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Personal finance for law students.

FOUNDATIONS OF INVESTING

Guidebook

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WHAT YOU'LL GET OUT OF THIS GUIDE

> *"An investment in knowledge pays the best interest."*
>
> **BENJAMIN FRANKLIN**

Whether you're a beginner or a seasoned pro, investing can seem a little daunting. Nevertheless, investing for your long-term goals is a critical step on your way to financial independence. The goal of this guide is not to make you an expert, but to take the intimidating process of investing and make it more approachable and workable for you!

Here are some questions that you'll have the answers to by the end of this guide:

- ☑ Why should I invest in the stock market?
- ☑ When is the best time to start investing?
- ☑ How does investing grow wealth faster than saving?
- ☑ Should I put all my money into the stock market?
- ☑ How do I get started with investing?
- ☑ What are important elements of investing?
- ☑ How do I know what types of investments are right for me?
- ☑ How do I set my investment goals?
- ☑ Are there costs to investing?

SAVING VS. INVESTING

"Investing is the process of laying out money now to receive more money in the future."

WARREN BUFFET

Investing is setting aside money for the future in a way that helps you boost your growth when compared to simply depositing it in a checking or savings account. While both saving and investing are key pieces to a well-balanced financial plan – here are some differences to understand:

	SAVING	INVESTING
OBJECTIVE	Accumulate cash for emergencies, periods of unemployment, and/or large purchases and experiences	Build wealth primarily for income during retirement and/or leaving an estate to heirs; take advantage of compound growth[1]
TIME HORIZON	Short or mid-term goals (0-5 years); ongoing protection for emergencies	Long-term (10+ years)
COMMONLY USED ASSETS	Cash, Money Market Mutual Funds, Treasury Bills (T-Bills)[3]	Stocks[5], Bonds[6], Mutual Funds[7], Index Funds, Target Date Funds
ACCOUNTS USED	Checking Accounts, Savings Accounts, Money Market Deposit Accounts[4], Certificates of Deposit[2]	Employer-provided retirement plans (401k, 403b, 457); Individual Retirement Accounts (Traditional and Roth)
AVERAGE RISK[8] AND RATES OF RETURN[9]	Little to no risk, little to no return	Higher risk, higher long-term return

The Right Mix

Even though investing can give you more bang for your buck in the long-run, you should determine the amount of risk you're willing to take on. Your investment options can range from conservative[10] to aggressive[11]. For example, bonds are usually seen as conservative investments, while stocks are seen as more aggressive. A conservative approach means accepting a lower return for the security of lower risk, while an aggressive investor will own more mid-to-high risk investments in hopes of getting a higher return. In reality, most investors own a mix of stocks and bonds that helps them sleep best at night depending on their time horizon, risk tolerance, and goals.

Find Your Own Risk Tolerance

Evaluate your own risk tolerance today by completing the Personal Risk Assessment in MAX Online. Most investing websites and brokerage firms also offer risk tolerance questionnaires to help determine your personal comfort level with volatility and risk. Along with setting your goals, this should be the first stop on your investing journey.

DEFINITIONS:

1: Compound Growth – When interest (or growth) is realized on returns you leave invested, which accelerates the overall growth of your money.

2: CD – A savings option that offers higher interest rates than most savings accounts, but you can't access your money for a specific period of time without a fee being charged.

3: T-Bills – A government savings option. The price you pay for a T-Bill is less than the face value, but you'll have to wait a specific amount of time until the bill matures – when you can cash out for the face value.

4: Money Market Account – A hybrid between checking and savings accounts. They offer higher interest rates than normal savings accounts, but may also allow you to make a limited number of purchases directly from the account.

5: Stock – A share of ownership in a company.

6: Bond – A loan to a company, government, or municipality.

7: Mutual Fund – A company that pools money from multiple investors to buy investments which are chosen by a portfolio manager.

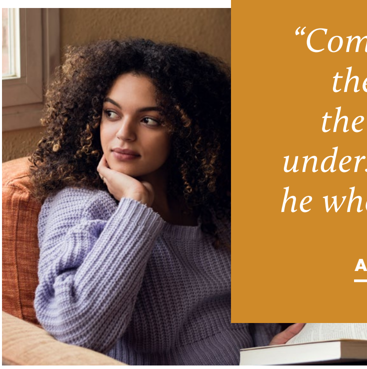
8: Risk – The potential loss of money, often used in conjunction with the term volatility, which is how often and how rapidly an investment changes in price.

