Financial Fitness

A series of Educational Seminars

Starting Fall 2007
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Created by Rishi Sondhi
http://rishi-sondhi.blogspot.com/

Introduction

- Background
- Financial Planning topics
- No specific financial advice
- Guest presentations – industry professionals & experts
- Audience participation

Agenda

- What is Financial Planning?
- Why we don’t know enough?
- Why is it important?
- Basic principles of money management
- Future seminars
- Questions

Financial Planning Overview

- Retirement
  - 401(k), 403(b), IRA, pension plans
- Investments
  - Stocks, mutual funds, Index funds, bonds, bills
- Savings & MMA, CDs
- Trusts & Estate planning
- Wills
- Insurance

Why we lack financial planning skills

- It is not taught in our schools & colleges
- We don't like discussing it with friends & family
  - 30% of couples have different opinions about retirement dates and lifestyle choices (Fidelity Investments)
- Experts want you to think it is "rocket science"
- Lack of time
- Lack of interest

Why is financial planning important?

- Retirement
  - ✓Nearly 50% people have less than $25,000 saved*
  - ✓Many companies are discontinuing pension plans
  - ✓Social security system may not be solvent
- Individuals are responsible for their retirement

* Source: EBRI 2007 Retirement Confidence Survey

Why is it important?

- Health care costs are increasing
  - expected to be majority of retirement spending
- We spend more than we earn
  - according to a survey*, national saving rate is ~0%
- College costs
  - Costs are increasing faster than inflation rate
- Estate planning
  - Probate and estate settlement costs can be up to 10%
- Emergency funds – car and home repair, loss of job
- Fun money – vacations, second homes, cars

* Commerce Department's Bureau of Economic Analysis

Basic Principles

- Saving & investment options
- Power of Compounding
- Dividends
- Effect of taxes
- Effect of fees
- Market timing

Different Assets

- Equities – stocks & funds
- Fixed income – bonds, treasury bills
- Cash
- Commodities such as gold, silver etc.
- Real estate

Common Terms

- Stock or shares: fractional ownership in a business
  - Microsoft: $29
  - Berkshire Hathaway: $118,000
- Mutual Fund: a professionally managed collection of investments (stocks, bonds etc.)
- Index fund: a collective investment scheme that tracks a specific index (S&P 500, MS EAFE)
- ETF: Open ended mutual fund that trades like stocks

Value of $1 in Different Assets

1802 – 2001	**Not adjusted for inflation**	**Adjusted for Inflation**
Stocks	$8.8 million	$599, 605
Bonds	$13,975	$952
Bills	$4,455	$304
Gold	$14	$1

Source: *Stocks For The Long Run*, Jeremy Siegel

Real Estate vs. Stocks

- Real estate vs. 15 different "paper" investments – stocks, bonds, commodities and real estate investment trusts (REITs) from 1978 to 2004*
  - Housing – 8.6%.
  - Commercial property – 9.5%.
  - The S&P 500 (proxy for stocks) – 13.4%.
- Stocks have several advantages – performance, costs, diversification and effort needed by the investor.
- Real estate's strong point is leverage.

* Jack Clark Francis, Baruch College, New York City, and Roger G. Ibbotson at Yale University

Asset Allocation with Funds

- Active (mutual funds) or passive (index funds or ETFs)
- International (established or emerging markets) or domestic
- Scale: large cap, mid cap or small cap
- Style: growth, blend or value
- Broad based (S&P 500) or sector oriented (real estate, technology, geography etc.)

