <u>Managed Mutual Funds</u> kept **47%** of the cumulative return
- <u>Index Fund</u> investors kept **87%**
- This means $<u>10,000</u> invested in the index fund grew by $<u>87,000 vs. $47,000</u> in the average actively managed stock mutual fund

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Managed Mutual Funds

- 12b-1 fees –
  - up to 1% for load funds
  - Up to 0.25% for no-load funds
- Transaction fees not reported
- Taxes not reported

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Index Funds—pros/cons

- Pros:
  - Convenient
  - Easy
  - Automatic investing
  - Return approximates the market average
  - Very low turnover – Very low capital gains
    - Long term Capital gains taxed at 15%
    - No measurable turnover costs (brokerage fees)
  - Inexpensive – .1% to .18% annual fee
- Cons:
  - Slightly under perform the market average

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Index Funds—pros/cons

- Not all are created equal—(Class B shares)

Index 500 funds	Expense ratio	w/Load charges
Fidelity Spartan*	0.07%	None
Vanguard Admiral*	0.09%	None
Vanguard Regular	0.18%	None
T. Roe Price	0.35%	None

* Minimum investment and/or specified holding period

Morgan Stanley	0.64%	1.40%
Wells Fargo	0.64%	1.39%
Evergreen	0.56%	1.31%
J. P. Morgan	0.53%	1.30%

The Little Book of Common Sense Investing—Bogle p128

Percent of active funds underperformed the indices

Fund Category	Benchmark Index	2004 to 2008	1999 to 2003
All Domestic Funds	S&P Composite 1500	66.21	50.76
All Large-Cap Funds	S&P 500	71.90	53.41
All Mid-Cap Funds	S&P MidCap 400	79.06	91.36
All Small-Cap Funds	S&P SmallCap 600	85.45	69.38

www2.standardandpoors.com/spf/pdf/index/SPIVA_Report_Year-End_2008.pdf

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Index Exchange Traded Fund (ETF)—pros/cons

- Pros:
  - Convenient
  - Easy
  - Automatic investing
  - Return approximates the market average
  - Buy and Sell like regular stocks
  - Somewhat Inexpensive – .15%-.2% plus trading fee
  - Capital gains taxed at 15% if held 18 months
- Cons:
  - Slightly under perform the index average
  - Cost normally higher than an Index Fund

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Index Exchange Traded Fund (ETF)—pros/cons

- Beware of "Ultra" ETFs
  - – leveraged
  - – short-term investing (36-60 times turnover)
  - "Individual investors...may not be aware of the risks these funds carry. Given their volatility, these funds typically are not suitable for most retail investors."

NASAA (North American Securities Administrators Association)

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Individual Account (Brokerage account)—pros/cons

- Pros:
  - You maintain control
    - When to buy – when to sell
    - Control Capital Gains
  - Beat the market average
    - (Long term even 1% difference can be a huge sum)
- Cons:
  - Must learn how to invest
    - Learn the language
  - Requires your time

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Invest in...

- Invest only in the best company
  - History of Sales growth and stability
  - History of Earnings growth and stability
  - History of stable Profit Margins
  - Reasonable Price
  - Reasonable Projected Growth
- (How? – We'll look at this later)

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Opening an account

- Managed Mutual Fund
  - Small initial investment ($100-200)
    - High expenses
- Index Fund –or– ETF
  - Larger initial investment ($2,000)
    - Low expenses – but high turnover (ETF)
- Individual account
  - Larger initial investment ($2,000-3,000)
    - Low Expenses
    - IRA very low initial investment

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Investing Methods...

