CHAPTER

12

Investing and Estate Planning

Reading for Meaning

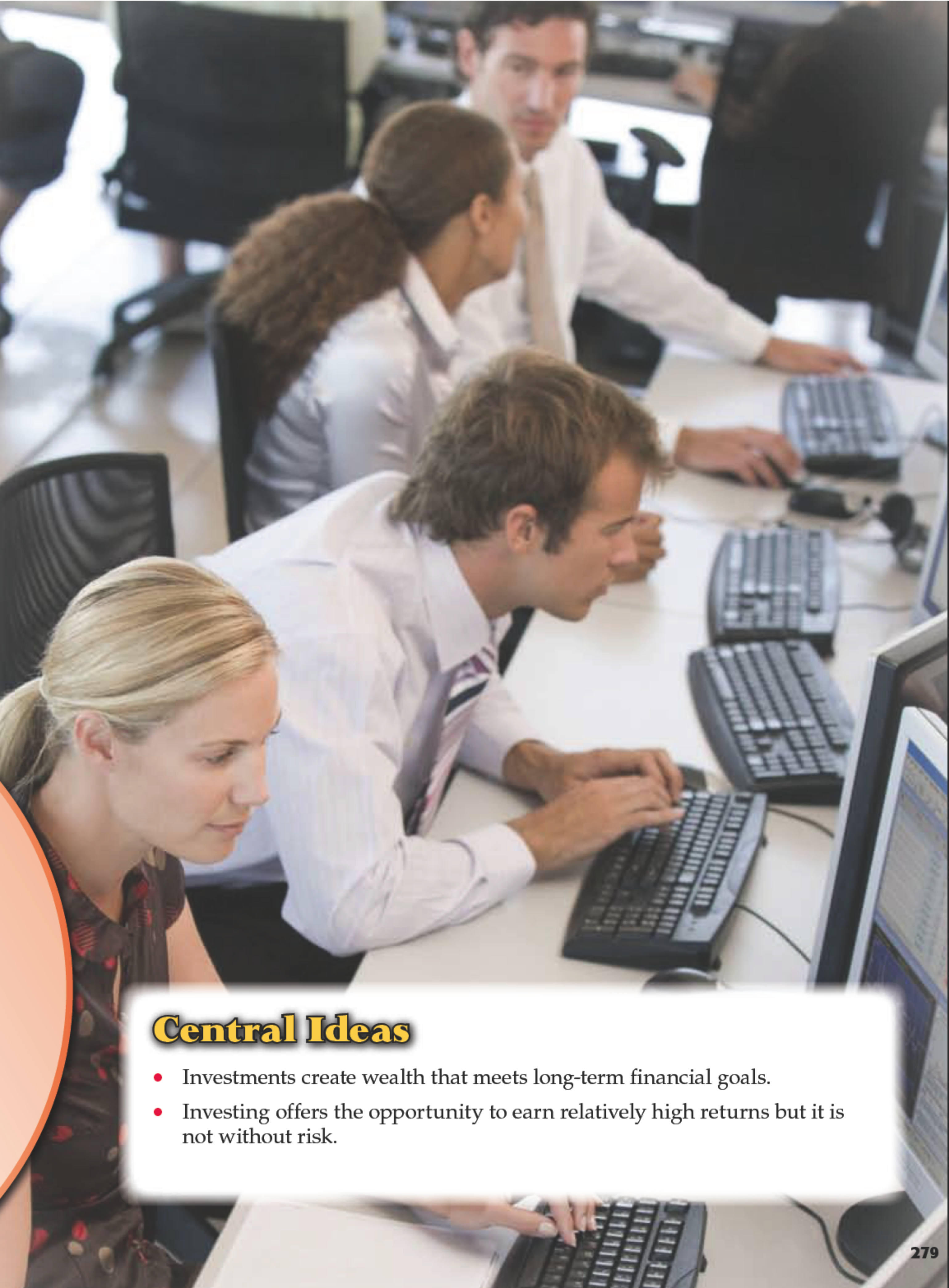
Read the review questions at the end of the chapter before you read the chapter. Keep the questions in mind as you read to help identify key information.

appreciation	bear market
capital gain	investment portfolio
stock	diversification
dividend	prospectus
common stock	dollar-cost averaging
preferred stock	annuity
securities exchange	estate
stockbroker	executor
bond	will
mutual fund	trustee
net asset value (NAV)	living will
money market fund	trust
bull market	probate court

CHAPTER OBJECTIVES

After studying this chapter, you will be able to

- **explain** the role of investments in overall financial planning.
- **identify** the various types of investment choices.
- **read** and understand market quotations.
- **explain** the role of real estate in an investment plan.
- **describe** factors to consider when choosing investments.
- **identify** retirement investment options.
- **explore** the basics of estate planning including wills and trusts.



