Applying PRISM to Achieve Common Financial Goals

AMERICAN ASSOCIATION OF INDIVIDUAL INVESTORS

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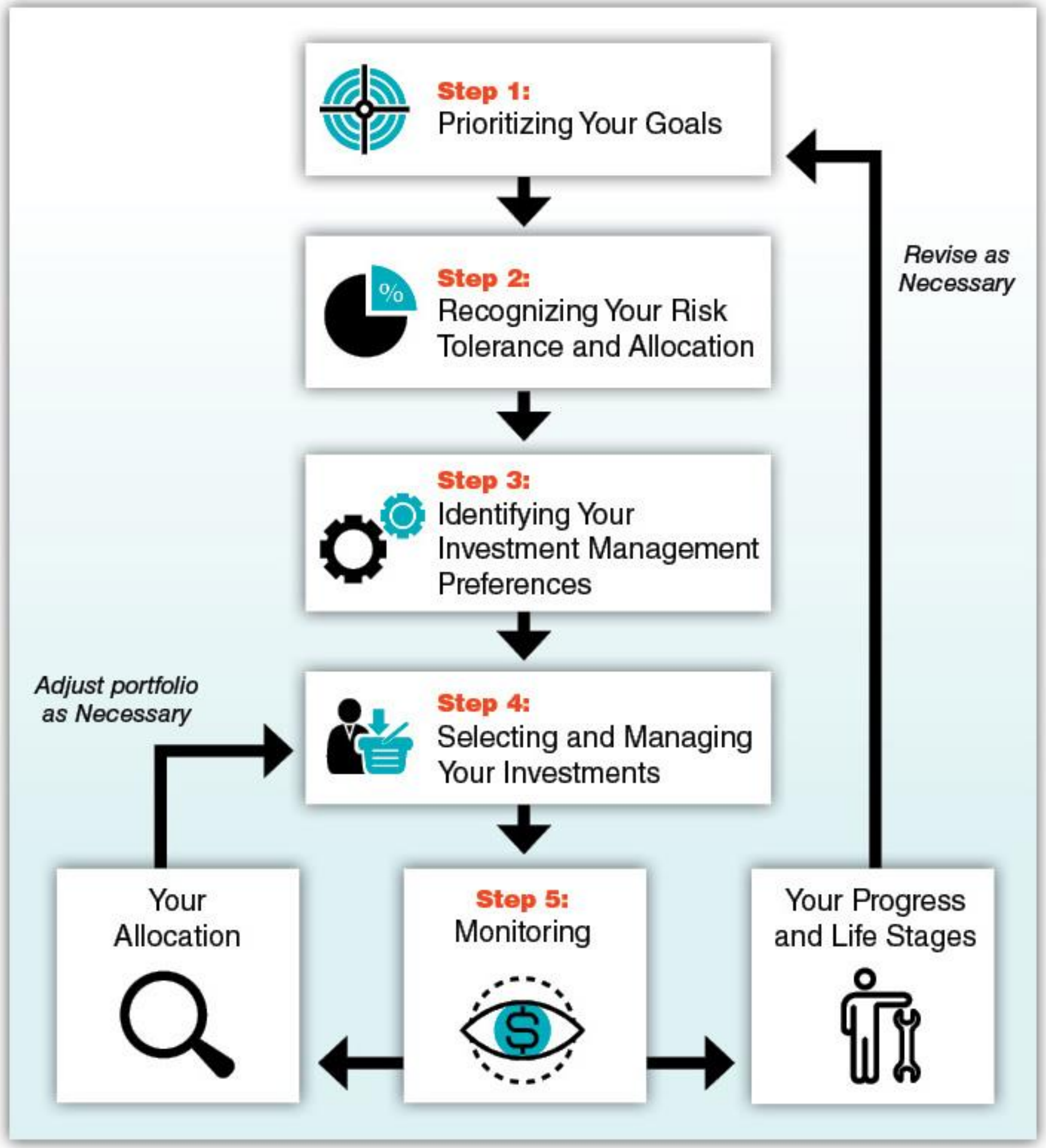
The PRISM Wealth-Building Process provides a framework for aligning your investment decisions with your goals.

The five steps of PRISM empower you to create a personalized investment plan and have the confidence to follow it.

