# The MoneyTrack Method

## A STEP-BY-STEP GUIDE TO INVESTING LIKE THE PROS

**Pam Krueger**

WILEY

John Wiley & Sons, Inc.

# The MoneyTrack Method

# The MoneyTrack Method

## A STEP-BY-STEP GUIDE TO INVESTING LIKE THE PROS

**Pam Krueger**

WILEY

John Wiley & Sons, Inc.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.



***Library of Congress Cataloging-in-Publication Data:***

Krueger, Pam
The moneytrack method : the real person's guide to successful investing / Pam Krueger.
p. cm.
Includes index.
ISBN 978-0-470-37232-6 (cloth)
1. Investments. 2. Finance, Personal. 3. Speculation. I. Title.
HG4521.K78 2009
332.67'8—dc22 2008021331

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

*To Harold Apfelbaum, Don Blandin, Neil Alford, Cynthia Zeiden and Katie Horgan, and the entire* MoneyTrack *team, all of whom add magic to everything they touch.*

# Contents

# Foreword

As president and CEO of the Investor Protection Trust, I spend a great deal of time talking to people from all walks of life about investing and the "R" word: retirement. I have come to understand that regardless of differences in economic background or level of education, most of us share similar hopes and suffer the same fears about life in retirement—and I include myself in this group. With increasing responsibility being put on the shoulders of Americans to prepare for their own long-term financial security—including 20 plus years in retirement—it is crucial that all Americans know the essentials of saving and investing, and how to use that information to make wise investment choices and avoid investment fraud. We all recognize that investors need to know certain key facts and concepts, but it may be even more important to their long-term financial security that investors learn the behavioral process of investing—such as checking the background of a stockbroker or investment advisor before investing. Americans do not know what they need to about the process of investing and are often not taking even the most basic actions necessary to make good investment decisions.

Planning is a first crucial step in the process of investing. Without a plan, Americans are saving and investing blindly, and are unlikely to build a nest egg that can provide them with long-term financial security. The first step in planning is to set specific and inspiring financial goals and develop a plan to reach those goals. To quote Yogi Berra, "If you don't know where you're going, you'll end up someplace else."

The Investor Protection Trust has initiated a number of educational programs to help people understand the process of investing. I strongly believe in the power of education as a means to protect and empower all investors. Along with many other investor education initiatives, IPT supports the *MoneyTrack* national public television series because it does a great job of educating investors in an entertaining way, using humor and real life stories to illustrate important and sometimes complicated investment concepts. The program, created and co-hosted by Pam Krueger, also focuses on investment scams, helping investors recognize and avoid them as they invest for their future financial security. Let's face it—scam artists are very good at what they do. Many of them prey on people they know. The key to avoiding investment scams is to recognize them up front.

Pam Krueger brings the same practical, humorous, and down-to-earth approach to *The MoneyTrack Method* as she does to the *MoneyTrack* series. In this book, Pam has managed to distill the advice of the investment pros and present it in an entertaining fashion. The book guides readers through lessons that feature real people dealing with real financial and investment issues. We read about people who've became successful investors, as well as the people who have been victimized by investment scams. *The MoneyTrack Method* offers positive, independent, and objective advice that can be hard to find in the media these days.

I believe *The MoneyTrack Method* will help us as we strive to reach our common goal of educating and protecting investors so they make wise and safe investment decisions. I also believe the "Scam Alerts" found throughout the book will help countless readers learn to recognize and avoid investment scams. Readers will come away from this book having learned about the process of investing. They'll also know how to check out the background of a stockbroker or investment adviser as well as the investment itself.

Because of educational initiatives like the *MoneyTrack* program and *The MoneyTrack Method,* we can continue to raise the investor IQ of our nation and make it a whole lot harder for the scam artists to make a living. *The MoneyTrack Method* provides investors and potential investors with the information they need to invest wisely and safely for their future financial security.

DON M. BLANDIN
President and CEO, Investor Protection Trust

# Acknowledgments

I would really like to thank Don Blandin, President and CEO of the Investor Protection Trust for developing so many outstanding programs that are helping ordinary investors make smarter investing decisions, and also for placing his faith in me by allowing me to be part of his vision. I am also grateful to all of the investing experts who've been on *MoneyTrack* Season Two, including Warren Buffett, John Bogle, Ben Stein, and many others with whom I've been fortunate enough to spend time dreaming up new ideas for turning dry investing lessons into real stories about real people. The *MoneyTrack* team at Beyond Pix and my co-host, Jack Gallagher, also deserve special recognition. (Who else would allow me to include the dog, Chloe, on a TV show about money?) Special thanks should go to Les Abromovitz who has the sharpest mind in the world of personal finance. I would also like to express my gratitude to Debbie Englander, Kelly O'Connor, and their colleagues at John Wiley & Sons, for their hard work on my behalf. Finally, Cynthia Zeiden should get all the credit she deserves for making sure *MoneyTrack* is seen on as many PBS stations as possible on this planet and any others we may discover.

