Investing Guide

Making money passively

a Practical Guide
for the savvy investor

Bill Holliday, CFP
aiofinancial.com

AIO FINANCIAL PRESENTS

INVESTING GUIDE

HOW TO MAKE MONEY PASSIVELY

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I am very interested in hearing your thoughts. Please let me know if this book has been helpful or if you have any suggestions to make it better. I welcome any comments or questions.

You can email me bill@aiofinancial.com or leave a message on Twitter (twitter.com/aiofinancial) or Facebook (facebook.com/AioFinancial).

Thank you for your interest in this topic and I hope you find this helpful.

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1.0 Introduction

"Most investors want to do today what they should have done yesterday." Larry Summers

The purpose of this book is to be a practical guide to help make investing accessible to everyone.

We present investing strategies that include and go beyond low cost index investing.

This eBook is meant for the beginning and intermediate investor. I will explore a variety of investment options to help you make smart investment decisions.

2.0 About the Author

"Fail often so you can succeed sooner." Tom Kelley

Bill is a fee only financial advisor who works with individuals to meet their financial objectives.

Bill Holliday is a Certified Financial Planner (CFP) and a member of National Association of Professional Financial Advisers (NAPFA). He is a founder of the fee only financial planning firm AIO Financial (aiofinancial.com/) which specializes inSustainable, Responsible, Impact Investing (SRI).

Bill works with clients as a fee only financial advisor at AIO Financial. He provides comprehensive financial service for most of them, which includes: investment management, tax planning, retirement planning, insurance review, and estate planning. He works on an hourly basis for others.

Bill hosts the Impact Financial Planners podcast about SRI (impactfinancialplanners.com) to make SRI accessible for anyone. He contributes for AIO Financial blog (aiofinancial.com/blog) which focuses on comprehensive personal financial planning issues, such as: investing, retirement, taxes, estate plan, debt, and more.

In 2012, Bill formed a 501(c)(3) non-profit charity that supports economic development and migrants in northern Mexico called ProMex Group (www.promexgroup.org). He is the current volunteer director of ProMex Group. Bill gives talks about the impact of the project to interested groups, leads trips to visit projects in Nogales, Mexico. He is fluent in Spanish.

Bill lives in Tucson, Arizona but has clients throughout the US and travels regularly. His wife is from Caborca, Mexico, where they spend most holidays, and he has two daughters.

Bill Holliday, CFP

3.0 Investing Overview

"Behind every stock is a company. Find out what it's doing." Peter Lynch

There are many investment options – it is more important to understand what you own than to hurry to get some of every option.

There is no single investment strategy that fits everyone. Each person needs to evaluate their situations, risk tolerance, time horizon, assets, debt, income, and expenses to determine their best financial strategy. Your best financial choices may be:

- owning your primary residence
- investing in your own business
- paying down debt
- owning a rental property

For you, these may be where you start before investing anything in the stock and bond markets. This eBook will focus on market investing, for longer term investments with money after you have taken care of these other issues. I believe the other investments mentioned (debt, real estate, and your business) are great but I will be concentrating on creating a diversified investment plan with other investments.

It is important to evaluate your investing goals to determine the best type of investment. You need to know the time frame you have for the investments. The type of account you choose will mostly help with taxes now or in the future. Accounts such as IRAs and 401k plans give a tax break in the year you contribute to them and they grow tax free, but taxes are due when money comes out of these accounts. A Roth IRA does not give you any tax break when you contribute but there are no taxes due when money is taken out and investments grow tax free. 529 College Savings Plans and Coverdell ESAs offer tax advantages for college savings.

We will explore a variety of investments and strategies. Not all of these are appropriate for everyone. You will need to factor in the amount of time you want to dedicate to your investments. Mutual fund and Exchange Traded Fund (ETF) investing can be very passive. You may only rebalance your accounts two or three times per year. In contrast, options trading is more active and involves regular activity.

You will also need to factor in your tolerance for loss. Individual stocks can see large swings in values from week to week. Whereas, market linked CDs protect you from loss while providing market exposure to the gain.

Time horizon, when you need investment money to be available is another important factor that will influence the type of investment that will work best.

The large number of investment options allows investors to gain rapid and inexpensive exposure to various equity and fixed income market segments, as well as to sectors and industries

We recommend diversification for smoother investment returns. There are many stories of investors with too much invested in a particular stock or other investment. We recommend having investments in bonds, US stocks, foreign stocks and alternative investments.

There are two main classes of investments - fixed investments and equity investments. Fixed investments are lending, such as:

- CDs (lending to banks)
- Bonds (lending to companies)
- Treasuries (lending to governments)

Fixed investments pay an agreed upon interest and if the entity is in business at maturity it returns your investment. In general, the upside is limited to the promised interest. Bond funds (mutual funds or ETFs) will fluctuate based on what the interest rate does. If the interest rate goes up the value of the bond fund will go down. The longer the length of the holdings of the fund, the more the interest rates affect the value.

Equities generally consist of owning stocks. Stocks generate money by paying dividends and by changing in value. There is no upside limit nor downside limit.

4.0 Exchange Traded Funds

"Don't look for the needle in the haystack. Just buy the haystack!" -John C. Bogle

An Exchange Traded Fund (ETF) is a basket of stocks and/or bonds that follow an index and have very low expenses

We very often use exchange-traded fund (ETF) as the basis for portfolios. They have very low expenses, are tax efficient, and give broad exposure in many distinct sectors (which makes rebalancing easy).

An ETF is a basket of securities created to track as closely as possible a particular market index, such as the Standard & Poor's 500 (S&P 500) Index or the Dow Jones Industrial Average (many stocks in large companies). They're similar to mutual funds in that they represent investments in the same types of securities, but they generally have lower fees and can be bought and sold with more pricing immediacy than mutual funds. Within ETFs, there is infrequent buying and selling; hence, they do not generate capital gains (which is a tax advantage). A capital gain is the difference between the purchase and the selling price. That gain is taxable (if they are in taxable accounts).

An expense ratio (further discussed in Section 14.2) is expressed as a percentage. It is the cost for operating a mutual fund and ETF. These costs include: the manager's fees, administrative costs, compliance, trading costs, and 12b-1 fees (sales fees). The expense ratio is a percentage that directly lowers the return to a fund's investors. ETFs generally have lower expense ratios because they are not being actively managed. This percentage of savings, in the long term, will produce significantly better overall returns.

An efficient market is when the price of a stock equals its value based on what is publically know about each company. Without any insider information, there are no underpriced nor overpriced stocks. Each price is valued based on expectation of earnings and growth. In an efficient market, choosing individual stocks will not yield a better overall return. Most fund managers, who dedicate their careers to analyzing and visiting companies to select stock, cannot beat an index. They cannot produce better returns then a diversified index portfolio. Hence, it can be argued that you are better off just selecting a variety of low expense index funds or exchange traded funds (ETF) over individual stock picking.

Warren Buffett made a $1 million, 10 year wager that he could get a better return on his simple investment strategy. Warren Buffett invested in an S&P 500 index and a hedge fund manager put money in a sample of 5 hedge funds. Hedge funds (which we will discuss in Section 8.0) are invested various types of complicated investments. To date (8 years into the bet), Warren Buffett's simple stock investment is up 64% while the hedge funds are up just 20%.

Since their launch in the early 1990s, there are now hundreds of ETFs available for investors to buy. Investors have embraced ETFs as a more efficient alternative to a mutual fund invested in the same securities.

How are ETFs created? An ETF is created by large investors who buy stocks aligning with the shares in a particular index, and then they exchange those shares – in baskets as large as 50,000 shares – for shares in the ETF. The redemption process works the same way in reverse, the investors exchange shares of the ETF for baskets of the underlying stocks.

