Investing Basics
Introduction to Investing

San Jose Public Library
April 6, 2023

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BetterInvesting™ Silicon Valley Chapter

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BetterInvesting™ Silicon Valley Chapter

Presenters – Who Are We?

We are volunteer directors with the Silicon Valley Chapter of BetterInvesting (BI).

BI is a 501(c)(3) non-profit organization founded in 1951.
It is dedicated to investor education and has numerous chapters across the country, all staffed by volunteers.

We have both belonged to BI and been investors for more than 30 years.

We are NOT licensed financial professionals.

In keeping with BI's mission, we do not give specific investment advice.

We try to help you understand investing so you can DIY.

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Agenda

A. Saving vs. Investing
B. Why Do People Invest
C. Managing Investments
D. Investing in Funds
E. Investing in Stocks
F. A Few Words about Bonds

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SAVING VERSUS INVESTING

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You May Be a Saver and an Investor Both Are Important

- The reasons for each are different
- Where you put your money is different
- Everyone can benefit from doing both
- The younger you start, the better

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Saving

Your goals are short-term: 1-5 years

- Building an emergency fund
- Saving for a vacation or wedding
- Saving to buy a car
- Saving to pay taxes
- Saving while learning about investing

Expectations

- Your money will be there when you need it.
- It won't grow much.
- Any growth probably won't beat inflation.

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First Reason to Save

Build an **Emergency Fund** of a minimum of 6-12 months of expenses.

- Loss of Job
- Medical Emergencies
- Car Repairs
- Household Repairs
- Family Emergencies

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Investing

Your goals are long-term: 5-20+ years

- College fund for kids
- Retirement
- Hobbies

Expectations

- You won't need the money to pay ongoing expenses.
- Your money will be at risk. You will definitely experience losses from time to time. You could lose everything.
- But, over the long term, it is likely that you will gain significantly more than you can with savings.
- You expect inflation to seriously erode your money's purchasing power over the long term and you want to maintain and hopefully build purchasing power.
- You will be able to sleep at night when things go wrong.

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Russell's Walls

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A Few Words About Debt

Debt problems can make both saving and investing impossible

- Paying off excess debt may be the best use of your money.
- The interest rates on credit cards can strain your budget and make it impossible to save or invest.
- Even if debt isn't a current problem, and you are living within your income, use debt wisely and pay off credit card balances as soon as possible.

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Free Sources of Information About Managing Debt

Consumer Financial Protection Bureau > Consumer Education
https://www.consumerfinance.gov/

Financial Industry Regulatory Authority (FINRA) > For Investors > Personal Finance
https://www.finra.org/#/

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Where to Put Your Money (Assets)

SAVING – Safer – Short Term

- Insured savings/checking account
- Short-term certificates of deposit
- Short-term US Treasury bills or notes

Unlikely or less likely to beat inflation

Average annual rate of inflation since 1913: 3.1%

INVESTING – Riskier – Longer Term

- Corporate bonds
- Mutual Funds & ETFs
- Stocks

Likely to do better than inflation long-term

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WHERE TO START A SAVINGS ACCOUNT

You can go to a local bank or credit union to set up a savings account or buy Certificates of Deposit.

Make sure your savings accounts or CDs are insured by the Federal Deposit Insurance Corporation (FDIC), which guarantees your money if the bank or credit union goes broke.

You can buy US Treasury notes and bills directly from the Treasury. For information: https://www.treasurydirect.gov/

WHERE TO START AN INVESTING ACCOUNT

You need a brokerage account to buy or sell stocks, mutual funds or bonds.
These are not FDIC insured against losses.

Some banks offer brokerage services. There are also many independent brokerages.

More on this later.

NOTE: Minors must use a custodial account with an adult • CUTMA or CUGMA in California.

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Other Kinds of Assets

Not the subject of tonight's presentation

- Real Estate
- Art
- Coins, stamps, collectibles
- Gold, commodities, wine

All are specialty fields of investing

All are harder to evaluate than financial assets

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Questions About Saving vs. Investing?

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WHY DO PEOPLE CHOOSE TO INVEST

Investing is generally regarded as risky

As a hedge against inflation
To take advantage of compounding
Stocks have historically been among the best performing investments

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Risk of Losses

The Stock Market Can Be Very Volatile in the Short Run
S&P 500, March 2011 Through October 2020

There is no guarantee that a fallen market will recover or how long that will take.