CHAPTER 1

# Investing 101

If you're like most people, Investing 101 is the course you knew you should sign up for but avoided taking. Even the introductory course on investing might frighten you or make you so sleepy that you shouldn't be operating heavy machinery. Nevertheless, the fact that you have avoided learning about investing doesn't stop you from complaining about how you don't have a dime put away for retirement or that your bills are piling up in that fruit bowl on your kitchen counter. Perhaps you're the type of person who whines that you don't have any money to invest, or even to buy a second fruit bowl, after paying your bills.

Investing doesn't have to be scary or complicated. On the *MoneyTrack* program that I co-host with Jack Gallagher, our motto is, "Keep it simple—and keep it real." Even when it comes to investing, we try to simplify complicated topics. Jack's role on the show is to make sure none of my advice or the advice from our experts goes over the viewer's head. You can be sure he wouldn't let this book make it into print if any of the investment topics we discuss are over anyone's head, especially his own.

Even though we feature guests such as high-energy CNBC stock expert, Jim Cramer, on our program, we take a low-key approach to money topics. There are no sound effects, except for an occasional groan in response to Jack's jokes. Since Jack is a former standup comic, he can't resist adding humor to every program. He also lightens up the educational presentations we conduct in conjunction with state securities regulators across the country. The securities regulators in each state ensure that investments and financial advisers are on the up-and-up.

Aside from experts, we feature real people each week with real money issues and questions. Our goal on the program and in this book is to show you what works and what doesn't work when it comes to money and investing in the real world. As you learn about investing, you can be assured that no one is trying to sell you anything. *MoneyTrack* is sponsored by the nonprofit Investor Protection Trust, whose primary mission is to provide independent and objective information so consumers can make informed investment decisions.

Learning about investing doesn't need to be tedious or painful, and the terminology shouldn't send you to the dictionary. You'll often find that a term you've heard for years has a very simple origin. Maybe you reach for the remote at the first mention of Wall Street on the business news. The terms "Wall Street" and "The Street" are used to refer to the investment and financial community. Many brokerage firms and banks were originally located on Wall Street in lower Manhattan.

Whether you're buying or selling stocks on the New York Stock Exchange or Nasdaq, where investors buy and sell securities online, it usually boils down to a simple concept. When you buy a share of stock, you're purchasing a small piece of a company with the hope that it will be worth more someday. Even with all of the changes that have occurred over the past few hundred years, many transactions are just that simple.

### The Origins of Wall Street and the New York Stock Exchange

Wall Street got its name a few hundred years ago when it used to be an area where cows grazed. A wall was built to keep the cows from escaping—hence the name *Wall Street.* I've given some thought to trying that with my dog, Chloe, a frequent guest on *MoneyTrack.*

Or maybe your eyes glaze over when you hear about the New York Stock Exchange. The New York Stock Exchange traces its roots to 1792. Twenty-four stockbrokers got together to form a private club. The club wasn't private for long, however. Well-off investors began buying and selling shares of each other's companies through the club, leading to the birth of the New York Stock Exchange. As a former stockbroker, I tip my hat to them.

Stocks are equity investments, since you own a piece of the company. In contrast, when you invest in a bond or put money in a savings account at a bank, you are a lender, not an owner. When you invest in equities, your potential rewards are greater. The historical performance of the stock market is far greater than the average return for other investments such as bonds, even though you might lose money over a shorter time frame.

OK, perhaps History 101 is even more boring to you than Investing 101, so let's fast forward to the present. Let's find an answer to this question: What do I need to know to begin investing like the pros?

## Investment Basics

According to the Investor Survival Skills Survey, prepared by Opinion Research Corporation for Securities Investor Protection Corporation (SIPC) and the Investor Protection Trust (IPT) which was released on December 13, 2005, four out of five U.S. investors failed the "survival skills" test. Eighty-three percent of the participants in the survey lacked the necessary blend of basic knowledge and smart behavior to build savings into a retirement nest egg.

The results of the 2006 AARP Michigan Investor Protection Trust Survey are just as disturbing. A September 2006 survey of Michigan AARP members found that 38 percent are very concerned about being the victim of financial fraud. The participants said that if they were worried about the legality of an investment product, they would go first to their personal stockbrokers. Only 3 percent would turn to the Office of Financial and Insurance Services in Michigan.

AARP Financial conducted a survey, "The Cost of Financial Jargon: Barrier to Smart Investing?," that sheds additional light on this subject. The survey found that 30 percent of the respondents who were over age 50 made an investment they regretted, because they didn't understand it. Sixty percent said they don't read financial literature, because it is too difficult to understand. Twenty-nine percent failed to invest, or waited too long to do so, because the information they received was confusing.

Unfortunately, your own fears and lack of investment knowledge may be leading you down the wrong track. Just in case you're a member of the group that doesn't understand the basics, let's get started by explaining the distinction between saving and investing.

Saving is the process of putting away money. Investing is the process of making it grow. It's not enough to save money. To reach your financial goals, you need to invest your savings and accelerate the growth of your nest egg.

