

CHAPTER 9

INVESTING

Prepare for Your Future

WHAT'S AHEAD

- 9.1** Investing Basics
- 9.2** How to Invest in Corporations
- 9.3** How to Invest in Mutual Funds
- 9.4** Research Investments
- 9.5** Retirement and Other Investments

LESSON 9.1

Investing Basics

GOALS

- ▶ Explain the relationship between risk and return when investing.
- ▶ Describe how to evaluate the level of risk you should accept when investing.

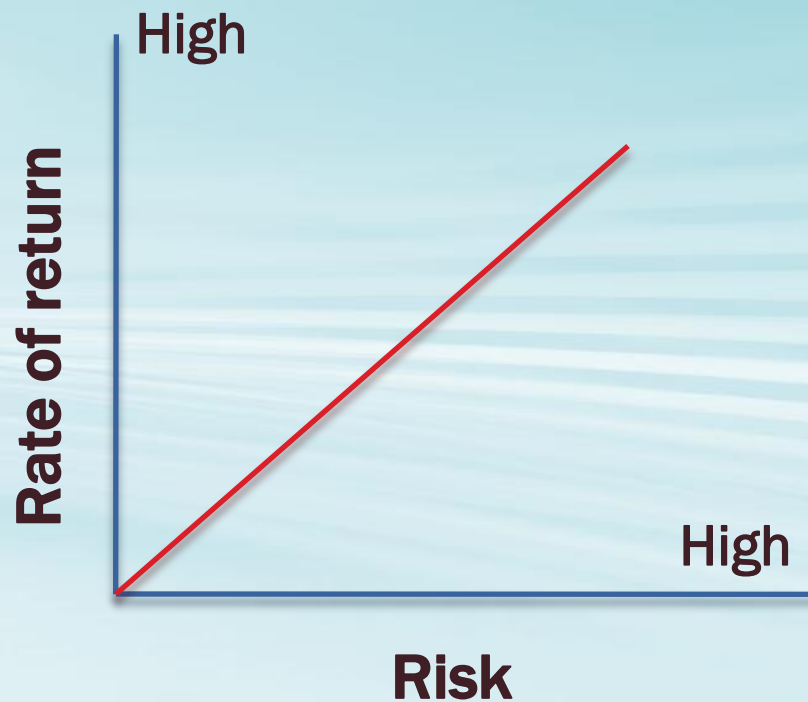
KEY TERMS

- investing
- risk
- return
- diversification

What Is Investing?

- ▶ Risk and rate of return
- ▶ Evaluate your risks
- ▶ Limit risk through diversification

Risk/Return



How to Make Investment Choices

- ▶ Your financial situation
- ▶ Your risk tolerance
- ▶ Your values

CHECKPOINT 9.1

- Why should you expect an investment with a greater potential return to have more risk?
- Why should you consider your financial situation, risk tolerance, and values when choosing investments?

CHECKPOINT 9.1 ANSWERS

- Why should you expect an investment with a greater potential return to have more risk?
 - Investors demand a higher return for accepting greater risk.
 - Organizations that offer investment opportunities must offer higher returns as their risk grows.

CHECKPOINT 9.1 ANSWERS

- Why should you consider your financial situation, risk tolerance, and values when choosing investments?
- Financial situations determine how much an investor can afford to risk.
- Risk tolerance determines what investments an investor is comfortable making.
- Investing according to values provides satisfaction beyond financial goals.

LESSON 9.2

How to Invest in Corporations

GOALS

- ▶ Describe the ways to purchase different types of stock.
- ▶ Explain the difference between investing in corporate stocks or corporate bonds.

KEY TERMS

- corporate stock
- stockholder
- stockbroker
- brokerage firm
- stock exchange
- NASDAQ
- dollar cost averaging
- preferred stock
- common stock
- corporate bond
- junk bond

Corporate Stocks

- ▶ How stock exchanges work
- ▶ How to trade on the NASDAQ
- ▶ How stockholders earn returns
- ▶ Why stock prices change
- ▶ Dollar cost averaging
- ▶ Types of stock
- ▶ What you should consider
- ▶ Returns are not guaranteed

Stock Classifications

- ▶ Blue chip stocks
- ▶ Growth stocks
- ▶ Large cap stocks
- ▶ Mid cap stocks
- ▶ Small cap stocks
- ▶ Sector stocks
- ▶ Cyclical and non-cyclical stocks
- ▶ International stocks

Corporate Bonds

- ▶ Why own corporate bonds?
- ▶ Junk bonds
- ▶ Bond rating services

CHECKPOINT 9.2

- What are the two ways to earn income by purchasing corporate stock?
- What is the difference between stock and bonds? Why does this difference matter to you as an investor?

CHECKPOINT 9.2 ANSWERS

- What are the two ways to earn income by purchasing corporate stock?

You may receive a return from owning stock if it pays a dividend or increases in value if you sell your stock.

