OREGON INVESTOR GUIDE

Strategies for Investing Wisely and Avoiding Financial Fraud

DFR Division of Financial Regulation

Department of Consumer and Business Services

Dear Oregon investor,

The Oregon Division of Financial Regulation (DFR) is excited to present the *Oregon Investor Guide: Strategies for Investing Wisely and Avoiding Financial Fraud*. This publication will be available as a free printed book and online on the division's community engagement and consumer education webpage (https://dfr.oregon.gov/help/outreach-education/Pages/index.aspx).

In addition to regulating the state's securities industry and enforcing securities law, the division is also tasked with helping to protect and educate Oregon investors. DFR strives to provide high-quality financial education resources to help consumers make informed decisions when using financial services and products. The division created this guide to take the mystery out of investing and provide a useful resource for new and experienced investors alike. The contents are accurate, unbiased, and simply stated to make investing concepts easy to understand, and to help you make the best investment decisions possible. Whether you invest on your own or entrust your investments with a professional, education is the best defense against fraud and making uninformed decisions.

Sections within the guide address:

- Fundamentals of investing
- Understanding types of investments
- Investing for retirement
- Avoiding scams and understanding high-risk investments
- How to choose an investment professional

The division's financial education program involves opportunities for everyone in Oregon, including in-person and virtual presentations, a variety of financial education publications, as well as a robust online platform.

DFR remains committed to its core mission of protecting Oregonians' access to fair products and services through education, regulation, and consumer assistance. We are excited to provide this guide as another resource for people as they look for safe ways to invest.

Sincerely,

Administrator, Oregon Division of Financial Regulation

Disclaimer: Any information offered in this guide is strictly for educational purposes and should not be construed as legal or financial decision-making advice or be relied upon as personalized-investment or financial-planning advice.

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INTRODUCTION

Investors have more responsibility than ever for achieving their financial goals. When it comes to retirement, most companies no longer offer ***pensions*** with guaranteed monthly payments to workers when they retire. In addition, Social Security is expected to replace less and less of the income a retiree earned while working. Instead, workers are increasingly having to take charge of their own retirement planning by setting up their own accounts or saving through employer-sponsored retirement plans.

This shift in responsibility requires us to know a lot more about making investments, yet too few of us feel equipped to make informed decisions about our financial future.

Many people are unable to explain the differences between stocks and bonds, the role of the stock market, and the value of ***portfolio*** diversification.

In addition, many investors fail to appreciate how significantly investment fees erode their long-term ***returns***, or understand how to minimize those fees.

When it comes to financial fraud, investors might be attracted to trendy new investment products including risky investments with promises of big returns. It is often difficult to fully understand the risks of new investment products, in part due to complicated structuring and lack of data on performance history, among other factors. Unfortunately, too many investors do not detect the warning signs before putting their hard-earned money into a product that is unsuitable for them or even fraudulent.

This investor guide was written to help investors – from beginners to those with more experience – precisely understand these topics. Whether you choose to work with an investment adviser or do it yourself, the guide will help you learn important investing terminology and principles to make more informed decisions. If you decide to seek assistance from a financial adviser, the investor guide will help you ask the right questions and do the necessary research, including using resources such as FINRA's BrokerCheck (brokercheck.finra.org), to evaluate your options and increase your chances of finding a financial professional you can trust.

To begin, let us address a basic question: Why invest?

***Pension*:** An employer-paid retirement plan that promises you a specified monthly benefit at retirement. Also called a defined-benefit plan.

***Portfolio*:** The collection of investment assets (e.g., stocks, bonds, mutual funds, real estate) owned by a person.

***Return*:** The profit or loss earned on investments, typically expressed as a percentage.

PART 1: WHY INVEST?

Why invest? The answer can be summed up in three points:

1. Investing puts your money to work, with the goal of earning more money and higher rates of return than a traditional savings account. By earning a higher rate of return, you can beat inflation and build wealth over time through the power of ***compounding***.
2. Investing can help you achieve a secure retirement. By investing for retirement during your working years, you create a source of income in addition to Social Security to cover your living expenses over what could be a decades-long retirement. Investing for retirement also provides you with tax savings opportunities.
3. Investing helps you reach important financial goals. In addition to achieving a secure retirement, investing can help you achieve other financial goals including saving for your child's education, buying a home, starting a business, or even retiring early.

All investing carries some degree of risk, however, so it pays to learn the investment basics before you get started.

Before investing, develop a plan for family money management

As you prepare to invest for the future, you will want to review the way you are managing your money today. A good place to start is by evaluating whether you are living within your means. You want to be sure that your monthly income is enough to cover your monthly expenses and allows you to save and invest. If you find yourself short of cash and unable to pay bills, you will need to solve these problems first. You will want to implement a budget and make necessary changes to either increase your income, or reduce your spending, or perhaps both.

Another priority is to pay down any high-interest debt you may have, especially credit card debt. The benefits of investing will be negated by the interest payments you make to creditors. If you use a credit card, work to pay off balances in full every month to avoid paying interest.

Besides reducing debt, families should build an emergency savings fund. Can you save a bit each month to build a $1,000 emergency fund? If so, that is a great start. Over

Compounding**:** The process in which an investment's earnings are reinvested and added to the principal to generate additional earnings over time. You might say compounding is earning interest on interest.

time, work to save three to six months of living expenses. This fund can help cover the costs of unexpected events, such as unemployment, repairs or replacement of a car or major appliance, prolonged illness of a family member, and medical expenses not covered by insurance.

The time value of money

The $1 you have in your pocket today is worth more than that same $1 will be worth next month or next year. That is the time value of money: The more time that goes by, the less value your money has.

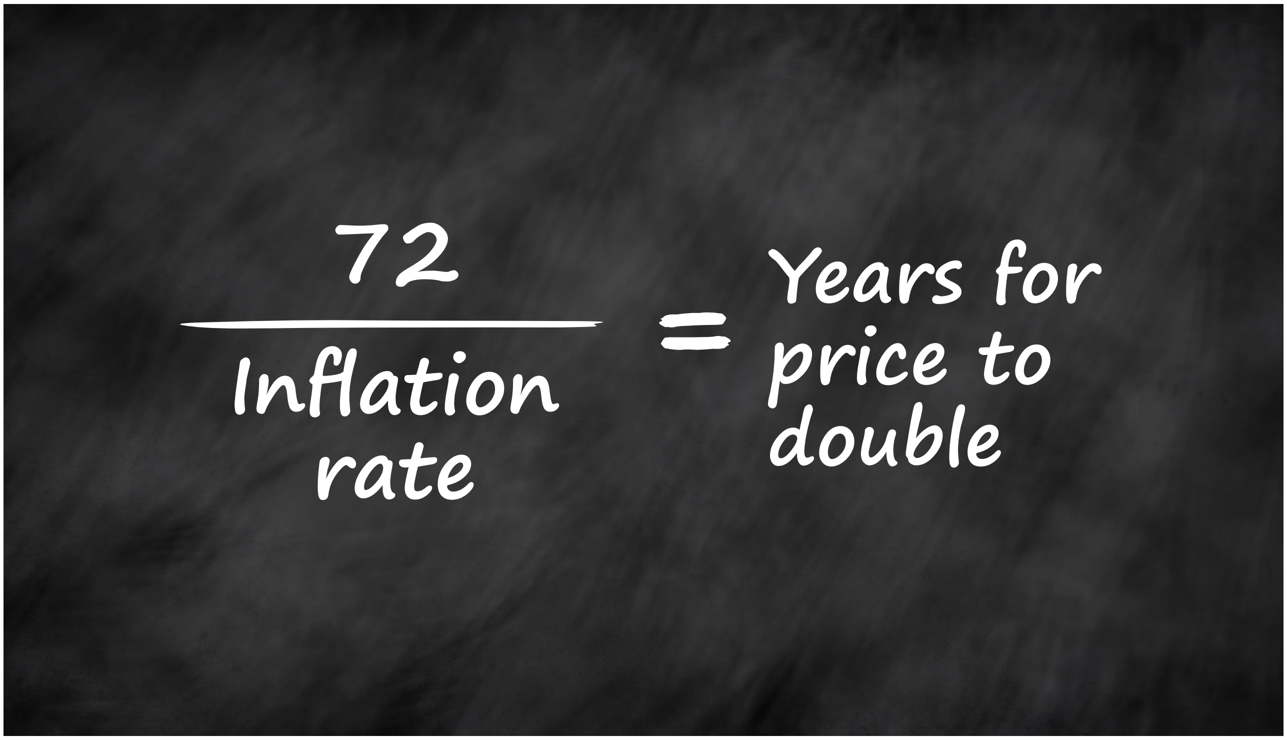
Money loses value – or buying power – as a result of inflation. Almost anything you buy now costs more than it once did. Inflation is a big part of the reason it will cost you more to live in the future than it costs now.

Inflation also does real damage to your savings, especially if the inflation rate is higher than the interest rate you are earning. If that is the case, your savings are actually losing rather than gaining value.

So, what is the solution? You will need a source of income in the future that will outpace inflation and close the gap between what things will cost and what you must spend.

Investments can provide that income.

The rule of 72



The rule of 72 is a simplified formula that can be used to estimate the number of years required to double an amount invested given an annual rate of return. It can also be used to show how inflation can erode your income. Here is how it works: Divide 72 by the ***annualized*** inflation rate, which has averaged 3 percent since 1926. Since 72 ÷ 3 = 24, you can expect your living expenses to double every 24 years.

That is an eye-opening number, because there is nothing unusual these days about a retirement lasting 24 years. It is critical, then, to have more income as time goes by. Keep in mind, too, that in some years inflation is higher than 3 percent. If inflation jumped to 6 percent, or soared past 12 percent, as it did in the late 1970s, then the damage to your long-term financial security could be severe.

The rule of 72 is also a quick and accurate way to estimate how quickly the money you invest will double in value. For example, if your investment portfolio provided a 6 percent annualized return, you could expect your account to be worth twice what you invested after 12 years (72 ÷ 6 = 12). That is even if you do not invest another cent – though ideally you would continue to add money to your portfolio every year.

One word of caution, though: No rate of return is guaranteed. The estimates provided by the rule of 72 depend on assumptions about the rate of inflation and the rate of investment return, both of which could differ significantly from historical averages or your expectations.

Investing for growth

If the value of your investment portfolio increases more quickly than inflation causes prices to rise, you will increase your ***net worth***, and be more financially secure. One way to do this is to invest for growth, or to try to achieve an annualized rate of return on your investments that is higher than the annualized rate of inflation.

Investing for growth is different from putting your money in a savings account or in a ***certificate of deposit (CD)***. With a savings account or CD, your money is safe because deposits are federally insured. Savings accounts and CDs are also liquid, making these great options to keep your emergency funds or money you need access to in the short

Annualized**:** To annualize a number means to calculate it to represent one year, rather than a shorter or longer time period. Interest rates, inflation rates, and rates of return are often annualized to represent these rates on a yearly basis.

Net worth**:** A measure of wealth calculated by adding up total assets and subtracting total liabilities.

Certificate of deposit (CD): A type of savings account with a fixed-term length and interest rate. When you cash in your CD, you receive the money you originally invested plus any interest.

term. The rates of return, however, are generally lower than the rate of inflation. This means your money is losing value over time.

To outpace inflation, investors typically purchase investments that have historically earned higher rates of return than savings accounts or CDs. These investments include stocks, bonds, mutual funds, exchange-traded funds (ETFs), and real estate, which we will discuss shortly.

Compound growth – time on your side

The sooner you start to invest, the more you can benefit from the power of compounding. Just as the $1 you have today is worth more than the same $1 next year, the $1 you invest today has greater potential for growth than the $1 you invest next year. But investing at any age helps you financially.

Investing for growth

Alice

- Invests $400 a month from age 25
- Realizes an average annual tax-deferred 6 percent return
- At 65, her account is worth $766,785
- Contributed $192,000 over 40 years
- Her investment grew by $574,785

Dave

- Invests $400 a month from age 40
- Realizes an average annual tax-deferred 6 percent return
- At 65, his account is worth $271,832
- Contributed $120,000 over 25 years
- His investment grew by $151,832

As this comparison shows, starting a ***tax-deferred retirement account*** at age 25 paid off for Alice. Her account ended up being worth almost three times as much as Dave's, who started a similar account at age 40.

In fact, even if Alice had stopped putting money into her account when she turned 35 – after just 10 years – and she left the money invested at a 6 percent annualized return, she would have accumulated $440,390. She would still have more in her account than Dave, even though he invested over 25 years. (Note: Neither example takes into account investment costs.)

Alice's outcome shows the power of compounding and the effect time has on investment outcomes. Compounding is the process in which an investment's earnings are

***Tax-deferred retirement account*:** An investment account that allows the individual to postpone paying taxes on the money invested until it is withdrawn in retirement. Examples include individual retirement accounts (IRAs) and 401(k)s.

reinvested and added to the principal – the original investment amount – to generate additional earnings over time. You might say compounding is earning interest on interest. Over time, growth accelerates because the investment will generate earnings both from the initial principal and the accumulated earnings from previous periods. The result is exponential growth. The key is to start early so you have as many years as possible to enjoy compound investment growth until you reach your goal.

Why people do not invest

The arguments against investing are persuasive – to a point. Investments are not insured, and your earnings are not guaranteed. In some time periods, you will have to stomach the fact the value of your investments has shrunk. You will also need to avoid locking in your losses by selling in a panic.

The reality is that by investing in a mix of stocks and bonds over extended periods of time – several decades, not one year or five years – you have a chance to achieve a much stronger rate of return, and much greater protection against inflation than CDs and savings accounts can provide.

For example, between 1926 and the end of 2020, the average compound annual growth rate was 10 percent for large company stocks, 12.1 percent for small company stocks, 5.5 percent for U.S. Treasury bonds, and 3.3 percent for U.S. Treasury bills. (Remember, inflation averaged 2.9 percent annually over this 95-year period.)

There is no guarantee your returns over 10 or more years of investing will closely track those historical returns; however, based on the track-record of these investments, you may determine it is worth the risk.

Some people are understandably concerned that they do not know how or where to start investing. The best remedy is to learn more about investing and how it works, which is what this investor guide is designed to help you do.