9: Return – The money made or lost on an investment, through growth of the investment and/or interest and dividends received.

10: Conservative approach – Accepting lower returns in exchange for less risk and volatility.

11: Aggressive approach – Willing to accept more risk and volatility for the potential of greater growth.

THREE REASONS INVESTING WORKS



“Compound interest is the 8th wonder of the world. He who understands it, earns it; he who doesn’t, pays it.”

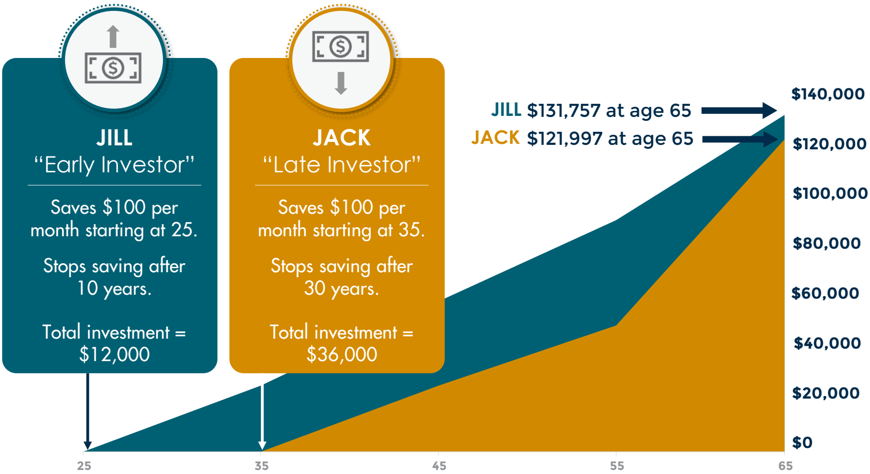
ALBERT EINSTEIN

Compound Growth

Jill vs. Jack

Compound growth is one of the clearest advantages of investing. Remember, when you start investing as soon as possible, leave your investments alone to grow, and reinvest any dividends[1] or interest[2] you receive, you will experience a ‘snowball’ effect as future growth and interest will be on the new, larger balance. This is the power of compound growth.

See the difference a decade of investing can make through the story of Jill, an early investor who starts at age 25, and Jack, who starts investing just ten years later. *(see graph on next page)*



The reflected outcomes are calculated at a 7% average annual return. In actual investing, returns vary from year-to-year.

This graph shows the differences in savings habits over the course of 40 years by Jill and Jack. Jill only saved $12,000 from age 25 to 35. Jack started saving 10 years later than Jill at age 35 and saved for 30 years, saving a total of $36,000.

The bottom line? Although Jill only saved for 10 years and saved a total of $24,000 less than Jack, she still ended up with over $9,750 more in her investment account! Interest and growth had more time to compound, giving Jill the advantage in the end.

Best Practice: Start investing early and often to harness the power of compounding growth over your lifetime.

DEFINITIONS:

1: Dividends – Profits periodically passed through from companies to shareholders.

2: Interest – Periodic (usually semi-annual) payments to bondholders who own bonds issued by companies, governments, or municipalities.

Investing Can Beat Inflation

"Inflation is the one form of taxation that can be imposed without legislation."

MILTON FRIEDMAN

Inflation is the overall general upward price movement of goods and services in an economy, as defined by the U.S. Bureau of Labor Statistics, which has various indexes that measure inflation.

While inflation varies year-to-year, it's a serious drag on your investments. For example, if your investments average a 7% return over 20 years, but inflation over that same period averages 3%, then your real return based on how much your money will actually buy is closer to 4%.

Put another way, in 2020 you would need $152.83 to buy the same amount of goods or services as $100 would have bought you in 2000.* That's a significant increase! Thankfully, investing can help you keep pace, or even beat, this silent killer.

***MAX Strategy**: Use the CPI Inflation Calculator at bls.gov/data/inflation_calculator.htm to run your own numbers as you build your inflation projections as part of your plan.



