



glossary of terms

Sources: www.wikipedia.org, www.investopedia.com

Investment earnings – interest, dividends, capital gains that accumulate in an investment account

Capital gain – an increase in the value (e.g. the stock price) of an investment or asset (e.g. real estate) that is not realized until the investment is sold when the investor sells it at a higher price than the original purchase price

Taxable – an investment account (e.g. mutual fund or index fund) in which the investor pays no income tax on increases in the investment's value until it is sold for a profit; the tax rate on the earning depends on the time over which the investment is held and the tax bracket of the investor

Tax-deferred – an investment account (e.g. IRA, 401K) that enables investors to postpone income tax on investment earnings in the account until some point in the future, allowing tax-free growth in the account, (often retirement or the age of 60) in exchange for very limited access to that money until that point

Tax-exempt – an investment account (e.g. Roth IRA) in which investors never have to pay income tax on the earnings generated in the account

Capital gains tax – a type of tax levied on capital gains or earnings incurred by individuals or corporations on their investments or assets and are only paid when the investment is sold

Mutual Fund – a security that gives small investors access to a well-diversified portfolio of equities, bonds and other securities; each shareholder participates in the gain or loss of the fund. Shares are issued and can be redeemed as needed

Brokerage account – an arrangement between an investor and a licensed brokerage firm that allows the investor to deposit funds with the firm and place investment orders through the brokerage for execution

Brokerage fees - Brokerage commissions are the fees that you pay a broker to buy or sell stocks, bonds or other securities. Brokerage fees are added to the cost of buying a stock or other security. They are added to your basis, which is the cost of buying a security. Brokerage fees lower investment returns

Commission – a service charge from the broker or investment adviser in return for providing investment advice and/or executing security transactions, which will vary according to how much advice and customized service the brokerage firm offers to the investor

Maintenance fees – a fee charged by the broker in exchange for holding and maintaining an investment account with that firm

Cash account – the most common brokerage account in which the investor deposits cash into the account, which is then used by the broker in executing security transactions

401K – an investment account established by employers that enables eligible employees to make salary-deferral (salary-reduction) contributions on a post-and/or pre-tax basis while employers can make matching contributions to the employees' account; earnings accrue on a tax-deferred basis and there are limitations on the timing and amount of withdrawals until a certain date



Traditional Individual retirement account (IRA) – a tax deferred investment account into which investors can contribute their earnings up to a specified dollar amount and withdrawals are treated as ordinary income and may be subjected to income tax when those withdrawals are made

Roth IRA – a tax-exempt investment account in which investors can contribute up to \$4000 of their annual earnings provided they make less than \$95,000 annually or until their annual salary exceeds that threshold that cannot be accessed until the investor is 59.5 years old

Market order – an order to a broker to buy or sell a stock at the best available price

Limit order – an order to a broker to buy a set number of shares below or at a certain price or to sell a set number of shares above or at a certain price, which typically cost more than market orders

Stop order – an order to a broker buy a security until its price rises to a certain designated price or sell a security until the price falls to a particular point

Taxable account - A taxable account is an account that does not receive the tax breaks that either a tax-exempt account or tax-deferred account are eligible to receive. (Both of these accounts are called tax-advantaged accounts. Tax-advantaged accounts are authorized by the IRS as investment vehicles to save for your retirement or the retirements of investors.)

Tax-advantaged account - A tax-advantaged account is an investment account with tax-deferred or tax-exempt features. The Internal Revenue Service authorizes the use of tax-advantaged accounts. These accounts are used to save for retirement or college and other educational expenses. Tax-advantaged accounts are tax-exempt until you take money out of the account. In some cases, distributions are tax-exempt provided the account holder meet certain conditions or the money is spent a certain way. In other cases, the entire amount of distributions is taxable.

Holding period - Holding period is the period you own an investment. Rate of return that you earn over this period is called the holding period return (HPR). For long-term capital gains, your holding period must be more than one year.

Dividends - Dividends are a distribution of profits that companies and mutual funds make to shareholders. Dividends are taxed as ordinary income and are often paid to shareholders on a quarterly (every three months) basis. You can reinvest your dividends in additional shares of a fund or stock or you can spend them.

