Financial Independence
Session 2 – Charting your course!

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White Lighthouse
Investment Management

Financial Independence Part II: Charting your course!

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Agenda

1. Introduction
2. Questions to Consider
3. Money Management
4. Investing Fundamentals
5. Understanding Risk
6. Group Work – Presentations
7. Saving and Investing
8. Conclusion

Part 1 – Introduction & Review – Welcome back

"People who like this sort of thing will find this the sort of thing they like."

- Abraham Lincoln

Previous Session

1. How much $ do I need to retire?
2. Factors:
   - Inflation
   - Taxes
   - Life Expectancy
   - Investment Return
   - Income Needs
3. We now have a “number”, probably 7 figures…How do we get there?

Charting Your Course

- A combination of saving and investing
- A balance between today and tomorrow
- Long-term perspective is needed
- Many sources
  - Government Pension
  - Company Pension
  - Private Pension
  - Private Savings
- Today we will focus on those areas where you have the most control – saving and investing privately

Discussion Question

How important is money?

Some Famous Money Quotations…

“Money can’t buy happiness, but neither can poverty” – Leo Rosten

“There is no amount of money in the world that will make you comfortable if you are not comfortable with yourself.” – Stuart Wilde

“While money can’t buy happiness, it certainly lets you choose your own form of misery.” – Groucho Marks

“Whoever said money can’t buy happiness simply didn’t know where to go shopping.” – Bo Derek

“I’d rather be rich and healthy than poor and sick.” – My Dad

“This contempt for money is just another trick of the rich to keep the poor without.” – Michael Corleone

“Money can’t buy you happiness, but it’ll let you park your yacht next to it.” – David Gilmour, Pink Floyd

“The real measure of your wealth is how much you’d be worth if you lost all of your money.” – Author Unknown

“Money is better than poverty, if only for financial reasons.” – Woody Allen

Quotations continued

- The old saying "money can't buy happiness" has been proven wrong by researchers at The University of Nottingham. A study into lottery jackpot winners – those who have won more than £1 million – found that a resounding 97% of interviewees were just as happy, if not happier, following their big win…
- "This planet [Earth] has – or rather had – a problem, which was this: Most of the people living on it were unhappy for pretty much of the time. Many solutions were suggested for this problem, but most of these were largely concerned with the movements of small green pieces of paper, which is odd because on the whole it wasn't the small green pieces of paper that were unhappy." – Douglas Adams
- "It's the kind of spiritual snobbery that makes people think they can be happy without money." – Albert Camus
- "When it is a question of money, everybody is of the same religion." - Voltaire

A Word or Two About Money

- Money should not be the focus of retirement or life planning…but it is the focus of this session…
- Financial freedom does make some choices easier…But freedom of choice is not easy.

Part 2 – Questions to Consider

"The chief value of money lies in the fact that one lives in a world in which it is overestimated."

- H.L. Mencken

Money or Time?

- Are you more likely to die (physically or otherwise) in retirement from boredom or lack of financial means?
- Is it more important to you to know what you want to do with your time or how you will finance it?

VS

Buzz Group Questions

1. How will you spend your time in retirement? (Don't forget to have something to do when you are financially independent.)
2. Where do you get your investment advice?
3. How do you decide when to buy or sell an investment?
4. How much are you saving each month towards retirement? % of income?
5. What is your biggest fear about investing?

Part 3 – Money Management

“The key to making money in stocks is not to get scared out of them.”

- Peter Lynch

3 Ways to Manage Money

- Who read the article?
- Before we get into Money Management…A review of some common mistakes and essentials about money…

25 Biggest Money Mistakes (not in order)

- Procrastinating about financial decisions.
- Having goals that are too general, undefined, or unrealistic.
- Not having a plan or having one that won't work.
- Ignoring the effect of taxes in your plan.
- Going uninsured against death, disability, and liability.
- Ignoring cost of living inflation in your plans.
- Being overweighted in the current fad (tech stocks).
- Making decisions based on emotion (fear and greed).
- Wanting to do it yourself to save money (sometimes).