PART 2: MAKING INVESTMENTS

It is tough to start investing when you are unfamiliar with the different types of investments you might make, and when changes in the investment markets sometimes seem irrational. But, if you are willing to put in the time to learn the basics, you will be much more comfortable taking the plunge.

The place to begin is by recognizing that every investment belongs to what is known as an ***asset class*** – a group of investments that have important features in common. In addition, most investors can focus on just four of these classes to help achieve their financial goals. There are more asset classes, of course, but these are a good starting point.

Asset classes

What you need to know first is that each asset class puts your investment dollars to work in a different way, provides a different level of long-term return, and exposes you to different types of risk. Much of the time, each asset class reacts differently from the other classes to what is happening in the financial markets and the economy in general. For example, in a year when stocks may be increasing in value, bonds may be flat or even losing value. In a different year, it could be the other way around. We will examine four major asset classes: stocks, bonds, cash and cash equivalents, and real estate.

Asset class: A group of investment products that behave similarly on the market and are subject to similar rules and regulations. Stocks and bonds are examples of two asset classes.

Stocks

Stocks, also called equities, are a type of investment that represents an ownership share in a company. Companies sell stocks to raise money and grow their business. Investors buy stocks as a way to share in the profits that businesses earn.

A company's stock price may go up or down, depending on how the company performs and how investors think the company will perform in the future. An investor who buys a company's stock hopes that over time the stock will increase in value.

You can make money with stocks in two ways:

1. Stocks may pay a ***dividend*** – a portion of the company's profits distributed to investors at regular intervals. A corporation has the right to decide whether or not to pay a dividend.
2. If the stock's share price increases during the time you own it, you can sell your investment for more than you paid for it, earning a profit. This is known as capital appreciation.

The risk with individual stocks is that the prices may be volatile – or change significantly in a short period of time – and neither their share price nor the dividend income they may provide is guaranteed. This means you could lose some or all of your money in a stock investment if its price dropped suddenly and you sold your shares.

Stocks are often categorized by investors based on certain characteristics. Here are some of the most common ways to categorize stocks:

- **Company size:** Companies are distinguished by their value, also known as ***market capitalization***. The three categories are large-cap (market value of $10 billion or more), mid-cap (value between $2 billion and $10 billion), and small-cap (value between $300 million and $2 billion).

Stock: An investment that represents an ownership share in a company. When you buy shares of a stock, you receive proportional ownership in the company and its profits.

Dividend: The distribution of a company's earnings to its shareholders. Dividends are often distributed quarterly and may be paid out as cash or in the form of reinvestment in additional stock.

Market capitalization: The value of a company that is traded on the stock market, calculated by multiplying the total number of shares by the present share price.

- **Location:** Stocks are often grouped by where companies are headquartered. U.S.-based companies are known as domestic stocks, while companies based outside of the United States are referred to as international stocks or emerging-market stocks, if based in a developing country.
- **Style:** This distinction has to do with popular investing methods. A stock may be described as a growth stock if the company is either growing quickly or expected to grow quickly. Value stocks are typically those that investors believe may be underpriced relative to their company's financial situation. Income stocks refer to stocks of companies that typically pay a dividend.

Bonds

When you buy a ***bond***, also known as a fixed-income investment, you are effectively lending money to the bond issuer, such as a corporation, government, or government agency, for a fixed period of time. The issuer pays the investor a fixed interest rate on a scheduled basis – hence, fixed income. When the bond comes due, or matures, the lender pays you back the face value of the bond.

The U.S. Department of the Treasury issues bonds on behalf of the federal government. A city or state may issue bonds to help pay for new roads, schools, or other public infrastructure. Corporations sell bonds to increase cash flow or to fund expansions into new markets.

> ***Bond:*** A loan to a company or government that pays investors a fixed rate of return over a specific time frame.

For example, you buy a 10-year bond with a face value of $1,000 and an interest rate of 6 percent. If you hold the bond to maturity, you would earn interest payments of $60 a year and then receive your $1,000 principal back at the end of 10 years.

Bonds are often bought and sold before maturity. If interest rates on new bonds rise, the market value of a bond that you already own will fall because newer bonds will pay a higher rate. That is because investors will not pay as much for a bond with a lower interest rate when they can buy a new bond with a higher rate.

Conversely, when interest rates on new bonds fall, bond prices rise. For example, a bond with a 3 percent interest rate is going to be more attractive to investors when new bonds are being issued with a 2 percent interest rate.

One of the major risks of bond investing is inflation, which eats into the value of the fixed payments the bond makes over time. To mitigate this risk, you might consider two types of government bonds that are designed to protect investors from the effects of inflation.

- I-Bonds are inflation-adjusted U.S. Savings Bonds that earn interest based on both a fixed rate and the inflation rate. This interest rate is adjusted twice a year.
- TIPS, or Treasury Inflation Protected Securities, pay principal-based interest that is adjusted for inflation. So as inflation increases, so do the interest payments.

Visit treasurydirect.gov for more information on U.S. government bonds.

Cash and cash equivalents

Cash is the money you hold in your wallet, and your savings and checking accounts. Cash equivalents, which are highly ***liquid***, include short-term certificates of deposit (CDs), ***U.S. Treasury bills (or T-bills)***, and ***money market mutual funds***.

Liquid: The ease with which an asset or security can be converted into cash without affecting its market price.

U.S. Treasury bills (or T-bills): Short-term U.S. debt securities issued by the federal government that mature over a time period of four weeks to one year.

Money market mutual funds: Fixed-income funds that invest in stable, short-term debt securities, such as commercial paper, Treasury bills, and CDs.

CDs are time deposits with fixed terms, typically ranging from three months to five years. On traditional bank CDs, you earn interest at a fixed rate. When you purchase a CD from a bank, your account is insured by the ***Federal Deposit Insurance Corporation (FDIC)*** up to the per depositor limit of $250,000. You usually pay a penalty if you withdraw funds before your CD matures.

There are many good reasons to hold cash or cash equivalents, the most important being that life never unfolds completely as planned. You should try to build a cash reserve to cover at least several months of expenses. You may lose your job or crash your car. You or a loved one may get hit with big out-of-pocket medical bills.

To be clear, the interest rate you earn on cash equivalents is low and may not exceed the rate of inflation in some periods. When it falls short of inflation, you will have a negative real return. A ***real return*** is the return minus the effect of inflation. So, if you earn a 2 percent return on your cash or cash equivalent investment and inflation is 3 percent, your real return is negative.

Cash equivalents expose you to limited investment risk. The FDIC insures accounts in banks and savings and loan institutions for up to $250,000 per depositor, and the National Credit Union Association does the same for depositors in credit unions.

U.S. Treasury bills are backed by the full faith and credit of the U.S. government. Money market mutual funds invest in U.S. Treasury bills and other low-risk, short-term debt securities to maintain their value at $1 per share, but are usually not insured and the $1 value is not guaranteed. That is an important way these funds differ from bank money market accounts, which are FDIC-insured.

Federal Deposit Insurance Corporation (FDIC): An independent federal agency that insures deposits in U.S. banks in the event of bank failures. Credit unions have a nearly identical government-guaranteed form of protection through the National Credit Union Administration.

Real return: The amount of return earned on an investment minus the inflation rate. This reflects the actual purchasing power gained (or lost). In contrast, the nominal return is the increase (or decrease) in value without accounting for inflation.

Real estate

By investing in real estate, we do not mean flipping houses, or buying rental properties, or even making improvements to your own home, although any of those may be considered a real estate investment. You can invest in commercial real estate – office buildings, apartment complexes, shopping malls, warehouses, or other developments – by buying shares of a publicly traded ***real estate investment trust (REIT)*** which is a company that owns, operates, or finances real estate.

The more varied a REIT's properties are, either by type or geography, the greater the protection it has against downturns in the real estate market. Owning shares in a REIT is a type of ***equity*** investment. But a REIT is different from individual stocks, stock mutual funds, or stock exchange-traded funds, because it must distribute at least 90 percent of its taxable income to its shareholders. However, that income isn't guaranteed and could be less than expected.

In addition, the return on a REIT is not necessarily correlated with the return on other equity investments. That is because real estate stocks may respond differently to changes in the financial markets or the economy as a whole than the stocks of companies providing other products and services. For example, equities often lose value as inflation increases, while REITs may gain value because the properties that REITs hold can raise rents as prices increase.

While a REIT has the potential to provide significant income, that income is taxed at a higher rate than the rate that applies to dividend income from most stocks. For that reason, many people choose to hold REIT investments in tax-deferred retirement accounts.

Real estate investment trust (REIT): Companies that own or finance income producing real estate across a range of property sectors.

Equity: In the broadest sense, equity means an ownership interest in some asset.

Investing through mutual funds and ETFs

Mutual funds and ***exchange-traded funds (ETFs)*** are similar in that they both invest in a basket of underlying investments, in most cases concentrating on a single asset class. And there are mutual funds and ETFs that invest in just about every major asset class in the world, including domestic and international stocks and bonds, REITs, and commodities. As a result, they provide an opportunity to invest more widely than you could otherwise do by buying individual stock or bonds.

Mutual funds

A mutual fund is a professionally managed investment product that pools money it raises from its shareholders to invest in a portfolio of ***securities***, including stocks, bonds, and other assets. The more shares the fund sells, the more money it has to build a broadly diversified portfolio much larger and more diversified than a typical investor could afford to build and maintain on one's own. Each share of the mutual fund provides the investor with a proportional ownership stake in the underlying investments and the gains or losses of the fund. The varied portfolios of some mutual funds make them less risky than buying individual stocks and bonds.

Mutual funds are divided into several categories representing the kinds of securities they invest in and their investment objective (either long-term growth, or income, or a combination of both).

A total U.S. stock market fund typically holds shares in the thousands of companies publicly traded on the major stock exchanges. Or, a stock fund might focus on one sector of the market – for example, large-company stocks as represented by the S&P 500 (formally known as the Standard and Poor's 500 Composite Stock Price Index), which includes 500 of the largest U.S. companies. Or, a stock fund might invest primarily in smaller companies it expects to grow rapidly.

Mutual fund: A type of investment that pools money from many investors to purchase securities such as stocks, bonds, and short-term debt. Mutual funds create a more diversified portfolio than most investors could on their own.

Exchange-traded fund (ETF): A type of pooled investment security, similar to a mutual fund, that is traded on a stock exchange.

Security: An investment instrument that holds value and can be traded. Stocks and bonds are examples of a security.

International stock funds hold equities in non-U.S. companies, either by owning companies in developed markets such as Germany, Japan, and Australia, or in emerging markets such as India and Mexico.

A bond fund might own a particular category of bond, such as municipal bonds, or a variety of corporate or government bonds. Or, it may own bonds with a specific term, such as long or short. Total bond market funds typically own all those types of debt.

You may be able to purchase shares online or by contacting a company representative. Fund companies have made it a lot easier to buy shares this way. You may also buy shares through salespeople at banks and brokerage firms or by participating in an employer-sponsored retirement savings plan that includes the fund as one of its investment options.

Mutual funds also make it easy to invest. Initial minimum investments are relatively low, and you can make additional investments of $50 or $100 on a regular basis – or any time you want. A mutual fund will also buy back any shares you want to sell based on the fund's price at the close of the business day. The price of each share of a mutual fund is called the ***net asset value (NAV)***.

Actively managed funds versus index funds

One significant way in which mutual funds differ is whether a fund is actively or passively managed. In an actively managed fund, a professional manager makes the decisions about which underlying investments to buy and when to sell them. In a passively managed fund, better known as an ***index fund***, the underlying investments are determined by the ***index*** the fund tracks. An index is a way to track the performance of a group of assets. For example, the S&P 500 measures the performance of 500 large U.S company stocks. Another index, the Russell 2000, tracks the performance of 2,000 small U.S. company stocks.

An actively managed fund tries to provide a stronger return than the benchmark index for the type of investments it makes. For example, a fund that invests in large-company

Net asset value (NAV): Represents a fund's per share market value. A fund's NAV is calculated by dividing the total value of all the cash and securities in a fund's portfolio, less any liabilities, by the number of shares outstanding.

Index fund: A collection of stocks that aims to mirror the performance of an existing stock market index, such as the S&P 500. An index fund will be made up of the same investments that make up the market index it tracks.

Index: A measurement of the performance of a specific "basket" of stocks considered to represent a segment of the financial market. For example, the Dow Jones Industrial Average (DJIA) is an index of 30 stocks of large U.S. companies.

Type of funds

Actively managed fund

- Manager invests to outperform a specific benchmark index (e.g., S&P 500)
- Higher fees than index funds
- Over time, most funds underperform their benchmarks

Index fund

- Fund invested to replicate performance of a specific benchmark index
- Lower fees than actively managed funds
- Over time, more consistent performance relative to their benchmarks than individual actively managed funds

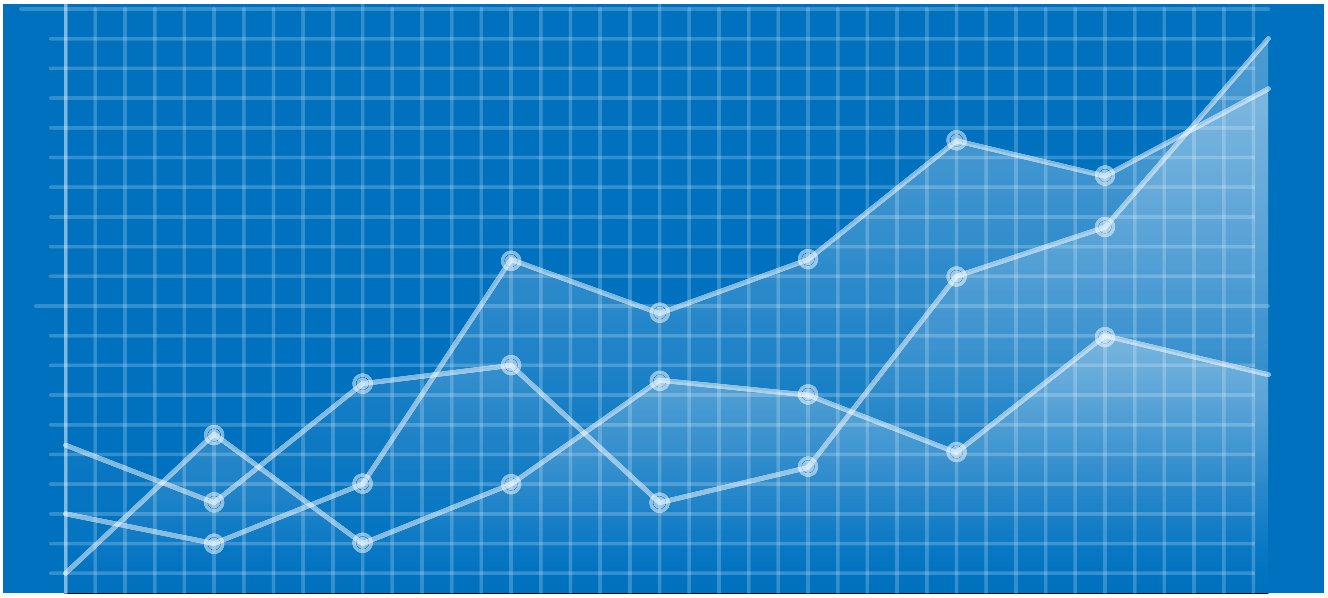
stocks typically wants to outperform the S&P 500. The fund's manager and his or her team researches companies, chooses investments in keeping with the fund's objective, and trades its underlying investments to achieve high returns. These factors increase the fund's costs, which are passed on to shareholders as fees.