Central Ideas

- Investments create wealth that meets long-term financial goals.
- Investing offers the opportunity to earn relatively high returns but it is not without risk.

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Investing is purchasing a financial product or valuable item with the goal of increasing wealth over time, in spite of possible loss. Investments generally offer greater returns or profit on your money than savings. However, they also present an element of risk.

As you read in Chapter 11, savings deposited at insured financial institutions are guaranteed against loss. Investments are not insured. When you invest, you risk losing some or all of your money. Careful investing for long-term financial goals reduces risk. Gains usually exceed losses over time.

Deciding to Invest

Understanding when to put money into savings and when to invest will help you make sound financial decisions. You are ready to invest when you meet all the following conditions:

- You pay your essential living expenses and have money left over.
- You do not have excessive debt.
- You are not paying finance charges, which may be higher than any earnings on an investment.
- You have adequate insurance protection.
- You have emergency savings of six to eight months of living expenses.

It is a good idea to set aside a given amount to invest every week or every month.

An investment plan is an important step to meeting long-term goals and achieving financial security. People invest for many reasons:

- ***To increase wealth.*** Many people invest with the intention of holding onto the investment and allowing its value to grow over time. Growth, or **appreciation**, refers to an increase in the value of an investment. Various types of investments grow at different rates.
- ***To earn a steady income.*** Some types of investments disperse earnings on a regular basis through checks sent to investors. Other types of investments offer continuous interest payments to investors. Owners of rental property, for example, can earn income from rents collected from tenants.
- ***To beat inflation.*** Inflation reduces the value of money and the return on investments. Due to inflation, a dollar will buy less next year than it did this year. To beat inflation, the rate of return needs to be higher than the rate of inflation.
- ***To take advantage of tax benefits.*** Some investments are tax exempt or tax deferred, such as certain retirement accounts. Also, capital losses can be deducted when calculating taxes. A *capital loss* occurs when an investor loses money because the selling price of an investment is less than the purchase price. **Capital gain** is income earned

Case Study: Making Plans

Money from the Keyboard

Cotelia is an outstanding pianist. She studies on scholarship at a local music center and attends a music camp in the summers. She wants to take lessons with the best music teachers to reach her potential as a serious pianist. She hopes to play with symphony orchestras around the world some day.

To fulfill her dreams, she will need a lot of money. However, her family is not wealthy. Cotelia plans to earn and save as much as possible. In her free time, she earns money by performing at parties and other events. In the past year, she earned about $1,800.

Cotelia thinks she can earn even more money by performing with several musician friends. They want to form a musical group and perform at concerts, dances, and parties. They believe they can earn a lot over the next few years.

Case Review

1. How would you advise Cotelia to save and invest her earnings over the next five years?
2. What might she be inclined to do with her money if she did not have these objectives—or if her family could afford to pay for her future study?
3. How do objectives like Cotelia's influence earning efforts, and savings and investment decisions?
4. What are some ways young people with other interests and talents can earn and invest for future goals?

when the selling price is greater than the purchase price. The government taxes capital gains.

Tax reduction strategies vary greatly from investor to investor and from year to year as tax laws change. Certain investments are especially important for those in high tax brackets. It pays to look for a competent tax accountant, lawyer, or financial planner for advice in this area.

- *To preserve wealth in unstable economic times.* Both investments and cash can lose value quickly during times of inflation or political and economic instability. Choosing a variety of investments helps protect your investments during periods of economic uncertainty.

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Consider your reasons for investing when developing an investment plan. For example, if earning income is important to you, look for investments that pay steady earnings and show high yields. If growth is more important, invest in companies that put earnings back into research, development, and expansion.

Selecting investments to meet your goals and objectives requires careful study. Investments are characterized by these four factors:

- ***Degree of volatility*** refers to quick and unexpected changes in value or price. The change can be either positive or negative. Volatile investments can present greater uncertainty as to risk and to return.
- ***Potential rate of return*** is the expected earnings on an investment for a given period of time. It is often expressed as a percentage. Look for investments that show a history of growth.
- ***Level of risk*** is the degree to which an investment may deviate from its expected return. Low-risk investments generally offer lower profits but more security. High-risk investments offer the possibility of big gains, but also big losses. Most investments fall somewhere between these extremes.
- ***Liquidity*** is the ease with which you can convert an investment to cash without serious loss. High-liquidity investments are actively traded on the stock market. Less liquid investments, such as antiques, coins, gold, and real estate, are more difficult to sell.