25 Biggest Money Mistakes (not in order)

- Being too conservative or too aggressive.
- Not understanding the concept of asset allocation.
- Concentration rather than diversification.
- Placing bets on hot companies (stock tips & speculating vs investing).
- Being overly influenced by others (friends & family).
- Placing market timing bets (speculating vs investing).
- Failure to take profits or cut losses.
- Idle assets (having too much in cash).

25 Biggest Money Mistakes (not in order)

- Assuming things will just work themselves out.
- Demanding immediate results and satisfaction.
- Wanting everything guaranteed.
- Lack of spending/savings/investment discipline.
- Thinking that any person, firm, or magazine knows where any market, or security, is going, and when.
- Not understanding the many problems with money.
- Over-reliance on expected inheritances, promotions, business ventures, marriages, winning the lottery, etc.
- Wanting something for nothing.

25 Biggest Money Essentials (not in order)

- Educate yourself about investments.
- Educate yourself about taxes.
- Educate yourself about inflation.
- Establish realistic short and long-term goals.
- Spend within your means.
- Use insurance appropriately.
- Involve your spouse and family.
- Don’t procrastinate over financial decisions.
- Develop a plan and commit to the process.

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25 Biggest Money Essentials (not in order)

- Avoid the current fads (e.g. dot com stocks, hedge funds).
- Deversify (no more than 5% in one stock).
- Do not have more than 80% in stocks.
- Don’t try to “time” any financial market.
- Determine and invest according to your risk tolerance.
- Save/Invest systematically – pay yourself first.
- Have enough cash reserves to handle emergencies.
- Make decisions logically, not emotionally.
- Realize that you will have to pay for expert advice.
- Plan for bad news on inflation and taxes.

25 Biggest Money Essentials (not in order)

- Make your own decisions and don't be overly influenced by others (colleagues, friends and family).
- Take profit and cut losses (buy low, sell high).
- Don't have too much in idle assets (cash, money market, CDs, etc).
- Take action – don't assume things will always work out and go your way if you just wait and do nothing.
- Understand the difference between market timing, security selection, and asset allocation.
- Realize that no person, TV show, or firm, knows where any stock, or market, is going, when, or by how much.

Survey Questions

- How many of you feel that you are better than average investors?
- Do you know your long-term average rate of return on investments? And if that is "good"?

3 Ways to Manage Money

- Security Selection
- Market Timing
- Asset Allocation

Advantages of Security Selection

- If you were right, a lot more than you were wrong, then you can make a lot of money quickly. Some stocks have gone up many times in less than a year (e.g., Amazon, Google).
- If your bet pays off, you can brag to everyone about what a genius you are.
- It's fun and exciting to watch your bets on a daily basis.

Problems with Individual Security Selection

- It’s too hard, risky, and depends mostly on guesswork.
- With over 50,000 mutual/investment funds, and 20,000 stocks globally, where do you start?
- There isn’t enough time to do an adequate analysis.
- There are too many qualified people out bargain hunting already. The more people looking, the less bargains.
- There is too little information available and it is quickly outdated. Only the “insiders” have the information that matters, and they can’t tell anyone because of the insider trading laws.
- If you get lucky, you can become overconfident, and then lose big the next time around.

Advantages of Market Timing

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Problems with Market Timing

- It's even more difficult and risky than security selection.
- Nobody can predict the future with any degree of consistency.
- Need to be correct more than 75% of the time to break even with mistakes, transaction costs, commissions, and taxes.[1]
- Only one in four "timers" beat the market two years in a row, and only one in eight, three years in a row.[2]
- Results of empirical studies also show that only one in 37 mutual funds showed any benefit from market timing.[3]

1: The New Finance, Robert A. Haugen, page 13

2: Managing Investment Portfolios, Donald L. Tuttle, Chapter 13, page 36

3: Modern Portfolio Theory and Investment Analysis, Edwin J Elton and Martin Gruber, page 36

Advantages of Asset Allocation

- It's investing and not speculating. The goal is consistent long-term good performance that's worth the risks, rather than spectacular (or disastrous) short-term results.
- It's a proven long-term diversification strategy that balances risks and returns.
- It takes guesswork and emotions out of investment portfolio management.
- It focuses on the portfolio as a whole, instead of on picking and timing each part separately.
- It's the best way to create a portfolio that will help stay in line with your unique investment objectives.
- It's easy to implement, monitor, and rebalance.