Are all ETFs based on indexes? Yes. Indexes, like the S&P 500 or the Hang Seng Index (the primary stock index of the Hong Kong Stock Exchange), are a listing of stocks reflecting the activity of a particular investment sector on a stock exchange. ETFs are available that track stocks in different countries, regions, industries, stock styles, and sizes of companies.

How are ETFs traded? Unlike mutual funds, which have their prices set at the end of the trading day, ETFs are priced and traded every moment of the trading day. That's generally more meaningful to institutional investors who buy and sell constantly than long-term investors who buy and hold. Furthermore, unlike mutual funds, ETFs can be bought on margin or sold short.

Why might ETFs be more tax-efficient? Generally, ETFs generate fewer capital gains due to the unique creation and redemption process as well as the usually lower turnover of securities that comprise their underlying portfolios. Investors can better control the timing of the tax treatment of ETFs relative to mutual funds. Most importantly — by holding an ETF for at least one year and a day, capital gains will be treated as long-term capital gains, which are currently taxed at a federal rate of 15 percent (5 percent for low tax bracket investors).

Are there other advantages? Unlike traditional mutual funds, which must disclose their holdings quarterly, ETF holdings are fully transparent, and investors know what holdings are in the ETF at any given time. Each ETF also has a NAV tracking symbol for even more precise analysis. This helps keep ETFs trading within pennies of their intraday NAV.

What about fees? Shares of index-based ETFs may have even lower annual expenses than similar index mutual funds, which, in turn, tend to be lower than those of actively managed mutual funds. ETFs must be bought and sold through brokers, and those trades may involve transaction costs. Many brokerage firms (like Schwab, Vanguard, TD Ameritrade, etc) offer many ETFs with no transaction fee.

What's the downside? Unlike regular mutual funds, ETFs do not necessarily trade at the net asset values of their underlying holdings. Instead, the market price of an ETF is determined by supply and demand for the ETF shares alone. For well traded indexes and most ETFs, the value closely reflects the value of the underlying shares.

One site that is useful for evaluating ETFs is www.xtf.com. They compare ETFs and show how well they follow the index.

5.0 Mutual Funds

"If you just work on stuff that you like and you're passionate about, you don't have to have a master plan with how things will play out." Mark Zuckerberg

Index mutual funds have lower expenses than managed funds but not as low as ETFs.

A mutual fund is an investment vehicle that is made up of a pool of investments collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments and similar assets.

There are index mutual funds which, like ETFs, do not have a manager picking stocks. They follow an index and have lower expense ratios than managed funds, although not as low as ETFs. Managed mutual funds have a manager and are trying to outperform the market. Many investment strategies are available with mutual funds, but in the long run, consistently beating the market has been shown to be very difficult.

Be aware of fees and expenses (Section 14.1) and be careful how you evaluate the performance (Section 14.3).

6.0 Individual Stocks

"If you don't study any companies, you have the same success buying stocks as you do in a poker game if you bet without looking at your cards." Peter Lynch

Constructing a diversified portfolio out of individual stocks is only cost effective with stock portfolios larger than $500,000.

You can construct a diversified stock portfolio with 30 or so stocks and have a competitive portfolio. Many investors combine strategies. They have a majority of their portfolio in index investments and put a small amount in individual stocks that they like.

We recommend buying stocks with good fundamentals and holding them. We do not recommend reacting to the news of the day. By the time news about stocks is public the price has already adjusted.

Many discount brokerage firms (such as Schwab, Vanguard, Fidelity) do not charge a transaction fee to buy or sell stock.

In selecting individual stocks, there are several considerations. First, be sure to construct a diversified portfolio. It is important to have stocks in different sectors, geographic regions and size of companies. Basic sectors include:

- Consumer
- Energy
- Financials
- Healthcare
- Industrials
- Infrastructure
- Natural Resources
- Technology
- Basic Material
- Telecom
- Utilities

Key statistics
There are several statistics that are worth looking at when evaluating individual stocks.

- The price-to-book (P/B) ratio represents the value of the company if it is torn up and sold today.

- Price to earnings (P/E) ratio is possibly the most scrutinized of all the ratios. If sudden increases in a stock's price are the sizzle, then the P/E ratio is the steak.

- The price to earnings growth (PEG) ratio. Instead of merely looking at the price and earnings, the PEG ratio incorporates the historical growth rate of the company's earnings.

The dividend yield shows how much of a payday you're getting for your money. By dividing the stock's annual dividend by the stock's price, you get a percentage. You can think of that percentage as the interest on your money, with the additional chance at growth through the appreciation of the stock.

By combining these methods of valuation, you can get a better view of a stock's worth. Any one of these can be influenced by creative accounting - as can more complex ratios like cash flow. Do not pay too much attention to any one indicator. Many should be looked at together to form an opinion on a company.

As stated above, it is very difficult to outperform a diversified index portfolio.

Fundamental vs Technical Analysis
These are the two basic strategies for evaluating stock. *Fundamental analysis* is evaluating the operations of the company. Looking at the balance sheet, industrial condition, earning, management of the company, sales, debt, news about the company, etc. *Technical analysis* is evaluating the movement of the share price and trading volume. Technical analysis does not involve evaluating the company, just the stock price.

Of course, some of both methods can be used together as well.

8 Sites to get information about stocks and markets

- http://www.morningstar.com/
- http://seekingalpha.com
- http://www.stockpickr.com/
- http://www.fool.com/
- http://www.thestreet.com/
- http://finance.yahoo.com/
- https://www.google.com/finance
- https://ycharts.com/

5 Free online stock screeners

- http://www.zacks.com/screening/stock-screener - The screener has the most breadth, with well over 100 fundamental metrics as well as analyst rating data, earnings estimate data, and earnings surprise data. The screener is also the most versatile as you can enter in whatever values you want instead of selecting from a drop down menu.

- http://www.finviz.com/screener.ashx - You can screen U.S. stocks using over 60 fundamental and technical metrics. Fundamental investors may find the stock screen lacking in comparison to Zacks' but if your process uses both fundamental and technical analysis then Finviz is a good resource.

- https://www.google.com/finance#stockscreener - In terms of breadth, Google Finance is top in that it allows you to screen across 37 different countries based on 56 fundamental metrics. For U.S. centric investors, Zacks' stock screener is still a better choice.

- http://caps.fool.com/Screener.aspx - Only has 30 fundamental metrics, but it has an additional set of metrics that all the others lack, Motley Fool's CAPS ratings for stocks. If you are unfamiliar, CAPS is the Fool's free investing community which aggregates the intelligence of investors to rate stocks from one to five. Players on Motley Fool CAPS make predictions on whether stocks will outperform or underperform the market. Motley Fool compiles that data into star rankings which have been shown to outperform the market.

- http://www.unclestock.com/ - It is by far the most versatile of the free stock screeners, with well over 200 different metrics you can screen by. It also has a large amount of depth in that you can screen across 13 different countries.

I enjoy researching individual companies and investing in individual stocks for clients; however, in my experience, stock picking does not consistently outperform investing in a diversified portfolio in the long run.

7.0 Individual Bonds

“Behold the turtle, he makes progress only when he sticks his neck out.” Bruce Levin

Bonds are loans to companies, treasuries are loans to governments, and CDs are loans to banks

Bonds are loans made to a company for a fixed period of time. The longer the duration of the bond (loan), the higher the interest the bond will pay (coupon). The lower the quality of the bond (rating), the higher the interest they will pay.

The risk to buying an individual bond is that if the company fails, you may not receive all of your investment back.
You can hedge your risk by buying a bond fund or ETF, many bonds bundled together. With a fund if one bond fails, it will have a smaller impact on the investment. Bond funds (and bond ETFs) have an average rating and duration (based on the underlying holdings).

