# EDUCATIONAL MATERIAL

# \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

# Four principles for successful investing

Essential guide for all investors

# Brokerage Account vs. IRA: An Overview

Details the difference between brokerage accounts and IRA for determining which (or both) is most suitable to you.

# Investment Advice for Millennials

Information for the newest generation of investors

# The Power of Compound Interest

Examines how compound interest works and the time value of money

# \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

# Four principles for successful investing

**Goals**

Create clear, appropriate investment goals.

An appropriate investment goal should be measurable and attainable. Success should not depend on outsized investment returns or impractical saving or spending targets.

Defining goals clearly and being realistic about ways to achieve them can help safeguard investors from common mistakes.

**Balance**

Develop a suitable asset allocation using broadly diversified funds.

A sound investment strategy starts with an asset allocation—a mix of assets with different characteristics, such as stocks, bonds, and cash equivalents—befitting the portfolio’s objective. The asset mix should reflect reasonable expectations for risk and returns and use diversified investments to avoid exposure to unnecessary risks.

Both asset allocation and diversification are rooted in the idea of balance. Because all investments involve risk, investors must manage the balance between risk and potential reward through the choice of portfolio holdings.

**Cost**

Minimize cost.

Markets are unpredictable. Costs are forever. The lower the costs of investing, the greater share of an investment’s return an investor can capture. And research suggests that lower-cost investments have tended to outperform higher-cost alternatives.1 To hold on to even more return, investments should be managed for tax efficiency. Investors can’t control the markets, but they can control the bite of costs and taxes.

**Discipline**

Maintain perspective and long-term discipline.

Investing can provoke strong emotions. In the face of market turmoil, some investors may find themselves making impulsive decisions or, conversely, becoming paralyzed, unable to implement an investment strategy or rebalance a portfolio as needed. Discipline and perspective, which includes impartial financial advice for those who want it, can help investors remain committed to a long-term investment program through periods of market uncertainty.

# Brokerage Account vs. IRA: An Overview

Brokerage accounts and IRAs are investment accounts that allow you to buy and sell stocks, ETFs, bonds, mutual funds, real estate investment trusts (REITs), and other securities.

In general, investors use brokerage accounts for day trading, long-term investing, and to save for short-term financial goals like buying a house or car. Meanwhile, IRAs offer investors a tax-advantaged way to save for retirement.

It can be a smart financial move to have both types of accounts. That way you can take advantage of the brokerage account’s flexibility and the IRA’s tax benefits simultaneously. Financial planners often recommend investing in this order:

1. If you have a 401(k) plan, contribute enough to get the company match first—it’s like getting free money.
2. Max out your IRAs to take advantage of the tax benefits and the power of compounding.
3. Invest through your brokerage account.

What Is a Brokerage Account?

As noted, a brokerage account is a taxable account that enables you to buy and sell stocks and other securities. You can buy and sell securities freely, with no caps on the amount you invest—and you can sell your investments anytime without penalty. As far as tax treatment goes, you’ll pay taxes on interest, dividend, and capital gain income in the tax year you earn it.

There are dozens of brokerage firms and choosing the best broker for you depends on your investing style, preferred investments, and the features you want in a trading platform. Once you decide on a brokerage firm, you can open and fund an account online, usually in a matter of minutes.

What Is an IRA?

An individual retirement account, or IRA, is a tax-advantaged investment account designed for retirement savers. The investment choices are limited compared to brokerage accounts (for example, you can’t hold naked options), but earnings grow tax-free or tax-deferred, depending on whether you have a Roth or traditional IRA.1

Unlike brokerage accounts, IRAs have strict contribution limits. For the 2021 and 2022 tax years, you can contribute up to $6,000 to your IRA accounts, or $7,000 if you’re age 50 or older.2

