

# Unit 13:

## Investing and Retirement

There is no more reading from the textbook or quizzes. The rest of the textbook is covered in the Advanced Family Finance class. However, there are a few things that I like to cover because many of you will not be taking the Advanced Family Finance class. This unit is on investing, but it barely scratches the surface. It is just a taste to get you interested in the topic. There is not a chapter of reading due, but there are a lot of website articles to read. For many of the topics below I would like you to read information from the SmartMoney University website. You might want to read all of the articles on the website, however, I will tell you which ones will be required reading for the final exam. There is a lot of information on this site and it is fun. There are a lot of graphs and charts that you can do fun things with. Following is the general website, the titles of the drop down boxes, the specific articles to read and the numbers they will be referred to in the notes. It might make more sense to read each article when it is discussed in the notes instead of all at once.

Website: [SmartMoney University: Investing 101](http://datek.smartmoneyuniversity.com/departments/investing101)  
(<http://datek.smartmoneyuniversity.com/departments/investing101>)

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## Investing

If you remember we discussed how each person should have plans for three areas: spending, risk management, and capital accumulation. We covered the spending and risk management, now we will talk more about how we can accumulate assets. This is generally thought of as investing. First there are a few things that you need to look at to see if you are ready to invest.

### Prerequisites to Investing

**Live within your means.** If you are overspending all the time, it is not time for you to invest. It is time for you to reduce debt and get control over your spending.

**Continue (or start) a savings program.** If you don't have any savings, it is best to start there. Everyone should have some money set aside for emergencies. If you have started a savings program, stick with it while you invest.

**Establish lines of credit.** This may sound strange, but many experts advise having lines of credit to use when needed so that you don't have to dip into your investments. As always though, be careful and use them wisely.

**Carry adequate insurance.** If you need life insurance and don't have any, it would be better to get the life insurance than to start investing. This holds true for all necessary insurances. You could have a lot of money invested, but if you don't have adequate insurance those investments could be wiped out.

**Establish investment goals.** If you want to invest you need to think about what you are hoping to gain by investing. The reason this is important is because you need to know what types of investments are appropriate for your goal. If you are investing for retirement, that is a long-term goal and you can invest more aggressively. If you are saving for a down payment on a home to buy in 2 years, that is a shorter-term goal. You wouldn't want to be as aggressive for that type of goal. You wouldn't have as much time to ride the ups and downs of the stock market.

**Look at risk tolerance.** No matter how much time you have to invest for your goals, you need to invest in ways that you are comfortable with. The figure on page 371 (13.2) of the textbook has a pyramid that shows risk levels. The investments on the bottom are a lot less risky than the ones at the top. Note that the more potential for risk however, the more potential for gain. You can lose more or gain more if you invest toward the top.

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## Three Rules for Successful Investing

If you have completed the prerequisites and have decided to start investing, keep in mind the following three rules.

1. Invest for the long-term. If you are trying to accumulate assets and wealth, you will have a much better chance if you invest for longer periods of time. Go to the [SmartMoney University](#) website and read articles 1 and 2.
2. Invest regularly. If you invested money only every once in a while, you would have to be a genius to time the market just right to make the most money. However, you can invest regularly and not worry about timing the market. The concept of "Dollar Cost Averaging" will be explained in the next website.
3. Diversify your investments. If we could all predict the market, we would know which investments would do the best for us. However, even the experts are often wrong. Therefore, it is a good idea to spread your investments around. It's the old "Don't put all your eggs in one basket." Go to the [SmartMoney University](#) website and read article 3.

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## Types of Investments

To start with, read the information at the following website:

[Investment Basics...For The Beginner](http://www.ianr.unl.edu/pubs/homemgt/g1160.htm)

(<http://www.ianr.unl.edu/pubs/homemgt/g1160.htm>)

When you can't afford to lose any of your investments, you would want to invest in the less risky investments. This would include a savings account, Certificate of Deposits, Money Market Mutual Funds, and Bonds. These are all types of investments that involve LENDING money. You lend your money to the bank, mutual fund company, government, or business, and they promise to give it back to you. For some of these investments, they also promise to pay you a set amount of interest.

**Money Market Mutual Funds** - have already been discussed along with savings accounts and Certificate of Deposits in the banking options unit. However, I would like you to become more familiar with the Money Market Mutual Funds and why you might want one. Read the information at the following websites:

[Money Market Mutual Funds: A Good Bet for Short-Term Goals](http://www.leeinvest.com/articles/mmmf_stg.htm)

([http://www.leeinvest.com/articles/mmmf\\_stg.htm](http://www.leeinvest.com/articles/mmmf_stg.htm))

[Money Market Mutual Funds](http://www.ameritrade.com/education/html/encyclopedia/tutorial4/t4_s6.html)

([http://www.ameritrade.com/education/html/encyclopedia/tutorial4/t4\\_s6.html](http://www.ameritrade.com/education/html/encyclopedia/tutorial4/t4_s6.html))

**Bonds** - are generally a very safe way to invest. However, as you recall on the investment pyramid they also have lower potential for return. Bonds are a good way to diversify your investments. Go to the [SmartMoney University](#) website and read articles 4 and 5.

