Solution

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Cliff Swatner's investment is not healthy because: -

Acquire knowledge of what one is doing if one is to achieve consistently superior returns. He must have a reasonable capital base to ensure that one is not exposing too much capital to any one investment, and to ensure that one can obtain a big enough return.

Have the discipline to enter and exit the market when entry and exit signals are given.
Monitor your investments.

Also, stock markets can be exposed to sudden downward market movements. (This can be an advantage, if you sell stocks 'short' at the time!)

• Stocks are volatile. A single stock's share price can vary widely from day to day, month to month, and year to year depending on numerous factors that are beyond your control.

The most effective way to invest in stocks is to "buy and hold" for the long-term and "diversify" (divide your stock holdings among several different stocks in various market sectors).

• The closer you get to retirement age, the more risks you assume with stocks, therefore stocks are best used in the early and middle stages of your career.

Since stocks are so volatile short-term, as you begin to reach retirement age, you should start gradually moving part of your assets into other sectors.

• Both buying and selling stocks cost you money in the form of brokerage commissions, so the best strategy for investing in stocks is to "buy and hold" for the long-term.

The disadvantage of stocks is that stocks are not guaranteed to return anything to the investor while the coupon payments and principal of bonds are. Thus, the possibility for high returns is greater with stocks but so is the possibility of losing money.

Disadvantages of bonds are:
• Bonds offer no hedge against inflation because inflation causes interest rates to rise which then causes bond prices to fall.
• Bond prices can be quite volatile because market interest rates vary after a bond is issued.
• Bonds over the long term have lower returns than stocks.
• Bond prices may swing 20% or more if selling bonds before maturity. Speculators might see this as an opportunity but conservative investors will need to ignore price changes if planning to hold to maturity.
• Individual bonds do not compound their interest. However, this is possible with bond mutual funds.
• Taxes will be owed on capital gains/losses (selling before maturity) and interest unless the bonds are tax-exempt.
• Diversification is hard to achieve (unless investing in bond mutual funds) because at $1000 for each bond, many different types of bonds would be needed.

If you're just beginning to invest or looking to diversify, mutual funds are a good choice because they:
• Pool the money of many investors, making investing easier and more affordable than buying individual securities.
• Are professionally managed and usually invested in a well-rounded portfolio of stocks, bonds and other securities.
• Reduce the risk associated with investing in a single stock or bond.

Advantages of Mutual Funds:

• Professional Management - The primary advantage of funds (at least theoretically) is the professional management of your money. Investors purchase funds because they do not have the time or the expertise to manage their own portfolio. A mutual fund is a relatively inexpensive way for a small investor to get a full-time manager to make and monitor investments.

• Diversification - By owning shares in a mutual fund instead of owning individual stocks or bonds, your risk is spread out. The idea behind diversification is to invest in a large number of assets so that a loss in any particular investment is minimized by gains in others. In other words, the more stocks and bonds you own, the less any one of them can hurt you (think about Enron). Large mutual funds typically own hundreds of different stocks in many different industries. It wouldn't be possible for an investor to build this kind of a portfolio with a small amount of money.

• Economies of Scale - Because a mutual fund buys and sells large amounts of securities at a time, its transaction costs are lower than you as an individual would pay.

• Liquidity - Just like an individual stock, a mutual fund allows you to request that your shares be converted into cash at any time.

• Simplicity - Buying a mutual fund is easy! Pretty well any bank has its own line of mutual funds, and the minimum investment is small. Most companies also have automatic purchase plans whereby as little as $100 can be invested on a monthly basis.

You may find it difficult to choose the mutual fund that's right for you from the thousands available. Your Financial Advisor will take the time to understand your personal objectives and overall financial situation, and determine the mutual funds with objectives that are best suited for you. Cliff Swatner cannot sell off his condominium, he lives there, the funds he can invest are 90k - 20k that is after his honey moon expenses, he has with him $70k for investment.

