I. **Learning objectives**
   A. What is insurance?
   B. Why do we need insurance?
   C. What is the risk management process?
   D. How does insurance work in reducing risk?
      1. Homeowners Insurance
      2. Renters Insurance
      3. Automobile Insurance

II. **INSURANCE**
   A. What is Insurance?
      1. Insurance is defined as the equitable transfer of the risk of a loss, from one entity to another, in exchange for payment.
      2. Insurance is a form of risk management primarily used to hedge against the risk of a contingent, uncertain loss.
   B. Why Do We Need Insurance?
      1. It represents our primary strategy to manage or hedge the risk of loss.

III. **The Risk Management Process**
   A. The Five Steps: (Table 10-1)
      1. Step 1: Identify sources of risk
      2. Step 2: Estimate risk and potential losses
      3. Step 3: Choose how to handle risk
      4. Step 4: Implement your risk management plan
      5. Step 5: Evaluate and adjust your plan

IV. **Managing Risk**
   A. Risk: The uncertainty of a loss that faces a person or property covered by insurance.
   B. Peril: potential causes of risk
      1. Hurricanes and Tornadoes
   C. Hazard: a scenario that increases the likelihood of a loss due to a peril
      1. Living near the ocean or in the Midwest

V. **Risk Management Methods**
   A. Avoidance: don’t build near the shore
B. Reduction: wearing a seat belt.
C. Self-Insurance: a special fund to cover losses.
D. Risk Shifting: buy insurance

VI. Planning the Insurance Program
A. Indemnity Principle limits insurance payout:
   1. You cannot receive more [$] than the economic loss suffered
B. Several factors can reduce the cost of insurance
   1. Deductibles
   2. Coinsurance
   3. Hazard reduction
C. Insurance policies contain vital information
   1. Perils covered
   2. Property covered
   3. Types of losses covered
   4. Time period of coverage
   5. Policy limits (maximum amounts)

VII. Home & Property Insurance
A. Homeowner’s Insurance
   a. Homeowner’s insurance is meant to protect against financial loss to do damage or destruction.
      1. Personal Property
      2. Living expenses if displaced
      3. Liability coverage: protection against legal actions or claims
      4. Medical payments
      5. Personal property floater: specific items of high value

VIII. Renter's Insurance
A. Many rental agents require renter insurance
   1. Cover damage to rental property by renter
   2. Cover personal property against loss by fire, flood
   3. Living expenses if displaced

IX. Home Insurance Form
A. Form HO-D1
   b. Section 1: Coverage’s and Amounts
      1. Dwelling
2. Other Structures
3. Personal Property
4. Loss of Use
c. Section 2: Coverage and Limits of Liability
1. Personal Liability – Each Occurrence
2. Medical Payments to others
3. Deductibles

X. Home Insurance Form
A. Policy Premium
B. Credits and Discounts
C. Other Coverage’s and Endorsements
D. State Surcharges and Taxes (if applicable)
E. Total Policy Premium
   1. Form HO-D2
   2. Specific/Amended Declarations

XI. Automobile Insurance
A. Financial Responsibility Law
d. State legislation that requires drivers to prove their ability to cover the cost of
damage or injury caused by an automobile accident
B. Automobile Insurance Coverage
   1. Bodily Injury Coverage
   2. Property Damage Coverage
C. Motor Vehicle Bodily Injury Coverage
   1. Bodily Injury Liability is for the risk of financial loss due to legal expenses, medical
      expenses, lost wages, and other expenses associated with injuries caused by an automo-
      bile accident for which you were responsible
   2. Medical Payments cover the costs of health care for people who were injured in your
      automobile, including yourself.
   3. Uninsured Motorists Protection covers the cost of injuries to you and your family
      but, in most states, not property damage
   4. No-fault Insurance System provides for drivers in an accident to collect medical ex-
      penses, lost wages, and related injury costs from their own insurance company.
D. Motor Vehicle Property Damage Coverage
   1. Property Damage Liability protects you against financial loss including vehicles, street signs, lampposts, and buildings.
   2. Collision insurance pays for the damage to the automobile regardless of who is at fault. But if another driver caused the accident, your insurance company will try to recover the repair costs for your vehicle from the other driver’s property damage liability coverage.
   3. Comprehensive Physical Damage covers you for such risks as fire, theft, glass breakage, falling objects, vandalism, wind, hail, or damage caused by hitting an animal.
   4. No-Fault Insurance: Under the no-fault system, drivers who are involved in accidents collect money from their own insurance companies.

E. Other Automobile Insurance Coverage
   1. Wage loss insurance will reimburse you for any salary or income lost due to injury in an automobile accident.
   2. Towing and emergency road service pays for the cost of breakdowns and mechanical assistance.

XII. AUTO INSURANCE COSTS
   A. Determinants of Cost
      1. Amount of Coverage
         a. Every state has laws that require or encourage automobile liability insurance coverage.
         b. Medical expenses and legal settlements have increased, so too the cost of automobiles, making higher amounts of property damage coverage necessary.
   B. Insurance Premium Factors
      1. Year, Make, and Model of your automobile
      2. Driver classification is a category based on the driver’s age, sex, marital status, driving record, and driving habits.
      3. Risk Pool assignment

XIII. Reducing Vehicle Insurance Premiums
   A. Establish and maintain a safe driving record
   B. Drivers under 25 can qualify for reduced rates by completing a driver training program and maintaining good grades in school
   C. Installing anti-theft devices
   D. Increasing the amount of the deductible
XIV. **Homework Assignment**

A. Do the Math: 2 a, b, 3

B. Question #1 (Applies just to those who currently rent)
   1. Does your landlord require renter's liability insurance?
   2. If so, what are the Coverage's? Deductibles?

