Morgan Stanley

Playbook: Your Guide to Life & Money

Investing: Cut the Bull—the Bear Basics of Investing

What Is Covered in This Chapter:

- The basics of investing, including asset classes, stocks vs. bonds, and the long-term play
- What “the market” actually means and ways to talk about it
- The principles of investing and the importance of managing risk
- Getting started and determining your investment strategy
- Ways to find the right Financial Advisor

In today’s fast-paced reality, balancing work, family life, and social engagements can be challenging enough—let alone finding time to create an investment plan. But creating an investment strategy that incorporates your lifestyle goals and tolerance for risk is essential. Setting clear goals for the short-term, long-term, and everything in between will help you decide what trade-offs you are willing to make to prepare for the important milestones ahead. This chapter will cover some of the basic principles of investing so that you can build your financial confidence and make more informed decisions about creating and managing your wealth.

If you thought investing was only for the super-wealthy, think again.

There are lots of ways that people at every asset level can start investing—as long as they have sought out appropriate advice and understand the risks involved.

Remember, saving is a prerequisite to investing. Make sure you have sufficient savings to cover monthly living expenses as well as cash reserves available in case of emergencies before you begin investing money in the markets.

The Basics

On the surface, investing can be intimidating. This makes sense since according to a survey conducted in 2014, almost 70% of Millennials have never received any formal financial education.[1] On top of that, investing can involve an endless number of financial buzzwords that tend to trigger the snooze button before you can fully comprehend what they mean. Let's break down some of the most important terms:

Saving
The act of putting money away in an account with a relatively low interest rate; for example, a bank account.

Investing
The act of putting money to work by committing financial capital (e.g., money) to an entity or a financial product (i.e., a stock or bond) in order to generate a potential profit.

Securities
Forms of ownership, such as stocks, that can be traded on a market (meaning there are buyers and sellers) and have a measurable monetary value.

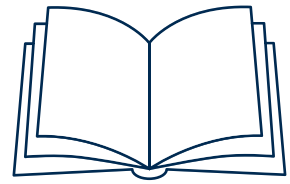
Exchange
A central location where buyers and sellers can trade securities.

Investment Index[2]
A snapshot of the performance and value of a certain selection of stocks. It is usually computed based on a weighted average of the individual stock prices. Investors use indices as a benchmark to compare performance across categories and industries.

Cash and Cash Equivalents
The money you have saved in your checking and savings accounts, as well as short-term, low-risk investments like money market funds and certificates of deposit.

Stock[3]
A share of the value of a company that can be bought, sold, or traded as an investment; this ownership is also referred to as equity.

Bond[4]
Essentially an IOU from the issuer to pay the bondholder a specific sum of money at specific intervals and to repay the principal amount of the loan at maturity. A bond is also referred to as fixed income.



Dividend[5]
A payout from a company to its shareholders using company profits.

Market Capitalization
A company categorization found by multiplying the current market price by the total shares outstanding. It basically measures the current price tag of a company. For example, "large-cap" refers to a company whose capitalization is typically $10 billion or higher in outstanding market value.

Diversification
The process of spreading your investments across multiple asset classes to manage risk.

Broker-dealer
A financial institution that is licensed to facilitate the buying and selling of financial securities.

Investment advisor
A person or firm that is in the business of providing investment advice to investors.

FINRA
The Financial Industry Regulatory Authority, Inc. is a private organization that regulates the securities business in the United States.

There's a good chance you already know how to invest. Time spent learning a new skill, studying a foreign language, hitting the gym—all of these activities represent instances when you've given something up in order to get something in return (whether it was an education or set of summer-ready biceps). "Investing," in a financial sense, is really no different. Quite literally, financial investing is defined as the act of "committing (money) in order to earn a financial return."[6]

After witnessing the impact of the 2008 financial crisis first-hand, it is no surprise that 93% of Millennials (ages 25 to 34) say they distrust the stock market and lack confidence when it comes to investing.[7] Don't give up on the markets just yet, though—investing is an integral part of building wealth.

By putting your money to work, investing may help you achieve higher returns than the lower interest rate earned in a savings account. However, the potential for higher returns comes at a price. Investing involves more volatility than saving and, as a result, the risk of losing your money is also considerably higher. Wise investing starts with understanding the different investment strategies that can help you manage risk and finding quality advice to help guide you through the process.

The Market

"The market is down. The market is up." No doubt you've heard these phrases before, but what do they actually mean? What exactly is "the market?"

A financial "market" consists of people buying and selling (also referred to as "trading") certain assets or valuables. There are many different types of markets: a wheat market, a car market, a market for commodities like gold, and yes, you guessed it…a stock market.

The stock market itself is made up of several exchanges. An exchange is a central location where investors can buy and sell securities in a regulated environment. Most stocks in the United States are traded on two exchanges: the New York Stock Exchange (NYSE) and the NASDAQ Stock Market. Exchanges can be in a physical location, also known as "floor-based" where industry professionals can do trading in-person, or computer-based, meaning that all trading is done electronically. The NASDAQ is a computer-based trading system, while the NYSE, formerly floor-based, is now a mix of both floor-based and electronic trading.

Making Sense of It All

When it comes to the stock market, financial professionals and investors love looking for clues and patterns to help uncover opportunities. Market trends are important because they can give investors a heads up about what might happen next and influence decisions about when to buy or sell certain securities. To help them track the performance of specific categories, such as a particular industry or company size, the concept of an "index" was created. An index represents a group of securities and acts as a performance benchmark for other similar investments. While it is not possible to invest directly in an index, there are funds that attempt to recreate the returns of a particular index.

