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FINANCIAL PLANNING FOR POLICE OFFICERS

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I. INTRODUCTION

"THOSE WHO DO NOT CREATE THE FUTURE THEY WANT, MUST ENDURE THE FUTURE THEY GET"
---anonymous

You want big things out of life, a dream home, a good education for your kids, a comfortable retirement, in short, the "American Dream." How can a policeman or policewoman have all these things on a government salary? One way to begin is by setting some specific financial and retirement goals. Once goals are determined, a strategy can be devised to reach as many of those goals as possible. One option, discussed in this paper, is a plan of "dollar cost averaging" investing. D.C.A. is one way for the "working man" to amass considerable savings over time. An individual who works for a salary may not have the potential earning power of someone who owns their own business or is in the corporate hierarchy, but with planning and a reasonable amount of sacrifice one can improve their chances for a comfortable lifestyle.

All police departments in Texas are required to send their cadets or officers through a police academy. The academy teaches police officers how to protect themselves from the physical dangers they may encounter during their careers. It teaches them how to act and react within the law. It teaches them how to protect the citizens in their charge. What many departments fail to teach, however, is how the police officers can protect themselves from the financial difficulties that seem to afflict the police profession. Many, if not most, police officers are poor financial planners. Police management must take an active role through some form of formal training in financial planning. Management must research plans available, both retirement and savings, and then make those plans known to their officers and employees. Education and opportunity are the keys to formulating and implementing a plan for a secure financial future.

Police departments range in size from a few employees to organizations employing thousands of people. Some of these departments have excellent pension systems, while some have none at all. This paper is intended to help all police officers devise a strategy for supplementing an existing plan or developing their own plan for financial security. Police officers who fail to take some action to plan for the future stand a chance of reaching retirement age without the required reserves to maintain a reasonable lifestyle for themselves and their families. They may find that social programs developed in the twentieth century to aid retirees may be over stressed by the growing, aging population. For those who will be facing retirement age in the twenty-first century, this is not just an academic discussion on the economy. The statistical facts are that more Americans are living longer and the employed ranks are growing smaller.[1]

This paper uses technical investment terms that the reader may be unfamiliar with, but a glossary has been provided at the end of the paper to provide definitions and explanations of key terms. It can be very easy to become intimidated

1 Burkett, Larry. Preparing For Retirement. Chicago: Moody Press, 1992.

by jargon used in the investment community. The glossary should give some reasonable idea of the meaning of the most commonly used investment terms and options.

For the majority of retirees, inflation is the most disastrous of all circumstances they may face. In a depressed economy, those living on a fixed income may actually do better, since some prices tend to fall (assuming the retirees' source of income is dependable during that time). Inflation, however, will eat the heart out of any retirement plan at a time when the retiree has little or no flexibility.[2] If the word "dilution" was substituted every time the word "inflation" was used, a better understanding of what inflation really is could be arrived at. If the government printed and circulated a million dollars for every million already in circulation, twice as many dollars would be chasing the same amount of goods and services, so they would rise to twice their original price. The true value of goods and services has not risen, but rather the value of the currency has been cut in half by doubling its quantity---hence dilutions have occurred.[3] No one should let inflation hold them hostage to a fear of never getting ahead, but the repercussions must be considered and adjustments made to overall plans. If the inflation rate rose to around 4 percent and remained constant, the costs of goods and services would more than double in approximately five years. What inflation does to the typical family, then, is create unrealistic expectations that they attempt to fulfill for their self-content. As millions of Americans see it, salaries must rise more quickly than

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[3] Van Caspel, Venita. Money Dynamics For The New Economy. New York: Penguin Books 1993.

inflation, expenses must not increase any faster and any deviation from this desired end is disastrous.[4]

While researching savings plans available to police officers, it became apparent that public employee systems tend to mirror private plans in many ways. Some private or corporate plans are more generous than police or public employee plans but the role is the same, to provide a comfortable fiscal future at a reasonable cost. Many smaller departments change plans every time there is an election of new city council members. This is frequently disastrous to employees' long term planning because the old plan is usually dissolved and the employee given his savings, and a new plan begun. This cycle might not be so bad except that the police officers seldom roll their money into the new plan. They spend it on bills, new purchases or whatever is important to them at the time. Therefore, they lose several different ways; they lose the advantage of compounding, they lose their savings base and they even may incur new debt instead of strengthening their economic situation. The same trend can be seen in some corporate plans, and although it may be for a different reason, the result is the same. This research paper will try to illustrate the strengths and weaknesses in the corporate systems that may also be tied to public employee plans.

In addition to the uncertain life span of private pension plans, there are other actual and potential problems. Inflation is a significant potential problem. Most private pension plans have no provision for inflation protection after an employee retires. While some companies have voluntarily made adjustments to the

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4 Sloane, Leonard. Book of Personal Finance. New York: Random House, 1987.

pensions of their retirees, corporations and public institutions are under no legal obligation to do so unless a union contract requires.

Most corporations and police departments today do not make voluntary inflation-based increases to their retiree' pensions. On the contrary, many in the private sector, are terminating pension plans when they become over funded in order to extract the extra money. A pension plan is over funded when the value of the assets in the plan is more than adequate to meet the pensions obligations to its' employees. By discontinuing the plan the employer gains access to the surplus. If an employer does terminate its' pension plan, it may or may not initiate a new plan for its employees. Moreover, even if it does initiate a new plan, it may not be as favorable as the old plan.