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Inflation is also a risk

A key reason people invest is to cope with the long-term impact of inflation.
Over time, inflation reduces the purchasing power of your money.
People invest to maintain and hopefully grow their purchasing power.

Value of $1 from 2000 to 2023

$1 in 2000 is equivalent in purchasing power to about $1.75 today, an increase of $0.75 over 23 years.
The dollar had an average inflation rate of 2.46% per year between 2000 and today, producing a cumulative price increase of 74.70%. Google 3/23/23

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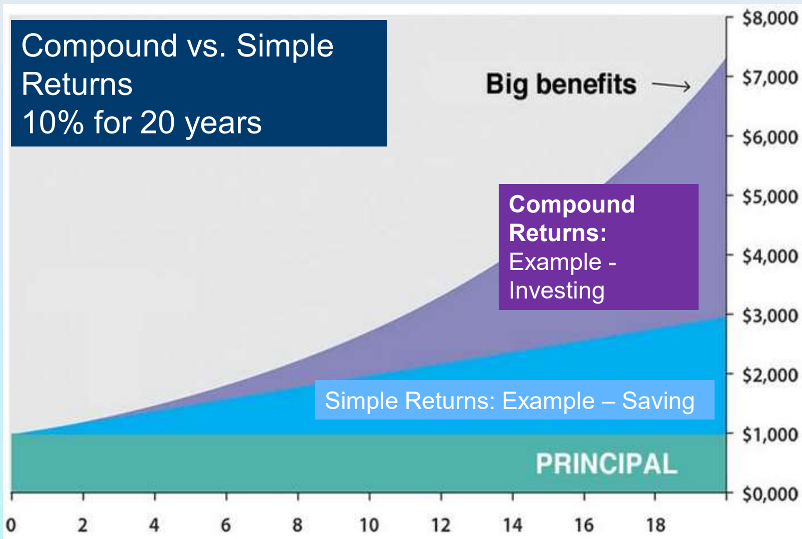
Investing provides an opportunity for compounding returns for growing your money faster over the long term to make up for inflation



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Simple Versus Compound Returns

Simple: Interest on the principal only

$1,000 at 10% simple interest gives you $100 every year. You get $100 after one year. You get $100 on the 10th year and every year in between. Over ten years, you earn an extra $1,000. **You now have a $2,000 asset. After 20 years, you have a $3,000 asset (20 x $100 + $1,000).**

Compound: Interest on the principal + prior interest

$1,000 at 10% compound interest gives you an increasing amount each year. Interest is paid on interest already earned, in addition to the principal. In 10 years, you earn an extra $1,593. **You now have a $2,593 asset. After 20 years, you have an asset worth more than $7,000.**

The longer the amount of time, the more beneficial compounding becomes.
The benefit is slow in the beginning but dramatic after many years.

Pay attention to whether your assets are earning simple or compound returns

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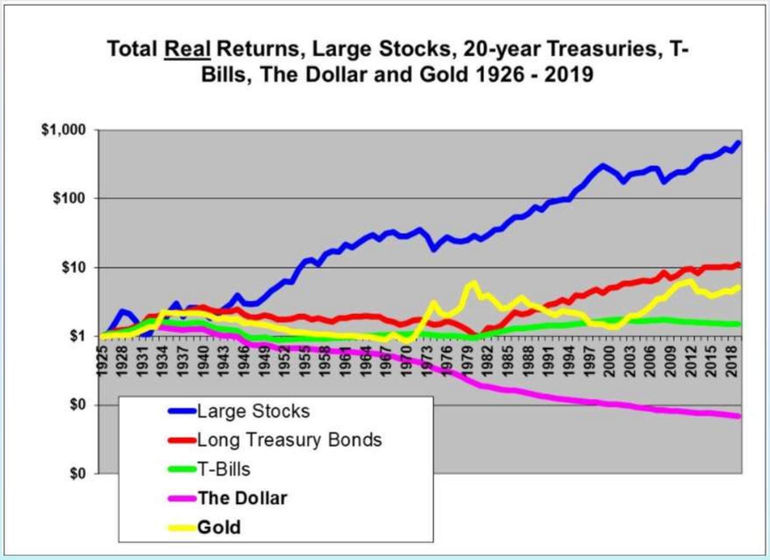
Another reason for investing is that stocks have historically beaten other investments over the long run.