Index Name	What it Reflects	# of Securities	Serves as…
Dow Jones Industrial Average[8]	Very large, well-established U.S. companies (e.g., American Express, Chevron, Johnson & Johnson, McDonald's)	30	An indicator of overall market trends; most referenced U.S. market index
Standard & Poor's (S&P) 500[9]	U.S. companies with capitalization of at least $3 billion (e.g., Apple, The Coca-Cola Company, Ford Motor, Hewlett-Packard)	500	An indicator of the strength or weakness of the larger U.S. economy, business growth and consumer confidence
Russell 2000[10]	Small-cap stocks (e.g., Alaska Air, Cracker Barrel Old Country Store)	2,000	A benchmark for smaller U.S. companies
NASDAQ[11]	All stocks that are traded on the NASDAQ stock market, the second largest stock market in the world.	Over 3,000	An indicator of how the information technology sector is performing

Disclosure: The companies mentioned in this table are used as examples only and are not a solicitation of an offer to buy or sell any security or other financial instrument or to participate in any trading strategy.

Types of Investments

Types of Investments

There are lots of ways to get in the game. Take candy as an example: you can choose to invest in your favorite chocolate brand, but you can also buy shares in the company that supplies the chocolate factory's energy, or the company that produces the aluminum foil wrappers for the chocolate bars. All of these investments are counting on your candy brand of choice performing well and all are considered to be financial assets since they represent something you own that has a measurable monetary value.

An "asset class" refers to a particular type of investment or category of securities. There are three main asset classes you should know about:

1. Cash and cash equivalents

Generally, the money you hold in cash and cash equivalents is meant to be the liquid part of your total assets (meaning if you needed to access that money to pay for something tomorrow, you could).

2. Bonds

Essentially an IOU, a bond allows investors to lend money to companies or governments (called "issuers") for a certain amount of time in exchange for interest payments until the money is repaid.

3. Stocks

When you buy a stock, you are buying a piece of a company (also known as a "share"). The value of the company (and your ownership stake) on any given day is determined by the forces of supply and demand. When a company is growing and making money, there can be more demand for its stock and the value of your share can increase as a result. But when a company experiences tough times and has to publicly lay off employees, people may start selling their stocks and the supply can soon outpace demand, which can decrease the value of your piece of the pie.

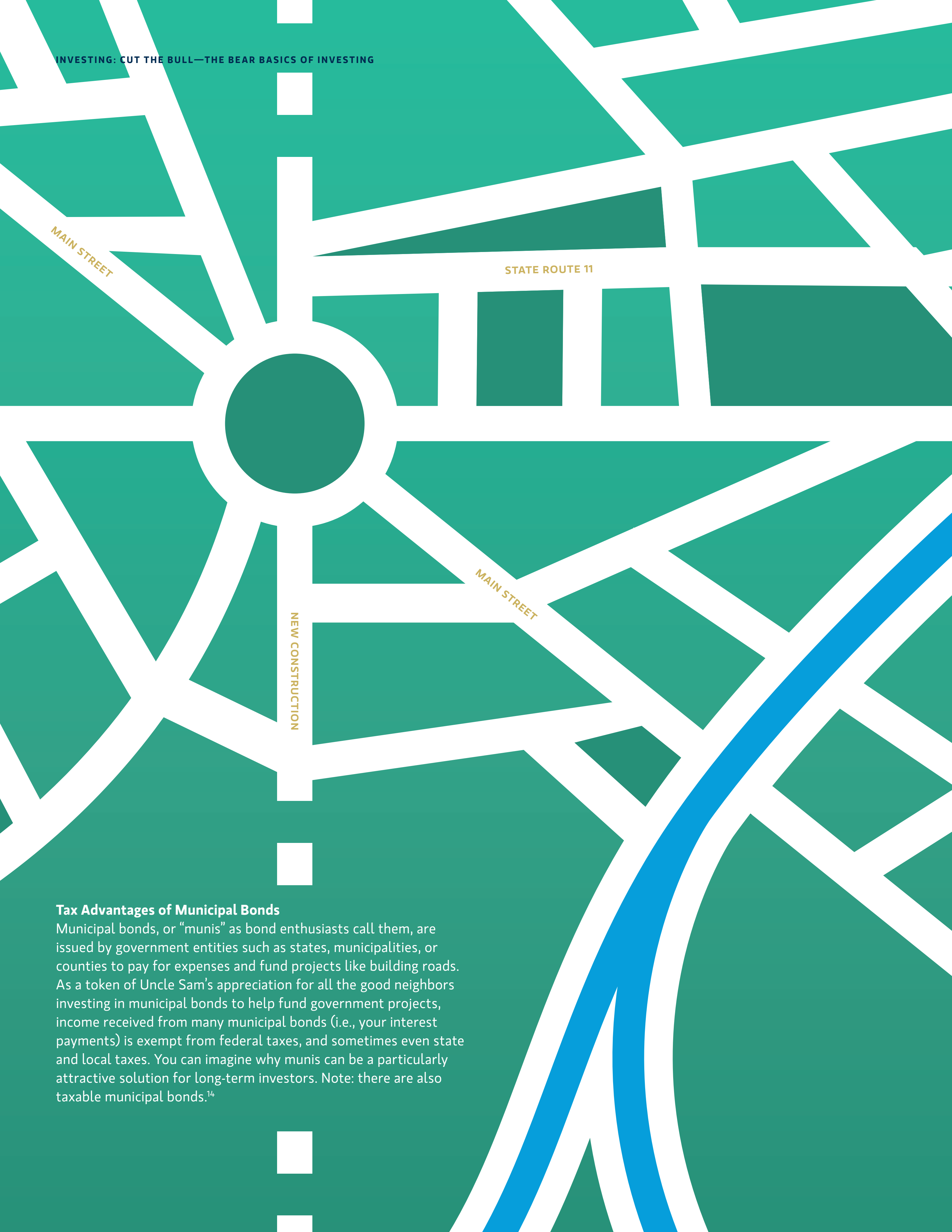
Bonds
Bonds are also known as notes, fixed income securities, debt securities, or debt obligations. When you buy or invest in a bond, the entity issuing that bond promises to pay you interest for lending your money to them. These interest payments, usually paid semi-annually, are based on the interest rate, also known as a "coupon". The coupon is one of the factors that determine the price of the bond. When interest rates rise, bond prices typically fall and the yield increases to compensate for new comparable bonds issued in the market at higher rates.

