Assignments

Financial Plan Assignment

It is important that you understand the environment in which you are investing. Understanding the key components of this environment is critical. You should decide whether you can invest on your own or whether you will need help. When assets are small, you can often make important decisions on your own. As the size of your assets increases, it may be a good idea to get help with your investment decisions.

First, be familiar with the major players in the investment world. Come to understand the strengths and weaknesses of each of the different providers of financial advice. Make sure they are operating in your best interests as fiduciaries, not just as brokers.

Second, think through the importance of diversification as you put your Investment Plan together. Fear and greed are typical feelings that affect us all. In order to minimize the problems of fear and greed, determine investment policies to help you as you work to achieve your goals. What is the maximum amount you will invest in any single investment? We are not talking about mutual funds, index funds, or ETFs, but single investments. Most institutions have a maximum of between 5 and 10 percent. Include your maximum total in Section III.A.2.

Third, determine whether you will use leverage to invest. Leverage is debt. I encourage you to not short-sell securities or buy on margin, but you can include your guidelines in Section III.A.3. Do not invest with borrowed money.

Finally, determine your investment benchmarks. Investment Principle 7 advises you to monitor portfolio performance. This means you must choose an appropriate benchmark for each of your asset classes and for each of your assets. If you would like help, I have included recommended benchmarks for each of the asset classes in **Learning Tool 27: Expected Return Simulations and Benchmarks**. When you select the asset classes in the spreadsheet you will receive three recommendations for asset class benchmarks. Include these benchmarks in Section III.B.1. and III.B.2. You will not include the allocations yet, but you should add the benchmarks.

Review Materials

Review Questions

1. What are securities markets?
2. What are the two types of securities markets? What role does each play in the securities market?
3. What are organized stock exchanges? What are the two main organized stock exchanges?
4. What is a stockbroker? Investment advisor? In what three ways are they usually paid?
5. What are the five questions you should ask before hiring a financial advisor?

Case Studies

Case Study 1

Data

After studying the fundamental trends in CHKP Company's annual report and doing a lot of research, Steve decided to purchase one round lot of the firm's stock on the open market. On Monday morning he calls a stockbroker and asks for the price of CHKP stock. The broker indicates that CHKP is bidding at $45.12, with an asking price of $45.19.

Calculations

A. Assuming Steve wants to place a market order to purchase shares, how much will he most likely pay (assume there are no major moves in the stock price)?

B. What are the advantages and disadvantages of a limit order versus a market order?

Case Study 1 Answers

A. The asking price of CHKP, $45.19, is the amount Steve would most likely have to pay for each share of CHKP stock. So, assuming he purchased a round lot (100 shares), Steve would pay $45.19 x 100 = $4,519 (assuming there were no commissions).

B. The advantage of a limit order is that it is not executed unless the stock reaches the specified price or better. The disadvantage is that it may not be executed if the market rises.

Case Study 2

Data

Steve's purchase of 100 shares of CHKP has been a good investment. Yesterday the stock closed at $53.75 per share. In order to lock in his gains, Steve decides to employ a stop-loss order.

Application

A. Assuming Steve sets the stop-loss order at $53, what is likely to happen?

B. At what price would you recommend setting the stop-loss order? Why?

Case Study 2 Answers

A. Because the stop-loss order price of $53 is set so closely to the recent close of $53.75, it is likely the stock will be sold when it fluctuates around its closing price. When stop-loss orders are set too close to the market price, the chance of the price declining results in too much trading. This generates high commission costs and taxes for the seller. Steve should hold for the long term and put his stop-loss orders farther away from the current price.

B. Steve should set his stop-loss order to safeguard against a major fluctuation, not a minor fluctuation. A stop-loss price of $49 or $50 would be more appropriate; this price is 7 to 10 percent below the current market price.