

# Maximize Your Retirement Investments



By the Editors of *Kiplinger's Personal Finance* magazine

In partnership with



for



Retirement



## Table of Contents

- 1 Three Fundamental Truths
- 2 Stocks Promise the Best Long-Term Gains
- 2 Stock Basics You Should Know
- 3 The Role of Bonds
- 4 Different Types of Bonds
- 6 Plug Into Mutual Funds
- 7 Choosing the Right Mutual Funds
- 10 Best Places to Keep Your Investments
- 17 Plans for the Self-Employed
- 19 Protect Your Money: How to Check Out  
a Broker or Adviser

Glossary of Investment Terms You Should Know

## About the Investor Protection Trust

The Investor Protection Trust (IPT) is a nonprofit organization devoted to investor education. Over half of all Americans are now invested in the securities markets, making investor education and protection vitally important. Since 1993 the Investor Protection Trust has worked with the States and at the national level to provide the independent, objective investor education needed by all Americans to make informed investment decisions. The Investor Protection Trust strives to keep all Americans on the right money track. For additional information on the IPT, visit [www.investorprotection.org](http://www.investorprotection.org).

**N**EXT TO PUTTING MONEY ASIDE for retirement in the first place, deciding where to invest that money is the most important step. Because the bulk of your nest egg's ultimate value will come from investment growth, rather than from dollars you invest, making the best investment choices is critical to your success.

To put your retirement investments on track and keep them there, you need only master a few financial fundamentals that will influence each retirement investment decision you make. Think of it as operating your own at-home business—Joan & Jim's Worry-Free Retirement Inc. The purpose is to build as big a nest egg as possible without taking unreasonable risks.

First you'll need to start thinking about investing your retirement money, not simply saving it. That means learning about the investment choices, deciding where they fit in your "business plan," weighing the risks and taking action.

## Three Fundamental Truths

Investing for retirement boils down to three fundamental truths.

**TRUTH #1: YOUR GOAL—MONEY FOR RETIREMENT**—brings investment choices into focus. Every investor should have a goal—say, buying a house, sending the kids to college or starting a business. Your goal is retirement, and it influences each decision you make with your nest egg.

It means that your time frame is long-term—stretching not just to the day you retire, but for the rest of your life. You'll want to keep money for other goals, such as vacations, cars or tuition, tucked away outside your retirement nest egg where it will be more accessible. Accumulating money for retirement is a unique goal, and there are distinctive means for reaching it.

For one thing, time is on your side. Whether you're five years from cutting your employment bonds or still have 25 years to go, one of your key investment allies is the ability of compound growth (where your interest earns interest) to build retirement capital automatically. For example, \$10,000 invested at 8% grows to \$14,700 after five years, \$31,700 after 15 years and \$68,500 after 25 years, even if you never add another dime to the pot.

With retirement as your goal, you don't need to worry about short-term investment swings, such as the ups and downs of the stock market. You're not an investment dabbler or someone who tries to precisely time each investment move; you're a long-term investor who stands to benefit from putting time to work.

**TRUTH #2: INVESTING SUCCESSFULLY FOR RETIREMENT REQUIRES TAKING SOME RISKS, BUT NOT UNNECESSARY RISKS.** Investing for retirement—which is to say, investing for the long term—highlights a conundrum about risk. The more time you have to reach your retirement goal, the more risk you can afford to take. But the longer you have to go until retirement, the less risk you actually need to take, since your nest egg has longer to reap the benefits of compound growth.

While no investor wants to lose money, investment categories with the best long-term performance records don't produce their standout results in a straight line. They inevitably experience ups and downs along the way. If you're caught in a

Your time-frame  
for retirement is  
long—stretching  
not just to the  
day you retire,  
but for the rest  
of your life.

“down,” you’ll lose money—at least on paper and at least for a while. But it isn’t a real loss until you sell, and as a long-term investor you aren’t selling. Thus, there is really much less risk than it might first appear. History testifies that in the long run, wisely selected investments will ride out those occasional short-term dips to deliver substantial gains for your retirement nest egg.

The best approach is to start out with higher-risk investments, then begin reducing the risk level of your investments once you’re within five years or so of retirement. If you were close to retirement and your nest egg wasn’t growing as fast as it should to meet your anticipated retirement-income needs, you might be tempted to increase your risk in hopes of achieving a higher return that would boost your nest egg more rapidly. But that’s not the answer. A better one is to consider delaying retirement until you’ve saved more and built the nest egg you need.

A willingness to take some risk with your money is what provides the chance for you to earn an increased return—something a great deal better than you would get in “riskless” bank certificates of deposit, U.S. Treasury securities or money-market funds. The hidden risk of retirement investing comes from taking no risks. With only supersafe investments, you forfeit your chance at bigger gains—and a more secure retirement. You swap one kind of risk (investment volatility) for another: the risk that your nest-egg performance won’t keep up with inflation—or that you’ll outlive your money.

**TRUTH #3: DIVERSIFICATION WORKS.** Deploying your retirement money among many investments is both a safe approach and a way to increase your opportunity for higher returns. Because no investment performs well all the time, when one is down, something else is likely to be up. And best of all, because a well-diversified portfolio can include some higher-risk choices, sensible diversification can also increase your return.

## Stocks Promise the Best Long-Term Gains

Where’s the single best place to invest a long-term retirement nest egg? Stocks. In the long-term, stocks have outperformed all other investment options by a big margin over almost any time period you choose. Since 1926, a basket of large-company stocks has shown an average annual gain of more than 10%. Small-company stocks, which tend to grow faster but with more risk, have produced an average annual gain of nearly 13% since the 1920s.

### STOCK BASICS YOU SHOULD KNOW.

The term “stock” usually refers to common stock, which represents an ownership share in the company that issued it. Common stock may or may not pay dividends, which are profits the company distributes to its owner/stockholders. Divide the current annual dividend rate by the share price and you get the stock’s yield. Both the dividend and yield are often included in newspaper stock listings, so you won’t need to do the math yourself.

There are six basic, sometimes overlapping common-stock categories to consider for your retirement portfolio: Growth stocks, blue-chip stocks, income stocks, cyclical stocks, small-company stocks and international stocks. You can buy them directly through a broker or gain instant diversification and the advantage of professional management by selecting mutual funds. Discount brokers can save you money on commissions, but they won’t offer any advice on which stocks to buy.

**GROWTH STOCKS.** These are so named because they have good prospects for growing faster than the economy or the stock market in general. Risk varies from moderate to high. Investors like them for their consistent earnings growth and the likelihood that share prices will go up significantly over the long term.

**BLUE-CHIP STOCKS.** You won't find an official "Blue Chip Stock" list. Blue-chip stocks are generally industry-leading companies with top-shelf financial credentials. They tend to pay decent, steadily rising dividends, generate some growth, offer safety and reliability, and are low-to-moderate risk. These stocks can form your retirement portfolio's core holdings—a grouping of stocks you plan to hold "forever," while adding other investments to your portfolio.

**INCOME STOCKS.** These securities pay out a much larger portion of their profits (often 50% to 80%) in the form of quarterly dividends than do other stocks. These tend to be more mature, slower-growth companies, and the dividends paid to investors make these shares generally less risky to own than shares of growth or small-company stocks. Though share prices of income stocks aren't expected to grow rapidly, the dividend acts as a kind of cushion beneath the share price. Even if the market in general falls, income stocks are usually less affected because investors will still receive the dividend.

