

What Every Investor Should Know...

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Defining Your Investment Objectives

Each investor has unique investment objectives that are affected by short- and long-term needs and requirements. This fact sheet will help you work with your financial adviser to determine how to best meet your financial goals.

Setting Goals and Identifying Needs This step provides the foundation of your relationship with a financial adviser. Step back and reflect on your short- and long-term goals, such as funding college for children, business expansion, travel plans, or retirement needs. You should identify these goals with your financial adviser so that his or her recommendations will directly address your needs.

(See the CFA Institute fact sheet “Managing the Relationship between You and Your Adviser” for more information on how to effectively communicate with your adviser.)

Risk Tolerance Risk is often defined as portfolio volatility, or the fluctuation in the value of your assets over time. At a personal level, risk can mean the chance that you won’t achieve your goals or the risk of losing your savings. Understanding your tolerance for risk, which differs for each investor, is key to choosing an investment program.

Your tolerance for risk is a very personal characteristic that may be difficult to determine and may change over time. Your emotional make-up plays a role in your willingness to take risk. But your objective ability to bear risk, given your wealth and financial needs, is important too. Your age may also affect how much risk you can assume: As you become older, there is less time to recover from poor investment results and your appetite to take risk may change — but your wealth and circumstances will probably change too. You may also have different risk tolerances for different parts of your portfolio, for example, money intended for retirement and educational funds for children.

Income Both your absolute income level and your return requirements may influence your investment decisions. Taxable investors — those who currently pay taxes on their investments rather than those who defer them — need to make decisions based on after-tax returns. Because your income level determines your tax rate, certain investment choices may be more attractive because of their relative after-tax appeal. Income may also influence risk preferences. High-income investors may be more willing to choose riskier strategies because they can more easily contribute additional investment capital should they sustain losses. If you must rely on your portfolio to meet income needs, you may be limited in the size of positions you can take in illiquid, non-income-producing investments.

Taxes You should fully inform your financial adviser about your tax situation and any special tax circumstances that may apply to you. These considerations will help determine whether you should seek tax-exempt or tax-sheltered securities as part of your portfolio

You and your adviser share the same goal — putting your interests first.





and how to best utilize tax-advantaged investment accounts.

Your overall investment objectives may be influenced by any tax-qualified or tax-deferred assets (such as IRA rollovers and 401(k) plans in the United States or Registered Retirement Savings Plans and Registered Retirement Income Funds in Canada) that will have separate investment objectives. Your financial adviser should consult with your accountant or attorney to coordinate the management of your tax situation.

Total Wealth Investment objectives should take into consideration not only the assets that your adviser will manage but also those you hold outside the portfolio. For example, if a substantial portion of your wealth is in a family owned business, then new investments may emphasize diversification. Alternatively, the value of expected pension, deferred compensation, or even Social Security benefits may affect the return objectives and risk tolerances of your security portfolio. Expected inheritance may also have a similar impact. Or, if your asset holdings are largely illiquid, you may seek investments with greater liquidity.

In addition, your level of wealth often impacts your lifestyle. Maintaining a desired standard of living will determine how much risk you can tolerate (i.e., how much you can afford to lose and still maintain your lifestyle) and needs to be factored into your investment objectives.

Time Horizon Your time horizon is vital in setting investment objectives. Questions to ask include:

When do you expect to draw on the assets in your portfolio? Should you choose assets of short or long maturity? Do you have time to recover from a declining market, or is capital preservation important to meet an immediate financial need?

Liquidity Liquidity is the ease with which you can convert your assets to cash at or near current fair market value.

Questions to ask include:

Do you require a portfolio that can be liquidated easily, or can you afford to wait?

Some examples of liquid assets are money market funds and publicly traded securities. Because greater liquidity generally results in lower return, it is necessary to give serious consideration to the inherent trade-offs. Your financial adviser can help you in this regard. Illiquid investments — those that cannot be readily converted into cash — include real estate, private equity, and hedge fund investments.

Other Considerations It is important that your adviser have a full picture of your financial situation. You should provide a full disclosure of your financial assets, expected income streams, and obligations, especially as they affect the portfolio under management. Questions to ask include:

Does your job provide an adequate retirement plan, or must you fund your retirement from your investment portfolio? If your employer provides a stock-purchase plan, is this a substantial part of your personal wealth, and should you consider it as a diversification issue when you make other portfolio choices? If you receive tax-qualified or tax-deferred assets from your job, how will these influence your investment decisions?

Putting It All Together A professional financial adviser can work with you to answer all of these questions. Your adviser will use your answers to develop a written investment plan that provides the basis of your investment relationship. Together you should be able to determine a target rate of return and an appropriate mix of assets to place in your portfolio. Regular feedback will enable your adviser to incorporate any changes in your needs or circumstances as they occur. Advisers particularly well qualified to help you with this process may hold the Chartered Financial Analyst® (CFA®) designation, awarded by CFA Institute.



CFA Institute is the global, non-profit professional association that administers the Chartered Financial Analyst® curriculum and examination program worldwide and sets voluntary, ethics-based professional and performance-reporting standards for the investment industry. CFA Institute was known as AIMR (Association for Investment Management and Research) from 1990 to early 2004 and before that was two separate organizations whose roots go back to 1947. More information may be found at www.cfainstitute.org.

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