Next: Part III

Expenses are Important

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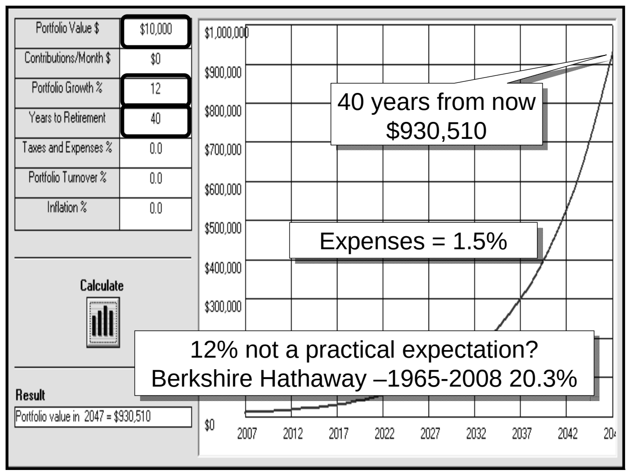
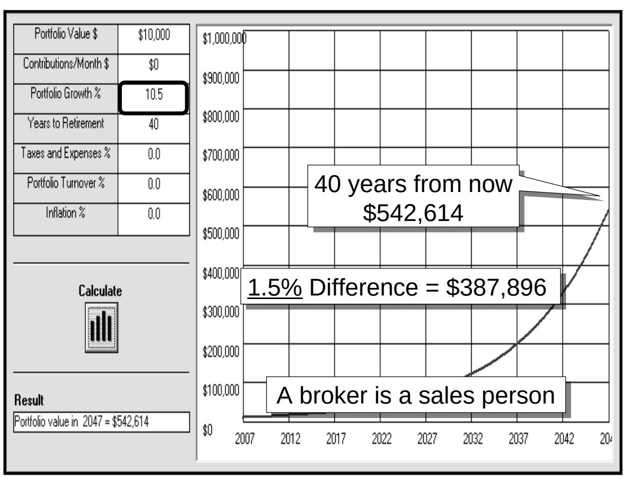
Expenses are Important

- The difference:
  - Your *broker's* yacht
- OR
  - *Your* yacht
- Before enrolling in a 401(k) plan
  1. Ask what fees are charged
  2. Ask who pays the fees
  3. Make sure you receive regular status updates





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But wait…there's more

- Uncle Sam <u>taxes</u> Mutual Fund Capital Gains
  - Each year 100-300% portfolio turnover
  - 2006 – Taxes cost Mutual Fund investors
    - 1.43%*

12b(1) fees -- .25% minimum – up to 1%

Result:
1.5% + 1.43% + .25% = >3% annual cost

* Reported by: LIPPER

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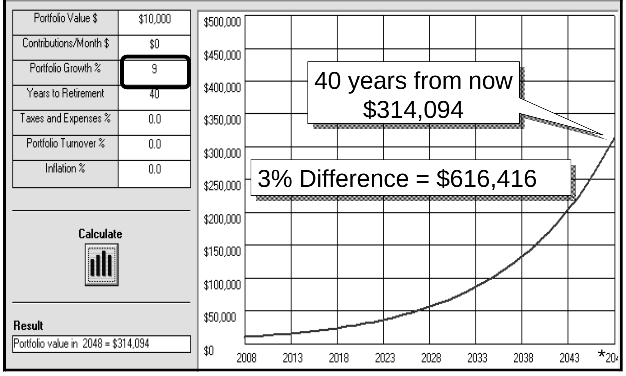
But... Wait there's more!



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But... Even MORE???

- We didn't include Brokerage Commissions

1% Annually*

Result:
1.5% + 1.43% + .25% + 1% = >4% annual cost

* John Bogle – *Common Sense Investing*

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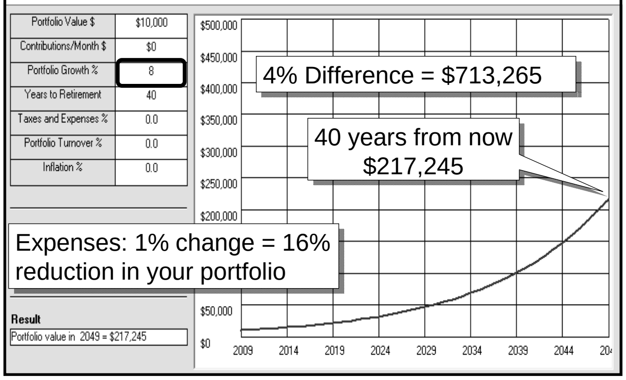
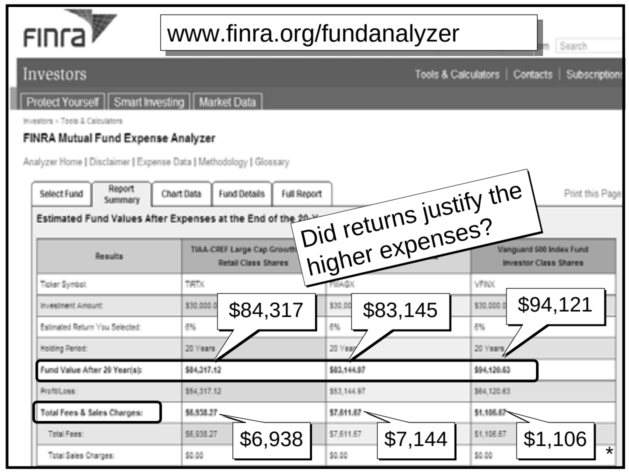
4% annual expenses





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Expenses are Important...