Although an employer may discontinue a pension plan, the benefits that an employee is credited with after having worked for a specified minimum time cannot be taken away. For example, if the employer's plan specifies an earned permanent pension benefit after five years, these benefits cannot be taken away even if the plan is terminated, so long as employment is continuous for the 5-year minimum period.

One cannot automatically expect pension benefits to increase because of inflation, however if extra benefits are provided by an employer, splendid! Dependence upon others to cope with inflation, as a rule, can and should be avoided. Personal investment planning is the key to counteract the problems associated with inflation.[5]

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[5] Raphaelson, Elliot and West, Debra Raphaelson. How To Be Your Own Financial Planner. Illinois: Scott, Foresman and Company, 1990.

The family's primary goal should be financial security. This arrives when a workable money management plan, for both the short and the long term, has been devised. Work is required to earn money in order to spend it, but spending can be in the form of a mortgage payment, a dinner at a fine restaurant, a vacation, or ten shares of common stock. If an individual can achieve the objective of having more discretionary income after taking care of his basic requirements, he will, at the very least, enjoy the realization that he has more control over his earnings than his earnings have over him.[6]

In the following sections, this paper will attempt to identify some basic problems and provide an alternate plan to help correct these problems. It will address issues such as procrastination and denial. It will illustrate financial pitfalls and how they can best be coped with through a definite plan of personal financial control. Police managers should take more responsibility for the fiscal well being of their people through education. This knowledge will allow employees to prepare a plan to care for themselves. This information must be made available to all employees of the police department and it is the job of managers to see that it is done!

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II. PROBLEMS FACING POLICE OFFICERS

Through personal observation, and after twenty-eight years of police experience, this author has found that many officers live in a constant state of denial. They are not going to get shot. They are unbeatable in a fight. They can drive at high speeds without fear of injury in an accident. They will never get too old to be a police officer and a belief that they will be financially protected in their old age by social security. Policemen, frequently, seem to live for the present not for the future. They will start that savings plan as soon as the boat, motorcycle, lake house, kid's college or whatever are finally paid off. The problem seems to be that these or similar expenses just keep reoccurring forever. The notion that there will always be tomorrow leads many to the end of their careers before they realize that they are not prepared for retirement.

Picture a working couple in their forties, just 15 or 20 years left to retirement. Unfortunately, they haven't started saving, even though a financial advisor sets their retirement needs at several hundred thousands of dollars. This goal may seem impossible, and very well may be for this particular live-for-today couple, but with time and discipline and the power of compounding, financial goals can be met. Imagine that $50,000.00 was needed in savings for a child's college education. That savings account, opened on the child's birth date and deposits begun at the rate of $87.00 per month, earning at least 10% annually, would be needed to meet the education goal for that one child. But put it off until the child is

12 years old and the monthly savings at 10% must increase dramatically to $517.00 per month[7].

This potentially real scenario requires a series of steps that can protect you against such a crisis. By the use of strategies like regular saving, compounding interest, deferring taxes and dollar cost averaging you and your department can overcome many of the pitfalls of poor planning. It should be the major role of a good police manager to see that his agency takes every step possible to guide employees to a secure lifestyle. Police officers that are financially troubled cannot devote the undivided attention to duty that is needed to protect themselves and their citizens.

The best solution for accumulating savings is to invest regularly through automatic monthly investment programs. These programs transfer a designated amount of money directly from your paycheck to your investment plan. The idea of "paying yourself first" has given millions of people a painless way to pursue their investment goals. Successful investing doesn't require enormous wealth or a strict diet of conventional wisdom. Watch out for those investing traps. Take advantage of the power of time. Employ commitment and consistency. You'll be well on your way to meeting your financial goals.[8]

Priorities must be set, if financial goals are to be attained. Begin by looking at your present position in life. Age, marital status, family plans, job position, financial status, geographical location and personal goals need to be examined. Stop and decide how you are going to achieve the goals and dreams for yourself

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7 Twentieth Century Services Corp. Investor Advantage. Kansas City, Mo., 1994.
8 IBID

and your family. Every person is responsible for themselves. To depend totally on one plan, whether it be social security, pension funds or personal holdings to provide for you and yours in later years is taking a great risk. Spreading financial exposure between several options protects investments from changes in politics and financial volatility in the world around us. Men and women in law enforcement must decide which path they will take. The path to immediate gratification by playing now and worrying later or the more responsible path to some comfortable lifestyle at the end of their working lives. Virtually every aspect of our daily lives is governed by some form of strategy, plan, budget or schedule.[9] Planning for financial security, however, seems to be one of those things that many people prefer not to think about. Perhaps it is the confusion or complexity that surrounds the financial world or an attitude of procrastination causes this to occur, but whatever the problem, it is apparent that it must be met with a determined effort if safety and security are to be achieved. Assessing your own emotional makeup may be the hardest step in the development of an investment program. Some individuals think of themselves as risk takers, but when the going gets tough, they discover that their stomachs weren't as strong as they thought.[10] It is apparent that a steadfast plan of dollar cost averaging is easily the most stress free form of saving and investing.

