BONUS Material for Rich As A King

How the Wisdom of Chess Can Make You a Grandmaster of Investing

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Insurance

The primary goal of insurance

The two main types of life insurance are "term" and "permanent." Term life is a pure insurance product, while permanent insurance, also called "whole life," has a savings component, too. Make term life your opening position, just like you should castle early in the game, since your highest priority is protecting your family. You can use permanent insurance along with the other more sophisticated policies, for differing strategies later on.

Characteristics of term life insurance

- **Low cost** – A term life policy, which is a temporary type of program since it ceases when you stop paying premiums, is cheaper than all other life policies since the only cost is the wager on your date of death. Younger people pay less for the arrangement as they have lower odds of dying than older people do. For example, a healthy forty-year-old man who buys a twenty-year level term policy (which means he locks in the premium amount for twenty years) will pay around $900 per year for a $500,000 death benefit. The same man at age fifty would pay about $2,000 per year, and at age sixty would have to pony up around $7,000 in order to insure his life for $500,000. (Note that these figures are only samples, and the true cost depends on many factors, including where you live, the quality and policies of the underwriting company, your health, and more.) When insurance agents tell you it's a "level premium" policy, you might feel like you are paying a fair amount. In reality, though, you are overpaying in the beginning in order to receive a lower yearly rate at the end. If you were to drop such a twenty-year policy after only ten years, you would have grossly overpaid for that first decade. As best as you can, therefore, try to figure out how long you will actually need coverage.
- **Temporary coverage** – Term policies normally cover periods of one, five, ten, or twenty years and, unless you renew them, they terminate. The benefit is that you get protection for your family for only the specific time that you need, such as when your children are growing up. The disadvantage is that once the policy ends, you have nothing to show for it. You have just filled the coffers of the insurance company. But don't despair – at least you're alive.
- **No cash value** – Since term policies don't accumulate cash as part of a savings plan, you can neither withdraw money nor borrow against this type of coverage.
- **Renewable** – Many term policies allow you to renew them when the initial term expires without having to show proof of insurability. That means that if you get sick during the term of the policy, you can still renew it even if you wouldn't pass the physical exam the second time around. If the policy lacks the "guaranteed renewable" clause, though, you would have to start applying from scratch, which may mean higher premiums or worse – not being able to get insurance if your health has deteriorated.
- **Convertible to permanent** – Though you might wisely choose to start out with term insurance, if your health worsens or if your retirement plans change during the duration of the policy, you might later decide that you want a permanent cash value policy. If your term life policy has a convertibility option, you would be able to switch to a permanent policy without having to undergo another medical exam.

Characteristics of permanent life insurance

- **Permanent protection** – Unlike term policies that end at a certain age, permanent life insurance gives lifetime protection as long as you pay the premiums on time.
- **More expensive to maintain** – You will pay higher monthly premiums with a permanent policy than with term coverage since you are not only paying the cost of insurance, but also the cost of savings.
- **Forced savings** – Since many people neglect to stockpile savings, having a policy that obligates you to make regular deposits can help less disciplined investors.
- **Cash accumulation** – Having cash build up in the policy allows for savings, a safety net in case you can't afford to make a premium payment, and the possibility of taking out a loan against the policy. Don't get too excited, though, because due to the internal costs associated with cash accumulation policies, it takes several years for a sizeable sum to accumulate in your policy. People like cash accumulation policies because they can borrow money from the underwriter. Conveniently, when borrowing against your policies, you have no set schedule for repayment. You can pay a little this month, more the next month, or choose to pay nothing at all. This feature, however, could turn into a disadvantage. For starters, if you don't repay the loan, the company will eventually subtract the amount owed from the policy, which reduces the death benefit. Second, by removing cash value from the policy, you may affect the dividends that you might earn on the account. Third, if you don't make sufficiently high monthly payments, the company's number crunchers will add the interest owed to the base loan, so you'll pay compound interest, meaning that you will pay interest on the interest. Eventually, if you don't pay back the loan and you deplete the cash value of the account, the policy will lapse, and you will have no more coverage at all.
- **The loan feature** – This feature really means that you borrow your own money from the insurance company and pay them interest and possibly fees for the privilege. Why would you want to do that? It's like finally getting your pawn to the back rank of your opponent's turf and, instead of electing to promote it to a queen, you exchange it for another pawn. That useless move, which is not even allowed in chess, is like building up your savings for years and then, when you finally decide to use it, you end up paying interest to borrow your own money. Contrast this to investing the money on your own, and when you need it you simply withdraw the funds from your bank or brokerage account without incurring extra interest payments and expenses.
- **Favorable tax treatment** – Due to the special tax status of insurance companies, the earnings inside the policy are not subject to tax. However, when you start taking withdrawals, you will have to pay regular income tax. If you need to take out money before you reach age 59½, you will have to pay a 10% penalty to Uncle Sam on top of the tax.
- **Level premiums** – Insurance companies design permanent policies to maintain a steady premium. Predictability in financial planning has huge benefits, since you don't want to find yourself unable to afford the rising costs of your policy. Remember what happened to people who had adjustable rate mortgages? When interest rates moved up more than they had originally anticipated, they could no longer afford the monthly payments and had to abandon their homes. The same problem can arise as you get older if you don't have a "level premium" policy to keep your annual payments fixed. Eventually, you may not be able to afford to pay them at all. Having level premiums, though not necessarily the most cost-effective way to buy insurance, affords you the comfort of knowing exactly how much you will have to pay each year over the life of the policy. You may find that predictability is well worth the extra cost.