**SMALL-COMPANY STOCKS.** These are typically newer, fast-growing companies. Shares in these companies are riskier than blue-chip or income stocks, but as a group historically their long-term average returns have been higher. The price of that historic advantage has been greater short-term volatility.

**FOREIGN STOCKS.** These investments also might have a place in your retirement nest egg, and they are easily available through a wide array of foreign-stock mutual funds. The two key benefits of adding an international flavor to your nest egg are diversification and performance.

Foreign shares help diversify your nest egg because international markets generally perform differently than the U.S. market does. When stocks in the U.S. are down, those in other countries may be rising. The reverse is also true, of course, but by investing in a mutual fund that owns stocks in many different countries, you can reduce the effects of a downturn in any one foreign market.

## The Role of Bonds

Some financial planners maintain that investors with ten or more years to go until retirement should have their money in the stock market—period. That view isn't universally held, and not all individuals feel comfortable enough with stocks—despite their long-term performance—to put an entire nest egg in that basket. Adding modest amounts of bonds or other fixed-income vehicles can reduce the overall risk level. The price may be a slightly lower return, but the additional diversification and safety of bonds will make for a steadier ride toward retirement.

### THE BASICS.

A bond is an IOU issued by a corporation or a government. When you buy a bond, you are making a loan to the bond issuer. In return, the company or the government agrees to pay a specified interest rate known as the coupon rate. You will be paid a fixed amount of interest, usually twice yearly, until the bond matures, at which time you are paid the bond's face value. For example, if the face value of the bond is

Adding modest amounts of bonds to your nest egg basket can reduce your overall risk level.

\$1,000, you get back \$1,000. If you wish, you can also sell the bond to another investor before it matures.

Why might you want to own bonds in your retirement portfolio? Both corporate and government bonds have lagged the stock market over the very long term.

Given that performance gap, why even consider bonds? If you are ten, 15, 20 or more years from retirement and won't be spooked into selling stocks if the market swoons, there's probably little reason. Go for the bigger gains that stocks are likely to offer over the long term.

But if stocks are just too unsettling to you personally, or if you have less than ten years until retirement, bonds' lower volatility is important. The net effect of holding a small portion of your nest egg here is to cushion the entire basket.

Still, bonds entail several kinds of risk. Chief among them is interest-rate risk. The bond market thrives when interest rates fall. The reason is fairly simple. A bond paying 8% that was issued last year will be worth more this year if new bonds are paying only 6%. So if you paid \$1,000 for your bond, you could probably sell it for around \$1,300.

But the reverse is also true. When interest rates rise, bond values drop, and if you happen to be holding some of those bonds, you could lose money if you had to sell. If you bought an 8% bond for \$1,000 and the going rate for new bonds jumped to 9%, your bond would be worth only about \$890. But you'd still be earning 8%, and if you hold the bond to maturity, price swings don't matter. You still receive full value when it comes due.

**If stocks are too unsettling, or you have less than ten years until retirement, bonds' lower volatility is important.**

### **DIFFERENT TYPES OF BONDS.**

As with stocks, there are several major categories of bonds and bond cousins for you to consider: U.S. Treasuries, corporate bonds, zero-coupon bonds, foreign bonds and bondlike instruments known as mortgage-backed securities. One kind of bond you don't want for your IRA, Keogh or other tax-deferred retirement account is the municipal variety. Because interest on those bonds is tax-free, there's no advantage to putting it in a tax shelter, and there's a big disadvantage: When the interest comes out of the shelter, it will be taxed.

You can buy bonds through a broker or, in the case of U.S. Treasuries, directly from the government. Discount brokers can save you money on commissions but won't provide advice on which bonds to buy. For most investors, bond mutual funds are the way to go. They offer instant diversification and professional management.

**U.S. TREASURIES.** These are the safest bonds to buy. In maturities of two to ten years they're known as Treasury notes; the longer maturities of ten to 30 years are called Treasury bonds. They are backed by the full faith and credit of the federal government, and interest is paid semiannually. Notes start with a \$1,000 minimum, then sell in \$1,000 steps. Longer-term notes and bonds also sell in minimum \$1,000 increments. Interest is free from state income taxes, which slightly boosts the in-your-pocket return.

**CORPORATE BONDS.** These bonds, which are backed by the companies that issue them, are riskier than Treasuries, so they pay higher rates to compensate investors. The safest bonds are those given the highest ratings from agencies such as Standard & Poor's Corp. ([www.standardandpoors.com](http://www.standardandpoors.com)) and Moody's Investors Service

(www.moodys.com). For example, bonds issued by the very strongest corporations receive AAA ratings from S&P. Corporate bonds with low ratings or no ratings at all pay the highest rates and are more commonly known as junk bonds. They are generally not appropriate investments for a retirement portfolio. Typically, corporate bonds are sold in increments of \$1,000, or sometimes \$5,000, with interest paid twice yearly.

**ZERO COUPON BONDS.** These bonds, known as zeros, pay interest only when they mature. At that point, they pay all the accumulated interest. You pay a relatively small sum for the bond when you buy it and receive a giant payback at maturity. Zeros come in face values as low as \$1,000 and are sold at large discounts of 50% to 80% from that face value, depending on how long you have to wait to collect the interest at maturity. For example, a \$10,000 zero yielding 7.5% and maturing in 20 years would sell initially for about \$2,350.

Because zeros sell for such huge face-value discounts, they're a good choice if you want to know precisely how much money will be available on a set date—at retirement, for example. The longer the term of the zero, the less you have to pay now to buy one.

Taxes are a potential drawback. Even though you don't actually receive interest on the zero each year, the IRS annually taxes the interest that accrues each year. This is why zeros work best inside an IRA, Keogh or other type of retirement account that allows investment earnings to build tax-free.

One final point: Zeros are much more sensitive to interest-rate changes than regular bonds. If market rates fall after you buy zeros, you could enjoy a significant profit by selling before maturity. But if rates rise and you have to sell before maturity, you could face a steep loss.

**FOREIGN BONDS.** Just as foreign stocks offer opportunities beyond U.S. borders, so do foreign bonds. If you own bonds, most of them should be issued by Uncle Sam or U.S. corporations. But bonds issued by foreign governments or corporations can pay higher yields—sometimes much higher (with correspondingly higher risk)—than their U.S. counterparts. The best way to buy is through foreign-bond mutual funds.

**MORTGAGE-BACKED SECURITIES.** These are not really bonds, but they have some similar characteristics. Briefly, these securities represent pools of home mortgages that have been made by lenders around the country. Owners of the securities receive payments of both interest and principal on those mortgages.

There are many types of mortgage-backed securities. Perhaps the best known are those guaranteed by a federal agency called the Government National Mortgage Association (GNMA, or Ginnie Mae). The guarantee means that if a homeowner defaults on a mortgage, the government will make good on all payments. Securities issued by two quasi-government organizations, Fannie Mae (formerly the Federal National Mortgage Association, or FNMA) and Freddie Mac (the Federal Home Loan Mortgage Corp. or FHLMC) are backed by the assets of those agencies but not directly by Uncle Sam. In all cases, the guarantee does not mean that the market price of the securities is guaranteed—this will fluctuate in response to changes in interest rates. In fact, mortgage-securities prices tend to fluctuate more than Treasury or corporate bonds.

