Chapter 11

Investing for the Future

11.1 Basic Investing Concepts
11.2 Making Investment Choices
Lesson 11.1

Basic Investing Concepts

GOALS

■ Why should you consider investing?
■ What are the stages of investing?
■ How do you manage risk when investing?
■ What are some investment strategies and options?
Why Invest?

- **Investing** is the use of long-term savings to earn a financial return.
- Investing is a proven and powerful way to strengthen your financial position over time.
- It is an essential part of providing for future needs. It provides a source of income in addition to a paycheck, allowing you to make money on money.
Investing Helps Beat Inflation

- **Inflation** is a rise in the general level of prices.
- Inflation reduces purchasing power over time.
  - As prices rise, it takes more money to buy the same goods and services.
- Investors seek investments that will grow faster than the inflation rate.

**Table of Inflation Rates**
Rule of 72

- The **Rule of 72** is a technique for estimating the number of years required to double your money at a given rate of return.
  - Divide the percentage rate of return into 72 to estimate how long it will take to double your money.
  - For example, if an investment is yielding an average of 6 percent, it will take 12 years to double your money (72 ÷ 6).
Investing Increases Wealth

- Financial success grows from the assets that you build up over time.
- Investing helps you accumulate wealth faster than if you simply saved your excess cash in a savings account.
- When you invest in stocks and bonds, you are participating in helping businesses make and sell new products and services.
- You will be rewarded with dividends and interest.
Investing Is Fun and Challenging

- Investors make choices and hope to pick winners.
- Once you gain experience, you can have fun choosing investments, buying and selling when the time is right, and using your knowledge to plan for your financial security.
Stages of Investing

- Stage 1. Put-and-take account
- Stage 2. Initial investing
- Stage 3. Systematic investing
- Stage 4. Strategic investing
- Stage 5. Speculative investing
A *portfolio* is a collection of investments.
Risk and Return

- **Investing risk** is the chance that an investment’s value will decrease.
- All types of investing involve some degree of risk.
- The greater the risk you are willing to take, the greater the potential returns.
- A safe investment has little risk of loss.
- Some people are willing to take more risks than others.
Diversification

- **Diversification** is the spreading of risk among many types of investments.
- Diversification reduces overall risk because not all of your choices will perform poorly at the same time.
- If one choice does not do well, the others will likely make up some or all of the loss.
Types of Risk

- Interest-rate risk
- Political risk
- Market risk
- Nonmarket risk
- Company and industry risk
Investment Strategies

- Many individuals never start an investment program because they think they don’t have enough money.
- But even small sums of money grow over time.
- To achieve financial security, start investing as soon as you can and continue to invest over your lifetime.
Criteria for Choosing an Investment

- Degree of safety
- Degree of liquidity
- Expected dividends or interest
- Expected growth in value that exceeds the inflation rate
- Reasonable purchase price and fees
- Tax benefits
Wise Investment Practices

- Define your financial goals.
- Go slowly.
- Follow through.
- Keep good records.
- Seek good investment advice.
- Keep investment knowledge current.
- Know your limits.
Temporary and Permanent Investments

- **Temporary investments** are investment choices that will be reevaluated within a year or less.

- **Permanent investments** are investment choices that will be held for the long run—five or ten years, or longer.
Lesson 11.2
Making Investment Choices

GOALS

■ What are the sources of investment information?
■ What are your investment choices and how risky are they?
Sources of Financial Information

- Newspapers
- Investor services and newsletters
- Financial magazines
- Brokers
- Financial advisers
- Annual reports
- Online investor education
Annual Reports

- An **annual report** is a summary of a corporation’s financial results for the year and its prospects for the future.

- The Securities and Exchange Commission (SEC) requires all public corporations to prepare this report each year and send it to their stockholders.

- Investors can use the information contained in the report to evaluate the corporation as an investment prospect.

- **Where to get annual reports**
  - Online at the SEC web site
  - Company web sites
  - Libraries
Investment Choices

- Low risk/low return
- Medium risk/medium return
- High risk/high return
Low Risk/Low Return

- Corporate and municipal bonds
  - **Bonds** are debt obligations of corporations (corporate bonds) or state or local governments (municipal bonds).

- U.S. government savings bonds
  - A **discount bond** is purchased for less than the maturity value.

- Treasury securities
Medium Risk/Medium Return

- **Stocks**
  - **Stock** is a unit of ownership in a corporation.

- **Mutual funds**
  - A **mutual fund** is the pooling of money from many investors to buy a large selection of securities.

- **Annuities**
  - An **annuity** is a contract that provides the investor with a series of regular payments, usually after retirement.

- **Real Estate**
High Risk/High Return

- Futures
- Options
- Penny stocks
- Collectibles
Futures are contracts to buy and sell commodities (products that are mined or grown) or stocks for a specified price on a specified date in the future.

The investor is betting that the price of the commodity or stock will be higher on that future date than it is at the time of the contract.

- If prices fall, the investor loses.
- If prices rise, the investor stands to make a lot of money.

This type of investment is not for beginners or for individuals who cannot afford to lose their investment.
An **option** is the right, but not the obligation, to buy or sell a commodity or stock for a specified price within a specified time period.

- As with futures, the investor is betting that, during the option period, the price of the stock will rise.
- If it does, the investor can choose to buy it at the lower option price, resulting in an instant profit.

Options are risky and not for inexperienced investors.
Penny Stocks

- **Penny stocks** are low-priced stocks of small companies that have no track record.
- The stock usually sells for under $5 per share.
- The small companies often have low revenues and few assets to assure future growth.
- Occasionally, a penny stock will be successful, and the investor will make a large windfall.
- Generally, penny stocks are highly risky.
Collectibles

- Collectibles include:
  - Coins
  - Art
  - Memorabilia
  - Ceramics

- The market for collectibles fluctuates.
  - If you collect an item that goes up in value, you can reap large rewards by selling.
  - Collectibles gain value when interest is high and lose value when interest is low.