Different policies suit different people depending on their situations in life, their tolerance for risk, their ability to watch their portfolios, and more. Though some individuals may like the forced savings and tax-deferred growth inherent in permanent life policies (sometimes called "cash-value" policies), others note that IRAs and 401(k) retirement plans force you to save, too, and the money accumulates on a tax-deferred basis. Also, permanent life policies tend to have high fees, and the insurance component may often be more expensive than that in a comparable term life policy. Above that, there are marketing and sales commissions, surrender charges if you drop the policy in the first ten years, annual investment fees (which are often complicated to determine), and a fee called the "mortality and expense" ("M&E") charge that compensates the company for various risks it assumes. Though the fees may not stop you from reaching your goals, they can certainly slow you down.

Should you buy term or whole life?

Focus on maximizing the effectiveness of each of your money moves. Just as a chess player moves two pieces at once when castling, maneuver your investments so that each, in its unique way, moves you toward your goal as quickly as possible. Specifically, go for the efficient route and handle insurance needs with a term policy and investments with a brokerage or bank account. While one-stop shopping may seem efficient, it can be more costly in the long term.

Illustrations

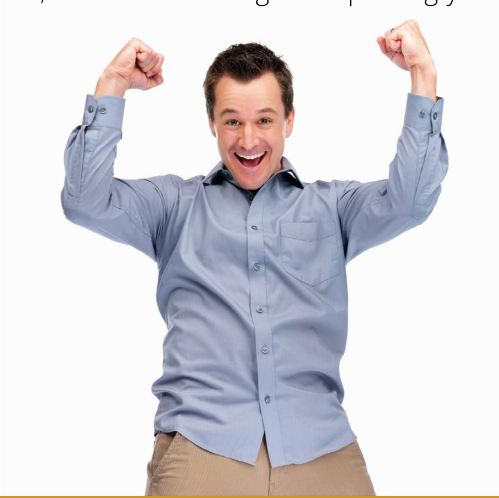
In tournament chess, players write down the moves. This allows them to study the progression of the game and compare one series of moves with another. Likewise, ask your insurance agent to supply you with a written policy illustration to see what the premium pattern looks like and compare apples-to-apples against other similar policies.

Riders

Riders in insurance policies are long shots. Policies almost never pay out for these extras, such as accidental death (which might double the death benefit) and waiver of premium (which takes over your monthly payments should you become disabled). Paying the extra cost to buy the rider, which can become a hefty sum when calculated over the years, is akin to a chess master advancing a specific pawn each and every move in the beginning stage of the game. He might get to the other side and capture an important piece, but the odds of that are slim. Instead of wasting time marching forward with this one piece, he could develop a much more potent strategy during those moves. Though some riders might make sense in your case, don't blindly buy them all. These add-ons complicate the core point of buying insurance, which is to protect you against a specific (though improbable) risk that you cannot afford to handle on your own.

When castling, not only do players swap their kings and rooks, but they also build a solid defense around the king using pawns, bishops, and knights. If the defensive players fail in their protection duty, or wander off to some other part of the board, the king is left by itself and all the effort of castling is for naught. Likewise, if you pay premiums to a second-rate company for years and if it subsequently fails or experiences significant fraud, you may be left defenseless. You can confirm the soundness of your insurer by checking with a rating company such as AM Best (www.ambest.com) that evaluates and analyzes the stability of companies. Though their review offers no guarantee, at least you get a sense of the stature of the company upon which you are relying to protect you and your family. In any event, though, most states have a "guaranty fund" designed to deal with insurance bankruptcies. Though there are limits to these funds, they normally offer enough coverage for the average consumer's claim.

Just as a grandmaster works multiple strategies simultaneously, insurance planning must also cover many possible eventualities. Spend time reviewing your life and disability programs, and also checking and updating your health, home, mortgage, car, and other coverages, too.



Take The Initiative And Use Trade Order Qualifiers

Look through these order qualifiers and decide which ones you'll use the next time you take the initiative in your financial game.