When the bond reaches its "maturity date", the investor is repaid the original amount or "face value" of the bond.

Bond ratings help investors make more informed assessments about the credit risk of a bond issuer. There are three dominant rating agencies: Standard & Poor's, Moody's and Fitch. Agencies may assign ratings ranging from AAA or Aaa to BBB- or Baa3 for Investment Grade, and BB+ or Ba3 to C for Non-Investment Grade Bonds (also known as High Yield Bonds).[13] As rating agencies downgrade the bond issuer due to a deterioration of the company's credit quality, the bond's market price may potentially decline causing yields to rise to compensate investors for the additional risk.

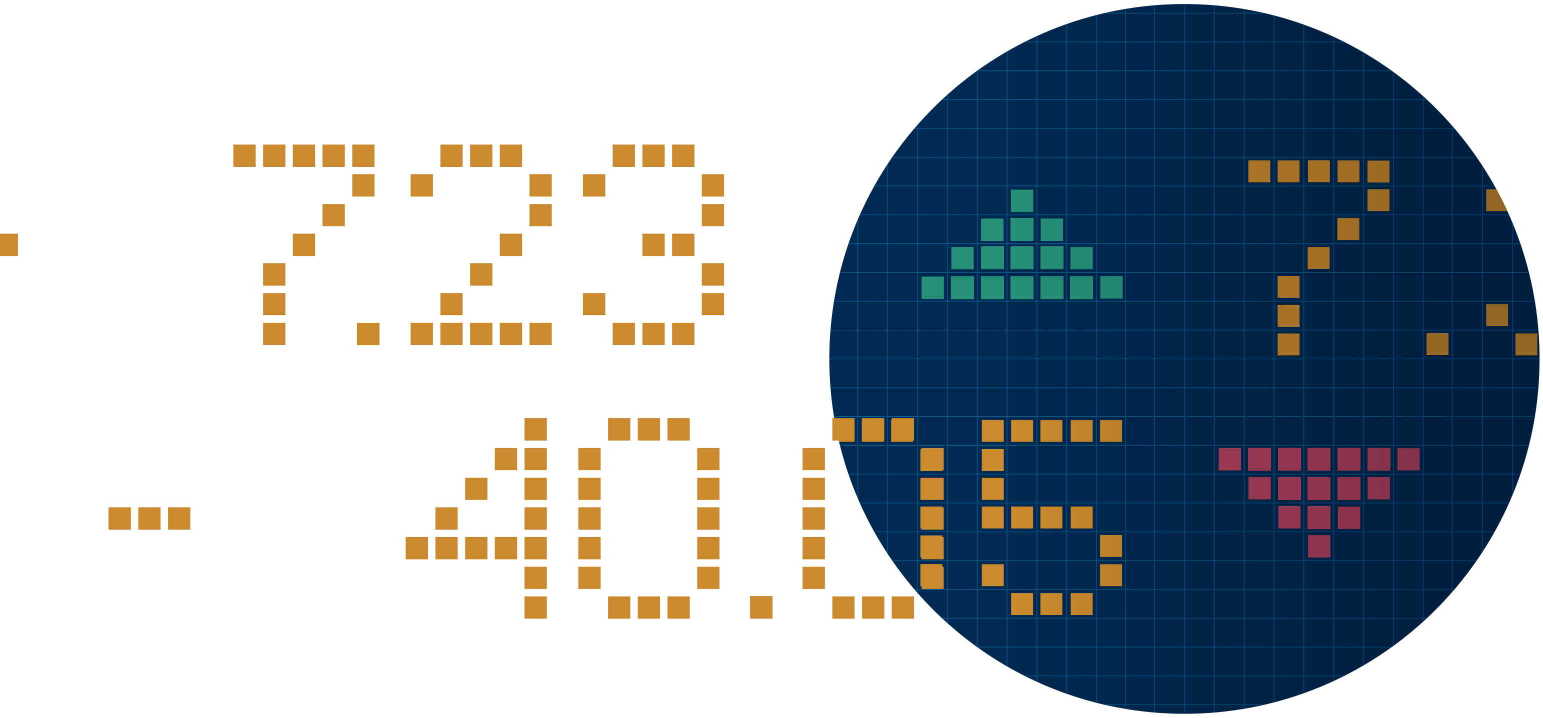
Bond Characteristics[12]

Bond Type	Maturity Period	Tax Status	Risks and Returns
Corporate Bonds Issued by companies to finance expansion and other activities.	1 to 40 years	Taxable	Considered higher risk than government bonds, particularly where issuers have higher potential for default. To compensate, they typically have higher coupons.
Municipal Bonds Issued by state and local governments to pay for construction and other projects.	1 month to 40 years	Exempt from federal, state, and local income taxes under certain conditions	Risks vary significantly depending on fiscal health of the issuing state or municipality. Lower pre-tax rates than comparable corporate bonds due to tax exemption.
T-Bonds Issued by the federal government as a major source of long-term financing.	20 and 30 years	Exempt from state and local income taxes	Very low risk of default because they are backed by the U.S. government, though the long maturities increase inflation risk and interest rate risk. Generally lower rates than comparable corporate or municipal bonds.
T-Notes Issued by the federal government to fund operations and pay interest on the national debt.	2 to 10 years	Exempt from state and local income taxes	Considered low risk, with commensurately low coupons.
T-Bills Issued by the federal government for immediate spending needs.	4 to 52 weeks	Exempt from state and local income taxes	Generally considered the lowest risk, lowest return of all fixed income investments due to government backing and short maturities.
Agency Bonds Issued by U.S. government agencies or government-sponsored agencies.	30 days to 20 years	Varies depending on issue	Considered marginally higher risk and higher interest than Treasury bonds.



