

It's Your Money

Investment World

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Registered Investment Advisor vs Broker

Registered Investment Advisor (RIA)

- Legally functions under a *fiduciary standard*.
- **A fee-only RIA** does not sell products
- Paid only by their client
- Full and fair disclosure
- Must disclose conflicts of interest
- Disclosure document is Form ADV

Registered Representatives (brokers)

- Legally functions under a *best interest standard (6/30/2020)*
- Must act in the best interest of the retail customer at the time the recommendation is made
- Takes into consideration only the brokerage account available – not entire financial picture
- Sells a product for a commission
- Transactional relationship vs ongoing
- Disclosure document is Form CRS (Client Relationship Summary)

Regulators

- Financial Industry Regulatory Authority (FINRA)
 - Self-regulatory organization for all U.S. securities firms
 - Any individual who sells securities must register with FINRA under the sponsorship of a broker-dealer.
- Securities & Exchange Commission (SEC)
 - Regulates securities industry and RIAs with more than \$100 million in assets under management
- California Department of Financial Protection and Innovation (DFPI)
 - Regulates securities markets and RIAs with less than \$100 million AUM.

Key terms and factors

- Fiduciary – make sure they function under the *fiduciary standard* and must act in your best interest
- Fee-only – this aligns their interest with yours and reduces conflicts of interest
- Education – most widely recognized designations are:
 - Certified Financial Planner™ or CFP®
 - Certified Public Accountant (CPA) or Enrolled Agent (EA) – Specialize in taxes
 - Chartered Financial Analyst (CFA®) – Specializes in investments
- Assets are held at a 3rd party custodian, such as Schwab, Fidelity or others for your protection
- Confirm they can meet your individual needs:
 - Do they work with similar clients?
 - How often will you meet?
 - How do they make investment decisions?
 - What services do they offer?
- Review their Form ADV at <https://www.adviserinfo.sec.gov>
- Use Broker Check to see advisers' background and potential disciplinary history at <https://brokercheck.finra.org>.

Securities licenses

- Series 7: sell all securities products except commodities and futures
- Series 24: supervise and manage branch activities at a broker/dealer
- Series 53: supervise municipal securities activities of a securities firm or bank dealer
- Series 63: holder can solicit orders for any type of security in a particular state
- Series 65: holder can give investment advice
- Series 66: combination of series 65 & 63
- <https://www.finra.org/investors/professional-designations>. “FINRA does not approve or endorse any professional credential or designation.” 9 pages of designations.

CFP® designation

- 8 classes of core education
- Exam requirement
- 3 years' experience before you can use the CFP® designation
- 15 hours/yr of continuing education required
- 2 hours of that every two years must be on Code of Ethics

Before you make any investment

- Risks
- Tax implications
 - Some investments better inside a retirement account than a taxable brokerage account
 - Actively managed funds or active trading best inside retirement account
 - Passive/index funds best inside taxable brokerage account
- Alternatives to accomplish the same thing
- Ask what it takes to *get out* of it

Products offered

- Annuities
- Mutual funds/ETFs/Individual stocks and bonds
- Limited partnerships
- REITs
- Insurance
- Commodities
- Mortgage-backed securities
- Reverse mortgages
- Alternatives investments & Bitcoin

2 major investment philosophies

- Active vs. passive investing
 - Active implies there's a way to beat the market
 - Passive says long-term no proof someone can beat the market, so most efficient to **buy the market** using broad-based index funds
 - John Bogle, Vanguard founder, champion of low-cost no-commission index funds for the public

How to buy stocks and bonds

- Can buy individually or inside a mutual fund or exchange-traded fund or ETF
- Funds provide diversification, professional management, efficiency
- Mutual funds are a “pooled investment” with professional management, low initial investment and use every dollar of your investment
 - Management fees and expenses
 - May have commissioned sales charges or “loads”
- At purchase or “front-end” sales charges = A shares
 - **Example: 5.75% front load, invest \$100,000 and will have a commission of \$5,750, so you’ve only invested \$94,250**
- “back-end” sales charges when you sell = B shares
- C shares a “level load” that includes annual charges for fund marketing, distribution and servicing
- No-load = no commission

Mutual funds

- No transaction fee or NTF funds = no transaction cost to the buyer or seller, fund company typically pays the brokerage firm a fee to be available as an NTF fund on the brokerage “platform”
- Morningstar has 25,223 mutual funds
- Usually found inside retirement accounts because individuals invest regularly with certain dollar amounts

Exchange-traded fund (ETF)

