

## Financial Planning Topics



Kevin C. Ahlgrim, A.S.A., M.A.A.A., Ph.D.  
Assistant Professor of Finance

## Outline

- The start of the process – establishing goals
- Financial risk protection – Insurance
- Accumulating wealth – Investments
- Retirement planning
- Estate planning
- Miscellaneous topics

## Establishing Financial Goals

- Individuals must balance current vs. future needs
- Current needs – housing, food, clothing, etc.
- Future needs – retirement, children's education, vacation
- The best goals are realistic goals with a specific target date
- Other family members input?

## Goals by Age

<u>Age</u>	<u>L-T Goals</u>	<u>Med Goals</u>	<u>S-T Goals</u>
College	<ul style="list-style-type: none"> <li>•Investment</li> <li>•Buy condo</li> <li>•Master's degree</li> </ul>	<ul style="list-style-type: none"> <li>•College loans</li> <li>•New car</li> </ul>	<ul style="list-style-type: none"> <li>•Job</li> </ul>
Single, mid-20s	<ul style="list-style-type: none"> <li>•Grad school</li> <li>•Save for home</li> </ul>	<ul style="list-style-type: none"> <li>•Vacation</li> <li>•Retirement fund</li> </ul>	<ul style="list-style-type: none"> <li>•Stereo</li> <li>•Emergency fund</li> </ul>
Married, late 30s	<ul style="list-style-type: none"> <li>•Kids college</li> <li>•Vacation home</li> </ul>	<ul style="list-style-type: none"> <li>•Second car</li> </ul>	<ul style="list-style-type: none"> <li>•Kids' braces</li> </ul>
Married, Mid-50s	<ul style="list-style-type: none"> <li>•Retirement</li> <li>•World cruise</li> </ul>	<ul style="list-style-type: none"> <li>•Downgrade home</li> </ul>	<ul style="list-style-type: none"> <li>•Job retrain</li> </ul>

## Formulating/Implementing a Plan

- Current needs establish a budget
- Future needs set saving/investing goals
  - Emergency fund
  - Future purchases
- Technology is helpful today
  - Web sites (<http://planning.yahoo.com/>, <http://moneycentral.msn.com/planning/home.asp>, financial services home pages)
  - Quicken, Money, etc.

## Areas of Financial Planning

- Insurance – protecting income and assets
- Investment – accumulating wealth
- Retirement – preparing for reduced income
- Estate – passing on wealth
- Taxes
  - Keep more of what you earn
  - Permeates all areas

## Insurance Needs

- Insurance reduces financial risks
- Life/health/disability coverages
  - Protects income
- Property coverage
  - Protects against damage to assets
- Liability coverage
  - Protects against (unintended) negligence

## Protection by Life Insurers

- Dying too soon (or living too long)
- Term life insurance
  - Death protection only (cheap)
  - May be guaranteed renewable
  - Cost increases with age
  - Employer provided group insurance
- Whole life insurance
  - Level premium forever (limited pay policies)
  - Cash value accumulation inside policy

## BTID

- Buy term and invest the difference
- Premiums for 35-year old, \$100,000 policy
  - \$1,460 whole life
  - \$283 5-year term
  - Difference = \$1,177

<b><i>Time</i></b>	<b><i>@2%</i></b>	<b><i>@6%</i></b>	<b><i>@10%</i></b>
5 years	6,125	6,635	7,186
10 years	12,888	15,514	18,758
20 years	28,598	38,919	67,413

## Other Types of Life Insurance

- Universal life
  - Flexible premium payments
  - Cash value credited competitive rates
- Variable life
  - Policyholder controls where cash value is invested
  - Accepts all investment risk

## How Much Life Insurance Do You Need?

- Life insurance is for family members who would suffer financially from your death
- Proceeds must satisfy
  - Funeral expenses
  - Living expenses (child care?)
  - Debts
  - Education needs (including a spouse?)
- Current funds/savings may offset needs

## Health Insurance

- Disability coverage – replaces income if you become disabled
- Medical coverage
  - Often employer provided
  - Indemnity coverage reimburses expenses
    - Deductibles, 80/20, out of pocket maximum
    - More claims forms
  - PPO (point of service) plans give patients a choice of network doctors or out of network
  - HMO restricts doctor choices