Now we move into a different type of investment, higher on risk and also higher on potential for return. Also, we are moving out of the lender types of investing to the owner types of investing.

**Stocks** - are ownership investing. When you buy stock you actually own part of that company. There is so much to learn about stocks we could spend the whole semester learning about them. Again, this class barely scratches the surface. The previous article titled "Investment Alternatives. . .For the Beginner" talks about 2 types of high grade stocks called preferred and blue chip stock. If you want to learn more about stocks, the textbook explains a lot about them in

chapter 14. For this class, go to the [SmartMoney University](#) website and read article 6.

**Mutual Funds** - are yet another type of investment. Mutual Funds can invest in CDs and Bonds and be very conservative. They can also invest in more risky stocks and be more aggressive. They can also spread their funds over different types of investments and be in the middle. Mutual Funds are basically a lot of people pooling their money to invest. Instead of owning one particular stock, you own a "share". With that share you have several different investments. Mutual Funds are great for beginners and great for people who want someone else to make the major decisions. It would be difficult for a beginner to afford to diversify very much. But with a mutual fund a person can become quite diversified with a relatively small amount of money. Go to the [SmartMoney University](#) website and read articles 7, 8, and 9.

**Others** - there are many other ways to invest such as owning your own business and buying real estate. These can also be great ways to diversify your investments.

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## How Much Do You Need to Start Investing?

You might need less than you think to start investing. Some people think they need thousands of dollars saved to start investing. Actually, you could probably buy one share of stock for \$10 and be "invested". However, most people don't just buy one \$10 share of stock. I think one of the best ways to start is to begin investing in a mutual fund. There are several funds that have initial investments for less than \$500. Some will go a lower if you set up an automatic investment plan. Can you afford \$50 a month? If you can you can probably start investing in a mutual fund. Remember the dollar cost averaging principle. Investing on a regular basis, like an automatic investment plan, is a great way to invest. You tell the company how much you want to invest every month and they take that amount right out of your checking or savings account. All you have to do is set it up and it takes care of itself after that.

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## How Do You Start Investing?

Most people start investing through a broker or a financial planner. Many people are starting to do it themselves with an online broker. The website [Online Broker Ratings](http://www.investingonline.org/gso/broker_ratings.html) ([http://www.investingonline.org/gso/broker\\_ratings.html](http://www.investingonline.org/gso/broker_ratings.html)) will give you a list of sites that rate and rank online brokers.

If you want to get a Mutual Fund, you can go through a broker or financial planner, but you can also do it yourself and find a "no-load" fund and save some money by not paying commission. Here are the steps I recommend to people when they are looking at mutual funds.

1. **Start with a list** - there are now thousands of mutual funds and it is very difficult to just start out on your own looking for one. There are several places you can look for a list. Most financial magazines have lists every so often and the Wallstreet Journal has them occasionally. Consumer Reports magazine has their mutual fund list every March. You can go to a library and look for *Consumer Reports'* March issue, or look at some financial magazines such as *Money* or *Kiplingers* and look for an issue with a list. They will usually have something about it on the front cover, so you don't have to spend hours looking for it. Also, many websites that have mutual fund information have ways for you to reduce the list of funds. For example, you could state that you wanted to look at funds with low initial investments, or no-load funds.
2. **Narrow your list to 10 or less** - see if you can reduce the list to a workable amount. Around 10 is about as much as you would want to have. You can reduce it by first looking at two criteria. Does it fit your goals and does it fit your risk tolerance? If it is an aggressive fund and you don't have a high risk tolerance then you can cross that fund off the list, or if the initial investment is more than you can afford you can cross it off, etc.
3. **Start comparing the funds** - you could order a prospectus to do this, however, I prefer to do it on a website such as [Morningstar.com](http://Morningstar.com). On this site you can click on funds and then enter the name of the fund in the box that says to enter the name or ticker number. You can then quickly learn a little bit of information about each fund you are considering. There are at least 4 things that your should compare.
  - o **Expense Information** - you don't know how any funds will perform in the future, but you can know how much they will cost you. All funds have management fees but they vary a lot. If they have a total management fee under 1% it is on the low side. There are other fees to look at such as initial , deferred, redemption, administrative, and 12b-1. It would be hard to compare one fund

with one set of fees to another fund with another set of fees except for the expense projections. Each fund is required to state how much you would pay in fees if you invested \$10,000 for either 1, 3, 5, or 10 years. This makes it very easy to compare fees.

Remember, the less you pay in fees, the more you will be able to actually invest.