- A type of pooled investment security that operates much like a mutual fund
- Unlike a mutual fund, trades like a stock with a per-share price vs investing every dollar, and prices fluctuate throughout the trading day
- Offer low expense ratios and fewer brokerage commissions than buying the stocks individually
- Can be more tax efficient than some mutual funds
 - Usually invest in a “passive index” of holdings, so not a lot of trading, very tax efficient
 - Uses a unique mechanism to buy and sell securities inside the ETF which makes them more tax efficient to own
- Brokerage firms often offer individual stocks and ETFs to buy and sell with no transaction fees

Individual bonds or “fixed income”

- A bond is a fixed-income investment that represents a loan made by an investor to a borrower, usually a corporation or government entity
- They usually have a fixed interest payment or “coupon” payment for the life of the bond, although some are “zero-coupon” payments, where the growth is accrued over the life of the bond and paid at maturity
- You can buy them individually or inside a mutual fund or ETF
- Rated by quality of the borrower. The higher the borrower’s credit, the lower the risk and therefore the lower the interest rate.
- Individual bonds have a fixed maturity date, provides some certainty of return of capital
- Buy inside a fund for diversification, professional management, but no certainty of maturity date
- A mortgage-backed security (MBS) is a bundle of home loans bought from the banks that issued them. For the investor, the MBS is as safe as the mortgage loans that back it up. So look to the credit quality! (Remember 2008 and the mortgage crisis, the movie The Big Short)

Real estate investment trusts, or REITs

- Two types, equity or mortgage REITs
 - They own real estate or mortgages inside the REIT
- Public REITs trade like a stock, required by law to pay out 90% of their income to shareholders
- Can specialize in certain types of properties, such as hospitals, office buildings, computer database companies, etc.
- May be purchased individually, or in a mutual fund or ETF
- The S&P 500 holds approximately 3% in REITs
- Private or “non-traded” REITs are a direct investment, have very high fees. Often formed as a limited partnership. Be very careful!

Commodities

- Grains, gold & silver, beef, oil, natural gas
 - Four broad categories: metal, energy, livestock and meat, and agricultural
- Known to be a risky investment because supply and demand is impacted by factors difficult or impossible to predict, such as weather patterns, epidemics, wars, etc.
- Can be seen as a part of a diversified portfolio, but are often represented in broad-based stock index funds such as the S&P 500
- Can invest in them via futures contracts, options, ETFs and mutual funds

Alternative investments

- Direct investments in precious metals or real estate
- Mutual funds or ETFs
 - Inverse funds (move the opposite of certain indices)
 - Long-short trades
 - Option trading
 - Leveraged equity (2x, 3x strategies)
 - Be VERY CAREFUL with these funds!!!!
- Viatical settlements (a policy holder has sold their life insurance and the viatical owner receives a pay off at their death)

Insurance – Annuities

Deferred Annuities

- Fixed – pays a fixed amount of interest. Multi-year guaranteed annuities or MYGAs are such a product.
- Variable – Money invested inside the policy in stocks and/or bonds so the returns fluctuate with market returns. You take on the investment risk and have the potential to make or lose money.
- Indexed annuity. Your return is linked to a stock market index, such as the S&P 500. You make (a limited amount of) money if the index goes up (the upside is capped), but if the index is negative your return is 0% instead of losing money. **You do not receive any dividends from the stocks within the index.** Gains very limited. Investor hears that there are “no fees,” when in fact the insurance company is making money on the difference between what you invest and what little percentage of that growth they pay you in return.

Annuities

They have various fees

- Mortality and expense – the general cost to have the annuity
- Administration – may be combined
- Fund expense – annual costs for the “sub-accounts” or funds inside the annuity
- Rider costs (if any) – for additional guarantees inside the annuity
- Contingent deferred sales charges (CDSCs) in a deferred annuity if you sell too soon, say over 7 years

Examples of VA fees

M & E	1.25%
Administration	0.25%
Fund expense ratio	1.00%
<u>Living Benefit Rider</u>	<u>1.00%</u> (guarantees a payout while the annuitant is still alive).
Total annual fees	3.50%

Annuities

- Immediate annuities
 - Provide an income for a period of time, e.g., lifetime, joint and survivor, etc. Check out www.immediateannuities.com for examples.
- An annuity can be a noun, such as an insurance product, or a verb, when you choose to “annuitize” an amount of money to give you a series of payments. For example, some companies will buy an annuity to provide employees a pension.

Reverse Mortgage



▪ Sources: Wade D. Pfau, www.retirementresearcher.com