- **All or nothing (AON)**. When buying stocks, a trader may only be able to get a few hundred shares at a time for a client – and these may not all be at the identical price. Or, it may not be possible to completely fill the order in one day. If, under these circumstances, you would not want your order executed, you can specify, "All or nothing." If you're interested in a large quantity of stock and stipulate AON on your trade, your order may not be filled because no one is interested in taking the other side of the transaction. Many brokerage firms have "block trading" desks that specialize in handling such large single-stock orders.
- **Day order**. An order to buy or sell that expires at the end of the day, unless it is executed or cancelled by the client before the closing.
- **Good 'til cancelled (GTC)**. A GTC order, also called an "open order," stays in effect until executed or cancelled by the client. Some brokerage firms limit the length of time that open orders can remain active, so check with your broker when placing such an order.
- **Limit**. You can give instructions as to the price (or better) at which you are willing to buy or sell. The trading systems will not execute your order unless the fill will meet, or improve upon, your request.
- **Market order**. This is an instruction to buy or sell stock at the best price currently available.
- **Stop order**. This is an order to buy or sell a stock after it reaches or trades at the specific price that you have requested. After the stop price is met, an order then becomes a market order and is filled along with other market orders at the best price currently available. When would you use a stop order? Let's say you own a stock now trading at $80 per share and feel confident in its prospects. However, some rumors have surfaced that, if true, could severely damage the company. Should you sell it now, thus missing out on the upside potential, or adopt a wait-and-see attitude? If you can handle some loss, but don't want to lose more than $5 per share, you could enter a sell order with a $75 "stop." If the stock begins to tumble and hits $75, then, and only then, will your order go through. By using a stop order, you get out of the stock only if it drops to your stop price. But if its price stays fairly steady or goes up, you hold.
- **Stop-limit order**. This order combines a stop order with a limit order. As soon as your requested price (stop price) is reached, your order changes automatically to a limit order. Then, if your order can be transacted at your requested price (or better), it will be carried out. If it cannot meet this requirement, it will not be executed. For example, presume your shares of XYZ currently trade at $45. You could give an order to sell them at a stop price of $40 with a limit of $39. If the stock subsequently trades at $40, your order will become active, and as long as you can get $39 or better, your order will be filled. On the other hand, if terrible news causes the stock to drop from $45 to $35, you will not sell your shares. Why? Because your limit of $39 can't be met. Since the price of the stock passed through $40, your order will become a regular limit order to sell at $39. But if the market for the stock is at $35, then you will not be able to sell at your limit of $39. You'll have to wait and hope that the price of the stock goes back up to your price. Or, of course, you could just change your order to a market order and sell the stock at $35 if you believe it's destined to continue dropping.

Four Rich As A King Patience Techniques to Make You a Better Investor

Try these techniques to truly make yourself a patient person:

- Choose to delay your decisions for a certain period. Depending on the issue at hand, wait a few hours, days, or weeks to commit. Get in the habit of separating yourself from the excitement of selecting an answer right now. Taking time to think is the exact opposite of what a casino wants you to do. They want you to act emotionally, quickly, and (obviously) wrongly, which is how they win more than lose. Don't confuse waiting with procrastination. Rather, defer decisions as a matter of policy. Not only will you become more patient, but you will have more time to seriously consider your options. In the investing world, there is a rarely a decision that must be made now.
- Keep a journal of your thoughts and experiences. Simply writing down events that may trouble you will allow you to look at them with a new, disconnected perspective. For financial issues, if you have recorded your considerations and decisions, you can look back later to see which thought processes have led to good or bad choices, and learn from your mistakes, much like chess masters learn from reviewing their games.
- Instead of tensing up when others bother you (like whiney kids in a restaurant, the woman crinkling her package of candies in the audience of the Shakespeare play, or the bad driver who can't accelerate above forty-five miles per hour on the highway), make yourself into a passive observer. If you mentally step back from the scene, you will gain a better perspective. After all, it won't help you to yell at them, and if you allow yourself to get angry for even sixty seconds, that's a whole minute of your life in which you've chosen stress over serenity. Josh Waitzkin, the subject of the movie *Searching for Bobby Fischer*, and author of the best-selling book, *The Art of Learning*, tells how his Russian archrival in the chess circuit used to kick him under the table at critical moments of the game. Though Josh was originally shaken by this (and other players were reduced to tears because of it), he knew he had to find a way to keep his cool. He developed the instinct "not to avoid the discomfort but to become at peace with it." Losing money in the markets often feels like a nasty kick under the table, but the emotional response that people have often makes the situation worse.
- To solidify the attribute of patience over the long term, work on creative skills like playing music, cooking, painting, gardening, exercising, and, of course, chess. Consider success stories like Warren Buffett, whose inexpensive but creative hobbies include playing ukulele and bridge, Cisco's CEO Sandy Lerner who enjoys jousting, or Ford's executive chairman William Clay Ford, Jr. who touts a black belt in Tae Kwon Do. Great leaders in every field who used chess to find their inner peace include Isaac Asimov, Napoleon, David Bowie, various kings and presidents, Bill Cosby, Leonardo da Vinci, Tom Cruise, Sigmund Freud, Zsa Zsa Gabor, Carl Icahn, Bill Gates, Harry Houdini, Madonna, the Marx brothers, and many Nobel Prize winners. The time you take away from your central focus in order to develop your attribute of patience will be one of your best investments.
- Lastly, if dealing with money physically upsets you, try the time-tested technique of controlled breathing. Breathing deeply or simply counting to ten slowly when you feel tense can help you relax, slow down, and make better decisions. Standing or sitting up straight and lowering your shoulders, breathe in deeply, all the way down to your stomach. Hold the air for a moment, and then release slowly.