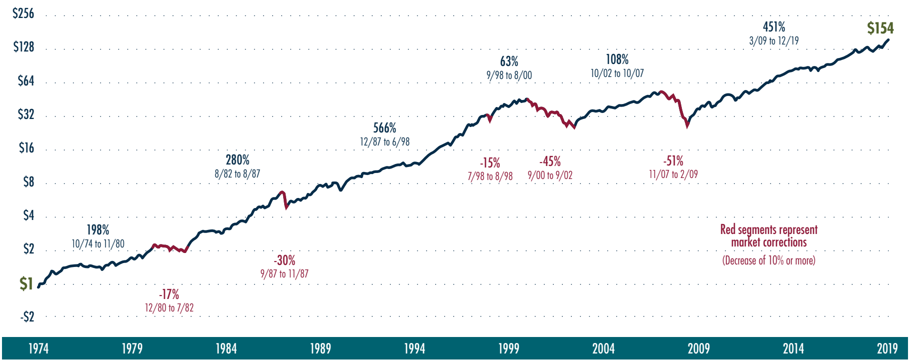
Staying the Course Pays Off

"The investor's chief problem—and his worst enemy—is likely to be himself. In the end, how your investments behave is much less important than how you behave."

BENJAMIN GRAHAM

GROWTH OF $1 INVESTED IN THE S&P 500 INDEX

Jan. 3, 1974 to Dec. 31, 2019



The stock market[1] has an average return of 6 to 10 percent annually, though the ups and downs for any given year can be significant. If you invested $1 in 1974 and left that investment alone until 2019, you would now have $154 - an increase of 15,300%!

In other words, for long-term investing, it is typically worth leaving your investments alone during a downturn. Historically, the market has always rebounded.[2]

In the short-term, investing in the stock market may not be the best bet if you are depending on having the money in five-to-ten years or less, since these shorter time periods have not performed as well as over the longer-term, as illustrated above.

1: Stock Market: This chart is illustrating one measure of the market – the S&P 500 Index, which includes 500 of the largest publicly traded companies in the U.S. It is a commonly used measure of investment growth or loss, along with other indexes like the Dow Jones Industrial Average and the NASDAQ.

2: Always remember, while it's helpful to see what the market has done in the past to inform your decisions now, previous performance does not guarantee similar results in the future!

HOW TO SET SMART INVESTING GOALS

> *"A goal without a plan is just a wish."*
>
> ANTOINE DE SAINT-EXUPERY

When setting investing goals, you'll want them to be SMART: Specific, Measurable, Achievable, Realistic, and Time-bound.

Common investment goals include:

- Saving for retirement
- Saving for a down payment on a house
- Establishing an estate to leave to heirs or a charity

For any investment goal, ask yourself these questions:

S What is your specific investment objective?

M What is your desired ending amount?

A How much can you start with today?

R How much can you realistically contribute each month?

T How many years away is your goal?

EXAMPLE:

Instead of saying, “I want to save for retirement”, try answering these questions to build your SMART goal.

- What is your specific investment objective? – Save money each month for retirement in my 401k and Roth IRA.
- What is your desired ending amount? - $1,000,000
- How much can you start with today? - $500
- How much can you realistically contribute each month? - $150
- How many years away is your goal? – 40 years

A SMART goal would be: “I want to save $1,000,000 for retirement in 40 years by starting with $500 and contributing $150 per month, steadily increasing my contributions as my pay goes up over that time.” If you’re not sure how much you’ll need to accomplish a certain goal like funding retirement, consult an online calculator like the one at choosetosave.org/ballpark/ or seek the assistance of an established financial planner.

Once you have an idea of what you’re aiming for, use the SMART Investment Calculator in MAX Online to crunch your numbers!

INVESTING FOR RETIREMENT

> *“When you invest, you are buying a day that you don’t have to work.”*
>
> **AYA LARAYA**

The most common investing goal is to build a “nest egg,” or investment portfolio, to provide income and stability throughout retirement. The average retirement age in the U.S. is 62 years old, and with many people living well into their 80s and 90s, saving to support yourself during retirement is more important than ever. Experts recommend that you save enough to replace at least 70 percent of your pre-retirement income, but more may be appropriate depending on your situation. Many savers do this through retirement savings plans – which come in many different forms and have different advantages. The main kinds of retirement plans are employer-sponsored plans like a 401(k) or a 403(b), and Individual Retirement Accounts, also called IRAs, which come in two varieties for individual savers – Traditional and Roth.

Here are some key features of these types of accounts. For a complete list of retirement investing accounts and their features and benefits, visit irs.gov/retirement-plans/plan-sponsor/types-of-retirement-plans.