Because a mortgage-backed security pays back both principal and interest through-

The longer the term of a zero coupon bond, the less you have to pay now to buy one.

out its life—unlike a bond, which pays only interest and returns principal at maturity—mortgage-backed securities behave differently than bonds and carry a higher risk. The good news is that they usually pay higher returns than corporate bonds or U.S. Treasuries. The bad news is that when interest rates drop, homeowners often rush to refinance their mortgages at lower rates, thus eating into the returns that investors receive on mortgage-backed securities.

## Plug Into Mutual Funds

Mutual funds can be an investor's best friend. They let small investors hire professional money managers to take over the legwork of investing—going through reports on thousands of individual companies to compile a suitable investment portfolio. By turning this work over to mutual funds, you can make your retirement-investment portfolio as easy to manage as possible.

A mutual fund is an investment company that pools money from many investors and buys a portfolio of stocks and bonds meant to achieve a specific investment goal. The fund might own a selection of blue-chip stocks, small-company stocks, foreign stocks, a mix of stocks and bonds, or a host of other investment types or combinations. Each fund's goals and other details are spelled out in its prospectus—a helpful document you'll receive and should definitely read before investing.

### VALUED FEATURES.

Mutual funds offer a combination of services that are ideal for retirement investors. They are especially well-suited for beginning investors who worry about their own ability to select good stocks and who could benefit most from this brand of professional management. But even experienced investors and those with large portfolios can benefit from what mutual funds have to offer:

- **Simple procedure to buy and sell.** The process of selecting individual stocks and bonds can be complex, time-consuming, costly and downright frustrating. Mutual funds offer an easy-buy, easy-sell concept. You can buy or sell with a phone call directly to the fund, through a broker, through the mail or online.
- **Professional management.** Each fund has one or more portfolio managers whose job it is to direct the fund's buying and selling.
- **Instant diversification.** Each mutual fund share buys an interest in whatever the fund owns. A typical large-stock fund, for example, owns shares in more than 100 companies, perhaps several hundred. This diversification doesn't insulate you from market movements. But if one stock drops, the impact overall is greatly softened.

While diversification is a key strength of mutual funds, you still need to take it a step further by diversifying among several different funds as your nest egg grows. No single fund can meet all your retirement-investment needs. Even if you start out with just one or two funds, you can add others later on as you continue to add funds to your retirement nest egg.

- **Small minimum investment.** Most mutual funds have a low minimum initial-investment requirement—typically \$250 to \$3,000. Some funds accept orders of as little as \$25; a few have no mini-





mum at all. This is often on the condition that you agree to make regular monthly contributions of \$50 or \$100. Once the initial investment is made, most funds permit additional investments as small as \$50 to \$250. Since funds issue fractional shares, you can invest in round-dollar numbers.

- **Automatic reinvestment of earnings.** Dividends paid by stocks in the fund's portfolio, interest from bonds, and profits (called capital gains) earned when securities are sold are distributed to fund shareholders, usually once or twice a year. Most funds will automatically reinvest that money to buy you more shares of the fund. That's a way to give your long-term plan a big boost because it puts the power of compounding to work on your behalf.
- **Service perks.** Mutual fund companies are eager to gain and keep you as an investment customer. The larger funds make it easy to inquire about your account, get current price and yield information, and make purchases, transfers or redemptions. Companies that manage a group of funds—a fund family—make it easy for you to switch your money from one member of the family to another, usually with a phone call.
- **Easy monitoring.** Keeping track of how mutual funds are doing is easy, too. Major newspapers publish fund prices daily, while personal-finance magazines regularly compare and rank mutual fund performance over a variety of time periods. The funds themselves issue quarterly and annual reports, and most have toll-free numbers you can call for daily share prices.

### THE LOAD / NO-LOAD CHOICE.

Mutual funds fall into two basic cost camps: those that charge commissions (load funds) and those that don't (no-loads). Front-end loads, charged when you first invest, typically range from 3% to 5.75%. Funds on the lower end of the scale are called low-loads. A back-end load, charged at the time you sell your shares, is also called a redemption fee. Numerous funds charge temporary or permanent redemption fees of 1% to 5%, which usually disappear for investors who hold the shares three to six years or more.

At first blush, it may seem foolish to pay a load if you can buy into another fund for free. And, indeed, there's no evidence paying a load buys you better management or performance. That makes sense, in fact, because the load doesn't go to the managers—it goes to the broker or other financial professional who sells you the fund.

The key to the load/no-load decision is whether you have the time and confidence to pick the funds for your retirement portfolio. If so, no-loads are almost surely the way to go. If you don't want to take the time or feel you don't have the ability to evaluate funds, however, you should seek the advice of a broker or financial planner. And you should expect to pay for that service via a load.

## Choosing the Right Mutual Funds

Note that's not, "Choosing the Best Funds." It usually isn't enough to pick one good fund, or even two or three good funds. You will want to put together a good

There's no evidence that paying a load buys you any better fund management or performance.

portfolio of funds that suit your needs. A portfolio is a group of funds, drawn from various fund types, that work together in all kinds of investing environments, so that while one fund might do badly, another may do well. By building a portfolio of funds, you reduce the risk that your overall holdings lose value and at the same time maximize the growth of your nest egg.

To begin the task of finding the right funds for your portfolio, concentrate on the fund types whose objectives and willingness to take risks most closely match your own. Within each category, you can compare performance records, costs and shareholder services of individual funds to help make your final choices.

The categories used to describe mutual funds do a pretty good job of indicating the kinds of investments they make. For example, aggressive-growth funds take the biggest risks by purchasing shares of fast-growing small companies, international funds invest in shares of companies based outside the U.S., balanced funds balance their portfolios between stocks and bonds, and so on.

Because the rate of return on your money should at least keep up with the rate of inflation before and even after you retire, you should keep a significant amount in stock funds. Just how much depends on how much time you have until retirement and your tolerance for risk. For example:

**IF YOU HAVE MORE THAN 15 YEARS TO RETIREMENT:** You should probably invest 100% of your money in stocks, whether your tolerance for risk is low or high. You might divide your money between aggressive-growth, long-term growth and international funds—fund types offering the greatest growth and risk—because you’ve got plenty of time to ride out and more than make up for any slumps.

To cite a recent example, the 20-year annualized return (the average annual return after compounding for the period ending December 31, 2004) for the aggressive-growth fund category was 11.43%, even though it suffered down years in which its return was -9.16%, -4.54% and -19.28% and in 2002, in the aftermath of 9/11, it lost 28.11%. Likewise, the 20-year return for the long-term growth category was 12.44%, whereas it had down years in which its return was only -0.67%, -7.99%, and it lost 16.53% through December 31, 2002.

**IF YOU HAVE SIX TO TEN YEARS TO RETIREMENT:** You might still keep 100% of your money invested in stocks if you’re comfortable with risk, or reduce that amount and invest the balance in bonds if you’re your tolerance is low. Either way, you might still invest your stock money in aggressive-growth, long-term growth and international funds.