Your investment goals and objectives will change over time depending on your earning power and your stage in the life cycle. *Risk tolerance* is the amount of uncertainty you can handle. It is connected to your level of comfort with the possibility of loss. Each person needs to determine his or her own emotional and financial risk tolerance and choose investments accordingly.

For short-term goals, use the savings instruments discussed in Chapter 11. The advantage of investing for a long-term goal is having many years before you will need your money. This allows you to keep money invested during the ups and downs of the economy and to achieve gains over time.

REAL LIFE CONNECTIONS

Financing Long-Term Goals

Many online calculators are available to help you estimate the financial investment needed to reach long-term goals. Here are some examples:

- College education: http://apps.collegeboard.com/fincalc/college_cost.jsp
- Retirement: www.calcxml.com/do/ret02
- New business start-up: www.homebiztools.com/startup.htm

Check out these sites and try the calculations.

Types of Investments

A *security* is a type of investment issued by a corporation, government, or other organization. The most popular investments—stocks, bonds, and mutual funds—are securities. Real estate and valuable goods can also be investments. Valuable goods include rare, pricey items, such as gold, gems, and antiques.

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Stocks

A **stock** is a share in the ownership of a corporation. Stockholders have *equity* in the company and share in the profits after debts, taxes, and operating expenses are paid. Corporations sell stock to pay the costs of business start-ups, continuing operations, and expansion.

Stockholders make money in several ways:

- ***Dividend income.*** A **dividend** is a portion of a company's earnings paid to stockholders. Dividends are distributed when declared by the company's board of directors. Instead of paying dividends to investors, some companies put profits back into the company in the hope of increasing its growth and stock value.
- ***Increased stock value.*** Investors purchase stock when they believe it will appreciate or rise in value. Then they can either sell it at a profit now or hold onto it for further gains. Investors make money when they buy low and sell high.
- ***Stock splits.*** A corporation may decide to split its stock to create more shares. When this happens the price per share goes down initially, but shareholders receive more shares. This generally increases the demand for and the price of the stock. Investors who owned stock before the split profit because they own more shares, which are likely to increase in value.

Stock Classifications

The two basic types of stock are *common* and *preferred*. Companies may issue other classes of stock, each with its own contractual rights.

Owners of **common stock** earn dividends declared by the company. They can also vote in the election of company directors and on other matters presented at shareholder meetings.

Owners of **preferred stock** receive regular dividends at a set rate. In addition, they have first claim on assets in the event of a company failure. However, preferred stock owners do not have voting privileges.

Being a stockholder does not make you responsible for any of the company's debt if it goes out of business. The company's creditors cannot come after stockholders for payment.

However, if a company closes its doors, stockholders may lose their investment in the company, along with any profits. The first in line for payment from the company's assets are creditors. Next, preferred stockholders' claims are met. Only then are the claims of common stockholders met.

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Since it is paid first, preferred stock is a more conservative, safer investment with less risk than common stock.

The price of common stock usually moves up and down more than preferred stock. However, preferred stock typically does not increase in value as much as common stock.

Besides the common or preferred labels, you may see stock described in one or more of the following ways:

- ***Blue-chip stocks*** are from large and historically successful companies. They are more expensive, but considered safe investments with moderate returns.
- ***Income stocks*** are issued by companies that pay above-average dividends to investors. These stocks are for investors, such as retirees, who want a regular source of income.
- ***Growth stocks*** are from companies that put a premium on long-term growth. Most or all profits are put back into the company and often there are no dividends. Growth stocks are for investors who plan to buy and hold their stocks for long term gains.
- ***Defensive stocks*** are issued by companies whose sales are relatively stable across the ups and downs of the economy. These companies often sell necessities—food, health care, and utilities.
- ***Cyclical stocks*** are from companies whose sales are sensitive to economic ups and downs. The companies provide goods and services that consumers buy when economic conditions are good. Consumers spend less in these areas during economic downturns, 12-1.

12-1

Auto manufacturing companies have cyclical stock. In economic downturns, consumers buy less cars, manufacturing slows, and stock value declines. In prosperous times, car sales often increase, manufacturing picks up, and stock value rises.

- ***Penny stocks*** are issued by companies with questionable sales forecasts. They are inexpensive, but risky. However, if the company becomes successful, investors can get above-average returns. Penny stocks can cost as little as a few cents or as much as $10 per share.