C. Question #2
   1. If you own a car, examine your policy and determine your coverage in terms of; (Use Table 10-4 as a guide)
      a. Bodily injury
      b. Medical payments
      c. Uninsured motorists
      d. Property damage
      e. Collision
      f. Comprehensive
      g. Managing health expenses
HEALTH INSURANCE
CHAPTER 11

I. HEALTH INSURANCE
A form of protection whose primary purpose is to alleviate the financial burdens suffered by individuals due to illness or injury.

A. Types of Plans
1. Group Health Insurance: employer sponsored who pay some or all of the premiums
2. Individual Health Insurance: Individual health insurance covers either one person or a family. Coverage and cost vary from company to company

II. HEALTH INSURANCE AND FINANCIAL PLANNING
A. Health Maintenance Organizations (HMO)
1. Prepaid health care
2. Frequently a best value option
3. COBRA
   The Consolidated Omnibus Budget Reconciliation Act of 1986 allows workers to keep their former employer's group coverage for a set period of time. Not everyone qualifies for COBRA.

III. HEALTH INSURANCE COVERAGE
A. Types of Health Insurance Coverage
1. Basic: includes hospital expense insurance coverage, surgical expense coverage, and physician expense insurance.
2. Hospital Expense: pays part or all of hospital bills for room, board, and other charges.
3. Surgical Expense: pays part or all of the surgeon’s fees for an operation.
4. Physician Expense: helps pay for physician’s care that does not involve surgery

B. Major Medical Expense Insurance Coverage
1. Protects against the large expenses of a serious injury or a long illness.
2. Hospital Indemnity Policies
3. Pays benefits only when you are hospitalized, but these benefits are paid to you in cash.

C. Long-Term Care Insurance
   Help that you could need if you ever have an illness or disability that lasts a long time and leaves you unable to care for yourself.
D. Non-Medical Insurance
   1. Dental Expense Insurance
      Dental expense insurance provides reimbursement for the expenses of dental services and supplies.
   2. Vision Care Insurance
      A recent development in health care coverage has been vision care insurance

IV. Health Insurance Policy Major Provisions
   A. Eligibility
   B. Assigned benefits (pay direct to doctor/hospital)
   C. Internal limits (max allowable payment)
   D. Copayments (flat fee paid on every visit)
   E. Service benefits
   F. Benefit limits (dollars or days)
   G. Exclusions and limitations
   H. Guaranteed renewable
   I. Cancellation and termination

V. HEALTH INSURANCE TRADE-OFFS
   A. The benefits of health insurance policies differ, so consider the following:
      1. Reimbursement (actual $) versus indemnity (specific $)
      2. Internal limits (fixed $) versus aggregate limits (total $)
      3. Deductibles (max you pay) and coinsurance
      4. Out-of-pocket limit (max you pay before they pay 100%)
   B. Benefits based on reasonable and customary charges: Two Choices
      1. Basic plus Supplementary (See Exhibit 9 – 1)
      2. Major Medical

VI. Health Plan Providers
   A. Hospital and Medical Service Plans
      1. Blue Cross & Blue Shield
         a. BC = hospital care
         b. BS = surgical and physicians services
      2. Health Maintenance Organizations (HMO)
         Health insurance plan that directly employs or contracts with selected physicians, surgeons, dentists, and optometrists to provide you with health care services in exchange for a fixed, prepaid monthly premium.
3. Preferred Provider Organizations (PPO)
   PPOs provide the services of doctors and hospitals at discount rates or give breaks in co-payments and deductibles.

4. Employer Self-Funded Health Plans
   Provide the amount of protection that a specific group of people desires and can afford.

5. Health Care Accounts
   Flexible Savings Accounts (FSA) allow employees to contribute pretax dollars to an account managed by an employer.
   Health Reimbursement Accounts (HRA) are funded solely by your employer.
   Health Saving Accounts (HSA) allow you to contribute money to a tax-free account that can be used for out-of-pocket health care expenses.

6. Medicare
   Medicare is a federal health insurance program for people 65 or older, people of any age with permanent kidney failure, and certain disabled people.
   Part A: Hospital benefits (inpatient)
   Part B: Physician services and medical supplies
   Part C: combines A & B
   Part D: Prescription drug coverage

7. Medigap: Privately sold Supplement for Medicare plans

8. Medicaid
   Title XIX of the Social Security Act provides for a program of medical assistance to certain low-income individuals and families. Medicaid is administered by each state within certain broad federal requirements and guidelines. Many members of the Medicaid population are also covered by Medicare.

