



■ INVESTING 101: THE KEYS TO ACHIEVING YOUR GOALS

YOU'RE ABOUT TO DISCOVER...

- The #1 reason to invest
- Your investment options
- An easy way to create an investment plan

WHY INVEST?

People invest a portion of their income in order to achieve their major, long-term goals and dreams. These dreams may include starting a business, building a home, supporting your favorite charity or simply being financially independent, so you can enjoy life any way you want.

When you invest, you forgo spending a portion of your money right now, in anticipation of having a larger amount of money in the future. As an investor, you would like to earn a return (income from your investment) by taking a risk in temporarily handing your money to someone else.

WHERE TO INVEST: FINANCIAL MARKETS

A financial market is a place where firms and individuals enter into contracts to sell or buy financial products such as stocks and bonds. Buyers seek to buy at the lowest available price; sellers seek to sell at the highest available price. Markets provide a meeting place for buyers and sellers where market demand can determine the price for financial products, which are called securities.

Some well-known securities markets include:

- New York Stock Exchange (NYSE)
- Nasdaq Stock Market (Nasdaq)
- American Stock Exchange (Amex)

WHAT ARE YOUR OPTIONS FOR INVESTING?

Cash and cash equivalents. This includes interest-bearing bank accounts, money market funds, certificates of deposit (CDs) and Treasury Bills (T-bills). On the plus side, they can be converted into cash very easily if

THERE'S A TRADE-OFF BETWEEN RISK AND RETURN

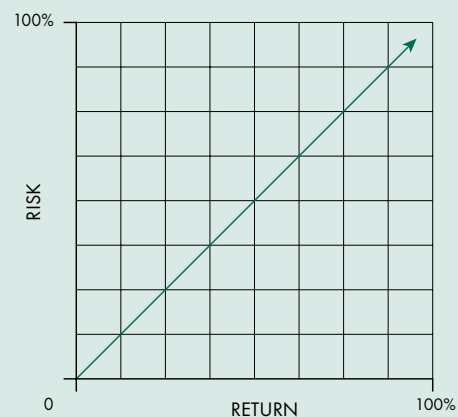
Low Risk = Low Return

Keeping all of your money in the safest investments (cash, for example) has a 0% risk but a near 0% return as well.

High Risk = High Return

By investing in a lottery, for instance, you have a 99.999% chance of losing all your money. But a huge return if you win.

Ideally, you should aim for the middle ground, taking a little bit of risk for a decent return.



you need liquidity. They are low risk investments but offer a low return as well.

Bonds. When you buy a bond, you are lending money to an organization for a specific period of time. The company or government agency you are lending to makes regular “interest” payments over the time period. If the company goes bankrupt, lenders (bond holders) get paid before stock holders. Interest income on bonds is taxed at regular income tax rates, which reduces the amount you actually earn. Bonds are relatively and historically low-risk investments that provide a medium-level investment return. Some useful terms to know about bonds:

- **Maturity** – The date on which the principal (original amount) is repaid.
- **Coupon** – The periodic interest payments from the organization.
- **Yield** – The rate of interest paid on a bond compared to its price.
- **Duration** – Bonds can be issued for periods up to 30 years; the length of time (duration) makes the bond sensitive to interest rate changes.

Stocks. When you own a stock, you own a piece (share) of a company. If a company is successful and its earnings (profits) go up, then the value of your stock may go up, and it could be worth more later when you sell the stock.

If a company declines in value or goes bankrupt, you can lose your money. The price of a stock can be affected by many factors. The higher risk and unpredictability of stocks is balanced by their potential for higher returns.

Some companies issue dividends – a small cash payment per share, each year – to their stockholders. Dividends are taxed as income. However, increases in the value of your actual stock are not taxed until you sell it. That is, until the gain is “realized.” These “capital gains” are taxed at a lower rate than regular income. Some useful terms to know about stocks:

- **P/E Ratio** – Price/earnings ratio is the most common measure of how expensive a stock is. The P/E ratio is equal to a stock’s market capitalization divided by its after-tax earnings over a 12-month period.¹
- **Yield** – For stocks, the yield is the annual dividend divided by the purchase price. This is not an accurate measure of total return, however, since it does not factor in capital gains. It is also sometimes referred to as the dividend yield or current yield.²
- **Earnings Growth** – This is a measure of growth in a company’s net income (profit) over a specific period, often one year.³
- **Market Capitalization** – This is the size of a company as measured by the number of shares outstanding multiplied by the stock price of one share.