Roth IRAs (but not traditional IRAs) also have income limits: For 2021, you can only contribute the full amount if your income is less than $125,000 for single filers or $198,000 if you’re married filing jointly.3 These limits increase for the 2022 tax year when the phaseout begins at $129,000 for single filers and $204,000 for married couples filing jointly.4

In general, withdrawals made before age 59½ can trigger a 10% penalty with either type of IRA, although there are some exceptions to this rule. However, you can withdraw your Roth IRA contributions at any time—for any reason—tax-free and penalty-free.1

You can open an IRA with a bank or brokerage firm. Keep in mind that an IRA is not an investment itself—it’s an account that holds the investments you choose. You can pick from a variety of investments, including stocks, bonds, mutual funds, ETFs, REITs, and even real estate.

How Are Brokerage Accounts and IRAs Taxed?

Nobody would argue that picking profitable investments is a vital part of investing and growing wealth. Still, investing in a tax-efficient manner is equally important since it lets you keep as much of your gains as possible. Depending on the type of account you have, earnings from dividends, interest, and capital gains may or may not be taxable—which brings us to a key difference between brokerage accounts and IRAs.

Brokerage Account Taxes

Brokerage accounts are taxable investment accounts. If you make money because your investments pay interest or dividends, or because your investments increase in value, you’ll owe tax on that income. The tax liability depends on the source of income:

* Interest. You might earn interest from investments like bonds, certificates of deposit (CDs), or from any uninvested cash you hold in the account. In general, interest income is taxed as ordinary income, with two exceptions: U.S. Treasuries are not subject to state or local income tax, and municipal bonds are usually exempt from federal taxes (and sometimes state and local taxes, too).56
* Dividends. Dividends are your share of a company’s earnings. There are two types of dividends, and each has a specific tax treatment. Qualified dividends—which represent most dividends paid to shareholders by public companies—are taxed at the lower, long-term capital gains rate. Unqualified dividends—which usually apply to REITs, master limited partnerships (MLPs), and business development companies (BDCs)—are taxed at the higher, ordinary income tax rate.7
* Capital gains. If you sell an investment for a profit, you will owe tax on that gain—but how much tax depends on how long you held the investment. Gains on investments you held for less than a year are considered short-term capital gains and taxed as ordinary income. On the other hand, gains on investments you held for more than a year are taxed at the more favorable, long-term capital gains rate.8

IRA Account Taxes

Contributions made to a traditional IRA are made with pre-tax dollars and may be tax-deductible, depending on your income and if you or your spouse are covered by a retirement plan at work. Roth IRA contributions are made with after-tax dollars, so there's no tax break the year you make the contribution. Instead, the tax benefit comes in retirement, when your withdrawals are tax-free.

Earnings in IRAs grow tax-free or tax-deferred, depending on the type of IRA you have:

* Roth IRA. There’s no upfront tax break, so contributions don’t lower your taxable income. But qualified withdrawals in retirement are tax-free, and you can withdraw your contributions at any time—for any reason—without penalty. And, unlike traditional IRAs, there are no required minimum distributions (RMDs) for Roth IRAs.9
* Traditional IRA. You may be able to deduct traditional IRA contributions the year you make them, which can lower your taxable income (and your tax liability). But withdrawals are subject to income taxes and early withdrawals usually trigger a 10% penalty. You can avoid the penalty (but not the tax) in certain circumstances—like using the money to pay for qualified first-time homebuyer expenses.101

Should I Open an IRA at a Bank or Brokerage Firm?

While you can open an IRA at a bank or brokerage firm, you will have more investment options—and higher potential earnings—at the latter. Banks tend to offer very limited, low-yield investment options, such as savings accounts and certificates of deposit (CDs). These low-risk investments may appeal to some retirement savers, but they won’t allow your nest egg to grow substantially—even over the long haul. You will generally find a much broader selection of investments and greater potential growth if you open an IRA at a brokerage account.

Is There a Minimum to Open a Brokerage Account?

