



THE USAA
EDUCATIONAL
FOUNDATION®

Good Information for Good Decisions.®

INVESTING

BASIC INVESTING



OUR MISSION

The mission of The USAA Educational Foundation is to help consumers make informed decisions by providing information on financial management, safety concerns and significant life events.



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2 INVESTING YOUR MONEY

BASIC RULES OF INVESTING

- Keep your goals in focus.
- Save or invest 10 percent to 15 percent of your net income.
- Respect your risk tolerance.
- Diversify your investments.

An Introduction

Is a new vehicle or home one of your goals? What about college tuition for your children? Or maybe a vacation home or early retirement?

Each stage in your life will bring changes that require you to make adjustments to your goals and investment plan. That is why it is a good idea to review your objectives annually and after any significant life event — marriage, birth or adoption of a child, home purchase, new job, etc.

Although you may not have the money now for everything you want, that does not mean you will not in the future. The key is to invest wisely and manage your money appropriately.

This publication will assist you in developing an investment plan to help you achieve your goals. You will also learn about the more common investment instruments and how risk affects your decision making when it comes to investing.

Assessing Your Resources

To get a good picture of your current financial situation, gather all the information related to your finances. Include personal insurance policies, pension plans, investments, income tax returns and any other financial related statements.

One of your goals should be to reduce or eliminate your debt. It makes more sense to save and invest your money, rather than paying high interest rates to lenders.

Remember, having positive cash flow gives you the opportunity to take advantage of the right investment at the right time.

Goal Setting

Determining financial goals is the basis of any personal financial management plan.

You should determine what your goals are and make sure they are realistic and attainable. Include goals such as marriage, children, education, homes, hobbies and other leisure activities.

If you need help reaching your financial goals, you can seek advice from a CERTIFIED FINANCIAL PLANNER™ (CFP®) practitioner. These individuals will help plan and coordinate all aspects of your financial situation and will help you focus on your specific needs and goals before recommending a financial plan.

Pay Yourself First

As you establish your financial goals, remember the first rule of an investment strategy. Pay yourself first. CFP® practitioners generally recommend saving or investing 10 percent to 15 percent of your net income. If you are unable to save or invest that much, make it a habit to save what you can. The sooner you start saving, the greater your potential for increasing your net worth.

Plan For The Unexpected

Your savings plan should include an emergency fund for unforeseen medical emergencies or job loss.

CFP® practitioners recommend an emergency fund be the equivalent of 3 to 6 months of basic living expenses. That money could help you get through a crisis without draining your assets.

An emergency fund should be liquid — quick cash without loss of value — and placed in a safe investment instrument.

You also need to consider protection against catastrophic loss — property, life, medical and long-term disability insurance. Those expenses need to be included in your savings plan.

CERTIFIED FINANCIAL PLANNER™ is a certification mark owned by the Certified Financial Planner Board of Standards, Inc. This mark is awarded to individuals who successfully complete the CFP® Board's initial and ongoing certification requirements.

**YOUR SAVINGS
PLAN SHOULD
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GENCIES OR JOB
LOSS.**

4 GOALS, RISK AND RETURN

Personal Risk Tolerance

Risk tolerance is a measure of your willingness to accept risk in exchange for higher potential investment returns. If you consider yourself an aggressive investor, you are likely to accept the risk of losing some of your investment in exchange for earning higher potential returns. If you are a conservative investor, you are not willing to accept much risk at all. A moderate investor is somewhere in between the two.

Your risk tolerance may also vary with different goals. If a goal is vitally important then you may not be willing to accept much risk.

Time can also have an affect on your risk tolerance. For example, if you do not need college tuition for 15 years, you can accept a greater amount of risk. The opposite is true when you have a shorter time frame.

Investment Risks

As you consider risk in your financial planning, remember that different investment instruments carry different levels and types of risk.

However, no investment is free of risk. “Safe” investment instruments, such as U.S. savings bonds, hold the risk of inflation-eroded returns even while preserving your principal — the cash value placed in an investment.

