CHAPTER 8
Saving and Investing
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Saving and Investing

What You’ll Learn

- **Section 8.1**
  - Explain how to establish goals for a savings or investment program.
  - Discuss ways to obtain funds for investing.
  - Identify the factors that affect your investment choices.

- **Section 8.2**
  - Identify the main types of savings and investment alternatives.
  - Explain the steps involved in developing a personal investment plan.

- **Section 8.3**
  - Describe your role in a personal investment plan.
  - Identify sources of financial information.
Investments

- **Q:** After paying my bills, I do not have much money left over. I save any extra that I get. Since I do not have a lot of money, why should I even considering investing?
- **A:** If inflation increases at a higher rate than your savings account return, you can lose purchasing power. To stay ahead of inflation and taxes, the money you set aside for long-term goals will need to earn more than the rates usually paid on savings accounts. Consider other investments that can earn a higher return.

Go to [finance07.glencoe.com](http://finance07.glencoe.com) to complete the Standard & Poor’s Financial Focus activity.
Main Idea

Laying a foundation for your savings or investment program will help ensure that you meet your future financial goals.

Can you think of any reasons to risk putting money in investments instead of a savings account?
Establishing Your Financial Goals

A savings or investment plan starts with a specific, measurable goal. You can reach that goal through:

- A savings account
- An investment

You might also decide that you should begin saving money in an **emergency fund**.
Your Goals and Values

Your goals should correspond with your values. You will have to choose whether to:

- Save or invest as much of each paycheck as possible
- Spend a lot of money on temporary activities, thus running out of money before you receive your next paycheck

Even a small amount of money saved or invested on a regular basis can add up to a large amount over time.
Outlining Goals

As you outline your financial goals, ask yourself these questions:

- How do I want to spend my money?
- How much money do I need to satisfy my goals?
- How long will it take to save the money?
- How much risk am I willing to take when I invest?
- Am I willing to make sacrifices to save?
- What will happen if I do not meet my goals?
Performing a Financial Check-Up

Before you think about investing for the future, you must take steps to be sure your personal finances are in good shape. Then you will be ready to move ahead with your financial plan.
Money to Get Started

You will be ready to start saving or investing after you have:

- Set your goals
- Completed your financial check-up
- Gotten the money
Section 8.1
Preparing for a Savings or Investment Program

Pay Yourself First

Instead of saving and investing money after you have paid all your other expenses, you should:

- Include the amount you want to save in your monthly expenses and pay that amount first.
- Pay your monthly living expenses, such as rent and food.
- Use money that is left over for personal pleasures, such as going to the movie or buying a new CD.
Section 8.1
Preparing for a Savings or Investment Program

Employer-Sponsored Retirement Plans

Your employer may offer a retirement plan, usually a:

- 401(k)
- 403(b)

With this ready-made investment program, saving is made simple because an amount you choose is deducted automatically from each paycheck.

Many employers will match part or all of the money you save.
Elective Savings Programs

Some employers provide the option of having money:

- Automatically withheld from your paycheck
- Deposited in a standard savings account

You can also arrange with a mutual fund or brokerage firm to take a certain amount from your bank account every month and invest it.
Section 8.1
Preparing for a Savings or Investment Program

Special Savings Effort

Another way to save is to set aside a specific time each year when you:

- Cut back sharply on what you spend.
- Put the money you save into an investment fund.
Gifts, Inheritances, and Windfalls

During your lifetime, you might receive:

- Gifts of money
- Inheritance money
- Bonuses at work
- Tax refunds
- Salary raises

Consider putting this extra money in a savings or investment program.
Section 8.1
Preparing for a Savings or Investment Program

The Value of Long-Term Investment Programs

Many people do not start investing because they:

- Have only a small amount of money
- Believe that they are too young to invest

Remember that small amounts of money add up because of the time value of money.
Section 8.1
Preparing for a Savings or Investment Program

Making Investment Decisions
Once you know how much money you need to meet your goals, you then have to think about where to invest it.

To make that decision, you need to:

- Understand the different risk factors.
- Consider each investment’s potential for income and growth as well as its liquidity.
Safety and Risk

You can select investments that are:

- Very safe
- Very risky
- In between these extremes

Generally, if you choose a safe investment, your rate of return will be low. With a speculative investment, you may:

- Earn a large profit in a short time
- Lose most or all of the money you invest
Choosing Your Risk Level

Without risk, it is impossible to obtain returns that make investments grow. The key is to:

- Determine how much risk you are willing to take.
- Choose quality investments that offer higher returns without an extremely high risk.
Section 8.1
Preparing for a Savings or Investment Program

Five Components of Risk
Evaluate the overall risk factor of an investment by examining five different components of risk:

- Inflation
- Interest rate
- Business failure
- Financial market
- Global investment
Section 8.1
Preparing for a Savings or Investment Program

Inflation Risk

Investing your money can help you stay ahead of inflation. However, during periods of rapid inflation:

- The return from your investments might not keep up with the inflation rate.
- You lose buying power, and your money will buy less.