Cliff Swatner should invest in following mutual funds:-
• AIM  $5,000• Alliance $5,000• American $5,000• Columbia $7,000• Dreyfus  $8,000• Eaton Vance $10,000• Federated $20,000• Fidelity $5,000• Franklin Templeton $5,000

You should consider the investment objectives, risks, charges and expenses carefully before investing in mutual funds.

Cliff Swatner needs to rebalance his portfolio from time to time:

Rebalancing your portfolio

If you are getting ready to retire, you are likely considering a shift in your portfolio to more conservative investments. This process of shifting assets to adjust for a change in your investment profile is called rebalancing.

As you approach retirement, you tend to be more averse to investment risk. Your investment strategy also tends to emphasize capital preservation. This increased conservatism is a very normal response. However, this shift in risk tolerance requires that you rebalance your portfolio.

Rebalancing may be as simple as moving 5 or 10 percent of your portfolio from stocks into bonds. Alternatively, a reallocation may include moving some of your stock investments to cash.
WHEN SWATNERS RETIRES

Let's look at the retirement account for Mr. and Mrs. Swatner. The Swatners are a retired couple entering their early 70s. Their portfolio is divided among the three major asset classes. The value of their retirement portfolio peaked at $400,000 when they were in their 60s.

Since retiring, the Swatners have withdrawn some of the capital in their retirement account to live on. As a result, the current value of their retirement portfolio is $350,000.

When the Swatners rebalanced last, they added 10% to bonds (to 20% of portfolio value) and reduced their allocation to stocks by 10% (to 70% of portfolio value). As they enter their 70s, they decide to allocate an additional 10% to both cash and bonds. As a result, they cut their allocation to stocks to 50% from 70%. The following table shows changes in their allocations.

Rebalancing stages for the Swatners' retirement portfolio:

30s and 40s 50s and 60s 70s and 80s
Cash $10,000 10% $40,000 10% $70,000 20%
Bonds $10,000 10% $80,000 20% $105,000 30%
Stocks $80,000 80% $280,000 $70% $175,000 50%
Totals $100,000 100% $400,000 100% $350,000 100%

Note that the calculation for rebalancing your portfolio is based on the percentage of the total account. It's also noteworthy that -- even as they enter their 70s -- the Swatners keep as much as half of their portfolio invested in stocks. This is because stocks are the only major asset class that outperforms inflation.

Most financial advisers recommend allocations of at least 50% to stocks, even late in life, in order to keep your portfolio growing at a rate at least as fast as the rate at which you are drawing it down to live on. For more on asset allocation, see the Asset Allocation educator.

When rebalancing in favor of bonds, a laddering strategy may help you reduce interest rate risk. With laddering, you invest in fixed-term deposits or bonds of serial maturities. For example, you may elect to have $5,000 each invested in 1-year T-bills, 3-year CDs, and 5-year CDs. When each investment matures, you roll over the investment for the longest-existing term (in this example, five years.)

Laddering creates a cycle of investments that mature at the periodic intervals. When the investment matures, current interest rates help you decide what to do with the proceeds. You may choose to reinvest or spend the money in one of the following ways:
• Reinvest in bonds. If interest rates are expected to remain low or fall even further, bond prices rise. As a result, you may wish to invest the proceeds in bonds.
• Invest in cash. If interest rates are expected to remain high or increase, bond prices fall. You may wish to invest the proceeds in an interest-bearing deposit such as a CD or money market fund.
• Spend the proceeds. A third option is to spend the proceeds. After all, your retirement fund is to provide you with a means of a living.
The above information is educational and should not be interpreted as financial advice. For advice that is specific to your circumstances, you should consult a financial or tax adviser.

The confusion in the question arises because the question does not mention why the mutual funds should be selected instead of stock and bonds. In addition, the question does not mention the criteria by which the mutual funds are to be selected. Finally, the question does not mention if stocks and bonds should be included in rebalancing.

References\*:
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