How to Talk About Money So Your Spouse Will Listen

When starting the dialogue with your spouse about finances make sure to be particularly sensitive, since money pushes a lot of emotional buttons in people, including fear, anxiety, guilt, and anger. The role of money in marriage ranges from enjoyment and security to status and domination, so strive to understand how both you and your partner view it. Does one of you come from a family of "old" money? Is one person more organized than the other? Do you both view giving to charity with the same level of importance? Does one of you like to spend while the other prefers to save? Distance yourself from the many myths that have penetrated into the world of money, such as lack of financial resources is the leading cause of divorce (perhaps not talking about the subject is the cause); money solves all problems (rich people have problems, too); the economy is so crummy that we'll never get ahead (lots of people are finding ways to deal with a bad economy); there are only two ways to handle money – the right way and the wrong way (there are plenty of different approaches, so you don't need to get locked into just one). Don't start with conclusions about how much you can afford and what should be cut from the budget. Begin with open-ended questions such as:

- What is important about money to you?
- What did your mother/father teach you about money – by actions and words?
- Did your parents do something with their money that you respected? Disliked?
- How do you feel when you have a lot of money? How about when you're feeling broke?
- How much money do you want to have?
- What would you do if you got a $5,000 inheritance from a distant uncle? How about a $500,000 windfall?

By creating an atmosphere of open communication, you will get into the habit of conversing with your spouse respectfully and in a non-combative way. Realize that your marriage is more important than any item that money can buy. Talking clearly, and more importantly, listening closely, both you and your spouse will feel at ease, and better able to explore your objectives together. Of course, make the structure of the discussion conducive to accomplishing your goal of managing your finances. Do this by meeting regularly, perhaps quarterly. Schedule a time when you are not tired, stressed, or in the middle of something else. Shut your cell phone for these conversations, and have a standard agenda (i.e., how did our spending go last month, what do we have lined up for this month, what are our concerns). Try having bigger, long-term planning discussions every six to twelve months to review your longer-term goals, to strengthen your commitment to building a solid base, and to make sure that you're both on the same page regarding how you want to handle your money.

12 Major Market Sectors

Keep in mind the following segments of the economy when choosing where to allocate money, and make sure your money is diversified among several sectors. Better yet, choose some sectors that traditionally move in opposition to one another to further hedge your risks:

- **Basic materials**. Companies in this group include those engaged in the acquisition and manufacturing of the basic substances that go into finished products, such as chemicals, paper and packaging, wood, and steel.
- **Capital goods**. These firms design, develop, produce, and service commercial machinery and construction-related items. Categories include aerospace and defense, construction and agriculture, mobile homes, and heavy-duty vehicles.
- **Conglomerates**. This refers to multi-industry corporations, a category that has widened considerably over the last few years. Samples of these include General Electric and Honeywell International.
- **Consumer cyclicals**. Companies in this group produce durable goods, such as automobiles, tools, television sets, and furniture. Because of the non-disposable nature of these items, the ups and downs in the economy greatly affect them. During a recession, for example, buyers often postpone purchasing new kitchen chairs until they feel more secure about the economic outlook.
- **Consumer non-cyclicals**. “Non-cyclical,” “nondurable,” or “defensive” items refer to goods that people consume and need to replenish, such as food, medicines, beverages, and various household products. Troughs in the business cycle have less of an impact on these companies than on more cyclical firms. They can defend themselves (hence the description, “defensive”) against down markets since consumers need their products on an ongoing basis, even during recessions.
- **Energy**. This group refers to companies engaged in the acquisition, harnessing, production, and distribution and service of various forms of energy, including coal, oil, and gas.
- **Financial**. Major brokerage firms, insurance companies, banks, and other money-related institutions are included in this category.
- **Health care**. This sector tracks the health and medical industry. Included are drug companies and those engaged in biotechnology, providers and insurers of health care, medical facilities, and manufacturers and suppliers of medical equipment.
- **Media and general services**. This very broad category is comprised of broadcast and cable TV, publishing, movies, and various aspects of these communications companies, along with restaurants, hotels, real estate, retailing, and all of the ancillary aspects of these businesses.
- **Technology**. High-tech companies are the core of this group, along with communications equipment, computer hardware, computer networks, electronic instruments and controls, semiconductors, software, and programming.
- **Transportation**. This sector includes companies involved in aspects of air and sea transport, railroads, trucking, and forms of public transportation.
- **Utilities**. These corporations acquire, furnish, and provide electricity, water service, natural gas, and telephone services to industry and the public.

Size Matters: Large, Medium, or Small-cap Companies

The size of a company

The term "market capitalization," or "market cap," refers to the size of a company. Determine this figure by multiplying the number of shares outstanding by the price per share. For example, a company with five million shares at a current market value of $14 per share has a market cap of $70 million.

"Large-cap" stocks usually refer to companies with a total market capitalization of over $10 billion. These well-established firms have names that everyone knows and they trade on the major exchanges. Their massive size normally cushions them from the volatility associated with smaller firms. They do not constantly focus on growing larger through new undertakings, but instead aim to grow more profitable by expanding and servicing markets for their existing product lines.

Mid-cap stocks are often newer, but still established companies with market capitalization in the $2 billion to $10 billion range. They have proven themselves capable of meeting their customers' needs, but in an effort to grow and achieve greater success, may choose to assume additional risk. While many companies will remain in this mid-cap category and continue to provide satisfactory returns for their shareholders, others will successfully enlarge their scope and join the large-cap grouping.

