

Getting Ready To Invest

Your Guide To Making
Safe, Smart, And
Rewarding Investments



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**In the long run, the difference
between a winning investment
strategy and a losing one isn't
luck, but knowledge.**

Getting Ready to Invest

Though people invest for different reasons, at different times in their lives, they generally have the same objective: achieving and retaining **financial security** for their families. Whether you are purchasing a home, saving for your children's education, or funding your retirement, you need to develop a solid **investment foundation**, that is, an accumulation of funds. In many cities, home prices are well into six figures. Today, a college education can easily cost \$100,000. Even a car is a major purchase that you must consider carefully. A good **investment strategy** can help finance your needs—today and tomorrow.



investment strategy

Before undertaking any investment program, it is critical that you assess your current financial picture. Once you've taken an accurate measurement of your **finances**, you're ready to determine how much you can invest reasonably.

Assessing Net Worth

An integral step in evaluating your finances is assessing your **net worth**. To determine your net worth, you need to figure out what you own and what you owe.

Determining the total amount of your assets and liabilities will enable you to calculate how much you have (or don't have) to invest.

The first step in this process is to determine the total amount of your assets. **Assets** are your possessions that have value such as money in bank accounts, stocks and bonds, real estate, etc. Once you've calculated your assets, determine the total amount of your liabilities.

Liabilities are financial obligations, or debts. These include credit card balances, personal or auto loans, and mortgages, etc.

Once you've calculated the total amount of your assets and liabilities, subtract the total amount of liabilities from the total amount of assets. Ideally, you'll want to have a greater amount in assets than liabilities. If your assets are more than your liabilities, you have a **"positive" net worth**. If your liabilities are greater than your assets, you

have a **"negative" net worth**. If

you have a negative net worth, it's probably not the right time to start



calculate your assets

investing. You

should re-evaluate

your finances and

determine how you

can decrease liabilities.

If you have a positive

net worth and cash

flow, you're probably ready

to start an investment plan.

Calculating Cash Flow

The next step in evaluating your present financial status is to look at your monthly **cash flow**. Begin by looking at your monthly **net income**—the money you take home every month after taxes. Monthly income includes your salary and other steady and reliable sources of income, such as income from a second job or business venture, interest from your bank account, child support or alimony that you receive, or social security. If you already own some stock, you may be receiving dividend payments; factor that amount into income, too.

Then calculate your average monthly **living expenses**.

These include legal obligations and monthly expenses.

Obligations are payments that you are legally or contractually obligated to make, such as your rent or mortgage payment, car lease or loan payment, personal loan or credit card payments. Factor in child support or alimony payments. Legal obligations are generally paid in fixed amounts over a long period of time.

Expenses are those things that you must purchase or pay for regularly. They're not as binding as legal obligations and can vary in amount, but generally they are necessary expenses—for example, money for groceries, utilities, child care, and insurance.

Transportation is an expense that virtually everyone has and it takes on many different forms—public transportation, car maintenance and registration, gasoline and parking. Average your actual expenses

over a three month period to come up with a reliable monthly estimate for your total expenses.

The balance of your monthly expenditures covers the range of products and services you choose to spend money on each month. Generally, these are discretionary items, not necessities; but to get a true picture of your cash flow, they need to be identified as expenses. They include, for example: cable television subscriptions; housekeeping, gardening, or any other monthly services fees; your average phone bill, including long distance,

Net Worth Worksheet

Assets

Savings account	\$ _____
Checking account	\$ _____
Investments	\$ _____
Life insurance policy	\$ _____
Pension equity	\$ _____
Profit-sharing equity	\$ _____
Employer savings plan	\$ _____
Retirement fund	\$ _____
Real estate	\$ _____
Other	\$ _____

Liabilities

Credit card bills	\$ _____
Medical and dental bills	\$ _____
Mortgage(s)	\$ _____
Home equity loan	\$ _____
Personal loan(s)	\$ _____
Car payment	\$ _____
Unpaid taxes	\$ _____
Other	\$ _____

Total Assets \$ _____

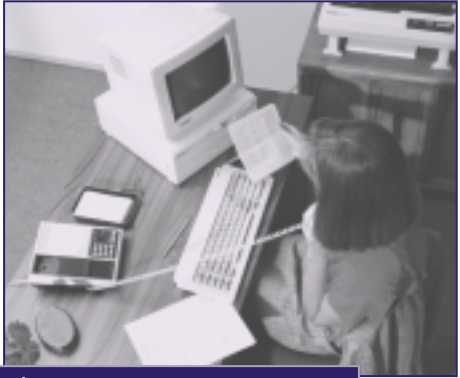
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Total Liabilities \$ _____

Net Worth \$ _____

cell phone, pager, and Internet service provider; club, gym, or organization dues; classes or lessons for anyone in the family, as well as tuition costs; costs for the dry cleaner, hair salon, nail salon, or pet care.

