Certified Retirement Counselor® (CRC®)

Fundamentals of Investments





International Foundation for Retirement Education

Raising the **RETIREMENT READINESS OF AMERICAN WORKERS** through retirement-specific, accredited certification and training for professionals



Course Topics

- Introduction to Investments
- Risk and Return
- Stocks
- Bonds
- Cash and Cash Equivalents
- Mutual Funds
- Annuities, GICs, Stable Value Funds, Real Estate and Other Investments
- Portfolio Management





Introduction to Investments



Importance of Investment Education

- Americans get failing grades in retirement literacy
- Short comings more acute for:
 - Women
 - Less educated
 - Older individuals



Fiduciary responsibility





Why Understand Investments

- Knowledge vs. Understanding
- Help integrate investments made through work and personally
- Employee control
- Portability of company retirement plans
- How retirement plans work
- Employees preparing for retirement



Investment Concepts

- Savings = short-term goals
- Investments = long-term goals
 - Expected return over a longer term
 - Income
 - Capital growth
- Low risk = low reward





Investor Expectations

- Longer time horizons usually mean potential for higher return
 - Personal risk tolerance
 - Experience
 - Knowledge
 - Personal resources
 - Liquidity





Types of Investments

- Securities/intangibles
 - Stocks, bonds, mutual funds
 - Property/tangibles
 - Actual physical items, e.g. land, buildings, art
- 3 main asset classes
 - Equity
 - Debt
 - Cash



Asset class returns A 15-year snapshot Ranked annual total returns of key indices

BLACKROCK°

	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
← Best	Fixed Income	Sm Cap	Int'i	Int'l	Int'l	Lg Cap Growth	Fixed Income	Lg Cap Growth	Sm Cap	Fixed Income	Lg Cap Value	Sm Cap 38.8%	Lg Cap Core	Lg Cap Growth	Sm Cap
	10.3%	47.3%	20.3%	13.5%	26.3%	11.8%	5.2%	37.2%	26.9%	7.8%	17.5%		13.7%	5.7%	21.3%
	Cash	Int'i	Sm Cap	Lg Cap Value	Lg Cap Value	Int'i	Cash	Int'i	Lg Cap Growth	Lg Cap Growth	Int'i	Lg Cap Growth	Lg Cap Value	Lg Cap Core	Lg Cap Value
	1.8%	38.6%	18.3%	7.1%	22.3%	11. 2 %	2.1%	31.8	16.7%	2.6%	17.3%	33.5%	13.5 %	1.4%	17.3%
	Div Portfolio	Lg Cap Value	Lg Cap Value	Div Portfolio	Sm Cap	Fixed Income	Div Portfolio	Sm Cap	Lg Cap Value	Lg Cap Core	Sm Cap	Lg Cap Value	Lg Cap Growth	Fixed Income	Lg Cap Core
	-9.8%	30.0%	16.5%	5.4%	18.4%	7.0%	-22.8%	27.2%	15.5%	2.1%	16.4%	32.5%	13.1%	0.6%	12.0%
	Lg Cap Value	Lg Cap Growth	Lg Cap Core	Lg Cap Growth	Lg Cap Core	Div Portfolio	Sm Cap	Lg Cap Core	Lg Cap Core	Div Portfolio	Lg Cap Core	Lg Cap Core	Div portfolio	Div portfolio	Div portfolio
	-15.5%	29.8%	10.9%	5.3%	15.8%	6.0%	-33.8%	29.5%	15.1%	1.8%	16.0%	32.4%	8.1%	0.1%	8.7%
	Int'i	Lg Cap Core	Div Portfolio	Lg Cap Core	Div Portfolio	Lg Cap Core	Lg Cap Value	Div Portfolio	Div Portfolio	Lg Cap Value	Lg Cap Growth	Int'i	Fixed Income	Cash	Lg Cap Growth
	-15.9%	28.7%	10.5%	4.9%	13.0%	5.5%	-36.9%	20.8%	13.0%	0.4%	15.3%	22.8%	6.0%	0.0%	7.1%
	Sm Cap	Div Portfolio	Lg Cap Growth	Sm Cap	Lg Cap Growth	Cash	Lg Cap Core	Lg Cap Value	Int'i	Cash	Div Portfolio	Div Portfolio	Sm Cap	Int'i	Fixed Income
	-20.5%	23.5%	6.3%	4.6%	9.1%	5.0%	-37.0%	19.7%	7.8%	0.1%	12.2%	20.3%	4.9%	-0.8%	2.7%
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	Lg Cap Growrh	Cash	Cash	Fixed Income	Fixed Income	Sm Cap	Int'i	Cash	Cash	Int'i	Cash	Fixed Income	Int'i	Sm Cap	Cash
	-27.9%	1.2%	1.3%	2.4%	4.3%	-1.6%	-43.4%	0.2%	0.1%	-12.1%	0.1%	-2.0%	-4.9%	-4.4%	0.3%





Goal:

To increase your wealth utilizing an appropriate risk and return approach with a diversified portfolio.