Small-cap companies have market caps ranging from $300 million to less than $2 billion. This group generally includes businesses in the startup phase. These firms must hunt for ways to raise money, expand their production, search for new markets, and compete with others in the industry in order to hold onto their foothold and hopefully forge ahead in the field. Consider investments in these companies much more speculative than investing in medium- or large-cap enterprises.

Premium Bonds: What Makes Them So Valuable?

A premium bond is one that you buy on the secondary market for more than par value ($1,000). For example, if you purchase a bond with a 9% coupon (when other newly issued bonds are only paying 7%), you might pay $1,150 for it. You willingly pay more than $1,000 for the bond because it generates more income every year ($90/year) than 7% offerings ($70/year) produce. When it matures, you will receive $1,000, which is less than what you originally paid. The difference, $1,150 - $1,000 = $150, is called the "premium." You accept that $150 loss because, when you first bought the bond, you knew that you would more than make up the loss of premium by getting higher coupon payments every year. Had you bought a bond at par, you would have gotten lower annual payments and not lost the premium. In general, you will end up with a fairly similar yield to maturity regardless of whether you buy the premium bond or the bond trading at par.

As an investor looking forward to receiving a predictable cash flow, consider the advantages of buying premium bonds:

- Because many price-conscious people never like to pay more for a product than the listed value, premium bonds will sometimes trade at a slightly lower price than you might expect (based on your calculations of returns), and their yield to maturity would be a bit higher than low-coupon bonds selling at a discount or new bonds selling at par.
- Premium bonds pay a higher coupon rate than discount or par bonds. Thus, each year you will receive more cash in your hand. With this extra money you can go shopping, pay your bills, or reinvest and earn interest on your earnings.
- During a period of increasing interest rates, premium bonds can make sense. For example, if you hold a bond with a 7% coupon while your neighbor keeps his 4% issue, as rates move up to 7% and beyond, your coupon will seem more in line with general expectations compared with his lower coupon of 4%. That higher coupon may cushion your bond, helping it retain more of its value than its lower coupon counterpart. The prices of bonds move inversely to interest rates. As such, if you want bonds that retain value in a rising interest environment, consider choosing premium bonds.

Mutual Funds Come in Many Formats

What is the difference between a mutual fund and an index fund?

With the abundance of theme funds available, and the ever-expanding number of growth funds, value funds, balanced funds, bond funds, tax-free funds, socially conscious funds, and more, how can an individual investor efficiently establish a broadly diversified account? Index funds.

Index mutual funds try to mirror, not outperform, the results of the securities listed on a particular index – such as the S&P 500. The S&P 500 comprises 500 widely held large-cap American stocks (Coca Cola, General Electric, IBM, McDonalds, Merck, etc.), and covers about 75% of the capitalization of the entire market. You can easily find indices of the NASDAQ 100, the Russell 2000, the Wilshire 5000, and various other small-cap, precious metals, international, and emerging markets listings as well. Whether the underlying index represents blue-chip corporations or more speculative companies, a mutual fund based on a particular index enables shareholders to own a portion of every included holding.

Is it a bad idea to buy into an index fund knowing that you will only reap an average return? Not at all. In many cases, index funds have outperformed diversified, general equities, and sector funds. In fact, professionals frequently debate the merits of active versus passive management. In support of passive investing, lower fees help the performance of index funds. Since their composition rarely changes, they have limited turnover (amount of trading each year) inside the fund. Less trading means fewer commissions. Moreover, having less activity means fewer opportunities for taxable capital gains like you find in actively managed funds. Managed mutual funds average a turnover rate of about 85%, meaning that most of the holdings change on an annual basis. Compare that with index funds, which normally see well under 10% variation year over year.

Since many indices use the "capitalization weighted" model to determine which positions have more sway on the return of the index, often a few stocks (like Exxon Mobil and Apple) represent a disproportionate amount of the fund. In other words, an index such as the S&P 500 will give more weight to larger companies, and thus its value will reflect the price movements of a fairly small number of stocks. So even though the "500" in the name of the index correctly refers to 500 individual companies in the portfolio, the top 10 holdings represent about 20% of the index's return – which is not much diversification. In fact, the single top holding, Apple, represents a greater percentage of the index than the bottom 100 stocks combined. You may want to own a fund with top-heavy weighting, so purchasing a capitalization weighted index fund makes sense. However, don't buy into such a fund believing it will diversify your money equally among all the elements of the index.

Open-end mutual funds

Most fund companies come under the heading of "open-end mutual funds." This means that they issue new shares to meet buyer demand (at a cost calculated daily, based on the net assets of the company divided by the number of outstanding shares) and buy back the shares when investors wish to sell (based on the same calculations). The fund's capitalization and number of outstanding shares changes daily.

Closed-end mutual funds

Most of the time, when people talk about mutual funds, they're referring to open-end funds. But closed-end funds (CEFs) have been on the scene for a long time and share many similarities with their more popular counterparts. Both types of funds employ professional managers, and both provide a diverse selection of holdings (often with a particular theme). However, their shares trade differently. With open-end funds, the company issues and redeems shares. If you want to buy shares, the fund receives your money (either directly or through your brokerage firm) and then creates new shares for you. When you sell, the fund liquidates shares and sends the proceeds to you or to your brokerage account.