## LIFE INSURANCE ILLUSTRATION

Plan: Whole Life

Initial Death Benefit: \$100,000

Insured: John Doe

Premium Mode: Annual

Premium Class: Male, Age 35 Non-Tobacco

Dividend Option: Accumulate

		Guaranteed Values			Non-Guaranteed Illustrated Values					
End of Year	Age	Annualized Contract Premium	Guaranteed Cash Value	Guaranteed Death Benefit	Annualized Premium Outlay	Total Annualized Premium Outlay	Annual Dividend	Accumulated Dividends at 6.50%	Cash Surrender Value	Total Death Benefit
1	36	1,460	0	100,000	1,460	1,460	0	0	0	100,000
2	37	1,460	307	100,000	1,460	2,920	0	0	307	100,000
3	38	1,460	1,474	100,000	1,460	4,380	20	20	1,494	100,020
4	39	1,460	2,678	100,000	1,460	5,840	22	43	2,721	100,043
5	40	1,460	3,918	100,000	1,460	7,300	24	70	3,988	100,070
6	41	1,460	5,192	100,000	1,460	8,760	52	126	5,318	100,126
7	42	1,460	6,502	100,000	1,460	10,220	101	235	6,737	100,235
8	43	1,460	7,848	100,000	1,460	11,680	152	403	8,251	100,403
9	44	1,460	9,229	100,000	1,460	13,140	200	629	9,858	100,629
10	45	1,460	10,647	100,000	1,460	14,600	248	918	12,097	101,450
11	46	1,460	12,103	100,000	1,460	16,060	297	1,275	13,983	101,880
12	47	1,460	13,596	100,000	1,460	17,520	345	1,702	15,978	102,382
13	48	1,460	15,128	100,000	1,460	18,980	394	2,207	18,091	102,963
14	49	1,460	16,700	100,000	1,460	20,440	443	2,794	20,329	103,629
15	50	1,460	18,311	100,000	1,460	21,900	494	3,469	22,696	104,385
16	51	1,460	19,960	100,000	1,460	23,360	594	4,289	25,247	105,287
17	52	1,460	21,644	100,000	1,460	24,820	700	5,268	27,994	106,350
18	53	1,460	23,361	100,000	1,460	26,280	805	6,415	30,944	107,583
19	54	1,460	25,108	100,000	1,460	27,740	912	7,744	34,107	108,999
20	55	1,460	26,882	100,000	1,460	29,200	1,015	9,262	37,488	110,606
21	56	1,460	28,617	100,000	1,460	30,660	1,117	10,981	41,029	112,412
22	57	1,460	30,375	100,000	1,460	32,120	1,165	12,860	44,754	114,379
23	58	1,460	32,157	100,000	1,460	33,580	1,213	14,909	48,674	116,517
24	59	1,460	33,966	100,000	1,460	35,040	1,262	17,140	52,804	118,838
25	60	1,460	35,799	100,000	1,460	36,500	1,312	19,567	57,156	121,357
26	61	1,460	37,651	100,000	1,460	37,960	1,366	22,204	61,738	124,087
27	62	1,460	39,521	100,000	1,460	39,420	1,424	25,072	66,569	127,048
28	63	1,460	41,401	100,000	1,460	40,880	1,488	28,189	71,660	130,259
29	64	1,460	43,285	100,000	1,460	42,340	1,556	31,578	77,027	133,742
30	65	1,460	45,171	100,000	1,460	43,800	1,630	35,260	82,690	137,519
31	66	1,460	47,054	100,000	1,460	45,260	1,704	39,256	88,663	141,609
32	67	1,460	48,939	100,000	1,460	46,720	1,778	43,586	94,972	146,033
33	68	1,460	50,825	100,000	1,460	48,180	1,848	48,267	101,633	150,808
34	69	1,460	52,710	100,000	1,460	49,640	1,911	53,315	108,661	155,951
35	70	1,460	54,595	100,000	1,460	51,100	1,972	58,753	116,078	161,483
36	71	1,460	56,469	100,000	1,460	52,560	2,036	64,608	123,900	167,431
37	72	1,460	58,324	100,000	1,460	54,020	2,103	70,911	132,151	173,827
38	73	1,460	60,146	100,000	1,460	55,480	2,177	77,697	140,850	180,704
39	74	1,460	61,922	100,000	1,460	56,940	2,255	85,002	150,020	188,098
40	75	1,460	63,650	100,000	1,460	58,400	2,331	92,858	159,691	196,041

These figures do not recognize that, because of interest, a dollar in the future has less value than a dollar today.

## Indemnity Coverage Example

- \$500 deductible, 80/20 coinsurance, \$2000 out of pocket maximum
- Patient has \$20,000 of covered expenses

$$0.20 \times (20,000 - 500) = 3,900$$

2,000 patient  
18,000 insurer

## Auto Insurance

- Combination of property and liability coverages
- Property
  - Collision – repairs your vehicle when in an accident
  - Comprehensive – other losses not related to an accident
  - Deductible has large impact on cost
- Liability
  - Bodily injury or personal property damage
  - 100/300/50 limits: per person/per accident/property
- Premiums higher for: males, urban areas, <25, single, more driving, driving record

## Homeowners Insurance

- Again, combo of coverages
- Various forms – HO-3, HO-4 (renters), others
- Usually all perils (fire, lightning, wind, smoke, etc.) EXCEPT earthquake, war, and flood
- Coverages
  - A is primary dwelling
  - B is other structures (garage, shed)
  - C is personal property (contents)
  - D is loss of use