Tax Advantages of Municipal Bonds

Municipal bonds, or "munis" as bond enthusiasts call them, are issued by government entities such as states, municipalities, or counties to pay for expenses and fund projects like building roads. As a token of Uncle Sam's appreciation for all the good neighbors investing in municipal bonds to help fund government projects, income received from many municipal bonds (i.e., your interest payments) is exempt from federal taxes, and sometimes even state and local taxes. You can imagine why munis can be a particularly attractive solution for long-term investors. Note: there are also taxable municipal bonds.[14]



Stocks
Companies sell stocks to investors in order to raise money. If you buy stock in a company, your ownership is calculated by dividing the number of shares you own as an investor by the total number of shares outstanding. For example, if a company issues 5,000 shares and you own 500, you technically own 10% of the company. The value of that ownership stake is based on the stock price, which can go up and down throughout the course of the trading day.

One benefit of investing in stocks is that you may be eligible to receive dividends. A dividend is a payout from a company to its shareholders. Whether or not companies pay dividends and how frequently they do so is up to the discretion of the company.

Types of Stocks
All stocks are not created equal. Stocks issued by large, established companies will have a different risk-return profile than smaller technology start-ups that recently went public. The following table outlines the various classifications to help you understand the differences between each type of stock as well as how each can affect your portfolio's performance.

Market Value and Pricing
The value of a stock can go up or down throughout the course of the day. This market value (equivalent to the price of the stock) is influenced by several factors:

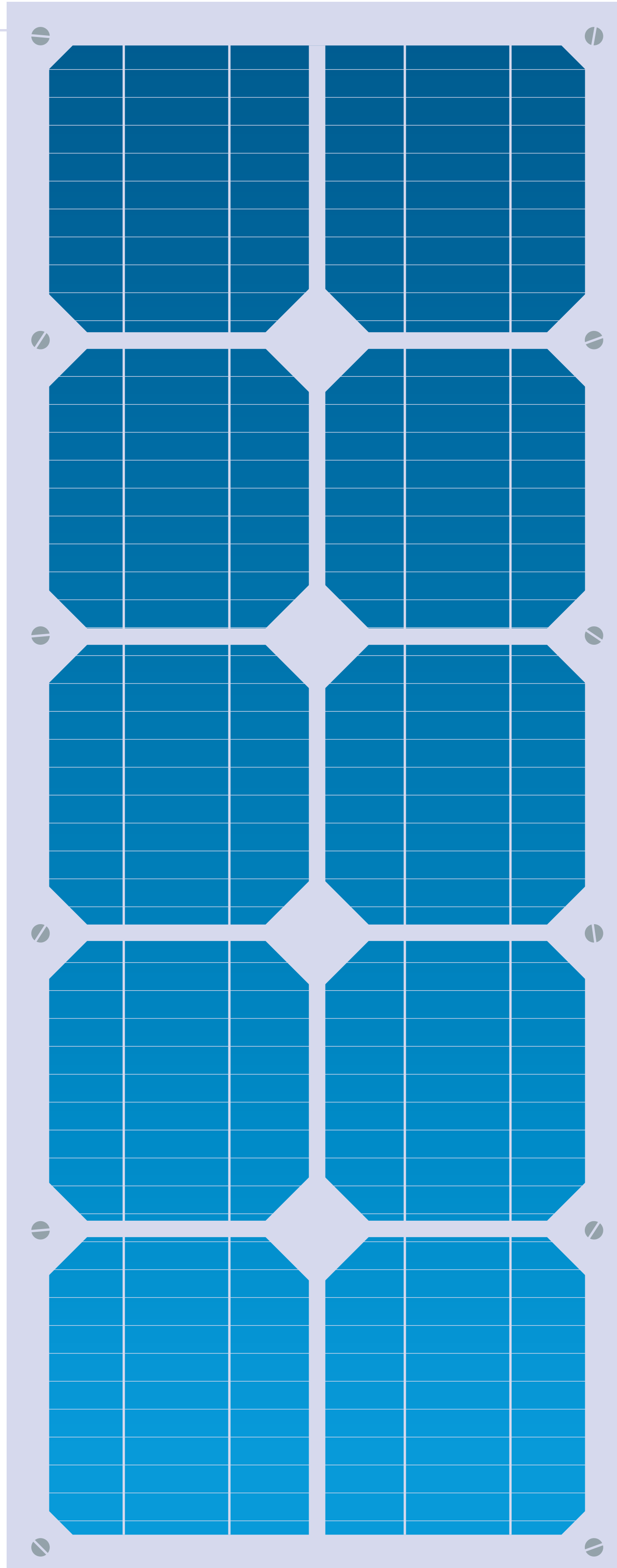
- How profitable the company is
- How quickly the company is growing
- The amount of debt the company carries
- Changes that impact the prospects for future profitability (e.g., a product launch, a new CEO, or a regulatory change)
- Interest rates
- Uncertainty in the geopolitical climate

Remember that one factor sets the actual price of a stock: the most recent trade, which reflects the opinions of one buyer and one seller about the stock's value.