Next: Part IV

Basics of Investing on Your Own

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So you want to do it yourself? – beat the market

- Patience!
- It's a learning process
- Look for:
  - Local classes
  - Local activities
- www.betterinvesting.org/puget

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So. . . you want to do it yourself?

- Learn through an Investment Club
- Object:
  - Beat the Market Averages

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Learn the Power of -- Compounded Growth

- If Earnings grow on top of Earnings –
  - (Normally the greatest source of growth)
- If Dividends grow on top of Dividends –
- If Interest grows on top of Interest –
  - **RESULT:**
    - An ever increasing portfolio value
- Allow GROWTH and TIME to work for you
  - Reinvest – don't spend

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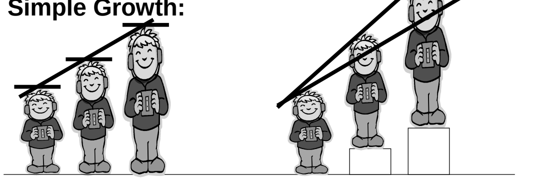
Compounded Growth: a simple illustration

- **How does it work?**

Parents sometimes measure a child's growth with a mark on the wall or door frame

§ **Compounded Growth:**

- **Simple Growth:**



*

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What is a High Quality Growth Company

- **Growth** Companies
  - Consistent sales growth
  - Consistent earnings growth
    - Track record of consistent growth (5 years min.)
- High **Quality** Companies
  - Good management (Consistent growth)
    - Maintained or improved profit margin
    - Invest company assets effectively

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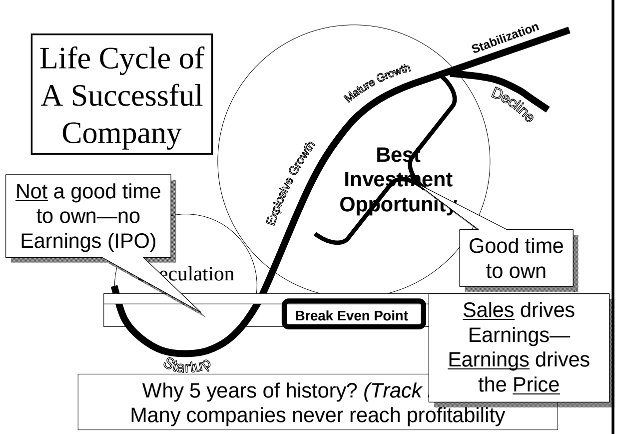

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Diversify

- Diversification reduces the risk
  - (Don't put all your eggs in one basket)
  - Invest in different industries
  - Invest in different sized companies
  - Invest in the U.S. and outside the U.S. (ADR)
  - Invest outside your own company too
  - Invest in a home

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Is the Stock Market Safe?

- "Risk" means different things to different people
- Short-term investment "risk" is high –
  - Price swings represent "risk"
- Long-term "risk" is low
  - Staying the course irons out the price swings

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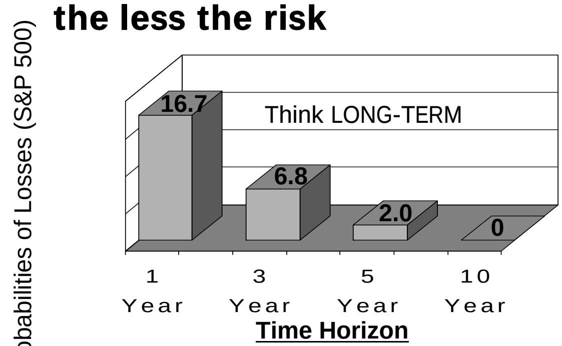
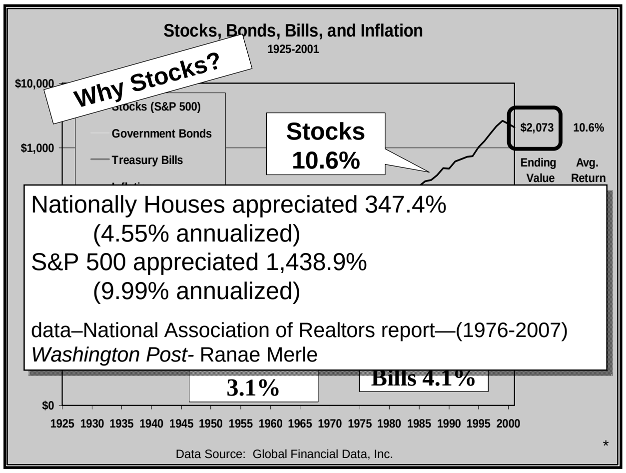
The longer the time period the less the risk