Some investments will protect you from inflation better than others.
Section 8.1
Preparing for a Savings or Investment Program

Interest Rate Risk

If you put money in an investment that gives you a fixed rate of return, the value of your investment will go down if interest rates go up. If you have to sell your bonds, you will get less than you originally paid.
Business Failure Risk

This type of risk applies to:

- Common stock
- Preferred stock
- Corporate bonds

When you buy stocks or corporate bonds, you are investing in a particular company. Lower business profits usually mean lower dividends.
Avoiding Business Failure Risk

To avoid losing your investment, you should:

- Do careful research on companies in which you might invest.
- Invest your money in more than one company.
Financial Market Risk

Sometimes the prices of stocks, bonds, mutual funds, and other investments go up or down because of the overall state of financial markets. Factors that affect financial markets include:

- Social conditions
- Political conditions
Global Investment Risk

If you plan to invest in companies outside the United States, take these steps:

- Evaluate international investments as if they were U.S. investments.
- Consider the currency exchange rate.

Also, keep in mind that the economic and political stability of a country can affect the value of your investment.
Section 8.1
Preparing for a Savings or Investment Program

Investment Income

There are a variety of other types of investments for income. The safest and most predictable investments include:

- Savings accounts
- Certificates of deposit (CDs)
- U.S. Savings Bonds
- U.S. Treasury bills

Other sources of investment include:

- Government bonds
- Corporate bonds
- Preferred stocks
- Stable mutual funds
Investment Growth

The best opportunities for investment growth usually come from:

- Stocks
- Growth stocks

Growth companies usually reinvest their profits rather than paying dividends. Growth that is financed by retained earnings usually contributes to increasing the stock’s value.
Investment Liquidity

A final factor to consider when choosing investments is investment liquidity. You may be able to sell some investments quickly, but you may not be able to regain your original investment, due to:

- Market conditions
- Other factors

A low-liquidity investment requires more time to sell.
Main Idea

The more you know about different investment opportunities and the planning process, the better able you will be to select a savings or investment program that meets your needs.
Types of Investments

When you have your personal finances in order, an emergency fund, money for investments, and you know how much risk you can take, you can begin to search different types of investment alternatives:

- Stocks
- Bonds
- Mutual funds
- Real estate
**Stocks**

A corporation gets its equity capital from its stockholders, who become owners when they buy shares of stock in the company.

The two basic types of stock are:

- **Common stock**
- **Preferred stock**

If a company fails, preferred stockholders receive dividends first and any assets that are left before common stockholders receive anything.
Section 8.2
Savings and Investment Options

Investing in Stock

Stock can be an attractive investment because, as owners, stockholders share in the success of the company.

However, you should consider several facts before you invest in stock:

- A corporation does not have to repay you what you paid for the stock.
- The current value of your stock is partially determined by how much another investor is willing to pay for your shares.
- A corporation does not have to pay dividends.
Corporate and Government Bonds

You may also consider investing in bonds. There are two types of bonds an investor can consider:

- A corporate bond
- A government bond

When you buy a bond, you are lending money to a corporation or government entity for a period of time.

**corporate bond**
a corporation’s written pledge to repay a specific amount of money, along with interest

**government bond**
the written pledge of a government or a municipality, such as a city, to repay a specific sum of money with interest
Section 8.2
Savings and Investment Options

The Value of a Bond

Two key factors affect the value of a bond:

- Whether the bond will be repaid at maturity
- Whether the corporation or government entity will be able to pay interest until maturity

Maturity dates range from 1 to 30 years, and interest on bonds is usually paid every six months.

The value of the bond is closely tied to the ability of the corporation or government agency to repay the bond at maturity.
mutual fund
an investment in which investors pool their money to buy stocks, bonds, and other securities selected by professional managers who work for an investment company

Mutual Funds
You may also want to consider joining a mutual fund. If one of the fund stocks or other securities performs poorly, the loss can be offset by gains in another stock or security within the mutual fund.
Section 8.2
Savings and Investment Options

Real Estate

The goal of real estate investing is to:

- Own property that increases in value so that you can sell it at a profit
- Receive rental income

Before making a decision to purchase any property, ask the following questions:

- Why are the present owners selling?
- Is the property in good condition?
- What is the condition of other properties in the area?
- Is there a chance that the property will decrease in value?
Evaluating Investment Alternatives

As you make your choices, remember it is wise to diversify.