Reinvesting - Reinvesting is the act of investing dividends and capital gains that you receive from a company or mutual fund into additional shares of the stock or fund. You may also choose to reinvest the dividends or capital gains in a different investment and interest rate. Investment performance of a stock or mutual fund often assumes that dividends and capital gains are reinvested in additional shares.

Total return - Total return is a rate of return that measures the investment performance of stocks, bonds, and mutual funds that invest in stocks or bonds. Total return assumes the investor reinvests any coupon or dividend income in additional shares or bonds. Realized or unrealized capital gains (change in the price of the security) are also included in the calculation. For periods longer than one year, the rate of return is generally shown as an annualized rate.



a closer look at investing and taxes

<http://money.aol.com/basics/>

- Whether you invest in a mutual fund, buy a CD, or purchase a stock your investment usually generates investment income. Mutual funds are professionally managed companies that invest in securities and pass on most of their income to investors who buy shares of the fund. In the case of stocks and mutual funds, income is earned as dividends. Dividends make up a type of investment income that is taxed at the same rate as capital gains.
- In the case of bonds and savings deposits, income is earned as interest. Interest is an expense that the company is paying to you. Interest makes up a type of investment income that is taxed as ordinary income. Ordinary income includes wages, salaries and other income that is not considered as capital-gains income.
- If you earn more than \$400 in dividends or interest with a taxable account, the Internal Revenue Service requires you to complete an additional schedule with your 1040 Form. Each institution that pays you dividends or interest is required by law to mail you a Form 1099 by Jan. 31 to help you gather the information necessary to file your income tax return.
- If you invest in a taxable account, your dividend and interest income is, naturally, taxable. But if you invest in a tax-deferred account -- an IRA or 401(k) plan for example -- you don't report the income until you begin to take distributions from the account.
- A common mistake occurs if you reinvest dividends earned on a stock or mutual fund. Reinvesting is a common investing strategy that consists of rolling over investment income into additional shares of the stock or fund. Investors sometimes think, mistakenly, that they don't have to report reinvested dividends and capital gains as income since they don't handle the money. In fact, they must report reinvested income on their tax returns.
- In the U.S., dividends are often paid four times a year. Bond interest is usually paid twice a year. The frequency that you receive dividends and interest -- your investment cash flows -- contributes to the total return you earn on an investment. Total return includes capital gains and any reinvested dividends or interest.
- When you file your income tax return, you can add certain expenses such as brokerage fees to calculate the basis of the asset. Increasing the basis allows you to report a smaller capital gain. For example, if you paid \$1 in brokerage fees to buy your \$15 share, your basis would be \$16. If you sold the share for \$20, your capital gain would be \$4.

the basics

brokerages (i.e. Fidelity Investments, Ameritrade, E*Trade, Scottrade, etc.)

- Brokers are middlemen that mainly exist to execute your trades.
- There are full-service and discount brokerages.
- Full-service brokerages offer recommendations and handholding, and for that they typically charge you up to \$100 or even several hundred dollars *per trade*. (This is why stockbrokers make so much money)



- However, if you want to conduct your *own* research, you can open your account with a discount broker. They typically charge \$10 or \$15 or less per trade and offer an ever-increasing array of services—including published research reports featuring recommendations.

mutual fund companies (i.e. Vanguard Funds, Fidelity Funds, American Funds, Franklin-Templeton, TIAA CREF)

- A Mutual Fund Company is a company that pools money from shareholders and invests in a variety of securities such as stocks, bonds, and money market instruments. (from Google Dictionary)
- However, you don't have to open up an investment account at a mutual fund company if you want to invest in a *mutual fund*. Most mutual fund companies offer brokerage services, and their commissions are usually significantly higher than online discount brokerages.
- A mutual fund company is a good choice if your plan is to invest only in index funds, especially if you are inclined to add small amounts to your account on a regular basis.
- Many discount brokerages will let you invest in mutual funds for free, so it makes little sense to go with a mutual fund company if you have plans to invest in individual stocks as well. (At the very least, perhaps you could invest in your desired index/mutual funds through the company, but also open a separate brokerage account for stock investing.)