As long as you hold your bond (or treasury or CD) to maturity and the organization is still operating, you receive your investment back along with the agreed upon interest.

The risk with a bond fund is that their value can change. The underlying bonds still pay interest but the value is evaluated each day and can move. If interest rates move up during the time you hold the fund, the value of the fund goes down. If interest rates move down, the value of the bond fund goes up.

Often we use CD ladders for a portion of a portfolio for money that is needed within 3 to 5 years. A CD or bond ladder is a series of CDs (or bonds) with staggered maturity dates. For example, you may have a CD maturing every 6 months for the next 5 years to cover expenses 6 months at a time. If some portion of the principle from the CD is not needed, a CD can be purchased with a maturity at the end of the ladder (5 years out for our example).

8.0 Alternative Mutual Funds

“If everything seems under control, you’re just not going fast enough.” –Mario Andretti

Alternative mutual funds are not a must for any portfolio but they are a liquid way to get a non-correlated exposure to various strategies.

Alternative investments seek to perform well when bond and stock markets may not be doing well. They are not correlated with other markets. That can give your portfolio stability and can improve returns. The expenses (expense ratio) is higher than using a ETF or index mutual fund because of the management and selection process. In addition, some of these investments are better suited for a tax deferred account (such as an IRA or Roth IRA). Some of the funds generate more capital gains each year because of active trading.

8.1 Long/Short Funds

An equity long-short strategy is an investing strategy, used primarily by hedge funds, that involves taking long positions in stocks that are expected to increase in value and short positions in stocks that are expected to decrease in value. 361 Global Long/Short Equity Fund (AGAQX) is an example of a long/short mutual fund. The goal for AGAQX is to perform as well as the stock market on the up side and have half of the losses. They are less volatile than the stock market.

AGAQX assumes the stocks with low volatility in each sector outperform stocks with higher volatility. AGAQX holds a long position (buys) stocks with low volatility and shorts (or bets against) stocks with high volatility.

8.2 Multi-Strategy Alternative Funds

These funds offer investors exposure to several different alternative investment tactics. Funds in this category have a majority of their assets exposed to alternative strategies. An investor's exposure to different tactics may change slightly over time in response to market movements. Funds in this category include both funds with static allocations to alternative strategies and funds tactically allocating among alternative strategies and asset classes. Two examples of multi-strategy funds are: 1290 Multi-Alternative Strategies Fund (TNMAX) and Grant Park Multi Alternative Strategies Fund (GPANX).

Here are some of the complicated alternative strategies used:

- Long/Short
- Dynamic Commodities Strategy, invests in commodities market and may take long or short positions.
- Upside Capture Strategy, maintains a permanent long exposure to a basket of investments across multiple asset classes
- Unconstrained Interest Rate Strategy, focuses on financial instruments of durations of three years or less and may take long or short positions.
- Event-Driven Strategies (i.e., merger arbitrage)
- Nontraditional Bonds, strategic income, macro-driven, credit long/short, and unconstrained
- Managed Futures, trading in the futures markets such as commodities.

9.0 Structured Products

"Everyone has the brainpower to make money in stocks. Not everyone has the stomach. If you are susceptible to selling everything in a panic, you ought to avoid stocks and mutual funds altogether." Peter Lynch

Structured products can protect your investment from loss and increase your gains.

Structured product, also known as a market-linked investment, is a pre-packaged investment strategy designed to give customized risk-return. This is accomplished by taking a traditional security, such as an investment-grade bond or a CD, and replacing the interest payment with a payoff based on the performance of one or more underlying assets.

These products were available, until recently, only to institutional investors or with very high minimums. They are excellent asset management tools. They allow an investor market exposure with downside protection or leveraged exposure to the market.

Most structured investments are for a fixed term (like a CD, with varying levels of protection from loss, and exposure to the return of an index).

Three basic structured investment categories are: principal protected, buffered return enhanced notes and return enhanced notes.

9.1 Market Linked

Market-Linked CDs are a type of principal protected notes. They offer 100% protection of your investment with 4 to 7 year maturity date. They are linked to an index such as the S&P 500, Dow Jones, Nikkei 225, Eurostoxx 50, currency indices, commodity indices …

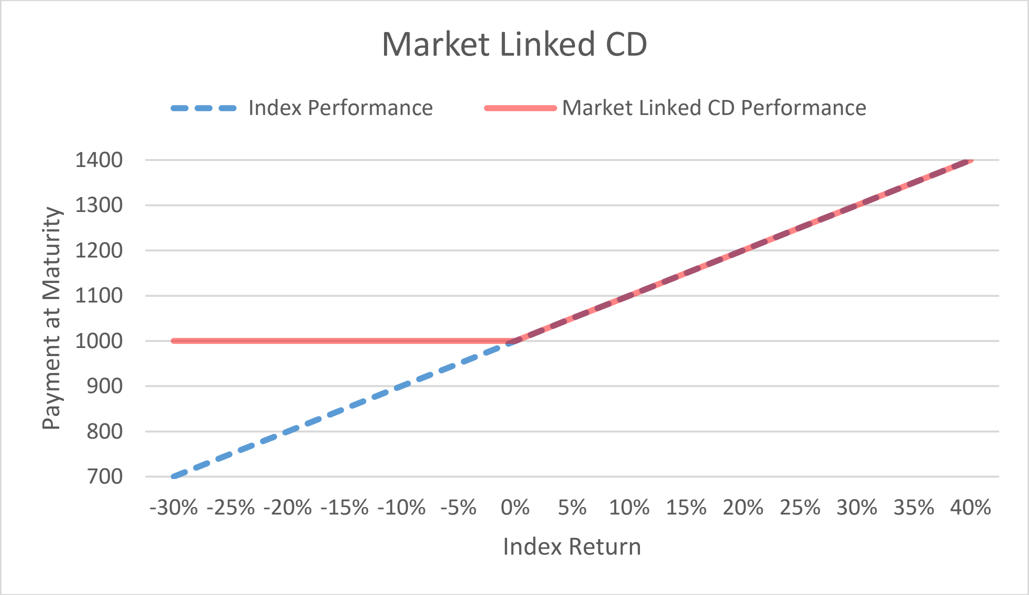
If at maturity the underlying index is up (higher than when it was purchased), the investor receives 100% of the principal plus that gain.

If the market is down at maturity, the investor receives 100% of the principal.

For example, if you purchase $1,000 of a Market-Linked CD and the underlying index is the S&P 500 and in 7 years the S&P 500 is 70% higher than it was when you purchased the Market-Linked CD, then you would receive $1,700. If the S&P 500 lost 40% during those 7 years, you would receive $1,000 at maturity.

No interest or dividends are paid. In the case of Market-Linked CDs, the principal is protected by a CD that is FDIC insured.

If the investor would like to sell the note before maturity, there is a secondary market (you can sell them before maturity) but due to the highly customized nature of the investment the market is limited. Structured notes are more popular in Europe but are fairly new in the US. A secondary market may develop over time. So be ready to hold the note until maturity.



9.2 Buffered Return Enhanced Notes

Buffered Return Enhanced Notes offer participation in an index with a varying amount of downside protection.

