

The MOAA Investor's Manual

*Essential Investment
Rules of Engagement*



The MOAA Investor's Manual: Essential Investment Rules of Engagement

Your career and personal life consume your days. Still, there are critical financial responsibilities that demand a part of your attention. MOAA wants to help make it easier for you to understand some of these essential benefit programs and financial issues that affect your life so you can get back to the things you enjoy. We hope you find this booklet a valuable reference. Call the MOAA Transition Center at (800) 234-MOAA (6622) or write to MOAA, Attn: MOAA Transition Center, 201 N. Washington St., Alexandria, VA 22314, if you have questions or want to talk.

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Introduction

MOAA finance and benefit counselors spend a lot of time corresponding with servicemembers and their families. We also conduct presentations across the nation. These experiences provide us opportunities to talk with thousands of people. We bring this practical experience to the table as we counsel members, helping them understand the financial environment and how to manage both their tactical and strategic money.

TACTICAL MONEY REFERS TO MONTHLY BUDGETS, INCOME, BILLS, CREDIT CARDS, LOANS, ETCETERA. STRATEGIC MONEY IS THE INVESTMENTS AND SAVINGS NECESSARY FOR A COMFORTABLE LIFE IN RETIREMENT AND THE WORST-CASE SCENARIOS OF LIFE.

Some common themes have emerged from our experiences. Senior noncommissioned officers and officers consistently tell us servicemembers need to hear our financial information. Our conversations regularly indicate people inadvertently hurt themselves by not knowing what to do with their investments.

We know you are busy professionals and family members who need strategies you can put in place and forget about, more or less. And we know studies indicate active management of your retirement accounts — guessing when to get in or out of a fund — is not a practical or successful option.

This publication addresses these common themes in the matter of strategic investments, Thrift Savings Plans, 401(k)s, Individual Retirement Accounts, and other investment accounts you might own.

***Note:** This publication provides general education on money and investment concepts and strategies. It is not intended to provide personal investment advice to members. Readers must evaluate for themselves whether these lessons, in whole or in part, provide value to their personal situations.*

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Chapter 1

Taking in the Big-Picture View

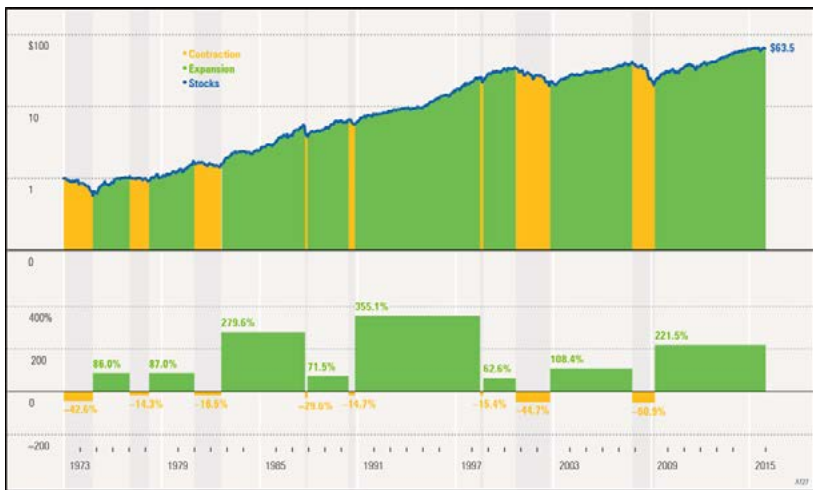
We live in a world that bombards us with real-time information. For managing your investments, this is not a good thing. To our detriment, we tend to focus on current events, and the media reinforces a short-term view.

A big-picture view is critical for proper investor behavior. Managing investments based on current events is like building your financial game plan on sand. Trends, fads, and current events come and go. Investments are either in or out of favor; the problem is, you don't know when the "right time" starts or stops.

Trying to time your selections, buys, and sells just wastes valuable time and effort. Professionals can't time the markets. Average citizens whose lives already are busy with careers and personal obligations have no chance.