In the coming chapters, important factors that lead to financial security will be discussed. Explanations and examples of dollar cost averaging, compounding interest and tax deferring are included. Questions will be addressed concerning the

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9 Spitz, William T. Get Rich Slowly. New York : MacMillan Publishing Co., 1992.
10 IBID

"457 deferred compensation plan", the only deferred compensation plan available to public employees. It will be apparent how all of these concepts mesh into an overall strategy that will defeat inflation and prepare for the future. A combination of all these strategies will form a basic concept of money management. A well managed police department should make it their primary goal to explain options fully and to assist in the implementation of a "457 deferred compensation plan".

III. MAXIMIZING INVESTMENT GROWTH

"Dollar cost averaging", what is it and how does it work? Dollar cost averaging is a technique in which a constant dollar amount is periodically placed in one specific investment. The investment can vary from a passbook savings to the most complicated form of investment portfolio. The type of investment makes no difference to the theory of dollar cost averaging.

In dealing specifically with investments in common stocks or mutual funds the following applies. The period can vary according to the desires of the particular investor. The advantage of this technique is that it allows purchase of more shares when prices are low and fewer shares when prices are high. Dollar cost averaging is effective only when the securities purchased have a long-term upward price trend. The technique is effective for small and large investors, particularly if there is a great deal of volatility in prices as with common stock and bond investments.[11] With dollar cost averaging, market-timing risks are eliminated. Instead of fretting over market fluctuations, an advantage can be gained by recognizing that those fluctuations offer opportunities over the long term. If dollar cost averaging is applied over a full market cycle, about five years on average, shares purchased should accumulate at below average prices[12].

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11 Raphaelson, Elliot and West, Debra. How To Be Your Own Financial Planner. Illinois: Scott, Foresman and Company, 1990.

12 Underwood, Don and Brown, Paul B. Grow Rich Slowly. New York : Viking, 1993.

The below listed example may better illustrate the process.

Example: The decision is made to invest $1,000.00 in an annual fund every six months.

Purchase #1. One hundred shares are purchased at $10.00 each. Investment = $1,000.00. The market then rises sharply in the following six months, and the fund share price rises to $20.00.

Purchase #2. The allotted $1,000.00 investment now buys 50 shares at $20.00 each.

The market drops a bit and the fund share price falls to $15.00. It appears that you're now even, but actually, a good profit has been realized. The total $2,000.00 investment purchased 150 shares. At $15.00 a share, the total investment is now worth $2,250.00—a 12 percent gain over your original $2,000.00 cost[13].

The secret behind dollar cost averaging, for the average police officer is that it doesn't take a great deal of money to get started. All that D.C.A. requires is consistency of regular dollar amount investing. Dollar amount participation should always increase gradually but should some other expenditure take priority, increased exposure can wait as long as you don't stop or alter the amount already allotted to your plan. Once started in the dollar cost averaging plan of regular, uninterrupted investments, reinvesting interest and allowing the power of

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13 Savage, Terry. New Money Strategies for the 90's. New York: Harper Collins, 1993.

compounding interest to work, the ease of creating that financial nest egg will be astounding.

The greatest asset to the average investor who depends on a gradual savings plan as his primary form of financial planning, is the principle of compounding interest. A clear example of compounding is the old story of a job offer, earning a thousand dollars a day for thirty-five days or earning one penny and doubling the balance every day for thirty-five days. Initially, the first job offer appears the most attractive, until a closer look is taken. Thirty-five thousand dollars for just thirty-five days work sounds hard to beat until the second offer is examined more closely. How much would be received if the second offer was chosen? The difference is amazing, $339,456,652.80! As anyone can see, one penny compounded at 100 percent per day produces over a third of a billion dollars in just thirty-five days.[14]

The above illustration is not realistic for the average investor but it does show the power of compounding over time. Compound interest is actually a simple concept. A the end of one year, a $100.00 portfolio earning 10 percent will be valued at $110.00. assuming the $10.00 in earnings is reinvested in the portfolio rather than spent, the second year's earnings will be 10 percent of $110.00, or $11.00. In year three, the portfolio will earn $12.10, and so on. Compound interest is a powerful force because your earnings are increasing every year, and at an accelerating rate.[15]

A formula used to better understand and apply the principle of compounding is the rule of 72. The rule of 72 not only explains how long it will

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14 Spitz, William T. Get Rich Slowly. New York: Macmillan, 1992.

15 IBID

take money to double through compounding, but also how long it will take for the spending power of that money to be cut in half by inflation. Simply take any number and divide it into 72. The resulting answer is the number of years it will take money to double. For instance, if 6 percent interest can be earned, divide 72 by 6, and the resulting answer---12---is the number of years it would take that investment to double. If 8 percent is earned, it would take only 9 years to double the investment. On the other hand, if inflation is running at 5 percent, divide 72 by 5, the resulting answer---14.5---is the number of years it will take for inflation to cut buying power in half[16]

When earned interest is re-invested instead of spent as it is earned, maximum use of the compounding principle is made and investment growth will be substantial, especially in the final years of your career. Remember, if earned interest is collected instead of reinvested it will destroy the entire process of compounding. Careful planning is required in the choice of your retirement date so that full advantage can be taken of these final few years of compounding. Retiring just a few years too soon can make a substantial difference in your lifestyle.