MAX Strategy: If your employer offers a match to your contributions, take it if you can. This is like getting a raise that you "unlock" by contributing to your retirement!

Non-Retirement Investing

For non-retirement, short- or long-term financial goals, you can invest in a taxable brokerage account[1] either online or through a financial institution like a bank or a brokerage firm. Investment growth will be taxed in the year you sell your shares as these accounts don't have any tax advantages.

These types of accounts are good for individuals who have financial savings goals for longer than five to ten years, but before retirement. They are also a supplemental investing vehicle for those who have contributed the maximum toward their retirement accounts annually and already have a fully funded emergency fund.[2]

EMPLOYER PROVIDED PLANS	
DEFINITION	401(k), 403(b), and 457 accounts are provided by employers to incentivize employees to save for retirement in a tax-advantaged way. Many employers will match contributions of their employees to these accounts up to a certain percentage.
FEATURES AND TAX BENEFITS	Contributions can be made up to an annual limit set by the IRS. They can be either tax-deductible in the year you make them, or if you choose you can make Roth contributions to forgo the tax deduction and pay taxes on your contribution in the year it's made. Because you already paid taxes, your investment and all growth will grow tax-free in a Roth version of these accounts.
MAY BE GOOD FOR	Pre-tax: Employed individuals expecting to be in a lower tax bracket in retirement or individuals wanting to lower their taxable income now. After-tax: Employed individuals expecting to be in a higher tax bracket in retirement.

TRADITIONAL IRA	
DEFINITION	An individual retirement account or IRA can be funded by an individual instead of through an employer. Because of this, there is more flexibility and control associated with IRAs.
FEATURES AND TAX BENEFITS	Contributions to IRAs are also tax deductible in the year they are made, up to the annual limit set by the IRS (which is much lower than the limit for employer-sponsored plans). You pay taxes on the money you withdraw after you turn 59 ½. If withdrawals are made before this age, you must pay a 10% penalty in addition to taxes.
MAY BE GOOD FOR	Individuals expecting to be in a lower tax bracket in retirement or individuals wanting to lower their taxable income now. There are income limits set by the IRS for deducting contributions to an IRA

ROTH IRA	
DEFINITION	A type of individual retirement account funded with after-tax dollars.
FEATURES AND TAX BENEFITS	If withdrawals from a Roth IRA are considered 'qualified' (after the age 59 ½ and held for at least 5 years), then they are entirely tax-free. Another key feature of a Roth is that you can access your contributions to the account at any time before 59 ½ without penalty since you already paid taxes on those funds!
MAY BE GOOD FOR	Individuals expecting to be in a higher tax bracket in retirement, or those who may need the funds pre-retirement for something like buying their first home or as a backup emergency fund. There are income limits for contributing to Roth IRAs, set by the IRS.

DEFINITIONS:

1: Brokerage Account – A taxable investment account used to buy stocks, bonds, mutual funds, or other investments.

2: Emergency Fund – Easily accessible savings account to help cover financial emergencies such as medical bills or unexpected car expenses. A common recommendation is to have three to six months of living expenses.

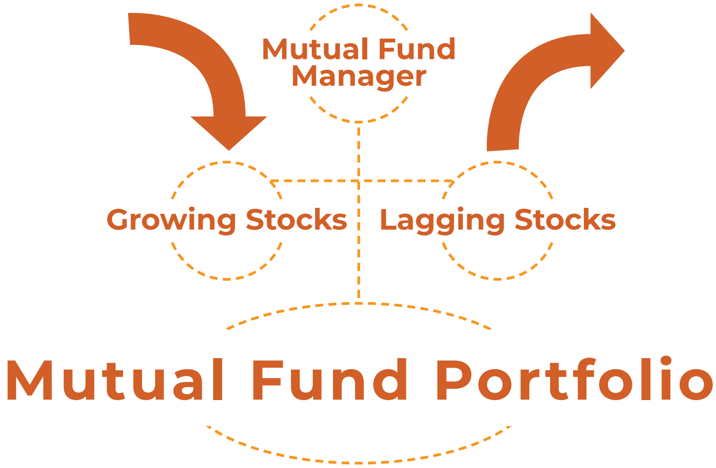
WHAT'S A MUTUAL FUND?

"Mutual funds were created to make investing easy, so consumers wouldn't have to be burdened with picking individual stocks."