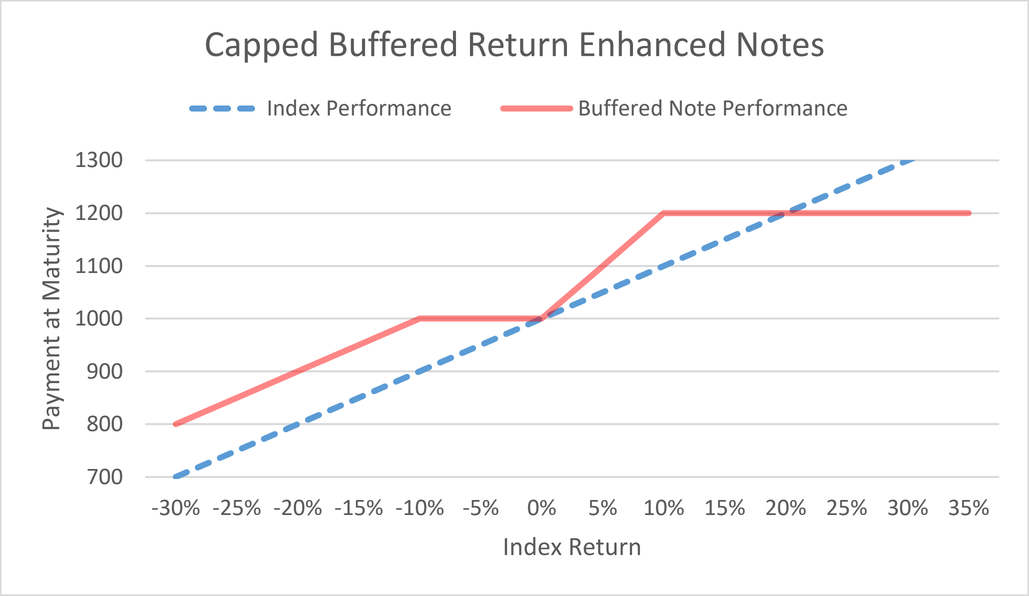
Another option is a buffered note. This is a 2 year capped buffered note linked to the S&P 500. Currently (1/2016), the down side is protected by 10%. So if the S&P 500 is down by 10% in 2 years, you get your money back. If it's down by more (like 15%) you lose 10% less than the fund (5% if the S&P is down 15%). On the upside, the return is doubled up to a cap. Currently (1/2016) the cap is 18%. So if the index is up by 9% or less, the return is doubled. Note that the standard deviation for the S&P 500 over the past two years is about 10%; hence, 67% of the time the S&P 500 will be in the range of the buffer or increased return.

No interest or dividends are paid. The return may be uncapped. As with the Market-Linked CDs, Buffered Return Notes are linked to various indices.

The standard deviation of the S&P 500 over the last two years is about 10% with an average return of about 5%. So there is about a 67% chance that return will be between 15% and -5% return. Hence, there is a good likelihood that in two years an investor will be completely protected from the downside or get a boost on the upside. But note that about 1/3 of the time the could be some loss (although 10% less than just holding the index) or the return will be more that the cap.

These notes are not FDIC insured. Their ability to pay depends on the credit of the bank issuing them, such as: Wells Fargo, JP Morgan, HSBC, and others.

The same option is available linking to small US stock index (Russell 2000), developed foreign stock index, emerging market index, and many others.



Another option includes a 4 year buffered note that is not capped. The downside buffer currently (1/2016) is 20% and the upside is uncapped 1.1 times the gain in 4 years.

9.3 Enhanced Return CDs

Enhanced return CDs are FDIC insured CDs that have a variable interest based on the performance of a group of underlying stock. The current (2/2016) offerings are for five year CDs. They evaluate five stocks (for example: Verizon, IBM, Cisco, Merck and Procter & Gamble). If all five have a share price that is higher than at the time of purchase, you get the higher interest for that year. Otherwise, you get the lower interest. This is evaluated five times during the life of the CD. There are three options (shown below) with A providing a higher minimum but a lower maximum and C giving the lowest minimum but highest maximum.

CD	Investor Preference		Potential Interest Rate
	Minimum Annual Interest / Performance Based Annual Interest		Minimum Annual Interest or Combined Return
A	0.75%	2.50%	0.75% or 3.25%
B	0.50%	4.00%	0.50% or 4.50%
C	0.25%	5.50%	0.25% or 5.75%

10.0 Illiquid Alternative Investments

"In investing, what is comfortable is rarely profitable." Robert Arnott

Alternative investments can give you exposure to assets that are uncorrelated with stock and bond markets

Alternative investments are investments in asset classes other than stocks, bonds, and cash. The term is a relatively loose one and includes tangible assets such as precious metals, art, wine, antiques, coins, real estate, commodities, etc. The returns of alternative investments are generally not correlated with the returns of stocks and bonds.

In this section, I will focus on three types of illiquid, not publically traded investments. The advantage of not publically traded investments for a portion of a portfolio is that they are not correlated much at all with the stock and bond market. Adding uncorrelated assets to a portfolio (investments that do not move together) adds stability without sacrificing return.

The disadvantage is that there is not specific date when you will get your investment back. Investments may project that in four to six years you will receive your investment back but it could be longer. For many illiquid alternative investments there is approximately a 2 year period to raise capital, a 2 year period to develop a history and run their operation, and a 2 year period to find a buyer and have a liquidation event. The time of the final liquidation is when an investors get their investment back. Normally, interest payments are made during the time you hold the investments.

Many illiquid alternatives provide a tax benefit. Many are taxed at the capital gains rate instead of the income tax rate (like interest and dividends).

Liquidity is a comforting characteristic in an investment (because you can get your money out at any time), but there is a lot of research finding that illiquidity may help produce better overall returns. Because the demand for illiquid investments is so low, they often have an excess return premium. They have served many investors well, including the David Swensen of Yale Endowment.

Another disadvantage is that many illiquid alternatives issue a K1 instead of at 1099. A K1 can be delivered later in the year and many cost a bit more for tax preparation.

Be very careful of fees for alternative investments. Investing in alternatives through a commission broker (commission or fee based) can take a large portion of your return. Many commission brokers receive over 7% for placing clients in alternative investments. Some investments pay an ongoing percentage (some over 4% per year) to the selling brokerage firm.

Also be aware of any other fees. Many discount brokerage firms (like Schwab, TD Ameritrade, Scottrade) offer alternative investments to be held in their accounts, but many times there is a fee. Consider this fee, depending on the amount you are investing, it may make more sense to invest directly with the alternative investment company.

Here are three types of alternative investments.

10.1 Energy

There are many energy illiquid investments. Many are in in the oil and other fossil fuel industries. In the past few years, renewable energy alternative investments have become available. Some acquire renewable energy power plants and sell the energy to cities, utilities, and companies through long term agreements.

You may need to be an accredited investor (have at least $1,000,000 of investable capital or earn at least $200,000 each year for at least two years) or meet the accredited light criteria (have at least $250,000 of investable capital or earn at least $70,000 each year for at least two years).

10.2 Real Estate

Real estate is another very common illiquid investment. One example of a real estate illiquid untraded investment. The expected term is 4 to 6 years depending on when you invest but there is no guarantee that you will receive your money at that time. They generally allow 2 years to raise capital, 2 years to run their operations and 2 years to liquidate.

You may need to be an accredited investor or meet the accredited light criteria.

10.3 Other

There are many other illiquid alternatives. Here are three.

There are business development companies (BDC) that primarily invest in floating rate, senior secured loans of private U.S. middle market companies. These can be liquidated on a quarterly basis, there is no maturity time.

Some companies offer investments in the purchase of business necessary equipment that they rent to secure companies or governments for a period of about 5 years (which covers the cost of the investment). At the end of the term, the equipment is sold, the loan is extended or the loan is sold. These can be domestic and/or international.

There are many companies that offer a one year term First Position Commercial Mortgage (FPCM). They only lend up to about 70% of the value of the property. There are investment minimums and the duration is usually one year.