Additional stock categories exist, each presenting different levels of risk and volatility. Choosing a combination of stocks with varying degrees of risk can reduce overall risk.

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Stock Trading

Stocks are bought and sold in several ways. Most securities are bought and sold on securities exchanges or over-the-counter markets. It also is possible to buy through an initial public offering. Some companies also sell their stock directly to the public.

Securities Exchanges

A **securities exchange** is a formal market where securities are bought and sold by stockbrokers. A **stockbroker** is an agent who buys and sells securities for clients. Brokers are licensed by the National Association of Securities Dealers to trade securities. Usually stockbrokers charge a commission on both "buy" and "sell" transactions.

In a securities exchange, the buyers and sellers themselves do not meet. The issuers of the securities are not involved in these transactions and receive no money from them. A securities exchange is sometimes called a *stock market*. One of the major international exchanges is the New York Stock Exchange (NYSE) Euronext.

The *National Association of Securities Dealers Automated Quotations (NASDAQ)* is an American-based electronic network for trading securities. NASDAQ lists the securities of more than 3,000 companies worldwide. International securities exchanges make it easier and less expensive to invest in foreign companies.

Over-the-Counter (OTC) Markets

Stocks that are not listed on securities exchanges can be bought and sold at over-the-counter (OTC) markets. OTC markets are virtual markets where dealers and brokers conduct business through an electronic network of computers and telephones. Other types of securities are also traded on OTC markets. OTC markets lack many of the rules and regulations imposed on brokers in securities exchanges. Investors need to be especially alert when trading OTC stock because there can be a high level of risk involved. The largest OTC markets in the U.S. are NASDAQ's Over the Counter Bulletin Board (OTCBB) and PinkSheets.

Initial Public Offering (IPO)

An initial public offering is a company's first sale of stock to the public. Companies usually make an initial public offering to raise capital for expansion or to become publicly traded. The company works with one or

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more investment banks that help determine the type of stock to issue, the price, and the best time to make the offering. The banks charge a commission to sell the securities to investors. The money raised from the sale of IPO stock, minus the bankers' commission, goes to the company. IPO stocks can be risky investments because the company is often a young business without a long track record of success.

If investors want to resell their IPO stocks, they do it on a secondary market. A securities exchange is a secondary market.

Stock Quotations

You can follow the ups and downs of stocks by checking daily stock quotations. Stock quotations, or listings, appear in the financial section of *The Wall Street Journal* and other major newspapers, 12-2. Listings are also available on the Internet. To find a particular stock, you need to know the ticker symbol, or the abbreviation used for the company.

Stock quotes contain valuable financial information. The current yield (Yld%) and the price/earnings ratio (PE) help investors determine the health or weakness of a company and the value of its investments.

Stock Quote

52 Weeks		Stock	Div	Yld%	PE	Vol 100s	Hi	Lo	Last	Chg
Hi	Lo									
19	13	Corp.X	0.50	3.00	28	19409	17.13	16.00	16.50	–0.25

52-Week Hi/Lo: Highest and lowest prices paid per share over the past year.

Stock: Company name or the stock's ticker symbol.

Div: Dividend paid per share of stock over past year. There will be no number if the stock does not pay dividends.

Yld%: Yield percentage or rate of return on one share of stock; calculated by dividing the annual dividend (Div) by the current price of the stock.

PE: Price/earnings ratio is the price of a share of stock divided by earnings per share for the last 12 months. Low-risk stocks usually have low PE ratios. Speculative and high-growth stock ratios are often much higher.

Vol 100s or **Sales 100s:** Previous day's volume, or total number of shares traded, quoted in hundreds. (For the above listing, sales totaled 1,940,900 shares.)

Hi: Highest price paid per share on previous day.

Lo: Lowest price paid per share on previous day.

Last or **Close:** Final price paid per share on previous day.

Chg: Compares the final price paid per share today with that paid the previous day. A positive number indicates a price increase; a negative number indicates a price decrease.

12-2

Stock quotations provide essential information for investing in securities and following those you own.

Bonds

A **bond** is a certificate of debt issued by a corporation or government. When you buy a bond, you are lending money to the issuer of the bond. Until the bond matures, you, the bondholder, are a creditor. The issuer owes you the amount of the loan plus interest on the bond's face value.

Information stated on a bond includes the following:

- ***Maturity date*** is the date a bond or other obligation is due to be paid.
- ***Face value*** is the amount for which a bond is issued and on which interest payments are figured. At maturity, the bondholder receives the face value.
- ***Yield*** is the percentage of a return on an investment.