**WITH FEWER THAN SIX YEARS TO RETIREMENT:** Even the most risk-taking investors should begin to move at least some of their stock money into bonds. More conservative investors will increase the proportion of the portfolios devoted to bonds.

**ONCE YOU’RE IN RETIREMENT:** You would continue moving your stock money into bonds—half or more, depending on your tolerance for risk. You would also switch some or all of your remaining stock funds to less risky fund types, such as growth, growth-and-income, and real estate funds.

Here are details on the major mutual fund categories that you should consider for your retirement-plan investing

Aggressive-growth funds carry higher risks than most types of stock funds, but can produce the biggest gains over the long term.

- **Aggressive-Growth Funds.** These funds seek big profits (that’s “maximum capital gains” in investment lingo) by investing in small to medium-size companies, developing industries, or wherever rapid growth—and strong increase in stock values—is expected.

Aggressive-growth funds seldom pay dividends. These funds carry higher risks than most other types of stock funds but can produce the biggest gains over the long term. Since 1926, small company stocks have posted an annualized return of nearly 13% compared with about 10% for large-company stocks. And that includes 2001, when aggressive-growth funds were one of the hardest-hit broad fund categories.

Managers of these funds do a lot of buying and selling. And because that involves commissions, expenses tend to be higher than for other types of stock funds. Small-company funds work best when they are given ample time to maximize earnings.

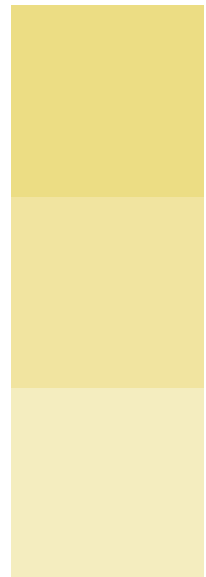
- **Long-Term Growth Stock Funds.** These funds seek long-term capital gains, usually by investing in larger companies than most aggressive-growth funds. This steady, inflation-beating growth feature makes these funds ideal for the heart of a long-term retirement portfolio, with less volatility than aggressive-growth funds. Here again, portfolio managers are not concerned about dividends.

- **Growth-and-Income Funds.** These also emphasize growth, but are more conservative than long-term growth funds. They invest mainly in established companies, many of which pay dividends. The best of these funds achieve long-term growth but with more mild share-price swings than long-term growth funds. This type of fund tends to be less volatile than most other stock fund entries.

- **International and Global Stock Funds.** International funds buy stocks in companies that are based outside the U.S., giving investors a chance to take advantage of growth opportunities in other parts of the world. Although they come with some inherent risks—foreign political upheaval, looser regulatory environments, and currency fluctuations—these funds can reduce your portfolio’s volatility. That’s because foreign markets don’t usually move in tandem with the U.S. market; when one is doing poorly, the other may be doing well.

Global funds (sometimes called worldwide funds) include some U.S. stocks as well, but they vary in just how much they keep invested in the U.S.

- **Socially Conscious Funds.** Many of these funds make their investment choices with an eye toward environmental awareness—investing only in companies that don’t pollute. Others avoid investing in weapons makers, cigarette companies, nuclear-energy producers, and so on. Many also look for companies known for management that treats employees with respect. Still others describe themselves as promoting “conservative” or “Christian” values and eschew companies, for example, that promote sex and violence in the media. There are dozens of socially conscious funds to choose from, and it probably won’t be difficult to find those that meet your social crite-



ria. Look for funds whose returns are competitive within their investment category, such as long-term growth or growth-and-income.

- **Sector Funds.** Because they concentrate their holdings in a single industry sector—transportation, energy, health care or precious metals, for example—sector funds are much more volatile than more diversified funds. As a result, these specialized funds are best suited for sophisticated investors who follow market signals and are prepared to switch funds often, or for long-term investors willing to assume above-average risk.
- **High-Grade Corporate Bond Funds.** These invest mainly in bonds issued by top-rated companies. Some specialize in short, some in intermediate and some in long-term bonds. A few concentrate on zero-coupon bonds, signaled by the words “target maturities” in the name of the fund.
- **U.S. Government Bond Funds.** As the category name says, these funds buy U.S. Treasuries and other types of bonds issued by the federal government or its agencies. These, too, specialize in short-, intermediate- or long-term maturities.
- **Mortgage-Backed Security Funds.** These are more commonly known as Ginnie Mae funds, so named for the assets they own—mortgage-backed securities issued by the Government National Mortgage Association, or GNMA. Though these funds load up on Ginnie Maes, they own other kinds of mortgage-backed securities as well. Mortgage funds are more volatile than bond funds, especially when interest rates are falling and homeowners are refinancing and taking their higher-rate mortgages out of the pool. Funds that own adjustable-rate mortgages (ARM funds) are more stable, but they aren’t immune to the same price pressures.
- **Index Funds.** The premise here is simple: If you can’t beat the market, buy it. Portfolios are constructed so that they match the components of an index, such as the Standard and Poor’s 500-stock index, small-company and international-stock indexes, bond indexes, and others. They offer these advantages for a retirement portfolio: predictability, as your investments will do as well or as poorly as the stock market does; low costs, at least in theory, because there’s little to manage; and above-average results, considering that just matching the S&P 500 makes your return above average—over the long haul, the S&P 500 has beaten roughly two-thirds of all stock funds. Index funds are a conservative way to invest in the market. Risk, because it matches the market’s exactly, is average with these funds.

## Best Places to Keep Your Investments

The key to a successful retirement-investment plan lies not only in choosing the right investments but also in choosing the right place to keep them. Congress has helped by creating several valuable tax shelters in which investors can store their

dollars: individual retirement accounts (IRAs), Roth IRAs, 401(k) and Keogh plans and more.

### INDIVIDUAL RETIREMENT ACCOUNTS.

Anyone with earned income to report on a tax return is eligible to set up a tax-sheltered IRA. You can put aside up to \$4,000 of your earnings yearly, and the maximum rises to \$5,000 a year in 2008. (For calculations here, we use \$4,000.) If you are age 50 or over, you can make “catch up” contributions, \$500 in 2005, increasing to \$1,000 in 2006. And, you can deduct all of it from your taxable income if you or your spouse are not covered by a pension plan or you meet certain income tests. Even if you don’t qualify for the deduction, you owe no taxes on the earnings in the IRA until you withdraw the money.

This is the real beauty of the IRA: Your earnings accumulate tax deferred, supercharging the already powerful effect of compound interest. A yearly \$4,000 nondeductible IRA contribution earning at a rate of 10% per year compounded annually over a 20-year period will grow to about \$252,000. If the earnings were taxed annually in the 25% bracket, the account would grow to only about \$186,000.

Married couples filing jointly for 2005 with adjusted gross incomes up to \$70,000, and singles and heads of households with adjusted gross incomes (AGI) up to \$50,000 got the full deduction whether they were covered by a company retirement plan or not. Above those levels, the deduction was phased out for those covered by a company retirement plan at a rate of \$10 for every \$50 above the thresholds. Thus it was gone completely for covered couples with \$80,000 of AGI, and singles and household heads with \$60,000 of AGI.

The income limits—and the phase-out zones—are scheduled to increase year by year for couples filing jointly, reaching \$80,000 to \$100,000 in 2007. If you are not covered by a retirement plan at work, you can deduct your contributions to a regular IRA regardless of your income.