PRISM Wealth-Building Process



Writing Goals Down Boosts the Odds of Reaching Them by 42%

December 2021

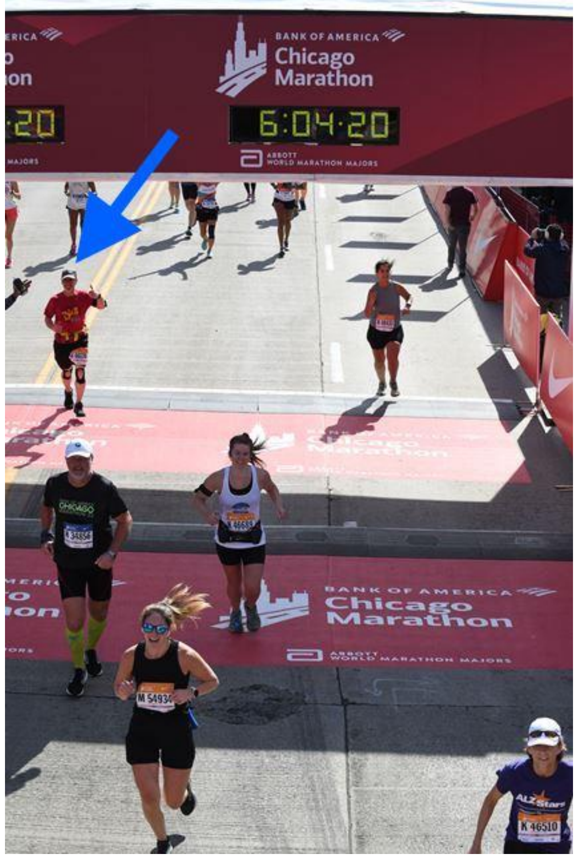

BANK OF AMERICA Chicago Marathon

CHICAGO IS YOUR START LINE

Charles, welcome to the 2022 Bank of America Chicago Marathon field! We are excited to have you join us for the 44th running of the race on Sunday, October 9.

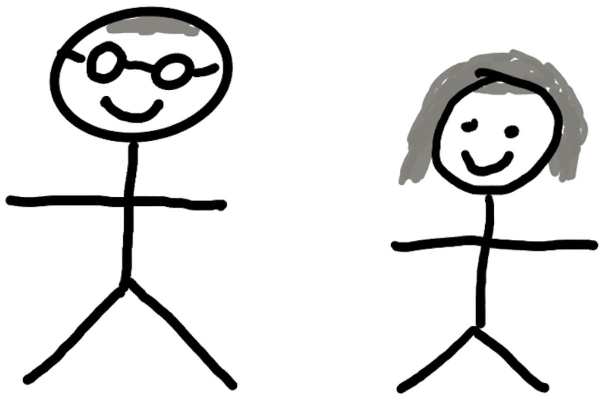
In the coming months, we will provide you with updates to keep you informed about race guidelines and all the events that will take place race weekend. If you have questions between updates, we encourage you to visit the Frequently asked questions page of our website or to contact us at office@chicagomarathon.com.

October 2022



Bob and Jane’s Wealth-Building Plan

- A recently retired couple
- Receive Social Security and pension benefits
- Have $1.5 million in savings
- Married with kids and grandkids
- Using PRISM to create a plan to help out with college expenses



Prioritizing Your Goals

Why Start With Goals?

- They define the reason you are investing
- Identifying and stating your goals brings clarity and purpose to the rest of the investing process
- The cost, timing, spending duration and priority of each goal drive all other decisions

Bob and Jane's Goals

PRISM WEALTH-BUILDING PROCESS

P | Prioritizing Your Goals

List of all of your financial goals below, ranked in the order of importance. Estimates can be used if there is uncertainty about the date of when the goal will be reached, its cost and/or its spending duration.

Goal	Number of Years Away	Spending Duration	Priority	Estimated Cost	Comments
Pay for Retirement	Now	30	1	$2.5 million	Social Security & Pension sufficient
Help w/ older grandchild's college education	8 years	4 years	2	$50,000	Do first, but balance w/ 2nd grandchild
Help w/ younger grandchild's college education	12 years	4 years	3	$50,000	Proportionately match w/ 1st grandchild
Leave an inheritance	30-35 years	Zero	4	$1.0 million	Invest aggressively for heirs
			5		

Recognizing Your Risk Tolerance and Allocation

Risk Tolerance and Asset Allocation

- Risk considers the timing of when assets will be needed, the financial ability to withstand drops in portfolio value and the psychological ability to cope with volatility

- Allocation is the mix of asset classes and asset class groups used to achieve your goals

Recognizing Your Risk Tolerance

Goal: Paying for First Grandchild's College Expenses

This worksheet will help you assess how much risk you should take to achieve a specific goal based on the timing of the goal (both when it will be reached and how long it will last) and your psychological and financial ability to withstand market volatility. Enter the number of points for each of the answers and total the scores for each section. Note: If investing for more than one goal, fill out a separate Risk Tolerance Worksheet for each goal.