As far as the big picture goes, you can see from the chart on the next page how down stock market periods (the yellow contraction periods) don't last very long when compared to the longer and more significant up periods. Stock market lows always hit bottom and then rebound. Downs are temporary; over the long term, up is permanent. *A solid investment plan takes advantage of the short-lived down periods to build wealth during the long up periods.*

Stock Market Contractions and Expansions, 1973–2015



Down stock market periods (yellow contraction periods) don't last long, compared to longer and significant up periods. Stock market lows always hit bottom and then rebound up again. You must implement a strategy that takes advantage of this situation.

Source: Morningstar

THE IMPORTANCE OF OWNERSHIP

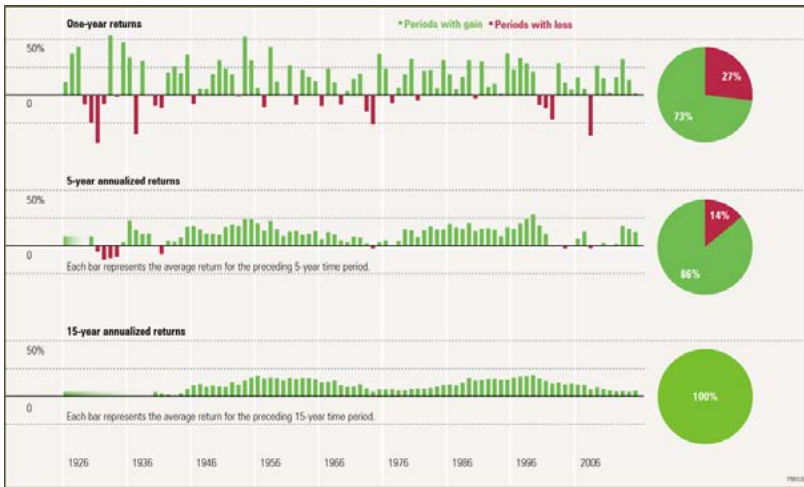
Building wealth — a key to a comfortable retirement — requires “ownership.” Only ownership provides the necessary investment returns to build wealth because historically ownership investment returns offset the negative impacts of taxes and inflation.

Ownership provides the necessary returns because it requires risk — and risk pays. Safe and conservative does not. If safe and secure paid, everyone would be in safe and secure accounts and no longer be in riskier markets. Your key to successful investing is knowing how to manage the risk and stop managing to the investment return. Managing risk will create investment returns as a by-product. This publication focuses on managing risk.

Examples of wealth-building ownership assets include: 1) shares of stocks in your retirement accounts, such as stock mutual funds in Thrift Savings Plans/401(k)s; 2) property; and 3) your own business. Most people won't own enough properties or run their own business, so buying stocks is usually the easiest route to ownership. To learn how one comes to own a lot of assets, thus becoming wealthy, follow along.

According to the one-year returns depicted on the facing page, the stock market was up 73 percent of the time between 1926 and 2015. This means it was only possible 27 percent of the time to accumulate maximum ownership in down markets when assets were cheap. Since 1926, there have been some challenging economic times; to be up 73 percent of the time despite this is good news.

Risk of Stock Market Loss Over Time, 1926–2015



From 1926–2015, the stock market was up 73 percent of the time, when viewed in one-year increments. Twenty-eight percent of the time, investors could accumulate maximum ownership in down markets, when assets were cheap. Think about how you can use this data to build wealth.

Source: *Morningstar*

UNDERSTANDING THE TRUE NATURE OF RISK

Risk, defined as the downward movement of the market, decreases the value of investment accounts. Checking the value of your account is about managing to the return, but remember — we aren't managing to the return anymore. We are going to manage to the risk.

Risk is inherent in all investments and savings. Even when you think you're being safe, your money decreases in value due to taxes and inflation. The only way to counterbalance the negative effect of taxes and inflation in your safe savings accounts is to 1) choose to live at a lower standard of living in retirement or 2) pile as much money as possible into your "safe" accounts while working to compensate for the lower returns.