That depends on the brokerage firm. Many brokers today offer very low minimum deposits (e.g., even zero) to get started. Of course, you will need to deposit at least $2,000 if you want to enable margin trading.11

Is a Roth or Traditional IRA Better?

With a Roth IRA, contributions are not tax-deductible, but qualified withdrawals in retirement are tax-free (even for earnings). Traditional IRA contributions are tax-deductible, so you could save money at tax time for the year you contribute. But you will owe income taxes on withdrawals in retirement—including on all that growth. In general, you’re better off with a traditional IRA if you expect to be in a lower tax bracket when you retire than you are now. If you think you will be in the same tax bracket or higher when you retire, a Roth may be the better choice because you’ll get your tax bill out of the way at your current, lower tax rate.1

The Bottom Line

Financial planners recommend having both accounts, if possible. You can use a brokerage account for day trading, long-term investing, and to save for short-term financial goals, while an IRA is intended for retirement savings. Brokerage accounts offer more flexibility, and there are no limits on contributions, withdrawals, or income to fund one. IRAs, on the other hand, have lower annual contribution limits, withdrawals may trigger a penalty, and if your income is too high, you might not be able to contribute.

# Investment Advice for Millennials

Are you planning for financial emergencies or your eventual retirement even if you are just starting to establish yourself in your chosen career?

In a November publication by the US Bureau of Labor Statistics, one of the fastest growing careers is financial planning with Certified Financial Planners increasing by 54% in the past decade. The primary reason for the need to seek financial advice especially in investments and retirement is because there are too many products in the market as well as uncertainties in local and global economies.

Other startling figures that should stir concern among the young working population include the cost of living keeps increasing regardless of your location, in the UK, the Public and Commercial Services Union predicts a 20% decrease income because of increases in pension contributions, pay cuts, and cost of living expenses. About 32% of Americans aged 18 to 29 are not saving for retirement and a retirement fund of less than $50,000 is not going to worth much with the high cost in medical care and treatments.

**Why the Young Working Population are not Saving**

There are several reasons why the Millennials are not too keen on saving for the future. The top reasons though are they are still paying for college loans, or they have gotten into the habit of using credit and slowly getting entangled with paying bills and luxuries on credit.

In addition, there is a pervading sense of “living for the moment” among Millennials which encourages instant gratification. Unfortunately, this does not encourage growing in financial maturity and could even lead to problems related to addiction, procrastination, and self-control.

**How to Encourage Investments among Millennials**

Not all those born in the millennial age are investment-ignorant or uninterested in saving for their future. However, compared to the 1970s, the so-called American dream (and its counterparts around the world) has changed drastically. Investing in a house is not as important anymore because of the property bubble catastrophe experienced by American homeowners in 2008-2009. For example, today, owning an apartment makes much more sense because you have the option of renting it out easily or living in it and taking in a roommate who will help pay bills and everyday expenses.

Anyone interested in encouraging the younger generation to start thinking about savings should focus on finding a good blend between providing them with gratification and giving them reason to save. With the number of highly advanced technological products being launched in the consumer market today, the ability to resist the temptation to buy the latest gadgets is severely challenged. How to help the younger generation learn to be satisfied with the gadgets they have instead of indulging their desires for new mobile phones and computer toys every half year or so is part of teaching them to be financially savvy.

Thus, a sense of responsibility for oneself should be reinforced especially because many governments around the world are unable to cope with the needs of their citizens. And this includes developed countries like the United States where in a national survey 79.8% of Americans feel that the so-called American Dream is not as feasible as it was 10 years ago.

A few tips on encouraging investing among the Millennials are:

**Tip #1 Start Saving Now**

Don’t wait until you get promoted or a better-paying job to start savings. No matter what you are earning now, 5 to 10% of the earnings should be set aside as part of a retirement fund. Once this fund is large enough for investment, use it to earn more than the meager interest rate of a savings account. You might need expert financial advice on what to consider as a sound investment or start doing the research on your own. The Internet is a treasure trove of investment ideas provided you can segregate the inane from the intelligent. This is possible by paying attention to these guidelines.