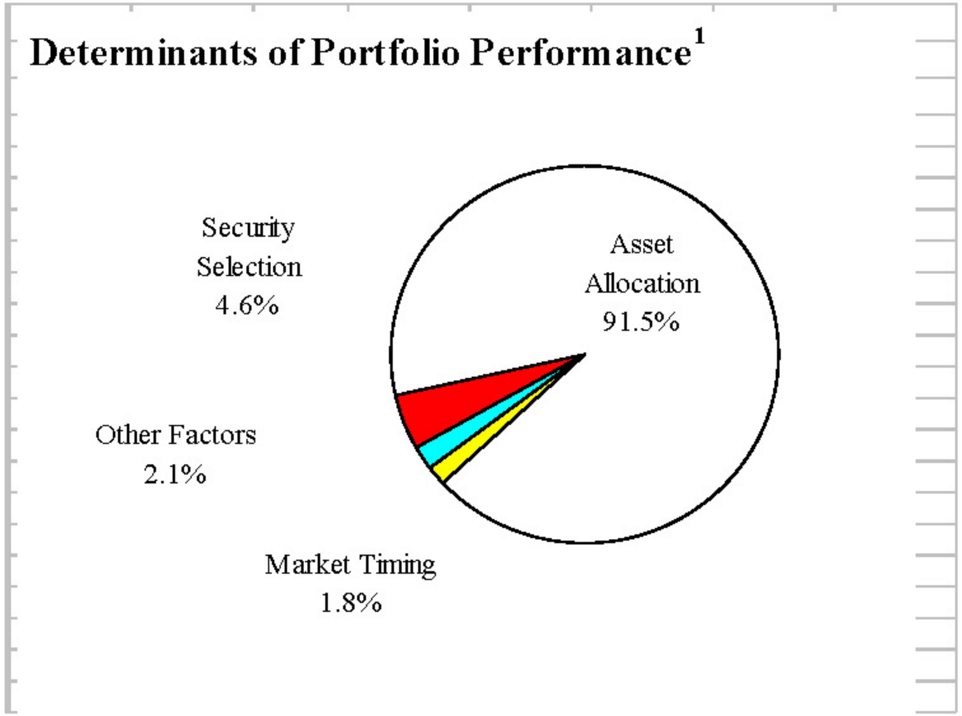
Problems with Asset Allocation

- It's very boring compared to security selection and market timing. Most of the emotional roller coaster is gone.
- By spreading your money around, your exposure to the highest performing asset classes is diluted. You're not going to hit the jackpot, but you're not going to lose everything either.
- Periodic rebalancing is needed. You should also rebalance when there is a change in your life situation.
- You have to decide which asset classes to use, and how much. You may have some asset classes you don't like.
- Inexperienced investors don't understand or like bonds.

Asset Allocation

Spreading the money in your portfolio between different types, or classes of investments

Asset Allocation accounts for between 75-91% of long-term portfolio performance.



1) Gary Binson, Brian Singer and Gilbert Beebower, "Determinants of Portfolio Performance II: An Update", *Financial Analysts Journal,* May/June 1991.

What is Asset Allocation - Review

Part A Basic Asset Class Allocator

Instructions – Fill in the 4 input cells (with yellow background) below under the column Choices.

Your 5 Asset Class Allocation

Input Selection	Choices	Labels	Asset Class	Percentage
Risk Category	Conservative	Take Survey Below	Cash and Cash Equivalent	10.0%
Portfolio Income Need	0%	Percent	Income (Government & Corporate Bonds)	32.5%
Investable Assets	200,000	US Dollars	Large Cap – Growth Stocks	25.0%
Income	100,000	US Dollars	International & Emerging Market Stocks	12.5%
Age	40	Years	Aggressive Growth Stocks: eg Small Cap, Sectors, Tangibles	20.0%
			Total	100%

Note: This guideline is for educational purposes only and can be used as a basis of discussion with your own advisor(s).

You should make investment decisions only with the assistance of your own personal financial advisor(s); this information here should not be seen as personal advice.