If one spouse has no earned income, you can open a separate spousal IRA for that spouse and contribute a total of \$8,000 a year to the two accounts, as long as neither account gets more than the \$4,000 maximum (plus possible catch up contributions) in a single year.

If you withdraw money from an IRA before you reach age 59½, you’re subject to a 10% penalty tax, plus regular income tax on the amount withdrawn, except under certain circumstances.

- **If you pay certain college** or other higher-education bills for yourself, your spouse, your child or grandchild, you escape the penalty, but owe the tax, on early withdrawals. Qualified expenses include tuition, fees, books, supplies and required equipment. For students attending at least half time, room and board also qualify.
- **If you withdraw up to a total of \$10,000** to buy or build a first home for yourself, your spouse, a child, a grandchild or your parents, you also escape the penalty. You do owe income tax on the withdrawal.
- **If you withdraw money to pay medical expenses** that exceed 7.5% of your adjusted gross income or to pay for your health insur-

Anyone with  
earned income  
to report on a  
tax return is  
eligible to set up  
a tax-sheltered  
IRA.

ance during a long period of unemployment you owe tax but no penalty.

- **If you withdraw funds to convert your regular IRA to a Roth IRA** (described beginning on the next page) you owe tax but no penalty. To be eligible to convert, your adjusted gross income must be less than \$100,000.

You may not make contributions to a regular IRA in the year you reach age 70<sup>1/2</sup> and you must begin withdrawing money no later than April 1 in the year following the year you reach age 70<sup>1/2</sup>.

### **CONTRIBUTE ON YOUR OWN SCHEDULE.**

You can make each year's contribution in one lump sum or in regular or irregular installments. Still, because dividends and other earnings that accumulate in IRAs won't be taxed right away, it may make the most sense to make your contributions as early in the year as possible.

IRAs can be opened and contributions made any time before the April 15 deadline for filing your federal tax return for the previous calendar year. There's a 6% penalty tax on contributions over the annual maximum, and the excess counts as taxable income when you withdraw it. Alternatively, you can absorb excess contributions by contributing less in a subsequent year. You still owe the penalty, though.

IRA investments must be made through a custodian or a trustee—in practice, a company that supervises the account and reports to you and the government each year. Banks, credit unions, mutual funds and others that provide IRA plans have standard IRS-approved custodial or trustee arrangements. All you have to do is complete a simple form. You can maintain more than one IRA account with the same or different companies (but total contributions to all of them can't exceed the yearly maximum).

### **MOVE YOUR MONEY AROUND.**

Despite the penalty for premature withdrawals, you are not required to keep your money in the same IRA from the time you open the account until you reach age 59<sup>1/2</sup>. The rules offer great flexibility for shifting the money around. There are two ways to do it:

**DIRECT TRANSFERS.** Funds can be transferred directly from one custodian or trustee to another—from a bank IRA, for example, to one sponsored by a mutual fund, or from one mutual fund to another. In a direct transfer, you never take possession of the money. You can move your IRA money around and open and close accounts at will using this method. However, charges imposed by plan sponsors, such as fees to set up an IRA, may make frequent shifts costly.

**ROLLOVERS.** If you take possession of the IRA funds during a transfer (you close an account with a stock mutual fund, for example, and then put the money in an insurance company's IRA), the law calls the transaction a rollover. You can use this method only once each year for each account. After you withdraw the funds, you have 60 days to complete the rollover. Any money that isn't contributed to a new account within that time is considered a premature distribution, and it will be fully taxed as ordinary income and trigger the 10% penalty, assuming you're under age 59<sup>1/2</sup>.

## CHOOSING YOUR INVESTMENTS.

The opportunities for IRA money are almost unlimited. You can find sponsors—banks, savings and loans, credit unions, mutual funds, insurance companies—offering almost every imaginable investment.

If you want to put together your own portfolio rather than rely on mutual fund managers, you can do it with a self-directed IRA. These accounts, usually set up through brokers, let you choose what you want to invest in, such as stocks and bonds of individual companies. You decide what and when to buy and sell, but if you wheel and deal too much, commissions can eat up a lot of your nest egg. The fees attached to this type of account demand close attention, especially in the early years of your IRA, when it holds a relatively modest amount.

## WHEN IT'S TIME TO TAKE THE MONEY OUT.

Not only will the government penalize you if you dip into your regular IRA early, but also it will impose a stiff penalty if you don't withdraw the money fast enough later on. Between the time you reach age 59<sup>1/2</sup> and the year you turn 70<sup>1/2</sup>, you can withdraw without penalty as much or as little as you want from your regular IRA. Once you reach approximately age 70<sup>1/2</sup>, there is a minimum withdrawal schedule based on your life expectancy—or on that of you and your beneficiary if she or he is more than ten years younger. The schedule is designed to make sure you make a serious effort to deplete the account (so the government can finally tax the money) before you die.

## ROTH IRAS.

Like a regular IRA, a Roth must be funded from earned income—in general, money you get paid for performing work. As with a regular IRA, contributions are limited to \$4,000 a year plus catch up contribution in 2005 through 2007, and to \$5,000 yearly in 2008), with the same contribution deadlines. Unlike the regular IRA, where contributions may be deductible, Roth contributions are always made with after-tax money.

For most people, though, it's the differences between a regular IRA and a Roth IRA that makes the Roth so attractive.

- **All earnings within a Roth are tax-free**, not tax-deferred, as in a regular IRA, assuming you don't try to withdraw earnings before you reach age 59<sup>1/2</sup>.
- **Because you've already paid the taxes** on your contributions, you can withdraw them at any time without incurring a penalty or tax. Note that this rule applies only to your contributions, not the account's earnings. If your withdrawals reach the point at which you're dipping into earnings, you may owe the penalty and tax if you're under age 59<sup>1/2</sup>. The tax and penalty are both waived on up to \$10,000 of earnings withdrawn—after the account has been opened for five years—for the purchase of a first home.
- **You can continue to contribute** to the account after age 70<sup>1/2</sup>.
- **There is no requirement that you begin withdrawing** money from a Roth IRA at age 70<sup>1/2</sup> or any other age. If you wish, you can leave the money there until you die.

Earnings within a Roth are tax-free, assuming you don't try to withdraw them before you reach age 59<sup>1/2</sup>.

- **If you die** with a balance in your account, it goes to your heirs tax-free. In a regular IRA, the beneficiary owes tax on the balance.

Not everyone is eligible for a Roth IRA, although the great majority of taxpayers do qualify. If your income tops \$150,000 on a joint return or \$95,000 on a single return—whether as an individual, head of household or surviving spouse—you begin to lose your Roth eligibility. (Married persons filing separately aren't eligible no matter what their income.) The phase-out zone goes up to \$160,000 for joint returns and \$110,000 for singles. If your income falls somewhere in that zone, your \$4,000 maximum contribution is reduced according to a prorated schedule: If you're halfway through the zone, your limit is cut in half; if you're two-thirds into the zone, it is cut by two-thirds, and so forth.