94 years. Logarithmic scale. Returns after inflation but excluding trading costs and taxes
https://www.investorsfriend.com/asset-performance/ Shawn Allen, CFA,CMA,MBA,P.Eng

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Questions About Why People Invest?

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MANAGING INVESTMENTS

Pay Attention to Costs

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What Eats Into Investment Returns?

- Inflation – We've discussed
- Taxes – Gains on taxable investments you sell
- Trading Fees – There are many kinds

You cannot avoid inflation, taxes or minor trading fees.

But with DIY trading and discount brokers,
you can avoid most fees and
have some control over when you take a tax hit.

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"Hire" Help Versus DIY Management

HIRE: Use financial planners or advisors and other professionals
for advice about financial matters. Will have fees. May have account minimums.

HIRE: Use a full-service broker
A **full-service broker** is a licensed **broker**-dealer firm that provides a large variety of **services** to its clients, including research and advice, retirement planning, tax tips, as well as buying and selling stock, funds, bonds for you.
Will have fees. May have account minimums.

DIY: Use your workplace 401K. Take advantage of any employer matching.

DIY: Use a discount broker
With discount brokers, you decide for yourself what your overall investment strategy should be, and you choose your own stocks, funds and bonds. You are your own advisor and portfolio manager. Low or no fees, depending on the asset type.

How to Open a Brokerage Account: https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-43

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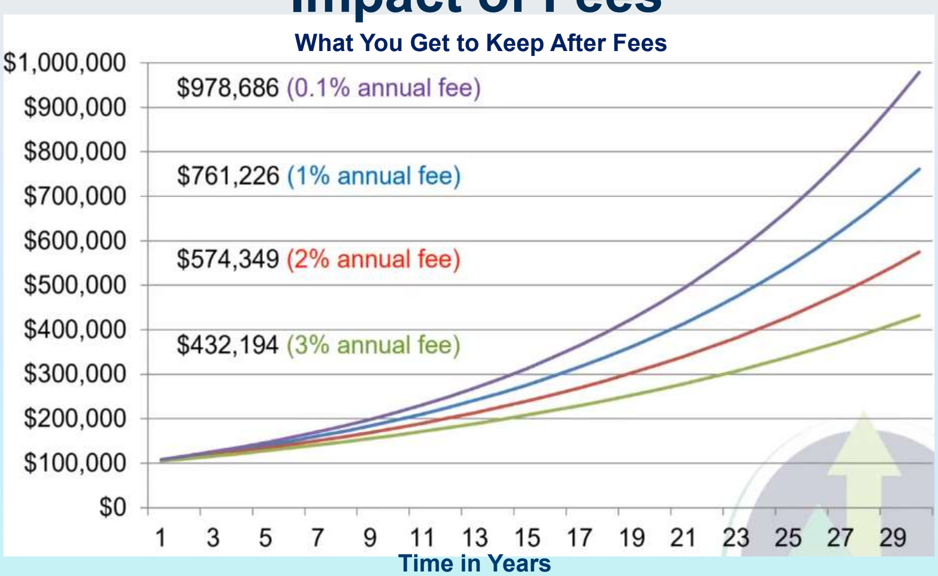
Impact of Fees



$100,000 invested; 8% annualized return over 30 years

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Management Choices

Consider hiring professional help
- If you can't or don't want to spend time on investing activities
- If you really dislike researching investments
- You're uncertain about your risk tolerance
- If the fees are acceptable to you – always make sure you know what they will cost

Professional Help – See: https://www.finra.org/investors/learn-to-invest/choosing-investment-professional

DIY
- If you have time to learn
- If you have time to monitor your investments at least quarterly
- If you like researching businesses or at least don't actively dislike it
- If you don't have a lot of money to invest
- If you want to save on fees
- To better control tax consequences of selling

Remember – Investing means leaving your money invested for at least 5 years.

- What you invest in may change,
  but you don't pull the money (principal) or the gains out and spend them.

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You will need a brokerage account

Whether you manage your own investments or use financial advisers, you will need to open a brokerage account.