• Don’t be drawn by get-rich schemes and large pay-outs

• Don’t decide based on fears of economic doom but on a study of the possible versus the probable

• Nothing earned legitimately is tax-free so be careful of tax-free schemes

• Be patient

**Tip #2 Listen to the Right People**

Everyone has a few self-proclaimed experts in their lives however aside from listening to them, also consider researching what other experts recommend. With the Internet, this is relatively easy and free.

It is equally important to remember that a retirement fund and an emergency fund are two different funds. As much as possible, you should not tap into your retirement fund for medical emergencies, family vacations, and special high-end treats. A retirement fund is also not something you should put a cap on because you’ll never know what would be enough by the time you reach retirement age.

# The Power of Compound Interest

It is rumored that Albert Einstein once quipped that the most powerful force in the universe is the principle of compounding.1 In investing and finance, this force manifests itself through the concept of compounding returns. In simple terms, compound interest means that you begin to earn interest on the interest you receive, which multiplies your money at an accelerated rate.

For example, if you have $500 and earn 10% interest per year, you will have $550 after one year. Then, if you earn 10% interest the next year on that $550, you end up with $605 by the end of year two. The process continues until, eventually, your original $500 may be eclipsed by the amount of interest you gained.

This is one way many top investors find success in building their wealth. But it's not just for the top investors—you can take advantage of compound interest through savings accounts and investment portfolios. Learn how to do that below.

What Determines How Much Compound Interest You Can Earn?

There are three main factors that can influence the rate at which your money compounds:

The rate of return, or the profit, on your investment: For example, if you are investing in dividend-paying stocks, this would be your total profit from capital gains and dividends. If you were putting money in a savings account, this would be the annual percentage yield (APY).

Time: The more time you give your money to build upon itself, the more it compounds. For example, all things equal, your money would grow more over a 10-year period than it would over a five-year period.

The tax rate, and when you have to pay taxes on your interest: You will end up with far more money if you don’t have to pay taxes at all, or at least not until the end of the compounding period rather than at the end of each year. This is why tax-deferred accounts, such as the traditional IRA, Roth IRA, 401(k), and SEP-IRA, are so important to consider.

Keep in mind that with traditional IRAs and 401(k) plans, you will owe taxes at your normal income tax rates at the time when you take money out of the account.2 A Roth IRA, and even a Roth 401(k), will grow and you won't owe taxes when you withdraw the money in retirement.3

**Compound Interest and the Time Value of Money**

The foundation behind compounding interest is the concept of the time value of money, which states that the value of money changes, depending upon when it is received. Having $100 today is preferable to receiving it a few years from now because you can invest it to generate dividends and interest income. Compounding allows that money to grow. If you waited two years to receive that $100, you'd miss out on two years of opportunity to earn compound interest. This is known as opportunity cost.

Opportunity cost is the loss of possible gains if an action is not chosen. In this case, the opportunity cost is equal to the amount of money you do not get in interest if you don't invest in that money.

In our earlier example, if you don't invest the $500 in an account with 10% annual interest, you'll lose the opportunity to earn $50 or more per year in interest. In 10 years, your $500 could be $1,296.87. But if you don't invest it, it'll still be $500 10 years later.

You can calculate how much you could earn on your money through the power of compound interest with a compound interest calculator.

When you understand the time value of money, you'll see that compounding and patience are the ingredients for building wealth.

Here's another example: Let's say you are 30 years old and want to have $1 million by the time you retire at age 65. You can afford to save $800 per month in an account with an 8% annual return on your investment. Will you be able to reach your goal? Using a compound interest calculator, you can see that you'd be able to turn that $800 per month into $1 million after 29 years—six years earlier than you plan on retiring.

**Compound Interest Results Over Time**

Another way to understand the power of compound interest is to put values into a compound interest table that shows you just how much your wealth can multiply over time.