An index fund invests to replicate the performance of the index it tracks, not to beat it. If the fund tracks the S&P 500, for instance, it owns the 500 stocks in that index, often in proportion to each company's market capitalization. If a stock drops out of the S&P 500, the index fund drops that stock as well and buys whichever stock replaces it. Similarly, if a fund tracks an index of small-company stocks, as does the Russell 2000, the fund drops and adds stocks once a year as the underlying index changes.

An index fund, then, does not have to pay a manager to choose investments. And there are few trading costs because the portfolio changes only when the index changes. The result is lower fees for the fund's shareholders.

Index funds generally provide stronger returns than actively managed funds over the long term, in part because of their lower costs.

An actively managed fund might do significantly better than its benchmark in one, three, or even five years, but few are able to do so consistently over the long term. One of the biggest traps investors fall into is picking an actively managed fund based on its recent track record of beating its index. Mutual funds that post stellar short-term returns rarely post equally strong returns over longer periods. In fact, funds that are the best performers one year often fall from the top of the heap fairly quickly.



Fee overview

There are two categories of mutual fund fees that apply to both actively and passively managed funds.

Some mutual funds have sales charges, called ***loads***, that you pay to purchase shares, and redemption fees if you sell within a restricted period set by the fund. You can avoid these fees if you buy only no-load shares and avoid premature redemptions.

Each mutual fund charges shareholders an annual fee for operating and marketing expenses. This fee, called an ***expense ratio***, is expressed as a percentage, and represents how much you will pay over the course of a year to own the fund. Simply stated, the fund's expense ratio is the cost of owning a mutual fund or ETF. For example, if you invest in a mutual fund with a 1 percent expense ratio, you will pay the fund $10 per year for every $1,000 invested.

These fees vary by fund issuer and by fund type, and may range between 0.05 percent to 2.5 percent. The average expense ratio of actively managed equity funds is 0.52 percent. Index funds making similar investments tend to have expense ratios closer to 0.07 percent. Expense ratio fees can add up over time and eat away at your long-term returns, so it is important to consider them when making investment choices.

Load: A sales charge or commission charged to an investor when buying or selling shares in a mutual fund.

Expense ratio: The amount an investment company charges investors to manage an investment portfolio, a mutual fund, or an exchange-traded fund. The ratio represents all of the management fees and operating costs of the fund.

You can find an explanation of a fund's fees in a table in the fund's ***prospectus***, which is a document that tells an investor important details about the fund, including its investment strategy, fees, risks, and historical performance.

Exchange-traded funds (ETFs)

Similar to a mutual fund, exchange traded funds (ETFs) are a type of pooled investment that holds a basket of securities. Like mutual funds, ETFs can contain all types of investments, including stocks, bonds, or commodities.

Unlike mutual funds, however, ETFs trade throughout the day on a stock exchange, and can be purchased and sold like stocks. The price of an ETF fluctuates throughout the day, reflecting supply and demand and other market forces. It is not reset at the end of the trading day based on its net asset value (NAV) as the price of a mutual fund is.

Most ETFs are index funds. That means an ETF portfolio is determined by the stocks or bonds included in the index it tracks. For example, an ETF named SPDR S&P 500 holds all the stocks in the S&P 500 Index.

There are several advantages to investing in ETFs. Their expense ratios tend to be low, and like mutual funds, they allow you to diversify broadly across asset classes and subclasses, as well as domestically and internationally.

Mutual funds

- Portfolio of securities selected to meet fund objective or to track an index
- Price determined by NAV (net asset value) at end of day
- Shares in fund purchased from fund or through a broker or adviser
- Fund must buy shares to accommodate shareholder redemptions, with potential tax consequences

ETFs (exchange traded funds)

- Portfolio of securities that reflects index being tracked
- Price determined by market trading throughout the day
- Shares bought and sold like stocks through a broker or adviser
- ETF does not redeem shares a shareholder wishes to sell, enhancing tax efficiency

Prospectus: A formal document required by and filed with the Securities and Exchange Commission (SEC) that provides details about an investment offering to the public.

Establishing an account

When ready, you can get started investing with a few simple steps. The process is not complicated, but it will take some time and require some decisions on your part.

- ✓ **Step 1**: You will need to open an account through which you will purchase your investments. Mutual fund companies, banks, and brokerage firms offer a variety of investment accounts. For retirement investing, many corporations and other businesses offer ***401(k) plans***. Public sector organizations may offer 457 plans, and nonprofit organizations and schools may offer 403(b) plans. If your employer does not offer a retirement plan, you can open an individual retirement account (IRA) and save for retirement on your own. Also, you can participate in an employer's plan and contribute to an IRA at the same time. There may be contribution limits annually for certain retirement plans or total contribution limits to multiple retirement plans.
- ✓ **Step 2**: Next, you will need to choose your investments, which may be your biggest challenge given the large number of investment products available. But you can start slowly, perhaps by opening an account at a mutual fund company and choosing a fund or two. You can broaden your investment base from there.
- ✓ **Step 3**: The third step, reinvesting, is the easiest. As your investments provide earnings, you will use that income to buy additional shares instead of spending the money. The reinvested amounts help build your account value. Because you can often reinvest automatically, especially with mutual funds, you won't miss the money you don't see.
- ✓ **Step 4**: The final step is continuing to invest and contributing new money to your account every month or quarter. One of the easiest and most effective ways to do that is by arranging for direct deposit from your paycheck, bank, or credit union account directly into your mutual fund or brokerage account.

If you are investing in an employer-sponsored plan that is available through your job, you defer a percentage of your salary each pay period. Once you get used to the idea, it is another easy way to invest without missing the money you do not see.

401(k) plan: A retirement savings and investing plan that employers offer. A 401(k) plan gives employees a tax break on money they contribute.

PART 3: PRINCIPLES OF INVESTING

Investing is a balance between risk and return.

Return, in this context, means investment return, which is based on two things: the change in investment value, plus any earnings the investment produces. If you sell an investment for more than you paid for it, you will have a gain, or positive return. But if you sell it for less than it cost you, you will typically have a negative return, or loss.

Example:

You buy 100 shares at $20 per share	$2,000
You sell 100 shares at $22 per share	$2,200
Profit ($2,200 – $2,000)	= $200
Company pays dividend of $0.25 per share	+ $25
Return ($200 profit + $25 dividend)	= $225 (or 11.25%)

The bottom line is that the higher your average annual return over time, the more likely you are to meet your financial goals.

Risk is the potential for losing money instead of making it, or making less than you had expected. Risk is also the possibility that the value of your return will be undermined by inflation, thereby reducing your buying power.

Understanding the risk/return relationship is essential to making sound investment decisions. The more risk you are willing to take, the greater the potential for a substantial return, but also the greater potential for experiencing a loss. On the other hand, if you take no risk, you will have a minimal return, if any.

Risk: Refers to the degree of uncertainty about the rate of return on an asset and the potential harm that could arise when financial returns are not what the investor expected.

For example, if you put $1,000 in a five-year bank CD paying 2 percent compounded annual interest, your return will be $104, giving you $1,104. But if you bought shares of a stock mutual fund providing a 6 percent annual return, your return over the same five-year period would be $338 – more than triple the return from the CD – giving you a total of $1,338.

While certain investments provide a minimal return, the trade-off is they keep your principal safe. You can be confident that you will be able to withdraw your $1,000 investment in the CD at the end of the term. But at any point, your mutual fund could be worth far less than $1,000. And if you sold it once it declined, you would have a loss.

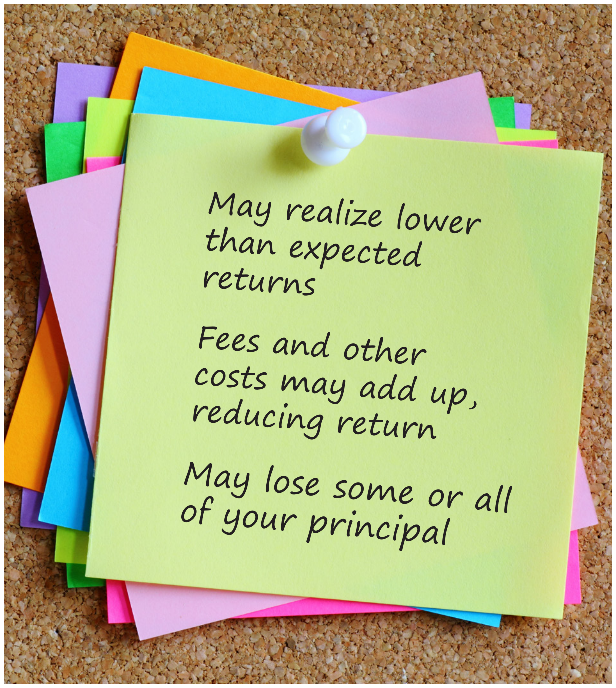
Keep in mind

If you are nervous by the thought of losing money in a short period of time – with investing, five years is fairly short – then you may not be ready to invest. But keep in mind it is entirely possible – though not guaranteed – that an investment that loses value at some point will regain its value over time and may be worth substantially more than when you first invested. The longer you can hold onto your investments, the better your chances for success.

Before you start investing, you will want to answer a few key questions related to risk:

1. What is your risk tolerance? Certain investments involve more risk than others. How unsettled will you be if an investment dips in value for a period of time? Your investment mix should reflect your willingness and ability to tolerate risk.
2. How long will you be invested? Your investment mix will be different based on your investing time horizon. Longer time frames reduce the risk that short-term ***volatility*** (the ups and downs of investment prices) will have on your portfolio. Those ups and downs are unpredictable, so in shorter time frames investors often choose more conservative investments. A longer time horizon may allow you to take advantage of the potential for greater returns from a more aggressive investment mix if you are able to tolerate shorter-term dips in the value of your portfolio.

Volatility: The degree to which an investment, an index, or the market at large varies in price or value over the course of a particular period of time.



Investment risk

The risk associated with investing typically fits into one of two categories: market risk or specific investment risk.

Market risk results from what is happening in the financial markets as a whole. If the economy is extraordinarily weak, as it was in 2008 and 2009, the markets can be extremely volatile – which means prices change dramatically over short periods of time. When that happens, investors tend to lose confidence in the markets and in investing in general. Some investors may stop making new investments and sell off the ones they own. This, in turn, helps to create a more severe downturn.

Investment risk, on the other hand, occurs when an individual investment loses value for one reason or another that is directly related to the investment itself. For example, investment risk may result from poor management that reduces a company's earnings and drives its stock price down. Or sometimes a company crushes its competition by introducing a product that runs away with the market, reducing the value of the competitor's stock. Mutual funds, although generally not as risky as investing in individual stocks, can sharply decline in value if they hold stocks in one narrow sector of the market or if the overall market falls.

Strategies to manage risk

While neither market nor investment risk can be entirely eliminated, there are strategies to help you manage the risks you face in investing. Two of the most effective are ***asset allocation*** and ***diversification***.

Asset allocation: The process of dividing the money in your investment portfolio among different asset classes, such as stocks, bonds, and cash to balance risk according to your goals, risk tolerance, and investment horizon.

Diversification: A strategy that can be neatly summed up as, "Don't put all your eggs in one basket." The strategy involves spreading your money among various investments in the hope that if one loses money, the others will make up for the loss.

These strategies do not guarantee success or protect you from losses in a serious market downturn. But they can help you mitigate risk while maintaining the potential for a strong return.

Asset allocation

Using asset allocation, you divide your investment assets among several broad categories of investments, or asset classes, on a percentage basis, rather than putting all of your proverbial eggs in one basket.

As we noted in Part 2: Making Investments, different asset classes – stocks, bonds, cash equivalents, and real estate – generally react differently to what is happening in the economy at any given time. You can take advantage of this phenomenon by investing in several different asset classes at the same time.

Asset allocation allows you offset losses in one class with gains in another. There is no guarantee that an asset allocation will protect from all market risk – in a severe market downturn, all asset classes can decline sharply – but putting all your money into one asset class is much more likely to produce a major loss than spreading it across several classes.

If you invested only in large-company stocks in the decade of the 2000s, you would have posted a negative annualized return of —1 percent. (The decade's returns were not helped by a whopping —37 percent return in 2008 alone, a free-fall that had many panicky investors pressing the "sell" button near the bottom of the market.)

Balanced portfolios, including a mix of stocks and bonds, would have fared better during the same time period. A portfolio of 70 percent stocks and 30 percent bonds would have produced an annualized return of 2.1 percent, and a 50/50 stock-bond split would have returned 3.9 percent. Those are modest returns, but they are in positive territory and at or above the inflation rate at the time.