Fund Style Map

RISK

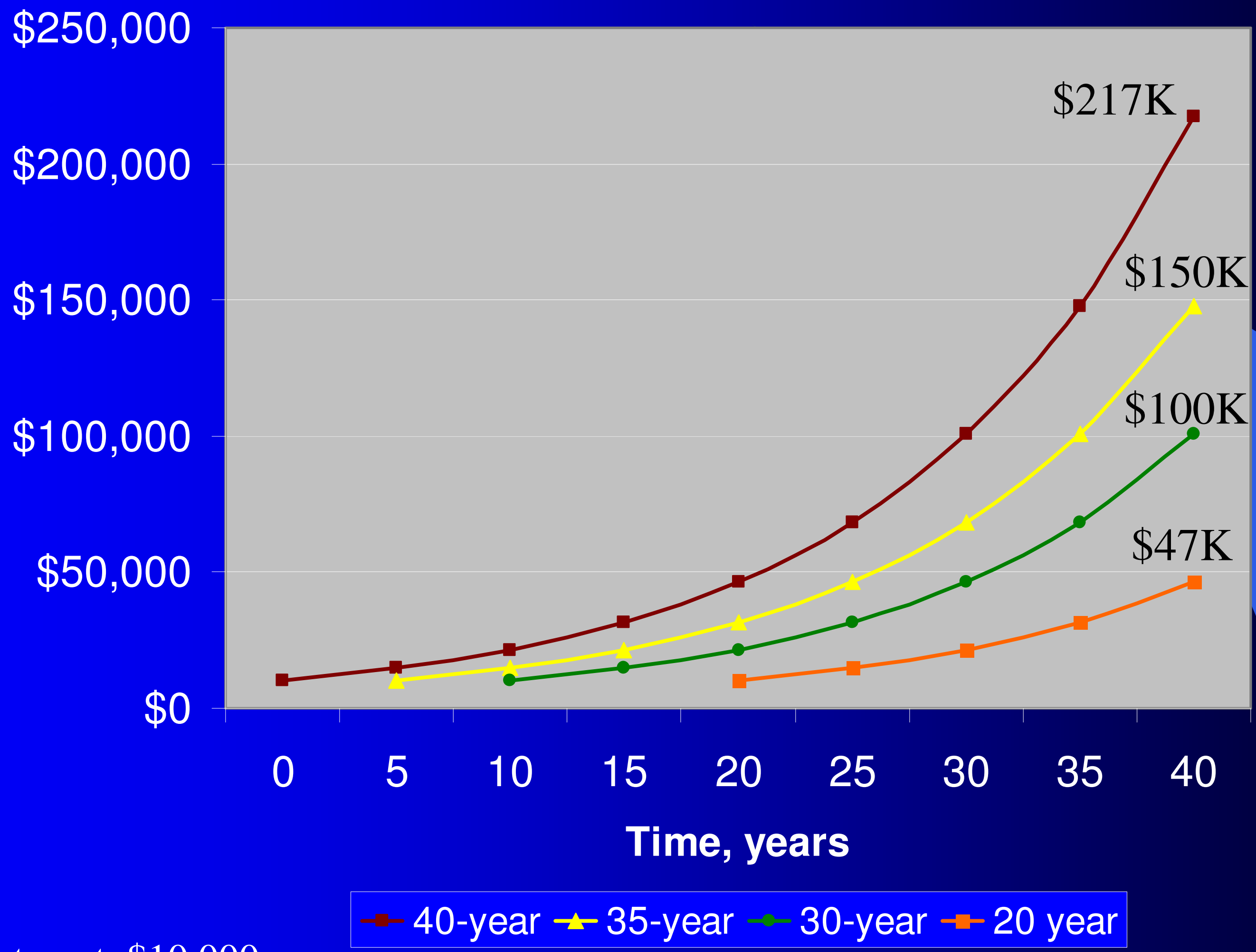
	VALUE	BLEND	GROWTH
LARGE CAP			Large Cap Growth fund
MID CAP		Mid Cap Blend fund	
SMALL CAP	Small Cap Value Fund		

Different Types of Funds

	Mutual Funds	Index Funds	ETF
Management Style	Active	Passive – tracks an index	Passive – tracks an index
Trade	Buy & sell at the end of the day	Buy & sell at the end of the day	Trades like a stock
Costs	High (1.5%)	Low (<0.5%), Tax-efficient	Low (<0.5%), Tax-efficient
Selection Criteria	Beat the market with active management	Match market returns with regular investments	Match market returns with lump-sum investments