VII. US Govt. Sources of Information
   A. Healthfinder includes links to more than 1,000 Web sites and lists topics according to subject (www.hhs.gov).
   C. NIH Health Information Page directs people to the consumer health information in NIH publications and on the Internet (www.nih.gov).
   D. FDA provides information about the safety of various foods, drugs, cosmetics, and medical devices (www.fda.gov).
VIII. **DISABILITY INCOME INSURANCE**

Benefits provide regular cash income lost by employees as the result of an accident, illness, or pregnancy. Generally disability income policies are divided into short-term and long-term policies. There are different definitions of disability. Some policies define it as simply being unable to do your regular work, while others are stricter.

A. Sources of Disability Income
   1. Private Income Insurance Programs
   2. Employer Plans
   3. Social Security
   4. Workers’ compensation

B. Disability Insurance Trade Offs
   1. Waiting or elimination period
   2. Duration of benefits
   3. Amount of benefits
   4. Accident and sickness coverage
   5. Guaranteed renewability

IX. **Current Issues in Health Care**

A. Why does medical care cost so much?
   1. We want the best medical care available.
   2. R&D for new cures is expensive.
   3. New medical technology is expensive
   4. Trial lawyers and frivolous lawsuits add to costs
   5. Duplication of tests, excessive or unnecessary testing
   6. Abuse of services
   7. Fraudulent claims

B. What is being done to reduce costs?
   1. Affordable Health Care Act (2009)
   2. Government control of health services
   3. Recent GAO and CBO studies suggest costs will be significantly greater than originally thought.
   4. Corporate Health Initiatives
   5. Fitness centers
   6. Financial incentives: weight, general health
   7. Self-care assistance and education
X. Homework

A. Questions: (Self-audit of coverage)
   1. Do you know what type of coverage you have?
   2. Are you on your parents' policy?
   3. Are you covered by a school policy?
   4. Do you carry your own policy?
   5. If so, what does your insurance cover in terms of;
      6. Injuries resulting from an fall
      7. Illness requiring hospitalization
I. Life insurance

A. What is Life Insurance and when should we get it?

*A means for protecting the financial security of those that depend on us for their safety and economic well-being.*

1. The best time to get it is when you are young and healthy.
2. You should have some by the time you marry or partner.
3. You are foolish not to have it when you start a family and acquire property (cars, home, investments, etc.)

B. Major Purposes of Life Insurance

1. Pay off mortgage or other debts at time of death
2. Provide lump sum payments or endowments to beneficiaries
3. Provide education or income to children
4. Make charitable donations
5. Provide retirement income (whole life / endowment policies)
6. Estate Planning (paying estate or gift taxes)

C. How Much Life Insurance Do You Need?

1. The answer depends on your personal life situation
   a. A young single person – not much
   b. An older person with family responsibilities – depends
   c. Number of dependents
   d. Magnitude of financial liabilities (mortgages, loans, etc.)
   e. Magnitude of income
   f. Social Security survivor benefit

2. Example #1: Family (spouse, children, household expenses)
   a. 7 times 70% of yearly income
   b. More if dependents are under 7 years of age.

3. Example #2: Dual Incomes no Kids (DINKs)
   a. Enough to cover debts
   b. Provide a financial cushion
Life insurance companies

A. Types of Insurance Companies
   1. Stock: Owned by the stockholders – sell nonparticipating polices
   2. Mutual: Owned by the policy holders – sell participating policies

B. Participating Policies (Mutual):
   a. Mutual LICs return a portion of its investment profits as dividend
   b. Premiums are invested in investment quality bonds and other high degree of safety investments (function of legal list requirements)

C. Type of Policies
   1. Term
      a. Coverage for a specified number of years
      b. After that period, policy may continue but typically with higher premiums.
      c. Categories
         Renewable, Level, Decreasing
         Convertible (to whole life)
      Return of Premium
   2. Whole Life (cash value / straight life / ordinary)
      a. Permanent premium paid for lifetime of insured
      b. Accrues cash values
      c. Cash values can be used as collateral for loans
      d. Limited Life (paid up after 20 or 30 years)
      e. Variable Life (value a function of stock market investment performance)
      f. Universal Life (ability to change premiums based on cash values)
   3. Group Polices: Associated with employment or affinity groups
   4. Credit Life – pay off a debt if you die before debt is paid
   5. Endowment Life – pays a sum at maturity to policy holder
   6. Selecting provisions
      a. What are the Key Provisions in a Policy?
      b. Naming the Beneficiary (or beneficiaries)
      c. Incontestability – policy cannot be cancelled after a certain period of time
      d. Grace Period (limit to late payment) – lapsed policy
      e. Reinstatement
      f. Policy loan provision (borrow against cash values)
      g. Suicide clause (within 1 year – no benefits)
h. Dividends if paid or used to offset premiums

7. Typical Riders
   a. Accidental death (2x)
   b. Waiver of premium if permanently disabled (age limit)

III. Buying life insurance

   A. Decision Criteria
      1. AM Best rating
      2. Costs and Features
      3. Availability of local agents
      4. Recommendations of Friends
      5. Articles in Kiplinger, WSJ, Money

   B. Choosing Settlement Options
      1. Lump-sum
      2. Installments
      3. Life income
      4. Financial planning with annuities

IV. What is an Annuity?

   A. An particular type of insurance plan structured to provide you with a fixed payment each [month] for a set period of years.