Part 4 – Investing Fundamentals

"Our favorite holding period is forever."

- Warren Buffet

"In this business, if you're good, you're right six times out of ten. You're never going to be right nine times out of ten."

- Peter Lynch

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Investment Planning - Process

- Focuses on your long-term goals.
- Identify your risk-return profile.
- Decide on a plan: Security Selection (stock pricing), Market Timing, and/or Asset Allocation.
- Incorporate assets not directly under your control (e.g. company pensions).
- Implement, Monitor, and Revise Plan as needed.

Investments

Is anyone in the class willing to share their best or worst investment experience?

Basic Investment Vehicles

- Stocks
- Bonds
- Cash Deposits
- Derivatives
- Investment Funds are centralized pools of money that have a number of investors, either individuals or other companies. These funds rely on the pooling of resources to invest in higher value investments than the individuals involved in the fund would normally be able to invest in.
- Investment Fund Advantages:
  - Diversification for smaller investment amounts.
  - Can be cost/fee efficient.
  - Leave "professional" management to the professional or use Index funds for relative safety.
  - Easier to manage a portfolio of funds than a portfolio of stocks and bonds.

Choosing an Investment Fund – Suggested Criteria

- Performance against it’s piers or benchmark over 1, 3, 5 years
- Management Tenure
- Fee Structure inside the fund
- Fee Structure to buy or sell the fund
- Minimum investment requirements
- Does the fund invest in the same types of investments it is classified as? (e.g. A small-cap fund holding Google, not good)
- Actual performance
- Tax appropriateness

Investing Fundamentals

- Diversification…A story.
- Keep expenses and fees low.
- Get professional advice when you need it.
- Time value of money.
- Be careful, cautious, skeptical: If something sounds too good to be true, it most likely is.
- Don’t be greedy.
- Be patient.
- Often the best learning experiences in investing are when you lose money.

Part 5 – Understanding Risk

"Risk – If one has to jump a stream and knows how wide it is, he will not jump. If he doesn't know how wide it is, he'll jump and six times out of ten he'll make it."

- Persian…author unknown

Personal Definition of Risk

Who will share your definition of risk with the class?

Part B Personal Definition of Risk

Instructions – Write your own definition of risk. E.g. Risk means losing more than 20% of my investment portfolio value in one year.

Quotes on Risk

"If you don't risk anything you risk even more." – Erica Jong

"What you risk reveals what you value." – Jeanette Winterson

"Be wary of the man who urges an action in which he himself incurs no risk." – Joaquin Setanti

"Take calculated risks. That is quite different from being rash." – George S. Patton

"The policy of being too cautious is the greatest risk of all." – Jawaharlal Nehru

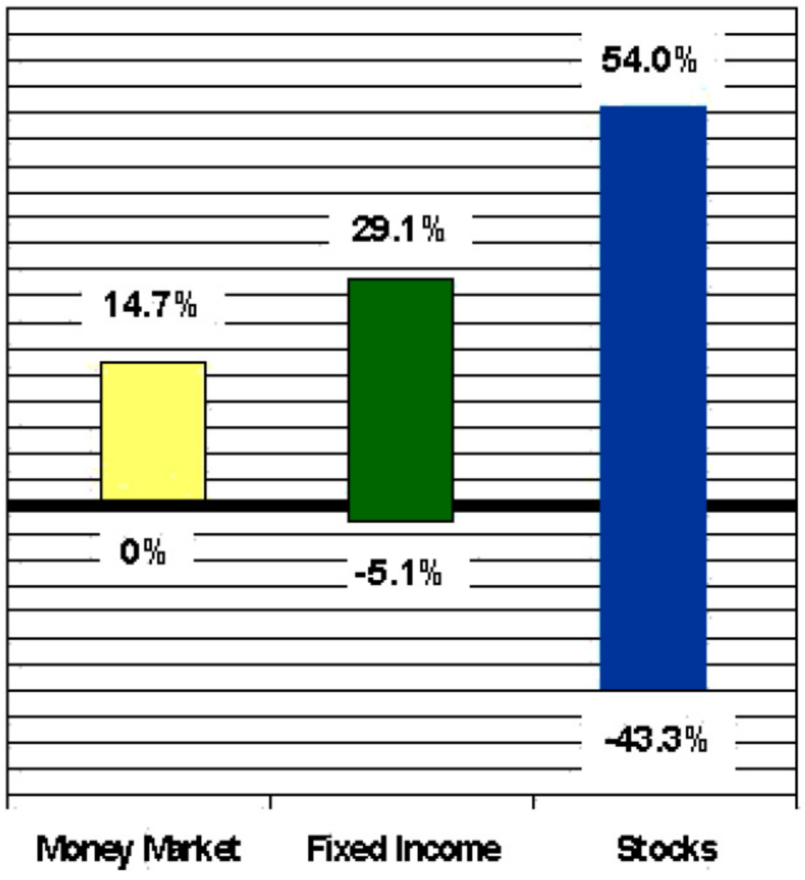
"There are risks and costs to a program of action. But they are far less than the long-range risks and costs of comfortable inaction." – John F. Kennedy