OWNING STOCKS MEANS OWNING A PIECE OF A COMPANY

For example, if you own shares of Apple Computer and:

- They introduce a new iPhone that fly off the shelves;
- The company makes money and is worth more; and
- Your shares are worth more, too.

However, if you own shares of Ford Motor Company and:

- The price of gas forces people to buy smaller imported cars;
- The company will sell less sport utility vehicles and make less money; and
- Your shares will drop in value, too.

1 http://www.investorwords.com/3656/P_E_ratio.html
 2 http://www.investorwords.com/3656/P_E_ratio.html
 3 http://www.investorwords.com/3656/P_E_ratio.html

HOW TO READ A STOCK TABLE

1	2	3	4	5	6	7	8	9	10
52 Wks YTD %CHG	HI	LO	STOCK (SYM)	DIV	YLD%	P/E	VOL 100s	CLOSE	NET CHG
4.4	22.36	15.05	Mattel (MAT)	.05	.3	21	38476	20	0.60

- | | | | |
|-------|---|----|--|
| 1 | Percent change in stock price over 52 weeks | 7 | Price/earnings ratio (price of one share/earnings per share) |
| 2 – 3 | High and low prices for last 52 weeks (in dollars) | 8 | Number of shares bought and sold that day |
| 4 | Name and symbol of stock | 9 | Closing price of stock that day (in dollars) |
| 5 | Dividend the stock is paying per share (in dollars) | 10 | Change in price of the stock from the previous day |
| 6 | Yield – return on investment:
$\frac{\text{Dividend}}{\text{Closing Price}} \times 100 = \text{YLD\%}$ | | |

FACTORS INFLUENCING STOCK PRICES

Why Stocks Go Up	Why Stocks Go Down
<ul style="list-style-type: none"> ■ Increasing sales and profits ■ Promising new executive is hired ■ Exciting new products or services are launched ■ Company lands big new contract ■ Flattering media coverage ■ Scientists discover product is good for something important ■ Famous investor buys shares ■ Lots of people buying shares ■ Analysts upgrade the company ■ Stocks in the same industry go up ■ Stock market is generally up (bull market) ■ Competitor’s factory burns down ■ Company wins lawsuit ■ More people are buying the product/service ■ Company expands globally ■ Industry is “hot” – sometimes for good reason, sometimes for no reason ■ Company may be bought ■ Rumors 	<ul style="list-style-type: none"> ■ Sales and profits slipping ■ Top executive(s) leave company ■ Analyst downgrades recommendation of stock ■ Company loses major customer ■ Lots of people are selling shares ■ A factory burns down ■ Stocks in the same industry go down ■ Stock market is generally down (recession/bear market) ■ Competitor introduces a better product ■ Supply shortage, so not enough of product can be made ■ Big lawsuit filed against company ■ Scientists discover product isn’t safe ■ Fewer people are buying the product ■ Industry used to be “hot,” now another industry is more popular ■ A new law might hurt sales/profits ■ A powerful company becomes a competitor ■ Rumors

Patience often pays off when you are investing in stocks. Although there have been some notable stock market “crashes,” you can expect that your investments will increase over the long term. In fact, stocks in the S&P 500 Index have gone up by an average of 10.3% for the past 50 years.⁴ Remember, investing is a marathon, not a sprint!

OTHER TYPES OF INVESTMENTS

Finally, there are other investments that you may want to consider for your portfolio.

