

Standard 5: The student will analyze the costs and benefits of saving and investing.

Time is Money



Aunt May and Uncle Augusto stop at April's house for a few days. They have been retired for five years and are now "snow birds," spending summers in Minnesota and winters in South Texas.

That night over dinner, they ask April's dad if he is worried about the stock market.

Dad says he has 15 years until retirement, so he is waiting to see what happens before making changes in his retirement account at work.

Uncle Augusto wants to move his money into something "safer" just in case the market drops. He cautions April's Dad about losing his money.

April is taking an investment course at school, and she says they both are right!

What do you think about April's answer?

Lesson Objectives

- ⇒ Determine how various saving and investment strategies vary with individual needs and circumstances.
- ⇒ Evaluate the impact of inflation on future earnings, saving, and investments.
- ⇒ Identify the different types of saving and investment products required to meet their financial goals.

Personal Financial Literacy Vocabulary

Asset class: A group of investments with similar characteristics.

Diversification: Investing in a variety of stocks, bonds, money market accounts, etc., in order to spread risk.

Equities: A group of investments involving ownership of assets.

Fixed income class: A group of investments involving loans made to someone else.

Inflation: A rise in the general or average price level of all the goods and services produced in an economy.

Risk tolerance: A measure of the likelihood of loss or profit the uncertainty of an investment's rate of return.

Introduction



Even though most people have a savings and investment strategy, those strategies vary from situation to situation, and from person to person. An individual's circumstances, goals, risk tolerance, income, and other factors play a big role in establishing a personal investment strategy. Understanding the reasons why people save and invest in different ways can help you make your own personal decisions.

Lesson

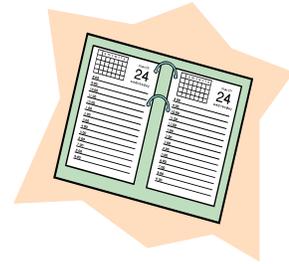
Life would certainly be boring if everything was just alike! What would happen if, suddenly, all houses looked alike, all cars looked alike, and all restaurants served the same food? Fortunately, things are different and provide each of us with different options. Where one person may want to drive a hybrid car to save on gasoline expenses on the commute to work, someone else may drive a pickup truck to haul horses to a show. People make different choices and decisions based on taste, need, and necessity.

Saving and investing is much the same. Even though some basic principles of saving and investing apply to everyone, there are still numerous individual choices you have

to make when deciding how to manage your money. These choices are based on many factors, but four of the most important ones are time horizon, risk tolerance, and shortfalls in funding future needs.

Time Factors

How long do you have between today and the time to meet your goals? If you are just starting high school, you probably have about four years until you go to college and many years before you could retire. At the same time, there is probably something at the mall that you want right now! As you are making choices on how to save or invest your money, time is one of the most important factors to consider. The longer you have to invest, the more aggressively you can invest your money. Investing in higher risk financial products is having an aggressive investment strategy.



An **asset class** is defined as a specific kind of investment. Different asset classes have different risk levels, and it is important to match your time horizon to the asset classes.

Following is a list of asset classes, from least risky to more risky:

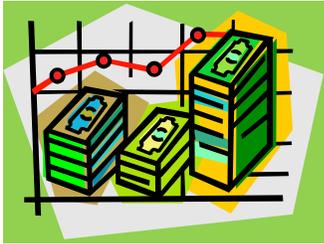
Fixed Income Items

Bank Accounts	Immediate access to cash; insured by the FDIC
Certificates of Deposit	Time varies based on contract; insured by FDIC
Government Bonds	Money loaned to the U.S. government
Municipal Bonds	Money loaned to a municipality (often a city)
Corporate Bonds	Money loaned to a business corporation

Equity Items

Large Cap Stocks	Ownership in large companies
Small Cap Stocks	Ownership in small companies
International Stocks	Ownership in foreign companies
Commodities	Ownership of hard assets such as gold or oil (usually in a mutual fund)
Microcap Stocks	Ownership in very small companies with a high rate of failure

The **fixed income** class includes bank accounts, certificates of deposit, and government bonds, which are also savings instruments. Municipal and corporate bonds are not usually savings instruments because they have more risk and are less liquid.



In general, fixed income items are associated with “loaning” your money to someone else. Banks use your money while it is in savings, and pay you interest for using it. Governments and corporations borrow money through bonds, also paying you interest for using your money. Fixed income items tend to have low risk, and therefore, pay lower interest rates.

Equities include stocks and commodities, and are generally associated with “ownership.” When buying stocks, you actually own a share of a company. When buying a commodity, you also take temporary ownership of that product. If a stock or a commodity increases in value, then you share in those profits. However, if they decline in value, then you share the loss.