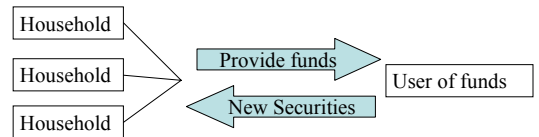
## Homeowners Insurance (p.2)

- Liability coverages
  - Lawsuits from negligence on your property
  - Separate umbrella liability coverage?
- Policy limits
  - Actual CV is only depreciated value
  - Probably want replacement value, not MV

## Fundamentals of Investing

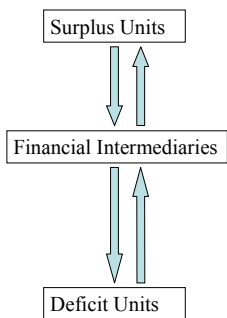
- What are investments? Where do they come from?
- Risk vs. return – risk aversion
- Stocks and bonds
- Diversification
- Mutual funds
- The economy, interest rates, and Alan Greenspan

## Financial Markets



Example: US Govt of 1980s and 2000s

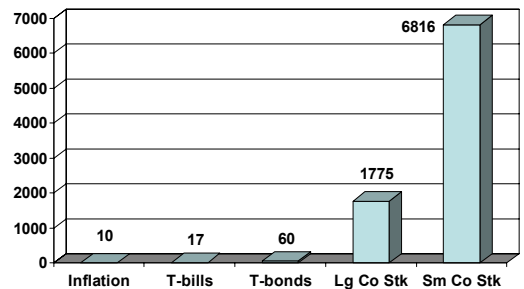
## Revised Flow of Funds



## Types of Financial Intermediaries

- Depository (banks, S&Ls)
- Non-depository (mutual funds, investment banks)

## \$1 invested in 1926



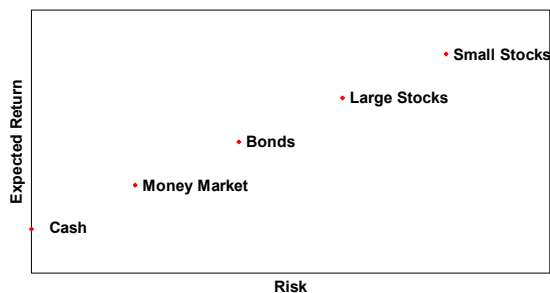
## Why a risk/return tradeoff?

- All investors could hold a risk-free asset
  - Default free Treasury securities
- Other securities are not guaranteed
  - We must consider the possibility of loss
- Investors are risk averse
  - Always prefer certain payoff over uncertainty
  - Require additional returns if an asset has any risk
- Your level of risk aversion affects investment selection

## Investor Constraints

- All constraints affect risk/return tradeoff and impact your choice of investments
- Resource\$
- Horizon(s) – retirement and vacation are different horizons
- Liquidity
  - Potential need for short-term cash
  - Liabilities

## Risk Return Tradeoff

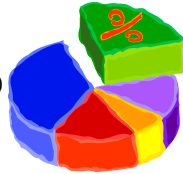


## Investing in Bonds

- Bonds are debt, interest paid periodically in the form of coupons
- Three major issuers
  - US Government (default free Treasury Bonds)
  - Other governments (municipal bonds, munis)
  - Corporations
- Two major risks
  - Interest rate risk
  - Default risk (bond ratings)

## Investing in Stock

- Stock (a.k.a. equity) represents partial ownership in a firm (“shares”)
- Rights
  - Voting (elect the board of directors)
  - Residual claim
  - Dividends
- (Loosely) Stock prices increase when profits increase
  - Or are “expected” to increase



## Hooray for Macroeconomics!

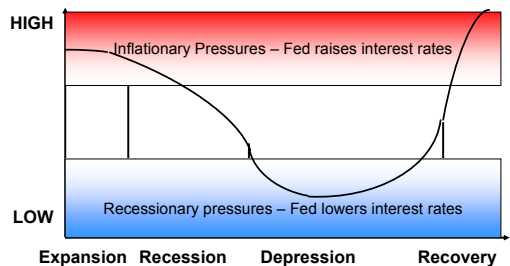
- Government attempts for low inflation, steady growth, and “full” employment
- Despite government fine-tuning, we still have ups and downs
  - Cycle of recession and recovery
- Some businesses are more sensitive to business cycle
  - Cyclical stocks
  - Defensive industries are less sensitive

## Simple Business Cycle

Economy heats up	Interest rates increase
Increase in purchases	People don't buy on credit
Unemployment decreases	Large item purchases decline
More people have more money	Unemployment increases
Maximum capacity met	Less demand for all products
Prices increase	
Increase in demand for money	Government intervention?