We've met people who played it safe, and many find they don't have enough savings to live the life they envisioned or to last as long as they need. It's been said that **retirement is like funding 40 years of unemployment**. Can you safely save enough to create 40 years of income? You need a good return to build your retirement nest egg. Your money has to work harder than you to build the wealth required for a comfortable retirement.

The risk involved in building wealth can be managed. You must learn to manage the risk of ownership or risk having too little saved for retirement and running out of money. Look at the above chart again and note the graph of the stock market over 15-year periods.

Risk management lesson No. 1: Taking a long-term, big-picture view eliminates all stock market risk, as the market is up 100 percent of the time over longer periods.

Markets

100
5,690.4

7,000
6,500
6,000



Q1
Q2
Q3

Q1
Q2
Q3

Chapter 2

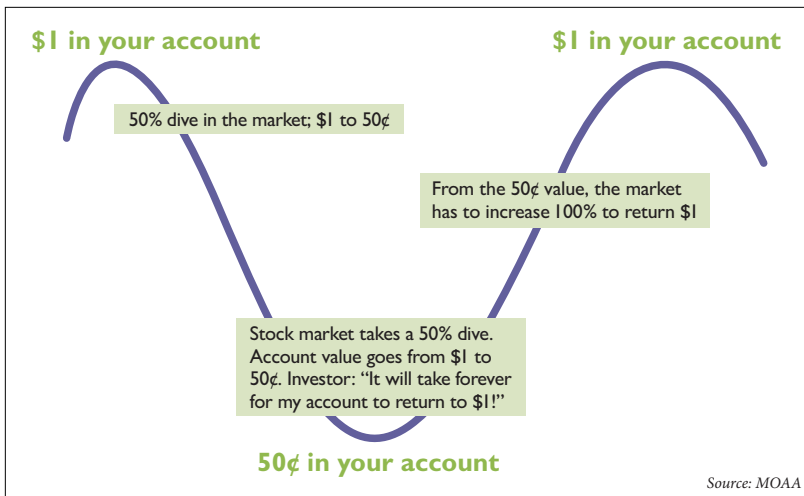
Averaging Down

Another way to manage risk and build wealth is by averaging down, also known as dollar-cost averaging. This is what you do when you make regular contributions to your 401(k)/Thrift Savings Plan every pay period.

Every investor knows the rule to buy low and sell high. However, no one does it, because we don't exactly know when stocks are "low." Also, investors tend to avoid buying low because that means the stock market is plunging downward. Was the media talking about buying when the dot-com or housing bubbles popped?

Averaging down forces you to buy low. The chart below shows how many people view their investment accounts and how averaging down works to counter these misplaced views of investing.

Averaging Down: Another View

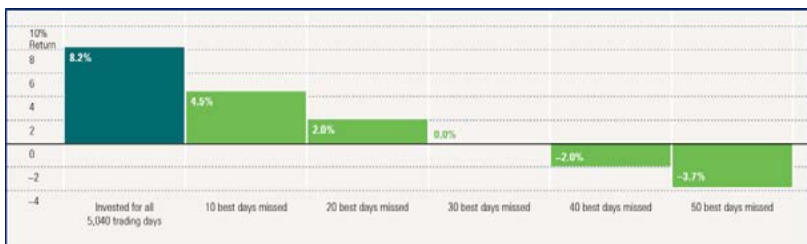


In 2007, no one knew the housing and mortgage bubble would burst that October, and no one knew how long the stock market would fall. Many people bailed stocks out of their retirement accounts after watching their account balances go down, but the market bounced back in March 2009. Managing investments by fear is unnecessary and can be stopped by having a strategy such as averaging down.

It's common for people to overreact after they find out the market has taken a dive, and the media encourages this when reporting on the Dow Jones industrial average, Standard & Poor's 500 index, and Nasdaq.

At some point during this down time, investors take money out of the stock fund options in their accounts to prevent the further loss of value. Perhaps they move their money into a fund they consider safer, or put their money into something they think will increase their account's current value to its original value faster. This is a mistake because they are no longer in the stock market during its best days, when it rebounds.