Timing of Goal

How far out into the future is the goal?

	Points	Score
Short-term — Five years or less	1	
Intermediate — Five to 10 years	3	3
Long-term — More than 10 years	6	

Over what time period do you anticipate spending money on the goal?

	Points	Score
Short-term — Five years or less	1	1
Intermediate — Five to 10 years	3	
Long-term — More than 10 years	6	

Relative to your wealth, how large of a withdrawal will your goal require over a period of five years or less?

	Points	Score
High — More than 25% of wealth	1	
Moderate — 10% to 25% of wealth	3	
Low — Less than 10% of wealth	6	6

Timing Score (total of scores above) 10

Based on your score, your timing risk is:

Short-term	3–5
Intermediate	6–11
Long-term	12–18

Financial and Psychological Risk

During drops in the stock market, have you:

	Points	Score
Significantly reduced your exposure to stocks and stock funds	1	
Somewhat reduced your exposure to stocks and stock funds	3	3
Maintained your allocation or bought more stocks	6	

How much of your spending needs are covered by non-portfolio income?

	Points	Score
None	1	
Some	3	
All	6	6

How would you describe your knowledge of key investing concepts?

	Points	Score
Basic/Low	1	
Moderate	3	3
High	6	

Financial/Psychological Tolerance Score (total of scores above) 12

Based on your score, your financial and psychological tolerance is:

Low	3–5
Moderate	6–11
High	12–18

Bob and Jane's Risk Tolerance

		Timing Risk		
		Short-Term 3–5	Intermediate 6–11	Long-Term 12–18
Financial / Psychological Tolerance	Low 3–5			
	Moderate 6–11			
	High 12–18		X	

(Put an "X" in the box that best describes you)

		Timing Risk		
		Short-Term 3–5	Intermediate 6–11	Long-Term 12–18
Financial / Psychological Tolerance	Low 3–5	Very Conservative	Cons. to Mod.	Mod. to Aggr.
	Moderate 6–11	Conservative	Moderate	Aggressive
	High 12–18	Cons. to Moderate	Mod. to Aggr.	Aggressive

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Bob and Jane have an intermediate timing risk due to the timing of when college starts

AND

A high financial/psychological risk because living expenses are covered by guaranteed sources of income even though the goal will be funded from savings.

R | Recognizing Your Allocation

Goal: Paying for first grandchild's college education

Risk Tolerance for Goal: Moderate to High

The goal you are attempting to achieve and your corresponding tolerance for risk for that goal should help you identify the appropriate allocation to use.

To help you determine what that allocation is, the AAII Asset Allocation Models are presented below. These models have long served as guidelines that individual investors can use to help construct appropriate portfolios.

You can select one of these models or, alternatively, enter in your preferred allocation manually in the form below.

Aggressive Investor **90%** Diversified Stock	Moderate Investor **60%** Diversified Stock	Conservative Investor **40%** Diversified Stock
Time Horizon	**Time Horizon**	**Time Horizon**
20+ Years: Long Investment Horizon ***For investors who are very risk tolerant***	**15+ Years:** Mid-Term Investment Horizon ***For investors who can tolerate some risk***	**10+ Years:** Short-Term Investment Horizon ***For investors who are not risk tolerant***
Characteristics	**Characteristics**	**Characteristics**
Growth: Substantial **Income:** Very Low **Risk:** Substantial Year-to-Year Volatility of Portfolio Value **8%** Average Annual Growth in Value **-37%** Bad Year	**Growth:** Moderate **Income:** Low **Risk:** Moderate Year-to-Year Volatility of Portfolio Value **7%** Average Annual Growth in Value **-21%** Bad Year	**Growth:** Low **Income:** Moderate **Risk:** Low Year-to-Year Volatility of Portfolio Value **6%** Average Annual Growth in Value **-12%** Bad Year
Allocations	**Allocations**	**Allocations**
10% Fixed Income **90%** Diversified Stock	**40%** Fixed Income **60%** Diversified Stock	**60%** Fixed Income **40%** Diversified Stock
Select ☑	Select ☐	Select ☐

They choose an aggressive allocation.