Full service brokers charge fees for trading and advice.
Discount brokers offer free trading but no personal advice.

Trading means buying or selling stocks, funds or bonds.

Brokerage accounts are not insured against losses in the market.

BetterInvesting does not endorse or comment on particular brokerage firms.

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Some Full-Service Brokers

Source: https://www.jdpower.com/business/press-releases/2022-us-full-service-investor-satisfaction-study

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Some Discount Brokers

Robinhood	Merrill Edge	First Trade
E*Trade	Interactive Brokers	Ally Invest
Fidelity	SoFi Active Investing	Webull
Charles Schwab	Vanguard	

Source: https://www.fortunebuilders.com/best-online-stock-broker-for-beginners/

These brokers have no minimum balance requirement and no commissions on trading stocks and exchange traded funds. According to the source, they offer some education and easy to use software.

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Questions About DIY Management vs. "Hiring" Help?

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INVESTING IN FUNDS:

A cross between "hiring" management and DIY

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What Are Funds?

Mutual Funds & Exchange Traded Funds (ETFs)

Similarities between mutual funds and ETFs

- Both are baskets of stocks, bonds or other assets
- Both provide some level of instant diversification
- Both are managed by the fund manager(s)
- You buy shares of the basket, not the components
- You have no control over:
  - Selection of the fund holdings
  - When or if holdings are sold
  - How much trading (buying & selling) the manager(s) do

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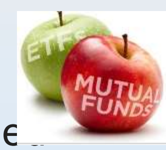
Funds

Mutual Funds & ETFs Exchange Traded Funds



Differences

Mutual Funds: More likely to be “actively” manage

ETFs: More like to mimic an index (“passively” managed)

Mutual Funds: Fees are often higher than for ETFs

Mutual Funds trade only once a day after the market closes

ETFs trade throughout the day

ETFs may be more tax efficient

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Funds: Between Hiring Management and DIY

Funds minimize but don't eliminate your job

You delegate most tasks to the fund managers
They choose what to buy and sell

Your job
Decide which funds to buy
Monitor them periodically
Sell them if they underperform significantly

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Diversification – A Key Investing Concept

Diversification involves acquiring a mix of assets in order to reduce portfolio risk and improve performance.

If one asset declines, the others may continue growing.

For Example:
Common ways to diversify stock funds and stock holdings:
- By economic sector and industry
- By geography – what country the company HQ is in
- By size
- By other characteristics

For investing terminology: https://www.investopedia.com/
Don't click on the ads.

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Value Line Stock Groups

SECTOR GROUPS AND INDUSTRY DETAIL

BASIC MATERIALS
Chemical (Basic)
Chemical (Diversified)
Chemical (Specialty)
Metal & Mining (Div.)
Paper & Forest Products
Precious Metals
Steel

FINANCIAL
Bank
Bank (Midwest)
Financial Svcs (Div.)
Insurance (Life)
Insurance (Prop/Casualty)
Public/Private Equity
R.E.I.T.
Reinsurance
Securities Brokerage
Thrift

TECHNOLOGY
Computer & Peripherals
Computer Software
E-Commerce
Internet
IT Services
Semiconductor
Semiconductor (Cap Equip)

CONSUMER-CYCLICAL
Advertising
Apparel
Auto Parts
Automotive
Cable TV
Educational Services
Entertainment
Entertainment Technology
Foreign Electron/Entertn
Furniture/Home Furnishings
Homebuilding
Hotel/Gaming
Newspaper
Publishing
Recreation
Restaurant
Retail Automotive
Retail Building Supply
Retail (Hard Lines)
Retail (Soft Lines)
Retail Store
Shoe

TELECOMMUNICATIONS
Telecom Equipment
Telecom Services
Wireless Networking

CONSUMER STAPLES
Beverage
Food Processing
Household Products
Retail/Wholesale Food
Tobacco
Toiletries/Cosmetics

HEALTHCARE
Biotechnology
Drug
Health Info Services
Medical Services
Medical Supplies (Invasive)
Medical Supplies (Non-Invasive)
Pharmacy Services

UTILITIES
Electric Utility (Central)
Electric Utility (East)
Electric Utility (West)
Natural Gas Utility
Oil/Gas Distribution
Telecom Utility
Water Utility