The Cost of Market Timing: Risk of missing the best days in the market, 1996–2015



Down stock market periods don't last long compared to longer and significant up periods. Stock market lows always hit bottom, then rebound up again. You must implement a strategy built to take advantage of this situation.

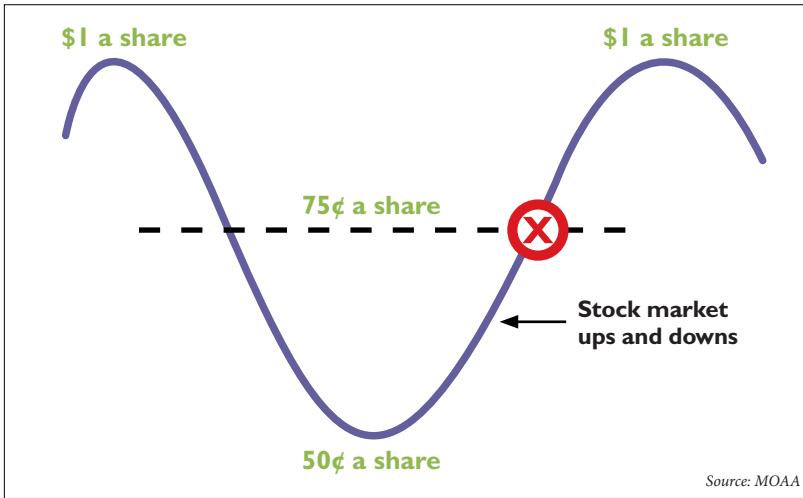
Source: Morningstar

WE'RE OUR OWN ENEMY

The chart above shows the damage to investment returns by being out of the stock market for a few days too long during the best times to be in the market. Reports indicate investors don't get back into stock funds until they are doubly sure the market is safe, so they miss much more than the best 50 days of the market before returning. By that time, the stock market is getting heated again and ready to take another plunge. Instead of buying low and selling high, they do the opposite — buying high and selling low.

By averaging down, you win the battle of plunging stock markets. You turn a risky, up and down stock market to your advantage. The volatility of the stock market becomes your friend; the downward action is desirable. See the chart on the facing page.

Averaging Down: Another View



By averaging down, you will come to like down markets, which provide opportunities to collect more shares of ownership and build wealth over the long term. This strategy removes the need to monitor your account and feel as though you need to make changes during emotional periods. You can stop listening to ill-informed talking heads and publications that make you nervous and switch from a short-term unmanageable situation to a long-term controlled investment situation.

HOW AVERAGING DOWN WORKS

Suppose you buy one share (paycheck contribution) for \$1 and another when the market drops and the share decreases to 50 cents. This means the average share price for this investment becomes 75 cents, and you are breaking even. You no longer have to wait for the account value to return to \$1 before you get even again. If you loaded up on shares at 50 cents, the average share cost would lower even more, and you would be breaking even and showing a profit even sooner.

This is what happens when you make regular contributions to your retirement fund every pay period: You profit sooner and more often because more shares are purchased when the share cost is at its lowest.

Notice the differences between boxes 1 and 2 on the next page. The person in box 1 has a \$400 investment in January. He watches his account value go down and back up as the share price moves with the stock market. He owns 40 shares, and the share price goes from \$10 to \$8 to \$4 and back to \$8. By April, his \$400 investment is worth \$320. He saw the volatility of the stock market and probably sold his stock funds at some point to save his account value.

The person in box 2 made regular paycheck contributions to her account. At the end of the same period, her account has \$400 invested — as much as the person from box 1 had — but her account value is \$480. This investor focuses on the accumulation of wealth, not her account

value. When the fund was \$4 a share, she raked in 25 shares of ownership. She bought more shares when they were “on sale” — or low. That allowed her to lower her average share cost and turn a profit sooner, even though the share price still is lower than the \$10 starting price.

