Investing and Saving

“Make Your Money Work for You”

Investing goals

The best time to start investing is while young. In this section, we will explore different ways to invest money. The longer a person invests, the more money accumulates. First, identify goals for investing. How much money do you want to make? When do you want to have the money available? What will you use the money for? These are all valid questions to ask as you enter the world of investing.

Risk

Once you decide what your goals are for investing, determine the amount of risk you are willing to take. Just like everything in life, **risk** implies that there is the potential to lose your money. Most investors agree that the time to take the most risk is when you are young. If you invest early in life and your investments don’t pan out as intended, you have time to recover. However, if you are near retirement age and lose money in your investments, there is no time to start over.

Two general rules to remember regarding risk:

1. Take more risk in investing when you are young and less risk as you get older.

2. Usually, the lower the risk, the lower the return on your investment; the higher the risk, the higher the return on your investment.

Investing basics

Two important things to know about investing are goals and risk, but there are other considerations. The **Rate of Return (ROR)** measures the amount of money earned based on your initial investment. The formula to calculate ROR is:

((Return – Capital)/Capital) x 100%

For example, if you invest $1,000 for six months, and it grows to $1,200, your ROR would be computed as follows:

= (($1,200 - $1,000) / $1,000) x 100%

= ($200 / $1000) x 100%

= .20 x 100%

= 20%

Diversification is another aspect to consider. You may have heard the phrase, “Don’t put all your eggs in one basket.” In this use, it means don’t put all your money in one account. Spread your money to various investment types so as to balance the risk and reward. It is also important to consider the **longevity** of your investments. Are you investing for retirement or for some big purchase in the future? The longer your money is invested, the more potential it has to grow. Last, there is the **compound effect** and **interest rate** that need consideration. The higher the interest rate on your investments, the more they will grow. Likewise, the longer the interest rate is compounded, the higher your return, or the bigger the compound effect.

Compute the Rate of Return (ROR) for each of the scenarios below:

1. You loan a friend $200. One month later, your friend pays you back $220. What is your ROR?
   Answer: (($220 — $200) / $200) x 100% = 10%

2. You invested $10,000 in a retirement account. At age 60, your $10,000 grew to $100,000. What is your ROR?
   Answer: (($100,000 — $10,000) / $10,000) x 100% = 900%

Types of investments

There are several ways to invest money, including savings accounts and certificates of deposit (CDs), mutual funds, bonds, stock, and real estate. As company-sponsored pensions dwindle, Individual Retirement Accounts (IRAs), 401(k)s, and 403(b)s are becoming more popular. Taking education seriously and starting or owning a successful business are other ways to invest for the future.

Savings

- Putting money into a **savings account** at a financial institution (bank, credit union, etc.) is the quickest and easiest way to start saving money. The drawback is that you won't earn much interest on your deposits. It's a safe and secure way to save and invest your money, however; most financial institutions insure your money up to $250,000.
- Another savings vehicle similar to a savings account is called a **Certificate of Deposit,** or **CD**. A CD is known as a time deposit. It acts like a savings account, but you must keep the money in the CD for a duration of time, usually from three months to five years. The longer the duration of the CD, the higher the interest rate, and the more you can earn. One element to note about a CD is that your money can't be pulled out until the CD matures (comes due); otherwise, there is a penalty for taking out the money.
- A third savings option is **a Money Market Fund**. This type of account normally requires a minimum balance in the account, of at least $1,000. You may take money out or deposit money at any time as long as you maintain the minimum balance. The advantage of a money market account is that the financial institution that issued it normally pays you a higher interest rate on your money than on a regular savings account.

Stocks and mutual funds

- The purchase of **stock** is another way to invest. When you buy a stock, you become part owner of the company and are known as a stockholder or shareholder.

  There are two ways to make money as a stockholder:

  1. The first way is by receiving dividend payments. A **dividend** is a money distribution by a corporation to its stockholders. Usually, companies declare dividends every quarter (every three months). A stockholder receives the amount declared for every share of stock owned. For example, if the company declares $.25 per share and you own 10 shares, you would receive $2.50 ($.25 x 10 shares).

2. The second way to make money on a stock investment is to hold onto it until the stock appreciates (goes up) in value, and then sell it. For example, if you purchase a share of stock for $10 and sell it for $110, you will make $100 profit on the sale. Keep in mind that stocks can also depreciate (go down) in value. There is no guarantee that stocks will appreciate in value. The key to investing in stocks is to do your research and learn about the company to predict how successful it will be in the future. If you feel that the company will continue to grow and increase profits, then it might be a good idea to buy stock in that company. One last note about buying stock: Always try to buy at a low price and sell at a high price. (More on the stock market, below.)