In the case of closed-end funds, however, the managers raise a large amount of capital in the form of an initial public offering (IPO). They collect the money and issue a finite number of shares at the outset. Investors thereafter wishing to purchase shares or get rid of their current holdings have to go to the stock exchange and buy or sell at prices set by supply and demand.

For example, if ABC Investment Strategists, Inc. wishes to create a closed-end stock fund, they may hire XYZ Brokerage Firm to help them raise $100 million. Once the money has been collected, ABC will begin trading with that cash. The people who put money in originally will each own a piece of the ABC portfolio. If you missed the original offering and want to own some of those shares, you would then have to buy them from a current owner at the market price. You would not have any direct interaction with ABC itself, because they no longer create new shares; they simply manage the closed portfolio.

Discount or premium

In many cases, the price per share of a closed-end fund will closely correspond with the actual value of the securities within the portfolio. In fact, it makes sense. You should expect the price per share to trade in line proportionally with the sum-total value of all the holdings (known as the "net asset value," or NAV). Sometimes, however, the price per share and the NAV fall out of line. If you could buy shares of the fund at a price below the actual NAV, you would say that the fund is "trading at a discount to NAV." In the opposite case, where the price per share is greater than the NAV, it's trading at a "premium."

Factors that create a discount or premium

If a fund had a net asset value of $10 per share, would you pay $11 per share – thus buying at a premium? Likewise, if you held a fund with a $12.50 NAV, would you sell it below that price at a discount? Many different factors influence the trading price of a closed-end share versus its actual, underlying net asset value. For example:

- **Out of sight**. Unlike open-end funds that advertise in order to increase their asset base, closed-end funds operate in relative obscurity. These funds have no reason to advertise, since they don't collect more money if more people own shares. In fact, if they spend money on advertising, they'll diminish their asset base and negatively affect their performance. Moreover, less money in the pot means slimmer management fees. Lacking the exposure of their more conspicuous cousins, closed-end funds generally command less attention, which leads to weaker demand, and thus they may trade at a discount to NAV.

- **Lagging performance**. If a fund's results trail a comparable index, large numbers of investors may sell, and new ones may not line up to buy. This lack of demand for shares will erode the price. In addition, as shareholders lose faith in the fund's managers, the share price will drop (as investors look to sell their shares) even if the underlying assets that define the NAV retain their value. There have been cases where the shareholders of funds trading at deep discounts have voted to disband the fund, sell off all the assets, and then actually profit by walking away with their share of the true value of the underlying companies and not the prevailing price per share. Even though many CEFs may trade at a discount, this type of scenario is very rare.
- Sometimes investors cannot readily buy certain stocks on foreign exchanges. When a country limits foreign investment or imposes certain restrictions, for example, a fund might offer the only route for individuals to get in on the action. That exclusivity may cause a greater demand for the CEF, thereby creating a market premium.
- **Priceless portfolios**. "Priceless" here doesn't mean expensive. Rather, traders cannot always establish a price for some investments – such as unusual bond issues, private placements, bankrupt companies, parcels of real estate, penny stocks, and more. CEFs that specialize in these more illiquid securities tend to trade at a discount because the funds' managers cannot quickly convert the assets into cash.

Tax exposure with closed-end funds

Like open-end fund buyers, CEF investors must also bear the brunt of the capital gains that the funds return. Often, a long-established CEF may hold large positions in highly appreciated stocks. If the fund sells those shares and pays out a capital gains distribution, its current shareholders must pay the tax on the gains. Immediately following these distributions, the share prices usually drop. Knowing about the potential tax liability could cause investors to shy away from a CEF, which would inevitably lead to its trading at a discount to NAV.

Pros and cons of open- and closed-end mutual funds

In addition to structural distinctions between open- and closed-end funds, there are differences in the managers' actual trading styles. Those in charge of open-end funds have to deal with fluctuating amounts of available money, as ups and downs in the markets often convince investors to buy in large amounts – thus loading up the fund with an influx of cash – or sell on bad news, making it necessary for management to dig into cash reserves, or even sell positions in order to redeem investors' shares. Closed-end fund managers, on the other hand, can invest following a pre-determined plan since they know in advance how much capital they have available. Along these same lines, closed-end fund managers can more easily invest in speculative or less liquid investments that they feel have great promise because they know the shareholders can't force them to sell at an inopportune time by redeeming shares. Note that open-end funds trade only once per day. In comparison, you can buy and sell CEFs throughout the trading day since they trade on a stock exchange.