BOX 1

Invest a Lump Sum

January: \$400 in ABC mutual fund at \$10 a share buys 40 shares

February: stock price \$8

March: stock price \$4

April: stock price \$8

Value in April: \$8 a share \times 40 shares = \$320 (or a -20-percent return)

BOX 2

Invest Monthly (Averaging Down or Dollar-Cost Averaging)

January: \$100 in ABC fund at \$10 a share buys 10 shares

February: \$100 in ABC fund at \$8 a share buys 12.5 shares

March: \$100 in ABC fund at \$4 a share buys 25 shares

April: \$100 in ABC fund at \$8 a share buys 12.5 shares

Value in April: \$8 a share \times 60 shares = \$480 (or a 20-percent return)

These two investors are complete opposites. In box 1, the investor panics as the market drops and his investment value decreases. He's guessing when to bail on stocks to protect his value. Meanwhile, the investor box 2 isn't worried about the market decline. Her program is on autopilot, and she realizes her ownership shares are increasing because of the down market. Over the long term, the box 2 investor knows she'll look back in the future to see how much lower the stock market was in the past — and recognizes down markets ultimately increased her account value.

What does this mean for you?

- First, don't let financial service firms and the media convince you investing is technical and complex. By averaging down, it's simple.
- Next, realize that down periods in the stock market are required for average income earners to build wealth. Wealth is about ownership. The shares in stock funds represent ownership in some of the world's best companies. Down stock markets provide the only opportunities for you to own enough to build wealth.
- Those who own the most shares win.

This is why a down market is your friend. A down market is the only way average wage earners and investors can build wealth. If the market only went up, our money would buy less and less over time because of ever-increasing prices. The stock and bond markets are dependably up and down, and that's a good thing.

Risk in the stock market is about a falling market, right? Not anymore. A falling market is your friend.

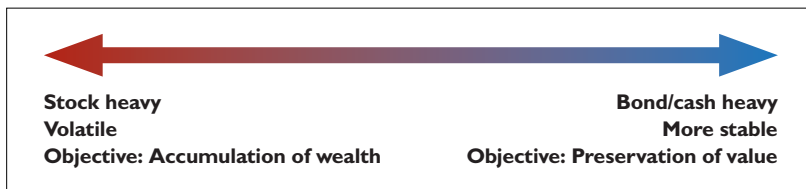
Risk management lesson No. 2: Manage risk by taking a long-term view and averaging down.

Chapter 3

Portfolio Allocation Management

Allocation is the mix of stocks, bonds, and cash (among other things) in an investment account. For illustration purposes, an example of an allocation is 80 percent of the value of your account invested in stocks, 15 percent in bonds, and 5 percent in cash.

Your allocation is how you control the long-term returns and volatility of your portfolio. Here's how it works.

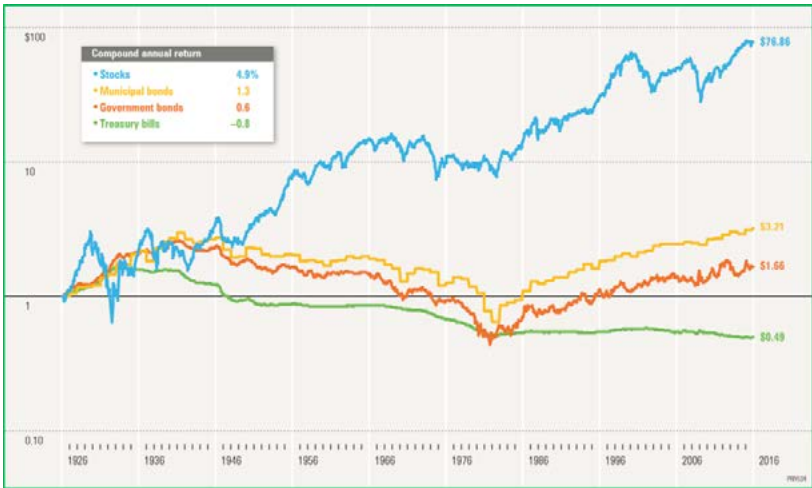


Over the long haul, stocks (for those with a Thrift Savings Plan [TSP]: the C, S, and I funds) outperform bonds (TSP F fund), and bonds outperform cash (TSP G fund). Stocks are more volatile than bonds and bonds more than cash. Put these data together and you get greater returns over time with stocks, but the ride will be bumpy.