Investment Strategies To Reduce Risks

Risks can be potentially reduced by understanding how financial markets work. Use the timing and the diversity of your purchases to reduce the different types of risk. Long-term strategies, such as those described below can help.

Dollar-Cost Averaging refers to the method of investing a fixed amount of money at regular intervals, typically monthly. Sometimes you will buy when prices are high and sometimes when prices are low. By following a consistent investment pattern, you receive more shares for each dollar when prices are low and fewer when prices are high.

Although there is no guarantee of profit, dollar-cost averaging is a good technique to use, particularly for someone who does not have the time or knowledge to analyze and evaluate market fluctuations.

Asset Allocation is an important factor in managing risk. It involves diversifying an investment portfolio, so it will withstand market fluctuations. Gains in one area tend to offset losses in another. Since the market tends to grow, you could post slow and modest gains over the long term, keeping pace with inflation.

There are many investment instruments available to the individual investor. The majority, however, are variations of just two investment types — debt and equity instruments.

Debt Instruments

When you purchase debt instruments, you are lending your money to an entity for a particular length of time at a stated interest rate.

- Types of debt instruments include corporate bonds, municipal bonds, certificates of deposit and U.S. savings bonds.
- Most can be held to maturity or traded by the purchaser.
- Some may be discounted or sold at a premium over their face amounts.
- Prices are primarily affected by interest rate movements. As interest rates rise, values of existing bonds fall; when interest rates fall, bond prices rise.
- They may preserve your principal and earn steady interest.
- Most are subject to purchasing power risk.
- Except for municipal bonds, all interest received is subject to federal, and usually state income tax.

Savings Accounts. Savings accounts allow a depositor to save money and earn guaranteed interest at a low level of risk.

- Major attraction is high liquidity; funds may be withdrawn at a moment's notice.
- Most accounts carry federal insurance against loss of principal, but rates of return are often lower than competing instruments.

Money Market Deposit Accounts. Because of their composition and track record, money market deposit accounts are generally considered to be very safe investments.

- They may provide an extra convenience of permitting check writing against the balance.
- Some require a minimum balance in order to earn interest.
- Service or transaction fees can erode the return.

Certificates Of Deposit. When you buy a CD, you are lending money to the institution.

- CDs are issued by financial institutions in a range from 90 days to 10 years.
- For large deposits, long-term certificates, interest rates can be substantially higher than those paid on other deposit accounts.
- CDs are considered low risk investments, but not all are federally insured.

- Rates are usually higher than money market deposit accounts since funds are committed for a specific term.
- Substantial penalties are charged for premature withdrawals.

Savings Bonds. U.S. savings bonds represent your loan to the federal government, one of the safest investments you can make.

- Savings bonds may not be sold or transferred to other investors and rates are nonnegotiable.
- Earnings are exempt from state and local income taxes, but not federal income taxes.
- Redeeming savings bonds for a dependent's college tuition may qualify for exclusion from federal income taxes.
- Before purchasing, review all regulations and limitations since not every investor will benefit.
- Generally, redeeming savings bonds early will result in a reduced return or a penalty.

Treasury Bills. U.S. treasury bills (T-bills) are loans to the federal government.

- They may be held to maturity or sold to another investor.
- Generally, the longer the maturity, the higher the rate earned.
- T-bills are exempt from state and local income taxes.

Corporate Bonds. Corporate bonds are debts of the corporation issuing the bonds. Because they have a higher credit risk than U.S. treasury bonds, they pay higher yields.

- The yield depends on factors including the financial health of the issuing company and on the prevailing market interest rate when they are first sold.
- Some individuals hold bonds to maturity, locking in their returns. Others sell them earlier.
- Premature selling presents both a risk and an opportunity.
 - If market interest rates happen to be lower than the bond's fixed yield, the bond's value generally rises.
 - If inflation pushes prevailing rates higher, the bond's fixed rate is no longer competitive and the price of the bond is generally reduced.

- One way to potentially lessen this risk if you have a specific financial goal is to buy a bond that matures when that goal is due.
- The issuing company may fail, reducing the value of the bond either to zero or to a fraction of its face value. Although buying a bond of an established company might seem to present minimum risk, consider what might happen to the company over the life of the bond.