SCOTT COOK

Most investors use mutual funds, index funds[1], or target-date funds[2] inside their employer-sponsored 401(k), 403(b) or 457 retirement accounts to invest for retirement.

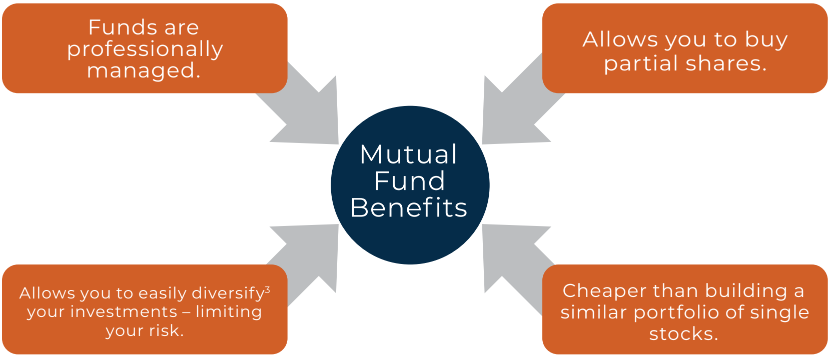
A mutual fund is a company that pools money from multiple investors to buy a variety of stocks, bonds, or other types of investments managed by a professional. The mutual fund manager's job is to decide which assets to move into and out of the fund. In the case of a stock mutual fund, they may try to buy stocks for the fund that are projected to perform well, while selling stocks out of the fund that have either underperformed or no longer support the goals of the fund. In this way, the fund manager is like the "lifeguard" of the mutual fund, and they get paid as part of the fund's expenses to provide this service.



Benefits of Mutual Funds

Mutual funds provide an opportunity to invest without needing a lot of money to start. They are cost-effective vehicles for many reasons:

- You can buy partial shares, which makes it easier to invest the same amount of money every month, also called *dollar-cost-averaging*.
- Mutual funds provide easier entry into markets for those who don't have the time or resources to learn the nuances of investing.
- Mutual funds give you exposure to hundreds of stocks and/or bonds at the same time, something that would be cost-prohibitive to do with a portfolio of single stocks or bonds.



With thousands of mutual funds to choose from, there's a fund for everyone! Mutual funds can own investments for all levels of risk tolerance and in different sectors of the market. There are growth stock mutual funds, aggressive stock mutual funds, bond funds, international stock funds, and more.

MAX Strategy: Never invest in something you don't understand. Before buying a mutual fund, look up the fund's prospectus for information on the fund's management, cost, holdings, and performance so you feel comfortable before making the purchase.

DEFINITIONS:

1: Index funds – A fund that creates a portfolio of stocks or bonds that mimics a market index like the S&P 500. These funds typically have lower management costs, fees, and turnover of stocks within the fund, making them very tax- and cost-efficient in the long-term.

2: Target-date-funds – A popular option for retirement savers, these funds automatically set your mix of stocks and bonds to match your time horizon to retirement. The further from retirement you are, the higher percentage of stocks in the portfolio. As you get closer to retirement, the fund automatically adjusts to a more balanced mix between stocks and bonds. These funds are as close to "set it and forget it" investing as it comes.

3: Diversification – Not all investments perform well at the same time. Holding a variety, or diversifying, can offset the effects of poorly performing ones. To start, you can diversify your portfolio by owning a broad-based index fund that invests in stocks across all industries, company sizes and geographical locations.

COSTS OF INVESTING

> *"Beware of little expenses. A small leak will sink a great ship."*
>
> **BENJAMIN FRANKLIN**

Mutual funds and other investments come with fees. The money you lose to fees compounds (rises exponentially) over time. Because investments with higher costs must overcome these expenses, their performance tends to suffer when compared against results for lower-cost investments.

KICKSTART YOUR INVESTING SYSTEM

Now that you know the basics of investing and how to set a SMART investing goal, it's time to kickstart your investing system!



There's no need to overthink investing for retirement. In fact, the more complicated we make investing, the less fruitful it often is. For most people, kicking off their retirement investing is as easy as 1-2-3:

1. Set up automatic contributions from your paycheck to a retirement account. Find a good starting percentage using your budget and a compound savings calculator like the one at Investor.gov.

2. Choose the mutual funds, index funds, or target-date fund inside the account that best fits your style.

3. As you're able, increase your contributions over time. Use the Monthly Spending Plan worksheet to stay on target.

NOTES

NOTES

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