## Economic Cycles

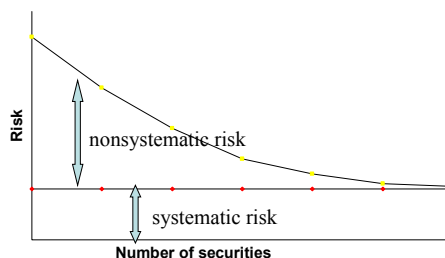
Levels of Employment and Production



## Most Important Investment “Tip”: Diversification

- Securities are exposed to two types of risk
  - Systematic or market risk (affect all firms)
  - Firm specific or nonsystematic risk
- Nonsystematic risk can be reduced by including more securities in a portfolio
  - Diversification
  - Example: ESOPs
- Systematic risk limits benefits to diversification

## Portfolio Diversification



**Lesson: you need to have a portfolio with many securities**

## Mutual Funds (Investment Companies)

- Mutual funds are companies that pool small investors' funds for investment
- Benefits
  - Diversification
  - “Professional” management
  - Recordkeeping and administration
  - Lower initial investment

## Closed- Vs. Open-end Funds

- Closed-end funds
  - Have a fixed number of shares
  - Investors wanting to cash out must sell to other investors on exchanges
- Open-end funds (mutual funds)
  - Investors buy/sell directly from fund
  - Number of shares changes daily

## Fee Structures

### Nothing is for free

- Different “classes” of shares have different fee structures
- Sales charges (loads)
  - Front end: Reduce the initial investment
  - Back-end: redemption fees often decline over time
  - 12b-1 fees: annual charges to assets
- Operating/management expenses
  - Usually 0.5% to 2 or 3%

## Investment Styles

- Where do you want your money invested?
- Equity styles
  - Value vs. growth
  - Small vs. large “cap”
  - Index (e.g., S&P 500)
  - International (add'l diversification)
- Bond styles (govt, S-T, L-T, muni)
- Balanced funds

## Dollar cost averaging

- Quit trying to time the markets
- Invest a fixed amount at regular intervals
  - Weekly, monthly, quarterly, etc.
- When prices are low, you buy more shares and vice versa
- On average, you pay a “fair price”



## Retirement Planning

- Social security benefits
- Roth vs. Traditional IRA
- Defined benefit vs. defined contribution pension plans



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# Morgan Stanley Mid-Cap Value Fund

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## Fund Overview

**Objective**  
Seeks above-average total return.

**Portfolio**  
Invests primarily in common stocks and other equity securities, including depository receipts and securities convertible into common stock of companies with a market capitalization in the range of companies included within the Russell Midcap Value Index.

## Fund Facts

Share Class	A	B	C	D
NASD Symbol	MDFAX	MDFBX	MDFCX	MDFDX
CUSIP	61747J108	61747J207	61747J306	61747J405
Inception Date	10/29/01	10/29/01	10/29/01	10/29/01
Fiscal Year End	8/31	8/31	8/31	8/31
Expenses	1.40%	2.16%	2.08%	1.16%
Portfolio Turnover	151	151	151	151



## Portfolio Data

Data as of 3/31/05

**Largest Holdings**

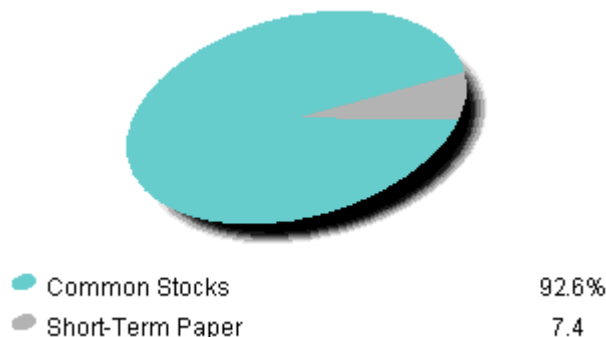
Hubbell, Inc. (Class B)	3.55%
Valassis Communications, Inc.	3.41
Southwest Airlines Co.	3.26
Sovereign Bancorp, Inc.	3.22
Scholastic Corp.	3.19
Applera Corp. - Applied Biosystems Group	2.99
Flour Corp.	2.80
Constellation Energy Group	2.65
PMI Group Inc.	2.63
Cooper Cameron Corp.	2.61

**Largest Industries**

Medical Specialties	6.98%
Electric Utilities	6.95
Specialty Stores	5.04
Electrical Products	3.55
Advertising/Marketing Services	3.41
Pharmaceuticals: Generic	3.40
Airlines	3.26

Savings Banks	3.22
Publishing: Books/Magazines	3.19
Engineering & Construction	2.80

### Portfolio Composition



Subject to change daily. Provided for informational purposes only and should not be deemed as a recommendation to buy or sell the securities mentioned or securities in the industries shown above. Morgan Stanley is a full-service securities firm engaged in securities trading and brokerage activities, investment banking, research and analysis, financing and financial advisory services.