ENERGY
Coal
Natural Gas (Diversified)
Oilfield Services/Equip
Petroleum (Integrated)
Petroleum (Producing)
Pipeline MLPs

INDUSTRIAL
Aerospace/Defense
Air Transport
Building Materials
Diversified Co.
Electrical Equipment
Electronics
Engineering & Construction
Environmental
Funeral Services
Heavy Truck/Equip. Makers
Human Resources
Industrial Services
Information Services
Machinery
Maritime
Metal Fabricating
Office Equip & Supplies
Packaging & Container
Power
Precision Instrument
Property Management
Railroad
Trucking

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Fund Terminology

NAV or Net Asset Value is the price at which a share of the fund is trading

Expense Ratio or management cost as a percent of fund assets

Loads or extra fees levied when you buy or sell. Don't buy funds with loads. Buy "no-load" funds only. Loads are another type of management cost

Category – or where it fits in terms of providing diversity

In the case of a fund, whether it is open to closed to new investments

Try to find the best rated ETF or no-load fund with the lowest expense ratio for its category.

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Indexes

An index is a set of assets that meet certain criteria.

Funds that mimic an index generally have very low management fees because management has little to do by way of asset picking.

Examples of Stock Indexes
S&P 500: largest 500 US publicly traded companies by market cap
Dow 30: 30 large publicly traded US companies
Russell 2000: smaller publicly traded US companies
S&P Asia 50 Index: leading stocks in Singapore, Hong Kong, Taiwan, Korea

Examples of Bond Indexes
Barclays U.S. 7-10 Year Treasury Bond Index
Bloomberg Barclays U.S. Aggregate Bond Index – corporate bonds

Some indexes are narrowly defined (S&P Asia 50 Index).

Indexes are frequently used to benchmark the performance of funds and stocks.

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For Beginning DIY Investors

Two characteristics of funds may make them the easiest place for a new investor to get started:

1. Someone else (the fund manager) makes all the buying and selling decisions about what to include in the fund

2. Funds provide some measure of instant diversification

There are many broadly diversified, index mutual funds and ETFs with very low management fees – often just fractions of 1%.

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Index Funds

- **Pros**
  - Provide easy way to track health of economy
  - Many track stock indexes
  - Fees are low because no active management
  - Indexes outperform active management over time
- **Cons**
  - Stocks with higher prices have a larger impact on movements
  - Lack of flexibility when there is market volatility
  - No opportunity to outperform the market and make larger gains

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Fund Shareholder - OWNER

- You have BOUGHT shares of a mutual fund or ETF (exchange traded fund)
- Funds are collections "baskets" of stocks and/or other assets chosen by a manager
- You buy shares of the fund, not its individual stocks or other assets
- Your shares become more valuable if the fund prospers
- Some of the fund profits may be used to pay you dividends

Advantages

Funds (Mixtures)

- Often less $ needed to start
- Don't have time, etc. DIY not right for you now
- Funds provide a measure of instant diversification
- No-load Index funds often have very low fees

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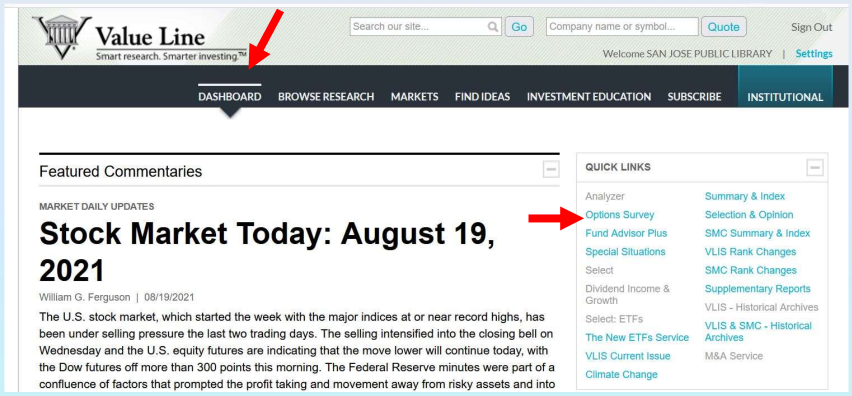
Researching Funds in the Library

Use the Library's Value Line subscription
It's free, online 24/7 to library card-holders



Value Line offers suggestions and information about some mutual funds in its Fund Advisor Plus.