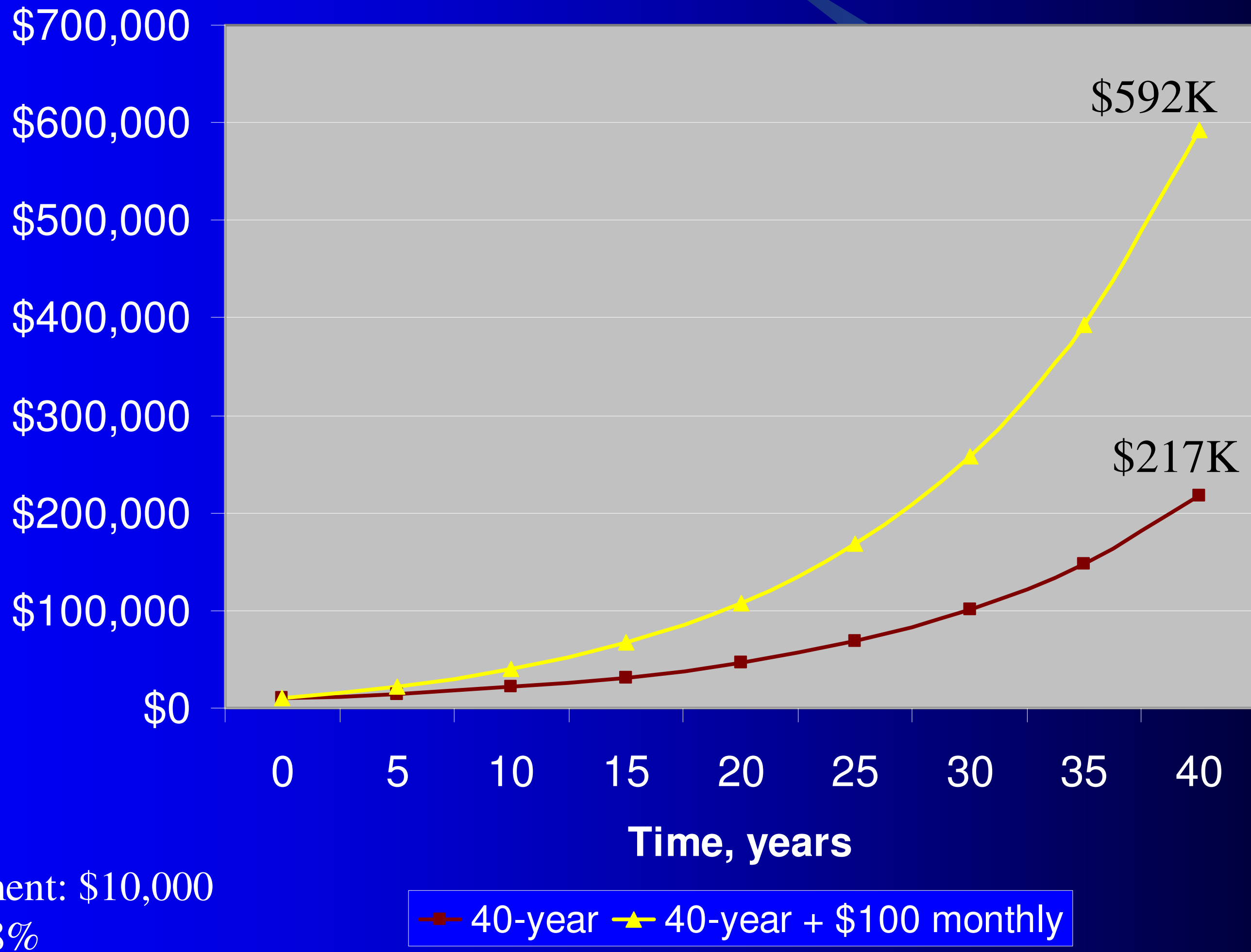
Basic Principles

Power of Compounding



Starting investment: $10,000
Rate of return: 8%

Compounding Effect with Regular Additions



Starting investment: $10,000
Rate of return: 8%

Rule of 72

- For an investment to double:
  - Rate of return * time = 72
  - At 8% return, an investment will take 9 years to double
- For an investment to double in 8 years, you need 9% rate of return
- Another example: for an investment to double in 6 years, you need 12% rate of return