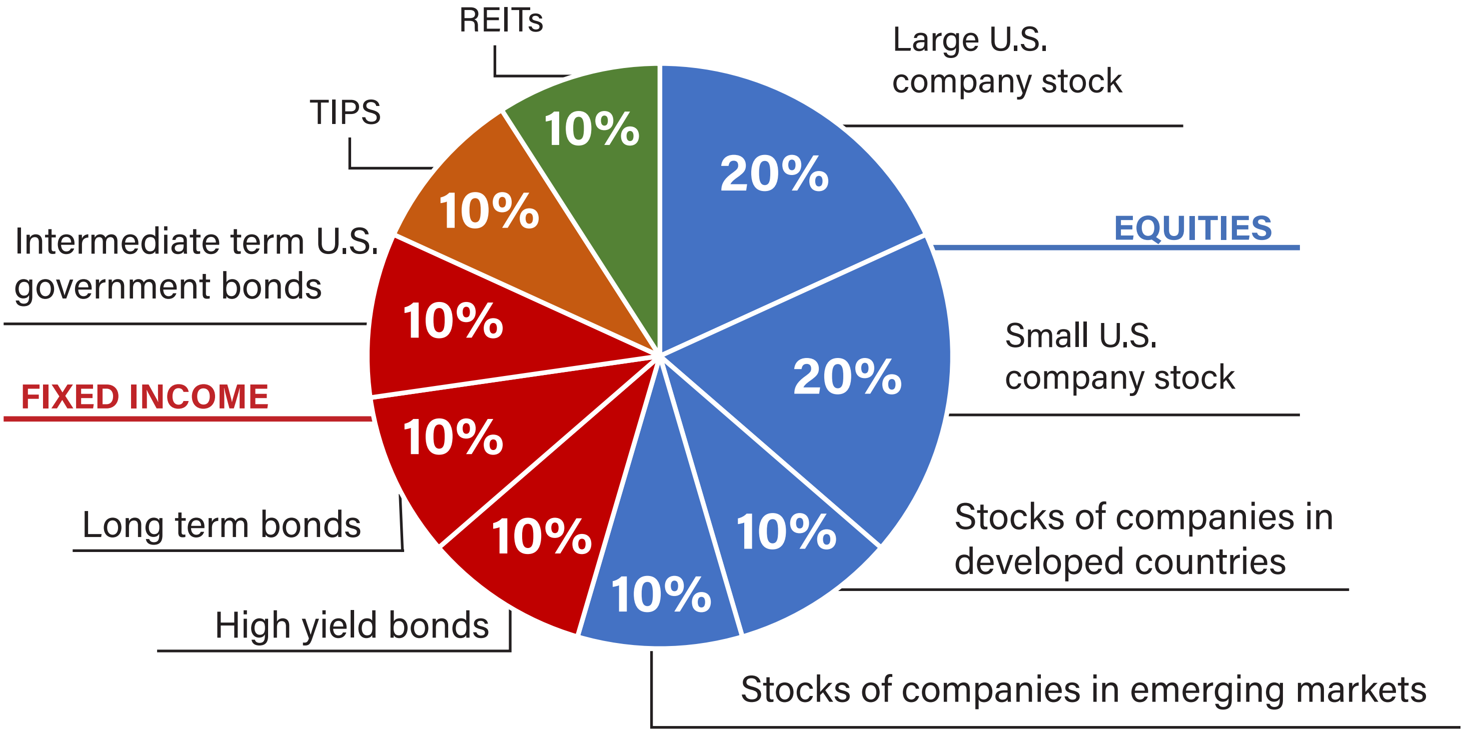
A long time horizon is important for investing because returns from all asset classes can vary widely.

Diversification

Asset allocation helps you manage market risk. You can help manage investment risk by diversifying, or investing in several investments within each subclass of an asset class. The goal is to protect the value of your overall portfolio in case a single security or market sector takes a serious downturn.

For example, a large-company stock and a small-company stock are both equities but belong to different subclasses.

Asset subclasses tend to differ from each other in some important ways, though they



all share the core characteristics of their class. For instance, a large-company stock and a small-company stock tend to increase in value at different rates, react differently to changes in the economy, and expose you to different levels of investment risk.

Similarly, bonds have different terms, different ratings, and different interest rates. They also have different issuers: the U.S. Treasury, various cities and states, and corporations large and small.

In the diversified portfolio example shown above, each asset class – such as equities (stocks) and fixed income (bonds) – includes mutual funds that make different types of investments.

It may be easier to understand diversification by understanding what it is not:

- You are not diversified if you own just a handful of stocks or shares of a mutual fund that is concentrated in the financial sector or some other specialized corner of the market.
- You are not diversified if the only bonds you own are issued by the state in which you live or by the same U.S. government agency.

Allocating your portfolio

There are many factors to think about when you begin investing and deciding on an initial allocation for your portfolio. How old are you? How long will it be before you retire? What are your financial obligations, such as debt and dependents? What is your risk tolerance – meaning, how would you react if a market downturn sapped a large percentage of your investment assets? If the answer contains the word "panic," you may want to stick mainly to safer investments, such as fixed income, and go easy on equities.

Your asset allocation is a personal decision that depends on many factors unique to your financial situation, family circumstances, and temperament. Do not allow yourself to be pushed into something you do not understand or that exceeds your tolerance for risk.

What is right for your brother-in-law, or for someone selling financial products, may not be right for you. There is nothing wrong with listening to someone's opinion, but ultimately you must do your own research and make your own decisions.

There is no allocation that is right for everyone or that works perfectly in every market environment; however, a handful of mutual funds invested in different asset classes may provide adequate diversification so that when one part of your portfolio falls in value, it does not sink the ship. Once you consider the following factors and open an account with a mutual fund company or brokerage firm, it is easy to find the funds you need to start building your portfolio.

Factors to consider in making investment decisions:

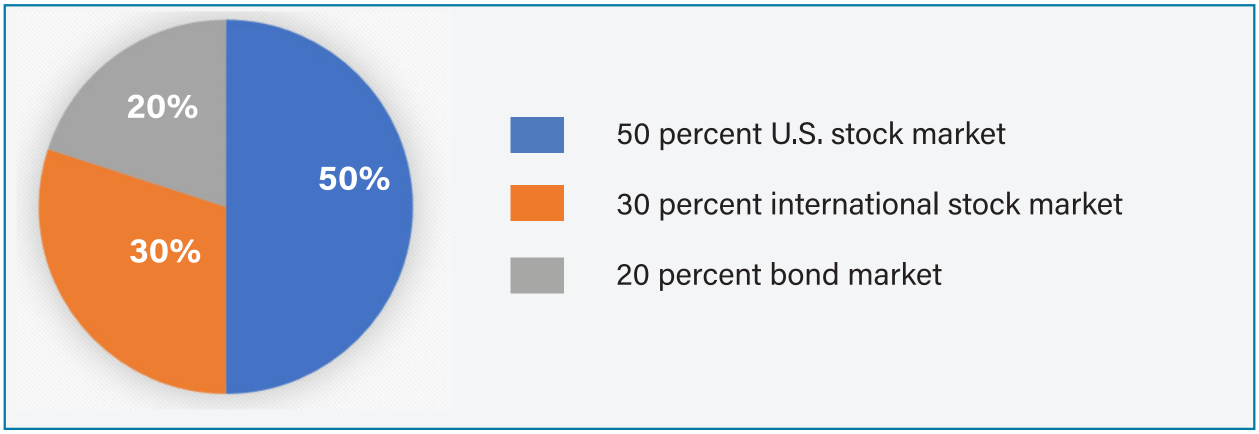
- The length of time you have to achieve the different goals for which you are investing. Investing to buy a home within the next five years is a lot different from investing for a retirement that will start in 30 years.
- The amount of risk you are comfortable taking. Even if you expect to work 30 or more years before retirement, you may not be able to stomach the risk that exists even in a diversified portfolio. "Sleeping well" was the investment criterion of the late Paul Samuelson, America's first Nobel laureate in economics.
- Other investments or expected sources of income. This includes Social Security, which provides lifetime benefits and therefore represents a significant financial asset for most Americans. You may also have earned a pension, or have a small business or income from family business interests. The amount of these assets can greatly influence the amount of risk you feel comfortable taking.

Sample portfolio allocations

The following pie charts show four portfolio allocation models. The appropriate split between stock and bond holdings will typically reflect an investor's financial situation, age, investment horizon, and tolerance for investment risk. The allocation that is most appropriate for you may be somewhat different from any one of these models.

While each model has been given a label (e.g., aggressive), it is important to note there is no set formula for what constitutes a conservative or aggressive portfolio allocation.

Aggressive portfolio

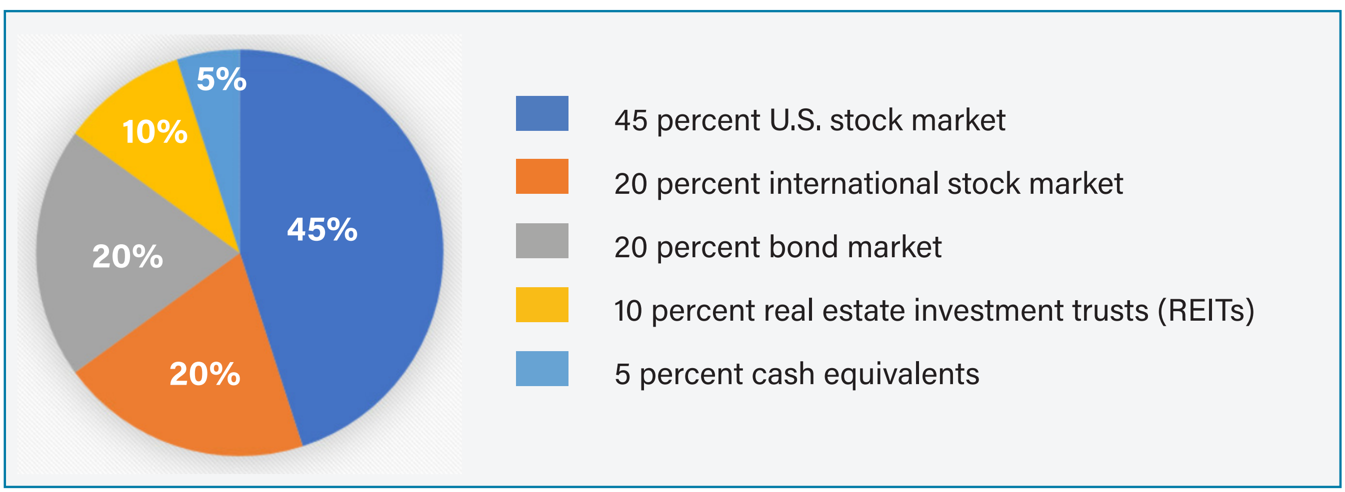


This portfolio has allocated 80 percent of its holdings to U.S. and international stocks. The U.S. stocks are diversified across industries through index and other mutual funds. A relatively small percentage is allocated to fixed income.

The allocation may be appropriate for investors who:

- Have a long time to reach their financial goals, so they can withstand the ups and downs of the market over time.
- Have enough current income and savings to meet everyday expenses as well as unexpected financial obligations.
- Have other sources of fixed income for the long term, such as a generous pension.
- Have a relatively high tolerance for investment risk, take a long-term view of investing, and do not panic when market prices drop.

Moderate portfolio

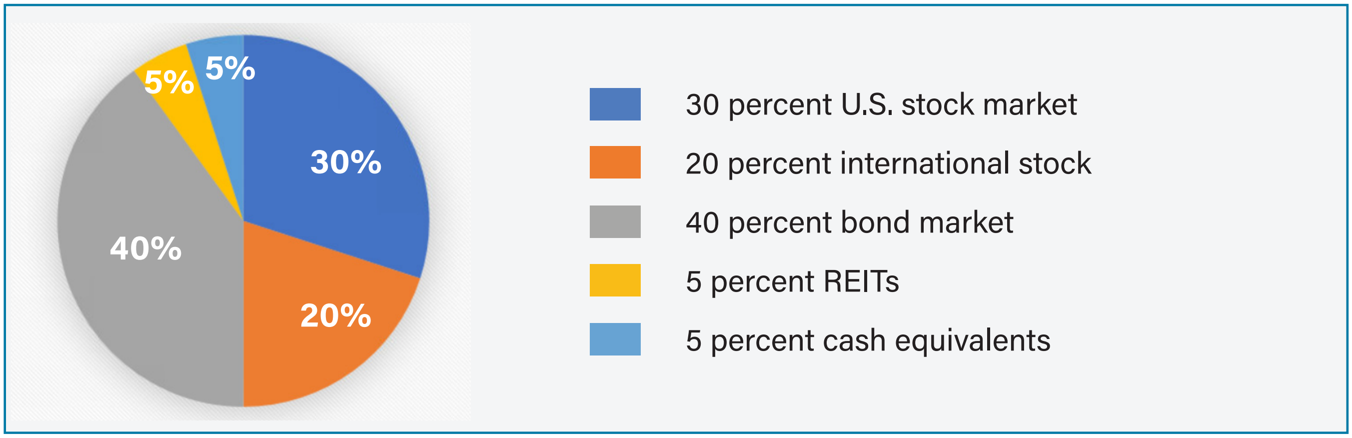


This portfolio has allocated 65 percent of its holdings to U.S. and international stocks, 20 percent to fixed income investments, and 10 percent to REITs.

This allocation may be appropriate for investors who:

- Have many years to reach their financial goals and can withstand the ups and downs of the market over time. However, they also want a cushion should market prices be down when they need the cash to meet expenses.
- Can afford to risk potential short-term losses in the equity markets and have sufficient cash equivalent investments to avoid having to sell their equity holdings when the market is down.
- Are approaching retirement but have other reliable sources of income.
- Have a moderately high tolerance for investment risk, take a long-term view of investing, but want to mitigate investment risk by allocating a portion of the portfolio to cash equivalents and fixed income.