comparing brokerages

There are, broadly speaking, two factors to consider when choosing a discount broker: fees and services

fees

- **how much do they charge per trade for a market order?** (A market order is just an order at the price that the stock is at in the market... basically you saying “buy” or “sell,” but not specifying any specific price. The answer might range from \$7 or less up to \$30 or more. If you only plan to trade once or twice a year, the difference shouldn't matter too much. But if you trade twice a month, the difference between \$10 and \$25 trades amounts to \$360 per year. (You may also worry about fees on “limit orders,” which you should be aware of if you want to be a bit more advanced in your investing))
- **is there an account minimum?** Is it lower for IRAs? Is it lower if you agree to an automatic deposit plan? If you're flush with funds, this factor might not be a deal-breaker for you. But if you've got just \$1,000 to invest, you can cross off any brokerages with minimums higher than that.



- are there any account maintenance fees (especially IRA fees)? What about account closing or transfer fees? Compare the fees that you're likely to be charged at any brokerages you're considering.

services

- **how you can trade:** All online brokers offer Web-based trading, but do they also allow you to make trades over the phone -- either by using a touch-tone keypad or by speaking to a human being (and how much more do they charge for these services)? Also, do they have local offices near you (if that's important to you)?
- **customer service:** Do they have a reasonably good reputation for customer service (i.e., if you need to speak to someone do you have to be put on hold for seven hours)? You can assess this for yourself just by calling or emailing each contender and asking any questions you have.
- **account statements:** Are their account statements easy to read? You may be able to view sample statements on their website. If not, perhaps some contenders will fax or mail you samples.

mutual funds/mutual fund companies

- Does the fund you're interested in have loads (i.e., commissions) or any other fees associated with it besides modest annual maintenance fees?
- What's the account minimum? Is it lower for IRAs or if you have an automatic deposit plan?
- Are there IRA account maintenance fees?
- What are the account closing or transfer fees?

making a choice

Check out a bunch of brokerages, make sure you understand the fee structures, look over the various services and features of interest, and then pick one. If you're getting butterflies in your stomach, pick one with no transfer or account-closing fees, and remind yourself that you can always switch if a better deal comes along.

Popular Online Discount Brokers:

Fidelity

www.fidelity.com

E*Trade

www.etrade.com

TD Ameritrade

www.ameritrade.com

Charles Schwab

www.schwab.com

Bank of America

www.bankofamerica.com/investing

Scottrade

www.scottrade.com

Sharebuilder

www.sharebuilder.com

Mutual Funds:

"Money 70:" best mutual
funds Money Magazine
money.cnn.com > rankings



opening the account

Although IRAs require some additional paperwork, opening a brokerage or mutual fund account is just like opening a bank account. Fill out a form and send them your money. Remember, you don't have to invest right away. You can put your money in a money market fund and let it rest a while before it's put to work in an index fund or stocks, and you'll probably be earning more in the money market account than you got in your savings account.

To set up an account with a mutual fund company, simply call the company (many phone numbers are listed online) to ask for an account application or go to its website where, in most cases, you'll be able to download an application. Remember to ask for an IRA application if that's the type of account you want to open.

Once you get to the site, you can print out the application forms, sign them, enclose them in an envelope with a check to initially fund your account, and you'll receive confirmation of your ability to start trading in pretty short order.

kinds of brokerage accounts

A brokerage account application will want you to choose among different types of accounts. So let's review the options here.

cash account: This type of account asks you to deposit cash (doing so with a check is fine), and then you can use that cash to buy stocks, bonds, mutual funds, etc. It's not much more complicated than that. Cash accounts are ideal for beginning investors.

margin account: In a margin account, the cash and securities in your account act as collateral for a line of credit available to you from the brokerage. In other words, with a margin account, you can borrow from your broker in order to invest in additional stock (or even just for your personal use). The interest rates that brokers charge, while below typical credit card rates, make the return that you need to earn on your investments much higher than if you're investing with your own cash. For example, if you're being charged 9% margin interest, then you'd better earn a good bit more than 9% on your investments in order to make the borrowing worthwhile. If your holdings head south for a while, you may find yourself making hefty interest payments while waiting for your investments to recover. (Alternatively, you might sell some of your holdings at deflated prices in order to cover your loan, or you might have to scrape together additional cash to deposit into the account.)

