Reference Material for Investing in Mutual Funds and Stocks

Educational Materials on Mutual Funds:
Investment Company Institute: http://www.ici.org/quiz/index.html
Morningstar: http://www.morningstar.com/
Investopedia: http://www.investopedia.com/

Mutual Fund Websites Sponsored by Mutual Fund Providers:

T.Price Rowe: http://mutualfunds.troweprice.com/index.html?phone=5341

Books:

Ben Graham's _Intelligent Investor_, revised Edition

How to Think Like Benjamin Graham and Invest Like Warren Buffett by Lawrence A. Cunningham

How to Pick Stocks Like Warren Buffett by Timothy Vick

Common Sense on Mutual Funds: New Imperatives for the Intelligent Investor, by John C. Bogle

The Morningstar Guide to Mutual Funds: 5-Star Strategies for Success, by Christine Benz

_Personal Financial Planning, _ by Gitman and Joehnk

A Guide to Elder Planning, by Steve Weisman

The Neatest Little Guide to Mutual Fund Investing, by Jason Kelly

5 Myths of Investing – Every Investor Should Consider

1. **The Efficient Markets Hypothesis applies to stock and mutual fund investing** – all possible information about a stock or mutual fund is imbedded in its price – therefore, you can do no better than the general market return and should buy an index fund and forget about mutual fund or stock selection. [If you believe in Efficient Markets you can go home now.]

2. **Investing requires an understanding of economics and finance** – one needs a degree (preferably a Ph.D.) in finance and economics in order to be a successful investor.

3. **I don't need to develop a set of investment guidelines before I start investing in stocks and mutual funds** – I know a good investment when I see it.

4. **Investing is a highly technical activity, you need to invest large sums of money and pay an advisor large commissions [i.e., front-end, back-end load with the mutual fund] in order to get above average returns** [If you believe this one, think of horse racing and saddle weights].

5. **Diversification when investing reduces risk, therefore the more diversification to my stock portfolio or mutual fund the better** – I want to invest in a mutual fund with a 1000 stock positions or more.

Investment Perspectives Gleaned from Berkshire Hathaway Annual Reports

"Wide diversification is only required when investors do not understand what they are doing."

"I've long felt that the only value of stock forecasters is to make fortune tellers look good."

"Success in investing doesn't correlate with I.Q. once you're above the level of 25. Once you have ordinary intelligence, what you need is the temperament to control the urges that get other people into trouble in investing."

"The strategy (of portfolio concentration) we've adopted precludes our following standard diversification dogma. Many pundits would therefore say the strategy must be riskier than that employed by more conventional investors. We disagree. We believe that a policy of portfolio concentration may well decrease risk if it raises, as it should, both the intensity with which an investor thinks about a business and the comfort-level he must feel with its economic characteristics before buying into it."

"We think diversification, as practiced generally, makes very little sense for anyone who knows what they're doing. Diversification serves as protection against ignorance. If you want to make sure that nothing bad happens to you relative to the market, you should own everything. There's nothing wrong with that. It's a perfectly sound approach for somebody who doesn't know how to analyze businesses."

"John Maynard Keynes, whose brilliance as a practicing investor matched his brilliance in thought, wrote a letter to a business associate, F. C. Scott, on August 15, 1934 that says it all: 'As time goes on, I get more and more convinced that the right method in investment is to put fairly large sums

into enterprises which one thinks one knows something about and in the management of which one thoroughly believes. It is a mistake to think that one limits one's risk by spreading too much between enterprises about which one knows little and has no reason for special confidence… One's knowledge and experience are definitely limited and there are seldom more than two or three enterprises at any given time in which I personally feel myself entitled to put full confidence."
Warren Buffett

Mark Twain on the Topic of Investing:

"OCTOBER: This is one of the peculiarly dangerous months to speculate in stocks, the others are July, January, September, April, November, May, March, June, December, August, and February."

Elements of Diversification
Asset Allocation Concepts:

Two Broad Methods of Asset Allocation: (1) **Internal Allocation** – where the investor determines the best mix between bonds, and equities (2) **External Allocation** – where the mutual funds owned by an investor have allocated funds between bonds, and equities.

