

# Building a Portfolio

**Setting:** Financial planning office (one desk with Sally seated on one side and two chairs on the other in front of classroom)

**Roles:**

- Sally - financial planner
- Sam and Lin - married couple
- Tommy - recent college graduate
- Jose - a local entrepreneur
- Frugal Fred - podcast sidekick
- Narrator

**Narrator:** Welcome to Sally's Financial Planning Office!

**Sally:** (waves and smiles to class)

**Narrator:** We will be observing Sally interact with various clients today. Pay special attention to how she interacts with each client and the advice she gives them. Look! Right now we have our first clients of the day, Sam and Lin, walking into the office.

**Sally:** Good morning, Sam and Lin. I am so happy to see you today. My secretary said you want to know more about index funds today, is that correct?

**Sam:** Yes, Sally. I just attended a retirement seminar at work, and they kept mentioning index funds. They even quoted Warren Buffet saying "The best way, in my view, is to just buy a low-cost index fund and keep buying it regularly over time".

**Lin:** What does this all mean?

**Sally:** Great question! Let's first start by explaining what an index fund is. An index fund is a collection of stocks, bonds and other investments in one grouping. Unlike mutual funds, index funds rarely have a professional manager because they simply follow a market index. As the market index goes up, the index fund will increase in value, and vice versa. As the market index goes down, the index fund will lose value.

**Sam:** I have to ask, what is a market index?

**Sally:** Sure. Let me explain. For example, the S&P 500 is an index of the 500 largest companies in the U.S. stock market. If you buy into this index fund you are buying a percentage of those companies. As the market index goes up, the index fund will increase in value. Vice versa, as the market index goes down, the index fund will lose value. And, of course, as the index fluctuates, so does the value of your investment.

**Lin:** So, which one should we select for retirement—index funds or other mutual funds?

**Sally:** Both have their pros and cons, but index funds often outperform other mutual funds and have lower fees. This means you may have the potential to earn more and pay less in an index fund than in other types of mutual funds.

**Sam:** Can you explain that a little more? Why are index funds less expensive? Do they have professional managers like mutual funds? And what about the risk?

**Sally:** That's a lot of questions, Sam. Let's take them one at a time. Most mutual funds have various types of fees because they have professional managers, but index funds rarely do. Having no fees

reduces the overall cost. While mutual funds have relatively low fees, they sure add up over a number of years. Now, risk. There's very little difference in the risk of index funds and other mutual funds.

**Sam and Lin:** Thanks, Sally. This helps us make an informed decision moving forward. Well, we have to get back to work now but will keep in touch with our decisions.

**Sally:** Anytime, Lin and Sam! I look forward to talking with you soon.

**Narrator:** Tommy, a recent college graduate, enters the room as Sam and Lin are leaving. Tommy is looking for ways to keep his costs low when investing and wants to know about the different fees investors may encounter, so he sits down to visit with Sally.

**Tommy:** Hey, Sally, I need some advice. I like to save money and make money. I am looking at investing my income into different accounts, but I'm so confused with all these fees! Can you explain them to me?

**Sally:** I am so happy you came in! Yes, I am happy to explain some common investing fees. First of all, you may encounter brokerage account fees. Brokerage fees are annual fees charged by a financial institution to maintain an account for you. Second, trade commissions are fees paid to brokers who provide a service by buying and selling investments like stocks, bonds, or other investments for you. Third, mutual fund transaction fees are fees you get charged when you are buying and selling mutual funds.

**Tommy:** That sure is a lot of fees!

**Sally:** Wait, that's not all. Expense ratios are annual fees charged by mutual funds, index funds and investment funds. Finally, sales loads are commissions paid to brokers. You might also pay advisory fees, such as what you are paying me to be your financial advisor.

**Tommy:** Wow. Thanks for letting me know.

**Sally:** And remember, all of those fees reduce the rate of return you earn on your investment. So, understanding fees is important to protect the value of your portfolio.

**Tommy:** Gee, I hadn't thought of that. One more question, Sally. Is it true the more I pay someone the better advice I get?

**Sally:** (Laughs...before answering). Well, there's really is no evidence that fees influence the quality of the mutual fund, so paying fees does not mean that one mutual fund has a better rate of return than another – or that one advisor is better than another. The best advice I can give you is to ask a lot of questions before signing any papers or making agreements. Finding reliable sources of information can make you informed and help you make better choices.

**Tommy:** Thanks, Sally! And that is why I pay advisory fees, right? I look forward to checking in with you soon.

**Sally:** Sure, Tommy. Any time. That's what I'm here for.

**Narrator:** Tommy exits the room and the next client, Jose, enters the office. Jose is a successful entrepreneur who is looking at his investments and trying to find a consistent, stable plan for him to build wealth with his various businesses and for his family.

**Jose:** Hi Sally!

**Sally:** Good afternoon, Jose. I am so happy to hear about the success of your businesses around town. I just visited your restaurant last week and it was wonderful!

**Jose:** Thank you, Sally. The last time I was here, you told me that I should save “early and often”. This got me thinking about all my investments. What are some ways I can start making regular contributions and building my wealth?

**Sally:** Great questions, Jose. As we discussed last time, the investment strategy of “dollar-cost averaging” means you invest a specified dollar amount on a regular basis no matter what the market is doing. Have you been doing this?