Balanced portfolio

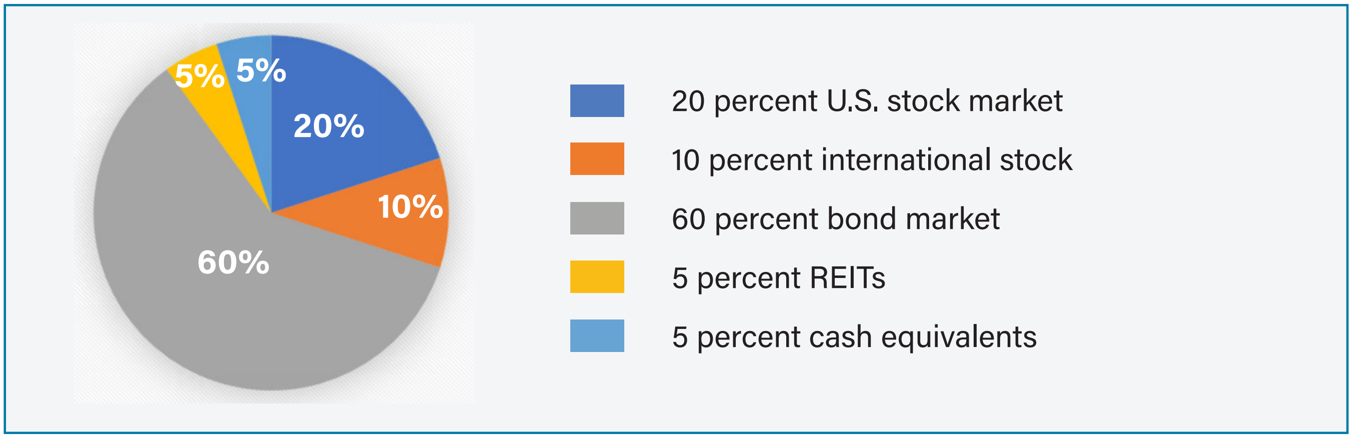


This portfolio strikes a balance between diversified stock mutual funds that account for 50 percent of the holdings, 40 percent allocated to fixed income, and 5 percent to REITs.

This allocation may be appropriate for investors who:

- Have achieved some of their financial goals, but still have others to reach.
- Want to capitalize on the potential upside of the markets while providing income from bond investments as a cushion against market downturns should they need cash to meet unexpected expenses.
- Have a moderate tolerance for investment risk and want to balance more stable, fixed income investments that preserve their earnings with the greater upside potential of equity investments, despite the higher risk.

Conservative portfolio



This conservative portfolio has an allocation of 30 percent in equity investments and 60 percent in fixed-income investments, with a smaller percentage in REITs and cash holdings.

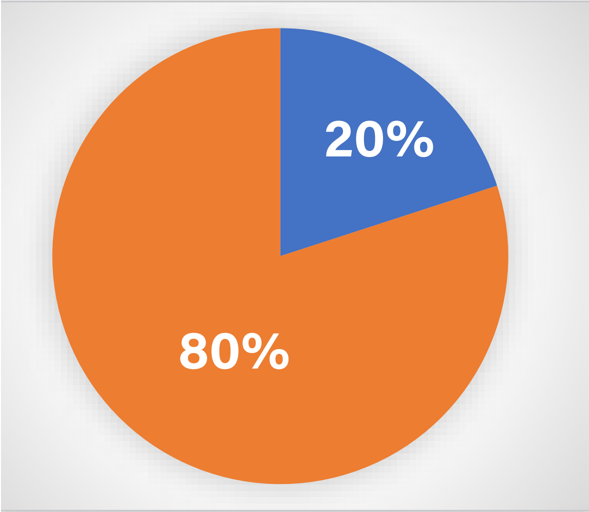
This allocation may be appropriate for investors who:

- Are approaching retirement and want to preserve some of their earnings while retaining their equity holdings as a hedge against living many years in retirement.
- Want to balance income and lower risk fixed-income investments with some upside potential from equity holdings despite the downside risks.
- Have a relatively low to moderate tolerance for investment risk and wish to preserve their capital while holding some equity investments to outpace inflation.

Portfolio returns

How have various asset allocations fared over time? Get a sense by looking at the following examples on Pages 32 and 33. Over long periods of time, portfolios that hold more stocks than bonds have higher average annual returns. On the flip side, stock-heavy portfolios are more likely to have years with a loss and are more volatile, which can make them prone to steeper losses. It is important to note that past performance is no guarantee of future results.

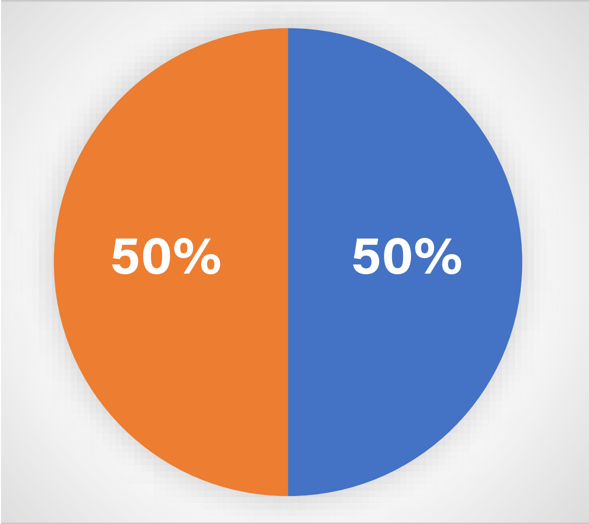
Note: In the following asset allocation models, the stock market returns were calculated using the Standard & Poor's 90 Index from 1926 to March 3, 1957, and the Standard & Poor's 500 Index thereafter. Bond market returns were calculated using the Standard & Poor's High Grade Corporate Index from 1926 to 1968, the Salomon High Grade Index from 1969 to 1972, and the Barclays U.S. Long Credit Aa Index thereafter.



Historical risk/return (1926-2021)

Average annual return: **7.5%**
Best year (1982): **40.7%**
Worst year (1931): **-10.1%**
Years with a loss: **16 of 96**

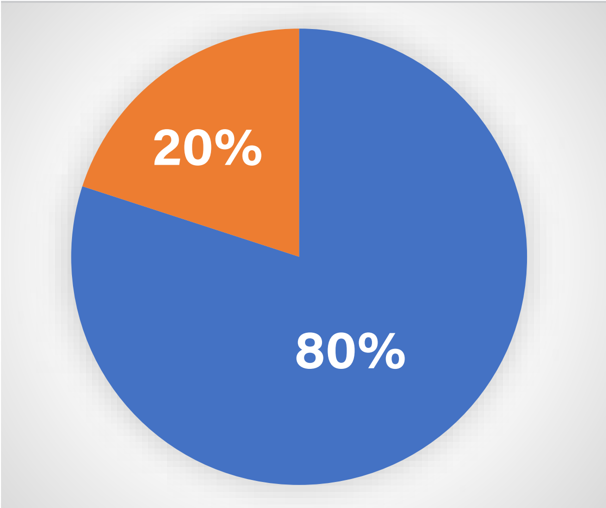
Bonds
Stocks



Historical risk/return (1926-2021)

Average annual return: **9.3%**
Best year (1982): **33.5%**
Worst year (1931): **-22.5%**
Years with a loss: **20 of 96**

Bonds
Stocks



Historical risk/return (1926-2021)

Average annual return: **11.1%**
Best year (1982): **45.4%**
Worst year (1931): **-34.9%**
Years with a loss: **24 of 96**

Bonds
Stocks

Making changes

The old adage that the only constant in life is change certainly applies to investing. Once you have carefully allocated your investment portfolio across diverse asset classes, you have taken a big step toward gaining some control over your financial future. But you are not finished. Two concepts are extremely important to keep in mind: reallocating and rebalancing. You should embrace both.

Reallocating

Reallocating is the process of adjusting your asset allocation as your circumstances change. The allocation you picked as a single 25-year-old is likely too aggressive when you are age 50 and facing the prospect of sending a child to college. You may want to trim the amount you have in equities and other more volatile investments and add more stable fixed income and cash equivalents.

Regardless, you should periodically take stock of your financial goals and life circumstances, and then reallocate your portfolio accordingly.

Reallocation: Making changes to the mix of stocks, bonds, and other investments in a portfolio. Investors typically reallocate to more conservative investments as they get closer to retirement.

Other factors may affect how and when to reallocate your portfolio as well. For example, conventional wisdom suggests that, as you approach retirement, you concentrate your portfolio more on fixed income investments and less on equities.

But as people live longer and enjoy fuller, more active lives in retirement – often accompanied by increased expenses – the traditional move to a more conservative allocation model may no longer be appropriate for everyone.

That is why some financial advisers now recommend that investors nearing or in retirement shift their allocation to fixed income investments at a slower rate, keeping more in equities well into retirement. This approach would apply especially to those who have other sources of fixed or earned income to meet everyday expenses as well as unexpected emergencies or changes in their financial situation.

Rebalancing

Rebalancing is the more regular process of adjusting your portfolio to account for swings in the financial markets. If one asset class has been doing either particularly well or particularly poorly over the past six months or year, it likely has skewed your portfolio away from your preferred allocation.

For instance, if you opt for an allocation of 60 percent equities and 40 percent bonds for your portfolio, over time the markets will alter that allocation. Stock market gains may increase your equity holdings to 70 percent and negative factors affecting the bond market may reduce your bond holdings to 30 percent. In that case, you should consider selling stocks and buying bonds to rebalance your portfolio back to your targeted percentages.

Alternatively, you could simply designate all of your new investment money to bonds until you have restored your 60 percent/40 percent balance. The benefits of rebalancing are significant. For one, the process helps provide you with the framework and discipline to sell high and buy low. In the above example, rebalancing by selling some of your booming equities stake will allow you to lock in solid stock market gains.

If you rebalance by buying more of an asset class after it slumps, you will lower your average cost in the investment and potentially set yourself up for future gains.

Rebalancing is also important because it restores your investment portfolio to the level of risk you decided you were comfortable with when you first established your asset allocation. In general, you should consider rebalancing when your allocation drifts about 10 percent from your targets.

Rebalancing is not easy on the psyche – everyone wants to stay with a winner. Yet selling

Rebalancing: The process of buying and selling investment assets to help an investor bring their portfolio back to their desired asset allocation mix.

holdings that have soared in value and buying assets whose prices have declined is one way to bring your portfolio back into balance.

Target-date funds

If allocating assets and rebalancing and reallocating your portfolio seems complicated, or you have never rebalanced or reallocated the investment accounts you have, you may want to consider a ***target-date fund (TDF)*****.** A TDF is a mutual fund that automatically rebalances its asset allocation as it gets closer to the investor's target retirement date.

If you contribute to a retirement plan at work, you probably have that option since employers are rapidly adding target-date funds to their 401(k) investment choices. You can also select these funds for a college savings account, an ***individual retirement account (IRA)***, or a taxable investment account.

An investor selects a TDF pegged to his or her expected year of retirement or the year in which a child goes to college. If the expected year of retirement is between 2038 and 2042, for example, the investor would select a 2040 TDF. The fund starts with a portfolio mostly in stocks and then shifts over time to increase the percentage of fixed income. In theory, the fund becomes less risky as retirement or college entrance approaches. The pace and timing of the reallocation is known as the fund's glide path – a reassuring term that implies a smooth landing.

TDFs have a lot of advantages, and they are promoted, with some justification, as one-stop shopping for investors who are perplexed by what can seem like an overly complex financial marketplace. But they also expose you to potential risks, as all investments do.

TDFs that share a target date – a 2040 retirement fund, for example – can have different allocations and different glide paths. So, in choosing a target-date fund, it is important for investors to determine whether the allocation is appropriate for their goals and tolerance for risk, rather than just picking one based on a certain year. Look at the underlying funds held by different TDFs to compare them to each other and determine which may be best for you.

As with mutual funds in general, TDFs may be actively managed and thus have higher fees, while others may use index funds and have lower fees, resulting in a big difference in the returns they pay.

Target-date fund (TDF): A mutual fund that automatically rebalances its asset allocation to become more conservative as it gets closer to the investor's target date – the estimated year when the investor will retire.

Individual retirement account (IRA): A long-term investment account that an individual with earned income can use to save for the future while enjoying certain tax advantages.

Many investors also have dangerous misconceptions about TDFs. A survey conducted for the ***Securities and Exchange Commission (SEC)*** found that nearly half of TDF owners did not understand that the funds do not guarantee income in retirement. These investors did not realize that TDFs are a ***fund of funds***, or a mutual fund that invests in other mutual funds. The value of any mutual fund or fund of funds depends on the performance of its underlying investments during the period in which they are invested. As with any investment, performance cannot be predicted, and returns cannot be guaranteed.

How investment costs affect your return

In addition to market risk and investment risk, you will need to consider the amount of fees and expenses you are paying to buy and own investments, because these costs directly reduce your investment return.

Some investment costs are unavoidable. It costs money to handle transactions. It costs mutual fund companies to manage their funds. It costs brokers to maintain their offices and websites and provide research about investments. But there are ways you can avoid paying more than necessary:

- When investing in a mutual fund, always check its expense ratio. To pay for its operating and marketing expenses, a fund annually charges a percentage of your account balance. If the expense ratio is 1 percent, for example, you will pay $100 for every $10,000 you invest. The fund may also impose sales charges, called loads, that are not included in the expense ratio. Both are published in a fund's prospectus and on the fund company's website. Many fund companies will sell you shares in their funds directly, with no sales charge. The point is to choose the least expensive of comparably rated funds.
- Choose lower-cost investment accounts. You might open an online brokerage account in which there are no commissions on purchases. With this type of account, though, it is up to you to identify investments and choose the right times to buy and sell, because your broker will not be making suggestions.

Securities and Exchange Commission (SEC): A U.S. government agency responsible for regulating the securities market and protecting investors.

Fund of funds: A mutual fund or exchange-traded fund that invests in other funds rather than individual securities.

The effects of fees

Assume you invest $10,000 in a tax-deferred account, make monthly contributions of $250 for 25 years, and realize an annual 6 percent rate of return. (Assume, for this example, that taxes are deferred until withdrawal.)

The theoretical total you would accumulate is $212,813; however, the actual amount you end up with will depend on the investment fees and expenses charged by the fund in which you invest, as illustrated by the following fund choices.