Their spending time frame ranges between eight and 12 years into the future.

If the grandchild was older, preservation of wealth might take on importance.

Identifying Your Investment Management Preferences

Factors Influencing Investment Management Preferences

- Desire to handpick securities versus relying on investment professionals
- Restrictions on what you can invest in [e.g., a 401(k) plan, employer rules, etc.]
- Other constraints (time available to do research, level of knowledge, interest, etc.)
- Any tasks that need assistance?

Identifying Your Investment Management Preferences

The following worksheet is intended to help you think through the various considerations about how your portfolio will be managed. You may view yourself as being a true DIYer, only to realize that your 401(k) requires you to cede some control to mutual fund managers. As such, this worksheet can serve as a prompt for you to include rules for buying and selling mutual funds in your personalized investing plan.

There are no right or wrong answers. Rather, the goal is to help you clarify the type of investor you are in terms of how portfolio decisions will be made.

1. How much control do you want in determining which investments are held in your portfolio?
   - [x] Complete
   - [ ] A mix of self-directed and an adviser
   - [ ] Just keep me informed about my portfolio

2. Do you prefer an active approach to investing, a passive approach (indexing) or a blend of the two?
   - [ ] Active (try to beat the market)
   - [ ] A blend (a mix of active and passive strategies)
   - [x] Passive (indexing/tracking the market)

3. Are there any constraints on your strategy?
   - [x] Limitations on what you can own [e.g., 401(k) plans, job-related restrictions, etc.]
   - [ ] Trading restrictions
   - [ ] Trusts or partnerships
   - [ ] Social or religious beliefs
   - [ ] Other: ______________________________
   - [ ] None

4. How comfortable are you in researching and following investments?
   - [ ] Enjoy researching and analyzing stocks
   - [ ] Enjoy researching and analyzing bonds
   - [x] Content looking at mutual funds or exchange-traded funds (ETFs)
   - [ ] Not interested

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Bob and Jane’s Investment Management Preferences

I am a combo investor. Based on my preferences and constraints, I will use the following types of investments (individual securities, mutual funds, ETFs, index funds, etc.):

We are going to use the mutual funds offered in our grandchild's 529 plan, with a preference towards index funds if available.

If I’m going to use the services of a professional, I will seek their assistance with:

ensuring the support we provide does not jeopardize opportunities for financial aid.

A key constraint for Bob and Jane is the 529 plan, which limits their investment options.

They will need to work with a professional versed in financial aid and may need to consult with their estate attorney as well.

Selecting and Managing Your Investments

S | Selecting Your Investments

Goal: Paying for first grandchild's college education

AAII founder James Cloonan encouraged investors to develop a consistent, well-defined approach to investing. The way to do so is have written rules governing your buy and sell decisions.

To provide you with a framework for creating rules, we've listed some of the major characteristics to consider for the major types of investments used by individual investors. You will notice the fields are blank. This was purposeful because AAII members follow a variety of investing strategies.

Here are some brief suggestions for what to consider in terms of creating rules for evaluating each type of investment:

529 Plan Buy and Sell Rules

Mutual Funds (Buy / Sell Rules)

Active or Passive:	Favor broad-based index funds if available; give lowest-cost active funds first consideration
Asset Class Group:	Diversify across large-cap, mid-cap and small-cap (preferably value) domestic and developed international equity stock funds
Relative Returns:	Returns should be close to or above category averages; consider selling if returns are more than a full percentage point below index benchmarks for two consecutive years
Expense Ratio/Cost:	Expense ratios should be lowest/near the lowest of available options; consider lower-cost options for active funds if they become available

Buy and sell rules will vary based on:

- The types of assets held
- The strategy followed
- Constraints on the choice of investments
- Constraints on buying and selling

Monitoring Your Allocation, Progress and Life Stages

M | Monitoring Your Allocation

Use this worksheet to compare your current portfolio's allocation against the target allocation you listed in Step 2 of the PRISM process, R - Recognizing Your Risk Tolerance and Allocation. If the difference between your current and target allocation is within your acceptable range of variability, no action is required. If your current allocation has strayed too far away from your target allocation, consider rebalancing (either directly or by via future contributions or withdrawals) to adjust your allocation back closer to your target.