Some financial advisers suggest that you think of your investment program as a pyramid, where:

- Level 1 provides a solid foundation with safe investments
- Levels 2 and 3 carry moderate risk
- Level 4 is highly speculative

**diversification**

the process of spreading your assets among several different types of investments to reduce risk
Figure 8.4  Possible Investments

Investment Pyramid

Level 1
Financial Security
- Cash, CDs, savings accounts, money market accounts, U.S. government bonds

Level 2
Safety and Income
- U.S. Treasury securities, conservative corporate bonds, state and municipal government bonds, income and utility stocks

Level 3
Growth
- Income and growth stocks, mutual funds, real estate, convertible bonds

Level 4
Speculation
- Options, commodities, precious metals and gems, speculative stocks, junk bonds, collectibles

High Risk

Low Risk

Building for the Future

Without a solid foundation, you risk losing your investment.

Should a good investment plan include investments from all four levels?
Section 8.2
Savings and Investment Options

Developing a Personal Investment Plan

To be a successful investor:

- Develop a plan.
- Put it into action.

Often the follow-through is the most important component of a successful, long-range, personal investment plan.
Achieving Your Goals

You may find these steps helpful to get started:

- Establish investment goals.
- Decide how much money you will need to reach those goals by a particular date.
- Evaluate the risks and potential return for each investment on your list.
- Choose at least two investments so that you have some diversity.
- Recheck your investment program regularly.

If your goals are important to you, you will be willing to work to attain them.
Main Idea

By becoming an informed investor, you will be able to reach your investment goals.
Section 8.3
Reducing Risk and Sources of Information

Financial Planners

There are two main factors to consider when deciding if you need a financial planner:

- Your income level
- Your willingness to make your own financial decisions

If you make less than $45,000 a year, you may not need a planner’s services.
Types of Financial Planners

There are four main types of financial planners:

- Fee-only planners
- Fee-offset planners
- Fee-and-commission planners
- Commission-only planners

When hiring a financial planner, find out the exact fees for specific services. Also discuss how and when the fees will be collected from you.
Selecting a Financial Planner

Look for a financial planner who will provide these basic services:

- Assess your current financial situation.
- Offer a clearly written plan with investment recommendations.
- Discuss the plan with you and answer questions.
- Help you keep track of your progress.
- Guide you to other financial experts and services as needed.
Section 8.3
Reducing Risk and Sources of Information

Certification of Financial Planners

The requirements for becoming a financial planner vary from state to state. Some states:

- Require that financial planners pass an exam
- Issue licenses to individual planners and planning companies
- Have no regulations at all

Although a financial planner may have credentials, not all planners are licensed. You should research and investigate any financial planner you might be considering.
Managing Your Investments

Most people do not have professional financial planners and need to learn how to manage their own finances.

You can take an active role by taking these steps:

- Evaluate investments.
- Monitor investments.
- Keep accurate records.
- Consider tax consequences.

Managing your savings and investments requires ongoing attention.
Evaluating Investments

Always research and evaluate before you invest so that you can make an informed decision. While your money is earning, you also need to continue to evaluate:

- Your current investment
- Future investment opportunities
Section 8.3
Reducing Risk and Sources of Information

Monitoring Your Investments
Always keep track of the value of your stocks, bonds, or mutual funds by checking price quotations reported:
- On the Internet
- In newspapers
- On financial news programs
Keep a chart of the value of your investments to check their progress over time.
Section 8.3
Reducing Risk and Sources of Information

Keeping Accurate Records
Accurate record keeping helps you notice opportunities to:

- Increase your profits
- Reduce losses

It can also help you decide whether to:

- Put more money in a stock, bond, or other investment
- Sell a particular investment
A Dollar a Day
Do you know that if you save a dollar a day—less than what you would spend on a soda and a candy bar—and save or invest it at 5 percent interest, in five years you will have more than $2,000? In ten years you will have $4,600!
How much would you have in 40 years?
Tax Considerations

In general, investment income falls into three categories:

- Tax-exempt
- Tax-deferred
- Taxable

You must report cash dividends on your tax return as ordinary income.
Capital Gains and Capital Losses

Capital gains are taxed according to how long you own an asset:
- Short term (12 months or less)
- Long term (longer than 12 months)

You can subtract up to $3,000 a year in capital losses from your ordinary income.

capital gain
the profit from the sale of assets such as stocks, bonds, or real estate
capital loss
the sale of an investment for less than its purchase price
Section 8.3
Reducing Risk and Sources of Information

Sources of Investment Information

Because there is so much investment information available, both complex and basic, you need to be selective. The important thing is to be sure that the source of advice and information that you receive is:

- Accurate
- Reliable
The Internet and Online Services

Most large investment firms have Web sites where you can obtain a variety of information and services, such as:

- Interest rates for certificates of deposit
- Prices of stocks, bonds, and other securities
- Advice on starting an investment program
- Trading of securities through online brokers
Section 8.3
Reducing Risk and Sources of Information

Newspapers and News Programs

The financial page of your metropolitan newspaper or *The Wall Street Journal* is another source of investment information that is easy to access.