   B. What are the Principal Types of Annuities?
      1. Immediate
      2. Deferred
      3. Variable [rate]
      4. Indexed [to a mix of stocks and bonds]

   C. Why do People Buy Annuities?
      1. Main reason is to remove market risk.
      2. There are also certain tax advantages.
      3. Thoroughly investigate before you buy!

V. Homework

   A. Do the Math: 1, 3
   B. Case 5
   C. What is an Annuity?
   D. What are the Principal Types of Annuities?
   E. Why do People Buy Annuities?
INVESTMENT FUNDAMENTALS
CHAPTER 13

I. **Starting Your Investment Program**

   A. Investing is more than mere saving because the goal is to make money off of
      your money rather than merely accumulate money through deposits.
   B. Are you ready to invest?
      1. Do you live within your income?
      2. Are you able to save regularly?
      3. Do you use credit wisely?
      4. Do you carry adequate insurance?
   C. Decide why you want to invest.
      1. To achieve financial goals
      2. To gain wealth and financial security
      3. To increase current income
      4. To meet retirement income needs
   D. Where can you get the money to invest?
      1. Pay yourself first
      2. Save any extra funds
      3. Participate in your employer’s retirement plan
      4. Make saving automatic
      5. When a debt is paid, continue the payments into your investments
      6. Break a habit
      7. Stop a cash leak
      8. Get a part-time job solely to invest the income
      9. Scrimp for one month
   E. What investment returns are possible?
      1. Current income from interest, dividends or rent
      2. Capital gains when you sell the investment
      3. The yield is the overall return stated as a percentage on an annual basis
      4. Calculating the real rate of return after taxes and inflation

II. **Identify Your Investment Philosophy.**

   A. Investment risk is speculative risk.
      1. Risk = deviation from what’s expected.
      2. Higher risk equals higher return over time.
3. Investors demand a risk premium
4. Figure 13-2 illustrates the risk pyramid
B. Ultraconservative investors are really just savers
C. What is your investment philosophy?
   1. Conservative investment philosophy
   2. Moderate investment philosophy
   3. Aggressive investment philosophy
D. Taking an active investing approach versus a passive investing approach
   1. Active investing requires careful study of the markets and the economy
   2. Active investing in an efficient market is very difficult
   3. Passive investing is most effectively done with index mutual funds
E. So what should you do?
   1. Identify the kinds of investments you want to make.
      a. Ownership versus lending investments.
      b. Short, intermediate, long-term investments to match your financial goals.
      c. Review components of total return for the investments you might choose.

III. Risks and Other Factors Affecting the Rate of Return on Investments
   A. Random or unsystematic risk is diversifiable.
   B. Market or systematic risk is much less diversifiable
   C. Other types of investment risk.
      1. Business failure—financial risk
      2. Inflation risk (deflation)
      3. Time horizon risk—the time horizon for financial goals are important
      4. Business cycle risk—cyclicality can affect some stocks and not others
      5. Market volatility—individual stocks can have high price swings
      6. Liquidity risk—individual stocks, mutual funds versus real estate
      7. Reinvestment risk—relates to the risk of a new investment when a previous one is sold
      8. Marketability risk—much like liquidity
   D. Transaction costs such as commissions reduce returns.
   E. Leverage—using borrowed funds to invest—can increase returns (and losses) dramatically.
      1. Leverage can enhance capital gains
      2. Leverage can magnify negative returns
F. Decide your long-term investment strategy

G. Long-term investors understand the importance of starting early.

H. Long-term investors understand bull and bear markets
   1. Bull markets are profitable for investors
   2. Bear markets turn into bull markets

I. Long-term investors accept substantial market volatility (?)

J. Long-term investors do not practice market timing (?)

K. There are only four strategies for long-term investors
   2. Strategy 2: Dollar-cost averaging—buys at “below-average” costs
      a. Dollar-cost averaging in a fluctuating market
      b. Dollar-cost averaging in a declining market
      c. Dollar-cost averaging in a rising market
      d. Dollar-cost averaging advantages—lower average cost and investor discipline
   3. Strategy 3: Portfolio diversification reduces portfolio volatility
   4. Strategy 4: Asset allocation—moneys are invested across asset classes with regular reviews to rebalance your portfolio
      a. Know your risk tolerance and how much time you have to invest
      b. Rebalance your investments at least once a year

L. When to sell an investment (Exit Strategy)
   1. When a significant change for the worse occurs in a company’s situation
   2. When a stock is overvalued by the market
   3. When the investment is simply doing poorly and causing you anxiety
   4. When you need cash for a worthwhile price
   5. When the stock is appropriately valued
   6. When your financial situation or goals have changed
   7. When there is a more promising place to put the money

IV. Some General Conclusions
   A. Successful long-term investors understand the need to take on investment risk by investing steadily over time in a diversified portfolio balanced to fit their time horizon and investment philosophy.

V. Homework
   A. Do the Math: 1, 2, 3
   B. On-the-Net: 1, 3
INVESTING IN STOCKS & BONDS

CHAPTER 14

I. Stock and Bond Investments
   A. Common stock represents ownership, meaning an investor has residual claim on assets, voting rights, and a right to receive any declared dividends. Investors have limited liability.
   B. Preferred stock has fixed-income characteristics, as it pays a fixed dividend. Such dividends must be paid before common stock dividends can be paid.
   C. Bonds represent a loan made to a corporation, a government, or a municipality. Money is lent at a fixed rate of interest for a certain length of time (maturity).