Instructions

- After each topic we will answer one question.
- Draw one "Life" card- per table
- Add/subtract amount from column A
- If you answer the question correctly you may choose to draw a "Risk" card
- Add/subtract amount from column B
- Add total amount of A & B to column C
- Add/subtract amount from column D





- Which of the following is/are the main type(s) of investment(s)?
 - a. securities
 - b. intangibles
 - c. property and securities
 - d. tangibles and property





Risk and Return



Risk and Return in Investments

- Risk has a direct relationship to reward
 - Uncertainty that realized return does not equal expected returns
 - No guarantees that outcomes (rewards) will occur as expected



Many meanings of "risk"



Risk Averse Investor

Risk-averse investors prefer guarantees

Guarantees usually pay low returns

- Little to no chance of losing principal invested
- Little or no chance of receiving high returns



Types of Returns

Interest: simple or compound

- Only cash equivalents and bonds pay interest
- *Dividends:* earnings of the corporation
 - Only stocks pay dividends
 - Capital gain/loss: change from original purchase price of asset
 - Only bonds and stocks generate capital gain/loss
- Total return: sum of income, dividends, capital gains/losses



Rates of Return Over Time

- Historical returns help set and manage investor expectations
 - Not a prediction of future performance
- Retirement investors focus on long-term rates of return
- Order of highest return: stocks, bonds, cash



Variables in Retirement Planning

- Time value of money calculations can manage expectations and risk
 - Relationship of time and money
- Risk is the uncertainty that an actual return will be different from the expected return



- Risk-return tradeoff
 - More potential return, requires taking more risk



Risks Investors Face

- Business
- Financial
- Liquidity
- Market
- Purchasing power/inflation
- Interest rate
- Reinvestment rate

Tax





There are no risk-free investments

All investments carry some risk

"No free lunch!"





Forecasting Risk

- Linear projection
 - Simple calculation and easy to understand
- Scenario
 - Changing several variables to see combined effect
- Monte Carlo simulation
 - Stochastic measure that models uncertainty
 - Many possible changes; many possible outcomes
 - Does not assume certainty
 - Demonstrates the likelihood of various outcomes
- ALL methods require good assumptions





2. Which one of the following statements is true regarding risk?

- a. Risk and return have an inverse relationship.
- b. Risk decreases overtime.
- c. Guaranteed and insured investments are protected against all forms of risk.
- d. Risk is the uncertainty around an investment's expected return.





Stocks



Owning Stock

Ownership of a company

Stockholder rights

- Voting on company matters
- "On the hook"
- Participate in the financial life of the company
- No maturity date as with bonds





A Stock for Every Investor

Many ways to categorize stock

- Blue chips
- Income
- Growth
- Value
- Speculative
- Cyclical/defensive
- Preferred





A Stock for Every Investor

More frequently used methods

- Market capitalization (market price x number of shares)
 - Large \$10 billion +
 - Mid \$1.5 billion to \$10 billion
 - Small \$1.5 billion or less
 - Usually initial public offerings (IPOs)

P/E Ratio



International Stocks

Global market

- Exchange rate risk
- American Depositary Receipts (ADR)
- Provide diversification





Index to Performance

- Use appropriate index to measure performance
- Dow Jones Industrial Average (DJIA)
- S&P 500
- Nasdaq
- Russell 2000
- Wilshire 5000





How are Stocks Valued?