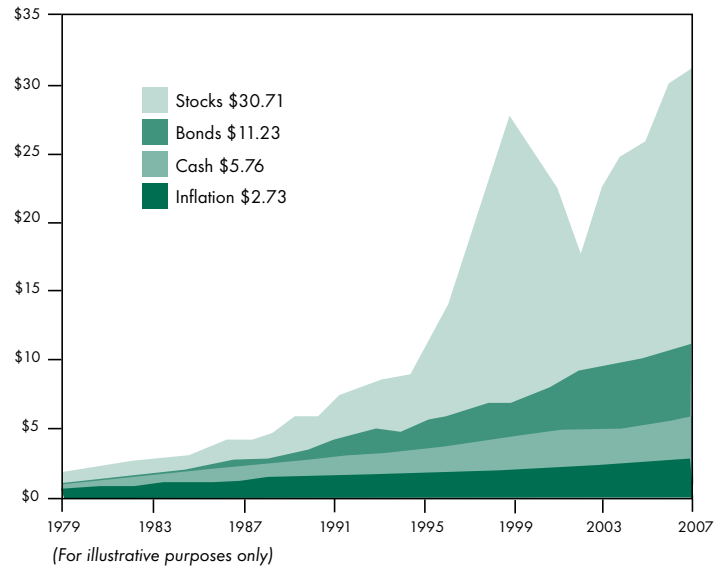
- **Alternative Investments** – can include private equity (ownership in privately held businesses and new start-up ventures) and hedge funds that pursue a variety of sophisticated investment strategies.
- **Real Estate** – either direct ownership of properties or partial ownership through Real Estate Investment Trusts (REITs).
- **Art/Collectibles** – such as antiques, paintings, jewelry, etc., which may or may not appreciate in value over time.

DEALING WITH INFLATION RISK

As we mentioned before, the greater the risk of an investment, the greater the rewards. However, sticking with safe, secure investments such as CDs or Treasury Bills can expose you to another kind of risk – inflation risk – or the loss of future purchasing power.

If your safe investments earn less than the rate of inflation (which was 4.1% for 2007⁵), then you are actually losing money in real terms. This is known as inflation risk. Historically, stocks and bonds have outpaced inflation over the long term and given investors purchasing power protection.

ACCUMULATED TOTAL RETURN OF \$1 (1980 – 2007)



VOLATILITY IS ANOTHER CONSIDERATION

Will you be able to sleep at night if the value of your investments falls by 10% or 20%? Your answer will help you determine which “asset class” or types of investment that you will be most comfortable with. Here are some historical rates of return and risk:

	RETURN	RISK	PROBABILITY OF LOSING MONEY IN 1 YEAR
Cash Equivalents	3.5	2.0	6%
Gov't/Corp. Bonds	5.8	10.0	25%
Real Estate	8.5	15.0	9%
High Yield	9.5	10.0	11%
Large Cap Stocks	9.0	15.0	23%
Mid Cap Stocks	9.5	16.0	24%
Small Cap Stocks	10.5	22.0	29%
International Stocks	9.0	17.0	24%
Alternative Assets	13.0	20.0	32%

(For illustrative purposes only)

4 http://www.fpanet.org/journal/articles/2002_Issues/jfp0702-art8.cfm?&
 5 <http://www.bls.gov/news.release/pdf/cpi.pdf>

HOW TO MINIMIZE THE POSSIBILITY OF LOSING MONEY

There are three ways to minimize your risk of losing money.

1. **Extend your timeframe.** Your portfolio is better able to weather the ups and downs of the markets over a longer period of time. A short-term drop may be reversed by a long, gradual recovery. As we mentioned before, the average annual return for the stock market over 50 years is 10.3%.
2. **Diversify your investments.** You can minimize risk by not “putting all your eggs in one basket.” Instead, you spread out your investments. For example, if you invest \$10,000 in the stock of one company and it fails, you’ve lost everything. Put \$10,000 into 10 different companies and if one fails, you’ve only lost 10% of your overall investment.

Diversification dampens the highs that your portfolio might reach, but it also cushions the lows. Since asset classes (stocks, bonds, cash) tend to behave differently, by owning several asset classes you tend to lessen your risk. When the stock market is going down, your bonds may be going up, and vice versa.

3. **Rebalance your portfolio.** Let’s say your investment plan calls for an asset allocation of 30% stocks, 30% bonds, 20% real estate, 10% alternative investments and 10% cash. In any given year, one asset class may outperform the other.