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Questions About Funds?

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INVESTING IN STOCKS - DIY:

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Advantages of Investing in Individual Stocks

If you have **TIME, KNOWLEDGE, TEMPERMENT**

- Individual Stocks have potential for greater returns by having control over:
  - What to buy
  - When to buy and sell
  - How much to pay
  - Taxes and fees

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Reasons to Select Your Own Stocks

- You believe you watch your money better than anyone else
- You enjoy learning about the businesses of the companies you invest in
- You enjoy or at least don't mind stock research
- You want to invest in companies that share your values
- You want to minimize fees
- You have time to learn to invest and to monitor your stocks once you buy them

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Individual Stocks

- **Pros**
  - Reduced or no management fees
  - Longer you hold a stock, the lower cost of ownership
  - Easier to manage your taxes
  - You understand what you own when you pick the stock
- **Cons**
  - Diversification is harder at the beginning
  - It requires more time to monitor your portfolio
  - Need to learn to keep emotions in check

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Emotions? What Emotions?

Many decisions are actually made by the unconscious centers of the brain. You are not even aware of the underlying reasons, which may not be rational.

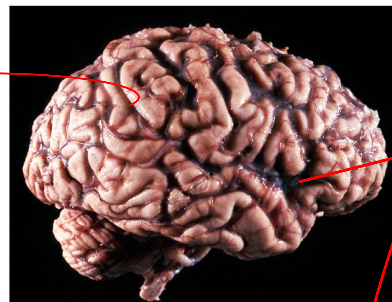
It's a nasty company

The CEO is a jerk

I don't like their products

They're in for a fall

What a weird name for a stock



CNRI/Phototake

Meets my performance standards now, but…

PE ratio is about to fall

I'm afraid of losing money

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Behavioral Economics

Humans did not evolve with stock markets.

Our brains do not always make rational decisions regarding investing.

Educate yourself about brain shortcuts that may hinder your investing.

Knowledge of these tendencies can help you avoid them.

Realize you will make mistakes occasionally.

Be sure to learn from your mistakes.

Even better – read and learn from others' mistakes.

The Behavior Gap – Simple Ways to Stop Doing Dumb Things with Money by Carol Richards

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Strategy for a Stock Portfolio

Add stocks to your portfolio as you can

Don't buy more stocks than you can monitor
You don't need lots of stocks to achieve reasonable diversification across sectors
- 5 - 10 can be fine
- 20+ may be unmanageable

Compare candidates to each other in terms of competitors.
Don't compare Verizon to Microsoft
- Compare Verizon to AT&T and T-Mobile
- Compare Microsoft to Apple, etc.

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Stock Terminology – P/E Ratio

Price of one share of stock / Earnings per Share
- Earnings are the company's profits. Shares refer to stock shares in circulation

Example: Price = $100 / EPS = $5. PE = 20

The PE ratio reflects what buyers are willing to pay for one dollar of earnings. Like price, it can fluctuate significantly over the course of a year

The PE ratio reflects enthusiasm (or lack) about a stock.
It is not necessarily a good indicator of the soundness of the company.

If a company has no PE, that means it is unprofitable. It has no earnings. Stay away, especially if you are a beginner.

Try to develop a sense of a company's typical PE and not buy above that.

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Stock Terminology - Yield

Some companies share their earnings (profit) with shareholders.

They pay shareholders a cash dividend, usually quarterly.

The dividend is expressed in dollars and also as a percent of the stock price (yield)

Example:

25 cent quarterly dividend in 2021 = $1
Price = $40
Yield = $1/40 = 2.5%

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Terminology - Total Return

Total Return is a combination of the rise in the stock price (price appreciation) plus any dividends.