(Rolling Total Returns 1970--2000

Based on data from Merrill Lynch Quantitative Strategy

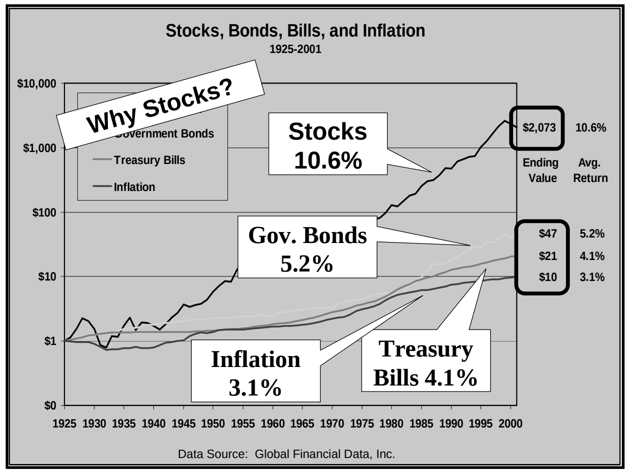
*



Nationally Houses appreciated 347.4%
(4.55% annualized)
S&P 500 appreciated 1,438.9%
(9.99% annualized)

data–National Association of Realtors report—(1976-2007)
Washington Post- Ranae Merle

*



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Basics...

Next: Part V
Company Analysis

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Company Analysis

- Annual Report Analysis form (free)
- Quick Analysis form (free)
  --*Kaush Meisheri*
- www.bob-adams.net