Types of Stocks

Classification	Description	Example
Blue-chip stocks	Blue-chip stocks are stocks of large, established companies that have a long history of growth, profit, and dividend payout.	Large, reputable companies like General Electric, Walt Disney, and Johnson & Johnson.
Growth stocks	Growth stocks are stocks of companies whose earnings are expected to grow at a faster rate than the industry average. Growth stocks typically do not pay dividends because the company would prefer to reinvest earnings into research and development or other projects.	Fast growing companies such as Apple, Amazon, and Amgen.
Income stocks	Income stocks are stocks of companies that pay regular, often higher than average, dividends. In general, income stocks have lower levels of volatility than the overall stock market.	Telecoms such as AT&T, Real Estate Investment Trusts, and Utility companies including electric and natural gas companies.
Cyclical stocks	A cyclical stock's price moves in sync with ups and downs in the business cycle or overall economy. Cyclical stocks typically include companies that sell discretionary items that consumers can afford to buy more of in a booming economy (e.g., technology, luxury goods), but will cut back on during a recession.	Includes retail companies and automotive companies.
Defensive stocks	Defensive stocks, also called non-cyclical stocks, are stocks of companies whose business performance and sales are either unaffected by or not highly correlated with changes in the business cycle. As their name suggests, defensive stocks may help defend your portfolio from losses during uncertain times because they tend to be less vulnerable to economic downturns.	Includes utility companies and healthcare companies.
Value stocks	Value stocks are stocks that tend to trade at a discount to their intrinsic value. Their valuation is also priced lower than broader market or similar companies in their industry.	Companies trading below their intrinsic value like McDonald's.
Penny stocks	The term "penny stock" generally refers to a stock that trades at less than $5 per share. They are considered high-risk and have low trading volumes.	Small, growing companies with limited resources and no track record. Can include companies that have filed for Chapter 11.

Disclosure: The companies mentioned are used as examples only and are not a solicitation of an offer to buy or sell any security or other financial instrument or to participate in any trading strategy.



Additional Asset Classes

Anything that is not a stock, bond or cash equivalent is referred to as an "alternative investment." Investing in alternatives is another way to diversify your portfolio and help manage your risk. Some of the most notable alternative asset classes include:

HEDGE FUNDS

These are funds that are actively managed by professionals. Generally, these are only accessible to institutional and accredited or qualified high net worth investors because you have to commit large sums of money for a relatively long period of time.

REAL ESTATE

In addition to the investment you might make in your own home, there are a few ways to incorporate real estate holdings into your asset allocation. You can either invest directly in an investment property or choose to invest indirectly through a publicly traded Real Estate Investment Trust (REIT)[15] or limited partnership (LP). The latter two options require you to pool your money with others to invest in a portfolio of properties (similar to a mutual fund).

COMMODITIES[16]

Wheat, gold, crude oil, live cattle, soybeans...pretty much anything you grow, raise, or dig out of the ground are commodities that can be traded. While the quality of the item traded may differ slightly based on the producer or source, it is generally uniform or "commoditized." Most commodities are traded in the form of futures, which means that two parties agree to buy or sell a commodity at a predetermined price in the future.

ART AND COLLECTIBLES

Valuables such as art, antiques, sports cars, or rare collectibles are purchased for aesthetic or personal reasons. In some cases, a collection or individual pieces in that collection can be considered an asset. Because the market is fairly opaque and unpredictable, investing in art and other non-traditional assets typically requires high transaction costs and highly specialized knowledge. Given the unique nature of alternatives, including potential barriers to entry and generally less transparency surrounding pricing, seek advice from a qualified Financial Advisor to help determine what strategies are appropriate for you.

The Rules of the Game

Principle #1: Risk and Return
Investing is not just about betting on that once in a lifetime new app opportunity, it's about the long-term plan. By thinking strategically about your future and making smart investment decisions today, you can reap the potential rewards of those choices down the road. Like any journey, there are various routes and each has their own potential for traffic, delays, or roadblocks. There is always the risk that the trip may not turn out exactly as planned, but in order to get there, you have to be willing to take that risk.

The balance of risk and reward is at the core of each investment decision—higher returns require greater risk, while lower returns denote lower risk. As an investor, you will have to take on some level of risk or uncertainty in order to make a return. However, with no guarantees, the key is to create a portfolio of investments that balances your risk and the potential return. Each asset class has a different risk-return profile:[17]

Relationship of Risk and Return

Principle #2: Inflation
Inflation is the increase in the prices of goods and services over time. In other words, life gets more expensive each year even if you keep shopping at the same stores. Although the rate of inflation only increases a small amount from year to year, it adds up over time. For example, with a 4% inflation rate, a house that costs $250,000 in 2014 will cost $360,000 in 2025.

In order to maintain your current standard of living, you should consider making investment returns that are equal to or greater than inflation. For example, if inflation is 4% and your investment portfolio is only returning 3% each year, you are technically losing money.

Principle #3: Diversification[18]
You probably know that having all your eggs in one basket is never a good thing; you risk losing everything if something happens to the basket. In finance, one of the best strategies for avoiding this scenario is diversification. Diversification is the process of spreading your investments across multiple asset classes (or "baskets") to manage risk. The rationale behind diversification is that over time, a portfolio that includes different asset classes may be less risky because when certain investments perform poorly, your downside can be balanced out by assets that are performing well.

Stocks can provide higher returns to investors, but these investments are also much more volatile than bonds. In other words, their price can fluctuate quite a lot from day to day based on market activity and company performance. A diversified portfolio helps manage this risk by including lower-risk securities (e.g., bonds) as well as higher-risk securities like stocks. If stocks are performing very poorly, your bond investments could help limit your downside.