Other things to consider (that might not come up at regular intervals)



review your expenses

are the amounts you spend on clothing, gifts, and the like. You should include these and any other expenses that come to mind for an accurate estimate of your total monthly **discretionary expenditures**.

Evaluating Cash Flow

Add up your monthly obligations, average expenses, and discretionary expenditures. Subtract this figure from your monthly net income to determine your leftover cash supply. If the result is a **negative cash flow**, that is, if you spend more than you earn, it could mean serious trouble. Review your expenses to see what you could reduce or eliminate.

A professional financial counselor might be able to help you with these calculations. *Before starting to invest, your spending must be less than your earnings—with some to spare.*

If the result is a **positive cash flow**, but your spending nearly equals your earnings, it might be too soon to start investing right now, outside of your employer's retirement program. Most people have more control over their expenses than their income, so taking a look at which expenses you could eliminate or reduce is a good first step. Maybe some of your discretionary expenses are luxuries that you could give up. Perhaps a **debt refinancing** or consolidation could reduce your monthly payments. A financial professional may be able to help you with these matters.

If the result is a positive cash flow with plenty of money to cover entertainment (restaurants, movies, even video rental) and incidental expenses (pocket money for postage stamps, a newspaper, and such), it may be time for you to embark on an investment plan. But there are still a few more things to consider.

Ideally, the money you use for investing should be free of other obligations. If you are "supplementing" your income by adding to your **credit card debt**, the money you have left over at the end of the month isn't truly left

over. Therefore, it would be

prudent to pay off your credit card debt before embarking on an investment plan. Do you know it will take 11 years



create a cushion

and an additional \$1,934 in interest to pay off a credit balance of \$2,000 at 18.5 annual interest rate, provided you make no new purchases, and pay only the minimum payment (about \$35) each month? If you can't pay off credit card debt immediately, work out a structured plan to pay off the balance as quickly as possible. However, the monthly payment that you're making needs to be included when you calculate your monthly expenses.

Creating A Cushion

Some investments will “tie up” your money for a relatively long period of time. Before you start investing, it's probably a good idea to set aside some money—about the equivalent of a few (3 to 6) months' living expenses—in a liquid (easily accessible) account. A **liquid account** might be a regular savings account at a bank or credit union that provides some return on your deposit, and from which your funds can still be withdrawn at any time without penalty. Having a living expense “**cushion**” ensures that you have something to rely on—in the event of an illness, unemployment, or other unexpected situation—without disrupting your investment plan.

After establishing a positive cash flow with money to spare, as well as an adequate emergency fund, it's time to explore your investment options. Knowing how much you can safely and reasonably invest is the first step to investing wisely. But, one more thing—since your income, monthly expenses, and lifestyle situations are likely to change over time, you should **re-evaluate** your

finances regularly, to be sure your expense and investment plan is still meeting your needs.

Objectives And Goals

Like most people, you know you want to save money and now you've determined whether your cash flow leaves you enough to invest. But, without clearly defined **goals** and **objectives**, it's hard to know how fast to save, whether the return on your investment is high enough, and if the investment is safe enough to rely on to be there when you need it. Knowing and understanding the desired outcome of your investment will help keep you motivated and focused. Knowing and understanding your personal investment goals will help you determine what kind of **growth/yield, income,** and **safety** to seek from your investments.

Before investing, ask yourself, "Why do I need my money to grow and when do I want to use it?" In other words, are you saving for a major purchase, such as a car or a house, in the near future? Or for your child's college education? Or, like the majority of investors, for retirement? The answer might be many or all of these. If you are saving for a car or a down payment on a house, you will likely need to have access to your money in a relatively brief period of time. You might consider a money market account or short-term bond fund if you will need your funds in 5 to 7 years or less. On the other hand, if you are a younger investor saving for retirement, the money need not be as readily available; you can afford to take more risk and invest money in ways that

will allow it to multiply over the long term. It's important to know the "why and when" of your investment goals, because investing for **short-term goals** differs from investing for **long-term goals**.

This series of brochures, produced by the NASD Office of Individual Investor Services, is designed to provide investors with the tools to make safe, smart, and rewarding investments.

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