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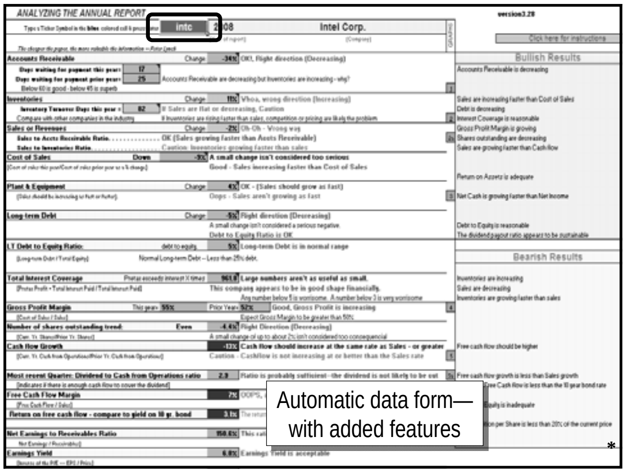
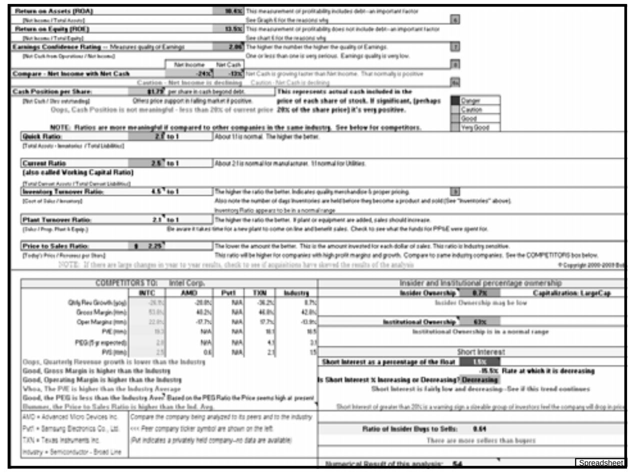
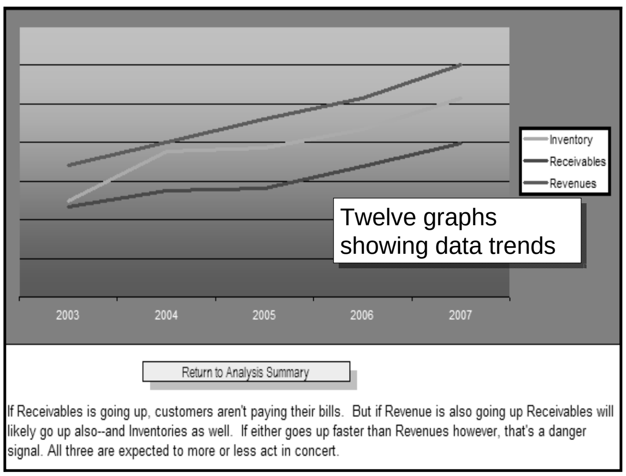
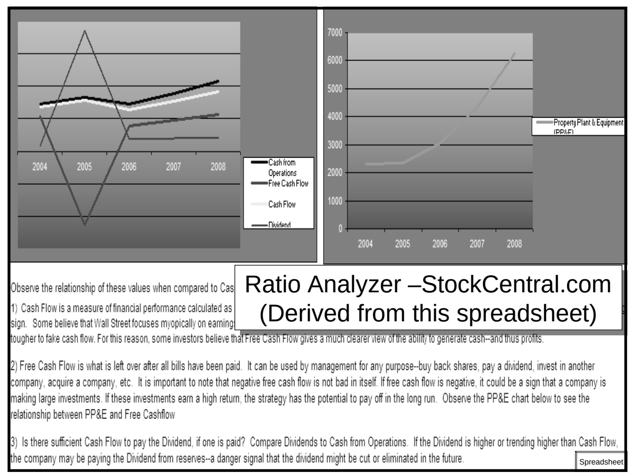
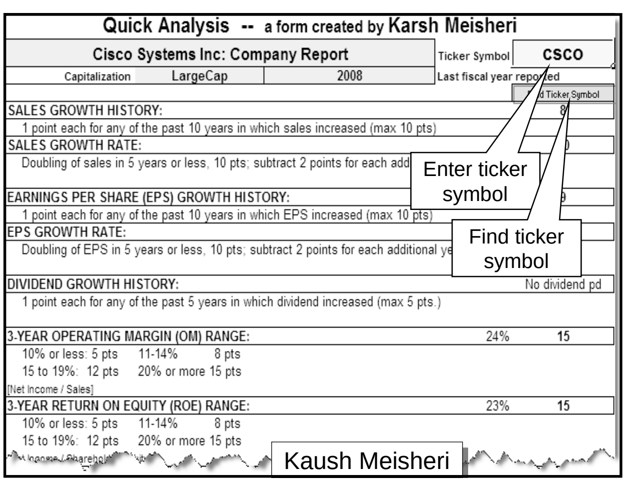
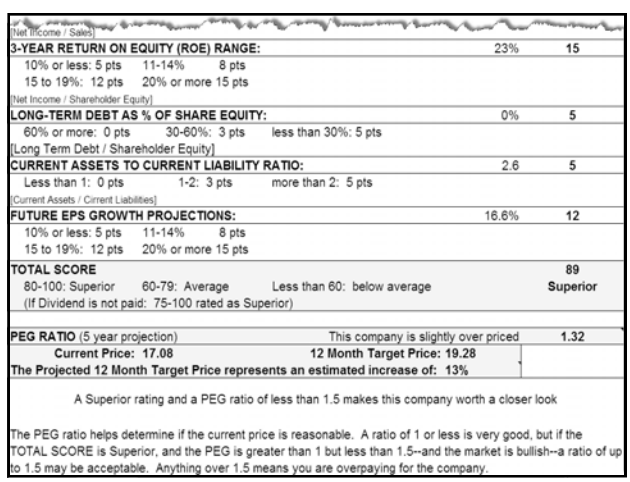












Quick Analysis -- a form created by Karsh Meisheri

Microsoft Corp: Company Report		Ticker Symbol	msft
Capitalization	LargeCap	2009	Last fiscal year reported

SALES GROWTH HISTORY:	8
1 point each for any of the past 10 years in which sales increased (max 10 pts)	
SALES GROWTH RATE:	6
Doubling of sales in 5 years or less, 10 pts; subtract 2 points for each additional year	
EARNINGS PER SHARE (EPS) GROWTH HISTORY:	7
1 point each for any of the past 10 years in which EPS increased (max 10 pts)	
EPS GROWTH RATE:	10
Doubling of EPS in 5 years or less, 10 pts; subtract 2 points for each additional year	
DIVIDEND GROWTH HISTORY:	4
1 point each for any of the past 5 years in which dividend increased (max 5 pts.)	