Par value refers to face value as listed on certificate

Book value is an accounting term based on the company's net worth

Market value is what someone is willing to pay for the stock



Making Money with Stocks

- Buy-and-hold is a long-term strategy ideally suited for retirement
 - Challenge: Know when to buy/sell
- Short-term trading
 - Market timers
 - Consider transaction costs and taxes
 - Ideal for long-term retirement investment
 - Demonstrated by longer holding periods





- 3. Which one of the following asset classes has historically outperformed inflation, even after taxes.
 - a. Cash
 - b. Bonds
 - c. Stocks
 - d. Convertible securities





Bonds



Fixed Income Securities

Like an IOU

- Fixed payment at regular intervals
- Legal obligation of issuer
- Can generate capital gains/loss
- Bonds generally considered less risky than stock; more risk than cash



Ins and Outs of Bonds

Par/face value

- Fluctuating value depending upon current interest rates
 - Premium
 - Discount
 - Coupon or interest usually paid every 6 months
 - Interest is a fixed dollar amount regardless of market value of bond



Bond Prices and Interest Rates

- Inverse relationship between bond prices and interest rates
 - -can be sold at a discount or premium
 - Keeps bond prices competitive
 - Coupon always stays the same
 - Market value changes
 - Creation of capital gain/loss


Ins and Outs of Bonds

- Bond "matures" and principal paid back to the lender
- Bonds with longer maturities possess higher interest rates
- Call feature protects the issuer of a bond
 Good news/bad news



Bond Quality





Bond Issuers

Federal government

- Treasury and government agencies
- Corporations
- State/local governments
 - "Munis"
 - Free from federal income tax
 - Tax consequences



Bond Returns and Risks

Interest rate risk

- Purchasing power risk
 - Double whammy: inflation and taxes
 - Risk reduction vs. Protecting buying power
- Reinvestment rate risk
 - TIPS
 - Bond mutual funds



Bonds in Retirement Accounts

- Bonds serve as a shock absorber in a portfolio
- Less price volatility than stocks
- Source of regular income payments
- Current income vs. Portfolio growth
 - Intermediate-term bonds trade off a bit of return for significant drop in risk





4. Which of the following is a type of risk for a bond?

- a. Interest rate risk
- b. Purchasing power risk
- c. Reinvestment rate risk
- d. All of the above





Cash and Cash Equivalents





- Short-term investment or temporary parking place
 - Stable / Safe
- High liquidity
 - High liquidity + low risk = low return
- Purchasing power risk over the long term



Cash Instruments

- Certificate of deposit
- U.S. Treasury bills
- Banker's acceptance
- Commercial paper
- Money market mutual fund
 - Various types
 - Higher yields than other cash investments





Risks of Cash

- Business??
- Financial??
- Liquidity??
- Market??
- Purchasing power/inflatior
- Interest rate??
- Reinvestment rate??

Tax??





Remember!

- Savings short term goal
- Investments long term goal
- Liquidity little or no loss in value
- General Rule low risk/low reward



Game of Life

5. Which one of the following is a liquid asset?

- a. A limited partnership
- b. A checking account
- c. A technology stock
- d. A bond mutual fund





Mutual Funds



Overview of Mutual Funds

Personal investment portfolio

Collection of securities

Used in plan investment

- DB plans
- DC plans

Easy for participants to invest in



Characteristics of Mutual Funds

- Simplifies investment choices
- Diversification
- Professional money management
- Cost effective investment management
- Variety of investment objectives
- Low minimums to invest
- Pooled from numerous investors



Prospectus

Legal document

Disclose

- Objective and strategies
- Past performance
- Fees
- Risks
- Fund management





Funds: By Investment Objectives

By asset class

- Subcategories based on objectives and assets
- Objective
 - Income
 - Growth
 - Income and growth
 - Growth and income
 - Tax free
 - Dividend





Funds: By Styles

- Stock: market capitalization and valuation
- Bonds: credit quality and interest rate sensitivity
- Popular with investors
 - Style boxes



Morningstar Investing Style Box



Types of Mutual Funds

- Index
- Sector
- Socially responsible
- Balanced
- Asset allocation
 - International

- Fund of funds
- International
- Exchangetraded
- Emerging markets



Target Date Funds





Target Date Funds

- Multiple asset classes
 - U.S. stocks
 - international stocks
 - bonds
 - others
- Allocations become more conservative over

time

- Automatic rebalancing
- "To" or "through" glidepaths



Mutual Fund Services

- Automatic investment
- Automatic reinvestment
- Systematic withdrawal
- Exchange/conversion privileges



Mutual Fund Investment Returns

- Created by the underlying investments in the fund
 - Dividends
 - Capital gain/loss from buying/selling by fund manager
 - Created by shareholder
 - Capital gain/loss from buying or selling shares of the fund
 - Concept of "paper loss/gain"



Selecting a Mutual Fund

- Tenure of manager
- Fund costs
- Fund turnover
- Performance consistency
- Risk-adjusted performance





Game of Life

6. Index funds attempt to

- a. time the market.
- b. outperform the market.
- c. analyze the market.
- d. match the market.





