Starting a Brokerage Account

– Full service brokers
– Discount brokers
–Deep-discount brokers
–Online brokers

Investor Protection

- Security Investors Protection Corporation (SIPC): Insurance fund covering investors' brokerage accounts with member firms.
- Most brokerage firms belong to the SIPC, which insures each account for up to $500,000 in cash and securities, with a $100,000 cash maximum.
- Important: The SIPC does not guarantee the value of any security (unlike FDIC coverage).
- Rather, SIPC protects whatever amount of cash and securities that were in your account, in the event of fraud or other failure.

- There are several important things to remember when you deal with a broker:
  - Any advice you receive is ***not*** guaranteed.
  - Your broker works as your agent and has a legal duty to act in your best interest.
  - However, brokerage firms make profits from brokerage commissions.
- Your account agreement will probably specify that any disputes will be settled by arbitration and that the arbitration is final and binding.

Arbitration – Financial Industries Regulatory Authority (FINRA – www.finra.org)

- In a margin purchase, the portion of the value of an investment that is not borrowed is called the margin.
- Of course, the portion that is borrowed incurs an interest charge.
  - This interest is based on the broker's call money rate.
  - The call money rate is the rate brokers pay to borrow money to lend to customers in their margin accounts.

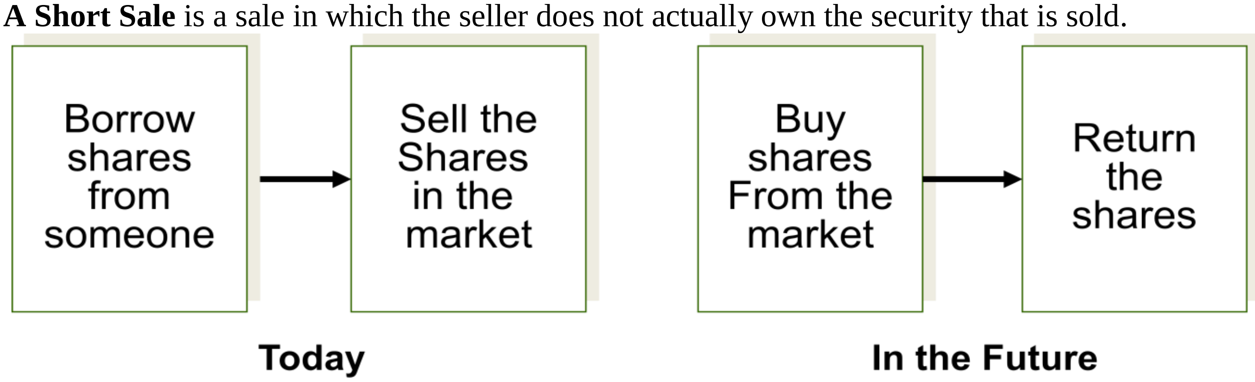
How margin works:

Amount purchased with cash	$1,000	
End of year value:	$1,200	$800
Return on your $1,000:	20%	–20%

Suppose you borrow $400 for the investment and invest only $600 of your money.
At the end of the year:

End of year value:	$1,200	$800
Repay loan:	–400	–400
Ending value:	$800	$400
Return on your $600:	33.33%	–33.33%

A Short Sale is a sale in which the seller does not actually own the security that is sold.



NOTE: Don't buy stocks on margin or short sell from this discussion!!!!!!

Typical Accounts

Taxable

Retirement Accounts
Common rules:
Earnings grow tax-deferred
Earliest distribution – 59 ½

401k (403b) – Contributions deducted from income, withdrawals fully taxed.

401k Plan Limits for Year	2016	2015	2014	2013	2012	2011	2010
401k Elective Deferrals	$18,000	$18,000	$17,500	$17,500	$17,000	$16,500	$16,500
Annual Defined Contribution Limit	$53,000	$53,000	$52,000	$51,000	$50,000	$49,000	$49,000
Annual Compensation Limit	$265,000	$265,000	$260,000	$255,000	$250,000	$245,000	$245,000
Catch-Up Contribution Limit	$6,000	$6,000	$5,500	$5,500	$5,500	$5,500	$5,500
Highly Compensated Employees	$120,000	$120,000	$115,000	$115,000	$115,000	$110,000	$110,000

Roth IRA – Contributions not tax deductible, withdrawals are tax-free.

Traditional IRA – Contributions deducted from income, withdrawals fully taxed.

Roth IRA Income Limits 2016

Filing Status	Full Contribution	Reduced Contribution
Single /Head of Household	Up to $117,000	$117,001 to $132,000
Married Filing Jointly	Up to $184,000	$184,001 to $194,000

Roth IRA Income Limits 2015

Filing Status	Full Contribution	Reduced Contribution
Single /Head of Household	Up to $116,000	$116,001 to $131,000
Married Filing Jointly	Up to $183,000	$183,001 to $193,000

Taxpayers with a filing status of Married Filing Separately (and living with their spouse), cannot make a Roth IRA contribution if their modified AGI is in excess of $10,000.