For example, at the end of the year, your asset allocation may have shifted to 40% stocks and 20% bonds, with

the other allocations remaining roughly the same. Even though stocks are hot, you should sell some to get back to your original long-term investment strategy of 30/30/20/10/10. Sticking to a disciplined investment strategy means that at least once a year, you check to see if your portfolio needs to be rebalanced.

CREATING YOUR INVESTMENT PLAN

Your investment plan should take into account your goals for income generation, wealth accumulation and wealth preservation. In order to figure out which types of investments make the most sense for your situation, ask yourself the following questions.

- **Your income needs** – Do you need any money from these investments right now?
- **Your investment timeframe** – How long do you expect to have this money invested?
- **Your tax situation** – What tax bracket are you in?
- **Your tolerance for risk** – Can you tolerate a decline in your investments? If so, by how much?

Your answers to these questions will drive your investment choices and how you build your investment plan. For example:

	CASH	BONDS	STOCKS	ALTERNATIVE INVESTMENTS
Income needs are high	X	X		
Short time frame	X	X		
Wealth preservation		X	X	X
Tax sensitive		X	X	X
Wealth accumulation			X	X

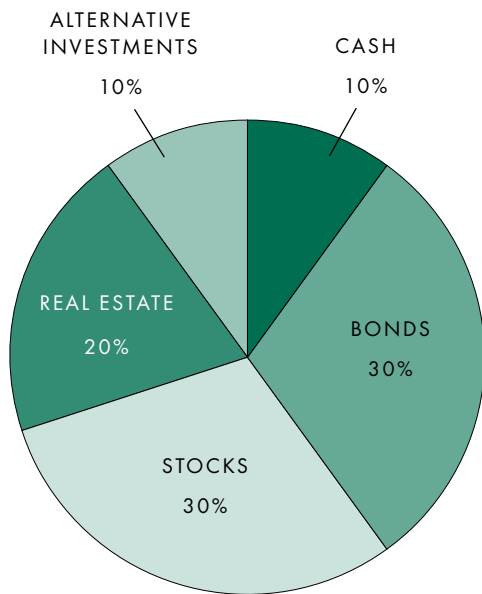
In turn, this will lead to your asset allocation mix. Deciding on an appropriate asset allocation is the foundation for your investment plan. Here is a sample asset allocation:

SAMPLE INVESTMENT PLAN

Investment horizon:	7-8 years
Risk profile:	Can accept moderate volatility
Portfolio goal:	Growth
Income requirement:	0%
<hr/>	
Cash:	\$10,000
Bonds:	\$30,000
Stocks:	\$30,000
Real estate:	\$20,000
Alternative assets:	\$10,000
Total assets:	\$100,000

(For illustrative purposes only)

SAMPLE ASSET ALLOCATION – GROWTH PORTFOLIO



6 http://personal.fidelity.com/research/eff/content/market_indexes.shtml

7 http://en.wikipedia.org/wiki/Bond_market and NYSE Bonds press release NYSE Bonds. Accessed May 1, 2007.

8 http://www.ici.org/stats/mf/2007_factbook.pdf

9 http://www.investmentadviser.org/public/nrsiaa_report_press-0605.pdf

IMPLEMENTING YOUR PLAN

When you have decided on an investment plan that makes sense for your goals, it’s time to implement your plan and build your portfolio. You have a lot of options to choose from:

- Nearly 15,000 U.S. stocks⁶;
- More than 6,000 U.S. bonds traded annually⁷;
- 10,000 plus mutual funds⁸; and
- More than 8,600 Registered Investment Advisors⁹.

You’ll want to monitor your investments on a regular basis to make sure they’re performing well. By sticking to your plan and rebalancing your portfolio as needed, you can make sure your investment mix/asset allocation stays on track to achieve your objectives.

The key to achieving your goals is to make the decision to start investing in your future today. Don’t be intimidated by the complexity. Many investors work with a professional investment advisor to help set up their account, provide detailed reporting and offer advice on asset allocation and security selection.

To find out more, contact a Northern Trust professional at a location near you or visit northerntrust.com

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