"A lot of people approach risk as if it's the enemy when it's really fortune's accomplice." - Sting

Risk

- Defined in terms of Standard Deviation
- Riskier assets will deviate more over time

Range of 1 Year Returns Since 1926

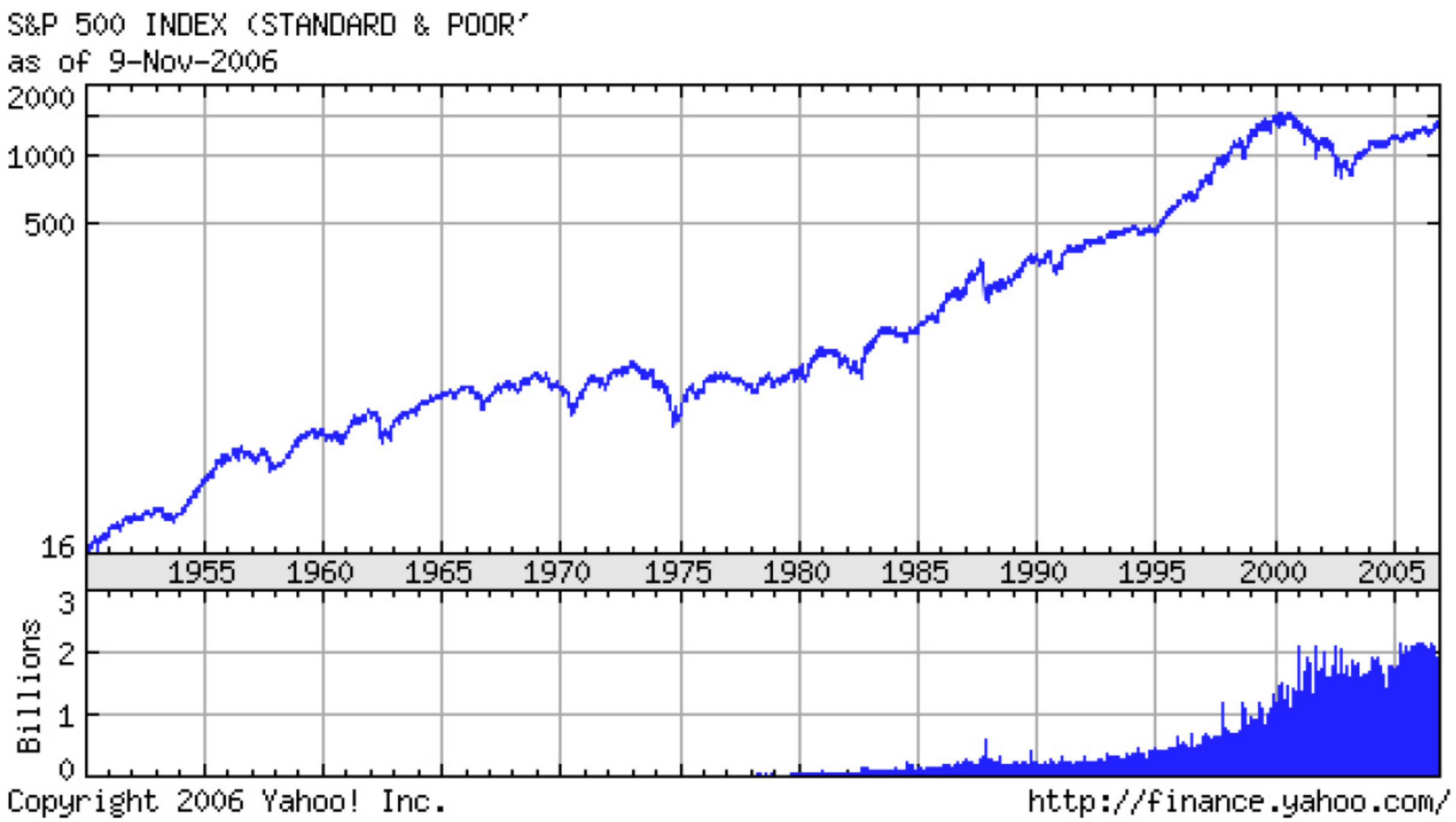


Risk vs Expected Return

S&P 500 Index

The S&P 500 Index comprises 500 companies that account for 85% of the dollar value of all NYSE stocks. It is a broader and more