Contribution Limits

The second limit that applies to Roth IRAs has to do with the contribution someone can make in a single tax year. The exact number really depends on two factors. If the accountholder is age 50 or older by the end of the calendar year, then it's possible to make an additional catch-up contribution.

The second factor that can affect the level of funding has to do with whether or not a reduced contribution applies because of the income limitation previously mentioned. The current contribution limits for Roth IRAs appear in the table below:

Roth IRA Contribution Limits

Tax Year	Annual Contribution Limit	Catch-Up Limit
2007	$4,000	$1,000
2008 to 2010	$5,000	$1,000
2011	$5,000	$1,000
2012	$5,000	$1,000
2013	$5,500	$1,000
2014	$5,500	$1,000
2015	$5,500	$1,000
2016	$5,500	$1,000
2017 and beyond	Indexed to Inflation	

Roth versus Traditional IRS – Which is better?

Suppose you deposit $5,000 in a traditional IRA (one-time) and are in the 30% tax bracket. You leave the money invested for 30 years, withdraw the money for 15 years, and earn a 10% interest rate throughout. How much can you withdraw each year?

5,000 PV
30 N
10 I/Y
CPT FV
$87,247.01

$87,247.01 PV
15 N
10 I/Y
CPT PMT
$11,470.69

Aftertax, you will have: $11,470.69(1 – .30) = $8,029.49

Suppose you do a Roth IRA instead. You will save $5,000(.30) in taxes, your equivalent cash flow (deposit) is $3,500.

3,500 PV
30 N
10 I/Y
CPT FV
$61,072.91

$61,072.91 PV
15 N
10 I/Y
CPT PMT
$8,029.49

A Roth IRA is a bet on taxes. With a lower tax rate in retirement, a traditional IRA has higher cash flows.

Advantages to Roth:
1) Higher income limits.
2) Higher deposits.
3) No minimum distribution (70 ½ with traditional).

Mutual Funds

- Mutual funds are simply a means of combining or pooling the funds of a large group of investors.

- The buy and sell decisions for the resulting pool are then made by a fund manager, who is compensated for the service provided.

- An Investment company is business that specializes in pooling funds from individual investors and making investments.

- An Open-end fund is an investment company that stands ready to buy and sell shares in itself to investors, at any time.

- A Closed-end fund is an investment company with a fixed number of shares that are bought and sold by investors, only in the open market.

- Net asset value (NAV) is the value of the assets held by a mutual fund, divided by the number of shares.
- Shares in an open-end fund are worth their NAV, because the fund stands ready to redeem their shares at any time.
- In contrast, share value of closed-end funds may differ from their NAV.

- A mutual fund is simply a corporation. It is owned by shareholders, who elect a board of directors.

- A "regulated investment company" does not have to pay taxes on its investment income.

- To qualify, an investment company must:
  - Hold almost all its assets as investments in stocks, bonds, and other securities,
  - Use no more than 5% of its assets when acquiring a particular security, and
  - Pass through all realized investment income to fund shareholders

- Mutual funds are required by law to supply a prospectus to any investor who wishes to purchase shares.
- Mutual funds must also provide an annual report to their shareholders.

Mutual Fund Fees

- *Sales charges or "loads"*
  - Front-end loads are charges levied on purchases.
  - Back-end loads are charges levied on redemptions.
- *12b-1 fees.* SEC Rule 12b-1 allows funds to spend up to 1% of fund assets annually to cover distribution and marketing costs.
- *Management fees:*
  - Usually range from 0.25% to 2.00% of the funds total assets each year.
  - Are usually based on fund size and/or performance.
- *Trading costs*
  - Not reported directly
  - Funds must report "turnover," which is related to the amount of trading.
  - The higher the turnover, the more trading has occurred in the fund.
  - The more trading, the higher the trading costs.

Mutual Fund Types

Short-term funds

- Short-term funds are collectively known as money market mutual funds.
- Money market mutual funds (MMMFs) are mutual funds specializing in money market instruments.
  - MMMFs maintain a $1.00 net asset value to make them resemble bank accounts.
  - Depending on the type of securities purchased, MMMFs can be either taxable or tax-exempt.
- Most banks offer what are called “money market” deposit accounts, or MMDAs, which are much like MMMFs.
- The distinction is that a bank money market account is a bank deposit and offers FDIC protection.