Other important terms relating to bonds include the following:

- ***Coupon rate*** is the annual interest the issuer promises to pay on the face value.
- ***Market value*** is the amount for which a bond sells. It may be more, less, or the same as the face value.
- ***Current yield*** is the annual interest or coupon rate divided by the market price of a bond.

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Types of Bonds

The three major issuers of bonds are corporations, municipalities, and the federal government.

Corporate bonds are issued by businesses that need money to operate and expand. The quality, coupon rates, and yields of these bonds vary with the financial soundness of the issuing corporation. Yields and market prices move up and down as market interest rates change.

Most corporate bonds are bought and sold by brokers. Some bonds are bought and sold on securities exchanges and are listed in newspapers and online. High-grade corporate bonds are considered safer investments than stocks because they are debt instruments. If a company goes bankrupt, it must pay its debts first.

Municipal bonds are issued by state, county, and city governments. Coupon rates and yields depend on market rates and the financial soundness of the issuing municipality. Interest on these bonds is exempt from federal income tax and in some cases state and local taxes as well. This makes municipal bonds attractive to upper income investors in high tax brackets.

Most municipal bonds are bought and sold by brokers. Some municipalities may allow investors to purchase bonds directly from the local government. Corporate and municipal bond listings are in the financial section of major newspapers and online. Look for certain key information when reviewing bond quotations, 12-3.

Bond Quote

Issuer Name	Symbol	Coupon	Maturity	Rating	Close	Change	Yield %
Bank ABC	B. ABC	2.250%	Mar 20XX	Aaa	100.985	–0.073	1.861
Corp. Y	COR.Y	8.500%	May 20XX	A	106.695	2.375	7.520
Z Corp.	Z.CO	2.250%	Mar 20XX	Aaa	101.042	–0.041	1.839

Symbol: Abbreviated name of the issuing corporation.

Coupon: The annual interest paid on the bond. Coupon rates generally are higher on lower quality bonds to reward buyers for taking greater risks.

Maturity: The date the bond is due.

Rating: The quality/risk rating of the bond. As the risk increases, the ratings decline from the highest quality or safest rated, Aaa or AAA, to the lowest quality rated, C or D.

Close: The closing price of the bond at the end of the day. Prices are usually shown as a percentage of the face value.

Change: Compares the closing price with the price paid the previous day. Some quotes show the change in increments of 1/32.

Yield: The actual return on investment. Calculations are based on the coupon rate and the current market value of the bond.

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Corporate bond quotations provide the information you need to track bond yields and prices in the marketplace.

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Corporate and municipal bonds are rated for quality and risk. The first four rating categories—AAA, AA, A, and BBB—are recommended for conservative investors. The other four categories—BB, B, C, and D—are considered too risky for average investors.

U.S. government bonds are issued by the U.S. Treasury and are the safest bonds you can buy. When you buy one, you lend money to the federal government. Treasury bills, notes, and bonds sell in increments of $100.

- ***Treasury bills (T-bills)*** are short-term debts with maturities ranging from a few days to 52 weeks. They are the most actively traded government debt. Treasury bills sell for less than the face value. They do not pay interest before maturity. You pay less than $100 for a T-bill and receive the full $100 at maturity. The difference between the price you pay and the amount you receive at maturity is the interest.

- ***Treasury notes and Treasury bonds*** are sold at auction and carry a stated interest rate. Buyers receive semiannual interest payments. Treasury notes are short-term securities with maturities of two, three, five, seven, or 10 years. Bonds are long-term investments with maturities of 30 years. Both notes and bonds are sold in increments of $100. The actual price you will pay for these securities depends on the interest coupon and the yield at auction. These may be paper

ECONOMICS in ACTION

Credit Ratings Agencies

Credit ratings organizations evaluate debt securities, such as bonds, and rate them according to risk. Investors use the ratings to help guide investment choices.

The U.S. Securities and Exchange Commission designates certain agencies as Nationally Recognized Statistical Ratings Organizations (NRSOs). To be considered an NRSO, the agency must reveal its method used to determine ratings. Some of the most well-known NRSOs are Standard and Poor's Ratings Services, Moody's Investor Services, and Fitch, Inc.

Critics question the objectiveness of ratings organizations. NRSOs have been accused of giving high ratings to risky securities to please issuers who pay for the rating services. When agencies receive payment from the corporations whose securities they are rating, critics cite a conflict of interest.

In the future, the SEC may establish stricter rules and regulations for NRSOs to prevent conflicts of interest.

certificates or entered into an electronic account. Today most are sold electronically.