### *The Basics of Successful Investing*

After talking with dozens of financial experts on *MoneyTrack,* we came to realize that the most basic investment advice is often the best. When you keep advice basic and simple, it's understandable and easy to follow. That's why we always try to break down the lessons from the pros into an action plan that's clear and concise. Here are five easy steps you can take to become a successful investor:

1. *Make investing a habit.* Get in the habit of investing a portion of your paycheck by contributing to a retirement savings plan through your employer. You can also arrange for a small amount to be deducted from your checking account each month and invested in a mutual fund or some other investment vehicle.
2. *Establish investment goals.* Investment goals are your investment objectives, whether it's putting away money for retirement or short-term goals such as coming up with a down payment for a house. Hopefully, you'll be able to work toward several financial objectives at the same time.
3. *Let time do the heavy lifting in reaching your investment objectives.* You take advantage of a concept known as the *time value of money*. If you have more time to save and invest, you are likely to end up with more money. You also utilize compounding, even if you only invest a small amount. With compounding, the money you originally invested produces earnings. You will receive additional earnings on the money you already received from the investment.
4. *Make sure your investments are diversified.* Increasing your diversification helps to reduce the risks that go hand-in-hand with investing. By owning a variety of assets, such as stocks, bonds, or cash investments like a savings account, you are couching your bets. It's extremely unlikely that all of these investments will perform poorly at the same time.
5. *Control the risk you are taking.* Investment temperament is your comfort level with risk. Some investors are open to taking

> significant risks with their money. Others are uncomfortable with investments that present any level of risk. A certain amount of risk is necessary, however, to increase your chances of reaching your investment goals.

It is a generally accepted principle that the potential rewards are greater with riskier investments. Nevertheless, taking foolish risks won't get you any closer to reaching your financial goals.

### *The Risk of Not Investing*

"Why should I have all that risk in the stock market?" a viewer in Boone, North Carolina, asked us. She couldn't see why investing in the stock market is a better idea than investing in CDs, which are certificates of deposit at a bank and are insured by the Federal Deposit Insurance Corporation (FDIC). You can also buy CDs through brokerage firms and credit unions. We posed her question to investment industry giant, John C. Bogle, the founder of Vanguard Investments.

Mr. Bogle responded by giving us a very practical comparison. He pointed out that if a savings account pays you 4 percent and the cost of living increases each year by 3 percent, you're only netting 1 percent each year. If you put $10,000 in that savings account, you'll end up with about $14,200 at the end of 35 years. If you put that money in the stock market and achieve a 7 percent return, your actual return is 4 percent per year after taking inflation into consideration. In 35 years, you'll have almost $40,000.

In fact, your return might be even better than 7 percent. From 1925 through 2005, the Standard & Poor's 500 Stock Index made up of large companies averaged 10.4 percent per year. Over the same time frame, the annual return for long-term government bonds was 5.5 percent.

Because you're usually losing about 3 percent per year to inflation, investments that are purportedly safe, such as CDs, are sometimes riskier than the stock market. Furthermore, capital gains from the sale of stock and dividends receive tax breaks that are not available to investors in CDs. On the flip side, however, you won't lose the original amount invested, even though the principal will be eroded by inflation.

Mr. Bogle wasn't advising our North Carolina viewer to stop investing in CDs, which certainly have a place in a diversified portfolio.

His point was that you also need stock investments to round out your portfolio and achieve the financial growth necessary to reach your goals. No matter where you put your money, the biggest mistake you can make is not saving and investing.

#### *The Risk of Investing*

With every investment, you are taking risks. If you invest in a CD at your bank that exceeds the coverage afforded by the FDIC, you might lose money if the financial institution goes belly-up. When you invest in a bond issued by a corporation, you might lose money if the company loses its ability to pay the interest owed to you or the amount to be paid back.

Within each category of investments such as stocks and bonds, there are different levels of risk. A mutual fund that invests in short-term bonds is less risky than one that invests in long-term bonds. Investing in government bonds is far less risky than buying so-called junk bonds, which are typically issued by companies that have a subpar credit rating. Buying shares of a large and established company exposes you to much less risk than investing in the stock of a relatively new business that has few assets.

You need to be aware of the risks that are unique to each investment you are considering. Here are a few of the common risk factors:

- *Purchasing power risk.* With conservative investments in particular, you risk losing purchasing power. Because of inflation, whether it's low or high, the purchasing power of each dollar you have goes down. A savings account that pays 2 percent is a losing proposition if the inflation rate is 3 percent.
- *Volatility risk.* With many investments, their price is volatile. At any given time, the value of your investment may rise or fall. If you need to cash in your investment, you risk having to sell it when the price is low.
- *Interest rate risk.* If you see the attention paid to the Federal Reserve, you're well aware of the risk that interest rates go up and down. Fixed-income investments like bonds go up or down based on changes in the interest rate. Fluctuations in interest rates also have an impact on many other investments.
- *Market risk.* The stock market, or any market for that matter, goes through periods where prices are rising or falling. Quite