FUTURE EPS GROWTH PROJECTION:

10% or less: 5 pts 11-14% 8 pts
15 to 19%: 12 pts 20% or more 15 pts

TOTAL SCORE 80
80-100: Superior 60-79: Average Less than 60: below average **Superior**
(If Dividend is not paid: 75-100 rated as Superior)

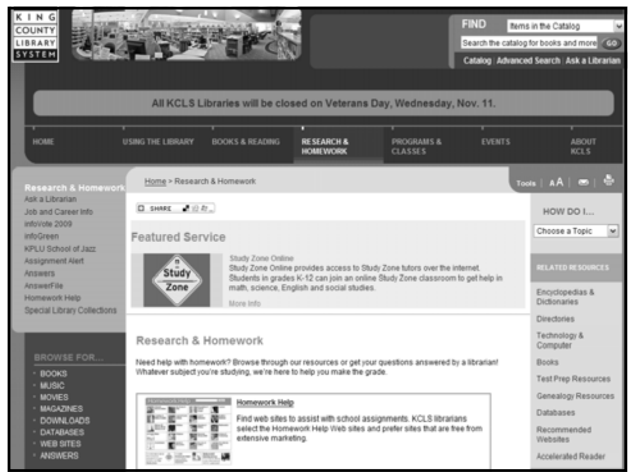
PEG RATIO (5 year projection) This company is slightly over priced **1.48**
Current Price: 25.05 **12 Month Target Price: 26.78**
The Projected 12 Month Target Price represents an estimated increase c7%

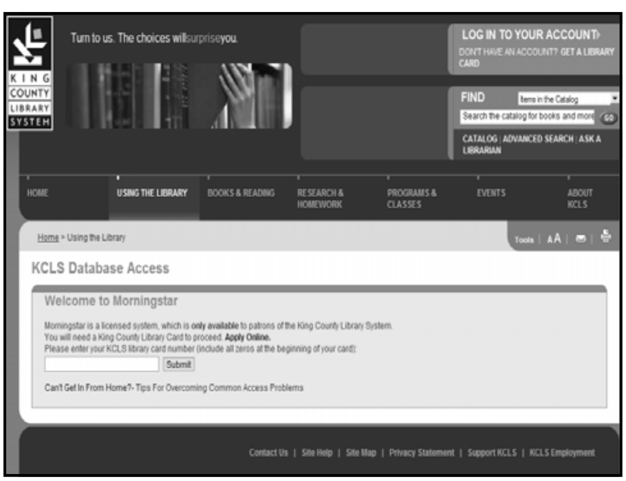
A Superior rating and a PEG ratio of less than 1.5 makes this company worth a closer look

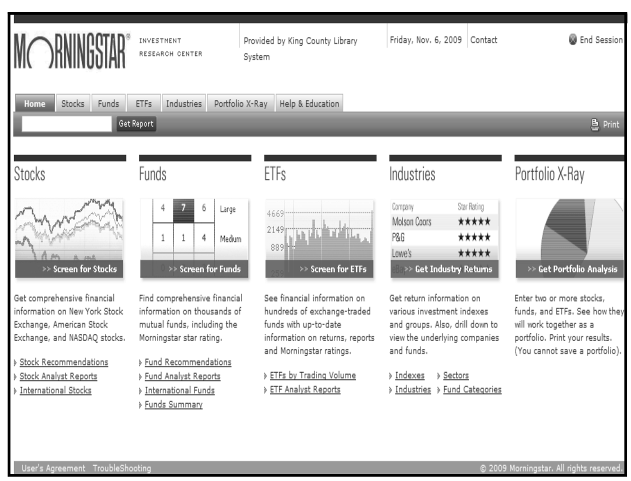
The PEG ratio helps determine if the current price is reasonable. A ratio of 1 or less is very good, but if the TOTAL SCORE is Superior, and the PEG is greater than 1 but less than 1.5--and the market is bullish--a ratio of up to 1.5 may be acceptable. Anything over 1.5 means you are overpaying for the company.

Research— Using Your Library

- Morningstar
  - Company & Mutual Fund research
- Valueline
  - Company research







MORNINGSTAR® INVESTMENT RESEARCH CENTER | Provided by King County Library System | Friday, Nov. 6, 2009 | Contact

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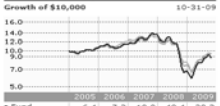
Enter a Ticker or Name | Get Report

Snapshot
Data Interpreter
Analyst Research
Stewardship Grade
Morningstar Rating
Total Returns
Tax Analysis
Risk Measures
Portfolio
Management
Fees & Expenses
Purchase Info
Formatted Report
Print

Fidelity Magellan FMAGX
See Fund Family Data ▸▸

Performance more ▸▸

Growth of $10,000 10-31-09



	2005	2006	2007	2008	2009
• Fund	6.4	7.2	18.8	-49.4	28.3
• +/- Cat	0.5	0.2	5.5	-8.7	4.1
• +/- S&P 500 TR	1.5	-8.6	13.3	-12.4	---

Trailing Returns % 11-05-09

	YTD	3 year	5 year
Fund	32.74	-6.18	-1.20
% Rank in Cat	24	83	86

This fund's record is very poor, with its five-year returns ranking among the very worst in its category. We focus on five-year returns because longer records have greater predictive value than shorter records. There may be a good explanation for this fund's poor performance, but it will need to be a good one to consider buying into this offering.