Margin accounts are generally for advanced investors. Still, even for seasoned investors, borrowing more than, say, 20% of the value of your holdings is pretty risky.

option account: This type of account allows you to trade options, which is a much riskier business than trading stocks. In general, options are also for advanced investors. They have relatively high fees associated with them, a short timeline, and can result in you losing *all* the money you put into them. (Very few stocks ever get to zero value like options can -- and often do.) Even options on good stocks can be bad investments. Most brokers won't let new investors open option accounts, so you don't need to worry about this one for a while.



IRA account: The popular Roth IRA is the best option for anyone who qualifies. Most of the tax-related work is done for you by the brokerage. (Note: Check to see if the broker charges an IRA account fee. Some do, and the service they provide is worth paying for, but some don't, and why pay if you don't have to?)

Be sure to specify whether you want to open a Roth IRA or a traditional IRA. The application form for each will be a bit different. Mainly you will have to specify beneficiaries who will get the account in the case of your death. Both mutual fund and brokerage accounts can be IRAs.

which account is right for you?

If you qualify for a Roth IRA, that should probably be your first choice. The tax advantages are so great that there just isn't any reason not to. After you've maxed out your Roth account and any company retirement plans, a plain cash account (or margin account if your broker requires it) is your next choice.

once the account is open

You generally go to the broker's website and log on with your account number and password. You can then check quotes, view your portfolio and account balance, and, if you like, make a trade. You can also view a history of prior trades over a given time period.

If you've never placed a trade over the Internet before, you might want to choose a brokerage that offers phone trading -- just in case. A phone trade will cost more, but you also get to pick the brain of the broker. After that, the next time you trade, the online form probably won't seem so intimidating.

Broker	Rank	Fees	Cash Rate	Products	Banking Services	Trading Tools	Research	Customer Service	Comment
E*Trade	1	9.99	3.25	*****	*****	*****	*****	*****	Top-ranked for second straight year, with high scores across the board.
Fidelity	2	10.95	2.66	*****	*****	*****	*****	*****	Strong in mutual funds and research, but some commissions on high side.
TradeKing	3	4.95	1.88	*****	***	*****	*****	*****	Improved service and low commissions. Weaker fund selection.
TD Ameritrade	4	9.99	0.1	*****	**	*****	*****	***	Thorough and easy-to-find research; plentiful trading tools.
Charles Schwab	5	12.95	2.01	*****	*****	*****	*****	***	Best mix of mutual funds and other investment products.
Firsttrade	6	6.95	1.99	*****	*****	***	**	*****	Speedy e-mail responses and phone pickup times. Lacks robust research.
OptionsXpress	7	9.95	0.75	*****	**	*****	***	***	Plenty of trading tools, but customer service slow with e-mails.
Muriel Siebert	8	14.95	2.31	***	*****	*****	***	*****	Improved customer service; limited investment products.
Scottrade	9	7	0.5	*****	*	*****	**	*****	Largest network of branches, but lacks many banking services.
Interactive Brokers	10	1	1.82	**	*	*****	**	**	Lowest commissions and fees overall, but spotty elsewhere.
WellsTrade	11	19.95	2.23	***	*****	*	***	*****	Combined \$25,000 in bank and brokerage earns 100 free trades.
Banc of America	12	14	2.22	*****	*****	***	**	*	360 free trades require \$25,000 in bank linked to a brokerage account.
WallStreet*E	13	9.99	1.99	*****	*****	***	*	*	Customer service needs work, but strong in mutual funds and banking.
Zecco Trading	14	0	2.02	**	***	*	*	*	The pitch: 10 monthly free trades.
SogoTrade	15	3	0.75	*	*	*****	*	**	The Catch: poor customer service.
ShareBuilder	16	9.95	2.03	**	*	*	**	*	No mutual funds and little research, yet numerous trading tools.
									Phone and e-mail service slow; scant research and tools.

Source: SmartMoney Annual Broker Survey

Source: Unless otherwise cited, all the information above was edited from Motley Fool's "How to Start Investing" guide, which is a great resource for those who want to learn more. The link is here: <http://www.fool.com/seminars/sharebuilder/index.htm?sid=0008&lid=600&pid=0000>.