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American Council on Education –  
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# Financial Literacy

## Module V – Guidelines and Tips for Retirement Savings

# Overview

- Retirement Investment Planning
- Target Portfolio, Life Cycle and Investment Strategy
- Diversification
- Taxes

# Retirement Investment Planning

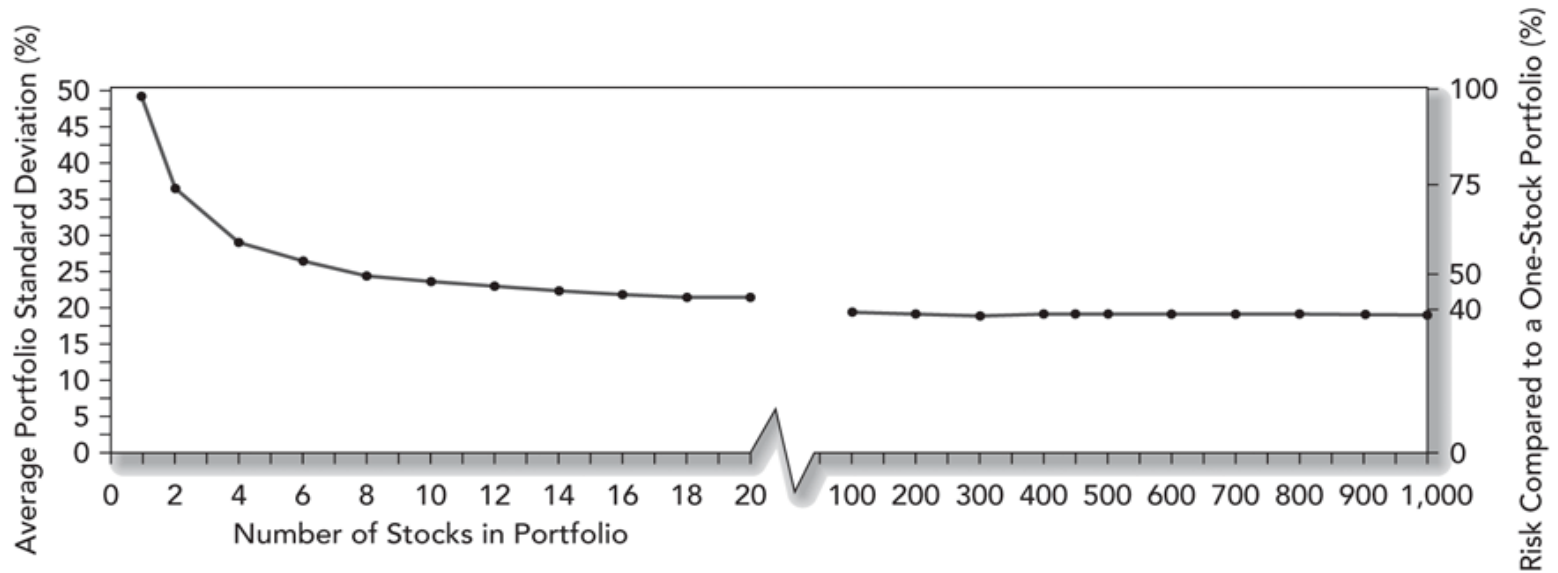
- Holistic approach to retirement investment planning
  - CalPERS, Social Security, Defined-Contribution Plan, Saving Accounts, etc...
- Determinants of investment planning
  - Risk aversion
  - Age
  - Family status
  - Career
  - Health

# Target Portfolio, Life Cycle and Investment Strategy

- Target portfolio
- Rebalancing and investment life cycle
- Market timing
  - Friesen and Sapp (2007)
- Pay yourself first

# Diversification

- Don't put all your eggs in one basket
- Why diversification?
  - Reduction in investment-specific risk



**FIGURE 7.2** Portfolio diversification. The average standard deviation of returns of portfolios composed of only one stock was 49.2%. The average portfolio risk fell rapidly as the number of stocks included in the portfolio increased. In the limit, portfolio risk could be reduced to only 19.2%.

Source: From Meir Statman, "How Many Stocks Make a Diversified Portfolio?" *Journal of Financial and Quantitative Analysis* 22 (September 1987). Reprinted by permission.

# Diversification

- How to diversify?
  - Individual securities vs. Mutual Funds and ETFs
  - Active vs. passive management
    - Gruber (1996)
- Diversification across asset classes
  - Stocks, Bonds, T-bills, Real Estate, Commodities, etc...
- Diversification across sectors and market capitalization
  - Consumer Goods, Financial Services, Healthcare, Technology, etc...
  - Small, Medium, and Large Firms

# Diversification

- Diversification across geographical regions

Equity - Domestic market capitalization (USD millions)

Source : World Federation of Exchanges members

Exchanges	April 2013 US\$ Millions	April 2013 % WFE Total
NASDAQ OMX	5 105 064.2	8.7%
NYSE Euronext (US)	15 571 595.6	26.6%
Americas	25 199 169.2	43.0%
Asia - Pacific	18 102 995.3	30.9%
Europe - Africa - Middle East	15 236 696.0	26.0%
WFE Total	58 538 860.5	100.0%



# Taxes and Investments

- Tax-exempt and tax-deferred accounts vs. taxable accounts
- Investment characteristics and account tax status

# Conclusion

- Investment strategy
  - Diversified portfolio
  - Life cycle considerations
- Be consistent with contributions
- Do NOT time the market
- Keep it simple!

# References

- Friesen, G. and T. Sapp (2007), "Mutual Fund Flows and Investor Returns: An Empirical Examination of Fund Investor Timing Ability", *Journal of Banking and Finance*, 31, 2796-2816.
- GRUBER, M. J. (1996), "Another Puzzle: The Growth in Actively Managed Mutual Funds", *The Journal of Finance*, 51, 783–810.



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