II. Classify common stocks according to their major characteristics.
   A. Price/Earnings ratios and Beta
      1. P/E ratio is the price of a share of stock divided by its earnings per share
      2. Trailing and projected price/earnings ratios
      3. Use beta to compare a stock to similar investments (SP500 is proxy for beta)
         a. Stocks with betas greater than 1 are more volatile than the market
         b. Stocks with betas less than 1 are less volatile than the market
   B. Cyclical stocks more in the same direction as the economy and countercyclical stocks move in the opposite direction with betas below 1 and, perhaps, negative.
   C. Income stocks pay high dividends with lower rates of increase in share price.
   D. Growth stocks (low or no dividends) have high potential increase in share prices.
      1. Well-known growth stocks
      2. Lesser-known growth stocks
   E. Value stocks are undervalued by the market and, thus, have potential for future increases in market value.
   F. Speculative stocks have potential for growth (or loss)
   G. Tech stocks: Offer technology related products and services.
   H. Blue-chip stocks are the largest and most well-known companies

III. Evaluating stock values.
   A. Fundamental analysis is based on the intrinsic value of the company and its prospects for future success as opposed to technical analysis which focuses on movement in the market as a whole and their effect on the value of a stock.
      1. Earnings per share (EPS)
      2. Price/sales ratio
   B. Additional numerical measures for evaluating stock prices
      1. Cash dividends
2. Dividends per share
3. Dividend payout ratio
4. Dividend yield
5. Book value
6. Book value per share
7. Price-to-book ratio
C. Calculating a stock’s potential rate of return
   1. Find out the alpha statistic
   2. Calculating a potential return takes five steps
      a. Use beta to estimate the risk of the investment
      b. Estimate the market risk
      c. Calculate your required rate of return = T-bill + beta × market risk.
      d. Calculate the stock’s potential rate of return—its approximate compound yield
      e. Compare your required rate of return with the potential rate of return
IV. Evaluate common stocks in which to invest using the Internet.
    A. Begin by setting your criteria for your stock investments.
    B. Seek basic investment information in financial publications.
    C. Use stock screening tools.
    D. Get a sense of the history of a stock.
    E. Go to the source for company information.
    F. Use security analysts’ research reports.
    G. Use research firm report for more in-depth information.
    H. Be aware of economic trends.
    I. Follow the movements of the major stock markets using stock market indexes.
       1. The Dow Jones Industrial Average
       2. Standard & Poor’s 500 Index
       3. NASDAQ Composite Index
       4. Wilshire 5000 Index
       5. Russell 3000 Index
       6. Foreign stock exchange indexes.
    J. Securities exchanges are where stocks are actually traded.
    K. Electronic communications network and the over-the-counter (OTC) market.
    L. Keep track of a stock’s price fluctuations.
    M. Use portfolio tracking to monitor your investments.
V. **How Stocks are Bought and Sold**

A. Stock brokers
   1. Discount brokers
   2. Online brokers
   3. Full-service brokers

B. Brokers charge commissions and fees

C. How to order stock transactions
   1. The process of trading stocks
   2. Matched or negotiated stock prices
   3. Types of stock orders; market, limit, stop-loss and time-limit orders

D. Tax consequences of investing
   1. Taxation of dividends and interest
   2. Taxation of capital gains and losses

E. Margin buying and short selling add risk to your investing.
   1. Margin trading is buying stocks on credit and increases both potential gains and losses especially in the event of margin call.
   2. Selling short is selling stock borrowed from your broker hoping that when the buy the stock back you will pay a lower price than at the original sale.

VI. **Investing in Bonds**

A. Types of bonds by grade and ratings
   1. Figure 14-4 illustrates the relationship between yield and risk for bonds
   2. Table 14-2 summarizes the ratings assigned to bonds

B. Corporate, U.S. Government and municipal bonds
   1. Corporate bonds pay reasonable returns
   2. U.S. Government securities represent quality and safety
      f. Treasury bills, notes and bonds
      g. Federal agency bonds pay slightly higher returns
   3. Municipal government bonds have tax advantages

C. Unique characteristics of bonds.
   1. Coupon rate
   2. Serial or sinking fund
   3. Secured or unsecured
   4. Registered and issued
   5. Book entry
6. Callable bonds
7. Zero-coupon bonds

D. Evaluating bond prices and return
   1. Interest rate risk results in variable value
   2. Long-term interest rates

E. Pricing a bond in today's market
   1. Present value of a bond calculation using Formula 14.4
   2. Premiums and discounts
   3. Current yield calculation using Formula 14.5
   4. Yield to maturity (YTM) calculation using formula 14.6
   5. The six decisions of bond investors
      a. Decide on credit quality
      b. Decide on maturity
      c. Determine the after-tax return
      d. Select the highest yield to maturity
      e. Decide when to sell
      f. Consider bond mutual funds

VII. General Conclusions
    Investors can be success investing in stocks and bonds if they understand how to effectively assess the quality of the issues they purchase and know when to sell an investment that is no longer appropriate for their goals.

