

Investing: Making Money Work for You

Overview:

- Ⓢ Know the difference between saving and investing
- Ⓢ Be familiar with the time value of money
- Ⓢ Be able to compare investment options
- Ⓢ Recognize the risks and rewards of investing
- Ⓢ Know how to integrate investing into your financial planning

Saving = Investing

Saving: is what people usually do to meet short-term goals.

Investing: means you're setting your money aside for longer-term goals. There's no guarantee that the money you invest will grow. In fact, it's normal for investments to rise and fall in value over time. But in the long run, investments can earn a lot more than you can usually make in a savings account.

Why are saving and investing so important to your financial plan? For one, saving or investing money for your financial goals makes you less tempted to spend it. It's in a totally different account from the one you pay your everyday expenses. But the best reason for investing is that your money is actually making money for you. Any interest or investment gains you earn get you that much closer to your financial goals.

The Time Value of Money

The Time Value of Money: Refers to the relationship among time, money, and rate of interest.

Inflation: which is a rise in the cost of goods and services over time. Inflation decreases the spending power of each dollar you have,

Earned Interest: is the payment you receive for allowing a financial institution or corporation to use your money.

Time, Money, and Rate of Interest

- Ⓢ The more **money** you have to save or invest, the more money you are likely to earn.
- Ⓢ The higher the **rate of interest** you earn, the more money you are likely to have.
- Ⓢ The sooner you invest your money, the more **time** it has to make new money, making it likely that you could earn much more as a result.

Compounding or Compound Interest: is the idea of earning interest on interest

$$A = P(1 + i)^n$$

A = the amount in the account

P = is the principal (which is the original amount invested)

i = the interest rate expressed as a decimal
 n = the number of years compounded

The most important thing is to get into the saving and investing habit NOW!!!

The Price of Procrastination

You know the more time you have to invest, the more money you are likely to end up having. But the flip side of that is true too. By waiting to invest, you're paying an opportunity to cost.

While saving for your goals involves delayed gratification, procrastinating in saving for your goals really delayed gratification. At least, when you're using a spending plan and saving, you have an idea of when you can expect to achieve your goal.

The Rule of 72

Risky Business

Stock Market: the place where stocks are bought and sold, and they think about the risk of losing all their money.

The risk/reward trade-off is the principle that an investment must offer higher potential returns to compensate for the increased potential unpredictability. So the greater the risk you take with your money, the higher the potential returns on your investments. The lower the amount of risk you take, the lower the potential returns will likely be.

Of course, the reward for taking on risk is your return on investment.

Dividends: which are a share of the profits you receive as a stockholder.

Capital gains: return that comes from growth stock prices

Capital loss: the difference if the investor ends up selling a stock at a lower price.

An Array of Investment Options

Savings Accounts: Often the first banking product people use, earn a small amount of interest; considered to be very low risk; therefore, they tend to pay low interest rates; you can take your money out at any time without penalty. It is a liquid asset, meaning it can be easily converted to cash.

U.S. Savings Bonds: The federal government pays interest to investors for loaning it money, just like banks and credit unions do. A **bond** is a formal agreement where the borrower, in this case the federal government, can use your money for a set period of time and you, as the lender, will get paid a specific amount of interest in return. You are agreeing to loan the federal government your money for at least a year; they typically pay higher rates of interest; savings bonds are designed to be held for up to 30 years, so if you cash a bond in within five years of purchase, you'll pay a penalty (usually three months of lost interest).

🌀 Two types of bonds

- Paper Series EE: purchase for half of its face value – the minimum is \$25 for a \$50 savings bond; it is guaranteed to accrue enough interest to reach face value in 20 years.
- Online Series EE or Series I: savings bonds at their face value and earn a fixed rate of interest.

Certificates of Deposit (CDs): Banks and credit unions have their own versions of CDs; you are loaning it (financial institutions) money for a set period of time – such as three months, six months, one year, two years, etc. – and getting interest in return; the longer the term the higher the rate of interest paid; you will lose a few months of interest in you cash them in early.

Money Market Deposit Accounts: offered by banks and credit unions; work like checking accounts, so you can take your money out whenever you want, usually without penalty; pay a higher rate of interest than savings accounts-although usually lower than CDs-and they are insured by the federal government; require a higher minimum balance

Money Market Mutual Funds: offered by mutual fund companies (a type of investment company that invest shareholders' money in a diversified group of securities of other companies); designed to be a stable way to save you money and earn potential income; not insured or guaranteed by the U.S. federal government; generally pretty safe investments; earn higher interest than MMDA's

Corporate and Government Bonds: these bonds typically pay the highest interest rates; a bond's potential return is usually referred to as its **yield**; government bonds are safer than corporate bonds because they are backed by the “full faith and credit” of the U.S. government; corporate bonds offer higher interest rates

Real Estate: investors buy property (land or buildings) hoping to generate a profit; considered less liquid than stocks because it's more complicated to sell.

Collectibles: are items that are relatively rare in number (paintings, sculptures, and other works of art are all collectibles); investors in collectibles don't make a profit (or loss) until they sell their items; these are viewed as high risk

Mutual Funds: takes money from many investors and uses it to make growth or income investments and uses it to make growth or income investments based on a stated investment objective; have several key benefits:

1. they offer investors an affordable way to own shares of many stocks, which is less risky.
2. they are professionally managed by an investment expert, also known as portfolio manager
3. with more than 6,000 mutual funds to choose from, you can probably indulge any interest you have in a particular type of company or investment style.

Diversification

Is reducing investment risk by putting money in several different types of investments. A mutual fund is an example of an investment that uses diversification.

Dollar Cost Averaging

The practice of investing a fixed amount in the same investment at regular intervals, regardless of what the market is doing. It's another key investment principle to know because it eliminates having to worry about investing at the “right” or “wrong” time.