Equities	Current Portfolio Allocation (%)	Target Portfolio Allocation (%)	Difference	Acceptable Range of Variability
Large-Cap Stocks	25 %	25 %	0 %	+/- 5 %
Mid-Cap Stocks	25 %	25 %	0 %	+/- 5 %
Small-Cap Stocks	25 %	25 %	0 %	+/- 5 %
International Stocks	25 %	25 %	0 %	+/- 5 %
Balanced/Target-Date Fund Portion	%	%	0 %	%
Other:	%	%	0 %	%
Total Equity Allocation	100 %	100 %	0 %	%

M | Monitoring Your Life Stages

Over the past year, have any of the following happened?

Family	Yes/No	Who	Does It Impact Your Goals?	Does It Impact Your Will, Life Insurance or Trusts?	Does It Change a Beneficiary?
Birth/Adoption	No				
Death	No				
Marriage	No				
Separation	No				
Divorce	No				
Start or Graduate From College	No				

Change in Health	Yes/No	Description	Does It Impact Your Goals?	Does It Impact Your Will, Life Insurance or Trusts?	Does It Change a Beneficiary?
You	No				
Spouse/Partner	No				
Dependent	No				
Other Close Relative	No				

Employment (You or Spouse/Partner)	Yes/No	Description	Does It Impact Your Goals?	Does It Impact Your Will, Life Insurance or Trusts?
New Job				
Change in Compensation				
Job Loss				
Retirement	Yes	Retired Last Year	No	No

PRISM Wealth-Building Process

M | Monitoring Your Progress

Yellow cells are used to modify default assumptions		
Blue cells are resulting calculations		
Assumptions During Savings		
Beginning Portfolio Value ($)	$27,500	Current portfolio value while accumulating wealth
Annual Rate of Return Before Goal (%)	8%	Annual rate of return earned on portfolio while accumulating wealth
Years Until Goal Is Reached (Years)	8	Number of years until start of withdrawal
Income (Salary)	$0	Current annual income
Savings Rate (%)	0%	Percentage of annual income that is contributed to portfolio
Annual Contributions (Savings)	$0	Income multiplied by savings rate
Accumulated Wealth at Start of Goal ($)	**$50,901**	Portfolio value before withdrawal begins
Assumptions During Withdrawal		
Spending Duration (Years)	4	Years that goal will need to funded
Rate of Return During Withdrawal (%)	3.0%	Annual rate of return earned on portfolio while withdrawing money
Annual Withdrawal ($)	**$12,500**	Annual withdrawal at beginning of each year that reflects the starting wealth, duration and return
Withdrawal Rate (% of Portfolio First Year)	**24.6%**	Annual withdrawal divided by accumulated wealth at start of goal
Worst-Case Drawdown	**40.0%**	Largest anticipated drawdown for chosen allocation strategy

Any changes identified in the final monitoring step should prompt you to adjust your portfolio according to your rules and/or revisit your goals.

PRISM is designed to be a personalized process you can follow to reach your goals.

Your PRISM process may look different than Bob and Jane’s and everyone else’s.

PRISM Wealth-Building Academy

- An interactive experience to help you create your own personalized wealth-building plan with PRISM
- All new video instruction and tools
- Community forums to share ideas and discuss PRISM with other AAII members

AAII PRISM Academy Syllabus

Introduction: Welcome to the PRISM Academy
The PRISM Wealth-Building Process Resource Guide

P - Prioritizing Your Goals

- Lesson 1: Prioritizing Your Goals
- Lesson 2: Why Start with Goals?
- Lesson 3: What Are Your Goals?
- Lesson 4: The Key Components of Goals
- Lesson 5: The Timing of Goals
- Lesson 6: Wealth Required to Fulfill Each Goal
- Lesson 7: The Importance of Prioritizing Your Goals
- **Webinar:** Prioritizing Your Goals

Worksheets

- Prioritizing Your Goals Worksheet
- Timing of Goals Worksheet
- Wealth Required to Fulfill Each Goal

Direct Link to PRISM Academy: https://bit.ly/prism-academy

PRISM Wealth-Building Academy:

www.aaii.com/learnandplan

AAII Community:

https://community.aaii.com/home

Some Final Thoughts

- Your PRISM Wealth-Building Process will evolve over time as your goals grow closer and your life changes
- PRISM provides a framework for you to make investment decisions within; its goal is to help you become a more effective manager of your own assets
- If you have multiple goals, prioritize them and complete steps 2, 3 and 4 for each goal

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