Principle #4: Asset Allocation
Asset allocation is an investor's bread and butter. It is the process of deciding how to divide your investment portfolio amongst the different financial asset classes to balance your risk tolerance, time horizon, and investment goals.

Conservative investors who do not want to take on a lot of risk or have shorter investment horizons may be better off with a portfolio that is weighted towards money market securities and bonds (which have lower risk, but also lower returns). Aggressive investors, on the other hand, are often willing to tolerate the higher risks associated with stocks.

Typically, the longer your investment horizon, the more risk you can take. This is because you won't need to access your money for a while and can afford to ride out the inevitable ups and downs of the markets.

Asset allocation, diversification, and rebalancing do not assure a profit or protect against loss in declining financial markets. There may be a potential tax implication with a rebalancing strategy. Please consult your tax advisor before implementing such a strategy.

Dollar Cost Averaging[19]
Dollar cost averaging is an investment strategy used to help minimize the impact of a volatile market. By investing equal amounts periodically over a longer period of time regardless of the price, rather than one lump sum at a particular price in one lump sum, you can reduce the risk of a sudden market downturn affecting your total investment.

"Life is about balance.
The good and the bad.
The highs and the lows.
The piña and the colada."

ELLEN DEGENERES

A Conversation With Audrey Choi

CHIEF MARKETING OFFICER AND CHIEF SUSTAINABILITY OFFICER, MORGAN STANLEY

Your investment strategy can be more than just a means of accumulating wealth; it can be a tool for supporting the positive change you wish to see in the world. Audrey Choi, Chief Marketing Officer and Chief Sustainability Officer of Morgan Stanley, shares her wisdom on aligning investment portfolios with personal values and putting your money to work toward a brighter future.

What defines sustainable investing?
We define sustainable investing as an investment approach that aims to generate market-rate financial returns while demonstrating positive environmental and/or social impact. For example, at Morgan Stanley, we talk about four broad categories of sustainable investing: Values Alignment, Environmental, Social, and Governance (ESG) integration, Thematic Exposure, and Impact Investing.

Do you need a certain level of wealth to start making sustainable investments?
Up until 3–5 years ago, sustainable investing was largely viewed as a private equity play. Most of the sustainable investment products were not accessible to the average investor. Today, there is a much broader range of products and managers available, spanning asset classes and themes such as fossil fuel aware, faith-based, gender lens, and mission-aligned approaches. There is something for all ages and at all asset levels—from ESG mutual funds and thematic ETFs to green bonds and customized portfolios.

What advice would you give someone who is new to sustainable investing?
Start by asking yourself what issues are most important to you and whether you want to focus on "screening out" (avoiding investments that do not meet certain criteria) or "investing toward" (proactively selecting investments that reflect your values or address issues you care about). Take a closer look at the investments you already own and evaluate whether there are any changes you can make to better align your portfolio with your values.

Are you seeing any generational differences when it comes to sustainable investing?
Because of the convergence of technology and big data over the past decade, there is a much higher degree of transparency across the whole value chain today. As a result, not only are Millennials three times more likely to choose an employer based on their commitment to sustainability, but they are increasingly aligning their investment preferences with their personal values.[20]

The fact that Millennials have a longer investment time horizon is particularly advantageous, because the value proposition of a sustainable investment may not come to fruition within a 12-month earnings period. These companies are incredibly strategic about operational efficiencies and managing their reputation, but incorporating these business practices takes time and patience.

How do you anticipate the industry evolving over the next 5 years?
Philanthropic and governmental resources are not enough to solve the pressing social issues we are facing; we need to incorporate investing as another means of addressing these problems. Within 5 to 10 years, sustainable investing may become a redundant term. When making an investment, people will consider environmental and social impact potential right alongside the traditional financial risk/return analysis.

“A focus on sustainability is a critical part of sound, far-sighted investing. Thinking about environmental and social implications of investing can help investors be more attuned to risk and find valuable opportunities.”

AUDREY CHOI, CHIEF MARKETING OFFICER AND CHIEF SUSTAINABILITY OFFICER, MORGAN STANLEY

Creating a Diversified Portfolio With Managed Funds

Picking individual stocks and bonds takes a lot of time, effort, and experience. Investing without these things can be quite risky, especially if you're new to the stock market. Fortunately, there are people who do this for a living. In exchange for a fee, a knowledgeable person will do the heavy lifting for you by creating a diversified portfolio that you can buy into as an individual investor. Instead of purchasing hundreds of individual stocks and bonds, you simply buy a share in a fund that is already made up of a mix of securities.

Two of the most popular types of managed funds are mutual funds and exchange-traded funds.

1 MUTUAL FUNDS[21]

A mutual fund pools the capital of many individual investors and invests it in a collection of stocks, bonds, and other securities. The company that issues the mutual fund manages the pool of money on behalf of the investors. The fund is traded on an exchange and the price is set at the end of the trading day. Because of this, you can only purchase mutual fund shares once a day after the market has closed.

Fund managers are compensated through commissions and fees. Sometimes referred to as "loads," commissions can be charged when you buy (i.e., "front-ended") or sell (i.e., "back-ended"). Fees typically range from 0.1-3% of the amount invested.

Mutual funds are not guaranteed or insured by the FDIC or any other government agency.

2 EXCHANGE-TRADED FUNDS (ETFS)[22]

An exchange-traded fund operates very similarly to a mutual fund. The difference is that you can buy an ETF from any brokerage firm at any time you want. ETFs are not actively managed and can be bought and sold at any time throughout the trading day just like stocks on the exchange. Because there is less management involved, fees are often lower than mutual fund fees.