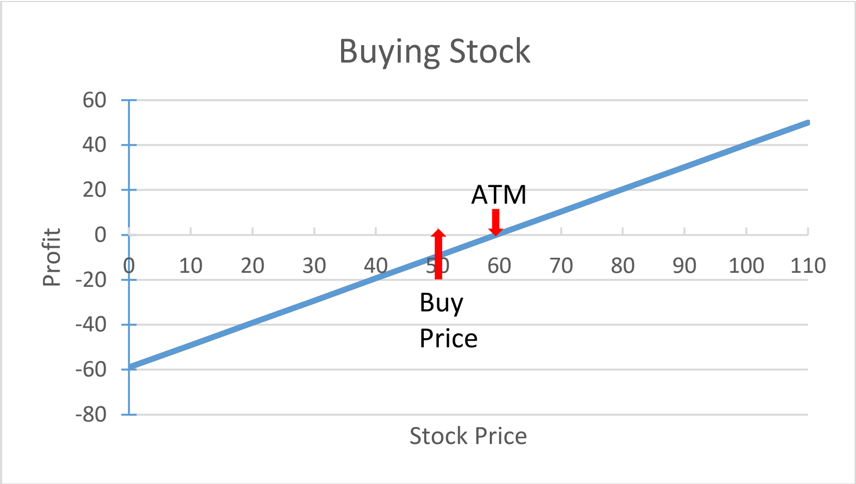
11.0 Options Trading

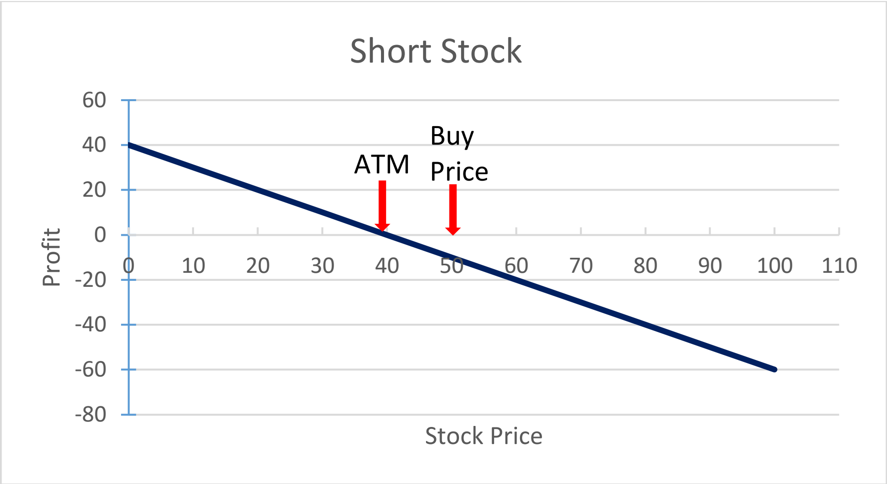
Options are more advanced and it is not necessary to use them. This is meant just so you know the basics of what they are.

Investing in options provides you with the opportunity to make money when the market is going up, down, or staying even. You can buy or sell options. With options, you need to evaluate the risks vs the rewards of each trade and, over time, the odds will provide a reasonable income.

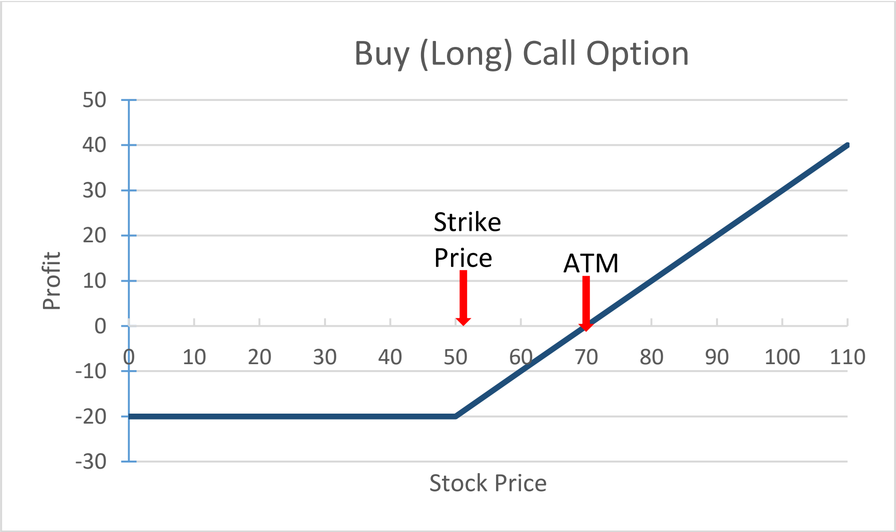
The following graphs show the basic option investments. The first graph shows what happens if you buy a stock. As the price moves up above the transaction fee you have a profit and as the stock price goes down you have a loss. ATM means "At The Money," the point where you break even and do not lose or gain money.

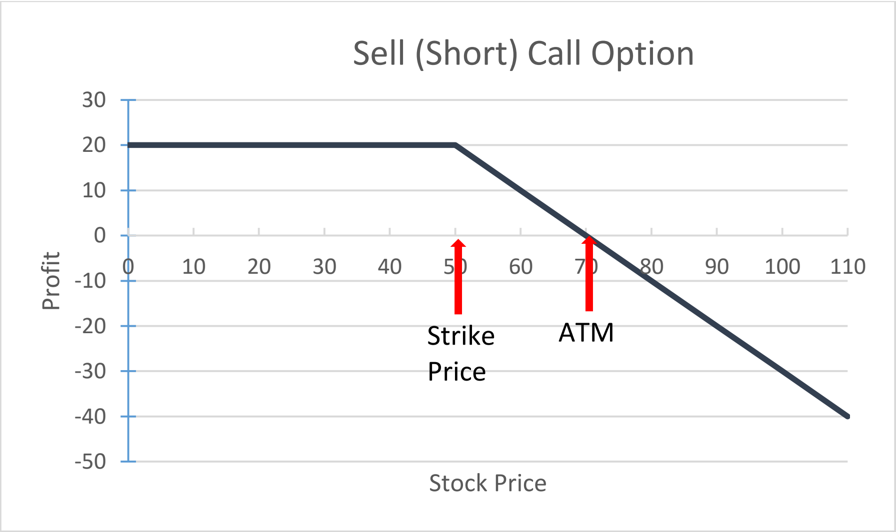
Shorting a stock involves investing against the stock where you make a gain when the stock loses value.