Bond Funds

- Bond funds may be distinguished by their
  - Maturity range
  - Credit quality
  - Taxability
  - Bond type
  - Issuing country
- Bond fund types include:
  - Short-term and intermediate-term funds
  - General funds
  - High-yield funds
  - Mortgage funds
  - World funds
  - Insured funds
  - Single-state municipal funds

Stock Funds

- Some stock funds trade off capital appreciation and dividend income.
  - Capital appreciation
  - Growth
  - Growth and Income
  - Equity income
- Some stock funds focus on companies in a particular size range.
  - Small company
  - Mid-cap
- Some stock fund invest internationally.
  - Global
  - International
  - Region
  - Country
  - Emerging markets
- Sector funds specialize in specific sectors of the economy, such as:
  - Biotechnology
  - Internet
  - Energy
- Other fund types include:
  - Index funds
  - Social conscience, or “green,” funds
  - “Sin” funds (i.e., tobacco, liquor, gaming)
  - Tax-managed funds

Hybrid Funds

- Funds that do not invest exclusively in either stocks or bonds are often called “blended” or “hybrid” funds.
- Examples include:
  - Balanced funds
  - Asset allocation funds
  - Convertible funds
  - Income funds

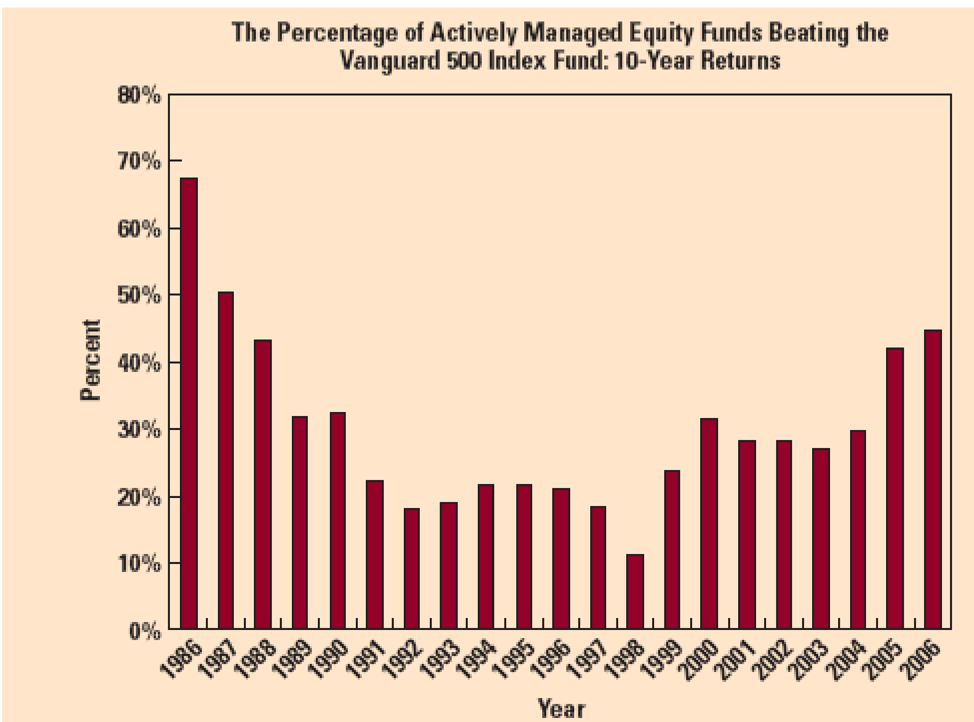
- A mutual fund “style” box is a way of visually representing a fund’s investment focus by placing the fund into one of nine boxes:

Mutual Fund Warnings

- While looking at historical returns, the riskiness of the various fund categories should also be considered.
- Whether historical performance is useful in predicting future performance is a subject of ongoing debate.
- Some of the poorest-performing funds are those with very high costs.

Index Funds

Efficient Markets Hypothesis



Exchange Traded Funds

- An exchange traded fund, or ETF,
  - Is basically an index fund.
  - Trades like a closed-end fund (without the discount phenomenon).
- An area where ETFs seem to have an edge over the more traditional index funds is the more specialized indexes.
- A well-known ETF is the "Standard and Poor's Depositary Receipt" or SPDR.
  - This ETF mimics the S&P 500 index.
  - It is commonly called "spider."
- Another well-known ETF mimics the Dow Jones—it is called "Diamond."

- A list of ETFs can be found at www.amex.com.

Websites

- http://finance.yahoo.com (general financial information)
- www.ici.org (mutual fund facts and figures)
- www.vanguard.com (example of a major fund family website)
- www.fidelity.com (website of largest investment advisory firm in US)
- www.mfea.com (information on thousands of funds)
- www.morningstar.com (one of the best mutual fund sites)
- www.domini.com (more "social conscience" funds)
- www.vicefund.com ("vice" funds)
- www.amex.com (exchange traded funds)

Taxes

Stock

Dividends are personal income.

Capital gain/loss when the stock is sold. Less than one year is short-term at income tax rate. More than one year is long-term at 5%, 15%, 25%, or 28%.

Bonds

Coupons are income.

Capital gain/loss when the bond is sold.

Mutual funds

Taxes on distributions:

- Dividend income.
- Short-term capital gains.
- Long-term capital gains.

What is the best investment for you?

What is the money for? If less than 3-5 years, no stock.

How much are you going to be involved?

Risk/Return

http://moneycentral.msn.com/investor/calcs/n_riskq/main.asp

http://www.bankrate.com/brm/news/investing/20011127a.asp

http://njaes.rutgers.edu/money/riskquiz/default.asp