GICs, Stable Value Funds, Annuities, Real Estate and Other Investments



Guaranteed Investment Contracts

- Investment contract between insurance company and retirement plan
- Portfolio of fixed income guaranteeing a rate of return
- Fits into "cash" asset class
 - Purchasing power risk over the long term



Stable Value Funds

Mixture of fixed income investments

Interest rates comparable to intermediateterm bond fund with principal protection like money market funds

Inflation risk over long term



Annuity

Insurance contract for protection of living longer than expected

- grows tax-deferred until withdrawal
 - payment made today in exchange for guaranteed payments in the future
- Types
 - Deferred
 - Income
- Components
 - Deferral phase
 - Annuity phase



Types of Deferred Annuity Contracts

Fixed (Fixed rate)

Fixed return for a certain time period

Fixed indexed (FIA)

Offer investors the potential of stock market returns while eliminating risk

Variable (VA)

–Allows the investor to choose investment funds and the performance of the annuity is based on underlying investments



Annuity Riders – Added for a Price

COLA

- Nursing home riders / long-term care riders
- Disability, unemployment & terminal illness riders
- "Living benefit" riders
 - Guaranteed minimum income
 - Guaranteed minimum accumulation
 - Guaranteed minimum withdrawal
 - Guaranteed minimum withdrawal for life



Types of Income Annuities

- Immediate income (SPIAs)
- Deferred income (DIA / advanced life / longevity insurance)
- Qualified Longevity Annuity Contract (QLAC)



Advanced Life Deferred Annuities

- Single-premium deferred income annuity, aka "longevity insurance"
- Provide fixed income starting at an advanced age, such as 85
 - Good idea to add an inflation rider for protection



Qualified Longevity Annuity Contracts (QLACs)

- Approved for use with Traditional IRAs, qualified plans
- Fund with up to 25% or \$125,000
 - Lessens RMDs
- Defer for 15 years or age 85
- Legacy benefits
- COLA may be available
- Low fee; no indexed or variables allowed



Annuity Payout Options

- Guaranteed lifetime income with period certain
- Straight annuity
- Period-certain annuity
- Joint and survivor







- How many payout options does your retirement system offer?
- What are the payout options?


Selecting an Annuity

- Fees: Sales charges, surrender charges, operating cost
- Weigh total costs against the guarantee of future income
- For variable annuities, examine investment performance and benchmarks
- Financial strength of insurance company





Income and appreciation

Limitations in retirement plans

- Real estate mutual funds
- Real estate investment trusts (REITs)



Personal Residence

- Personal question: Home as a retirement planning asset?
- May be a large portion of net worth
- Options to access value of home in a reverse mortgage





Reverse Mortgages Considerations

- There are fees and other costs
- The borrower owes more over time
- Interest rates may change over time
- Interest is not tax deductible each year
- The borrower has to pay other costs related to their home
- What happens to the borrower's spouse?



Reverse Mortgage Payment Options

- Single disbursement option
- Term
- Tenure
- Line of credit
- Combination of monthly payments and line of credit
- Borrowers may be able to change their payment option for a small fee



Other Investments

- Tangibles such as gold, art, jewelry
 - In a DC plan, usually through self-directed option
 - Via mutual funds that invest in natural resources, gold, mining
 - Commodities
- Options aka Derivatives
 - Intangibles because they derive value from underlying securities
 - Right to buy or sell at a specific price, time
 - Rarely used by retirement plan investors
 - Commodities





7. Listed below are types of deferred annuities except

- a. Fixed
- b. Fixed indexed
- c. Guaranteed minimum income
- d. Variable





Portfolio Management



Bringing It Together

- Portfolio management brings together the "pieces and parts"
- Utilizing risk, investments, diversification and allocation effectively
- Portfolio is the vehicle that helps investor achieve goals
 - Investment mix determines the speed at which goals are attained



Efficient Retirement Portfolio

Assets from all sources must be considered

- Critical to examine an asset in the context of all investments available for retirement income
 - Coordination of all retirement-related investments for one portfolio purpose



Retirement Income

"Legs" of the 4-legged stool

- Social Security
- Personal savings
- Work
- Employer-sponsored plans



Social Security

How much/little to count on when planning for retirement?