	Fund 1	Fund 2	Fund 3
Value before fees and expenses	$212,813	$212,813	$212,813
Expense ratio	0.2%	0.8%	1.2%
Upfront sales charge	None	None	4.75%
Effect of fees and expenses	–$6,858	–$25,993	–$39,168
Accumulated value	**$205,955**	**$186,820**	**$173,645**

In this example, if you invested in Fund 1 you would end up with $205,955. But if you had invested in Fund 3, you would have $173,645. That's a difference of $32,310 – money you would rather keep in your pocket than add to a fund's revenues.

As you can see, the effects of fees and sales charges on your mutual fund investment return can be substantial. Even seemingly small fees add up over time.

Despite what some high-priced fund managers might tell you, study after study has shown there is no evidence that higher-cost investments produce superior returns.

Keep in mind that the cost of investing may not stop with the expenses charged by the mutual funds themselves. If you invest in mutual funds and stocks through a brokerage account, you pay commissions when you buy the funds, and you could pay additional fees for account maintenance.

You have no control over many investment variables – the direction of the market, the rate of inflation, or the tax rate on your earnings. But you do have control over one of the most critical variables – what you pay to buy and own your investments.

The lesson is clear: The higher a fund's expense ratio and the more you pay in sales charges, commissions, and other fees, the smaller your return will be. Every dollar counts when maximizing your investment return.

PART 4: INVESTING FOR A SECURE RETIREMENT

When you start thinking about retirement, one of the first things to consider is what it will cost you to live comfortably. That gives you a basis for determining the income you will need.

Some of your current expenses will likely decrease when you retire. You will no longer need to commute. Your mortgage may be paid off, or nearly so. Your children may be college graduates with jobs and no longer living with you. There may be other expenses that will drop as well. On the other hand, certain expenses will probably cost more. Health insurance and out-of-pocket health care costs top the list. Real estate taxes and property insurance may go up. You may want to spend more on travel, hobbies, or other activities and interests you have been waiting to pursue until you had more time to devote to them. And you will still be spending money on food, clothing, and other necessities.

The consensus is that in retirement you will need at least 70 percent of your last working year's income to maintain your lifestyle after retirement. You will probably need more if you are single or the main breadwinner in your family.

Inflation is a primary factor: Your costs will increase over time, some faster than others. Each year that you are retired, you are likely to need more income than the year before.

The good news is there are a number of ways to ensure you have enough income in retirement. A few sources of retirement income include Social Security, pensions, annuities, and tax-advantaged retirement accounts that include employer-sponsored retirement plans and individual retirement accounts (IRAs).

Social Security

If you have worked and contributed to Social Security for the equivalent of 10 years, you can expect to receive benefits when you retire. How much you will receive depends on a number of factors, such as the number of years you participated, the amount you paid into Social Security, and the age at which you start to collect. The earliest you can start collecting is age 62.

As a rule, the longer you wait to begin collecting benefits, the higher your monthly payments. If someone who is currently 62 waits until the full retirement age of 67 to claim benefits, they will receive a monthly benefit that is nearly 40 percent higher. If he or she waits until 70, the monthly benefit increases by another 25 percent.

To help you determine at what age you should start claiming your Social Security benefits, check the retirement estimator calculator and other information at www.socialsecurity.gov.

Pension plans

A pension is an employer plan that is designed to provide retirement income to employees who have vested, or worked enough years, to qualify for the income.

Defined-benefit plans promise a fixed income, usually paid for the employee's lifetime or the combined lifetimes of the employee and their surviving spouse. The employer contributes to the plan, invests the assets, and pays out the benefit.

The amount you will receive in pension payments depends on the years you worked, the compensation you received, and other provisions that are specific to your company's plan. You should check with your human resources department well in advance of your retirement about the plan details, including payout options and other decisions.

Tax is due on your pension income at your regular rate, so a percentage is withheld from each check. If the state where you live taxes retirement income, those taxes are withheld, too. But, pension income is not subject to Social Security or Medicare withholding.

Annuities

Another possible source of retirement income is an annuity, which is an insurance company contract intended to provide regular income payments, often for your lifetime. There are three basic types of annuities:

- An immediate annuity converts a sum of cash into a steady stream of income. You typically pay for an immediate annuity with a single, upfront payment before the payout phase begins.
- A deferred annuity is typically purchased by paying premiums to the issuing company during your working years. The accumulated value of your account provides a source of regular income after you retire. Any earnings in your account are tax deferred until you start withdrawals.
- A longevity annuity resembles an immediate annuity. You purchase it with a lump sum or transfer the money from your IRA or employer-sponsored plan balance. The difference is that instead of beginning to pay income right away, as an immediate annuity does, the start date for receiving income from a longevity annuity is a number of years in the future, based on the age you select. It just cannot be older than 85.

Annuities can be complicated products with many different features and fees. While advocates point to the regular income that annuities guarantee, critics maintain that the costs eat into the benefits these products provide. And there is always the risk that the company providing the annuity will be unable to meet its financial obligation to its contract holders.

If you are planning to purchase an annuity, you can consult a knowledgeable fee-only financial professional to help you make appropriate decisions about annuities for your financial situation.

Tax-advantaged retirement accounts

Any investment we have discussed so far – stock, bond, mutual fund, ETF – becomes a retirement investment when you own it in a tax-advantaged retirement account, such as a 401(k) or IRA.

Because investments by themselves do not distinguish a retirement account from a nonretirement account, what does? It is the way that earnings in the accounts – and sometimes the contributions made to them – are taxed.

In a taxable nonretirement account, income tax is due on all earnings in the year you receive them, although different types of investment income are taxed at different rates. If you collect $100 in interest payments in a year, that $100 is added to your other ordinary income, including salary or wages, and is taxed at the same rate.

Tax-advantaged accounts on the other hand let your investment earnings grow on a tax-deferred, or in some cases, tax-free basis during your working years. Some tax-advantaged accounts are employer-sponsored and others you can set up on your own.

Note: The following sections discuss rules that may change from year to year including contribution and income limits, deduction amounts, and age requirements. Be sure to check with trusted resources for changes to these rules.

Employer-sponsored retirement plans

- **401(k) plans** – 401(k) plans are offered by many employers as an employee benefit. The employee that signs up to participate agrees to have a percentage of their earnings paid into an investment account. The employer may match part or all of the employee's contribution. This is free money! The employee then chooses to invest the money among a number of investment options, typically mutual funds.

  The employee's contributions to traditional 401(k) accounts are deducted from their gross income before income taxes are calculated, thus lowering their taxes. For example, you would be taxed on $50,000 of income if you earned $55,000 and contributed $5,000 to your 401(k) in that year. Investment gains grow tax-deferred until you withdraw the money in retirement.

  You can begin to withdraw money from your 401(k) penalty-free starting at age 59 ½. In certain circumstances, you may be able to withdraw money even earlier without paying penalties.

  Some employers also offer an after-tax Roth 401(k) account. You contribute after-tax, not pretax, income to a Roth 401(k) so your taxable income is not reduced for the years you contribute. But everything you withdraw from the account after you retire is totally tax-free provided you are at least 59½ and the account has been open at least five years.

  There is an annual cap on 401(k) contributions imposed by the federal government. The limit is $23,000 in 2024, plus a catch-up contribution of $7,500 if you are 50 or older.

- **403(b) plans** – A 403(b) plan is similar to a 401(k) retirement savings plan. It is for employees of not-for-profit organizations, including charities, public school districts, universities, foundations, and other public-sector entities.

  Like a traditional 401(k), your contributions to a traditional 403(b) are tax deductible, and any earnings are tax-deferred until withdrawn. Contributions to a Roth 403(b), which some but not all employers offer, are made with after-tax dollars, but the withdrawals are tax free if the account has been open at least five years and you are 59½ or older.

- **457(b) plans** – 457(b) plans are available to state and municipal employees. The limit is $23,000 in 2024, plus a catch-up contribution of $7,500 if you are 50 or older. If your 457(b) plan offers a Roth account, you contribute after-tax income, but withdrawals are tax free if you are at least 59½ and your account has been open at least five years.

OregonSaves

OregonSaves is a retirement savings program available to Oregon workers whose employers do not offer a workplace retirement plan. It is also available to self-employed individuals, and others who want an easy way to save. You can learn more about OregonSaves at oregonsaves.com.

Individual retirement accounts (IRA)

Whether or not you participate in an employer-sponsored retirement account, you can also open an IRA.

If you receive a salary, wages, commissions, or other income for work you do, you can contribute to an IRA. What you may not realize is that you can contribute to an IRA in addition to participating in a 401(k), 403(b), or other employer-sponsored retirement plan. Or you can choose an IRA instead of those plans if you do not qualify to participate in an employer plan.

Even if you do not have earned income, you may be eligible to open a spousal IRA if your spouse has earned income.

Much like employer-sponsored plans, IRAs may be traditional or Roth. With a traditional IRA, earnings in your account are tax deferred, and no tax is due as those earnings compound. You choose your own ***custodian*** – a mutual fund company, bank, credit union, brokerage firm, or other financial services company – and then select investments from among those the custodian makes available. If you invest with a mutual fund company, you will likely have more choices than a typical employer provides through a 401(k). You can buy and sell as often as you like without tax consequences, though you may pay trading costs.

Like employer-sponsored plans, IRAs have an annual contribution limit: In 2024, it is $7,000. And like a 401(k), there is a catch-up provision – in this case, $1,000 – for a total contribution limit of $8,000 if you are 50 or older. Note that contributions limits for IRAs and employer-sponsored plans may change from year to year, so be sure to check the limits each year.

You can make a catch-up contribution every year you have earned income starting at age 50 and make up a lot of ground in saving for retirement. For example, if you are 50 and have saved nothing for retirement, you can contribute $7,000 every year to an IRA, plus a $1,000 catch-up contribution. You could save even more if the annual contribution or the catch-up amount increases, as it sometimes does.

Traditional IRA

In a traditional IRA, your earnings are not taxed until you withdraw them from your account, usually after you retire. If you are at least 59½, there is no penalty for taking the money out, even if you are still working.

You may qualify to deduct your contribution to an IRA based on your ***modified adjusted gross income (MAGI)***. In 2024, you can deduct up to the amount of your contribution limit if you file as a single taxpayer or as a head of household and your MAGI is less than $77,000. If your MAGI is between $77,000 and $87,000, you can deduct a gradually decreasing percentage, until your eligibility phases out with a MAGI greater than $87,000. If you are married and file a joint return, you qualify for a full deduction up to a MAGI of $123,000, with gradually phased out eligibility until your MAGI reaches $143,000. Above that amount, you do not qualify for a deduction.

You also may be eligible to deduct your contribution despite your MAGI if you are not covered by a retirement plan at work; however, there are limits if you are married, file a joint return, and your spouse is covered by a plan at work.

Custodian: A financial institution that holds a customer's securities or other financial assets for safekeeping. Custodians may also handle investment activities, such as purchases, sales, and payments on behalf of its customers.

Modified adjusted gross income (MAGI): A measure of your household income that the IRS uses to determine your eligibility for certain tax benefits.

In the years you qualify, taking a deduction for your traditional IRA contributions will reduce your taxable income. But remember, those contributions will be taxable, along with your IRA earnings, when you begin making withdrawals.

With a traditional IRA, you must begin to take ***required minimum distributions (RMDs)*** when you reach 73, whether or not you need the money.

Roth IRA

A Roth IRA has the same contribution limits and provides the same tax-deferred earnings as a traditional IRA. But there are significant differences between the two.

With a Roth IRA, you are not required to start making withdrawals at any age as you are with a traditional IRA. And, as with any IRA, you can continue to contribute as long as you have earned income, even if you are in your 90s.

Even better news is that you can withdraw your earnings tax free if you are at least 59½ and your account has been open at least five years. However, your contributions to a Roth IRA are never deductible. They are always made with after-tax income.

There are eligibility requirements for contributing to a Roth IRA, based on your MAGI. In 2024, as a single taxpayer, you are qualified to make a full contribution, if your MAGI is less than $146,000, and to make an increasingly smaller contribution until your MAGI reaches $161,000. The comparable limits if you are married and filing a joint return are $230,000 and $240,000.

Individual retirement accounts (IRAs)

Roth IRA

- Contributions are made with after-tax dollars and are not tax-deductible
- Income limit for contributions
- Your earnings grow tax-free
- Withdrawals are tax-free
- Withdrawals are never required

Traditional IRA

- Contributions may be tax-deductible based on income (MAGI)
- No income limit for contributions
- Your earnings grow tax-deferred
- You pay income tax on withdrawals
- Withdrawals mandatory after age 73

Required minimum distributions (RMDs): The amount of money that must be withdrawn annually from an employer-sponsored retirement plan or traditional IRA.

	Employer Plan	IRA
How to participate	Depends on whether your employer offers a plan	Anyone with earned income can open an IRA, though there are income limits on Roth IRAs
Investment choices	Choices determined by your employer's plan	You choose the custodian which will typically offer more choices than employer-sponsored plan
How they are funded	Contributions are withheld from your pay. Employers may offer a matching contribution (free money)	You contribute money from your bank or credit union account
Contribution limits (2024)	$23,000 + $7,500 catch-up	$7,000 + $1,000 catch-up
Withdrawal flexibility	Must begin withdrawals after turning 73	Required after age 73 for traditional IRAs; Roth IRAs do not have required withdrawals

Employer plan or IRA

Saving for retirement, like everything in investing, is a matter of choice. You can choose to participate in a workplace plan such as a 401(k), or you can opt out of the employer-sponsored plan and establish an IRA, either traditional or Roth. Or, you can choose to contribute to both an employer-sponsored plan and an IRA.

An IRA is likely to have more investment choices than a 401(k), 403(b), or 457 plan, and IRA fees may be lower, based in large part on the investments you choose. And while traditional IRAs, such as a 401(k), 403(b), or 457 plan, require you to take withdrawals after you turn 73, you may have more control over managing how you take those withdrawals with an IRA than you do with an employer-sponsored plan.

On the other hand, employer-sponsored plans have much higher contribution limits, which allow you to build your retirement savings faster if you can contribute more than the cap on IRA contributions. Investing is probably easier with an employer-sponsored plan as well because all you need to do is sign up. Your contributions are automatically withheld from your pay and deposited directly into the investments you have chosen. If your employer matches your contributions, remember, this is free money; take advantage of this opportunity.