VIII. Homework
    A. Do the Math: 1 (a, b), 2, 4
    B. On the Net: 2, 3
INVESTING THROUGH MUTUAL FUNDS
CHAPTER 15

I. Why Should You Invest In Mutual Funds?
   A. The net asset value (NAV) is the price paid/sold for a mutual fund share: equation 15.1.
   B. Mutual funds distribute income and realized capital gains to shareholders.
   C. Mutual funds offer many advantages over simply buying stocks or bonds directly.
      1. Diversification
      2. Affordability.
      3. Professional management.
      4. Liquidity.
      5. Low transaction costs.
      6. Uncomplicated investment choices
   D. Services unique to mutual fund companies include:
      1. Convenient access via toll-free telephone or online.
      2. Easy purchase and sale of shares.
      3. Check writing and electronic transfer of funds.
      4. Automatic reinvestment of income and capital gains.
      5. Easy low- or no-cost exchange privileges.
      6. Automatic investment of newly invested funds.
      7. Effortless establishment of retirement plans.
      8. Beneficiary designation.
      9. Multiple mechanisms for withdrawing funds.
   E. There are several types of investment companies.
      1. Open-end mutual funds
      2. Closed-end mutual funds
      3. Real estate investment trusts (REITs)
      4. Unit investment trusts
      5. Exchange-traded funds (ETFs)

II. Mutual Investment Objectives, Types, and Characteristics.
   A. Income objective
      1. Money market funds (safety)
      2. Bond funds (income): Short, Intermediate, Long-Term
   B. Growth objective (equity)
   C. Growth and income objective (debt & equity)
III. **Mutual funds fees and charges.**

A. Load and no-load funds exist.
   1. Load funds always charge transaction fees
   2. No-load funds charge no transaction fees at purchase
   3. Some no-load and load funds assess 12b-1 fees
   4. Many load and no-load funds assess charges when shares are sold back to the mutual fund

B. Mutual fund share classes are A, B and C depending on the structure of their fees.

C. Fees are disclosed in a standardized expense table that includes the expense ratio that can vary from 0.1 percent to 4 percent.

D. There is no hard fast rule as to whether load or no-load funds are best. Keep overall fees low.
   1. Sales commissions reduce returns
   2. 12b-1 fees kill long-term returns
   3. Avoiding large management fees is critical to investment success

IV. **Strategies to Evaluate and Select Mutual Funds**

A. Review your own investor objectives, philosophy, risk tolerance, and understanding of investments.

B. Eliminate funds inappropriate for your investment goals.

C. Create a portfolio of funds in which to invest

D. Choose no-load funds with low management fees

E. Obtain investment information and advice.

F. Screen, compare, and select funds that meet your criteria.

G. Monitor your mutual fund portfolio.
   1. Use portfolio monitoring on the Internet.
   2. Check fund quotations in newspapers
   3. Figure 15-6 illustrates how mutual funds are quoted

V. **Conclusion:**

The diversification provided by mutual funds makes them ideal way to reduce investment risk. They are easy to buy and sell

VI. **Homework**

A. Do the Math: 1 (a & b), 2 (a)

B. On-the-Net: 1, 3
REAL ESTATE AND HIGH RISK INVESTMENTS

CHAPTER 16

I. Making Money in Real Estate
   A. Can you make current income while you own?
      1. Importance of price-to-rent ratio
      2. Current income results from positive cash flow
      3. Computing the rental yield
   B. Can you earn capital gains when you sell property?
   C. How can leverage increase the return on investment (ROI)?
   D. Investopedia explains 'Price-to-Rent Ratio'
      The price-to-rent ratio provides a comparison between owning and renting properties in
      certain cities.
      The ratio uses the average list price with average yearly rent on two-bedroom apart-
      ments, condos and townhomes that are listed on www.trulia.com, a real estate search
      website.
      The price-to-rent ratio is calculated by dividing the average list price by the average
      yearly rent price, as follows: Price-to-rent ratio = Average list price / (Average Rent * 12)
   E. Trulia establishes thresholds for the ratios as follows:
      1. Price-to-rent ratio of 1 to 15 = much better to buy than rent
      2. Price-to-rent ratio of 16 to 20 = typically better the rent than buy
      3. Price-to-rent ratio of 21 or more = much better to rent than buy
      4. For More Information: http://www.investopedia.com/terms/p/price-to-rent-ratio.asp#ixzz26lgMEMmT

II. Taking Advantage of Beneficial Tax Treatments
   A. Depreciation is deductible.
      Table 16-1 illustrates the benefits of deductible depreciation
   B. Interest is deductible.
      Table 16-2 illustrates the benefits of deductible interest on returns
   C. Capital gains are taxed at reduced rates.
   D. Exchanges of properties can be tax-free.
   E. Taxes can be lower on vacation home rental income.
III. **Pricing and financing real estate investments.**
   A. Pay the right price using the discounted cash-flow method.
      Table 16-3 illustrates using the discounted cash-flow method to determine an estimated purchase price
   B. Financing a real estate investment
   C. Timesharing is a financial disaster.