Imagine you're an investor who sets aside a lump sum of $10,000. Take a look at the table below to see the influence of time and different rates of return on this investment. Over time, saving money is not the only key to a large fortune; compound interest plays a big part.

**Compound Interest Chart**

4% 8% 12% 16%

10 Years $14,802 $21,589 $31,058 $44,114

20 Years $21,911 $46,610 $96,463 $194,608

30 Years $32,434 $100,627 $299,599 $858,499

40 Years $48,010 $217,245 $930,510 $3,787,212

50 Years $71,067 $469,016 $2,890,022 $16,707,038

For instance, a 20-year-old who invests $10,000 today and parks it in Treasury bills, earning 4% per year, on average, for the next 50 years, will have $71,067, if the purchases were made through ​a tax-free account such as a Roth IRA. If they had invested in stocks and real estate, earning a 12% average annual rate of return over the same time, they would end up with $2,890,022. Adding asset classes with higher returns would result in over 40 times more money, thanks to the power of compounding.

**How Compound Interest Could Impact Teens and Their Savings**

Your teenage years are a good time to start saving money for the future. Because you have time for that money to grow before you may need it to buy a house or retire, you can benefit greatly from compound interest. One easy way to start earning compound interest is to open a high-yield savings account and contribute a set amount to it every month. Over time. your money could grow a lot and allow you to build your wealth. While you may only be able to earn a small amount of interest in a savings account, the compound interest could add up over time. For example, if you contributed $50 per month to a high-yield savings account and earned 0.5% interest per year, you could have over $12,000 after 20 years.

Once you've got the savings part down, you could try your hand at investing to potentially benefit even more compound interest. For example, let's say you opened an investment account with the help of an adult (you usually need to be 18 years or older to invest). If you contributed $100 per month to the investment account for 40 years, and earned a 10% annual rate of return on investment each year, your money could grow to be more than $530,000.4

**A Higher Rate of Return Often Comes With More Risk**

You may want to do whatever it takes to earn a higher rate of return on your savings or investments, but that can also be dangerous because higher rates usually bring higher risk. No matter how successful you are along the way, you'll always want to avoid the possibility of losing more than a budgeted amount of the money you invest.

To lower your risk, consider all your investment possibilities. You could start with a high-yield savings account, earning a decent amount of interest on that money year over year. There are also certificates of deposits (CDs) and money market accounts that offer you the chance to earn interest on your money. Stocks, bonds, exchange-traded funds (ETFs), index funds, and mutual funds are also investments to explore. Adding a variety of investments to your portfolio can help you diversify that risk and build your wealth through the power of compound interest.

**What is compound interest?**

Compound interest is when you earn interest on top of the interest you've already earned on the principal amount of money. For example, if you started with $100 and earned 10% interest in one year, you'd have $110 after one year. If you earned 10% on that $110 over the course of another year, you'd end up with $121. Compound interest is the money you earned in that second year because the interest applied to your original principal and the interest you earned in the first year.5

**How do you calculate compound interest?**

Compound interest can be easily calculated with the help of a compound interest calculator. But if you want to do it manually, you'll need to follow this formula: Multiple your annual interest rate by your principal starting value. Add the result to the principal starting value. This is your new principal value. Repeat the process. For example, 10% x $100 = $10, $10 + $100 = $110, $110 is your new principal balance.

**How can you get compound interest?**

You can get compound interest by opening a financial account that offers some sort of annual rate of return. For example, you could open a savings account with an APY of 0.5% and contribute money to it every month to get compound interest and grow your money.

**What is the difference between simple and compound interest?**

Simple interest is calculated only on the principal balance, while compound interest is calculated on both the principal and any interest that you've already earned.6 So if you had $100 and earned 10% on that $100 principal balance every year, you'd be earning simple interest. If the 10% interest applied to the new balance every year ($100 in year one, $110 in year two, etc,) you'd be earning compound interest.