Key Stats more ▸▸

Morningstar Category Large Growth

Morningstar Rating ★

Morningstar Risk Above Average

This fund earns only 1 star under Morningstar's rating methodology, meaning that compared with other funds in its category, it has historically generated awful returns given the amount of risk it has taken on. Part of the problem in this case is that the fund has been volatile compared with its peers.

Expense Ratio % 0.71

This fund has a very low expense ratio for a no-load offering in its category. Expenses are a big factor in long-term, relative performance, and funds with lower expenses generally outperform those with higher expenses.

Manager	Manager Start Date
Harry Lange	10-31-05

% Rank in Cat	24	83	86

This fund's record is very poor, with its five-year returns ranking among the very worst in its category. We focus on five-year returns because longer records have greater predictive value than shorter records. There may be a good explanation for this fund's poor performance, but it will need to be a good one to consider buying into this offering.

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Manager	Manager Start Date
Harry Lange	10-31-05

This fund's manager has been at its helm for 4 years. When evaluating the fund's long-term performance record you may want to bear in mind that not all of that record is the product of the current manager's abilities.

Mutual Fund

Stock

Analyst Note 08-18-2009 | by Rick Hanna

Hewlett-Packard's HPQ third-quarter results were a mixed bag, but they were consistent with our estimates and we are maintaining our fair value estimate. Total revenue growth before unfavorable currency exchange rates was 4% versus last year, exclusively due to incremental revenues from the EDS acquisition. Every business unit except services reported steep double-digit sales declines versus last year, but there are some pockets of slight improvement relative to the previous dismal quarter. Particularly encouraging was the 14% improvement versus last quarter in Intel-based INTC x86 servers. Overall enterprise hardware spending increased 6% sequentially, which doesn't mean the floodgates are open on new demand, but it may indicate that the worst is over. Sales of personal computers did not fare as well, increasing only 3% sequentially as revenues continue to be deflated by falling average selling prices. We also remain concerned about continued weakness in the company's software and printing businesses, which declined both versus last year and last quarter.

Bulls Say

- HP is the largest technology infrastructure company in the world in terms of revenue and is using its global scale to lower costs.
- Cost-cutting has made HP more competitive in each of its business segments. It is now in a better position to capture additional market share.

Bears Say

- The printing business will become increasingly competitive as the market matures and the product lines blur between printers and multi-function devices.
- The trend toward more industry-standard architectures for servers and workstations will further commodify and bring more price pressures to the market.

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Basics...

