Understanding Owned Assets

Experts suggest that you need [80% of your pre-retirement income level] to live comfortably during retirement. Given that many people are not working during retirement (or are working only part time), that money must come from sources other than a salary. Outside of dedicated retirement accounts and Social Security benefits, you have the option to invest on your own.

Owning involves investing by purchasing an asset, like a house, gold, diamonds, mutual funds, or stock. As the owner, you receive the potential increase in value of your investment, and the potential to receive distributed profits or dividends, but there are no guarantees on your principal deposit. Depending on market conditions, you may make money from your investment (e.g., selling a home for more than you bought it for), but you also may lose money if you need to sell fast.

Mutual funds and stocks have fees that can affect your investment growth in the short term and even more significantly in the long term. Fees vary depending on the type of investment and the account manager. All fees legally have to be stated, so read the fine print before opening an investment account.

You also need to consider how tax liability can affect the future value of your investment as you may have to pay taxes on any proceeds you get when you sell an asset.

> **Note:** When you own an asset outright, it is subject to market fluctuations and supply and demand.

Consider the following owned assets:

Real Estate

Investing in real estate simply involves purchasing a property and hoping that its value increases over time. Renting out real estate that you have invested in may generate income and help pay the mortgage. To earn money on real estate investments that you rent, you will need to charge more for rent than you are paying for the mortgage, upkeep, and other expenses.

- **Pros:** Steady income stream when rented out, and capital appreciation
- **Cons:** No ready liquidity, large capital investment, potential periods not rented, maintenance expenses, risk of depreciation

Note that real estate is heavily influenced by location. The area's employment rate, local economy, crime rates, transportation facilities, schools, and property taxes all play a role in determining both price and demand.

Mutual Funds

A mutual fund is made up of money sourced from many individual investors that is pooled together and invested by a single entity into a portfolio of stocks, bonds, and other assets with the purpose of producing income for each investor. Mutual fund portfolios consist of anywhere from 20 to 200 different investments.

Think of it as giving the portfolio manager – the person making investment decisions with your money – a sum of money to invest how they see fit. Other investors do the same thing, and so the amount of money that the portfolio manager is working with is much more than what you alone contributed to the mutual fund.

- **Pros:** Diversification, professional management, multiple options for profits
- **Cons:** Managed investment fees, market fluctuations, capital gains

Many people only look at the past performance of a mutual fund without investigating how long the current manager has been responsible for performance. If the manager is new to the fund, try to find out what fund they previously managed and how it performed so you have an idea of their track record. If your fund hires a new portfolio manager, investigate where they were previously.

There are four primary categories of mutual funds.

1. **Stock funds:** Stock funds are made up of a collection of different stocks. There are three types of stock funds.

- Growth stock funds seek capital appreciation, rarely pay dividends, and are high risk, but also potentially high reward.
- Value stock funds try to achieve capital appreciation by buying stocks that are priced low compared to their value, often pay dividends, and are typically lower risk than growth stock funds.
- Index stock funds are designed to copy the performance of a particular stock index. They offer low fees and capital gains distributions, but the amount of risk varies.

2. **Hybrid funds**: Hybrid funds may invest in different types of investments like common and preferred stock, bonds, and money markets to create a more diversified portfolio.

Within these funds, you can choose between growth and income, fixed income, and balanced portfolios.

- Growth and income portfolios seek long-term capital appreciation and to provide income. They invest in common and preferred stock, convertible securities, bonds, and money markets, and there's a medium level of risk involved.
- Fixed-income portfolios seek to provide current income, may provide capital appreciation, and are comprised of bonds and preferred stock. The risk is comparable or a little lower than you'd find with growth and income portfolios.
- Balanced portfolios are designed to create stability and seek to provide both income and appreciation. They consist of common and preferred stock, bonds, and money markets and are of similar risk to fixed-income portfolios.

3. **Bond funds:** Bond funds buy and sell certain types of bonds to generate current income for investors. Unlike originally issued, individual bonds, these funds may experience either capital appreciation or depreciation due to an actively managed portfolio. They can be made up of corporate, government, municipal, or high-yield bonds, depending on the level of risk you are willing to assume. All bond funds seek to provide income.
4. **Money market funds:** Money market funds are a low-risk investment choice, but there is always the possibility of losing money. Money market funds are made up of short-term investments of the U.S. government, corporations, and banks. Any income you make from these funds is based on the current interest rate.

Stock

When you buy stock in a publicly traded company, you are buying part of the business itself. Stock is typically bought from other stockholders through regional or national stock exchanges, though it could be purchased directly from the company in an initial public offering (IPO). The main U.S. stock exchanges are the New York Stock Exchange and NASDAQ.

- **Pros:** Liquidity, potential for dividends, historically prices appreciate above inflation
- **Cons:** No insurance, no guaranteed return on investment, capital gains taxes

Stock prices are determined by supply and demand. Demand is determined by company revenue and earnings, the potential for growth, and current or expected conditions of the stock market or economy. If demand is high, there are more purchase orders than sale orders, and the price goes up. If there are more people selling than buying, the price goes down. Most investors make purchases through a brokerage firm. You make decisions about the purchases and sales you would like to occur, but the brokerage firm executes the transactions on your behalf.

There are two classes of stock: common and preferred.

- Most publicly traded shares are common stock, meaning there is greater potential for price appreciation. Shareholders have voting rights, but they are the last to receive any investment back if the company goes out of business.

- Preferred stock has greater price stability, but less potential for appreciation. Shareholders don't have voting rights, but they may receive a portion of their investment back if the company goes out of business after both creditors and bondholders are repaid.

Further, growth and income stock are classified according to how they use corporate earnings. Growth stock reinvests earnings to grow their business and is purchased with the primary objective of capital appreciation. Income stock pays dividends to shareholders and is purchased with the primary objective of generating current income. Some companies fall into both categories since they reinvest earnings in their companies but also pay dividends to shareholders.

Stock can also be classified as large cap or small cap, which has to do with a company's market capitalization. Market capitalization is calculated by multiplying the price of one share by the number of available shares. Small cap stock has a market capitalization of $2 billion or less and may be less stable during a bad economy, but often has more potential for growth. Large cap stock has a market capitalization of $10 billion or more, may be more stable during a bad economy, and is also more likely to pay dividends.

What are employee stock options?

Employee stock options provide you the right to purchase your employer's stock in the future at a determined price known as the *grant price*. This is typically the market price at the time the options are granted to you. At that time, you may buy the stock (exercise your option) or delay the purchase and wait to see if the price increases. If it does, you have the right to buy the stock at the original grant price and sell it for a profit at the current price. Note that you may be taxed on your stock purchase or required to pay capital gains tax on any earnings.

When it comes to planning for retirement, diversification is one of the tried-and-true strategies that can lead to success. Putting all your money into one form of investment can lead to failure if market conditions don't remain favorable. It's important to consider true retirement accounts (like a TSP, 401(k), or IRA) and loaned assets before turning to other investment types. If you have questions about types of investments, our Education Team can be contacted at 888-298-4442.