IV. **Assess the Disadvantages of Investing in Real Estate**
   A. Complex and time consuming
   B. Business, liquidity and interest rate risk
   C. High transaction and legal costs

V. **Investing in Collectibles, Precious Metals, and Gems**
   A. Collectibles: fickle, faddish
      1. Making a profit in collectibles is not easy
      2. Buying and selling collectibles on the Internet
   B. Gold and other metals
      1. Fear pushes up gold prices
      2. Gold were stagnant buy recently have soared
   C. You can invest in gold in several way
      1. Gold bullion
      2. Gold bullion coins
      3. Collectible gold coins
      4. Gold mining stocks, mutual funds and ETFs
   D. Investing in silver, platinum, palladium and rhodium
   E. Stones and gems

VI. **Options and Futures Contracts: [Hedging or Speculating?]**
   A. Options are simply the right to buy and sell an asset at a predetermined price.
      1. Page 499 illustrates how options work
      2. Options are created by an option writer
      3. Conservative writers profit by selling covered calls
      4. Conservative investors reduce risks by purchasing covered puts
      5. Speculative investors try to profit with options
      6. Speculative investors buy calls to create tremendous leverage
      7. Calculate breakeven prices for prices and calls using equations 16.2 and 16.3
      8. Selling options
B. Commodities futures contracts
   1. Economic need creates futures markets
   2. Speculators may trade in futures markets
   3. Futures are a zero-sum game

VII. **Conclusions and Observations**
   A. Real estate and high-risk investments are appropriate only for the most sophisticated investors.
   B. Use of Options and/or Futures should be limited to investors knowledgeable of the risks entailed in high leverage financial instruments (derivative securities).

VIII. **Homework**
   A. Do the Math: 1, 2
   B. On-the-Net:
      1. Check the www.trulia.com for local (Wilmington) sale prices
      2. Check the www.bankrate.com site for current mortgage rates
I. Understanding your Social Security Retirement Income Benefit.
   A. Your contributions to Social Security are the FICA and Medicare taxes. FICA taxes are applied up to your maximum taxable yearly earnings.
   B. Become qualified for Social Security retirement benefits by accumulating 40 credits—up to 4 per year for 10 years.
      1. Fully insured applies to retirement benefits and results from accumulating 40 credits
      2. Currently insured applies to survivor's and disability benefits and results when you have accumulated 6 out of the last 12 possible credits
      3. Transitionally insured is a status for those who reach age 72 without accumulating the 40 credits necessary for receiving Social Security retirement benefits
      4. Not insured applies to workers under age 72 who have not accumulated 6 credits
      5. Table 17-1 outlines the eligibility requirements for the various Social Security programs
   C. Estimating your Social Security retirement benefits
      1. Benefits are based on your average earnings over your working years indexed for inflation
      2. Request an estimate of your benefits at www.ssa.gov/estimator/
      3. Begin receiving benefits at your full-benefit retirement age—67 for people born in 1960 or later
      4. Begin receiving benefits as early as age 62 but with a permanently reduced benefit as much as 30 percent less if you start benefits at age 62 and were born in 1960 or later
      5. Benefits may be further reduced if you take benefits early and still have earned income
      6. Delay benefit beyond your full benefit age and receive a permanently higher benefit
   D. You should verify your Social Security record after each [fiscal] year
II. Calculate the amount you must save for retirement in today's dollars.
   A. Project your annual retirement expenses and income.
   B. An illustration of retirement needs.
      1. Determine annual income needed
      2. Subtract annual Social Security and pension income
      3. Determine the nest-egg needed at retirement to fund the annual income for the number of years you will be retired after factoring in your expected return on investment and inflation.
4. Subtract how much of that nest egg you will have attained through employer and personal retirement savings
5. Calculate the amount you must save each year to fund the nest egg shortage
6. Subtract the amount you already plan to save yourself or from employer contributions
7. The remainder is the additional amount you should be saving
8. Page 518 provides an example of a retirement savings needs calculation

C. Save through investments purchased through 401(k), 403(b) plans or an IRA.

III. **Investing for Retirement Through Tax-Sheltered Retirement Accounts**

A. **First benefit:** Your contribution into the accounts may be tax deferred if made into pre-tax accounts; 401(k), 403(b) or a traditional IRA.

   Table 17-2 illustrates the tax reduction benefits of tax deferred deposits

B. **Second benefit:** Tax-deferred earnings allow you to accumulate much more retirement money.

   1. You accumulated $334,300 by making *after-tax* investments that are not tax-sheltered at a cost of $105,000
   2. You accumulate $516,950 by make annual *after-tax* investments that are tax-sheltered at a cost of $105,000
   3. You accumulate $516,950 by making annual *pretax* investments that are tax sheltered at a cost of $78,750
   4. You accumulate $646,188 by making annual tax-deductible investments that tax-shelter growth plus invest the money that would have gone to the IRS at a cost of $131,250

C. **Third benefit:** Your withdrawals might be tax free. Your contribution into after-tax accounts—Roth IRA, Roth 401(k)—will not be tax-deductible. However, withdrawals of contributions and investment earnings built up will be tax-free at retirement.

IV. **Employer-Sponsored Retirement Plans**

A. Employer-sponsored plans are government regulated for your protection.

   1. With cliff vesting you are fully vested after three years
   2. With graduated vesting, your vesting is phased in 20 percent at a time after years 2 through 5

B. Most common today are defined-contribution plans that place the responsibility to participate on employees and are self-directed. Many companies offer employer matching contributions when employees make contributions.