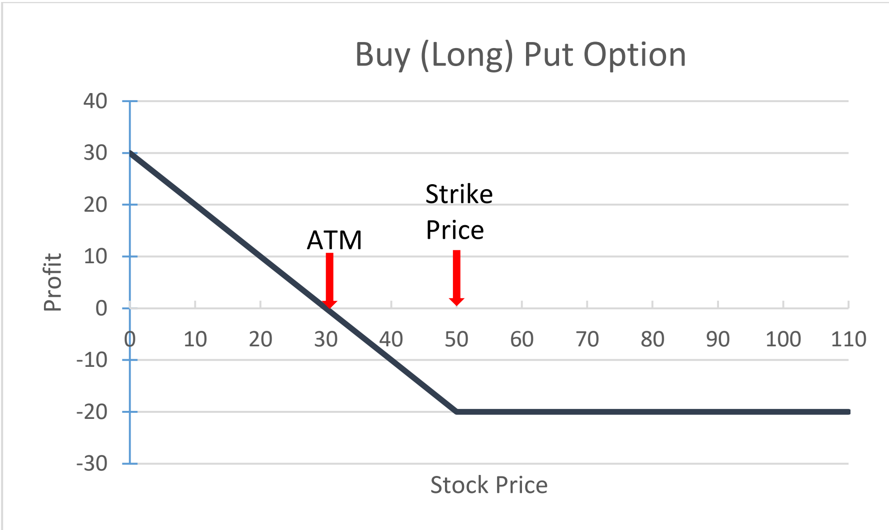


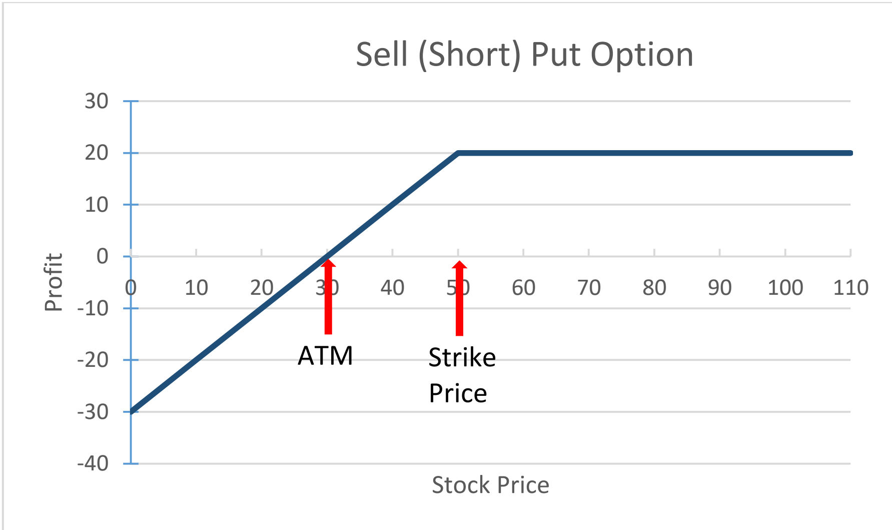


The following are the four single options: buying and selling call options, buying and selling put options.

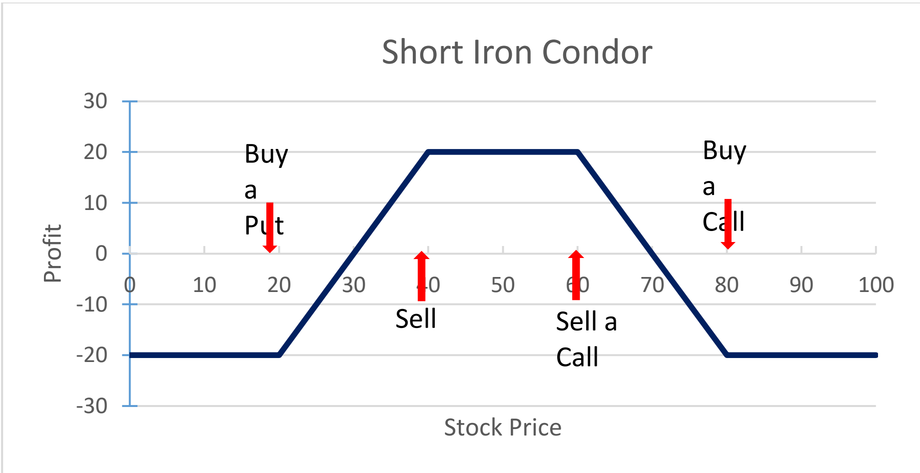


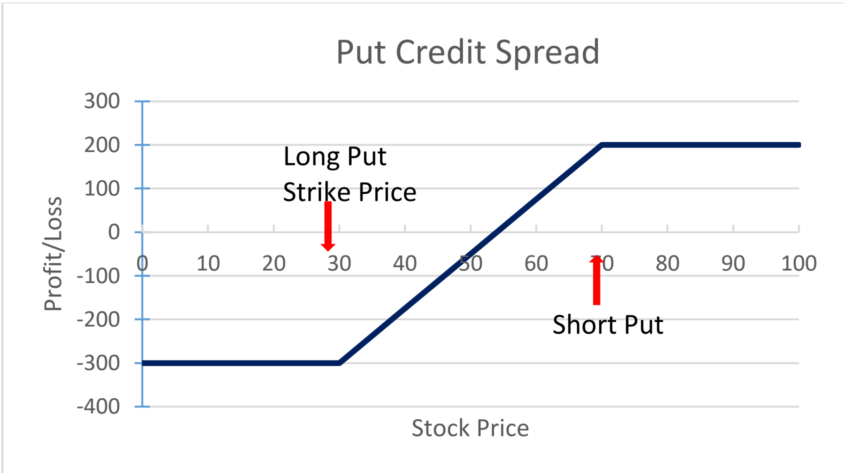






The basic options (buying and selling puts and calls) can be combined to limit losses or make gains when there is no stock price movement.





I have not seen evidence that, long term, option trading produces better returns than holding a diversified portfolio. I'm sure there are investors who have done great with options, I just do not see where the long term advantage can be found.

12.0 Steps to Investing

It is important to evaluate when you will need this investment money, your risk tolerance, and generate an investment policy

It is important to understand your financial situation before deciding what assets to purchase. You should have an understanding of when you will need this money, consider tax implications, risk tolerance, and investment policy.

12.1 Liquidity Needs

A prudent reserve of about 3-6 months of living expenses is recommended. It should be invested in very short term non-volatile holdings such as money market or a short term bond fund. The idea is to have money available if something were to happen so you would not need to use high interest credit cards. For example, if you were in an accident and needed to cover expenses without income for a while or if you need major home repair, the prudent reserve is there to cover deductibles and other needs. For some people with adequate insurance and low deductibles, this can be on the lower end of the range. For many self-employed people without significant insurance, it may be advisable to exceed the recommended range. You should review your insurance coverage to determine how much reserve is needed and where it should be held.

You should have an understanding of your long term spending plan (even a rough idea). A different investment model (or balance of assets) for each time period that investments will be used. For funds that are needed within the next two years, a very conservative portfolio may be recommended. For investments needed between two and five years, a moderate portfolio may be used. More aggressive portfolios may be used for investments not needed for more than five years.

12.2 Risk Tolerance

"Be Fearful When Others Are Greedy and Greedy When Others Are Fearful" - Warren Buffett

It is important to know how much volatility you can handle. What you do not want to happen is that when the market goes down (which it inevitably will) you get nervous and sell your holdings at a low point and when the market is high, you get excited and buy into an inflated market.

A study was conducted (DALBAR) that calculated what the average investor actually earned over the past 20 years. If the average investor started with $100,000 in an investment account 20 years ago and earned what the S&P 500 earned (7.8%), the account value would have been $1,043,427 (this assumes no taxes or fees). The average investor earned only 3.5%/year over that time period or $479,744 in total (no taxes or fees). One problematic tendency of the average investor is that they tend to buy high and sell low.

The following are some example risk tolerance questions. The goal is to get you to start thinking about how much risk you can comfortably take. Be as honest as possible. It is not a problem if you do not want much exposure to risk. This is an important step in determining what type of portfolio will best meet your needs:

1. When do you expect to begin withdrawing money from this investment account?
   Immediately (0 pts) 1-5 years (3 pts) 6-10 years (6 pts) >11 years (8 pts) only as required (10 pts)

2. How long do you expect withdrawals to last?
   <1 year (0 pts) 1-5 years (3 pts) 6-10 years (6 pts) >11 years (8 pts) over lifetime (10 pts)

3. I will stay with my investment plan despite significant short-term losses in the value of my account if it will increase the likelihood of achieving higher long-term investment gains.
   Strongly Disagree (0 pts) Disagree (3 pts) Agree (7 pts) Strongly Agree (10 pts)

4. Choose the most appropriate statement for you.
   I want investments that provide consistent, but most likely lower returns year-to-year. I want a low level of risk. (0 pts)
   I don't mind periodic fluctuations in the value of my investments, but I would prefer to avoid investments that could generate big losses over time. (5 pts)
   I would accept investments that frequently lose value in exchange for a chance to earn higher average returns over time. (10 pts)

5. Choose the most appropriate statement for you.
   I am not comfortable with losses. I would rather earn lower returns than lose money. (0 pts)
   I am willing to accept lower returns in order to keep my investments stable. (3 pts)
   I am fine with middle-of-the-road returns because I would prefer not to see my investments decline too often. (5 pts)
   I can handle declines in my investments a few times each year. (7 pts)
   I am not concerned with frequent and sometimes large market drops. (10 pts)

6. During market declines, I tend to sell portions of my riskier assets and invest the money in safer assets.
   Strongly Agree (0 pts) Agree (3 pts) Disagree (7 pts) Strongly Disagree (10 pts)

For this example set of questions, add up your points to determine what type of portfolio is appropriate for you. Below are simplified categories.