- *U.S. savings bonds* were discussed in Chapter 11.

Mutual Funds

A **mutual fund** is created by pooling the money of many people and investing it in a collection of securities. Professional managers at investment firms select the securities that make up a mutual fund.

Inexperienced investors often start with mutual funds because of three key advantages:

- *Professional management.* Mutual funds are managed by professional investors who follow the markets carefully and are assisted by a team of researchers.
- *Diversification.* Mutual funds offer diversification in a single investment. As mentioned earlier, when you invest in several securities, you spread your risks.
- *Liquidity.* Mutual fund shares are easy to buy and sell.

Mutual funds also have some drawbacks:

- *Management fees.* Mutual fund managers charge fees to pay for research, administration, sales, and other expenses. Usually the fees are near industry averages. However, some management fees are extremely high and cut into your earnings significantly. These costs must be paid even if the fund performs poorly.

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- ***Lack of control.*** You give up control over the selection and timing of your investments. The fund managers make these decisions.
- ***Minimum investment.*** Many mutual funds require a minimum investment of $1,000 or more.

Types of Mutual Funds

The two basic types of mutual funds are closed-end or open-end. A *closed-end fund* offers a fixed number of shares. These shares are traded like stocks on securities exchanges and secondary markets. You buy and sell shares in these funds through investment brokers, not through an investment company.

The *open-end fund* has an unlimited number of shares. It sells and redeems shares at their net asset value. Current market value or **net asset value (NAV)** is the fund's assets minus its liabilities. The *value per share* is the NAV of the fund divided by the number of shares outstanding.

Most mutual funds are open-end funds. Open-end mutual funds may be load or no-load funds. *Load funds* charge a commission or "load" of up to eight percent of the amount you invest when you buy shares. The average commission is three to five percent. *No-load funds* do not charge fees when you buy shares. However, you may be charged fees when you sell or redeem your shares.

Several different types of mutual funds are available.

- ***Income funds*** buy conservative bonds and stocks that pay regular dividends. Their primary goal is to provide current income.
- ***Balanced funds*** invest in common stock, preferred stock, and bonds. Their goal is to provide a low-risk investment opportunity with moderate growth and dividend income.
- ***Growth funds*** invest in securities that are expected to increase in value. They emphasize growth over income, but involve more risk.
- ***Specialized funds*** invest in securities of certain industries or sectors, such as all technology or all health care companies. They may also invest in certain types of securities, such as all municipal bonds or common stock. Some concentrate on foreign securities.

Mutual funds are often divided into families. Each fund has its own name and investment objectives. Mutual fund quotations display the names of individual funds listed within each family group, 12-4.

A **money market fund** is a type of mutual fund that deals only in high interest, short-term investments, such as U. S. Treasury securities, certificates of deposit, and commercial paper. *Commercial paper* is a short-term note issued by a major corporation. The funds are managed and sold by investment companies, brokerage firms, and other financial institutions.

The interest earned, minus management fees for operating the fund, is passed along to the depositors. Interest rates on money market funds go up and down with money market rates.

Investing in money market funds has many advantages. These funds provide small savers with high yields when interest rates are high. They

Mutual Fund Quote

Fund	NAV	Chg	YTD % return	3-yr % chg
Fund Company 123				
BalFundA	9.89	0.01	28.1	−4.7
SpecFundB	31.72	0.02	28.6	1.2

Fund: Name of the fund company that sells the funds, followed by the names of individual funds offered.

NAV: The dollar value of one share of the mutual fund.

Chg: Difference between the day's NAV and the previous day's NAV.

YTD (Year to Date) %: The percentage gain or loss since the first trading day of the year.

3-yr % chg: The fund's total gain or loss over the past three years, indicated as a percentage.

12-4
Mutual funds quotes appear in the financial pages of major newspapers and online.

can be liquidated at any time since they have no term or maturity date. No interest penalties apply for early withdrawals. They can be used as collateral for loans.

Money market funds have some disadvantages, too. The rate paid on money market funds changes daily. If money market rates drop, so does the rate of return. A minimum investment of $1,000 or more may be required. Unlike money market deposit accounts, the savings instrument discussed in Chapter 11, money market funds are not FDIC-insured.

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Factors Affecting Returns

In a market economy, the laws of supply and demand determine the price of stocks and many other investments. *Supply* is the amount of a product or service producers are willing to provide. *Demand* is the quantity of a product or service consumers are willing to buy. Both supply and demand are closely connected to price.

Certain information can help predict investment returns, including economic indicators, current events and trends, and data about particular economic sectors, industries, and companies.

