Investment 101

Sooner or later nearly everyone makes investment-related decisions, often without realizing it. That's why an understanding of investment basics is important, whether or not you consider yourself an investor.

There's something about the words *investing* and *investments*. Many people shrug off investment knowledge as important only for the well-off, accountants, speculators, and people who spend their day on the floor of the New York Stock exchange shouting "Buy!" and "Sell!" until they're hoarse.

The fact is, sooner or later nearly *everyone* makes investment-related decisions, often without realizing it.

The "without realizing it" part is why we believe everyone should understand at least a few investment basics. The idea isn't to turn you into a professional investor, but to provide useful information for times when investment-related opportunities and decisions arise.

Happily, the basics of investment aren't nearly as complicated as some would make them out to be.

▶ Investor? Me?

Investing is no more nor less than an impressive-sounding word for *taking a sum of money and doing something with it in hopes of making it bigger.*

Investing comes in all shapes and sizes, from the inconceivably large, complex, and risky, all the way down to the small, simple, and safe. The kinds of high-stakes deals played up in the news media represent but one end of the spectrum, with the likes of U.S. Savings Bonds and the humble savings account representing the other. If you have ever placed money in a savings account, you can call yourself an investor.

Some investments offer a larger return than others, but not without a catch. Investments where you're sure not to lose a penny tend to offer the lowest rates of return. Investments that offer higher rates can actually lose money, and often do.

So before investing, it's wise to know something about the various types of investments out there, their average rate of return, and just how safe—or not—they will keep your money.

But first, you need to ask yourself an important question.

▶ Start with the whys

Before embarking on an investment plan, we recommend pausing to ask, "Why?"

One good reason to invest is to avoid losing value to *inflation*. Since it's more common for prices to rise than fall, the buying power of your money is likely to go

down if you leave it idle for too long. Skillful investing can counteract inflation.

But another, possibly more important reason to invest is to meet your own investment goals. To be sure, investing for its own sake can be fulfilling, but if you approach investing with a meaningful goal in mind, chances are you'll be more motivated to stick to your plan. Plus, goals give you a measuring stick for evaluating how well your plan is working.

All of which means that, before investing, it's a good idea to set some goals, that is, to decide what you are investing *for*.

In the short run, perhaps you'd like to pay off a credit card, buy a car, or go on a dream vacation. In the long run, maybe you'd like to buy a home, open a business, put yourself or someone else through college, start a charitable organization, or perhaps someday retire.

There is no "right" or "wrong" reason to invest. You get to decide what matters to you. Just be sure your goals fall within the realm of possibility, and that you clearly lay out expectations as to amounts and timing. That is what separates a workable plan from wishful thinking.

▶ A word on risk

Now would be a good time to start thinking about just how much risk you're willing to take on when you invest.

It need not be an all-or-nothing decision. Many people maintain a mix of low, medium, and high-risk investments. This is known as a "diversified portfolio." The idea is to balance funds that are more secure but may earn less with funds that are at greater risk but may earn more.

Remember that with many investments, risk is not limited to not earning interest. It is possible to lose some or even all of your original investment. When it comes to high risk, it's wise not to invest funds you cannot afford to lose.

▶ Types of investments

Once you have mapped out your investment goals and considered what level of risk is appropriate for you, it's time to learn about investment types. We'll start at the lowest-risk and lowest-return end of the spectrum and work our way up.

• ***Savings accounts*** only technically qualify as a form of investment. Though they pay interest and tend to be safe, they tend to pay the lowest interest rates. It is likely that funds kept in a traditional savings account will not even keep up with inflation.

• ***Cash alternatives*** offer a slightly better return than traditional savings accounts, with only slightly more risk. These may include certificates of deposit (CDs), money market deposit accounts, money market mutual funds, and U.S. Treasury bills, also known as T-bills. Some of these may be FDIC insured, making them all but risk-free, but provide less freedom in terms of deposits and withdrawals.

The "higher return" from cash alternatives is still not terribly high. As with savings accounts, money placed in cash alternatives is not likely to keep up with inflation.

• ***Bonds*** are usually issued by a government or corporation. By purchasing a bond, you essentially lend the government or corporation your money. Interest, which may be fixed or floating, is set in advance and is usually paid every six months. Interest rates are generally higher than those earned from savings accounts and cash alternatives, but greater risk is involved. There is no guarantee that a bond will earn interest, and it is possible to lose some or all of your principal investment.

There are two ways you may profit from investing in bonds. One is simply to collect interest. The other—and this is where things get interesting—is to sell the bonds to other investors. If interest rates go down, you may be able to sell the bonds for more than you paid. The risk, of course, is that things could go the other way, so that you end up selling your bonds for less than you paid.

• ***Stocks*** represent shares of ownership in a company. If the company is profitable, it may from time to time distribute profits among you and its other shareholders. Profits distributed to shareholders are called *dividends*. If the company isn't profitable, or if its directors choose not to issue dividends, you'll receive nothing.

Like bonds, stocks can be bought and sold. If you're lucky enough to have purchased stocks that increase in value, you can sell them for more than you paid. Once again, this works both ways. If you decide to sell a stock whose price has dropped, you will sell at a loss.

• ***Other investments***—There are endless ways to invest that are beyond the scope of this article. These include real estate, collectibles, commodities such as wheat or gold whose values fluctuate, and more.

All investments come with varying degrees of risk, pitfalls, and opportunities. Newcomers and experienced investors alike should always proceed with caution.

▶ Are we having funds yet?

YOU MAY FIND it easier, and possibly more profitable, to pool your funds with other investors and appoint a professional to choose and manage investments for all of you at once.

That's the idea behind ***mutual funds***. Mutual funds employ professional fund managers who invest according to a carefully spelled-out strategy. It's not unusual for mutual funds to invest in and monitor anywhere from a few dozen to hundreds of securities.

When you buy shares in a mutual fund, you own a piece of the fund's total portfolio. It can be a convenient way to receive potentially higher earnings without having to worry about the day-to-day details.

Mutual funds vary widely in character, approach, and level of risk. Moreover,

there is no guarantee that you will earn interest or that you won't lose money. Before investing in a mutual fund, carefully review its prospectus, giving particular attention to the fund's objectives, risks, and fees.

Another pooled investment type is the ***Exchange-Traded Fund, or ETF.*** ETFs do not rely on fund managers. Instead, investments are chosen in accordance with a specific index, such as the S&P 500. As with mutual funds, ETFs entail risk, so it's important to scrutinize the prospectus before investing.

▶ When to call a pro

One of the benefits that come with understanding investment basics is the increased likelihood of knowing when it may be time to obtain a little help.

Most people are comfortable on their own handling investments at the lowest-risk end of the spectrum. As balances grow and you eye moving up the risk ladder, you may want to consider meeting with and possibly retaining a qualified, licensed financial professional.

The right financial professional can help you with some or all of the investment process, including setting goals, determining appropriate risk levels, evaluating markets and investments, and managing your portfolio.

Wealth management professionals vary as widely as investment opportunities. It's important to find someone you can trust and with whom you feel comfortable.

We hope this article has provided useful information for a solid start toward investment planning. For more information, or for a free, no-obligation consultation, we invite you to call us.