### Prices

Prices as of

Data as of 3/31/05

Monthly

Share Class	A	B	C	D
NAV - Net Assets Value (\$MM)	11.61	11.30	11.32	11.71
NAV Change (\$)	0.03	0.03	0.03	0.04
MOP - Maximum Offering Price	12.25	11.30	11.32	11.71



### Performance

#### Average Annual Total Returns with sales charges as of 3/31/05

	CLASS A	CLASS B	CLASS C	CLASS D
1 Year	6.11	6.09	10.28	12.28
3 Year	2.97	3.14	4.13	5.11
5 Year	—	—	—	—
10 Year	—	—	—	—
Since Inception	5.71	6.08	6.63	7.65

#### Average Annual Total Returns without sales charges as of 3/31/05

	CLASS A	CLASS B	CLASS C	CLASS D
1 Year	11.99	11.09	11.28	12.28
3 Year	4.84	4.07	4.13	5.11
5 Year	—	—	—	—
10 Year	—	—	—	—
Since Inception	7.39	6.58	6.63	7.65

**Performance data quoted represents past performance, which is no guarantee of future results, and current performance may be lower or higher than the figures shown. For the most recent month-end performance figures, please visit [morganstanley.com](http://morganstanley.com) or speak with your financial advisor. Investment returns and principal value will fluctuate and fund shares, when redeemed, may be worth more or less than their original cost.**

**Class A shares include maximum front-end sales charge of 5.25%; maximum annual 12b-1 fee is 0.25%. Class B shares include deferred sales charge of 5% declines to zero after sixth year; maximum annual 12b-1 fee is 1.00%. Class B shares convert to A shares approximately 10 years after purchase. Class C shares include deferred sales charge of 1.00% declines to zero after**

first year; maximum annual 12b-1 fee is 1.00%. Class D shares include no sales charge or 12b-1 fee. Available only to certain limited categories of investors, including those whose cumulative investments in Class A and D shares meet a minimum of \$5,000,000.



## Distributions

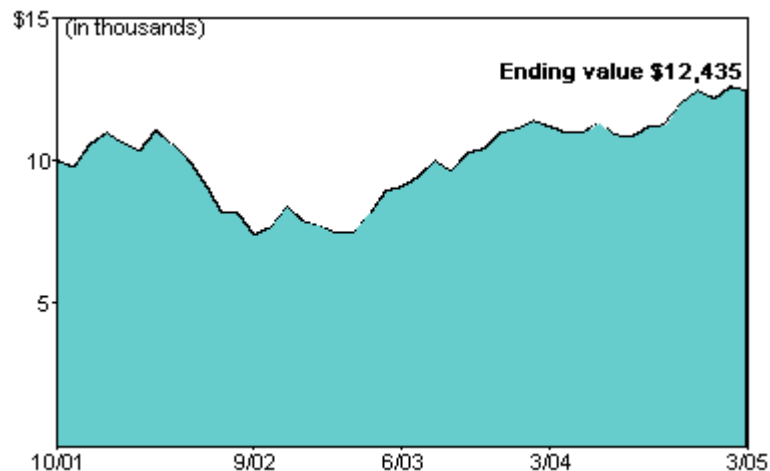
Share Class	CLASS A	CLASS B	CLASS C	CLASS D
YTD Dividends	\$0.000	\$0.000	\$0.000	\$0.000
YTD Short-Term Capital Gains	\$0.000	\$0.000	\$0.000	\$0.000
YTD Long-Term Capital Gains	\$0.000	\$0.000	\$0.000	\$0.000
Annual Total Distributions	\$0.000	\$0.000	\$0.000	\$0.000

Income dividends are normally distributed to shareholders annually and capital gains (if available) are paid in December.



## Growth Charts

Growth data current as of  
Data as of 3/31/05  
Monthly  
Performance of \$10,000



Since inception; includes reinvestment of dividends and capital gains and excludes sales charge. Performance for other share classes will vary.



## Complete Holdings

Data as of 12/31/04

	Par/Shares	Market Value
ACE Ltd. (Cayman Islands)	151,790	\$6,489,022
Advanced Micro Devices, Inc.	154,920	\$3,411,338
Amerada Hess Corp.	60,040	\$4,946,095
Applera Corp. - Applied Biosystems Group	454,130	\$9,495,858
Assurant, Inc.	141,480	\$4,322,214
Bausch & Lomb, Inc.	94,620	\$6,099,205
BearingPoint, Inc.	612,406	\$4,917,620
BISYS Group, Inc. (The)	694,496	\$11,424,459
Cadence Design Systems, Inc.	497,290	\$6,867,574
Conseco Inc.	370,160	\$7,384,692