Fund Expenses

In addition to their regular expense ratio and trading costs, funds may assess sales charges as follows:

- **Front-end load (A-shares)**. You pay front-end loads at the time of purchase. Funds usually impose a fee in the neighborhood of 3% to 6% of the total investment. Sometimes they also charge when shareholders choose to have their capital gains and dividends reinvested in additional shares. You can receive discounts on the commissions of A-shares by using a few different techniques:
    - Breakpoints give you a volume discount on sales charges when making purchases of $25,000, $50,000, $100,000, or more.
    - Letters of intent allow you to tell the fund that you plan to invest enough additional money in the next year to reach a breakpoint. The fund then takes a lower fee for your current smaller purchase, since you agree to invest more in the near future. The fund will grant you the discount, but if you fail to fulfill your letter of intent ("LOI,") they will retroactively charge you the higher fee.
    - Rights of accumulation allow you and your family to effectively view all of your investments in one mutual fund family (not just one of their funds, but any of their funds) as one big investment with regard to break-point benefits. Thus, if you put $60,000 into a stock fund and your wife invests $40,000 in a bond fund, you can claim the $100,000 breakpoint in order to get a lower commission. Also, if you invested $20,000 in a fund last year (with a $50,000 breakpoint) and now add $30,000, you should get the discounted charge on the newly invested money, as you have now reached the required breakpoint.
    - Transfers, also known as "switching," allow you to move money between different funds in the same family of funds without having to pay a charge for the trade. Sometimes the company charges a small transaction fee.
- **Contingent deferred sales charge (B-shares)**. Sometimes referred to as a backend load or a redemption fee, mutual fund companies impose this charge on a gradually decreasing scale, and you pay no up-front charge. For example, if you buy shares and then sell them in the first year after the purchase, you would pay 5% of the value of the sale. Sell them in the second year and pay 4%, then 3%, until you get down to 0%. As with the A-shares, you can move between different funds within the family without incurring a sales charge, and without forfeiting accumulated time on the holding pattern. In general, if you liquidate shares and withdraw money, the fund assumes you are selling the oldest shares first, so you end up paying the lowest possible fee. Though many people like the "B-share" structure, it often ends up costing more in fees than A-shares and also does not allow for getting discounts by reaching breakpoints. You can quickly run a cost comparison by using the FINRA Fund Analyzer (look in the "resources" section of www.RichAsAking.com for a link).
- **Level-load (C-shares)**. This class of shares doesn't have a front-end load, but usually charges 1% if you sell within the first twelve months. After that, you would pay no surrender charge. While you hold the fund, you'll pay a "level-load" of 1% per year on top of the fund's other expenses.

Other fees associated with mutual fund investing include:

- **Investment advisory fees**. Covering the fund's overhead, this expense can often range from half a percent to well over 1%.

- **Administrative costs**. This pertains to general operating outlays and fees for related fund services.
- **12b-1 fees**. Named after an SEC rule, 12b-1 fees cover the marketing and distribution fees for the mutual funds.
- **Trading fees**. No mutual fund can tell you how much trading it will do in the future. As such, you cannot find that information in the prospectus. Nonetheless, when transacting on the exchanges, the funds must pay commissions. Though they may only pay pennies per share for their trades, they pass along these costs to the investors, and over time, the numbers become significant. More actively traded funds, for example, might run up 1% to 2% or more in extra costs over the course of a year.

Don't pay tax on someone else's gains

Sometimes, timing can save you money. Most funds make their capital gains and dividend distributions around the end of the calendar year. If you plan to buy into a fund, consider doing so after it has made these distributions. If you buy the fund right before it pays out, you will appear on record as the owner of the fund and have to pay tax on the profits (which may have come into the fund months before you bought your shares). For example, let's say you buy shares in January at $8 each and during the year earnings of $2 come in. At the end of the year, when the stock is selling for $10, you will receive a distribution of $2 and a statement indicating you owe taxes on the $2. After this distribution, the price of the share will be worth $2 less and so the share price will fall to $8 (to take into account the amount deducted from the fund and distributed to shareholders). Now let's consider what would happen if your neighbor bought the shares in December, just two days before the distribution date. He would pay $10 per share.

Two days later, he too would receive a distribution of $2 per share and a statement saying he owes taxes on this $2. In January, his shares would also be worth $8, just as yours are. Now, although he got back $2 on his $10 purchase (in effect he only paid $8) he had to pay taxes on the $2. Had he bought the shares a week later, in January, he would be out-of-pocket the same $8, but would not be liable for taxes on the $2 distribution.

In addition to paying taxes on distributions, you must also pay long- or short-term capital gains taxes when you sell shares at a profit. If the market didn't move in your favor, you can take a loss to offset other profits.

In order to ease your calculating gains and losses, keep statements showing your "cost basis," the price you paid for the shares you bought. If you acquired more shares through a reinvestment program, each new purchase will have its own cost basis. If you inherit shares from a U.S. citizen, the IRS allows you to "step up" the cost basis to the value of the shares on the date of death of the person who bequeathed the stock. So if your Uncle Bob left you shares of a fund that he had bought at $4 each, and if those shares were worth $50 apiece when he died, and if you sold them right away at $50, you wouldn't owe capital gains tax.

Not every shareholder worries about the cost basis of his shares. If you hold mutual funds in tax-deferred investing accounts (e.g., IRAs) you don't pay taxes on distributions or capital gains each year. Instead, you will only have to pay tax when you withdraw money from the account.