### OPEN A ROTH?

There are some circumstances under which the Roth IRA has clear advantages over the old-style IRA. More commonly, it's a tough call. If your situation is such that you can't deduct your contributions to a regular IRA, then by all means open a Roth and pour in the money. If you can deduct regular IRA contributions, the picture gets murky. You have to choose between a tax deduction now and tax-free income years from now, when you may or may not be in a lower tax bracket. But also consider the other attributes of the Roth—the lack of a mandatory withdrawal schedule, and the tax-free inheritance for a loved one.

### CONVERT YOUR OLD IRA TO A ROTH?

The arguments in favor of a Roth are compelling, which raises a natural question if you have been contributing to a regular IRA all these years: Should you convert to a Roth? The law lets you do it if your adjusted gross income is \$100,000 or less, regardless of your filing status (except that married couples filing separately can't convert).

## THE NEW ROTH 401(K)

Starting in January 2006 companies may amend their 401(k)s to include the new Roth 401(k). Rules for Roth 401(k)s are similar to those for Roth IRAs: Payins do not reduce taxable income because they are made with after-tax dollars. Withdrawals from them are tax free, including earnings on the account, if you take them after more than five years and after you reach age 59½.

But there are important differences, most of them favorable. You can contribute more annually to a Roth 401(k) than you can to a Roth IRA. The standard 401(k) limits apply—a \$15,000 maximum for 2006 plus up to an additional \$5,000 for participants over age 50. The 2006 ceiling on payins to Roth IRAs is paltry by comparison—\$4,000 plus up to \$1,000 extra for individuals who are age 50 or older. Note that any Roth 401(k) payins will count toward the regular 401(k) cap. You won't be able to

contribute the maximum to both types of accounts.

No income limitations apply to contributions to Roth 401(k)s, unlike the \$160,000 adjusted gross income ceiling for regular Roths. Distributions will generally have to be made after you reach age 70½, unlike for Roth IRAs, which do not require any lifetime withdrawals. You might be able to avoid the age 70½ rule by rolling the balance of the Roth 401(k) over to a Roth IRA, but the IRS hadn't ruled on this when this booklet went to press.

Contributions to Roth 401(k) plans will have to be segregated from deferrals to regular 401(k)s, along with earnings on each account. Matches of employee Roth 401(k) contributions aren't tax favored. The matches go in a special account and are taxed as income when paid out.

Roth 401(k)s are set to lapse after 2010. But Congress is likely to make them permanent, given the number of firms expected to offer the Roth 401(k).



If you do convert, you'll be spared the 10% penalty on early withdrawals, but you will have to pay income tax on all earnings and any contributions that were deducted from your taxes. If you've been pouring non-taxed cash into an IRA for many years, and the IRA has had substantial earnings, the prospect of paying income tax on all that money can be daunting.

The decision to convert depends on whether you'd be better off paying the tax now or later. If you expect to be in a higher tax bracket when you retire, then it makes sense to convert and pay the tax now at the lower rate. If you expect that your bracket will be the same—and you'd have to deplete IRA funds to pay the tax now—converting would ultimately make no difference in your spendable income later on. If you expect to be in a lower bracket when you start withdrawing your IRA money, then you might as well leave well enough alone and not convert.

### **DEFINED-CONTRIBUTION PLANS.**

As traditional pension plans, known as defined-benefit plans, have become increasingly expensive for companies to sponsor, more and more have turned to defined-contribution plans. The most common is the 401(k) plan. (Public-school teachers and employees of nonprofit organizations may encounter the 403(b) plan, and government employees are eligible for the 457 plan, close cousins.) These plans get their rather awkward-sounding names from the sections of the Internal Revenue Code that authorize them. They generally give employees the option to divert a portion of their salary to a tax-sheltered investment account set up by the employer. Some plans automatically enroll employees in the plan and deduct part of the employees' salary into the plan unless the employee opts out. Most firms allow you to contribute between 2% and 15% of pay each year, and the IRS agrees to postpone taxing the portion of the pay you agree to contribute. Earnings accumulate tax-free until you take the cash. Meanwhile, the company may match your contribution in whole or part.

A 401(k), because it is a defined-contribution plan, takes the investment risk off the company's shoulders and puts it squarely on yours. Still, the attractions are considerable. Say you make \$50,000 a year and work for a company that allows you to put up to 10% of your salary in a 401(k), and say that you contribute the maximum. You benefit twice, and possibly three times: First, you're taxed on only \$45,000, which saves you \$1,250 in tax if you're in the 25% bracket; second, your \$5,000 goes to work in a tax-sheltered account, meaning that whatever it earns as the years go by is shielded from tax until you withdraw it, presumably in retirement; and third, any amount that your company puts in as a match is pure gravy. If your employer adds 50 cents for every dollar you put in, that's an immediate 50% return on your investment.

In 2005, you could put up to \$14,000 in your plan, with the maximum rising to \$15,000 in 2006. A "catch-up" provision for workers age 50 or older permits them to contribute even more each year, starting with an additional \$1,000 and rising to \$5,000 more in 2006. You are immediately vested in the money you contribute, meaning it's yours if you leave the company at any time, but any company contributions will probably be vested over a period of years.

Although the company plan determines the maximum contribution, you decide how much, if any, to contribute. If financial demands increased, you could suspend contributions and have 100% of your pay show up in your paycheck—not counting withheld tax, of course.

The decision to convert to a Roth IRA depends on whether you'd be better off paying the tax now or later.

### CHOOSING WHERE THE MONEY GOES.

Your choices of where to invest your 401(k) set-asides are determined by the company. They may include a list of mutual funds including stock, bond or money-market funds and the company's own stock. You can diversify your funds among the plans' investment alternatives, and you should periodically assess how your account is performing. The further away you are from retirement, the more of your 401(k) money could be in stock-oriented funds because of their superior long-term results.

### GETTING THE MONEY OUT.

Because the aim of 401(k) plans is to encourage saving for retirement, the IRS puts restrictions on your ability to take the money out. You can't have it back until you leave the company, when you can roll the money into an IRA or into your new employer's 401(k) plan, if the rules of the new plan permit it.

If you leave the job in the year you reach age 55, or later, you can take your money with no penalty, although you'd probably want to roll it directly into an IRA to avoid the big tax bill. If you take possession of the money, your employer will have to withhold 20% for the IRS. You won't get the money back until you file your tax return, showing that you have rolled the money into a qualified plan. If you leave before that, you avoid the penalty and the tax by rolling the money into an IRA.

In addition, you are permitted to use all or part of the money without penalty if you need it to pay medical bills that exceed 7.5% of your adjusted gross income, if you are disabled, or if you elect to receive the money in a series of equal installments based on your life expectancy.

A major exception to the no-early-withdrawal rule lets employees tap the money they've contributed to their accounts in the event of financial hardship. Just what qualifies as a hardship is not always clear, but the rules have gotten tougher in recent years. You must be able to prove that you're facing an immediate and substantial financial need and that you don't have another source of money. Even if you meet the hardship definition, withdrawals before age 59½ are subject to a 10% penalty. And, of course, you'll owe regular income tax on the withdrawn amount.

You may also be able to tap your account early by taking a loan against your account. If your plan permits it, you can borrow as much as half of your account balance, up to a maximum loan of \$50,000. Most plans require you to repay the loan within five years unless you use the money to buy a home, in which case there is no time limit.