- Low Risk 0-20
- Moderate Risk 20-40
- High Risk 40-60

Based on your timing of liquidity needs and your risk tolerance, you can start to develop an asset allocation that meets your needs.

12.3 Diversification

"If you have trouble imagining a 20% loss in the stock market, you shouldn't be in stocks." John Bogle

I recommend establishing an investment policy. By investment policy I mean establish target percentages that you want to have in each of the major asset classes. The goal is to have a diversified portfolio and to have a target that you can rebalance to.

Diversification is not a tool to boost performance rather it is used to reduce risk. By picking a variety of groups of investments, you can limit your losses and reduce the fluctuations of investment returns without sacrificing too much in potential gain.

Diversification looks at picking asset classes that are not perfectly correlated. Correlation is a measure of how much the returns of two investments move together, up or down. When you put assets that have low correlations together in a portfolio, you may be able to get more return while taking on the same level of risk, or the same returns with less risk.

A diversified portfolio should be diversified *between* asset classes and *within* asset classes. Another important aspect of building a well-diversified portfolio is that you try to stay diversified within each type of investment. For example, within US stocks, to be diversified you should have stock of companies have different sizes and represent a variety of industries.

Rebalancing is bringing your portfolio back to your original asset allocation mix. This is necessary because over time some of your investments may become out of alignment with your investment goals. You'll find that some of your investments will grow faster than others. By rebalancing, you'll ensure that your portfolio does not overemphasize one or more asset categories, and you'll return your portfolio to a comfortable level of risk.

Shifting money away from an asset category when it is doing well in favor an asset category that is doing poorly may not be easy, but it can be a wise move. By cutting back on the current "winners" and adding more of the current so-called "losers," rebalancing forces you to buy low and sell high.

The following are three examples of investment policy distributions.

Example Asset Allocations for Various Risk Tolerances and Time Horizons

Broad Type of Asset	Asset Class	Example Asset Allocations		
		1. Low Risk, Short Time Horizon	2. Moderate Risk, Mid Time Horizon	3. High Risk, Long Time Horizon
Fixed	Money Market and Hold to Maturity Holdings (US Treasuries, CDs, Individual Bonds, Community Investment Notes, Structured Products)	40%	25%	10%
	Bond Funds (short, intermediate, inflation protected, long, high yield, foreign)	40%	25%	10%
Equities Stock	US Stock Funds (Large Cap, Mid Cap, Small Cap, Value, Core and Growth)	15%	35%	50%
	International Stocks (Developed and Emerging Markets)	5%	15%	25%
Alternative	Alternative Investment	0%	0%	5%

13.0 Evaluating Investments

"If I'd only followed CNBC's advice, I'd have a million dollars today. Provided I'd started with a hundred million dollars." John Stewart

13.1 No Load Funds

Be aware of how much you are paying in fees and minimize them as much as possible.

If you are working with a commission or fee-based financial advisor or a broker, you typically pay a sales charge or commission when you buy and/or sell mutual funds. The charge goes to the advisor for selling you the fund. These fees are called loads. In addition, a load fund usually has a *12b-1 fee* that is paid on an ongoing basis to the advisor for keeping their clients in these funds. The 12b-1 fee is considered an operational expense and is included in a fund's expense ratio. It is generally between 0.25-1% of a fund's net assets. The fee gets its name from a section in the Investment Company Act of 1940.

There are five main mutual fund classes:

A Class Shares – normally have a front-end sales charge paid to the advisor/broker at the time of the initial purchase. This class has the lowest 12b-1 ongoing charge. Front-end loads reduce the amount of your investment. For example, if you have $10,000 to invest in a mutual fund with a 5% front-end load. The $500 sales load you must pay comes off the top and goes to the broker (and the broker's company) who sold you the fund, and the remaining $9,500 will be invested in the fund. The Maximum sales load is 8 1/2%.

B Class Shares - have back-end sales charges paid when selling the shares within a specified number of years. The ongoing 12b-1 fee is larger than A-shares. Back-end loads start with a fee about 5 to 6 percent, which incrementally discounts for each year that the investors own the fund's shares. The rate at which the fee declines is disclosed in the prospectus. B shares have higher annual expense charges. Hence, even though the back-end load decreases with them, the investor is paying a higher annual fee (reducing their investment return) each year.

C Class Shares - do not have a front-end or back-end fees. However, Class C shares have the highest 12b-1 ongoing expense charges – this directly reduces the return you receive on your investments. The expense ratio for C Class Share funds can be over 2%. That's 2% per year coming out of your earnings.

No Load Funds – no load funds do not have any sales charge when buying or selling and there is no ongoing 12b-1 expense.

I Class Shares – have the lowest expense ratios, about 0.5% lower than No Load Funds. They are usually only available to large (institutional) investors with minimum investment amounts of $25,000 or more. There is often a transaction fee of $20 or $50 for buying and selling. Smaller investors can gain access to the institutional class shares through employer sponsored retirement plans (401k, 403b), through some financial advisors, or in some separately managed accounts.

At AIO Financial, we use No Load Funds for small buys and sells (under $10,000), to rebalance accounts. We use Institutional Shares for larger purchases (over $10,000). Generally, we annually move No Load Funds to Institutional Shares each quarter, if the amounts are large enough. You can move from No Load Funds to Institutional Shares without occurring any capital gains by following the instructions of your brokerage house.

In addition to loads, there may be transaction fees. When you buy or sell a stock or ETF you generally pay a fee. Currently, at many discount brokerage houses (like Charles Schwab, Vanguard, Fidelity), there are no transaction fees. If you use a broker, fees to buy and sell stocks and ETFs could easily exceed $200 per trade.

Brokerage houses have a list of transaction free mutual funds. If you do not use that list there is generally a trading cost of up to $50 per trade. This can be significant.

Ask what the charge will be before you trade. These fees can significantly reduce your overall return on investments.

13.2 Expense Ratio

There is an operating cost for mutual funds and ETFs. It is the costs from an investment company to operate a mutual fund. It includes the manager's fees, administrative costs, compliance, trading costs, 12b-1 fees paid to brokers and advertising. The expense ratio is a percentage that directly lowers the return to a fund's investors. If a fund's assets grew 10% during a particular year and the expense ratio is 1%, the investor would receive a 9% return on their investment. If the fund lost 5% during a year and had a 1% expense, the investor would lose 6%.

The expense ratio is a very critical number when comparing investments. Over years a percent or even fraction of a percent can add up and make a big difference. In general, small cap funds and international funds have higher expense ratios than large US stock funds.

Studies have shown that, over the long run, it is very difficult to outperform low cost index funds. Markets are efficient, meaning that the prices are based on publically available information. Stocks outperform when performance is better than the expected results. A manager may be able to guess what sector is going to out perform the market in the short term, but over time it is not possible to consistently out guess the market.

13.3 Performance and Ratings

In evaluating funds, focus on the expense ratio and compare performance with the sector index.

Good performance of a portfolio is the ultimate goal, but be careful about chasing good returns. It can be tempting to look at your holding and buy more of what has done well and sell what has not done as well. It is also tempting to evaluate the options in an asset class and buy the best performers over the last year.