Finally: Part VI
Beating the Market

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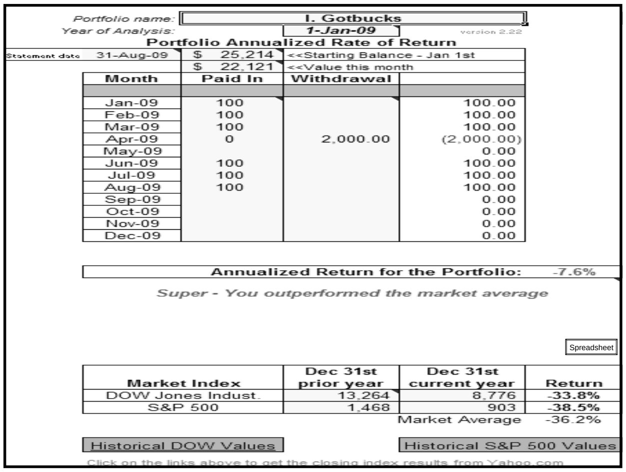
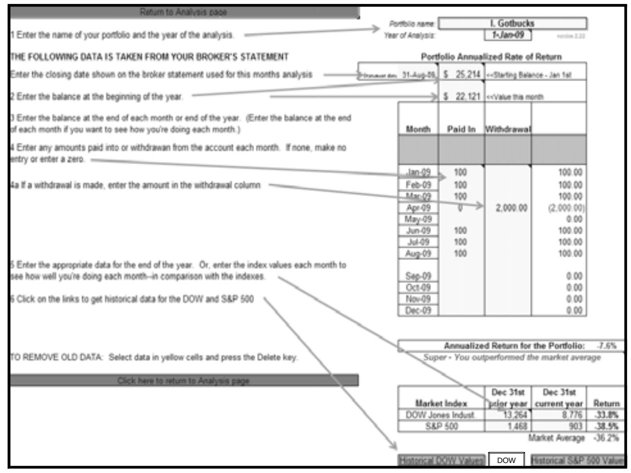
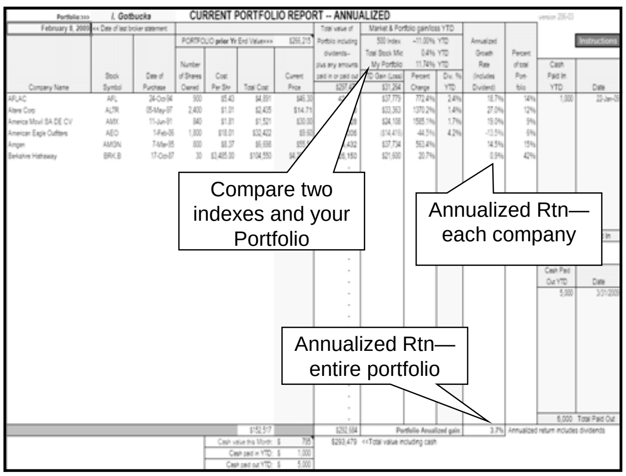
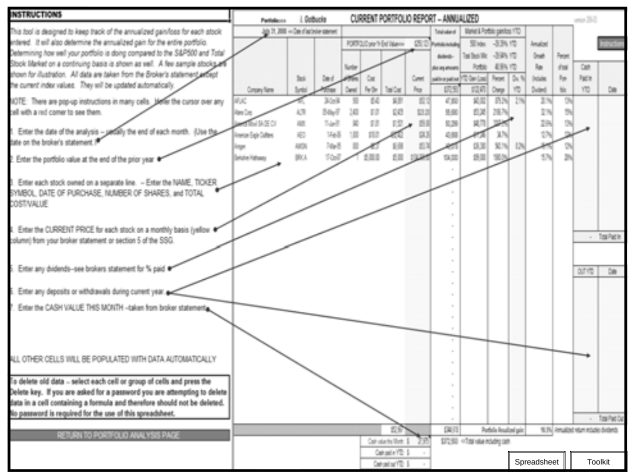
Did You Beat the Market

- It's ***Imperative*** you know!
  - Three tools help:
    - Two spreadsheets – companies
    - Morningstar – Mutual Funds









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Managed MF what to look for—

- If you insist on mutual funds-what to look for:
  - No load—front or back—no class B shares
  - Low expense ratio—under 1%
  - Low turnover ratio (low tax cost ratio) <70%
  - Manager in place for 5 years or greater
  - Compare 3-5 year return
    - Has current mgr been in charge during that time?
  - Don't buy recent hot performers
  - Use Morningstar for this information

Bottom line:

- Save 10% of your paycheck
- Open an Index Fund
- Learn to invest in individual companies
- Slowly move from Index Fund into individual companies
- Beat the market

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The last word...

- The ideas expressed are not for everyone
  - 1 If you can't sleep at night (financial worry)
  - 2 If you will need the money in 5 years
  - 3 If you are living off the income
- More stable investments might be better
  - Bond index fund
- Information presented during this presentation is meant to invoke thoughts and ideas only. No recommendation is intended. Individual needs and interests vary.

Toolkit

Assignment:

1) Use these tools to analyze companies
2) Buy on paper at a good price
   (Superior rating and good PEG ratio)
3) In one year:
   Determine how well you did
   Did you beat the market?

Educate yourself
Attend classes and events
Join an investment club
Consider joining BetterInvesting

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Good Reading:

- One up on Wall Street
  - *Peter Lynch*
- Take Stock
  - *Ellis Traub*
- Bogle on Mutual Funds
- Common Sense Investing
  - *John Bogle (Vanguard)*
- The World is Flat
  - *Thomas L. Friedman*
- The Future for Investors
- Stocks for the Long Run
  - *Jeremy Siegel*
- A Random Walk Down Wall Street
  - *Burton Malkie*
- You can be a Stock Market Genius -- *Joel Greenblatt*

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Articles to read:
The other Big Scandal—
Consumer Reports

Homes vs. Stocks
National Association of Realtors