Constellation Energy Group, Inc.	166,900	\$7,295,199
Cooper Cameron Corp.	164,000	\$8,824,840
Darden Restaurants, Inc.	125,450	\$3,479,983
Edison International	207,306	\$6,640,011
Edwards (A.G.), Inc.	175,420	\$7,579,898
El Paso Corp.	700,800	\$7,288,320
Fluor Corp.	168,540	\$9,187,115
General Growth Properties, Inc.	200,800	\$7,260,928
Goodrich Corp.	304,226	\$9,929,936
Horace Mann Educators Corp.	229,230	\$4,373,708
Hubbell, Inc. (Class B)	231,490	\$12,106,927
IMS Health Inc.	237,670	\$5,516,320
International Flavors & Fragrances, Inc.	78,490	\$3,362,511
Joint repurchase agreement account, 2.223%, 01/03/2005	11,525,000	\$11,525,000
Linens 'N Things, Inc.	260,890	\$6,470,072
Lyondell Chemical Co.	418,590	\$12,105,622
Macerich Co. (The)	117,500	\$7,379,000
Magna International Inc. (Class A) (Canada)	91,200	\$7,528,560
Manpower, Inc.	170,439	\$8,232,203
Newell Rubbermaid, Inc.	322,990	\$7,813,128
Northern Trust Corp.	127,750	\$6,206,095
Office Depot, Inc.	431,140	\$7,484,590
Pall Corp.	232,250	\$6,723,637
Pinnacle West Capital Corp.	157,940	\$7,014,115
PMI Group, Inc. (The)	209,700	\$8,754,975
Regional Bank HOLDRS Trust	12,000	\$1,703,400
Sabre Holdings Corp.	185,260	\$4,105,361
Scholastic Corp.	267,360	\$9,881,625
Southwest Airlines Co.	501,220	\$8,159,861
Sovereign Bancorp, Inc.	474,000	\$10,688,700
Starwood Hotels & Resorts Worldwide, Inc.	133,790	\$7,813,336
Temple-Inland Inc.	45,320	\$3,099,888
Transocean Inc. (Cayman Islands)	182,010	\$7,715,403
Valassis Communications, Inc.	318,020	\$11,133,880
Valero Energy Corp.	113,688	\$5,161,435
Watson Pharmaceuticals, Inc.	260,190	\$8,536,833
Wisconsin Energy Corp.	208,050	\$7,013,365

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## Risk Information

There is no assurance that a mutual fund will achieve its investment objective. Funds are subject to market risk, which is the possibility that the market value of securities owned by the fund will decline and that the value of fund shares may therefore be less than what you paid for them. Accordingly, you can lose money investing in this fund. Please be aware that this fund is subject to certain additional risks, including those associated with:

**Foreign securities.** The fund may invest in foreign securities; should it do so, the portfolio may be subject to additional currency, political, economic, and market risks.

**Mid-cap stocks.** Stocks of medium-sized companies entail special risks, such as limited product lines, markets, and financial resources, and greater market volatility than securities of larger, more-established companies.

**Convertible securities.** In addition to risks associated with common stocks, investments in convertible securities are subject to the risks associated with fixed-income securities, namely credit, price and interest-rate risks.

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## MUTUAL FUND LOADS

	A	B	C	D
Front	5%	0%	0%	2%
Back				
Yr1	0%	7%	0%	0%
Yr2	0%	6%	0%	0%
Yr3	0%	5%	0%	0%
Yr4	0%	4%	0%	0%
Yr5	0%	3%	0%	0%
Yr6	0%	2%	0%	0%
Yr7	0%	1%	0%	0%
12b-1	0%	0%	1%	0.25%

Investment \$	10,000
Return	10%

<u>Year</u>	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>
0	9,500	10,000	10,000	9,800
1	10,450	10,230	10,900	10,756
2	11,495	11,374	11,881	11,804
3	12,645	12,645	12,950	12,955
4	13,909	14,055	14,116	14,218
5	15,300	15,622	15,386	15,604
6	16,830	17,361	16,771	17,126
7	18,513	19,292	18,280	18,796
8	20,364	21,436	19,926	20,628
9	22,401	23,579	21,719	22,640
10	24,641	25,937	23,674	24,847
11	27,105	28,531	25,804	27,269
12	29,815	31,384	28,127	29,928
13	32,797	34,523	30,658	32,846
14	36,076	37,975	33,417	36,049
15	39,684	41,772	36,425	39,563
16	43,652	45,950	39,703	43,421
17	48,017	50,545	43,276	47,654
18	52,819	55,599	47,171	52,301
19	58,101	61,159	51,417	57,400
20	63,911	67,275	56,044	62,997
30	165,769	174,494	132,677	159,721

