The Fundamentals of Investing

Advanced Level
Investments - assets purchased with the goal of providing additional income from the asset itself but with the risk of loss.
All Investments Have Some Risk

Return
Profit or income generated by saving and investing

Trade off
Higher returns
Higher risk (chance of loss)

Investment Risk
Possibility that an investment will fail to pay the expected return

Investments have the potential for higher returns
## Investments are Important to Building Net Worth

<table>
<thead>
<tr>
<th>Statement of Financial Position for:</th>
<th></th>
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</thead>
<tbody>
<tr>
<td><strong>Date:</strong></td>
<td>--</td>
</tr>
<tr>
<td><strong>Assets</strong></td>
<td>--</td>
</tr>
<tr>
<td><strong>Monetary assets</strong></td>
<td>--</td>
</tr>
<tr>
<td>Cash on hand</td>
<td>--</td>
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<tr>
<td>Value of checking account and savings account</td>
<td></td>
</tr>
<tr>
<td>Other:</td>
<td>--</td>
</tr>
<tr>
<td><strong>Subtotal of monetary assets</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>Tangible Assets</strong></td>
<td>--</td>
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<tr>
<td>Market value of home</td>
<td>--</td>
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<tr>
<td>Market value of household furnishings</td>
<td>--</td>
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<tr>
<td>Market value of automobile</td>
<td>--</td>
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<tr>
<td>Market value of electronics</td>
<td>--</td>
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<tr>
<td>Market value of clothing</td>
<td>--</td>
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<tr>
<td>Other:</td>
<td>--</td>
</tr>
<tr>
<td><strong>Subtotal of tangible assets</strong></td>
<td>--</td>
</tr>
<tr>
<td><strong>Investment Assets</strong></td>
<td>--</td>
</tr>
<tr>
<td>Value of investments</td>
<td>--</td>
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<tr>
<td>Other:</td>
<td>--</td>
</tr>
<tr>
<td><strong>Subtotal of investment assets</strong></td>
<td>--</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>--</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td>--</td>
</tr>
<tr>
<td>Home mortgage balance</td>
<td>--</td>
</tr>
<tr>
<td>Installment loan balance for automobile</td>
<td>--</td>
</tr>
<tr>
<td>Student loan balance</td>
<td>--</td>
</tr>
<tr>
<td>Credit card balance</td>
<td>--</td>
</tr>
<tr>
<td>Money owed to others</td>
<td>--</td>
</tr>
<tr>
<td>Other:</td>
<td>--</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>--</td>
</tr>
<tr>
<td><strong>Net Worth = Total Assets - Total Liabilities</strong></td>
<td></td>
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</tbody>
</table>

### Savings Tools = Monetary Assets
(liquid – quickly and easily converted to cash)

### Investment Tools = Investment Assets
(may not be easily converted to cash or penalties charged to access the funds early)

*Investments are less liquid than savings tools*
Money invested is usually used to pay for **long-term** goals.

- Buying a House
- Higher Education
- Retirement

It is recommended that at least 10% of net income is dedicated to savings and investments each time income is received.
# Saving vs. Investing

<table>
<thead>
<tr>
<th>Saving</th>
<th>Investing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Emergencies</td>
<td>Long-term goals</td>
</tr>
<tr>
<td>More liquid</td>
<td>Less liquid</td>
</tr>
<tr>
<td>Limited risk</td>
<td>Higher risk</td>
</tr>
<tr>
<td>Lower returns (0-4%)</td>
<td>Higher returns (8-12%)</td>
</tr>
<tr>
<td>Financial security</td>
<td>Net worth</td>
</tr>
</tbody>
</table>

What types of feelings result from saving and investing?
Rate of Return

Total return on investment expressed as a percentage of the amount of money saved

\[
\text{Total Return} \div \text{Amount of Money Invested} = \text{Rate of Return}
\]
Mandy saved $2,200 in a money market deposit account. After one year, she has a return of $110.

What is Mandy’s rate of return?

\[
\frac{\$110}{\$2,200} = 0.05 = 5\%
\]

Mandy’s rate of return on investment is 5%
Inflation
Rise in the general level of prices

Inflation Risk
The danger that money won’t be worth as much in the future as it is today

Strive to have the rate of return on investment be higher than the rate of inflation

How does inflation relate to investing?
Types of Investment Tools

- Bond
- Stock
- Real Estate
- Speculative Investments
- Mutual Funds
- Index Funds

What do you already know about each investment tool?
## Bond

### Definition
- Form of lending to a company or the government

### Description
- Organization pays interest to the lender (purchaser) until the maturity date is reached

### Investment Risk
- Least amount (typically)
- Depends on the type of bond

### Return
- Fixed interest rate

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Maturity date – specified time in the future when the principal amount of the bond is repaid to the bondholder
Stock

A share of ownership in a company

Stockholder or shareholder

Owner of the stock

Usually a stockholder owns a very small part of a company
Stock Returns - Dividends

Dividends

Share of profits distributed in cash to stockholders

Stockholder may or may not receive dividends
**Stock Returns – Capital Gains**

**Market Price**
Current price a buyer is willing to pay

- **Stocks sells for a price higher than what was paid**
  - Capital gain – unearned income received from the sale of an asset above its purchase price