You have to do a little more upfront work with an IRA, including choosing a custodian, selecting investments, and arranging to have money from your paycheck or checking account transferred directly into your IRA on a regular basis.

Whichever retirement savings choice you make, you should not pass up this opportunity to save for retirement with tax-deferred earnings.

Cash-outs and rollovers

If you participate in a workplace retirement account, the balance you have built up is a tempting source of ready cash. You can usually borrow from your account with favorable repayment terms. And when you switch jobs, you can cash out, putting all the money in your pocket; however, doing so may sabotage your retirement planning. If an employee cashes out from an employer plan and does not roll the money into another qualified retirement account, he or she faces income taxes and potentially a stiff tax penalty.

Similarly, public- and private-sector workers who participate in a pension plan do not always consider all the ramifications of withdrawing money from their pension accounts. Pension plans in solid financial shape can provide a monthly annuity payment for life – a valuable benefit available to fewer and fewer U.S. workers and one not to be surrendered lightly.

Pension benefits also attract unscrupulous investment salespeople who can reap a windfall in commissions and fees by convincing pension holders to roll over some or all of their money into other, supposedly higher-yielding investments. Pension holders run the risk of putting their money into an inappropriate, high-cost investment or, at worst, investing in a fraudulent investment program. As always, make sure you deal with a registered investment adviser and take the time to understand the fees and costs you may pay.

Keep in mind

Before taking a loan from an employer plan, remember, too, that if you leave your job and have an outstanding loan balance, you must repay it in full within a strict time frame. Otherwise, the amount that has not been repaid is considered a withdrawal. Income taxes and perhaps a 10 percent tax penalty will apply for any outstanding loan balance.

If you switch jobs, rolling over your plan assets to a new employer plan or IRA is one way to make sure your money continues to grow tax-deferred. Or, if you are comfortable with your former employer's plan, you may be able to keep your assets there. But cashing out will only damage your retirement savings.

PART 5: AVOIDING SCAMS AND UNDERSTANDING HIGH-RISK INVESTMENTS

In 1906, American satirist Ambrose Bierce coined the word incompossible, as in, "Two things are incompossible when the world has scope enough for one of them, but not enough for both."

That word perfectly describes the kind of mindset that makes investors susceptible to fraud – reaching for the "incompossible dream" of high returns with very little or no risk.

The warning signs of fraud

To safeguard against investment fraud, there are specific promotions to avoid and warning signs to heed:

Tips from those you know: Churches, community organizations, retirement communities – all are fertile ground for what is known as affinity fraud, where a con artist exploits an affiliation with a group as a way to win an investor's confidence. The crook may be a member of the group or may just pretend to be. A fraudulent investment scheme may spread quickly among the group's members and can often extend to trusting family members and friends.

Affinity fraud can turn into a Ponzi scheme, where early investors may – but not always – receive their promised returns with the money coming from later investors in the fraud.

Advertising – online and traditional: The explosive growth of social media, and online communications in general, has provided more avenues for fraudulent investment promoters to hawk their wares. It does not take much effort for a promoter to stake out a place on the internet and solicit funds for a fraudulent scheme.

Investors should remember that the apparent sophistication of a promoter and the professionalism of a website or social media channel are meaningless when it comes to selling investments.

Traditional advertising has not gone away, however. Advertisements for investments that range from inappropriate and misleading to downright fraudulent are still common on the radio and in the print and online formats of newspapers and magazines. Be wary of investment endorsements from celebrities, professional athletes, or other influencers. Just because a famous person has endorsed an investment product does not mean it is legitimate or appropriate for all investors.

Free-lunch offer: Speaking of mail, if you are older than 50, you may receive a steady stream of invitations to supposedly educational "free lunch" and dinner seminars. It is less of a hassle to eat elsewhere. At best, these invitations are pure marketing. They

can also serve as a sales pitch for a high-cost, unsuitable investment, and at worst they are a breeding ground for fraud.

Unsolicited calls, emails, and text messages: “Boiler rooms” – the term for a roomful of salespeople making unsolicited phone calls to try to hook investors – remain plentiful. Call screening make it easy to reject unsolicited offers. Hanging up works, too. Also, text messages – including “hot stock” tips or other investment opportunities addressed to someone else but are sent “by mistake” to another potential investor or victim – are a common tactic used by fraudsters.

Junk mail: For mail solicitations, buy a shredder, and use it.

Pressure to act: Never be pressured into making hasty investment decisions – a legitimate investment is not like a one-day-only sale at a department store or a short-term window to buy inexpensive plane tickets. If it is a good investment today, it will still be a good investment when you have had time to evaluate it.

Things you do not understand: Never hesitate to ask hard questions if you are unclear about the investment offer, or if the responses to your questions are confusing or evasive. A salesperson may be able to make the most convoluted investment sound reasonable – even irresistible – while keeping the details vague. Ask yourself if you really understand how the investment works.

All talk, no documents: Financial promoters must explain the costs, risks, and obligations of the investment. If there is no paperwork provided with that breakdown, do not invest. Before buying any investment, check to make sure the salesperson is licensed, and that the investment is registered.

Payments to individuals: Do not invest with anyone who instructs you to pay for an investment or investment advisory services by check payable to an individual and not payable to the company, or to transfer funds to an individual, not the company. This is a red flag you may be dealing with a scammer. Likewise, do not lend money to the adviser or broker.

Keep in mind

The best warning for investors is the old cliché: If an investment seems too good to be true, it probably is. And depending on your financial situation, even some legitimate investments should be avoided if they are not suitable for your financial goals.

You can defend yourself against crooks by being aware of the tactics they use, by carefully checking all the investment material they provide, and by investigating their credentials before you act. Ask questions to make sure you understand the investment and the risks of the investment. If you do not understand an investment or how it works, the investment is likely not suitable for you at this time. Ultimately, you are responsible for taking steps to avoid fraud, just as you are for the other investment decisions you make.

When you suspect fraud

If you suspect a violation of the law or believe you have received grossly inappropriate financial advice, you can contact the Oregon Division of Financial Regulation (DFR) with general questions or you can file a formal complaint. You can also check with DFR to see if a professional is licensed and if an investment being offered is registered in the state. DFR's consumer advocates are available Monday through Friday from 8 a.m. to 5 p.m. at 888-877-4894. Visit DFR's website at dfr.oregon.gov or send an email to dfr.financialserviceshelp@dcbs.oregon.gov.

To make a formal complaint, it is important to gather the following information:

1. The name of the account holder
2. The type of investment involved
3. The name of the salesperson or representative who sold you the product
4. A chronological list of events, starting with the initial contact made by the company
5. Copies of documents in support of the complaint, including statements, letters, forms, and applications
6. A description of how you want the company to rectify the situation

Top threats to investors

Certain types of investments raise red flags and require careful scrutiny. While it is always important to read the contracts and offering documents carefully before you make any investment, it is especially important for complex investment strategies with which you may not be familiar. If an investment sounds too exotic, or complex, or the salesperson promises big returns with minimal risk, consider just saying no.

Do not wager your savings on a "can't-miss" investment fairy tale.

Threat: Unregistered individuals

Risks to investors: If you buy an investment from someone who is not licensed to sell securities in your state, chances are high you are putting your money into a fraud.

What to do: Anyone acting as a sales agent for a company selling stocks, bonds, or other investments to the public must be licensed to do so. Always check to confirm that a person you are considering investing with is actually licensed to sell investments. You can do this by visiting DFR's website at dfr.oregon.gov.

Be aware that some fraudsters may try to impersonate licensed investment professionals. To avoid this threat, investors can look up the firm's phone number online and call that number directly or meet the professional in person at their office.

Threat: Cryptocurrency offerings

Risks to investors: Cryptocurrency offerings are extraordinarily volatile – in other words, risky – and almost impossible for a layperson to understand. Cryptocurrency prices continue to be in a constant cycle of boom and bust. Promoters of these investments look to take advantage of people who are swayed by the idea of virtual currencies as a quick path to wealth. Promoters will emphasize guaranteed, secure profits while concealing basic facts, such as the names of their principals and even the physical address of their office. In these instances, investors are transferring funds to anonymous parties operating from undisclosed locations – and they will have little recourse if their money is stolen.

Technology can create the illusion of professionalism, expertise, and success. Promoters manipulate video to falsely show they maintain cutting-edge facilities, use stock photographs to fictitiously represent company officials, and spoof email to represent that established businesses are recommending their securities offering.

What to do: Keep in mind that purchasing cryptocurrency involves significant risk and that cryptocurrency-related investment markets are not regulated like other securities. Cryptocurrency assets are rarely suitable for most investors. Despite these risks, if anyone chooses to purchase cryptocurrency, they should determine some basic facts about the company before doing so. Make sure you can identify the principals of the company and its physical location. If you do not, you will be transferring funds to anonymous third parties at undisclosed locations. Also ask to see audited records or other financial information to back up any claims of high profits.

Most important, deal with licensed parties. State registration requirements should apply equally to traditional securities and emerging securities, including products tied to cryptocurrencies.

Threat: Talking heads

Risks to investors: It is easy to believe that someone who dispenses financial advice on the radio, online, or in books, has special expertise that can put you on the safe and secure path to wealth. But that is often not the case.

The airtime for many investment radio shows is bought and paid for by the hosts, who may or may not have legitimate financial credentials. The content may not always be objective, but slanted to benefit the host or guest speakers.

The internet is even more of an ethics-free zone for posting financial content, and there are many alleged financial experts who tout their books, articles, or other materials that may not always reflect the reality of the products, services, or investments they are promoting. A growing number of "finfluencers" – social media influencers who focus on financial topics – have amassed huge followings. Many of these finfluencers have relationships with various companies and may receive compensation for endorsing the products and services they feature. Any compensation paid to a finfluencer is a conflict of interest that you should consider when evaluating the statements made by the finfluencer, along with other facts related to the product or service.

What to do: Listen to and read pundits with skepticism. Some base their advice on risky investments that are not suitable for most investors. Some do not disclose conflicts of interest and the fees they get for making certain recommendations.

A lot of pundit talk is just noise, and it is best to tune out anything that distracts you from sound investing principles.

Seek out unbiased education resources. One such source is the Securities and Exchange Commission's investor education website: investor.gov. You can also review a mutual fund's prospectus or a company's financial statements, which are required to be filed with the SEC and can be found at SEC.gov.

Threat: Active trading

Risks to investors: Active trading of stocks, bonds, foreign currency, and cryptocurrency is a tough way to consistently earn profits.

Foreign currency is a vast global market where prices are volatile, and losses can pile up in a few hours. There is a huge risk in buying into investment promotor promises that predict the prices of currencies and guarantee enormous profits with little or no risk.

Promoters often solicit investors with outsized claims of profitability – 3 percent a week, or 30 percent a month – that may tempt investors to start counting their expected windfall.

What to do: Make sure the trader and the firm are licensed to sell securities, currencies, or commodities. Currency traders, for example, must be registered with one or more federal regulatory agencies and in most cases licensed by the state securities regulator in the states where they operate.

Keep in mind the unusual complexity and skill involved in earning consistently high returns in the rapid trading of any asset.

Threat: Targeting the elderly

Risks to investors: Older people sometimes accumulate substantial assets after a lifetime of working and saving. They may also be experiencing cognitive decline. These are some of the reasons con artists target them.

Cold calls remain a staple of investment fraud. The longer a caller can get someone to stay on the line, the greater the chances he or she can steal their victim's money. Older people who welcome a chance to engage with others may be especially susceptible to this type of scam.

The U.S. Congress passed the Senior Safe Act in 2018 to provide legal immunity for financial firms that report suspected financial fraud involving senior citizens. According to the law, senior citizen is defined as a person who is 65 or older. The North American Securities Administrators Association (NASAA) has helpful resources to combat the financial exploitation of older investors. You can find it at www.nasaa.org/serveourseniors.

What to do: Get a reality check from a trusted family member. Money is often a touchy topic within families, but for an older person, a family support network is ideal.

No matter our age, most of us could use a trustworthy and informed friend or family member to give advice on large financial transactions or a change in investment strategy. A financial professional could help, too, whether it is a certified public accountant, attorney, certified financial planner, or licensed investment adviser.

Sometimes older people delay reporting fraud out of embarrassment, thinking it is an admission they can no longer handle their own affairs. But it is important to report suspected fraud as soon as possible. The quicker fraudulent activity is reported, the more likely an investor will be able to get his or her money back and the more likely the authorities will be able to catch the fraudster and prevent others from becoming victims.

PART 6: FINDING A FINANCIAL PROFESSIONAL YOU CAN TRUST

At some point you may turn to a financial professional for help with investing decisions, particularly if you are trying to achieve different goals – such as retirement, paying for a child's education, and buying a home. Before you can begin the search for someone you can trust, you need to identify the type of help you need. While some may only need a professional to point them to a suitable investment, others may need help in developing and executing a strategic long-term plan that is in their best interest. There are a wide range of investment professionals to choose from, and there are key differences in the ways they are compensated, the kinds of credentials they may have, and in the duty they have to act in your best interest.

Let us begin by exploring the distinction between two basic types of financial professionals – ***investment advisers*** and ***broker-dealers***.

Investment advisers

An investment adviser, as the name implies, is a person or firm that is compensated for providing individually tailored investment advice to their clients. They often help clients understand market trends, develop an asset allocation strategy, make investment decisions, and manage their portfolios. They may also offer financial planning services such as estate and tax planning. Investment advisers have a ***fiduciary*** duty, or legal requirement to act in your best interest, not for their own personal gain.

Investment adviser: A financial professional who provides guidance to investors to help them make investing decisions. The adviser may also manage an investor's portfolio.

Broker-dealer: A person or firm licensed by the SEC to buy and sell securities for its own account or on behalf of its customers.

Fiduciary: An individual or organization legally responsible for managing assets on behalf of someone else, usually called the beneficiary. The assets must be managed in the best interest of the beneficiary.

Investment advisers (IAs) may work as sole practitioners or, more commonly, at advisory firms that employ a number of advisers. Investment advisory firms are also called ***registered investment advisers (RIAs)***, and the advisers who work for them are known as investment adviser representatives (IARs).