Municipal Bonds. Municipal bonds (or munis) are IOUs of cities, states and government-like entities, such as public schools, airports, sewer or water authorities.

- Municipal bonds are exempt from federal, state and local income taxes.
- They are generally attractive investments for individuals in higher tax brackets.
- Risk and liquidity varies greatly from bond to bond, so be cautious before entering into such a purchase.

Equity Instruments

Equity instruments represent a share of ownership, such as stocks and real estate.

- Unlike debt instruments, they carry no fixed yield.
- When the issuing company makes money, its shareholders may be paid dividends. Share prices range from pennies to thousands of dollars and may give the owner voting rights or an option to buy more shares at discounted prices.
- Although there are many factors, stock prices generally reflect the movement of the economy. They tend to rise when the economy is expanding because expansion indicates higher corporate revenues and profits.
- Stock prices may drop during a recession since corporate sales are slower and unemployment rises.

The investment instruments listed on the next page offer higher potential returns, but at higher risk levels, particularly market risk. Capital gains — the profits that result when an investment is sold for more than its cost — and dividends are generally subject to federal and often state and local income tax.

Stocks. Stock is issued by corporations to raise capital. Purchasing stock essentially buys you ownership in the corporation.

- Stocks hold the potential for high returns, accompanied by a corresponding amount of risk.
- They are often chosen to keep your returns in step with inflation.
- Buying and selling individual stocks can be done through a registered broker who will charge a commission, or sales fee, on each transaction.
- Commissions reduce returns you earn.
 - If you feel confident to make your own purchase decisions, low commission or discount brokers can execute your buy and sell instructions at a much lower cost than traditional full-service brokers.
 - If you do use a traditional stockbroker, make sure the broker has a securities license and is employed as a registered representative of a brokerage or mutual fund company.

Real Estate. Real estate is also used as a hedge against inflation because when inflation rises, real estate values usually rise with it.

- Real estate moves in cycles like other investments and should be evaluated as a long-term investment.
- While you own real estate, you are liable for property taxes.
 - Federal, and possibly state, income tax deductions may be available for those payments, as well as for interest charges and maintenance expenses.

Mutual Funds. A mutual fund pools the money of many investors, and then invests in a variety of stocks, bonds or other securities.

To accommodate a wide range of these objectives in one portfolio, investment companies have developed “families” of funds.

- A typical “family” may include the following funds:
 - Aggressive growth
 - Growth
 - Income
 - Balanced
 - Money market
 - Index
 - Tax-exempt

ADVANTAGES OF MUTUAL FUNDS

While fund returns are not guaranteed, mutual funds offer many advantages, especially for the inexperienced investor.

Diversification	Allows you to invest in a variety of industries and categories of stocks, bonds and money market investments, which may be difficult to do individually without having large amounts of money to invest.
Liquidity	Highly liquid; you can redeem or sell your shares at any time at their current value.
Flexibility	Families of funds let you switch investments as goals change.
Convenience	Most funds allow you to invest automatically with an allotment or automatic withdrawal from your bank account. In addition, you can buy or sell fund shares by phone, by mail and increasingly online.
Professional Management	Managed by professionals; individual investors usually cannot get the same level of investment advice without a large portfolio.
Regulation	Regulated by the Securities and Exchange Commission.
Low Cost	Some fund families, such as “no-load” fund families, allow you to invest without paying a commission or transaction fee.

SELECTING A MUTUAL FUND — FACTORS TO CONSIDER

Fund Objectives	Objectives can range from income to growth to balanced funds and each brings its own measure of risk — or volatility.
Fund Performance	When assessing an individual fund, compare its performance — the historic rate of return — over periods of 3, 5 and 10 years.
Fund Reputation	Research the mutual fund company. How long has it been in business? How is it ranked among other fund companies?
Fund Costs	“Load” mutual funds carry a sales charge that is paid to the investment firm that sells the fund. “No-load” mutual funds do not carry a sales charge and are normally sold directly from the investment company that manages the fund. Every mutual fund, regardless of whether it has a load or not, will have operating expenses. You can find fund costs in a fund’s prospectus.