The table, inserted on the next page will better illustrate the drastic difference between losses and gains when the effect of compounding is taken into consideration. Take note of the difference that a single percentage point can make in either losses or gains.

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16 Savage, Terry. New Money Strategies for the 90's. New York: Harper Collins, 1993.

TEN YEARS OF COMPOUND GAIN AND LOSS[17]

ANNUAL PERCENT GAIN	$10,000 GROWS TO:	EXTRA $ GAIN PER EXTRA 1%	ANNUAL PERCENT LOSS	$10,000 SHRINKS TO:	EXTRA $ LOSS PER EXTRA 1%
0%	$10,000	———	0%	$10,000	———
+1%	11,046	$1,046	-1%	9,044	$956
+2%	12,190	1,144	-2%	8,171	873
+3%	13,439	1,249	-3%	7,374	797
+4%	14,802	1.363	-4%	6,648	728
+5%	16,289	1,487	-5%	5,987	661
+6%	17,908	1,619	-6%	5,386	601
+7%	19,672	1,764	-7%	4,848	546
+8%	21,589	1,917	-8%	4,344	496
+9%	23,674	2,085	-9%	3,894	450
+10%	25,937	2,263	-10%	3,487	407

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17 Fosback, Norman G. Stock Market Logic. Dearborn: Financial Publishing, Inc., 1993.

IV. METHODS OF SAVING

Saving money can take many forms. There are passbook savings, certificates of deposit, stocks and bonds, mutual funds, employee participation pension plans, etc. The passbook savings account is probably the most common form of saving money. The primary problem with the pass - book plan is that your savings are taxable every calendar year, therefore you are not taking full advantage of deferring interest and compounding. Certificates of deposit usually offer a little better interest rate but suffer from the same problems as the passbook savings account. A positive for both passbook and certificates of deposit is that they can be Federally insured when kept at a bank or savings and loan. Pension plans are excellent when matching funds are available from your employer; however, if your contribution is not matched, there might be a better way for you to save.

In this section a plan that has been made available for police officers and other public employees will be discussed. This plan can be payroll deducted, making it nearly painless for the employee (if you don't get your hands on the money, it's easier to save). It is tax deferred and its' flexibility allows it to fit the most conservative portfolio or one at the highest risk level. The plan referred to is the "457 deferred compensation plan" offered to government employees. This plan can include fixed interest accounts, growth mutual funds, aggressive growth funds, income funds, bond funds, balanced funds, managed funds and all styles of low and high risk combinations. The 457 plan is ordinarily handled by a plan administrator. This administrator can be an insurance company, brokerage firm or a corporation such as the Public Employee Benefits Service Corporation or "P.E.B.S.C.O." Some of these companies offer a very limited menu of investment options while some have a fairly large menu. Companies offering a large menu will probably have several choices that the investor can choose from that will allow him to mix options until he feels at ease with his exposure.

The first mutual fund was founded in the 1920s. Since then billions of investor's dollars have found their way into mutual funds. Why? The answer lies in the fact that most everyday people cannot buy individual stocks because they do not have the financial savvy or connections to keep ahead of the stock market. That is why mutual funds, with professional managers are perfect for the everyday working person. The informed mutual fund manager picks the stocks to buy for the fund. This method of saving relieves stress from the investor because stocks are bought and sold regularly without the investor having to make all the decisions. This is where mutual funds really come into their own. Basic decisions must still be made involving degrees of risk but the primary decision lies in choosing the mutual fund and manager that most fits your emotional and financial make-up. In order to understand the workings of the typical "457" deferred compensation plan this author has listed five important questions and answers that were encountered when making investment decisions.

#1. What exactly is a "457" deferred compensation plan, how much will it cost and what options are available to get money out of the plan?

Deferred compensation is a tax favored supplemental retirement savings program that allows public employees to contribute a portion of their salary, before federal taxes, to a retirement account. Provided for by Internal Revenue Code Section 457, and offered exclusively to public employees, this tax-deferred program was designed to help build your own supplemental financial security.

Deferred compensation offers the means to postpone taxes now, to build savings more effectively and create a portfolio of investments that is well-balanced. The end result is supplemental retirement income, not just retirement savings, but money for whatever needs that might be encountered upon retirement from public service.[18]

The cost to the investor can vary from a minimum of $15 or $20.00 per pay period to as much as the maximum allowed by the Internal Revenue Service. The maximum, at this time, is 33 1/3 percent of your includable compensation (normally 25% of your gross income) to a maximum of $7500.00 per year.[19] There is also a "catch-up" clause in the Act that allows deferral of as much as $15,000.00 per calendar year during a specified three year period. This clause is for persons who have not deferred the maximum amount over the years of their past participation and want to maximize their account before retiring. One more important fact to remember is that a contribution of, for example $20.00 per pay period, does not actually cost $20.00 of your net income. It will cost several dollars less than $20.00, depending upon your tax bracket, because income taxes are being deferred until you withdraw the money at retirement age.

The final part of this question is a little complicated; however, available options will be covered as completely as possible. The first withdrawal option is retirement. Your retirement age is determined by your police department. By law, it may not exceed 70 years of age. Second is termination of your employment (several pay-out options may be available). Third is an unforeseeable emergency, as defined by the Internal Revenue Service and your department's plan. The final option is upon death. In this event, the deferred compensation account is paid out to your last recorded beneficiary.