CHECKPOINT 9.2 ANSWERS

- **What is the difference between stock and bonds? Why does this difference matter to you as an investor?**
- **Stocks are ownership, and returns depend on the company's performance.**
 - **Bonds are loans the company must repay in a specified time frame with a specified interest.**
 - **Because bonds must be paid on time, they are less risky.**

LESSON 9.3

How to Invest in Mutual Funds

GOALS

- ▶ Explain what mutual funds are and how they benefit investors.
- ▶ Discuss different fund objectives and how to select the right funds for you.

KEY TERMS

- mutual fund
- portfolio
- load

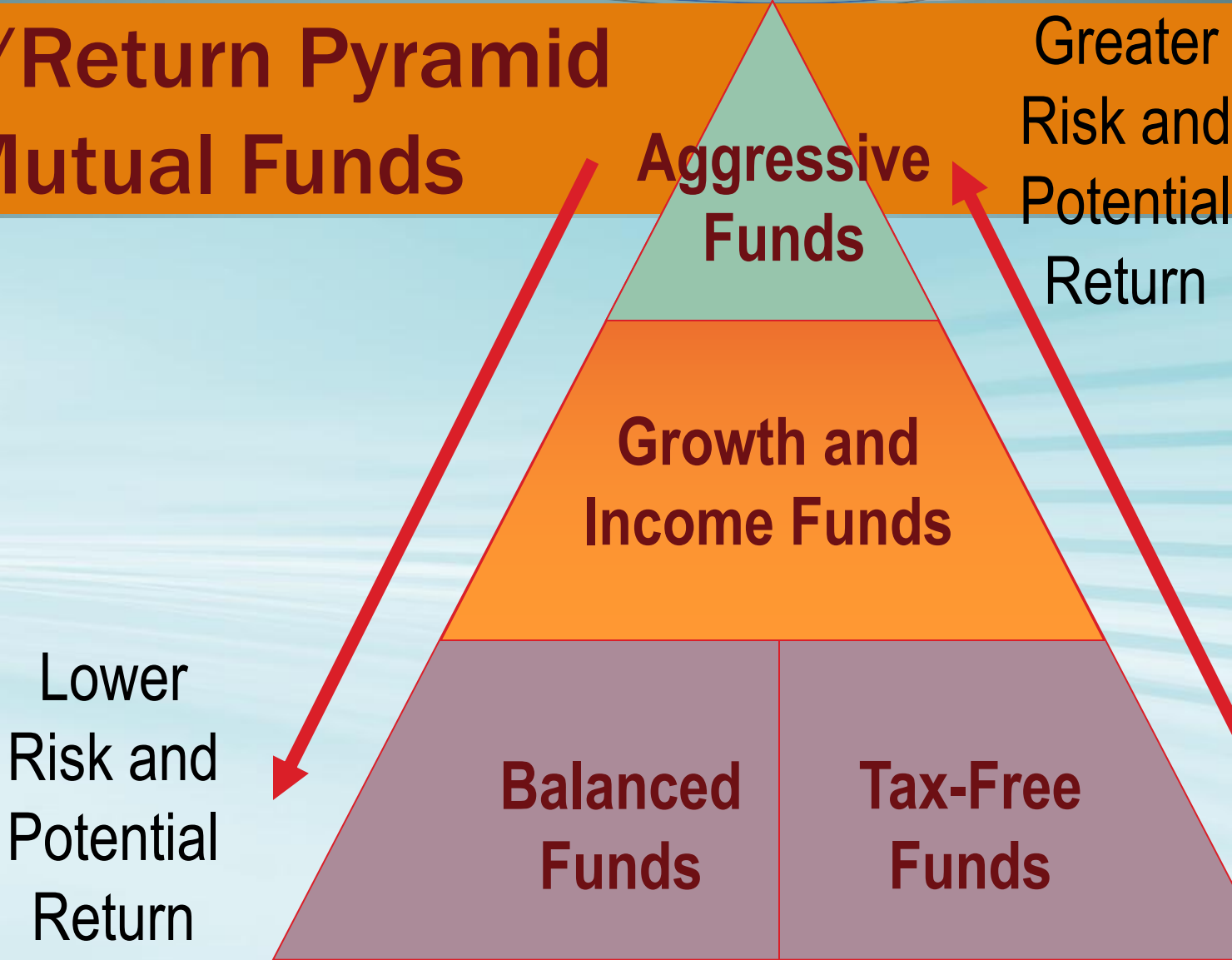
Mutual Funds

- ▶ An easy way to diversify
- ▶ Costs of mutual funds
 - ▶ Annual maintenance fees
 - ▶ Front-end load
 - ▶ Back-end load
 - ▶ No-load funds

Mutual Fund Classifications

- ▶ Index funds
- ▶ Balanced funds
- ▶ Large cap funds
- ▶ Mid cap and small cap funds
- ▶ Aggressive funds
- ▶ Sector funds
- ▶ International funds
- ▶ Bond funds
- ▶ Tax-free funds
- ▶ Exchange traded funds

Risk/Return Pyramid for Mutual Funds



Greater Risk and Potential Return

Lower Risk and Potential Return

CHECKPOINT 9.3

- How do mutual funds work?
- How can the classifications of mutual funds help you select the right fund?