Index Funds [23]

For the passive investor who does not have the time, interest, or expertise required to buy and sell individual securities on a daily basis, index funds can be an attractive solution. These funds track a particular index (like the S&P 500) or benchmark with the goal of mimicking their performance over time.

The Way to Invest

There are a wide variety of investment solutions to accommodate an equally wide variety of needs. Here are a few of the service providers who can help you get in the game.

Brokers: The Middlemen

A broker helps investors buy and sell securities. For investors looking for trading support and guidance on investment decisions, a "full-service broker" offers access to research and customized advice as well. Typically, full-service brokers charge an annual fee of 1–2% of the assets they are managing on your behalf in exchange for a more personalized, goal-based approach.

For investors who prefer to do their own research, "discount brokers" also facilitate trade execution, but without the added advice. Like the name suggests, discount brokers are often less expensive than full-service brokers because they charge a fee per transaction (i.e., trade commission) rather than an annual fee to cover the personalized advice.

Discount brokers can be a cost-effective option for the DIY investor; however, since their revenue is based on the quantity of transactions rather than the quality of service, their "discount" service can end up costing you a pretty penny.

TIP: Check the details on a broker or Financial Advisor's background and qualifications for free on FINRA's BrokerCheck website.

Robo-Advisors: The New Kids on the Block

The rapid growth of technology has given rise to new, digitally-driven investment providers. These "robo-advisors" run on autopilot, cost just a fraction of traditional advisory fees, and are typically available to people with smaller amounts to invest. However, as an automated service, they can fall short of a human-based solution when it comes to understanding your needs and providing customized advice.

Investment Advisory and Brokerage Relationships[24]

Money is a sensitive topic. It is the primary source of stress for many Americans and has a profound impact on everything from your romantic relationships to your ability to achieve long-term goals.

The emotions associated with money can easily cloud your judgment, creating unintended blind spots. People often shy away from talking about their finances with others because it is so personal and requires an established foundation of trust.

Your Financial Advisor may be registered as an investment advisor, a broker-dealer or both, and may offer investment advisory services, brokerage services or both. Either or both types of services may be appropriate for you. It is very important that you ask your Financial Advisor which type of services they are providing, and that you understand the differences between investment advisory and brokerage services, including the manner in which you pay for these services.

When your Financial Advisor provides brokerage services to you, they assist you with individual securities transactions and are paid a commission on each transaction. In an investment advisory relationship, your Financial Advisor provides you with ongoing investment advice and other services related to your investment portfolio. In an investment advisory relationship, your Financial Advisor is paid an annual advisory fee for their services, as opposed to transaction-specific fees. This fee for applicable programs is known as a "wrap fee" and generally covers investment advisory services, compensation of Financial Advisors, execution of transactions, custody of account assets and reporting.

Factors to consider when choosing a broker:

- Do they charge a commission for trades?
- Is the fee per trade or does it vary depending on level of trading?
- How many shares are being bought or sold?
- What range of products is available on their platform?
- Is there a minimum for opening an account?
- Do they offer trading on foreign exchanges?
- Do they offer their own mutual or index funds?

When your Financial Advisor acts as your investment advisor, they are a fiduciary to you under applicable law. As a fiduciary, they are obligated to act in your best interests by providing investment advice that is based on your stated overall financial situation and investment objectives.

When your Financial Advisor provides brokerage services to you, they may recommend that you purchase, sell, hold or exchange a security. As a broker, your Financial Advisor must have a reasonable basis for believing that the recommendation is suitable for you. However, when your Financial Advisor acts in a brokerage capacity, they do not have a fiduciary or investment advisory relationship with you, and their obligations to disclose information regarding their business, conflicts between their interests and yours, and other matters are more limited than if they did.

In general, brokerage services are more appropriate for investors who wish to pay only for assistance with their individual transactions. Investment advisory programs may be best suited to investors who want to receive ongoing investment advice that is tailored to their investment objectives and risk tolerances, as opposed to an engagement on a transaction-by-transaction basis, and who are willing to pay an annual fee for this advice and associated services.

PRO TIP

"If your financial goals entail directing basic monthly savings to a simple allocation of stocks and bonds then perhaps some of the automated platforms can fit the bill. Our experience has shown us however that most clients want financial advice that is holistic and customized. This means taking into consideration a host of factors that include dynamics and choices around your job, family responsibilities, debt and borrowing needs, tax status and philanthropic interests. At the heart of the advisory relationship is the concept of education and personalization that ultimately allows you to make the choices about your financial health that are right for you."

LISA SHALETT, HEAD OF INVESTMENT AND PORTFOLIO STRATEGIES, MORGAN STANLEY WEALTH MANAGEMENT

How Are Advisors Compensated?

There are a few different ways advisors in the financial services industry can be compensated:

COMMISSION ONLY

Certain investments and financial products pay commissions to the advisor when purchased. When an advisor invests your money into those products, the "commission" and/or fees will come out of your invested amount and be paid directly to the advisor. There is no service charge for financial or investment advice.

FEE-BASED OR FEE AND COMMISSION

A base fee is charged for the financial or investment advice provided by the advisor. In addition to this fee, you may pay commissions on certain investments.

SALARIED

No direct service fee, but incentives and awards are often offered by the advisor's company in addition to his or her salary. The advisor may receive a small bonus or income boost when a client purchases certain financial products based on the advisor's recommendations.

FEE ONLY

In a fee only structure, the advisor is typically compensated based on a percentage of client assets under management (the amount in your investment account) or as a direct fee based on hourly consultation or a retainer for a specific project. The advisor does not receive commissions.