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18 P.E.B.S.C.O. Basic Questions & Answers., Brochure, July, 1993, pp.3.

19 IBID

If retirement is your decision, upon reaching the eligible age, withdrawal of funds should be offered in several and varied forms. Lump sum withdrawal is one option that might be offered. Systematic withdrawals at a designated amount or over a designated time period is another. An annuity of some kind will probably be offered. There are usually several variations to choose from. Whatever withdrawal plan chosen, taxation (hopefully at a lower income tax rate) will be levied only on the amount received in any calendar year. The 457 plan cannot be rolled over into any other type deferred compensation plan except another 457 plan. This allows the plan to follow, should a change of employment to another police department or governmental agency occur.

#2. How to choose the person or company to manage the "457" plan?

There are several important factors essential in choosing a deferred compensation plan administrator. First, a large menu of investment options is very important. If the plan administrator offers only one or two funds to choose from, you can't diversify enough to feel protected from market twitches. There should be enough funds offered to allow a choice in, at least, the aforementioned groups. Second, movement within the funds offered should be almost unlimited. Unlimited movement within the funds is also important because it allows the investor choices between the types of funds as the market or your personal situation changes. Movements of investments (within the plan) should be without penalty and with little or no time constraints. There should be several "families" of funds available so that advantage can be taken of different managerial styles. "Loaded" funds should be avoided. Those funds that have front end or back end charges are known as, "loaded" funds. Your administrator should be able to get large funds such as Fidelity, Twentieth Century, American or any participating funds offered, to waive their loads for your deferred compensation plan. The plan administrator should have a fixed fee that he charges to manage the account. It may be a percentage of the total money, an annual fee or some other arrangement, just be sure a clear understanding is reached before signing up with the company. Next, the administrator should offer full service. There should be a local contact person available, to answer any questions about funds available. This contact person, may not be a licensed broker, so advice concerning specific investments cannot be offered by him. He should, however, be knowledgeable enough about the funds to answer general questions. Along with a contact person, a 1-800 number or hotline would be helpful for moving money or checking on fund performance. Finally, choose an administrator experienced in government "457" deferred compensation plans. Discover what other cities, counties or states are using this firm. Take the time to make a few telephone calls before signing up. Make the prospective administrators bid for your department's contract, a little competition is always healthy.

#3. How does a mutual fund work?

A mutual fund is a company that consolidates its shareholder's money and buys and sells securities on their behalf. When money is invested in a fund, shares are received representing part ownership of the fund's securities and of any profits they produce. These profits can take the form of stock dividends, interest paid by bonds and money-market instruments, or capital gains realized from selling securities for a higher price than the fund originally paid for them.[20] No stock or bond fund can guarantee that it will not lose money, as is the case with bank savings accounts and certificates of deposit. But it does offer many advantages that are normally available only to the wealthiest investors, including professional management, diversification, and reduced brokerage fees.[21]

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20 Ellis, Junius. Winning With Mutual Funds. Birmingham: Oxmoor House, 1987.

21 IBID

#4. What are the most popular types of mutual funds?

The following is a partial list of general fund types offered by many deferred compensation plans. Also furnished is a brief explanation of their goals and volatility levels.

Beginning with one of the biggest money makers or losers is the **aggressive growth fund.** The aggressive growth fund seeks to achieve maximum capital appreciation. This strategy is most risky for the investor because all company profits are dumped back into the company for rapid growth and none is used for dividends. This fund doesn't pay much attention to income but prefers to obtain maximum growth by investing in common stocks.

The **growth fund** is next on this list of mostly higher risk funds. The growth fund is heavy on growth but does want some income. It is less risky than aggressive growth because it does require that companies be able to pay some dividends and does not require all money to be reinvested in the company for more growth.

The next is **growth and income funds.** This fund is very interested in dividend income and will invest in stocks such as utilities, oil, banks and insurance companies. This fund tries for a balance but one that is more income heavy over growth heavy.

Next is **equity income funds.** This fund wants high dividend stocks and convertibles as well as bonds. Because this fund deals in stocks and convertibles, yields may be lower and prices may fluctuate more than in income funds that deal primarily in bonds.[22]

Next is **international or global funds.** These funds invest in mostly stocks and bonds issued in countries outside of the United States. They can run the gamut from high risk aggressive growth funds to low risk funds dealing with established large companies. If this type fund is one of

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22 Ellis, Junius. Winning With Mutual Funds. Birmingham: Oxmoor House, 1987.

your investment choices tailor it to certain parts of the world that may be emerging financial powers, i.e. Asian markets, Latin groups (Central or South America), European markets, etc.

Last are the **money market funds**. These are very conservative and are popular with many older investors. The money invested in this type of fund is easily tracked by keeping abreast of the "money market rates" listed in daily papers and periodicals. You can usually move money very easily in and out of this type of fund.

The above list is just a sampling of available funds. There are virtually hundreds of variations. There are sector funds, precious metal funds, index funds and many, many more. Individuals must determine their exposure by examining their personal situation and tailoring a plan to suit their needs, goals and temperament.

#5. Large fund or small fund?