   1. Names of defined-contribution plans include 401(k) plans, 403(b) plans 457 plans and SIMPLE IRAs
2. There are limits on annual contributions
3. A catch-up provision allows those age 50 or older to contribute an additional $5000
4. Table 17-3 illustrates how much you give up without matching employer contributions
5. Withdrawals are subject to a 20 percent withholding rule
6. Avoid withholding and penalties through a trustee-to-trustee rollover into a rollover IRA or new employer’s plan
7. Low- and moderate-income taxpayers qualify for the retirement plan contribution tax credit.

C. Defined benefit plan—old-fashioned pension plan—are now less and less frequently offered by employers.
   1. Should you take normal or early retirement
   2. Defined-benefit plans have disability and survivors benefits

D. Cash-balance plan—an employer paid hybrid plan that offers low return on an after-tax basis.

E. Additional employer-sponsored plans
   1. Employee stock-ownership plans (ESOP)
   2. Profit-sharing plans

V. Personally Established Retirement Accounts
   A. Individual Retirement Accounts (IRAs)
      1. Traditional IRAs shelter investment growth and, usually, deposits but taxes are owed at withdrawal
      2. Roth IRAs shelter investment growth and may be tax-free at withdrawal
   B. Keoghs and SEP-IRAs for self-employed individuals.

VI. Techniques for Avoiding Withdrawal Penalties and Living in Retirement Without Running out of Money
   A. Withdrawing retirement money early
      1. Penalty-free withdrawals do exist after age 59 1/2, for early retirement after age 55, for medical, college and home buying expenses, or loans from 401(k) plans.
      2. The IRS has a 20 percent withholding rule
      3. Negative impacts of unqualified early withdrawals include taxes owed, a 10 percent penalty, and the loss of future investment growth
      4. How to manage your retirement money after leaving your employer
         a. Leave it
         b. Transfer it to a new employer’s plan
c. Transfer it to a rollover IRA
   d. Take it and pay income taxes and penalties (a very bad idea)

B. Figure out how many years your money will last.
   Table 17-4 provides estimates of how long retirement money will last given certain withdrawal rates

C. Buy an annuity with a portion of your nest egg at retirement to provide monthly income for life.
   1. With immediate annuities income payments start right away
   2. Income payments start at a later date with deferred annuities
   3. Income options include money for life, money for a specific number of years or money in a specific amount as long as it will last
   4. All annuities carry sales commissions and fees
   5. Variable annuities carry more investment risk
   6. Deferred annuities should not be bought through a 401(k) or IRA until you are ready to retire

D. Consider the benefits of working part-time.

VII. Conclusion
    While the goal of saving several million dollars for retirement 40 years in the future seems daunting it is very achievable by starting young and by supplementing an employer-sponsored account or setting up an IRA through which you invest in stock mutual funds.

VIII. Homework
    A. Do The Math: 1, 2, 3
    B. On the ‘Net: 1
I. How to Transfer an Estate
   A. Most of your assets can be set up as non-probate property and transferred outside of a will and outside of probate court.
      Figure 18.1 illustrates the distinction between non-probate and probate estate
   B. Transfer your estate by contracts.
      1. Transfers by beneficiary designation
      2. Transfers by property ownership designation
      3. Transfers by payable-on-death contract designation
   C. Transfer the rest of your estate (probate property) via your will.
      1. Transfers with a will go to your desired heirs under the guidance of the probate court and your executor
      2. You need to appoint a guardian in your will if you have minor children
      3. A letter of last instructions provides guidance to those left behind
   D. Without a will, your property may not go to your desired heirs.
   E. Spouses have legal rights to each other’s estates.

II. Use trusts to transfer assets and reduce estate taxes.
   A. Who should consider setting up a trust?
   B. Trust terminology.
      1. Grantor
      2. Trustee
      3. Corpus
      4. Beneficiary
      5. Remainder beneficiaries
   C. Living trusts take effect while you are still alive.
      1. Revocable living trusts
      2. Irrevocable living trusts are required for avoiding estate taxes
   D. Testamentary trusts take effect at your death.

III. Prepare advance directive documents.
   A. A health-care proxy appoints someone to make medical decisions on your behalf.
   B. A living will specifies what types of medical treatment are desired if you become terminally ill and unable to make your own decisions.
      1. General phrasing for a living will
2. Specific phrasing for life sustaining procedures in a living will

C. A durable power of attorney gives someone the power to handle your legal affairs and finances.

D. Prepare List of Documents Needed to Settlement and Transfer Your Estate
   Pages 559 and 560 provide a checklist

IV. **Estate and inheritance taxes**
   A. What is the amount of an estate that is exempt from federal estate taxes?
   B. What is the impact of estate and inheritance taxes at the state level?

V. **Conclusion**
   Everyone needs a will so that the probate court will follow their wishes when dispersing their estate. Advance directives are also needed to express your wishes regarding handling your financial affairs and health care if you become incapacitated and should you become terminally ill.

VI. **Homework**
   A. Do the math: 1 parts a, b)
   B. On the ‘Net: 3, 4