In addition, you can find economic information and financial news on:

- Many radio and television stations
- Television channels such as CNN Fn (Financial)
Section 8.3
Reducing Risk and Sources of Information

Business and Government Publications

You can find general news about the economy as well as information about individual companies in magazines such as:

- *Barron’s*
- *BusinessWeek*
- *Forbes*
- *Fortune*
- *Harvard Business Review*
Other Publications

You can find information and advice designed to improve your investment skills in magazines such as:

- *Money*
- *Consumer Reports*
- *Smart Money*
- *Kiplinger’s Personal Finance*

In addition, national news magazines often feature stories on the economy and finance.
Section 8.3
Reducing Risk and Sources of Information

Government Publications

The United States federal government is also an excellent resource of information—and much of it is free. Two sources of useful financial information are:

- *The Federal Reserve Bulletin*, published by the Federal Reserve System
- *Survey of Current Business*, published by the Department of Commerce

You can read articles from both of these publications on the Internet.
Corporation Reports

The federal government requires that any corporation selling new issues of securities must provide investors with a prospectus.

All publicly owned corporations also send investors quarterly reports and annual reports that contain detailed financial data.

prospectus

a document that discloses information about a company’s earnings, assets and liabilities, its products or services, a particular stock, and the qualifications of its management.
Statistical Averages
You can keep track of the value of your investments by following one or more recognized statistical averages, such as:
- The Standard & Poor’s 500 Stock Index
- The Dow Jones Industrial Average
These averages are reported daily online and in newspapers.
Section 8.3
Reducing Risk and Sources of Information

Investor Services

Five widely used and useful publications are:

- *Standard & Poor’s Stock and Bond Guide*
- *Value Line Investment Survey*
- *Handbook of Common Stocks*
- *Morningstar Mutual Funds*
- *Wiesenberger Investment Companies Yearbook*

Both professionals and individual private investors can refer to these publications to become well-informed when making investment decisions.
Key Term Review

- emergency fund
- speculative investment
- dividends
- retained earnings
- investment liquidity
- equity capital
- common stock
- preferred stock
- corporate bond
- government bond
- mutual fund

- diversification
- financial planner
- tax-exempt income
- tax-deferred income
- capital gain
- capital loss
- prospectus
Reviewing Key Concepts

1. Explain why it is important to have a goal before making investments.

Before investing, you should set financial goals that are compatible with your values.
Reviewing Key Concepts

2. Describe sources of funds for investing.

You can obtain money to start investing by:

- Setting aside funds before you buy other things
- Contributing to employer-sponsored retirement plans and savings programs
- Saving gifts of money and unexpected windfalls
Reviewing Key Concepts

3. Describe a demographic group that may not prefer investment risk. Describe another demographic group that may be more comfortable with a greater degree of risk.

Beginning investors may be afraid of the risk associated with some investments. However, it helps to remember that without risk, it is impossible to obtain returns that make investments grow.

It may be easier to take risks when you:

- Are younger
- Have more experience as an investor
Reviewing Key Concepts

4. Compare the main types of investment alternatives in terms of their risk and liquidity.

The following are the main types of investment alternatives:

- Stocks
- Bonds
- Mutual funds
- Real estate
Reviewing Key Concepts

5. Write an investment plan for yourself.

A savings or investment plan starts with a specific, measurable goal. You can reach that goal through:

- A savings account
- An investment

You might also decide that you should begin saving money in an emergency fund.
Reviewing Key Concepts

6. Describe the role of the investor in the investment process.

To be a successful investor:

- Develop a plan.
- Put it into action.
7. List four specific sources of financial information.

Five widely used and useful publications are:

- *Standard & Poor’s Stock and Bond Guide*
- *Value Line Investment Survey*
- *Handbook of Common Stocks*
- *Morningstar Mutual Funds*
- *Wiesenberger Investment Companies Yearbook*
Newsclip: Less Savings

Americans do not save as they once did. Weak savings mean fewer investments in the economy, and that contributes to slower economic growth.

Log On  Go to finance07.glencoe.com and open Chapter 8. Learn more about the different types of investments. Write down the investments you would like to buy and why.