When you borrow from your 401(k) account, the plan will deduct the amount of the loan from your account balance and set up a repayment schedule at a specified rate of interest. As you repay, the money is added back to your balance. Because you are, in effect, borrowing from yourself and paying yourself interest, some plan participants think of 401(k) loans as "free money." But these loans aren't free. The real cost consists of loan set-up fees you pay, plus the lost earnings on these funds while they are out of your account. For instance, if you were to pay interest at 7% over a period during which the rest of the account earned 10%, your true cost of the loan would be 10%—the 7% you're paying out of pocket plus the 3% your money's not earning, plus the loan set-up costs. That's not free.

### SIMPLE PLANS.

Firms with fewer than 100 employees can establish what's called a SIMPLE plan,

short for “savings incentive match plan for employees.” The company sets a percentage of each employee’s pay that can be contributed to the plan, up to a maximum of \$10,000 a year per employee in 2005 with future increases keyed to inflation. If you are age 50 or older, you can make additional catch-up contributions to your SIMPLE plan—\$2,000 in 2005 rising to an additional contribution of \$2,500 in 2006. The employee chooses where the money goes, just as in a conventional 401(k).

In exchange for the simplicity of the plan, the employer must agree to contribute to workers’ accounts, matching up to 3% of pay contributed to the plan, or, at a minimum, 2% of everyone’s pay, even those who don’t participate in the plan themselves. Workers are vested immediately in the employer’s contributions. All contributions—the workers’ and the company’s—escape taxation that year and grow tax-deferred as long as they remain in the account.

The SIMPLE plan is a nice cross between an IRA and a 401(k). It allows a smaller maximum annual contribution than a conventional 401(k)—\$10,000 versus \$14,000—but more than twice the limit of an IRA. Rules governing the plan are essentially the same as for a 401(k), with the exception that leaving the plan within the first two years of joining the plan raises the 10% early-withdrawal penalty to a whopping 25%.

## Plans for the Self-Employed

IRAs and Roth IRAs are excellent retirement-saving vehicles, but the \$4,000 annual limit on contributions probably won’t allow you to build a nest egg big enough to fund a comfortable retirement. You will probably need to set aside more than that, especially as retirement gets near. And if you work for yourself, or for a company with only a few employees, the business probably can’t afford a generously funded pension plan. Congress has created IRA-like instruments especially for situations like this.

### KEOGH PLANS.

Self-employed workers with an eye on retirement have the late U.S. Representative Eugene Keogh of New York to thank for a wealth of tax-favored possibilities. When John Kennedy was in the White House, Congressman Keogh pushed through legislation that extended to the self-employed many of the advantages that had previously been reserved for employee retirement plans. Favored by doctors, dentists, architects, lawyers and other professionals, as well as by moonlighting consultants and free-lance writers, Keogh plans can be used even if you’re already participating in a company pension program and have an your own IRA. Annual contributions are deductible from your taxable income in the year in which they’re made. Brokerage firms, banks, mutual funds and other types of financial companies offer standardized Keogh accounts, most of which are no more difficult to open than an IRA.

### DIFFERENT KINDS OF KEOGHS.

- **With a money-purchase Keogh plan**, the annual contribution limit boils down to 25% of self-employment income, to a maximum contribution of \$42,000 for 2005. The catch is that you are required to choose a fixed percentage of income and make that contribution each and every year. If, for example, your plan calls for a 25% contribution, you have to deposit that amount even if business has had a down year.

The SIMPLE retirement plan, set up for small businesses, is a cross between an IRA and a 401(k).

- **A profit-sharing Keogh plan** has smaller annual limitations on contributions but is more flexible and therefore favored by part-timers whose self-employment income isn't very reliable. The maximum deductible contribution is 25% of net self-employment income per year, up to a maximum annual contribution of \$42,000.
- **A defined-benefit Keogh plan** often allows you to contribute more because it is designed to produce a preset amount of retirement income. You decide how much you would like to receive in annual retirement income, and then you work backward from that figure to design a contribution schedule to achieve it. You can contribute up to 100% of self-employment income. For example, the contribution limit in 2005 was the amount it would require to produce a maximum yearly pension that would be the average of self-employment income during your three highest-earning years, or \$170,000, whichever was less. These Keogh plans are especially attractive to self-employed people who have the money to fund big annual contributions to a plan who have but relatively few years to go until they plan to retire. The rules and calculations are complex, and you should get the help of an accountant or lawyer to set up such a program.

### **TAX ADVANTAGES OF A KEOGH.**

Dividends, interest and other earnings accumulate tax-deferred. Neither the contributions nor the earnings are subject to tax until the money is withdrawn at your retirement.

You can't start withdrawing your Keogh funds without incurring a 10% penalty until you're 59½, unless you become disabled, use the funds to pay catastrophic medical bills, or withdraw the money as part of a series of roughly equal payments tied to your life expectancy (same as the IRA rules). You may also get the funds penalty-free as early as age 55 if you close the business that generated the self-employment income. But you don't have to start drawing from the fund until after you reach age 70½. Keogh funds may be paid out in a lump sum, or installments or annuity payments, and you're taxed accordingly. The payouts though, cannot be scheduled to exceed your life expectancy or the life expectancies of you and any beneficiary you name. As with IRAs, the government wants its tax money eventually.

You can buy an annuity to fulfill the payout requirement, or you can keep the account intact and arrange for your own annuity-type payments to come out of it. The proper installments can be calculated from IRS tables prepared for that purpose.

If you have any full-time employees, they must be included in your Keogh plan. You may include part-timers, provided you include all the eligible ones.

### **SIMPLIFIED EMPLOYEE PENSIONS.**

A simplified employee pension, or SEP, is a kind of combination IRA and Keogh. The annual contribution limit is about 20% of income, the same as for profit-sharing Keoghs, up to a maximum of \$42,000 per year. The rules governing deductibility of contributions, tax-deferral of earnings, penalties for early withdrawals and distribution minimums after age 70½ are the same as for IRAs. Because of the IRA connection, they are sometimes called SEP IRAs or Super IRAs.

The advantage of a SEP over a Keogh is it's simpler to administer; the paperwork burden isn't so onerous. And it's flexible: Like a profit-sharing Keogh, a SEP lets you vary the contribution from year to year or skip it entirely if profits aren't there.

Finally, like Keoghs, SEPs can be especially valuable for moonlighters with sideline businesses who are in search of a way to cut their current tax bill and save for retirement at the same time.

## Protect Your Money: How to Check Out a Broker or Adviser

Federal or state securities laws require brokers, advisers, and their firms to be licensed or registered, and to make important information public. But it's up to you to find that information and use it to protect your investment dollars. The good news is that this information is easy to obtain, and one phone call or a web search may save you from sending your money to a con artist, a bad broker, or a disreputable firm.

This is very important, because if you do business with an unlicensed securities broker or a firm that later goes out of business, there may be no way for you to recover your money — even if an arbitrator or court rules in your favor.

### **BROKERS AND BROKERAGE FIRMS.**

The Central Registration Depository (or "CRD") is a computerized database that contains information about most brokers, their representatives, and the firms they work for. For instance, you can find out if brokers are properly licensed in your state and if they have had run-ins with regulators or received serious complaints from investors. You'll also find information about the brokers' educational backgrounds and where they've worked before their current jobs.