Business Cycle Fluctuations

When the economy is growing, most businesses and investors do well. However, when economic growth slows, many businesses and investors lose money as sales decline. Cyclical industries are more sensitive to the ups and downs of the business cycle. The performance of these companies is often tied to interest rates, fuel costs, and products that are not immediately essential to the consumer. The stock issued by companies within these industries is categorized as cyclical.

Investment Analysts

Investment analysts help their employers make investment decisions. They work for investment banks, insurance companies, mutual and pension funds, securities firms, and the business media. They examine company financial statements and analyze economic and market factors to determine a company's value and to project its future earnings.

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Being aware of the ups and downs of the economy can help investors make wise choices. The Chapters in Unit 1 discussed some economic indicators that help economists assess the health of the economy. These include the unemployment rate, GDP, consumer price index, and consumer confidence. These statistics are released by government economists and other groups on a regular basis.

Interest Rate Fluctuations

Fluctuations in interest rates affect the value of securities and other investments. Bonds and real estate are directly affected by interest rate ups and downs. For example, as interest rates rise, bond prices fall. This is because investors can receive higher returns by investing in bonds with the new higher rates. Conversely, as interest rates fall, bond prices rise. Real estate sales increase as interest rates fall and suffer when they rise. Business growth generally is more robust when interests rates are low and suffers when rates increase.

Stock Market Fluctuations

Bull and *bear* are terms used to describe the strength or weakness of the stock market. **Bull market** is an extended period of consumer confidence and optimism when stock prices rise. The sense of optimism often encourages the exploration of other investment opportunities, including real estate and valuable goods.

Bear market is an extended period of uncertainty and pessimism when stock prices fall. It occurs when investors feel insecure and uncertain about the economy. Fearing further drops in the value of their investments, they often sell them. However, this is often a buying opportunity because prices are low.

Product Innovation

Historically, investors who financed winning products in their infancy, such as the automobile, microwave oven, and cell phone, made handsome profits. Those who invested in products that did not succeed lost their money. Most investors fall somewhere between high profits and big losses.

Business failure is caused by many factors ranging from poor management to new competition and government regulations. Technological advancement can cause new companies and industries to spring up, while making outdated companies obsolete.

Government Actions

Actions by government can impact the value of an investment positively or negatively. Product recalls, new regulations, and increased taxes often have a negative impact on company stock. Trade barriers protecting companies from foreign competition often improve the outlook of stock in protected industries.

Exchange-Rate Risk

For investors who trade securities of companies in other countries, the currency exchange rate needs to be considered. It may be necessary to exchange dollars for another currency. Dividends and gains or losses may be presented in foreign currency. The ups and downs of the exchange rate, whether buying or selling, become a potential risk for the investor.

Real Estate

Buying *real estate* (land or buildings) is another way to invest for future profit. This type of investment usually requires enough money for a down payment plus a long-term loan.

For most people, buying a home is their first experience in real estate. When the real estate market is strong, owning your home can increase your net worth and protect against inflation. Property usually increases in value over time. Still, most financial experts advise thinking of a home first in terms of a place to live and second as an investment.

Buying land or buildings for investment purposes is not for amateurs. Before investing in real estate for profit, buyers need to know about property values and property management. They also need to learn about mortgages, down payments, taxes, titles, insurance, and the legal aspects of leases and property ownership. These considerations are described in Chapter 18.

Finance

Real Estate Appraisers

Real estate appraisers estimate the value of land and buildings, ranging from residential homes to major shopping centers. They write detailed reports on their research observations and explain reasons for arriving at their estimates.

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REITs and Real Estate Mutual Funds

Purchasing stock in a *Real Estate Investment Trust (REIT)* is a way to invest in real estate without the complications and financial commitment of owning property. A REIT is a company that owns profit-earning real estate, such as apartments, shopping malls, office buildings, or hotels. Mortgage REITs specialize in buying and selling mortgage-backed securities.

The government requires that REITs distribute most of their profits to shareholders through dividends. Shares of many REITs are traded on securities exchanges.

Real estate mutual funds are another way to indirectly invest in real estate. Funds may include a mixture of securities from REITs, commercial developers, and other types of real estate companies.

Investing in REITs and real estate mutual funds requires less capital and offers more liquidity than purchasing property. Changes in interest rates, housing prices, and demand for housing can affect the rate of return. As with other securities, investors should research before investing and carefully review prospectuses and annual reports.