- **Stock sells for a price lower than what was paid**
  - Stockholder will lose money
Real estate can be time consuming but the potential for returns is high.
Speculative Investments

High risk investments

Have the potential for significant fluctuations in return over a short period of time

- Futures
- Options
- Collectibles

Type of return depends on the investment
Mutual Funds

When a company combines the funds of many different investors and then invests that money in a diversified portfolio of stocks and bonds

What is Included

- Bonds
- Stocks
- Real Estate
- Speculative Investments

Type of Returns

- Interest
- Dividends
- Rents
- Capital Gains
Mutual Funds

Advantage

- Reduces investment risk
- Saves investors time

Disadvantage

- Fees may be high
Ariana has $150 to Invest
Option 1 - Stock

Ariana invests in **one** company’s **stock**

Company C has had a bad year and their market price drops significantly.

Ariana may **lose** her $150 investment.
• Market price of companies C and F decreased
• Market price increased for all other companies

Ariana has reduced her investment risk and may still earn money
Index Fund

- Type of mutual fund designed to reduce fees by investing in the stocks and bonds that make up the index

Index

- Group of similar stocks and bonds

Example

- Standard and Poor’s 500
Lending vs. Owning

When investing, consumers either lend money to the company/organization or they own the asset.

Lending
- Bonds
  - Interest

Owning
- Stock
  - Dividends
- Real Estate
  - Rents
- Speculative investments
  - Capital Gains
Knowledge of the General Risk Level Helps Manage Risk

Type of return

- Interest
  - Bonds
  - Mutual Fund
  - Index Fund

- Dividends
  - Stock
  - Mutual Fund
  - Index Fund

- Rents
  - Real Estate
  - Mutual Fund

- Capital Gains
  - Stock
  - Mutual Fund
  - Index Fund

Type of Investment

- Decreased inflation risk
- Increased potential for high returns
- Increased investment risk
Characteristics of Investment Tools

Order cards from lowest to highest

Investment Risk

Order cards from lowest to highest

Potential Returns

Order cards from lowest to highest

Inflation Risk

Speculative

Stock and Real Estate

Mutual Funds and Index Funds

Bonds
Everyone has a tolerance level for the amount of risk they are willing to take on.

Generally divided into three categories: conservative, moderate, aggressive.

Time may influence investment philosophy.

If someone was an aggressive investor, what types of investment tools would they primarily have in their portfolio?
Portfolio Diversification

Portfolio diversification – reduces risk by spreading money among a wide array of investments

Goal: create a collection of investments that will provide an acceptable return with an acceptable exposure to risk

Reduces investment risk

Investing in a mutual fund is an automatic form of portfolio diversification
Stock Exchange

Investments are purchased from a stock exchange (except for real estate and some speculative investments)

Stock exchange provides an organized, central service to buy and sell all stocks, bonds and other investments that are traded.

Worldwide, there are many different stock exchanges.

A limited number of people are allowed to buy and sell directly from each stock exchange.
Brokerage firms facilitate the buying and selling of investments on the stock exchange.

**Discount**
- Only completes orders to buy and sell investments
- Advice is not offered

**Full-service**
- Offer investment transactions and a financial advisor
- Financial advisor – trained professional that helps make investing decisions
Discount Brokerage Firm Fees

Will usually charge a fee for completing a buy/sell transaction

Additional fees may include:

- Service fee
- Maintenance fee
- Inactivity fee
- Fees specific to an investment

Total fees are often lower, but an individual must have the knowledge and time to monitor their investments.
Financial advisors are compensated for the time and knowledge they provide investors. Most charge fees using one of these methods.

- % of the Investment Value
- % of the Amount Invested
- Hourly Rate & Flat Fee

In addition to fees, financial advisors may earn commissions paid by the company.
Choosing a Brokerage Firm

Important to research the financial advisor and firm he/she works for

Questions to ask:

- How are the firm’s financial advisors compensated?
- How long has the firm been in business?
- Does the firm have a history of positive reviews and success?
- How does the firm rank in comparison to other brokerage firms?
Government encourages people to invest in certain types of investments

Savings and investments are a form of unearned income and therefore subject to income tax

Tax-advantaged investments reduce, defer or adjust the current year tax liability

Most common: 
- Retirement
- Education
When are taxes for tax-advantaged investments usually paid?

Money is invested and **taxes are paid**

Money grows untaxed with help from compounding interest

Money is withdrawn

OR

Money is invested

Money grows untaxed with help from compounding interest

Money is withdrawn and **taxes are paid**
Choose an investment

Usually mutual funds

Contribute money

Typically tax-advantaged

When possible, use an employer-sponsored plan

Employer may match funds (up to a certain limit)
## Retirement Accounts

### Employer Sponsored
- Similar plans
- 401(k)
- 403 (b) (tax-exempt organizations)

### Personal Retirement
- Traditional IRA (taxes when money withdrawn)
- Roth IRA (taxes paid when money deposited)

There are many other types of plans available.

The trade-off to tax advantages is most accounts have penalties if money is withdrawn early.
Investments are important to building net worth

A trade-off to higher returns is lower liquidity and higher risk

Investments are ideal for the long-term

Take advantage of portfolio diversification

Discuss your goals with a financial advisor

Use tax-advantaged investments & employer-sponsored plan