You can ask either your State Securities Regulator or NASD to provide you with information from the CRD. Your State Securities Regulator may provide more information from the CRD than NASD, especially when it comes to investor complaints, so you may want to check with them first. You'll find contact information for your State Securities Regulator on the North American Securities Administrators Association (NASAA) Web site ([www.nasaa.org](http://www.nasaa.org)). To contact NASD, go online to [www.nasd.com](http://www.nasd.com), or call 800-289-9999.

### **INVESTMENT ADVISERS.**

People or firms that get paid to give advice about investing in securities must register with either the U.S. Securities and Exchange Commission (SEC) or the State Securities Regulator where they have their principal place of business. Investment advisers who manage \$25 million or more in client assets generally must register with the SEC. If they manage less than \$25 million, they generally must register with the State Securities Regulator.

Some investment advisers employ investment adviser representatives, the people who actually work with clients. In most cases, these people must be licensed or registered with your State Securities Regulator to do business with you. So be sure to check them out.

To find out about advisers and whether they are properly registered, read their registration forms, called the "Form ADV," which has two parts. Part 1 has information

Investment  
advisers must  
register with  
either the SEC or  
State Securities  
Regulator where  
they do business.

about the adviser's business and whether they've had problems with regulators or clients. Part 2 outlines the adviser's services, fees and strategies. Before you hire an investment adviser, always ask for and carefully read both parts of the ADV.

You can view an adviser's most recent Form ADV online at [www.adviserinfo.sec.gov](http://www.adviserinfo.sec.gov). The database contains Forms ADV only for investment adviser firms that register electronically using the Investment Adviser Registration Depository, but will expand to encompass all registered investment advisers—individuals as well as firms.

You can also get copies of Form ADV for individual advisers and firms from the investment adviser, your State Securities Regulator (see the box below), or the SEC, depending on the size of the adviser. To contact your State Securities Regulator go online to [www.nasaa.org](http://www.nasaa.org). If the Securities and Exchange Commission (SEC) registers the investment adviser, you can get the Form ADV for \$ .24 per page (plus postage) from the SEC.

### **WRAP UP.**

So whether you are self-employed or work for someone else—or you're a spouse whose mate has income—there is an investment opportunity for everyone to help build a secure retirement nest egg. A key is to start building that nest egg now, with whatever you can afford. As you can afford more, increase your contributions. And take full advantage of tax-favored investment vehicles.

### **STATE SECURITIES REGULATORS**

State Securities Regulators have protected investors from fraud for nearly 100 years. Securities markets are global but securities are sold locally by professionals who are licensed in every state where they conduct business. State Securities Regulators work within your state government to protect investors and help maintain the integrity of the securities industry.

#### **Your State Securities Regulator can:**

- Verify a broker-dealer or investment adviser is properly licensed;
- Provide information about: prior run-ins with regulators that led to disciplinary or enforcement actions; serious complaints that may have been lodged against them; their educational background and prior work history
- Provide a computer link or telephone number or address where you can file a complaint; and
- Provide non-commercial investor education and protection materials.

For contact information for your State Securities Regulator, visit the North American Securities Administrators Association (NASAA) Web site at [www.nasaa.org](http://www.nasaa.org) and click on "Contact Your Regulator."

## GLOSSARY

**Bond**— An interest-bearing security that obligates the issuer to pay a specified amount of interest for a specified time, usually several years, and then repay the bondholder the face amount of the bond.

**Diversification**— The method of balancing risk by investing in a variety of securities.

**Dividends**— Shares of company earnings paid out to stockholders.

**Face value**— The amount an issuer pays to a bond holder when the bond reaches full maturity.

**Load**— A sales commission charged by many mutual funds. Some are front-end loads (fee paid when the shares are purchased) or back-end loads (fees paid when the shares are sold).

**Maturity**— The amount of time it takes for a bond to pay the face value. Bonds are issued with varying maturity dates.

**Mutual Fund**— A professionally managed portfolio of stocks and bonds or other investments divided up into shares.

**Portfolio**— The collection of all of your investments.

**Prospectus**— A document that describes a securities offering or the operations of a mutual fund.

**Risk**— The possibility that you may lose some (or all) of your original investment. In general, the greater the potential gain from an investment, the greater the risk is that you might lose money.

**Stock**— A share of stock that represents ownership in the company that issues it. The price of the stock goes up and down, depending on how the company performs and how investors think the company will perform in the future.

**Total return**— A measure of investment performance that starts with price changes, then adds in the results of reinvesting all earnings generated by the investment during the period being measured.

**Volatility**— The degree to which a security varies in price. In general, the more volatile a mutual fund or stock, the more risk is involved.

**Yield**— In general, the annual cash return earned by a stock, bond, mutual fund or other investment. Bond yields can take many forms. Coupon yield is the interest rate paid on the face value of the bond. Current yield is the interest rate based on the actual purchase price of the bond, which can be higher or lower than the face value. Yield to maturity is the rate that takes into account the current yield and the face value, with the difference assumed to be amortized over the remaining life of the bond.

The following booklets from the Editors of *Kiplinger's Personal Finance* magazine, the Investor Protection Trust and the American Library Association are available at your library.

#### **FIVE KEYS TO INVESTING SUCCESS**

- Make investing a habit
- Set exciting goals
- Don't take unnecessary risks
- Keep time on your side
- Diversify

#### **THE BASICS FOR INVESTING IN STOCKS**

- What is a stock?
- Types of stocks and their relative risks
- How to buy stocks
- Stock terms you need to know, such as price/earnings ratio (P/E), book value, dividend yield and dollar-cost averaging
- Selling your stocks and determining earnings
- Mistakes even seasoned investors sometimes make—and how to avoid them

#### **A PRIMER FOR INVESTING IN BONDS**

- What is a bond?
- How bonds work
- Types of bonds and their relative safety
- Why bonds can be an important part of your investment portfolio
- Yield and how it relates to bond prices
- Bond ratings and how they can help you reduce risk

#### **MUTUAL FUNDS: MAYBE ALL YOU'LL EVER NEED**

- What is a mutual fund?
- Advantages of investing in mutual funds
- Cost of investing in mutual funds
- Find the right mutual funds for you
- What to look for in a mutual fund prospectus
- Types of mutual funds and relative risk
- Determining your earnings

#### **GETTING HELP WITH YOUR INVESTMENTS**

- Choosing a broker
- Full-service, discount and online brokers
- Opening a brokerage account
- Records you need to keep
- Problems with your broker
- Financial advisers
- How to choose an adviser
- Investment clubs

#### **WHERE TO INVEST YOUR COLLEGE MONEY**

- Creating a college fund portfolio based on your time horizon
- College investment vehicles
- State-sponsored college savings plans

#### **MAXIMIZE YOUR RETIREMENT INVESTMENTS**

- Three fundamental truths about retirement investing
- Stocks, bonds and mutual funds to consider for your retirement portfolio
- Determining your portfolio mix, depending on your time horizon and risk tolerance
- Retirement investment vehicles



919 Eighteenth Street NW, Suite 300  
Washington, DC 20006-5517

[www.investorprotection.org](http://www.investorprotection.org)



North Carolina Department  
of the Secretary of State  
Securities Division  
PO Box 29622  
Raleigh, NC 27626-0622  
800-688-4507  
[www.sosnc.com](http://www.sosnc.com)