Some advisors think an important criterion is a fund's size, as measured by its total assets under management. A relatively large stock fund, for example, can diversify its holdings broadly, thereby reducing the likelihood that a few bad stocks will pull the portfolio down. A big fund can also get volume discounts on brokerage costs. On the other hand, a large fund often buys and sells stocks in such big blocks, each block represents 10,000 shares or more, that it cannot get into or out of a company quickly without adversely affecting the share price, pushing it up as a buyer and knocking it down as a seller.

In contrast, a small fund has a greater flexibility to take advantage of, or reduce its exposure to, changing market conditions. It can nimbly buy or unload securities and take large positions in those up-and-coming companies that, because they are newly public or have relatively few shares outstanding, are frequently off-limits to big-block trading funds. If only one of these fast growing companies takes off, the small fund can make prodigious profits.[23] All this information tells us that there are greater profits in greater risks. The decision to invest in higher or lower risk funds must still be a personal one. It has to be based on the amount of exposure to risk one is willing to bear.

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SAVING SMARTER

Save smarter by taking advantage of tax deferring. Tax-deferred investments are simply regular taxable investments such as stocks, bonds and mutual funds that are purchased within an officially approved, qualified investment plan. Examples of this type of plan are annuities, company 401(k) savings plans, pension plans and Individual Retirement Accounts.[24] The 457 public employees deferred compensation plan is also one of the approved plans.

Deferring the impact of income taxes is worthwhile because dramatic increases in investment returns can be achieved. Simple strategies for deferring taxes are available to everyone, although many people fail to take advantage of them. Perhaps they don't understand the financial bonanza that occurs when taxes are deferred on interest income and profits.[25]

Let us assume that $2,000.00 per year is paid into an I.R.A. that earns 9 percent annual rate of return and the taxpayer is in the 28 percent tax bracket. In the early years, there appears to be little impact because of income taxes. But at the end of 30 years the difference is dramatic. The result of this method of deferring is reflected in a balance of $297,200.00 in the I.R.A. account and only $183,300.00 if the money was saved outside this tax-sheltered investment.[26] Of course, when money is removed from an I.R.A., (this applies to a 457 plan also) income taxes must be paid on the portion removed. However, few people take the money out all at once, so the account can continue to grow even as funds are used for retirement expenses. When the combination of time

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24 Savage, Terry. New Money Strategies for the 90's. New York: Harper Collins, 1993.

25 IBID

26 IBID

and tax deferral is allowed to work in an investment plan, an unbeatable formula for accumulating wealth is achieved.[27]

The investor must realize that interest is gained, not only on his regular contribution but also on the money that would have been paid to the government, in the form of state or federal income taxes. This additional savings may not appear to amount to a great deal, but when compounding is taken into consideration the results can be very attractive.

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CONCLUSION

Police officers and police administrators who have taken the time to read this paper are obviously looking for answers. All the answers are never that easy to come by. Every individual must formulate a financial plan that best fits his own personal situation. For those who are making decisions in developing a supplemental plan for your department's retirement program, the information is available. The best generic plan possible must be found. All employees concerned must be educated in the advantages of participating and the program initiated. No one plan will fit the needs of everyone but management must choose the best plan and plan administrator available. After choosing the administrator and educating the employees, management should allow employees to make the final decisions in choosing their personal portfolio of funds and investments.

As difficult as it may be, given the typical procrastinating police officer's attitude, the primary role of a good management team is to take every opportunity to stress the importance of financial planning to their officers and employees. It can and will make a tremendous difference in their future lifestyle if they start saving now; not tomorrow, next week, next year or whenever they feel as if they can afford it, but right now!

It would be ill-advised to direct you specifically as to the" best" or "right" mutual funds to invest in, that determination must be personal. The investor still has to do his own research and decide how much risk he can allow himself in growth stocks, bonds, mutual funds or whatever he chooses. One thing that may be of assistance is to relate my own experience and you can draw your own conclusions from my financial decisions. Keep in mind, however, that my choices should not necessarily be your choices.

In 1978, a 457 deferred compensation plan for public employees was introduced to my police department. Because the department already had an existing pension plan, the idea didn't excite many employees. In addition, we thought the existing retirement plan would be sufficient to sustain us in a comfortable lifestyle. I, personally, thought I couldn't afford to take on any savings plan at that time because my bills were overpowering me as it was. After some self examination, it dawned on me that I was never going to be ready to begin saving because I was looking for excuses not to get started, not for ways to get started. It was clear if I were ever to begin it had to be with my next paycheck. The plan was begun with just \$25.00 per pay period because the net change on my paycheck was only about \$20.00. The difference of \$5.00 was saved due to tax deferring. As small as it was, it was a beginning. After fifteen years of gradual increases, the monthly contribution has now reached the maximum allowed by the I.R.S. The maximum contribution is currently set at \$625.00 per month.

My portfolio is divided into five mutual funds and one fixed interest account. The fixed interest account contains approximately forty percent of the total portfolio value and the remaining sixty percent is in mutual fund accounts. At present, the fixed account is dormant and all monthly allocations are invested equally at the rate of 20% each. The risk spread of these monthly allotments are as follows; one aggressive growth fund, one growth fund, one growth and income fund and two foreign funds. This formula is subject to change with the economy but excessive movement, to try and time the market, should be avoided. The whole concept of this fund diversity strategy is to minimize damage during bad times and maximize gains during good times, so when investments are moved around on a hunch or whim you may destroy this diversity strategy. If this theory of dollar cost averaging and diversity is successful the returns should beat most other forms on investing. With today's returns, this thinking might be over optimistic but by following this personal investment plan, the opportunity to gain a better life in retirement is a real possibility.