Check out the chart on the next page showing the long-term results of various assets, including the impact of taxes and inflation.

As you review these data, please keep in mind you will be an investor until the day you die. Even in retirement, you must ensure your investments stay ahead of taxes and inflation eroding your accounts' value — especially considering your retirement years probably will last for many decades.

Ibbotson® SBBI® After Taxes and Inflation, 1926–2015



Stocks equal growth and wealth accumulation. Bonds and cash are for wealth preservation. Too many people save in bonds and cash believing they are accumulating wealth. Historically, after taxes and inflation, bonds and cash savings don't provide enough return to build wealth. That means to build wealth in bonds and cash, you have to save larger proportions of your income to compensate for the smaller returns. Have a plan to use stocks for wealth creation and take advantage of the volatility of the stock market.

Source: *Morningstar*

Notice how the stock line provides the best long-term returns. Given its volatility in the short-term, it is the perfect situation for the “averaging down” strategy. Taking the long view, you’ll be glad every time stocks drop, because each dip is a chance to rake in more shares before the next higher advance up the stock chart.

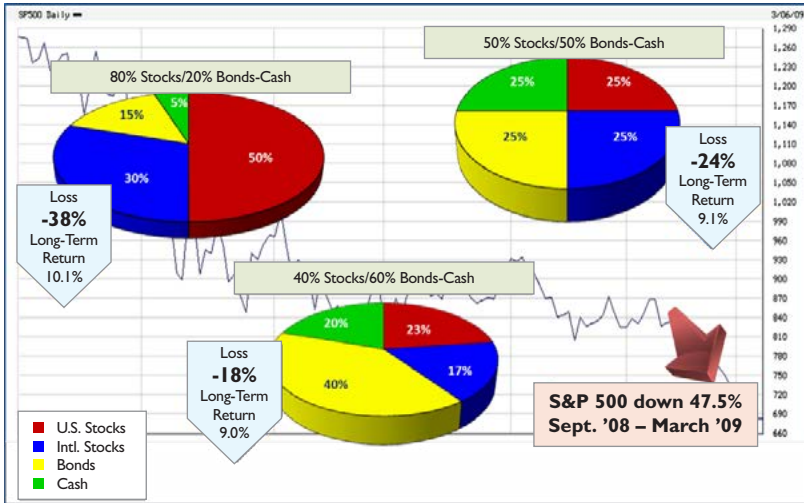
- People far from retirement age tend to be heavy into stocks.
- People closing in on retirement tend to shift gears.

Investors with 10 or more years until retirement want and need the volatility in combination with the greater returns to build wealth. Their mission is to accumulate ownership, which builds wealth. The value of your account is not an issue at this point in time. The accumulation of shares is everything; lots of ownership.

Those closing in on retirement need to start the shift from “share accumulation” to the “protection of account value.” You need to stabilize your account value (without sacrificing necessary growth potential — portfolio balance is critical) so the value is there for you when you retire. If your portfolio is too stock heavy and the market dips as you close in on retirement, your account value will suffer, possibly leading to a lower standard of living or having to work longer.

Here's how to manage your portfolio and make your allocation work for you. The chart "Allocation Matters" is based on real-life situations. The Standard & Poor 500 index dropped 48 percent between September 2008 and March 2009. You can see how different allocations reacted to the 48-percent drop in the pie charts.

Allocation Matters



For those with 10-plus years until retirement, the 80/20 portfolio dropped 38 percent, which is good news for people accumulating wealth as the market drops. Most people will be taking action to stop the bleeding of value in their accounts. Resist the urge to follow the herd.