While performance is one indicator to look at there is another that is easy to overemphasize - the MorningStar five star system. It is one piece of information to look at but it is not a perfect tool. The star system compares the return of the fund with its closest index and looks at how the volatility compares. This can be a good tool when looking at ETFs or index funds that strictly follow indexes but many mutual funds do not purely follow an index. They may be compared to a US large cap index (such as the S&P500) but they may have 20% foreign holdings and 30% mid and small cap holdings. Hence, it is not a good comparison.

14.0 Example Portfolios

“Most people don’t plan to fail, they fail to plan.” John L Beckley

The appropriateness of a portfolio depends on several factors including risk tolerance, liquidity needs, and volatility.

There are many ways to construct a diversified portfolio. You can use combinations of mutual funds, ETFs, individual stocks, individual bonds, alternative investments and/or CDs.

A diversified portfolio can be constructed completely out of ETFs. We recommend having broad exposure over many asset classes and rebalancing the accounts regularly (such as once every 3 to 6 months). If SRIs are not desired, there is no advantage to incurring additional expenses to invest in a managed mutual fund that, over time, will underperform the index.

Once an investment policy (or portfolio distribution) is defined, you can use SRI or non-SRI investments for each asset class.

Please read the prospectus of the investments or discuss them with your financial advisor before making any investments.

15.0 Investing Mechanics

"How many millionaires do you know who have become wealthy by investing in savings accounts? I rest my case." Robert G. Allen

If you have any troubles or want any support – contact us and we will help: aiofinancial.com/contact-us/

15.1 Where to Invest

To begin, if you do not have a brokerage account open an account at a place such as Charles Schwab, Vanguard or Fidelity.

Consider the transaction fees for the types of investments you will be using. We us Schwab because they have no transaction fee for the investment we use and they offer a wide variety of options (unlike Vanguard).

15.2 Consideration if Looking for an Advisor

If you feel like you need support there is no shortage of financial advisors. One of the most important things to know is how they are being compensated. Unfortunately, financial investment firms are often very unclear about the cost of their services and investment products. This lack of transparency and concealing of fees is an unfortunate reality.

There are many ways investment firms get compensated. They may receive: sales loads, surrender fees, management and administrative fees, 12b-1 fees, transaction fees, redemption fees, brokerage fees, inactivity fees, transfer fees, market impact costs and more. These fees directly reduce the return on your investments – they are costing the investor money. Many financial professional are being compensated for selling products, such as annuities and life insurance that may not be appropriate for their client.

One way to avoid this conflict of interest is to work with a fiduciary Fee-Only advisor. A fiduciary keeps their clients' best interests first as opposed to the majority of the financial sales people who receive commissions and are benefited by selling certain products. Fiduciaries are not compensated by selling product or earning money on commissions.

Fee-Only Advisors work in a number of different ways, including: hourly, assets under management (pay a percentage, usually about 1% per year of the assets being managed), lump sum (depending on the complexity of your situation). If you just need a check up and some occasional guidance, consider an hourly or short term lump sum arrangement.

The National Association of Personal Financial Advisors (NAPFA) is a national organization for Fee-Only financial advisors. There is a directory of advisors on their website.

Another designation to look for is a CFP (Certified Financial Planner). In addition to investing, a CFP can help you with retirement projections, tax planning, insurance review, estate planning, and education planning. Depending on your situation, this may be important.

AIO Financial is a fee-only financial planning firm, a member of NAPFA and their financial advisors have CFP designations.

15.3 Account Maintenance - Rebalancing

I recommend rebalancing your account at least every six months. By rebalancing I mean getting it back into the distribution of your target Asset Allocation. What this means is that you will be selling the investments that have done well during that period and buying investments that have not done as well. This forces you to buy low and sell high and improve the overall performance of your portfolio. It also keeps you from getting overexposed in any one area.

16.0 Resources

"Investing should be more like watching paint dry or watching grass grow. If you want excitement, take $800 and go to Las Vegas." Paul Samuelson

AIO Financial (AIOfinancial.com) – AIO Financial is a fee only financial planning firm specializing in Socially Responsible Investing. The offer a free upfront meeting, webinars, blog and podcast.

Impact Financial Planners (ImpactFinancialPlanners.com) – Impact Financial Planners was created to help make Socially Responsible Investing (SRI) as easy as possible for investors who are concerned about what they invest in.

AMA Financial Adivsors (AMAfinancialadvisors.com) – fee only financial advisors specializing in the unique issues pertaining to athletes, musicians, and actors.

Expat Planners (expatplanners.com) – fee only financial planners specializing in working with Americans living abroad. Services include: investment management, tax planning, estate planning, insurance analysis, and spending planning.

Virtual Help for RIAs (virtualhelpria.com) – provides virtual assistant support for investment advisors. Services include: data entry (emoney, moneyguidepro), meeting preparation, meeting follow up, placing trades, preparing forms, accounting (quickbooks), answering phones, sending meeting reminders, and marketing support.

Tus Financieros (tusfinancieros.com) - asesores financieros que trabajan con persones en los EEUU y america latina con: inversiones, plan de jubilarse, presupuestos, impuestos, testamentos, y seguranza.

ProMex Group (ProMexGroup.org) - a 501(c)(3) non-profit charity that supports economic development and migrants in northern Mexico.

NAPFA (NAPFA.org) - The National Association of Personal Financial Advisors - is a professional association for Fee-Only financial advisors—highly trained professionals who are committed to working in the best interests of those they serve. You can search for fee-only advisors throughout the US.

Charles Schwab (Schwab.com) – Schwab is a brokerage firm. It provides accounts where you can invest in a large variety of SRI mutual funds, ETFs and community investment notes.

Vanguard (Vanguard.com) - Vanguard is the world's largest mutual fund company. They act as a brokerage firm where you can make investment in Vanguard funds and SRI funds as well.

Fidelity (Fidelity.com) - Fidelity is a mutual fund company and a brokerage firm. Like Schwab and Vanguard, Fidelity offers account where you can invest in SRI.

iShares (ishares.com) - provide ETFs (exchange traded funds).

Zacks - The screener has the most breadth, with well over 100 fundamental metrics as well as analyst rating data, earnings estimate data, and earnings surprise data. The screener is also the most versatile as you can enter in whatever values you want instead of selecting from a drop down menu.

Finviz - You can screen U.S. stocks using over 60 fundamental and technical metrics. Fundamental investors may find the stock screen lacking in comparison to Zacks' but if your process uses both fundamental and technical analysis then Finviz is a good resource.

Google.com/finance#stockscreener - In terms of breadth, Google Finance is top in that it allows you to screen across 37 different countries based on 56 fundamental metrics. For U.S. centric investors, Zacks' stock screener is still a better choice.

Fool.com/Screener - Only has 30 fundamental metrics, but it has an additional set of metrics that all the others lack, Motley Fool's CAPS ratings for stocks. If you are unfamiliar, CAPS is the Fool's free investing community which aggregates the intelligence of investors to rate stocks from one to five. Players on Motley Fool CAPS make predictions on whether stocks will outperform or underperform the market. Motley Fool compiles that data into star rankings which have been shown to outperform the market.

Unclestock - It is by far the most versatile of the free stock screeners, with well over 200 different metrics you can screen by. It also has a large amount of depth in that you can screen across 13 different countries.

XTF - compare ETFs and show how well they follow the index.

17.0 Thank You

"A goal without a plan is just a wish." Antoine de Saint-Exupery

Thank you very much for your interest in investing and for reading *Investing Guide, How to make money*. If you would like more information about investing, please sign up for our newsletter and follow our podcasts and blogs at aiofinancial.com.

Please share your thoughts and comments. I would like to make the next version even better and more useful.

You can email me at bill@aiofinancial.com or leave a message on Twitter (twitter.com/aiofinancial) or Facebook (facebook.com/AioFinancial).

Bill Holliday and family