## EFFECTS OF EXPENSES

Investment return = 10%

<u>Year</u>	<i>Expense Ratio</i>			
	<u>0.20%</u>	<u>0.50%</u>	<u>1.00%</u>	<u>1.50%</u>
0	10,000	10,000	10,000	10,000
1	10,980	10,950	10,900	10,850
2	12,056	11,990	11,881	11,772
3	13,238	13,129	12,950	12,773
4	14,535	14,377	14,116	13,859
5	15,959	15,742	15,386	15,037
6	17,523	17,238	16,771	16,315
7	19,241	18,876	18,280	17,701
8	21,126	20,669	19,926	19,206
9	23,196	22,632	21,719	20,839
10	25,470	24,782	23,674	22,610
11	27,966	27,137	25,804	24,532
12	30,706	29,715	28,127	26,617
13	33,716	32,537	30,658	28,879
14	37,020	35,629	33,417	31,334
15	40,648	39,013	36,425	33,997
16	44,631	42,719	39,703	36,887
17	49,005	46,778	43,276	40,023
18	53,807	51,222	47,171	43,425
19	59,081	56,088	51,417	47,116
20	64,870	61,416	56,044	51,120
30	165,223	152,203	132,677	115,583

## Social Security (OASDHI)

- 7.65% tax on you and your employer
  - 5.20% for old age and survivors' insurance
  - 0.90% for disability insurance
  - 1.45% for hospital insurance (part A only)
- Tax base on OASDI is 90,000 in 2005
- Eligibility
  - Usually 40 quarters of income of \$920 (2005)
- Benefits related to your contributions/pay

## SS Financing

- Pay-as-you-go
  - No prefunding like corporate pension plans
- SS crisis
  - Fewer workers support more retirees
- Potential solutions
  - Reduce benefits
  - Adjust tax base/retirement age
  - Private accounts

## Roth vs. Traditional IRA

- Individual retirement account (IRA)
- Money set aside grows tax free
- May be income restrictions / limits on contributions
- Must be 59½ before withdrawing
- Traditional IRA
  - Not taxed going in, but taxed in retirement
- Roth IRA
  - Invest after-tax, but proceeds are tax-free
  - Fewer requirements for mandatory withdrawal

## Defined benefit pension plan

- Employer provides specified retirement benefit
- Employer responsible for funding over working life of employee
- Employer has investment risk

## Defined contribution pensions

- Employers contribute some amount in employees' accounts
- Employee chooses investment policy
- Pension payments are based on accumulated value of investment account over employment
- Employee accepts investment risk
- 401(k)/403(b) plans are DC pension plans

## Life Annuities

- Insurance against outliving your income
- Translate lump sum into income stream
  - DC proceeds
- Variable annuities (life insurer products)
  - Period of accumulation
  - You choose investments (mutual funds)
  - At retirement, withdraw or annuitize

## Miscellaneous Decisions: Mortgages

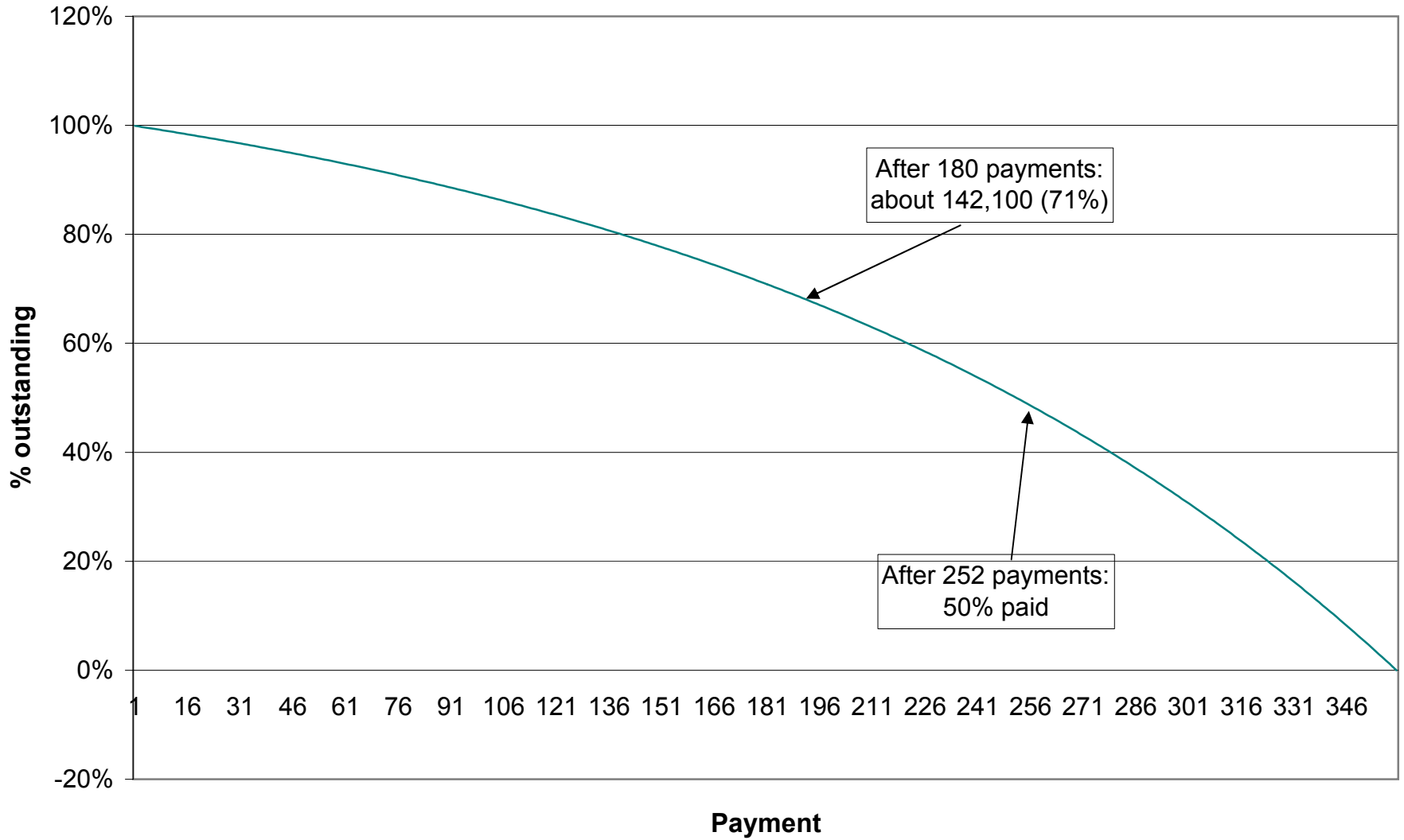
- Adjustable rate (ARM) vs. fixed rate
  - Usually lower rate initially for ARM, but with risk of increasing interest rates
  - How long will you be in your home?
- Discount points
  - Up front fee to “buy” a lower interest rate
- How much can you afford?
- Mortgage payments and balances