Those within 10 years of retirement should be thinking about protecting their account values — for example, the 50/50 or 40/60 split. They suffered a loss of value as well, but it was a more reasonable and manageable amount. Ask yourself this question every year:

If the stock market took a 40-percent drop today, would you have time to recover before you need your assets for retirement?

As you mull this over, consider whether, and for how long, you still would be averaging down. Averaging down shortens the recovery period. If you are not averaging down, your allocation becomes the primary strategy for managing risk. Therefore, your gains, losses, and recovery times rely entirely on your allocation to do all the work. If your allocation is doing all the work, a more balanced portfolio will work best over the long haul to smooth the bumps while maintaining enough growth potential.

You'll be retired for a long time — 20, 30, or even 40 years. Your accounts must continue to grow to offset taxes and inflation and ensure you don't run out of money, so you can't avoid stocks entirely. Stocks provide the ability to grow your money over time and offset the effects of taxes and inflation.

That's it. Stop trying to time the market by guessing when to buy or sell shares of specific funds in your account. No one knows when it's the best time to buy or sell, and you have better things to do with your time.

Risk management lesson No. 3: Your allocation should match your objective: the accumulation of ownership or preservation of wealth. Use your allocation as a faucet to increase or decrease the level of volatility and potential returns over time.

Chapter 4

Rebalancing Your Portfolio Allocation

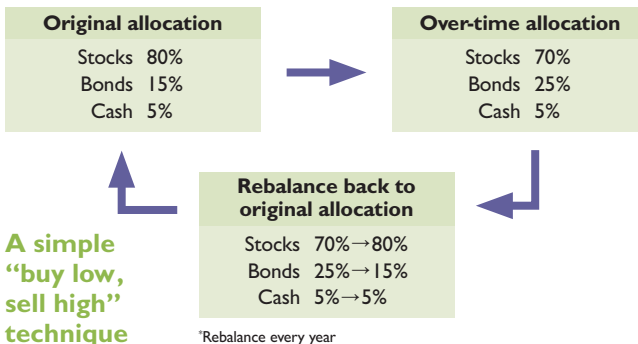
Rebalancing is a simple concept. You have a set allocation based on your objective. Over time, as stock and bond markets go up and down, eventually, your allocation will get out of balance, which means you are not maintaining your objective.

Suppose your intended allocation is 80-percent stocks, 15-percent bonds, and 5-percent cash. Over time, with the markets jumping around, your account might morph into a 70/25/5 allocation. In this example, your stocks decreased in value from 80 percent to 70 percent, while your bonds increased in value from 15 percent to 25 percent of your portfolio.

Either manage your account online or ask your 401(k) or Thrift Savings Plan provider to help rebalance your account back to your established allocation of 80/15/5.

Rebalance

**Stick with your allocation to meet your objective.
What you start with will change over time.**



To get your allocation back in its original state, the plan administrator will have to sell bond funds. The bonds are at 25 percent but should be at 15 percent. Technically, that means you have a profit in your bonds. You sell the bonds, which means selling high — a good thing.

The stocks are down from 80 percent to 70 percent. The profits from the sale of bonds will be used to buy stocks. The stocks are down at this point so you will be buying low — another good thing.

Now, your allocation is back to normal. Do this annually. Each time you do it, you will be buying low and selling high by accident. Who knew “buy low, sell high” could be so easy?