Dividends

- Dividend: portion of company's earnings that are returned to the shareholders
- Dividend yield: $100 stock pays $2 yearly dividend → 2% yield
- Invest thru stocks or funds/ETFs
- Better investment: $1,000 invested in 1950 in IBM or Standard Oil?*
  - IBM: $1,000 (1950) → $961,000 (2003)
  - Standard oil (Exxon/Mobil):
    $1,000 (1950) → $1,260,000 (2003)

**The Future for Investors,* Jeremy Siegel

Dividends

- Dividend-paying stocks beat non-dividend-paying stocks over long periods
- Cash dividends for income or reinvest for growth (DRIP plans)
- Dividends cannot be faked!
- Low risk & Lower taxes – 15%
- **Avoid the Highest Dividend Stocks**

Frictional Costs

Effect of Taxes

- Say you find an $1 investment that doubles every year. Two options:
  - A: Sell the investment at the end of the year; pay taxes; and reinvest the net proceeds; do the same thing for 20 years
  - B: Hold the investment for 20 years and then pay taxes.
- A: $25,200 after-tax profit
- B: $692,000 after-tax profit

Assume 34% tax bracket

Effect of Taxes

- Most recent report by Lipper
  - Mutual fund shareholders paid $24 billion in taxes in 2006
  - Those who sold their shares paid even higher taxes
  - Over past 20 years, shareholders in a taxable account gave up 17-44% of their returns to taxes

Effect of Fees

- Financial industry has all sorts of fees
  - Management fees
  - Advisor fees
  - Transaction costs or commissions
  - Marketing fees
  - Account maintenance fees
  - Sales load
- Investors loose up to 20% of their returns every year to fees

Market Timing

"We've long felt that the only value of stock forecasters is to make fortune tellers look good." – Warren Buffett

- $1,000 in the S&P 500 in 1981 → $25,584 in 1998.
  - Missed 30 best days (<1% of trading days) → $4,549 or 82% less[1].
- $1,000 in January 1978, 20 years later→ $21,750
  - Missed the 15 best months → $6,010, or 72% less[2]

[1] With reinvested dividends. Source: Dow 100,000: Fact or Fiction.

[2]Source: Ibbotson Associates, Stocks, Bonds, Bills and Inflation, 1997 Yearbook.

Summary

- Different aspects of financial planning
- Different investment options
- Basic principles
- Frictional costs
- Time in the market not market timing!
- Trading frequently is hazardous to your wealth!

Future Seminars

October 11th 2007

20 Common Investing Mistakes

By Selena Maranjian, journalist for The Motley Fool

Agenda

- Not tracking your investment returns.
- Holding on too long.
- Paying too much in commissions.
- Letting emotions rule your investing.
- Having unrealistic expectations.

November 8th 2007

Trusts & Estate Planning

By Dan Caplinger, Attorney and journalist for The Motley Fool

Agenda

- Overview: Why Estate Planning Is Important (orderly transfer of assets, addresses family obligations, taxation)
- Common EP Documents (will, trust, power of attorney, living will)
- Description of estate process (probate for wills v. administration of trusts)
- Brief discussion of tax issues for rich estates

December 13th 2007

The Practical Approach to Investing

By Sham Gad – Managing Partner, Gad Partners Funds

Agenda

- Understand why a value oriented investment operation offers the most sensible and practical approach to managing money.
- The ideas and philosophies developed by Ben Graham in the 1930's and extended by Warren Buffett today.
- Six characteristics that define an intelligent investment approach.
- A simple value based investment case study.

January 10th 2008

Retirement Planning

By Rishi Sondhi

Agenda

- Different retirement plans: 401(k), 403(b), SEP, IRA, Roth IRA
- Investment options: stocks, mutual funds, ETFs
- Target and life-cycle funds
- Asset Allocation

Closing Comments

- Presentation will be available on my blog http://rishi-sondhi.blogspot.com/
- List of books, articles, electronic sources available at the library
- Feedback forms
- Questions