Questions to Ask Your Financial Advisor

1. Is my portfolio aligned with my life goals?
2. Do I need to make any changes to my current portfolio allocation to help plan for my short-term and long-term saving and wealth goals?
3. What economic indicators and market trends should I be aware of that may impact my portfolio?
4. Where can I afford to take on additional risk, and where should I mitigate my risk with diversification or portfolio rebalancing?
5. Are there any alternative asset classes that I might want to consider investing in (if appropriate)?

Must Reads

A Random Walk Down Wall Street
AUTHOR: BURTON G. MALKIEL

Recommended as one of the first books to buy when starting a portfolio, this book helps explain successful investment strategies.

The Little Book That Beats the Market
AUTHOR: JOEL GREENBLATT

An easy to understand, step-by-step guide for investors written by a hedge fund manager and professor.

The Intelligent Investor
AUTHOR: BENJAMIN GRAHAM

Warren Buffett described this classic that shares the philosophy of an investment advisor as "by far the best book on investing ever written."

Buffett: The Making of an American Capitalist
AUTHOR: ROGER LOWENSTEIN

The behind the scenes look at Warren Buffett and his story of starting from scratch in Nebraska to then becoming the richest man in the country.

Thinking, Fast and Slow
AUTHOR: DANIEL KAHNEMAN

A look into how cognitive biases shape our decisions from a renowned psychologist and winner of the Nobel Prize.

Disclosures

CITATIONS:

[1] TD Bank Financial Education Survey. (2014).

[2] The indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment.

[3] Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment. Companies paying dividends can reduce or stop payouts at any time.

[4] Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

[5] Companies paying dividends can reduce or cut payouts at any time.

[6] "investing." Merriam-Webster.com. Merriam-Webster, 2015.

[7] Capital One. Share Builder Survey. (2015).

[8] Dow Jones Industrial Average is a price-weighted index of the 30 "blue-chip" stocks and serves as a measure of the U.S. market, covering such diverse industries as financial services, technology, retail, entertainment and consumer goods. An investment cannot be made directly in a market index.

[9] S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. An investment cannot be made directly in a market index.

[10] Russell 2000® Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represents approximately 11% of the total market capitalization of the Russell 3000 Index. An investment cannot be made directly in a market index.

[11] NASDAQ Composite Index is a market-value-weighted index of all NASDAQ domestic and non-U.S. based common stocks listed on the NASDAQ stock market. An investment cannot be made directly in a market index.

[12] Morris, Virgina and Morris, Kenneth. The Guide to Money & Investing. Lightbulb Press. (2012).

[13] Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

[14] Interest on municipal bonds is generally exempt from federal income tax. However, some bonds may be subject to the alternative minimum tax (AMT). Also, municipal bonds acquired in the secondary market at a discount may be subject to the market discount tax provisions, and therefore could give rise to taxable income. Typically, state tax-exemption applies if securities are issued within one's state of residence and, if applicable, local tax-exemption applies if securities are issued within one's city of residence. The tax-exempt status of municipal securities may be changed by legislative process, which could affect their value and marketability.

[15] A security that is usually traded like a stock on the major exchanges and invests in real estate directly, either through properties or mortgages. The risks of investing in Real Estate Investment Trusts (REITs) are similar to those associated with direct investments in real estate: lack of liquidity, limited diversification, add sensitivity to economic factors such as interest rate changes and market recessions.

[16] Investing in commodities entails significant risks. The commodities markets may fluctuate widely based on a variety of factors including changes in supply and demand relationships; governmental programs and policies; national and international political and economic events; war and terrorist events; changes in interest and exchange rates; trading activities in commodities and related contracts; pestilence; weather; technological change; and, the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention.

[17] Morgan Stanley. Saving And Investing Seminar. (2015).

[18] Diversification does not assure a profit or protect against loss in declining financial markets.

[19] Any type of continuous or periodic investment plan does not assure a profit and does not protect against loss in declining markets. Since such a plan involves continuous investment in securities regardless of fluctuating price levels of such securities, the investor should consider his/her financial ability to continue his/her purchases through periods of low price levels.

[20] Morgan Stanley Institute for Sustainable Investing. Sustainable Signals: The Individual Investor Perspective. (February 2015).

[21] Investors should carefully consider the investment objectives, risks, charges and expenses of a mutual fund before investing. The prospectus contains this and other information about the mutual fund. To obtain a prospectus, contact your Financial Advisor or visit the mutual fund company's website. Please read the prospectus carefully before investing.

[22] An investment in an exchange-traded fund involves risks similar to those of investing in a broadly based portfolio of equity securities traded on an exchange in the relevant securities market, such as market fluctuations caused by such factors as economic and political developments, changes in interest rates and perceived trends in stock prices. The investment return and principal value of ETF investments will fluctuate, so that an investor's ETF shares, if or when sold, may be worth more or less than the original cost.

Investors should carefully consider the investment objectives, risks, charges and expenses of an exchange-traded fund before investing. The prospectus contains this and other information about the exchange-traded fund. To obtain a prospectus, contact your Financial Advisor or visit the exchange-traded fund company's website. Please read the prospectus carefully before investing.

[23] Index Funds are offered by prospectus. An investor should read the prospectus carefully before investing. It is not possible to directly invest in an index. Index funds carry the same risks as the investments comprising the indices they track. By definition, index funds are designed to match, not beat, the performance of their underlying indices. Index funds are also subject to tracking error that may result in losses greater than those of the underlying indices.

[24] Morgan Stanley offers a wide array of brokerage and advisory services to its clients, each of which may create a different type of relationship with different obligations to you. Please consult with your Financial Advisor to understand these differences.