representative average than the DOW but both move in tandem most of the time. The S&P 500 Index does not include dividends. It is capitalization weighted, meaning that stocks with the highest value (number of shares outstanding multiplied by the price per share) have the greatest affect on the index.

S&P 500 – 55+ Years



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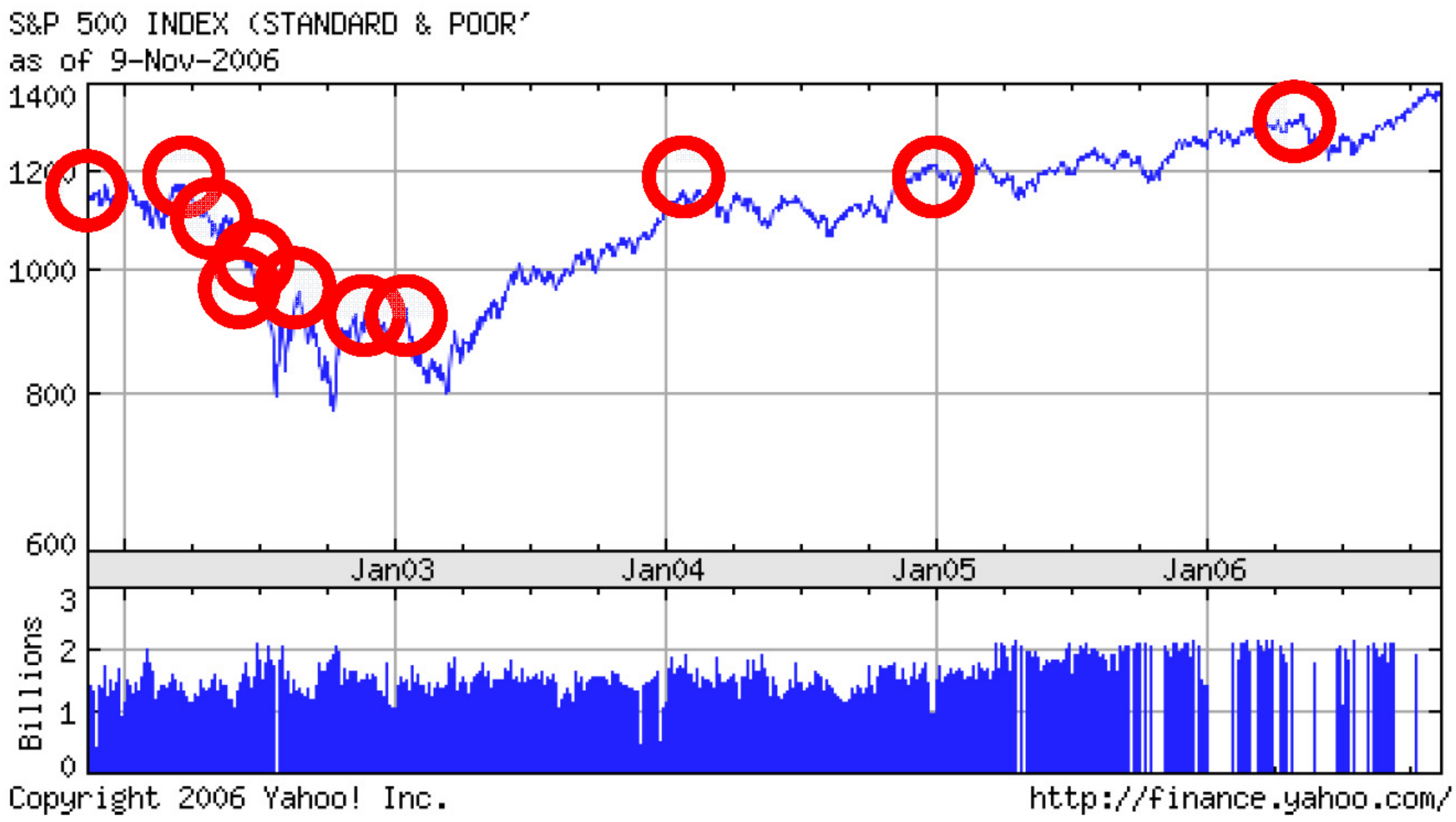
S&P 500 – Last 5 Years