Stress should be placed on the importance of the police Chief and his staff in the initiation of a sound pension plan. Whether a pension plan does or does not already exist, the introduction of a "457" plan and instructions in basic financial planning should still be part of the package. With basic education in personal financial planning, employees can make decisions based in fact not guesswork. Without education in the minimum basics of investing in the "457", the average police officer will be so confused that he may not make any investments at all for fear of making a mistake. Management must take the lead. Without concerned management, no plan or strategy has a chance of succeeding. Police officers, especially the young, depend on their supervisors for leadership and guidance. To be a police manager is to shape the direction of your department and its' people in all areas of concern.

At this time it is important to reiterate the main ideas management must keep in mind when initiating a deferred compensation plan. Most importantly, choose a plan administrator very carefully. Interview several different firms to make them as competitive as possible. Make sure a sufficient number of investments are available in the plan. Be certain the administrator chosen has a local contact person and an 800 number available to all employees involved in the plan. Insist that employees really understand the importance of participating. Finally, convince older employees that it is never too late to begin and insist that younger employees understand the need to get an early start.

In closing, several goals have been accomplished with this research project. One, to make the reader realize that <u>he is the decision maker,</u> not his police department or city government. Two, no matter what your age, if you haven't started saving for your future, <u>start your plan now!</u> Three, don't wait for someone to offer you a plan. If one is not available, <u>devise your own strategy.</u>

Finally, if you honestly examine your lifestyle, will $20.00 a pay period, towards your future, really change your quality of life? Try it and you'll find yourself just as well off as before and you will have taken a giant step towards financial security.

GLOSSARY OF INVESTMENT TERMS

AMEX: The American Stock Exchange, located in New York City.

ANNUITY: Investment yielding fixed annual payments.

ASKED PRICE: The price asked for a security offered for sale. Quoted, bid and asked prices are wholesale prices for inter dealer trading and do not represent prices for the public.

ASSET: On a balance sheet, that which is owned or receivable.

BALANCED FUND: A mutual fund that is required to keep a specified percentage to its total assets invested in senior securities.

BEAR MARKET: A declining stock market.

BLOCK: A large holding or transaction of stock, popularly considered to be 10,000 shares or more.

BOND: Basically an I.O.U. or promissory note of a corporation, usually issued in multiples of $1000.00. A bond is evidence of a debt on which the issuing company usually promises to pay the bondholders a specified amount of interest for a specified length of time, and to repay the loan on the expiration date. In every case, a bond represents a debt, its holder is a creditor of the corporation and not a part owner, as is the shareholder.

BOND FUND: A mutual fund invested completely in bonds.

BULL MARKET: An advancing stock market.

CERTIFICATE OF DEPOSIT (CD): Receipt for funds deposited with a financial institution payable to holder at some specified date and bearing interest at a fixed rate .

COMMON STOCK: Securities that represent an ownership interest in a corporation. If the company has also issued preferred stock, both common and preferred have ownership rights. Claims of both common and preferred stockholders are junior to claims of bondholders or other creditors of the company. Common stockholders assume the greater risk, but generally they also exercise the greater control and may gain the greater reward in the form of dividends and capital appreciation .

CONVERTIBLE: A bond, debenture or preferred share that maybe exchanged by the owner for common stock or another security, usually of the same company, in accordance with the terms of the issue .

DEBENTURE: A promissory note backed by the general credit of a company and usually not secured by a mortgage of lien on any specific property .

DIVERSIFICATION: Spreading investments among different companies in different fields. Another type of diversification is also offered by the securities of many individual companies because of the wide range of their activities.

DIVIDEND: The payment designated by the board of directors to be distributed pro rata among the shares outstanding. On preferred shares, it is generally a fixed amount. On common shares, the dividend varies with the fortunes of the company and the amount of cash on hand, and it may be omitted if business is poor or the directors determine to withhold earnings to invest in plant equipment. Sometimes a company will pay a dividend out of the past earnings even if it is not currently operating at a profit.

DOW JONES AVERAGE: Widely quoted stock averages computed regularly. They include an industrial stock average, a transportation stock average, a utility average and a combination of the three.

EXPOSURE: The degree of financial risk a person expects when investments are made in lesser to greater risk funds. The greater risk, the greater exposure to loss of capital. The lower the risk the lower the exposure to loss of capital.

GOVERNMENT BONDS: Obligations of the U.S. government, regarded as the highest grade issues in existence.

GROWTH FUND: A fund whose rate of growth over a period of time is considerably greater than that of businesses generally. An average rate of 10 percent per year is used by some analysts as definitive.

INCOME FUND: A mutual fund with a primary objective of current income.

I.R.A.: Individual retirement account. A qualified I.R.A. can have up to $2000.00 per year and interest earned tax deferred until withdrawal.

MANAGEMENT FEE: The fee paid to the investment manager of a mutual fund. It is usually about one-half of one percent of average assets annually. Not to be confused with the sales charge, which is the one-time commission paid at the time of purchase as a part of the offering price.

MATURITY: The date on which a loan or a bond or a debenture comes due and is to be paid off.