Example

A stock price rises from $50 to $54 in a year.
Company pays 4 dividends of 25 cents each

Stock cost = $50
Price appreciation = $4 (8%)
Dividends = $1 (2%)

Total Return = $5 / $50 = 10%

Dividends are often a significant part of total return

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Investment Clubs

- Pool your money with club members
- Share a similar interest in investing
- Help each other learn as you earn

We will talk about investment clubs on May 18

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Researching Stocks in the Library

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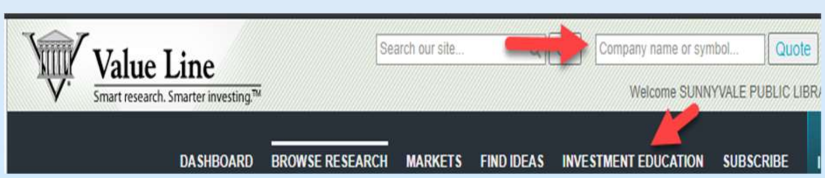

Value Line provides information to
- To help evaluate stocks
- Get more investment education

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Stock Shareholder - OWNER

- You have BOUGHT shares of a company
- Your shares become more valuable if the company prospers
- The company may use some of its profits to pay you cash (dividends) periodically

Advantages

Individual Stocks

- DIY is for you:
  - Time
  - Temperament
  - Skill
  - Interest
- Historically best long-term returns
- You are OK with slowly diversifying

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Questions About Stocks?

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INVESTING IN BONDS

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A Few Words About Bonds

- Bonds are different from stocks
- Bondholders are creditors to the corporation, entitled to interest and repayment of principal
- Creditors in a bankruptcy have legal priority over other stakeholders and are made whole first
- Bonds have a fixed duration and expire on the date specified in the bond (maturity date)
- Return is the fixed rate of interest established by the bond and paid by the bond on a periodic basis

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Types of Bonds

Bond – a loan to the entity issuing the bond

- A corporation: Microsoft, Verizon, Domino's Pizza, etc.
- A government; city to state ("municipal" bonds – aka "munis")
- The United States government - Treasury bills, notes, bonds

Munis and US government bonds are partially or totally tax free
For that reason, their yields (interest rates) are generally lower than for corporate bonds.

Some brokers trade bonds as well as stocks and funds.

You can buy US Treasury bonds, notes and bills directly from the Treasury. For information: https://www.treasurydirect.gov/

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Bond Coupon Rate vs. YTM

Bonds are issued with a stated interest rate, the coupon rate. Example 3% per $100 (par value) and a date when the principal will be paid back (maturity date)

Some bond holders put their bonds on the "secondary" market to trade. Buyers may pay more or less than par value. This changes the effective interest rate they will receive.

If you have to pay $110 to acquire this $100 bond, your interest rate is only 2.7% despite the stated coupon rate of 3%.

The impact of paying more or less than par value is reflected in the Yield to Maturity (YTM). Example: 2.7%, not 3%. Pay attention to the stated YTM, not the coupon rate.

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Bond Risk

Interest Rate Risk or Inflation Risk
If you need to sell a bond before it matures, other assets, including newer bonds, may offer more attractive returns. You bond may be worth less than you paid. Conversely, if other assets are less attractive, your bond may be worth more than you paid.

Credit Risk
Bonds are issued with credit ratings. Do not buy bonds below investment grade

Prepayment Risk
Sometimes issuers have the right to "call" the bond and pay bondholders off early. In that case, you will be paid the par value (not the price you paid) + any interest that has accrued. But you will no longer hold the bond and will lose the income stream you were depending on. Callability is stated in the bond description.

Note: Whenever bonds mature or are called, holders are paid the par value of the bonds in a lump sum, not what they may have paid for them.

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Bonds

- **Pros**
  - As long as you hold a bond to maturity, you have some certainty about returns.
  - You know how much interest you will earn.
  - You know what the par value is and when it will be paid.
  - If other kinds of assets drop in value, you might be able to sell your bond for more than you paid for it.
- **Cons**
  - Interest rate risk or inflation risk
  - Credit risk
  - Prepayment risk
  - If you need to sell your bond before it matures, you may not get what you paid for it.

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Bondholder - LENDER

You have LOANED money to a company or a "Muni" – a government entity

You receive periodic cash (interest) payments from the company or muni for a set period of time until your loan is paid back

Advantages

Individual Bonds

You know exactly what your returns will be

You are OK with historically low returns

DIY is for you

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Thank You for Coming
Questions and Comments

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Next in the Series

Free Library Resources
April 20, 5:30 pm

Slides will be posted at: https://www.betterinvesting.org/chapters/silicon-valley/news-articles

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