Unlike broker/dealers, who typically earn a commission on trades they make on your behalf, investment advisers charge a fee for their services, sometimes based on a percentage of the money they manage, sometimes on an hourly basis, sometimes on a flat fee, and sometimes on a retainer basis for a package of services. The term "fee-only financial adviser" means the adviser is not paid commissions on the products they sell or trade.

In selecting an adviser, be sure to do your homework. Advisers must provide you with key information, such as their credentials, years and type of professional experience, the services they provide, how they are compensated, and any conflicts of interest that may apply. You should also ask about a prospective adviser's work with other clients whose financial situation may be similar to your own.

Investment advisers are required to be licensed with one of two regulatory authorities, depending on the size of their business:

- Investment advisers who manage up to $100 million in total assets under management (AUM) must be licensed with and inspected by the state securities regulator in the state or states where they operate.
- Investment advisers with more than $100 million in assets under management must register with the U.S. Securities and Exchange Commission (SEC).

The SEC requires registered investment advisers to provide clients with their background information and other important disclosures on what is known as Form ADV. Before doing business with an investment adviser, review their firm's Form ADV Part 2A brochure. This part of Form ADV must be written in plain English and contain information about:

- The RIA's business practices and any significant changes the firm has undergone recently
- Fees and compensation

Registered investment adviser (RIA): A financial firm or individual that advises clients on securities investments and may manage their investment portfolios. RIAs have a fiduciary duty to act in their clients' best interest.

- Multiple costs folded into a ***wrap fee*** charged to clients
- Conflicts of interest that the firm has or may have in representing a client
- The firm's social media accounts
- Types of clients the firm has
- Disciplinary information, if any, about the firm and its employees
- When and how the firm reviews client accounts
- Financial information about the firm

You can also find a firm's Form ADV at the SEC's Investment Adviser Public Disclosure website at www.adviserinfo.sec.gov.

Brokers

Like the term investment adviser, the terms broker and broker-dealer are legal terms that refer to the individuals and brokerage firms who are in the business of buying and selling securities on behalf of customers.

Wrap fee: An all-inclusive charge for the services of an investment adviser. The fee generally covers investment research, trading cost, and administrative fees.

Individual salespeople employed by brokerage firms are called stockbrokers and are officially referred to as agents, salespersons, or registered representatives. But these individuals use other unofficial titles, too, including financial consultant, financial adviser, and investment consultant. In recent years, brokerage firms have offered a broader range of investment planning services in addition to trading securities.

Many brokers' compensation is based on the commissions clients pay each time they buy or sell a security – a potential conflict of interest that could mean investors end up paying more than they should if brokers illegally trade excessively or if they sell products for which they receive exceptionally high commissions.

Historically, brokers have not had a fiduciary relationship with their clients but have been required to recommend only those assets that were suitable for a particular client. In its Regulation Best Interest (Reg BI), which took effect in June 2020, the SEC changed that standard. While still not fiduciaries, brokers must take each client's best interest into account and provide investors with a Form CRS which explains:

- The services it provides
- Its fees and other costs
- Any potential conflicts of interest
- The standard of conduct to which the firm and its employees adhere
- The disciplinary history of the firm and its employees

Retail investors should take particular interest in the potential conflicts of interest that might arise, the circumstances in which those conflicts might occur, and how they will be addressed.

Brokers may be required to be licensed with more than one regulatory authority, depending on where they live, to whom they offer securities, and the type of business they operate. Brokers engaged in the offer and sale of securities are required to register with the state securities regulator in states where they operate, which in Oregon is the Division of Financial Regulation. These brokers may also be subject to the oversight of the Financial Industry Regulatory Authority (FINRA).

It is not a common occurrence, but it will sometimes take months or years for both investment advisers and brokers to report disciplinary actions and other red flags, such as customer complaints, civil court cases, and bankruptcies. Failure to report relevant information in a timely way, which generally violates securities regulations, means potential investors do not have all the information they need when considering hiring an adviser or broker.

Dealing with registered brokers and advisers

Be sure to investigate any financial professional you are considering working with until you are satisfied that he or she is legitimate and check to see if they are licensed. Use FINRA's BrokerCheck website (brokercheck.finra.org) or visit the Oregon Division of Financial Regulation's website (dfr.oregon.gov) to check a license.

Researching a broker, adviser, or representative

To research a broker, adviser, or representative, start with the FINRA's BrokerCheck website, a database that holds licensing and registration information for broker-dealer firms and investment adviser firms as well as representatives of those firms in the United States. The BrokerCheck report will tell you about a representative's track record, including:

- Employment history for the past 10 years
- Disciplinary actions that have been taken by federal, state, and self-regulatory organizations
- Whether the broker or agent holds other professional designations such as a certified public accountant (CPA) or certified financial planner (CFP)
- Civil judgments and arbitrations in securities disputes
- Pending written complaints
- Criminal convictions or indictments
- Bankruptcy filings
- Outstanding liens and judgments

The BrokerCheck report may not be a complete record, however. It relies on self-reporting by registered firms and individuals, not all of whom submit to FINRA every document they should. It also does not include certain disclosures that are more than 10 years old, including bankruptcies, customer complaints, and lawsuits.

Robo-advisers

Investors who are comfortable handling financial matters online have another option for help: a robo-adviser. A robo-adviser is a digital platform that gathers personal and financial data from its clients to create and automatically rebalance algorithm-driven investment portfolios appropriate to meet the client's goals.

You can start the process of enlisting a robo-adviser by filling out an online questionnaire on the website of one of the dozens of firms that offer this service. You will be asked to detail your financial goals, income, assets, risk tolerance, short- and long-term goals, and investing time horizon.

Using a variety of high-tech tools – including advanced software and algorithms – your robo-adviser then crunches the data you have provided and churns out what it determines to be the most appropriate mix of assets for your portfolio.

Robo-advisers can handle single accounts, such as an individual retirement account, as well as multiple portfolios of taxable accounts, college savings accounts, or other categories of investment accounts.

Fees for robo-advisers typically are substantially less than those charged by traditional advisers because the service is largely automated. Fees are often 0.2 percent to 0.5 percent of the account balance. In addition, robo-advisers use low-cost index funds and ETFs to build portfolios. The required minimum investment is often in the $5,000 range, making the opportunity to invest available to a wider range of people.

Because not everyone is comfortable getting all their advice online, some robo-adviser services have expanded to offer a dose of human interaction. The cost of this expanded service varies, depending on whether you want to talk to someone online or on the phone, and how often.

One thing you should make sure you are clear on is how often your robo-adviser rebalances assets in your account to ensure that the overall mix of investments does not significantly differ from your target allocation. But rebalancing more than once a year may be excessive and can result in higher than necessary trading costs.

Rebalancing, which involves selling some assets and buying others to keep your portfolio aligned with your investment strategy, can also affect your taxes. For example, if the robo-adviser updates your portfolio frequently, you could have large short-term gains that are taxed at the same rate as your regular income rather than at the lower rate that applies to long-term gains. To qualify for a long-term gain, you must hold an asset for more than a year before selling it.

Finally, be sure to consider a robo-adviser's approach to investing before signing up. Just like their human counterparts, robo-advisers have varying investing styles and offer different investment products. The final decision on how to allocate assets in your portfolio is up to you.

Financial planners or advisers

Investment advisers are not the same as financial planners or advisers and should not be confused. The terms "financial planner" or "financial adviser" are generic terms, whereas the term "investment adviser" is a legal term that refers to an individual or company that is registered as such with either the Securities and Exchange Commission (SEC) or a state securities regulator. There are a dizzying number of credentials and professional designations for financial professionals, and the rigor and experience required for these designations varies widely.

Unlike the terms investment adviser and broker, the terms financial planner and financial adviser are not legally defined terms. The titles financial planner and financial adviser generally refer to someone who develops, and may also implement, comprehensive financial plans for clients based on their long-term goals.

A financial plan typically covers such topics as estate planning, tax planning, insurance needs, and debt management, in addition to more investment-oriented objectives, such as retirement and college planning. But you will want to be sure to ask about a planner's experience and credentials before you sign a contract to work with him or her.

Making sense of professional designations

A financial professional may use various titles, whether or not he or she is licensed with a regulatory authority. The problem is that there are at least 150 designations in use. According to an investor bulletin from the SEC and the North American Securities Administrators Association: "The requirements for obtaining and using [professional designations] vary widely, from rigorous to nothing at all."

Some designations fit no one's idea of rigorous. The chartered senior financial planner designation, for example, requires limited professional experience, a three-day course, and one exam. To become an accredited retirement adviser, an applicant can buy a study guide for a 100-question, multiple choice test. There is no coursework, and no way to check disciplinary actions or submit a complaint. This does not mean that individuals with such designations are unscrupulous, only that they have not undergone any rigorous testing and may not have the experience or knowledge clients may expect.

There are, of course, many designations that require extensive testing and continuing education, and whose oversight body may impose disciplinary sanctions. Earning the chartered financial analyst (CFA) designation requires hundreds of hours of study to pass three six-hour exams, and four years of work experience. Earning the certified financial planner (CFP) designation requires the completion of seven courses and three years of financial planning experience. CFPs have agreed to adhere to the principles of honesty, integrity, competence, and diligence when working with their clients and are subject to oversight by the CFP Board.

Investors need to look beyond the acronym or designation to determine what is behind it: the exams, ethical standards, and oversight body, as well as the continuing education required to maintain the designation.

One resource is FINRA's "Understanding Professional Designations," which provides a snapshot description of more than 200 designations. The site is not comprehensive, does not provide a comparison of the designations, and does not evaluate the designations. But it is a good place to start.

The proliferation of "senior adviser" certifications targeting elderly clients is a growing problem, according to the U.S. Consumer Financial Protection Bureau (CFPB). There are more than 50 such designations in use, with many of the titles practically identical. That is confusing for investors, on top of the typically wide variance in training and education these professionals receive.

If a financial professional tells you that he or she has a certain credential, ask some direct questions:

- Who awarded you the credential?
- What are the training, ethical, and other requirements to qualify for this credential?
- Do you have to take a course and pass a test?
- Does the designation require a certain level of work experience or education?
- To maintain the designation, are you required to take refresher courses?
- How can I verify your standing with this organization?

Keep in mind

As a reminder, investment advisory firms are required to provide their clients with information about their employees in Form ADV Part 2B, which is known as the brochure supplement. If an employee claims to have a professional title, the brochure supplement must include an explanation of the minimum qualifications for the title. This is not the case with brokerage firms or financial planning firms.

Questions to ask

Once you have researched potential investment advisers and brokers, it is time to ask questions. In "The Little Book of Safe Money" (Wiley & Sons Inc., 2009), author Jason Zweig, personal finance writer for The Wall Street Journal, recommends you sit down with the candidates and ask the following questions. While it can be intimidating to ask difficult questions of the representative, you may be entrusting your life's savings to the individual and should expect them to provide you with clear and direct answers. Professionals should be willing to answer your questions and explain things to you in terms you can understand.

- What made you want to become a financial adviser?
- Do you focus primarily or exclusively on asset management, or do you also have

expertise in taxes, retirement, and estate planning, as well as budgeting and debt management? What education, training, experience, and licenses do you have in these practice areas?

- What is your philosophy of investing? Do you rely mainly on lower-cost index mutual funds? (If the answer is "No," ask to see evidence that the alternatives actually have worked as well or better.)
- How high an annual return on my investments do you think is feasible? (Anything above 10 percent suggests the adviser is either delusional or dishonest. Answers below 8 percent start to make sense.)
- How do you manage risk?
- What needs and goals does your typical client have?
- How many clients do you have, and will you personally manage my account? How much time should I reasonably expect you to devote to me over the course of a typical year?
- Describe something you achieved for a client that makes you proud.
- What is the worst mistake you have made with a client?
- How do you go about resolving conflicts with clients?
- Describe the process you have in mind for helping me to achieve my goals.
- How will you monitor our progress?
- Would any investments you recommend create a potential conflict of interest between doing what's best for me and doing what benefits you?
- When recommending investments, do you accept any form of compensation from any third party? Why or why not?
- What are your services likely to cost me in a typical year? What percentage of my assets will you charge in annual fees? How do you report your fees and commissions?
- May I see a sample account statement, and can you explain it to me clearly?
- Can you provide me with your resume, your Form ADV, and at least three references?

As you ask these questions, take written notes on not just on how the adviser seems to respond to your queries but also on how the answers make you feel. Do you sense that this person is trustworthy? You should come away feeling that you would have no concerns about sharing a close secret with this person – because sooner or later, you probably will. If you have any doubts, find another adviser.

You, in turn, should be prepared to openly and honestly answer questions from financial advisers:

- Why do you think you need a financial adviser?
- How knowledgeable are you about investing and financial matters, and how confident are you in your knowledge?
- What does money mean to you?
- What are your biggest fears? What are your fondest hopes?
- How much time and energy are you willing to invest in any financial plan we develop?
- What would it take for you to feel our working relationship is successful?
- When someone presents you with evidence that your opinions may be mistaken, how do you respond?
- How do you deal with conflicts or disputes?

Invest time in picking a good financial adviser. It will be one of the most important decisions you make and one of the most significant relationships you ever have.

Regardless of the type of financial professional you choose to help you, be sure to read the contract before signing. That sounds like obvious advice, but it is advice that some investors do not heed. Read all pages of the contract, front and back. Pay close attention to any small print. Read carefully any terms addressing dispute resolution, noting any clauses in the contract requiring arbitration of disputes, and clauses that designate a specific forum for arbitration. Read the adviser fees and compensation section to understand how payments occur and if the adviser can change the fees charged to you without your subsequent acknowledgment.

Knowing the precise terms of the contract can prevent misunderstandings, disagreements, and even lawsuits down the line. Clear up any questions with the prospective financial professional ahead of time, and if necessary, consult with a lawyer, accountant, or trusted third party to review the contract terms.

As long as you are working with a financial professional, it is a good practice to annually review the professional's status on BrokerCheck to make sure they are still licensed and to see whether any new complaints or regulatory matters are posted.

Finally, whether you work with an investment professional or not, take the time to read and review investment account statements on a regular basis. Keep an eye out for any notices of changes to account fees or terms.

Department of Consumer and Business Services

Division of Financial Regulation

Visit dfr.oregon.gov
Call 888-877-4894 (toll-free)
for consumer help

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