MONEY MARKET: The market created by the sale or purchase of short-term financial instruments, including commercial paper and government securities.

MONEY MARKET FUND: A mutual fund that invests in money market instruments.

MUNICIPAL BOND: A bond issued by a state or a political subdivision, such as a county, city, town or village. The term also designates bond issued by state agencies and authorities. In general, interest paid on municipal bonds is exempt from federal income taxes and from state and local income taxes within the state of issue.

N.A.S.D.A.Q: An acronym for National Association of Securities Dealers Automated Quotations. An automated information network that provides brokers and dealers with price quotations on securities traded over the counter.

NET CHANGE: The change in the price of a security from the closing price on one day to the closing price on the following day on which the stock is traded. The net change is ordinarily the last figure on the stock price list. Example: the mark +2 1/8 means up $1.125 a share from the last sale on the previous day the stock traded.

NEW ISSUE: A stock or bond sold by a corporation for the first time.

N.Y.E.X: New York Stock Exchange, the largest securities exchange in the United States.

OFFER: The price at which a person is ready to sell. Opposite of bid, the price at which one is ready to buy.

OPTION: A right to buy or sell specific securities or properties at a specified price within a specified time.

OVER THE COUNTER: A market for securities made up of securities dealers who may or may not be members of a securities exchange, Over-the-counter is mainly a market made over the telephone. Thousands of companies have insufficient shares outstanding, stock holders, or earnings to warrant application for listing on an exchange. Securities of these companies are traded in the Over-the-counter market between dealers who act either as principals or as brokers for customers.

PAR: In the case of a common share, par means a dollar amount assigned to the share by the company's charter. Par value may also be used to compute the dollar amount of the common shares on the balance sheet. Par value has little significance so far as market value of a common stock is concerned.

PORTFOLIO: Holdings of securities by an individual or institution. A portfolio may contain bonds, preferred stocks and common stocks of various types of enterprises.

PREFERRED STOCK: A class of stock with a claim on the company's earnings before payment may be made on the common stock and usually entitled to priority over common stock if the company liquidates. Usually entitled to dividends at a specified rate, when declared by the board of directors and before payment of a dividend on the common stock, depending upon the term of the issue.

PROSPECTUS: The document that offers a new issue of securities to the public. It is required under the Securities Act of 1993.

PROXY: Written authorization given by a shareholder to someone else to represent him and vote his shares at a shareholder's meeting.

PUT: An option to sell a specified number of shares at a definite price within a specified period of time. The opposite of a call.

QUOTATION: Often shortened to "quote." The highest bid to buy and the lowest offer to sell a security in a given market at a given time. Example: 45 1/4 to 45 1/2 means that $45.25 is the highest price any buyer wanted to pay at the time the quote was given on the floor of the exchange, and that $45.50 was the lowest price any seller would take at the same time.

REGISTERED BOND: A bond that is registered on the books of the issuing company in the name of the owner. It can be transferred only when endorsed by the registered owner.

S.E.C: Securities and Exchange Commission, established by Congress to help protect investors. The S.E.C. administers the Securities Act of 1933, the Securities Exchange Act of 1934 and the Trust Indenture Act, the Investment Company Act, the Investment Advisors Act and the Public Utility Holding Company Act.

SECTOR FUNDS: A mutual fund that invests in stocks of related industries or other areas, such as insurance, utilities, electronics and gold (precious metals).

SPLIT: The division of the outstanding shares of a corporation into a larger number of shares. A 3-for-1 split by a company with one million shares outstanding results in 3 million shares outstanding. Each holder of 100 shares before the 3-for-1 split would have 300 shares, although the proportionate equity in the company would remain the same; 100 parts of one million are the equivalent of 300 parts of three million.

STOCK: Ownership shares of a corporation.

STOCK CERTIFICATE: A certificate that provides physical evidence of stock ownership.

TAX SHELTER: A means by which taxable income may be decreased, deferred, or, in some cases, eliminated. Tax-advantaged investments are legal incentives to encourage investment in areas of social need.

TREASURY BILL: Short term U.S. government paper with no stated interest rate. It is sold at a discount in competitive bidding and reaches maturity in ninety days or less.

TREASURY BOND: U.S. government bonds issued in $1000.00 units with maturity of five years or longer. They are traded on the market like other bonds.

TREASURY NOTE: U.S. government paper, not legally restricted as to interest rates, with maturities from one to five years.

TREASURY STOCK: Stock issued by a company but later re acquired. It may be held in the company's treasury indefinitely, reissued to the public or retired. Treasury stock receives no dividends and has no vote while held by the company.

WARRANT: A certificate giving the holder the right to purchase securities at a stipulated price within a specified time limit or perpetually. Sometimes a warrant is offered with securities as an inducement to buy.

WITHDRAWAL

PLAN: A mutual fund plan that permits monthly or quarterly withdrawal of specified dollar amounts, usually involving the invasion of principal. Alternately, a plan may permit varying withdrawals based on the liquidation of a fixed number of shares monthly or quarterly.

YIELD: Also known as "return." The dividends or interest paid by a company expressed as a percentage of the current price. A stock with a current market value of $20.00 a share that has paid $1.00 in dividends in the preceding twelve months is said to return 5 percent ($1.00/$20.00). The current return on a bond is figured the same way[28]

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