Call Options

When you buy a call option (a contract) from a seller (sometimes called the option "writer"), it gives you the right to buy a specific number of shares of a stock from him at a set price (strike price) for a limited period of time (until the option expiration date). For example, let's assume that BCD stock is now selling at $35 per share. You feel that within the next six months it will go way up, but you lack the funds to invest in the company now. You might buy an option today that allows you to purchase 100 shares of BCD at $35 at any time during the next half a year. For the right to buy the shares at $35 (regardless of the market price at that time) you must pay the current owner (the seller/writer) a premium, for example, $1 per share ($100 for the 100 share contract). If you predicted correctly, and the stock starts moving up, as the price goes above $35 and reaches, say, $38, you can exercise your option and buy the 100 shares at the strike price ($35 per share for a total cost of $3,500). Then you can turn around and sell the holding for $38 (total amount $3,800) and come out $300 ahead. Excluding taxes and commissions (as do all examples in this book, unless otherwise noted), you will profit by $200 – and your total risk was your $100 outlay. Your $100 investment made a profit of $200 (Sale value: $3,800, minus purchase cost of the shares: $3,500, minus option cost: $100, adds up to a profit of $200, or 200%).

Proceeds from sale of stock	$3,800
Cost to purchase stock when exercising option	-$3,500
Cost of option	-$100
Total profit	$200

Buying the call gave you the right, but not the obligation, to purchase the stock at $35. It's like in the chess example on page 190 of the printed version of *Rich As A King*, under the heading "23. Prepare to attack long before you fire the first shot." You knew that you wanted to get onto square d5 (that is, you wanted to buy BCD at $35), so you placed a piece on a square that would protect d5 for you in the future. Thus, you bought a call option to protect the $35 price at which you could purchase the stock for the next six months. With the options strategy, you bought the call to make sure that you would be able to buy the stock at a known price (no matter how much the stock had appreciated in value, you would be able to buy 100 shares at $35). You prepared for the future purchase by making a move well in advance.

Keep in mind that if you choose to buy options, time becomes your enemy. Like a chess tournament clock, if the time runs down to zero, you lose. In other words, if you buy a six-month $35 call and the stock drops to $30 and stays there for half a year, your option will be worthless when it expires.

After all, why would you exercise your right to buy the stock at $35 when you could just go ahead and buy it on the open market at $30? In such a situation, since you have no obligation to buy it, you would obviously simply let the call expire, thus losing your $100 investment. As most options expire worthless, meaning that if you hold one on expiration date you will get zero, make sure that you've got a rock solid strategy in place before trading in these often complex instruments. No grandmaster makes a move without a reason, and neither should you.

Benefiting from Losses in ETFs

Tax-loss swaps don't offer you a best-of-both-worlds opportunity only in bonds. (See "28. Profit from trading pieces" on page 196 of the printed version of *Rich As A King*.) If you own ETFs (exchange traded funds), you can unload a losing position and buy a similar fund at the same time. The breadth of the ETF market and the competition among ETF creators means that you can likely find two ETFs that move similarly, but that are different enough that the IRS won't consider it a wash sale if you sell one and buy the other. Don't sell one company's S&P 500 index fund and buy another's, since the IRS would probably assert that the two are significantly similar securities regardless of the difference in names. However, in the case of the S&P 500 index, you can find several ETFs that also trade in the large-cap universe and, over a thirty-day period, will have substantially similar results. By making the tax-loss swap, you maintain your market exposure (which could be good or bad, depending on the market's movement) and utilize the loss to offset gains on your tax return. When making the decision about whether this approach will work for you, don't forget to take into account the trading costs. If commissions will eat up any tax savings, then skip it this round and plan to do a similar review next year.

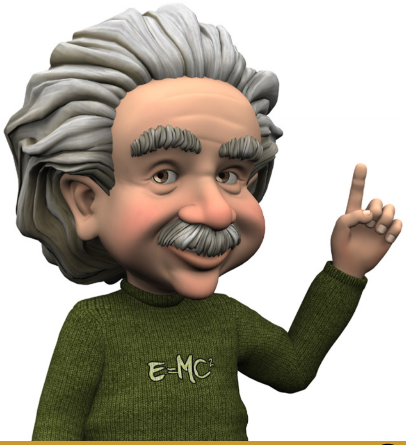
Rich As A King Overconfidence Test

Answer the questions on the following page with a range of numbers, not just a single figure. Enter the range (minimum and maximum) of numbers within which you are 90% certain the answer lies. For instance, if the question asks for a specific year, give a range of years between which the particular event occurred. If you have no idea of the answer to a question, then expand your range of possible answers in order to feel 90% confident that the true answer lies somewhere between your two guesses. On the other hand, if you think you can give a good educated guess, then choose a smaller range and still be 90% confident. Don't look at the correct answers until you have written all of your own responses. If you don't write them down, this experiment won't work.

	Minimum	**Maximum**
1. John F. Kennedy's age at his death		
2. Year that the Statue of Liberty came to New York		
3. Number of countries in the world (as of 2013)		
4. Air distance, in miles, between Alaska and Spain		
5. Number of bones in the human body		
6. Distance in miles from the earth to the moon		
7. Average amount of vegetables an American eats in a year (in pounds)		
8. Length of the Amazon River (in miles)		
9. Year that Beethoven was born		
10. Population of Iceland (in 2013)		

Did you fill in a minimum and maximum for all of the questions? Turn the page to see the actual answers.

1. 46
2. 1886
3. 195
4. 5032
5. 206
6. 239,000
7. 415
8. 4000
9. 1770
10. 322,000



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