- **Mutual funds** are another way to invest money. In essence, when you buy a mutual fund, you become a shareholder in a fund that has invested in many different companies. By investing in a mutual fund, you diversify your money, or spread your risk across many companies rather than relying on just one company to perform well. Mutual funds have varying degrees of risk, so it is important to educate yourself about where your money is being invested. And these funds have costs, like management fees.

Stock market

If you’re going to invest in stocks, you should find out about the stock market and how it works.

First, there is the **Dow Jones Industrial Average,** which is a stock market indicator of 30 blue-chip stocks on the **New York Stock Exchange**. Blue-chip stocks are companies that have been in business for a long time and represent several industries throughout the United States. There are no pre-determined criteria to be a blue-chip company except that components should be established U.S. companies that are leaders in their industries; companies considered for inclusion in the Dow are subjected to rigorous analysis before they join.

The **NASDAQ** is the **National Association of Securities Dealers Automated Quotations**. It is a computerized stock exchange where stocks are traded (bought and sold). Most major companies can be found on this stock exchange. **Standard & Poor’s (S&P)** is an American financial services company that publishes financial research and analysis on stocks and bonds. Last, there is the Securities Exchange Commission (**SEC**), which is a government commission that regulates the security (stock) markets and protects investors.

Bonds

Investing in **bonds** is different from investing in stocks and mutual funds. When people buy bonds, they are lending money to a governmental agency or to a company with the idea that they will pay it back, plus interest, once the bond matures (comes due). In essence, a bond is like an IOU. If you buy a bond, the government or company that you are lending the money to promises to pay interest during the period of the bond and repay the entire face value (the amount you lent) when the bond comes due or reaches maturity. Bonds are rated so that investors know the likelihood of getting their money back after maturity. The best rating for a bond is "AAA;" the worst rating for a bond is "C." Usually, government bonds are considered to have the best ratings.

U.S. Savings Bonds, for example, are issued and backed by the government. There are different types of savings bonds, each with slightly different features and advantages. **Treasury Bonds** (T-Bonds) (also backed by the federal government) are issued with terms of more than 10 years. Interest is paid semi-annually (twice a year) on Treasury Bonds.

Last, there are **Treasury Bills** (T-Bills) and **Treasury Notes** (T-Notes). Treasury bills are short-term investments with maturities of three months, six months, or one year. Treasury notes have maturities of two to 10 years, and interest payments are made every six months. Bonds, bills, and notes are sold in $1,000 increments. These investments may be purchased directly from the Treasury through Treasury Direct at: www.treasurydirect.gov.

Retirement investments

Next to the purchase of a home, investing for retirement is one of the best investments possible. As we age, most of us will become restricted in what we can do, which may limit what kinds of work we can do. If you start planning now for retirement, you might be able to live comfortably and maintain a decent standard of living without having to work into old age.

Investing in your own retirement is something all Americans should do. There are many different types of investments that you can begin now in preparation for retirement.

In the next section, we will cover several retirement investments, such as 401(k), 403(b), Roth IRAs, and Traditional IRAs, in more detail.

Real estate (housing)

Owning a home is probably be the biggest and wisest investment one can make. This would be considered a **real-estate** investment. Interestingly, one common trait of most millionaires is that they own their homes. Once the mortgage is paid off, it is one gigantic expense you no longer have to worry about. If you pay your mortgage regularly, no one can take your home away from you, which provides security and less stress in your retirement years.

Traditionally, home values tend to appreciate (go up) in value over time. If you decide to sell your home, you will most likely get more than what you paid for it. And you can deduct the interest you paid on the loan on your federal tax return (check with your tax adviser for details).

Entrepreneurship and education

Most of us will spend the rest of our lives working for a company or for someone else. Starting your own business (**entrepreneurship**) would be considered an investment if you choose to open a business and be your own boss. Also, investing in your own **education** will open many doors for you during your working years. The fruits of your labor as a student will multiply many times over with an education.

Research tools for investing

Throughout this section, it has been emphasized to educate yourself about investing. With today's technology and the Internet, everyone can be on the same playing field when it comes to investing. Researching the Internet for financial information or looking for brokers to assist in investing your money is simpler than ever. Reading the newspaper, business magazines, and anything you can will help you learn about money and live a financially secure, worry-free life.

Conduct Internet research to determine interest rates on the following CDs. Apply this interest rate to your goal amount of savings and find out how much your return would be.

CD	Interest Rate
3-month CD	
6-month CD	
12-month CD	
18-month CD	
24-month CD	
30-month CD	
36-month CD	