Part 6 – Group Work – Building a Basic Investment Portfolio

"Individual commitment to a group effort – that is what makes a team work, a company work, a society work, a civilization work."

- Vince Lombardi

"There is no such thing as a self-made individual. You will reach your goals only with the help of others."

- George Shinn

5 Groups

1. Cash
2. Bonds
3. Large Cap Growth Stocks
4. International Equity / Emerging Markets or Country Specific
5. Aggressive Growth: Sector Funds, Tangibles, etc.

Group Instructions

Each group has to work as a team to choose an investment from one of the classes and explain to the class the rational for their choice.

1. Cash
2. Bonds
3. Growth Stocks
4. International Equity / Emerging Markets or Country Specific
5. Aggressive Growth: Sector Funds, Tangibles, Etc.

Several website are available from your browser, here are a few:

morningstar.com

screen.morningstar.com/FundSelector.html?fsection=ToolScreener

swissquote.ch/index/index_funces_e.html

Each group has to choose 2 investments to build our portfolio and tell the class why they chose the investment and why the class should invest in it.

Asset Allocation – Group's Choices

Part A Basic Asset Class Allocator

Instructions – Fill in the 4 input cells (with yellow background) below under the column Choices.

Your 5 Asset Class Allocation

Input Selection	Choices	Labels	Asset Class	Percentage
Risk Category	Conservative	Take Survey Below	Cash and Cash Equivalent	10.0%
Portfolio Income Need	0%	Percent	Income (Government & Corporate Bonds)	32.5%
Investable Assets	200,000	US Dollars	Large Cap – Growth Stocks	25.0%
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Age	40	Years	Aggressive Growth Stocks: eg Small Cap, Sectors, Tangibles	20.0%
			Total	100%

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Part 7 – Saving and Investing

"The right to private property meant at the same time the right and duty to be personally concerned about your own well-being, to be personally concerned about your family's income, to be personally concerned about your future. This is hard work."

- Mikhail Khodorkovsky

Solving for Some Numbers

- How much money do I need to save each month/year to meet my retirement goals?
- If I have a lump sum of X, how much can I afford to spend each year until I run out of money.
- Back to Retirement Calculator – Part 2
  Savings
  Investment

How much money do I need to save each year…?

White Lighthouse Retirement Calculator	Inputs
Annual Income Goal (Today) – After Tax	$100,000
Percent of Income Covered by Govt + Company Pension	10.0%
Years Until Retirement	10
Number of Years Required after Retirement	25
Inflation	3.00%
Portfolio Yield – Before Taxes	7.00%
Portfolio Yield – After Taxes – Before Retirement	5.60%
Portfolio Yield – After Taxes – In Retirement	4.90%
Average Tax Rate on Investment Earnings – Before Retirement	20%
Average Tax Rate on Investment Earnings – In Retirement	30%
When you Retire, your annual income needs (from your portfolio) will be	%120,952
In 10 years we need a lump sum of (PV of Growing Annuity Stream)	$2,334,996
Current Savings	$1,000,000
Amount Needed to Save each year to Reach Goal	$47,202

Year	2007
Retirement Year	2017
Year Portfolio Runs Out	53

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If I save X each year how much will it be worth when I retire?...