CHECKPOINT 9.3 ANSWERS

➤ How do mutual funds work?

By investing in a mutual fund, small investors can benefit from sharing the cost of employing professionals with other owners of the fund.

CHECKPOINT 9.3 ANSWERS

- How can the classifications of mutual funds help you select the right fund?

The major classifications can help people choose mutual funds that have investment philosophies that are similar to their own.

LESSON 9.4

Research Investments

GOALS

- ▶ Identify sources of investment information.
- ▶ Discuss signs of dishonest investment schemes and how to protect yourself.
- ▶ Describe types of regulation placed on the investment industry.

KEY TERMS

- **Securities and Exchange Commission (SEC)**
- **Financial Accounting Standards Board (FASB)**
- **insider trading**

How to Find Investment Information

- ▶ Printed sources of information
 - ▶ Mutual funds
 - ▶ Stocks
- ▶ Information on the Internet
- ▶ Request information from companies
- ▶ Ask a stockbroker

Make an Investment Plan

- ▶ An investment plan is part of a life-span plan.
- ▶ Investors can make their own investment decisions or obtain the help of stockbrokers and financial planners.
- ▶ Most stockbrokers earn income from fees.
- ▶ Financial planners charge a flat fee.

Investment Schemes

- ▶ Any promise of a large return at low risk should make you suspicious.
- ▶ Check out investment offers.

Investment Regulation

- ▶ **Stockbroker self-regulation**
- ▶ **Securities and Exchange Commission**
 - ▶ **SEC protections**
 - ▶ **Investment scandals**
 - ▶ **Insider trading**

CHECKPOINT 9.4

- Why might you receive better advice from a financial planner than from a full-service stock broker?
- What clues tell you that an investment may be dishonest? How can you protect yourself from shady deals?
- What forms of regulation are used for firms that advise and trade stocks or bonds for investors?

CHECKPOINT 9.4 ANSWERS

- Why might you receive better advice from a financial planner than from a full-service stock broker?
- Full-service stock brokers' incomes depend on fees charged when they complete transactions for investors.
 - Financial planners may provide better advice if they are paid a flat fee for their service rather than a commission for sales.

CHECKPOINT 9.4 ANSWERS

- What clues tell you that an investment may be dishonest? How can you protect yourself from shady deals?
- Some clues are hard-sell approach, unrealistically high promised return with supposedly low risk, unknown seller who won't supply contact information or a written offer, demands for immediate payment, and the suggestion that the seller knows something no one else knows.
- To protect yourself, ask for information in writing and check it out. Invest with established brokerages. If it sounds too good to be true, it probably is.

CHECKPOINT 9.4 ANSWERS

- What forms of regulation are used for firms that advise and trade stocks or bonds for investors?
- The FINRA is a stockbrokers' professional organization that regulates its members by testing brokers and registering those who passed the test.
- FINRA also maintains a database of complaints filed against registered brokers.
- The SEC is responsible for enforcing trading laws and overseeing stockbrokers and the firms that employ them.

LESSON 9.5

Retirement and Other Investments

GOALS

- ▶ Identify strategies you may use to create and carry out a financial plan for your retirement.
- ▶ Describe ways to earn a return on nonfinancial investment options.

KEY TERMS

- tax-deferred
- 401(k) plan
- individual retirement account (IRA)
- 403(b) plan
- real estate investment trust (REIT)

Plan Your Retirement

- ▶ Pension plans are less common today than in the past.
- ▶ Workers must take more responsibility for their own retirement savings.
- ▶ Many retirement plans are tax-deferred.
- ▶ The trade-off for receiving a tax advantage is a penalty for early withdrawal.

Types of Retirement Plans

- ▶ 401(k) plans
 - ▶ Employer matching programs
- ▶ IRA plans
- ▶ 403(b) plans

Other Investment Options

- ▶ **Real estate**
 - ▶ Your home as an investment
 - ▶ Other types of real estate investments
 - ▶ Real estate investment trusts (REIT)
- ▶ **Collectibles**

CHECKPOINT 9.5

- What are several tax-deferred plans available to investors in the United States?
- How might you earn a return from nonfinancial investments?

CHECKPOINT 9.5 ANSWERS

➤ What are several tax-deferred plans available to investors in the United States?

- Traditional and Roth IRAs
- 401(k) plans
- 403(b) plans

CHECKPOINT 9.5 ANSWERS

- How might you earn a return from nonfinancial investments?
- Nonfinancial investments can be made in real estate or collectibles.
 - Real estate usually increases in value over time, so investors can earn a capital gain by selling the property later or by renting out the property to earn current income.
 - Investing in collectibles involves substantial risk and is best undertaken by professionals.