Internal Allocation – the investor has direct control over allocation and can change an asset mix at will.
External Allocation – the investor has only indirect control over the allocation mix, relies on the mutual fund managers to develop the appropriate asset strategy and the investor may not know immediately of a change in asset strategy [i.e., the mutual fund managers may change the mix over a period of months or quarters.

Two Factors that Impact Returns when Altering Asset Mix:
(1) Unless the mutual fund is in a tax advantage account [i.e., IRA, 401K, 403B or pension plan] a change in asset mix will involve selling securities which may result in capital gains and the payment of taxes
(2) The sale of securities will involve the payment of transactions costs, brokerage fees, for mutual funds – possibly load fees [front-end or back-end fees].

Investor's should avoid purchasing mutual funds that have front or back-end loads, or high 12-1B annual marketing fees. These charges serve to reduce return below what investors could receive in no-load funds with small 12-1B fees.

Investor's should also avoid mutual funds that turnover securities often – some funds turnover 80% or more of their investment portfolios in a given year. This churning of investments only serves to increase sale commissions while lowering returns to investors.

Internal Allocation: Two Rule of Thumb Methods – (1) {100 – [Your Age]}% = percent of your total invested assets devoted to equities (2) Age based allocation using the following general guideline table
(3) Conservative 50/50 rule in both accumulation and distribution stages

Allocation Mix [Stocks/Bonds]

		Accumulation Phase	Distribution [Retirement]
AGE	Older	70/30	50/50
	Younger	80/20	60/40

John C. Bogle, Common Sense on Mutual Funds, p. 63, Figure 3.1

Re-balancing to Achieve Desired Asset Mix Over Time

How often should the investment portfolio be re-balanced?

Ridged Strategy: Whenever the mix gets 10% out of alignment – e.g. due to increases in the equity markets, your desired 60/40 mix goes to 70/30.

Advantages – takes emotion out of determining when to rebalance, forces one to recognize profits at some point in time [bird-in-the hand], overtime you will build a decent sized bond fund which can be used to invest in equities in a down market [contrarian investing].

Disadvantages – may require you to rebalance more often increasing taxes[non issue with tax advantaged accounts] and commission costs, you may sell part of a winning equity investment thereby losing the opportunity for greater gain [the cost of insurance].

Flexible Strategy: The desired asset mix may be managed to a position anywhere between 50/50 to 70/30 and depending on market conditions you may have a mix between these ranges.

Advantages – allows you to take advantage of different market conditions over the business cycle, it may also permit you to stay fully invested in a winning investment, reduces in investment turnover.

Disadvantages – adds the element of emotion into the investment strategy [Will you commit to re-balancing if the mix goes to 70/30?], you may stay longer in equities than you should resulting in loss, you may not build a large enough bond fund to be able to fully take advantage of a market down turn in equity prices.

Whichever re-balance strategy is used – investors should try to alter mix gradually over a reasonable length of time rather than abruptly. Gradual change will allow an investor to assess the strategy and determine ways to improve the allocation. One caveat if you are uncomfortable with economic or outside environmental issues [hurricanes, terrorist attacks] you should take action to lock in profits and go to a conservative bond mix [up to 50/50]. You deserve to sleep well at night.

Relationship of Time to Mutual Fund Investment Return and Risk

Golden mean to investing – neither too much invested in equities or bonds. Too much in bonds will lower investment return over an extended period of time. Too much devoted to stocks will lead to a higher of risk of loss that may not be recoverable if your time horizon is limited.

Risk and Allocation (1926 to 1997)

Stock/Bond Allocation (%)	Number of Years with a Loss	Average One-Year Loss	Three Year Loss (%) 1930-32	Two Year Loss (%) 1973-74
100/0	20	-12.3	-60.9	-37.3
80/20	19	- 9.8	-45.6	-29.2
60/40	16	- 8.2	-30.2	-21.1
40/60	15	- 5.5	-14.9	-13.0
20.80	14	- 3.7	+ 0.5	- 4.9

John C. Bogle, Common Sense on Mutual Funds, p. 59, Table 3-1.