White Lighthouse – Future Value – Inflated Savings	Inputs
Annual Savings Amount – Year 1	$33,757
Current Savings / Investment Balance	$250,000
Years Until Retirement	20
Portfolio Yield – Before Taxes	7.00%
Inflation (applies to annual savings amount)	3.00%
Portfolio Yield – After Taxes – Before Retirement	5.60%
Average Tax Rate on Investment Earnings	20%
Future Value of Current Savings	$743,393
Future Value of Annual Savings	$1,189,76
Future Value of Total Savings	$1,,933,069
Annual Savings could be substituted with a deposit today of:	$400,083

Will my savings be enough?

White Lighthouse Retirement Calculator – Lump Sum	Inputs
Current Savings	$250,000
Annual Income Goal (Today) – After Tax	$84,000
Government and Company Pension	$70,000
Years Until Retirement	0
Number of Years Required After Retirement	25
Inflation	3.00%
Portfolio Yield – Before Taxes	5.60%
Portfolio Yield – After Taxes – Before Retirement	5.60%
Portfolio Yield – After Taxes – In Retirement	20%
Average Tax Rate on Investment Earnings – Before Retirement	20%
Average Tax Rate on Investment Earnings – In Retirement	20%
When You Retire, Your Annual Income Needs (From Your Portfolio) Will Be	$14,000
In 0 Years, We Need a Lump Sum of (PV of Growing Annuity Stream)	$249,735
Positive # = Savings May Be Enough / Negative #, Savings Not Enough	$265

Year	2007
Retirement Year	2007
Year Portfolio Runs Out	2032

A Word (Or Two) About Precision

- No one knows what the future holds.
- You or your spouse may pass away, end up in a nursing home, or strike it rich in a business venture, win the lottery, or get an unexpected inheritance.
- Nobody knows what your expenses will be.
- Inflation and taxes won’t be constant.
- Risk and rates of return won’t be constant.
- Numbers in the reports are just extrapolations, not predictions.
- Government benefits may be reduced.
- Company may get sold or go bankrupt and reduce or not honour pension commitments.
- The goal is to spot trends and balance risk.

Investment Portfolio

- Learn more about asset allocation.
- Work with a trusted professional(s) if you can.
- The 5 asset class model that we built together is a starting point.
- Don't expect long-term average annual returns, after taxes and fees, to be too high. 7% is a reasonably good year when inflation is low.

Part 8 – Conclusion

"I believe the true road to preeminent success in any line is to make yourself master in that line. I have no faith in the policy of scattering one's resources, and in my experience I have rarely if ever met a man who achieved preeminence in money making…certainly never one in manufacturing…who was interested in many concerns."

- Andrew Carnegie

Charting Your Course

- A combination of saving and investing.
  "In the old days a man who saved money was a miser; nowadays he's a wonder." – Author Unknown
- A balance between today and tomorrow.
- Take all advice with perspective and skepticism – especially from someone who has something to sell (T.V. Advisors, Myself, etc)
  "The economy depends about as much on economists as the weather does on weather forecasters." – Jean Paul Kauffmann
- Long-term perspective is needed.
- Many sources – use them all
  - Government Pension
  - Company Pension
  - Private Pension
  - Private Savings

Concluding Thoughts

- Time and education are your best assets
- Are you saving enough?
- Save early and often – Time Value of Money is a Miracle
  Einstein misquotes: A lot of stuff like, “Compound interest is the greatest mathematical discovery of all time”, “The most powerful force in the Universe is compound interest”
- Are your expectations realistic?
- Remember risk vs reward – There is no such thing as a free lunch
- Keep fees and expenses low
- Find professional help when you need it
- Understand the difference between gambling and investing
- Don’t expect government, company, family or children to take care of you: You are in the driver’s seat.
- Financial independence sessions should be a starting point…and present more questions than answers…
- Don’t look at your portfolio often & things change. Be prepared!

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