## Buying a Car

- Do your research first ([www.edmunds.com](http://www.edmunds.com))
- Negotiate car prices, not monthly payments
- Work up from invoice price (or lower)
- Leases
  - Originally, lower down payment
  - You pay for depreciation of car
  - Still negotiate the selling price

<i>Month</i>	<i>Outstanding Principal</i>	<i>Payment</i>	<i>6% Interest</i>	<i>Principal</i>	<i>Remaining Balance</i>
0					200,000.00
1	200,000.00	\$1,199.10	1,000.00	199.10	199,800.90
2	199,800.90	1,199.10	999.00	200.10	199,600.80
3	199,600.80	1,199.10	998.00	201.10	199,399.71
4	199,399.71	1,199.10	997.00	202.10	199,197.60
5	199,197.60	1,199.10	995.99	203.11	198,994.49
6	198,994.49	1,199.10	994.97	204.13	198,790.36
7	198,790.36	1,199.10	993.95	205.15	198,585.21
8	198,585.21	1,199.10	992.93	206.17	198,379.04
9	198,379.04	1,199.10	991.90	207.21	198,171.83
10	198,171.83	1,199.10	990.86	208.24	197,963.59
11	197,963.59	1,199.10	989.82	209.28	197,754.31
12	197,754.31	1,199.10	988.77	210.33	197,543.98
13	197,543.98	1,199.10	987.72	211.38	197,332.60
14	197,332.60	1,199.10	986.66	212.44	197,120.16
15	197,120.16	1,199.10	985.60	213.50	196,906.66
16	196,906.66	1,199.10	984.53	214.57	196,692.09
17	196,692.09	1,199.10	983.46	215.64	196,476.45
18	196,476.45	1,199.10	982.38	216.72	196,259.73
19	196,259.73	1,199.10	981.30	217.80	196,041.93
20	196,041.93	1,199.10	980.21	218.89	195,823.04

# Balance Outstanding



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Term\*:  months

Interest Rate\*:  %

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\* indicates a required field

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## Lease Example

Selling Price	25,000
<u>-Down payment</u>	<u>-2,000</u>
Capitalized cost	23,000
<u>-Residual value (3 yrs later)</u>	<u>-10,000</u>
Depreciation	13,000

## Estate Planning

- Helps make decisions when you can't
  - Administer and distribute your assets upon death (minimize tax exposure)
  - Make medical decisions
- With no plan, the state and federal govts determine who gets what for a fee
  - No one is too young, no estate is too small
  - Marital deduction and unified tax credit

## Estate Planning Areas

- Will – direct disposition of property
- Power of attorney – if incapacitated, gives agent responsibility of financial affairs
- Medical decision documents
  - Living will
  - Durable power of attorney
- Trusts – transfer property/income for the benefit of third parties

## Conclusions

- Establish written goals (be explicit)
  - Resolve conflicts between current wants and future needs
- Start early and review often
- [kahlgrim@ilstu.edu](mailto:kahlgrim@ilstu.edu)
- (309) 438-2727