Treat it like a bond for diversification and allocation purposes

When to take





Strategy for efficient use of personally held investments

- Role of taxes
 - Ordinary income vs. Capital gain



Coordinate tax planning within retirement portfolio



Working in Retirement

Advantages

- Delaying retirement
- Some work during retirement



- Impact on retirement portfolio investments and planning
 - More aggressive investment choices
 - Use of additional wage income



Employer-Sponsored Plans

- Defined benefit payments considered as bonds in terms of investment portfolio
 - Impact of fixed-income payments over time
 - Inflation-adjusted?



Attention to tax planning issues during distribution



An Efficient Portfolio

- Portfolio that yields the greatest return for a given amount of risk
 - Seeks a reasonable balance of risk/return
 - Requires using multiple investments
- Challenge for retirees: How to invest portfolio to achieve retirement goals?



Asset Allocation Strategy

- As much as 90% of a portfolio's variation in return may be attributed to asset allocation alone
- Asset allocation considers factors such as:
 - Projected return
 - Projected cash flows
 - Correlations for each asset class
 - Estimates of risk



Efficient Portfolio-Diversification

- Diversification combines different asst classes
 - Usually lowers risk and increases return
 - Diversification across asset classes as well as within an asset class
- Diversification does not protect against all types of risk







Using Allocation Models

- Standard/suggested models based on traditional definitions aim to protect against one risk—loss of principal
- Define terms: aggressive, conservative, balanced
- What kind of model does a retiree need to consider?





Portfolio While Working

- Tend toward growth investments and try for higher returns
 - Rely on diversification, negative correlation
- Modifying exposure to equities while moving through work career toward retirement



Responsive to time horizon



Retirement Portfolio

What longevity factor should be used for retirement lifespan?

- Asset allocation during different phases retirement
 - Early retirement
 - Mid retirement
 - Late retirement



Spending and Investing Buckets





What's Best for the Individual?

- Age/Time horizon
- Investment experience
- Risk tolerance
 - Personal financial factors
 - Net worth
 - Job stability/income
- Investment suitability



Rebalancing the Portfolio

Strategy to maintain portfolio allocation

- Usually one or two times a year depending upon investment performance
- As objectives/life stage changes



Measuring Portfolio Performance

- Measuring progress toward goal
- Measure risk/reward relationship
- Utilize appropriate indices as benchmarks
 - Retirees should consider an inflation benchmark



Cash asset class returns A 15-year snapshot Ranked annual total returns of key indices

2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Div			Div			Div								
Portfolio			Portfolio			Portfolio								
-9.8%			5.4%			-22.8%								
					Div				Div			Div	Div	Div
					Portfolio				Portfolio			portfolio	portfolio	portfolio
					6.0%				1.8%			8 1%	0.1%	8 7%
		Div		Div			Div	Div Dertfelie						
		Portiolio		Portiolio			Portiolio	Portiono						
		10.5%		13.0%			20.8%	13.0%						
	Div									Div	Div			
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	-9.8%	30.0%	16.5%	5.4%	18.4%	7.0%	-22.8%	27.2%	15.5%	2.1%	16.4%	32.5%	13.1%	0.6%	12.0%
	Lg Cap Value	Lg Cap Growth	Lg Cap Core	Lg Cap Growth	Lg Cap Core	Div Portfolio	Sm Cap	Lg Cap Core	Lg Cap Core	Div Portfolio	Lg Cap Core	Lg Cap Core	Div portfolio	Div portfolio	Div portfolio
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	-27.9%	1.2%	1.3%	2.4%	4.3%	-1.6%	-43.4%	0.2%	0.1%	-12.1%	0.1%	-2.0%	-4.9%	-4.4%	0.3%





8. An efficient portfolio seeks to balance

- a. dividends and capital gains.
- b. growth and income.
- c. gains and losses.
- d. risk and return.





9. <u>lowers the overall</u> risk of a portfolio or increases its return by combining different asset classes and or industries.

- a. Correlation
- b. Efficient
- c. Diversification
- d. Asset Allocation



Game of Life- Where do you fall?

Superstar Investor	Savvy Investor
\$1,127,000	850,000
Room for	Keep working and
improvement	saving
\$600,000	\$300,000



Thank you!