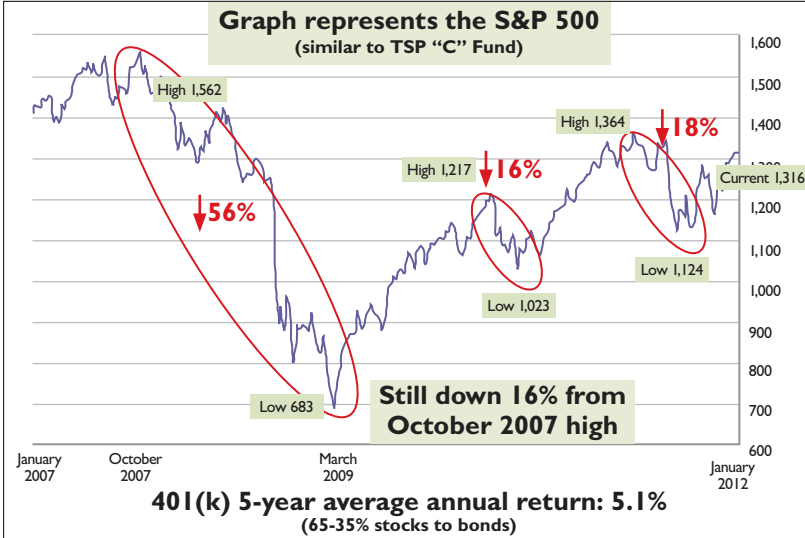
Risk management lesson No. 4: Rebalance to maintain your portfolio’s strategic objective.

Chapter 5

Positive Results in a Negative Environment

Averaging down, allocation, and rebalancing are three key investment concepts worth implementing. This chapter will look at a real-life example of the concepts in action by using real 401(k) results. This illustration shows how these investment concepts worked during a rough period in the stock market. Results will vary due to factors such as different fund choices, allocations, rebalancing times, and plan costs.

Personal Example



During one of the worst five-year periods in stock market history, 2007-12, a person with a 65-percent stock and 35-percent bond portfolio earned a 5.1-percent average-annual return. A person with a higher proportion of stocks would have seen a better average-annual return. How? Just by averaging down, having the proper allocation for his or her objective, and rebalancing — oh, and by ignoring all the so-called experts and news reports, staying calm, and sticking to the game plan.

Source: Chart and data is S&P 500 from Sept. 1, 2008 (1287.83) to March 9, 2009 (676.53), a decline of 47.5 percent. Long-term results are annualized returns for 30 years to June 30, 2009. Morningstar and Money magazine, September 2009.

We chose the five-year period from January 2007 to January 2012 because of the stock market's extreme volatility during this time. We used Standard & Poor's (S&P) 500 index graph because most of you probably have an investment option that allows you to invest in an S&P 500 fund. For those with Thrift Savings Plans (TSPs), it's the "C" fund.

The "Personal Example" chart on the previous page shows the S&P 500 over the five-year period. Besides the three obvious significant drops over the period, from the top of the period to the ending level, the market still is down 16 percent. If you were an investor in an S&P 500 fund in your 401(k)/TSP at this time, you might expect your account to be down 16 percent, or at least in negative territory.

Our 401(k) investment's annualized rate of return was 5.1 percent over this five-year period. The allocation was a relatively conservative 65-percent stocks, 35-percent bonds. Our allocation was based on a person who had about 10 additional work years. Given this person's working timeline, it would be okay if the stock market stayed on this rocky course for another five years or so.

How did this person have a positive return over this five-year period when the chart — and the media — might lead you to believe we should have had a negative return? It's about averaging down, allocation, and rebalancing working in concert. Buying stock funds as the market tumbled allowed this person to accumulate more and more ownership at bargain-basement prices. When the market hit bottom in March 2009, they started turning a profit quicker on more shares each time the market rose.

This is the type of market environment that deters many people from investing in stocks. Remember the media frenzy in 2008 when the housing market and Wall Street collapsed? People saw their account values plummet. Most people pulled their investments out of their stock funds late into the big dive between October 2007 and March 2009, according to money flow reports. Most waited many years after the time period conveyed in this chart for more consistent positive returns and for the economy to improve before they got back into stock funds. Most people who bailed their stock funds during the dive missed one of the greatest opportunities to build wealth they would ever have in their lifetime.

Risk management lesson No. 5: A comprehensive plan of multi-pronged strategies incorporating a long-term view, averaging down, proper allocation, and portfolio rebalancing will help you achieve your objectives. Knowing what you are doing will give you the confidence to succeed and not be tempted by the masses or your emotions.

Prepared by experts from the
Military Officers Association of America (MOAA)
Transition Center

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