**Jose:** Not really. What if the market is doing terrible?

**Sally:** While it may be tempting to stop investing when the stock prices drop, it is best to continue because investing is a long-term commitment. You can actually buy more shares at lower prices, which will allow your investments to grow when the value rebounds. It’s like buying supplies for your business while they are on sale. Of course, no one can predict what will happen to the market, but over time you can ride through any fluctuations in prices. Diversifying your investments also is key.

**Jose:** Remind me what it means to diversify.

**Sally:** Diversifying says you want to vary the risk and investments in your portfolio. Stay tuned for my podcast for more information, Jose. We’re going to talk about that. I’m the guest host this month. My first segment is called Building a Portfolio. Gotta run. It starts in five minutes!

**Jose:** Thanks, Sally. I sure will! You’ve given me several things to about before our next meeting.

**Narrator:** Now for a commercial break from our teacher while Sally gets ready for her first caller.  
(Wait for teacher’s instructions before continuing.)

**Narrator:** Sally grabs her headphones, microphone and laptop as she starts her podcast. Today’s topic is Building a Portfolio. It’s about how you can determine which collection of investments can help you achieve your specific financial goals.

**Sally:** Welcome to Sally’s Financial Advice podcast! I am filling in for Budget Bob while he’s on vacation in the Bahamas this month. Today, we’re going to discuss how to build an investment portfolio. My sidekick, Frugal Fred, is joining me today as well.

**Frugal Fred:** Thanks, Sally. I’m excited to be here! It looks like we already have an email from Henry who has a question about how to open an investment account.

**Sally:** Wow. That’s a great question, and a great way to start our program. Henry, here’s what I’d recommend for someone who wants to start investing. Remember, there are a lot of options to a new investor, so it’s important to consider what kind of account you want. Do you want something online that you can manage yourself or do you want to come to a broker like me? A brokerage firm like mine can provide more assistance but generally has more fees because you’re paying for our help. Either way, you’ll want to find the brokerage firm that’s best for you. A brokerage firm is simply a company that buys and sells stocks and bonds.

**Frugal Fred:** Great advice, Sally. Anything else for Henry?

**Sally:** I probably should add that you should also compare the various fees and services offered when comparing brokerage firms. While we all do basically the same thing, we are still a little different. Once you decide what kind of account you want and what broker you want to use, then you’ll just need to fill out some paperwork and start investing. It’s all really rather easy to do. Most firms will open an account for you with a minimum of \$100. And with some investment apps, you can start with even less.

**Frugal Fred:** Thanks for the question, Henry. It's a great lead-in to the rest of our discussion on portfolios today. Building an investment portfolio that works best for you is so important. You need to look at your financial and personal goals, the amount of money you have to invest and the amount of time you need to meet your goals.

**Sally:** Yes, the "safest" investment may not always be the right choice. Diversification is key factor, too. I also like to educate others on the rate of return (ROI), which is taking the earnings or profit you gain from your investment and dividing it by the cost or the amount you paid for your investment.

**Frugal Fred:** Yes, it is very helpful to do this, but remember ROI does not include any risk that is associated with that investment and will not tell you about potential losses. You mentioned diversification. I want to echo that! It simply means not to put all your eggs into one basket. In investment terms, make sure to include stocks, bonds, and a variety of higher and lower risk investments when you are building your portfolio.

**Sally:** Correct, Fred! By diversifying, you can protect the overall value of your portfolio because if one sector of the economy is declining, other sectors may be growing or remaining stable. This helps you provide yourself a more secure financial future.

**Frugal Fred:** I think we are a great team, Sally! This has been fun. Now, let's start taking some phone calls and get on to the fun questions!

**Narrator:** Sally and Fred continue to discuss portfolios with callers. They remind the callers that building a portfolio is not a one-time shot. Once you start, you will want to keep it on track by reviewing its performance. That doesn't mean you need to make a change in the contents of your portfolio every time something fluctuates; instead, you will want to make periodic reviews to rebalance your investment as needed or to meet any changes in your goals. Financial planners often recommend that young people have a greater percentage of their portfolio in higher-risk investments than people who are nearing retirement. Therefore, as you get older, you may need to rebalance by moving some of those higher-risk investments to more moderate/low-risk investments. You may also want to make some changes if you get married, have children, or have other changes in your personal life.

Achieving your long-term goals requires taking some risks. But building a good portfolio can help better manage those risks. Choosing the right mix of investments and keeping them balanced throughout your life will have a big impact on the outcome.

Now, back to our teacher to wrap up the show.

**Part 1.** Sally's Financial Planning Office. Listen carefully for the following terms and write down their meaning as Sally answers questions from some of her clients.

Index Funds:

Market Index:

S&P 500:

Mutual Funds:

Brokerage Fees:

Trade Commissions:

Mutual Fund Transaction Fees:

Expense Ratios:

Sales Loads:

Advisory Fees:

Dollar-Cost Averaging:

**Part 2:** Sally's podcast. Listen carefully for the following terms and write down their meaning as Sally and Frugal Freddie start the podcast.

Portfolio:

Brokerage Firm:

Diversification:

Rate of Return:

**Part 3. Questions**

a. Why is it important to diversify your portfolio?

b. List two questions you should ask before investing.

c. When should you re-evaluate your portfolio?