- **History** - you should look at how the fund has done in the past. Even though you can't tell how a fund will do in the future by how it has done in the past, you can see how it has done compared to the market. You can usually find a chart or graph that will compare the fund to all funds in the same category and to an index (like the S&P 500). If the fund you are looking at has done worse than most others in that category, you probably want to look for another fund.
  - **Management** - this is the hardest one for me to do. You will be able to find information about the manager such as how long they have been the manager. You might also want to look at the investment philosophy of the fund and see if the manager is following the philosophy.
  - **Mechanics** - this is what I call the other things you need to look at such as initial investment. Look at how much you will need to have to start investing. Sometimes the amount is different for an IRA or for an automatic investment plan. There will be an initial investment amount as well as an additional amount. The first one is how much you need to open the account and the other is how much you need to have each time you invest. You will want to try to find information on their turnover rate. The more times stocks are bought and sold, the more tax liability you will have each year. If you are opening an IRA, this will not be a factor since there is no tax liability. Also look at things like how to buy and redeem shares, contact the company, etc.
4. **Narrow your list to 2 or 3** - use the above stated criteria to reduce your list again. This time you want to call the funds on your list and order a prospectus. This is a small booklet that has information about your fund. It may look a little overwhelming at first. Just look for the same information that you were looking at when you had a list of 10. This time you will look in the prospectus for that information. You will be able to read more about the management and the investment philosophy. After you have compared these funds it is time to make your choice.
5. **Fill out an application** - it is likely that the mutual fund companies sent you an application with the prospectus. If they didn't, call them again and ask for one. If you are planning to use the fund as an IRA, be sure to request an IRA application. The application will ask you if you want your dividends reinvested. I recommend that you do if you want your fund to grow faster. It works like compounding interest if you reinvest your dividends. If you cash out your dividends, you will receive a small check in the mail occasionally.

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## Retirement

Planning for retirement is one way you will want to use your investment knowledge. Retirement can be like a three-legged stool. It is supported by the three legs of an employee sponsored retirement plan, social security, and a person's own investments.

I usually add that if an individual doesn't have good support from each of those three areas, they may need to add a fourth leg - working. Look on page 506 (figure 18.1) of the textbook to see a chart of the income of the average person in retirement. Most people would like to avoid working in retirement. If you feel that way, you will need to make sure you are doing well in those three areas.

**Employee sponsored plans** - This is one of the things that you will want to check out when you are looking for a job. If you have a good plan at your work, it makes it a lot easier to have the kind of retirement you are hoping to have. There are two basic types, the defined benefit and the defined contribution plans. Most people have defined contribution plans now. This means that you have no guarantee as to how much you will have at retirement, you only have a set amount contributed to the plan. To find out more about these plans, go to the following website and read the sections on defined benefit and defined contribution plans and 401(k) plans (you might want to read the entire article for your own information):

[What You Should Know About Your Retirement Plan  
\(http://www.dol.gov/ebsa/publications/wyskapr.html\)](http://www.dol.gov/ebsa/publications/wyskapr.html)

**Social security** - do you think social security will be around when you are ready to retire? That is a big question right now. Many people are wondering about that. Most of the experts I have heard state that they think something will be around. It will likely be different than it is now, but they think we will have some form of social security benefits. Read the information at the following website:

[Social Security Benefits Planner - Frequently Asked Questions  
\(http://www.ssa.gov/planners/faqs.htm\)](http://www.ssa.gov/planners/faqs.htm)

**Personal savings** - the most important thing you can do to save for retirement is to start early! Remember the time value of money concept. The earlier you start, the more you will have. A good way to save for retirement is an Individual Retirement Account (IRA). Many people are a little confused about IRA's. They think that an IRA is one certain type of investment. Actually, an IRA can be a lot of different types of investments. It just needs to be tracked as an IRA. Some people contribute to an IRA to save on taxes now. A traditional IRA may save you taxes. Remember on the tax assignment when we subtracted their IRA

contribution from their income? That means they didn't have to pay taxes on that money. However, when they take the money out at retirement, they will have to pay taxes. Other people don't qualify for a traditional IRA, or they would rather just pay the taxes now and not pay them when they retire. These people get a Roth IRA. With a Roth IRA you pay the taxes up-front but you don't pay taxes when you retire. With both of them, the investment grows tax-free. In the past you have only been able to contribute \$2,000 per person per year. That is changing now with the new tax reform act and the amount is increasing. Read the information at the following website:

### [IRA Basics](#)

([http://www.wellsfargo.com/retirement\\_center/start\\_plan/how\\_to/ira\\_basics.jhtml](http://www.wellsfargo.com/retirement_center/start_plan/how_to/ira_basics.jhtml))

There is one other type of investment worth mentioning. Some people also consider getting an annuity. This is like an insurance policy for retirement. You pay an insurance company a set amount of money and they agree to pay you a set amount of money in retirement. Generally what I read about annuities is that you don't need to get one if you aren't contributing as much as you can to your 401(k) and an IRA. If you are doing that and you still want to save more, then you might consider an annuity. Go to the [SmartMoney University](#) website and read article 10.

One last bit of information about retirement. There is a website that has a lot of information about retirement. It is not required for this class, but I recommend it to you if you are trying to make wise retirement decisions. It is [Planning for a Secure Retirement](#) (<http://www.ces.purdue.edu/retirement>)