10 EVALUATING WHERE TO INVEST YOUR MONEY

Establishing Your Goals

Begin the process of establishing your goals with the work sheet on the following page. Estimate the amount of time and money you will need to achieve each goal.

Once you have an idea of what investments are available, you can consider specific alternatives. Take time to research the materials available, consult with knowledgeable sources and read each prospectus carefully. Make sure that the investment instrument you choose is one that matches your goal and risk tolerance.

Every alternative comes with its own level of risk and opportunity for profit or loss. Likewise, you will find different levels of liquidity. Whether you have a short-, intermediate- or long-term goal will affect the way you evaluate these characteristics.

A short-term goal usually requires a very liquid type of investment, one that is easily converted to cash without loss of principal. However, all highly liquid investments do not have the same risk and return potential; you have to evaluate the amount of risk you are willing to take for the goal you have in mind. In one situation you may have to accept a lower return in order to be assured that your principal is preserved. Under different circumstances, you may be able to take a higher risk in the hopes of a significantly higher return.

INVESTMENT CHARACTERISTICS

Your investment choice is a complex decision, and the following factors must be weighed before a choice is made.

- Liquidity.
- Risk level and type.
- Potential return.
- Preservation of principal.

GOAL CHARACTERISTICS

- Time available.
- Money required.
- Importance.

SETTING TARGET DATES FOR PERSONAL GOALS 11

Now it is time to list your goals and set target dates to achieve them. Determine what your most critical goals are and list them in order of importance. Estimate the time frame needed to achieve your goals as well as the cost.

Your goals can vary from a new home or vehicle to your child's education expense or to providing care for your parents. Whether it is child-care costs or funding your dream vacation, list what you consider to be your financial goals.

GOAL	UP TO 3 YEARS		4–6 YEARS		7+ YEARS	
	TIME	\$ NEEDED	TIME	\$ NEEDED	TIME	\$ NEEDED
Example: Child's education					12 yrs.	\$80,000
1.						
2.						
3.						
4.						
5.						

Matching Investments To Goals

Refer to your list of prioritized goals in the chart above to complete the chart on the next page. List the name of the goal, the time needed to reach your goal, the name of the potential investment and the amount you estimate needing for that investment to reach your goal. See the example below. If you are not sure which investments are appropriate for your goals or how to put a plan together that is right for you, consider seeking advice from a CERTIFIED FINANCIAL PLANNER™ practitioner.

GOAL	TIME	POTENTIAL INVESTMENT	\$ NEEDED
Example:			
1. Child's education	12 yrs.	529 plan	\$25,000
		Mutual fund	\$40,000
		Savings account	\$15,000
Total			\$80,000

12 MATCHING INVESTMENTS TO GOALS

GOAL	TIME	POTENTIAL INVESTMENT	\$ NEEDED
1.			\$
			\$
			\$
Total			\$

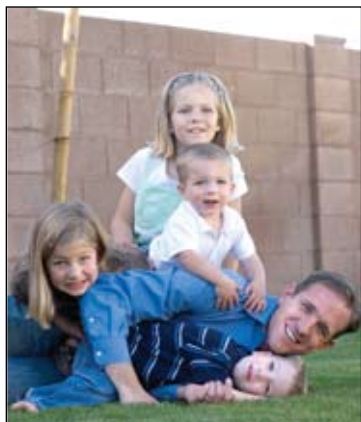
GOAL	TIME	POTENTIAL INVESTMENT	\$ NEEDED
2.			\$
			\$
			\$
Total			\$

GOAL	TIME	POTENTIAL INVESTMENT	\$ NEEDED
3.			\$
			\$
			\$
Total			\$

GOAL	TIME	POTENTIAL INVESTMENT	\$ NEEDED
4.			\$
			\$
			\$
Total			\$

GOAL	TIME	POTENTIAL INVESTMENT	\$ NEEDED
5.			\$
			\$
			\$
Total			\$

RESOURCES



The USAA Educational Foundation offers the following publications.

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