Stocks are purchased in a stock market or in a mutual fund. Commodities are sold in a commodities market or in a mutual fund. Both are higher risk investments than products in the fixed income class.

Financial experts have studied the results of both equities and fixed income investments for many years. Based on historical results, they recommend that equities are a better option if you have at least seven years until your financial goal. However, if your time is less, then it is best to “diversify” your investments by including some fixed income products. The shorter the time to reaching your goal, the more you should rely on fixed income or savings.

In the box below, summarize what you have learned about time factors and investments.

- 1.
- 2.
- 3.
- 4.

Risk Factors



Do you like roller coasters? Do people call you a dare devil? Or do you prefer to try something safer? In either case, your personality will tend to influence how you invest your money. Understanding your risk tolerance is one key to developing your personal investment strategy. **Risk tolerance** relates to how much negative change (potential loss) you can handle with your investment. If you are a risk taker, you may really enjoy investing in the stock market or other high risk investments. On the other hand, if you prefer to walk on the safer side and low risk tolerance, you may prefer fixed income or saving products.

A wise investor will consider some of both because it provides a balance for your investment portfolio. This balance is often called **diversification**. Portfolio is a common name given to all of your personal assets, including savings, investments, and cash. Basically, your portfolio is all of your money!

Losses in your portfolio can be difficult to replace. If you buy a stock for \$100, and it loses 50% in value, then it is worth \$50. For that stock to return to its previous price of \$100, it needs to increase in value by 100% ($\$50 + \$50 = \$100$). When you are investing for a long period of time, you can recover that kind of loss; however, it is difficult to recover in a short period of time. That is the reason most financial experts recommend investments with less risk (or savings) to meet your short-term goals.

At the same time, choosing low risk investments to meet long-term goals is not the best option. Low risk savings and investments have less potential for growth than equity items. Taking the safe route on long-term investing may leave you short of your financial goals.

Taking the time to review your investments and make adjustments in your portfolio is just as important as reviewing your personal and financial goals.

Many people will hire a financial planner, stock broker, or other financial expert to provide advice on investments. Even that does not guarantee success. Remember, NO ONE cares more about your money than you. So, be informed about your choices.

In the box below, explain your level of risk. Do you think you have a high or a low risk tolerance? Why?

Online Risk Quiz: If you have access to a computer, you may want to try this online risk quiz to see how your assessment of your risk compares with it.
http://moneycentral.msn.com/investor/calcs/n_riskq/main.asp

Inflation Factors

Did you know that if you keep your money in a checking account that does not earn interest, and you spend no money out of the account, you are actually losing money? Your lost money is the result of inflation. **Inflation** refers to increases in the average price of goods and services from one year to the next. The United States has an average inflation rate of about 3% per year.

With a 3% inflation rate, \$100 this year is worth only \$97 next year. If your savings and investments portfolio is not earning at least 3% annually, then you are really losing money. If you earn 8% in your stock portfolio, you really only earned about 5%. While the formula is a little more complicated than $8\% - 3\% = 5\%$, it is a good estimate of your real earnings.



COMPLETE: Financial Planning: You Decide – Activity 5.4.1

Ask your teacher to review your answers before continuing this lesson.

What did you learn from completing this activity?

Conclusion

You have many different options when deciding how to save and invest your money. Remember to consider your time horizon, risk tolerance, and the impact of inflation as you decide what will be the best options for you to choose. Even if you trust someone else to provide advice for your choices, it is your responsibility to decide what is best for you.

If you agree with April's answers, then you are right too!

Uncle Augusto and Aunt May might want to consider other options for their money because the stock market is high risk when you have an immediate need for your money.

Dad is also right. He will not be using the money he is saving in his retirement account for 15 years. His investment has time to recover from any fluctuations in the market.

Name: _____ Class Period: _____

Financial Planning: You Decide – Activity 5.4.1

You have been hired by Financial Planners, Inc., to help provide advice on savings and investments to your customers. Read through the descriptions below and determine what kind of savings and investment products they should consider to meet their financial goals.



Client 1: Joannie is a single mother with three young children. One is in preschool and two are in elementary school. Joannie has a good job, but limited amount of money for saving and investing. Her top goal is providing a college education or other training for her children. What do you recommend to her?

Client 2: Francisco and Maria are planning a vacation to the Bahamas for their 25th anniversary next summer. What do you recommend to them?





Client 3: Frank is just starting his senior year in high school. He knows that the senior prom will be an important time for him and his special date. Frank works part-time at McBurgers and wants to start saving money so he can pay for all of the expenses for the prom. What do you recommend to Frank?

Client 4: MJ is a high school sophomore. Her parents have promised to help buy her a new car when she graduates from high school. She needs to save enough money for her part in just two years. What do you recommend to MJ?