Valuable Goods

People have collected precious goods and objects for thousands of years and continue to do so today. These items can be attractive investments because their value is not eroded by inflation as paper money can be. Valuable goods include the following:

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- ***Collectibles*** are objects purchased for the pleasure of ownership and because they are expected to increase in value. Common collectibles include rare coins, books, stamps, art, antiques, sports memorabilia, and vintage automobiles.
- ***Precious metals*** include gold, silver, platinum, and other metals. People buy them in the form of pieces of jewelry, coins, bars, or ingots from banks and dealers. An *ingot* is a bar of metal that is sized and shaped for easy transportation and storage.
- ***Precious gemstones*** include diamonds, emeralds, sapphires, and others. They are collected as stones or as pieces of jewelry.

Consider the risks before you choose these investments. They are less liquid than stocks, bonds, and mutual funds. Like real estate, valuable goods can be difficult to sell quickly. When collectors are ready or forced to sell these assets, they sometimes must accept less than what they originally paid. These valuable goods can also be hard to store and protect from damage and theft.

Judging the worth of valuable items is often difficult unless you have expert knowledge and considerable experience. Only then are you safe in purchasing these items from dealers and online auction sites. Before buying valuable goods for investments, consult a reputable professional with experience in estimating value. Ask for a formal appraisal before making a significant investment in collectibles.

Prices for precious metals, particularly gold, silver, platinum, and copper, are posted on business Web sites. Prices for these goods are often volatile.

Keep in mind there is no guaranteed return on investment in valuable goods. Putting money into a savings account generates interest. Over time, investing in securities usually pays off. Historically, real estate goes up in value. The rate of return on collectibles and precious metals and gems is less predictable.

Choosing Investments

An **investment portfolio** is a collection of securities and other assets a person owns. Successful investors diversify their portfolios. **Diversification** refers to spreading risk by putting money in a variety of investments. Building a diversified portfolio involves gathering information, considering strategies, and selecting investment methods.

Sources of Information

Check the following sources before choosing an investment. Consult a professional for advice on complex investments. Financial experts can help in areas where you do not feel confident and competent on your own, 12-5.

Financial Experts		
Job Title	**Description**	**Credentials**
Accountant	• Keep, audit, and inspect financial records of individuals and businesses • Prepare financial reports and tax returns	**CPA (Certified Public Accountant)** indicates an accountant is certified by the American Institute of Certified Public Accountants.
Financial Planner	• Assist consumers in forming a financial program • Give advice on insurance, savings, investments, taxes, retirement, and estate planning	**CFP (Certified Financial Planner)** indicates completion of training and certification administered by The Certified Financial Planner Board of Standards, Inc. **ChFC (Chartered Financial Consultant)** may be used by those who have completed additional education and training with the CFP Board. Financial planners are not required by law to be certified or licensed.
Investment Broker-Buyer	• Buy and sell securities and other investment products	Must be registered with the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA).
Registered Representative	• Salespeople who work for broker-buyers, commonly known as brokers	Must be registered with FINRA and licensed by the appropriate state securities regulator.
Investment Adviser	• Provide information and advice on different types of securities	Advisors managing over $25 million in client accounts must be registered with the SEC. Advisors managing less must be registered with the state securities regulator.

For more information, visit www.finra.org/investors.

12-5

Consulting an experienced professional can help in managing financial and legal matters.

Online Resources

Today's technology allows you to use the Internet to view important investment information. In the recent past, this type of information was only available to brokerage firms and investment analysts. Investment-related Web sites provide useful information about individual securities and market movements. On company Web sites, look at investor information or press releases to evaluate the company's investment potential.

The U.S. Securities and Exchange Commission (SEC) is the government agency that regulates the securities industry. Its mission is to combat fraud as well as ensure the securities markets operate efficiently and fairly. All publicly traded companies are required to file financial statements and documents with the SEC. The SEC manages the EDGAR database and keeps it up-to-date as a guide for investors. Visit www.sec.gov to explore this database.

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Annual Reports

Most corporate Web sites offer access to annual and quarterly reports. These sources give a good picture of current and predicted market performance.

One piece of information in annual reports—earnings per share (EPS)—is especially important. When earnings per share increase from year to year it is an indication the company is doing well. *Earnings per share* is the total corporate earnings, after taxes, divided by the total number of shares.

Prospectuses

A **prospectus** is a legal document that gives a detailed description of a security. When an investor buys a security, the issuer must provide a prospectus. You may also get a copy mailed to you if you are considering buying a security. A prospectus can usually be found on a company's Web site or the SEC's EDGAR database.

A prospectus lists company officers, describes business history and operations, and outlines plans for the future. It also includes the following financial information:

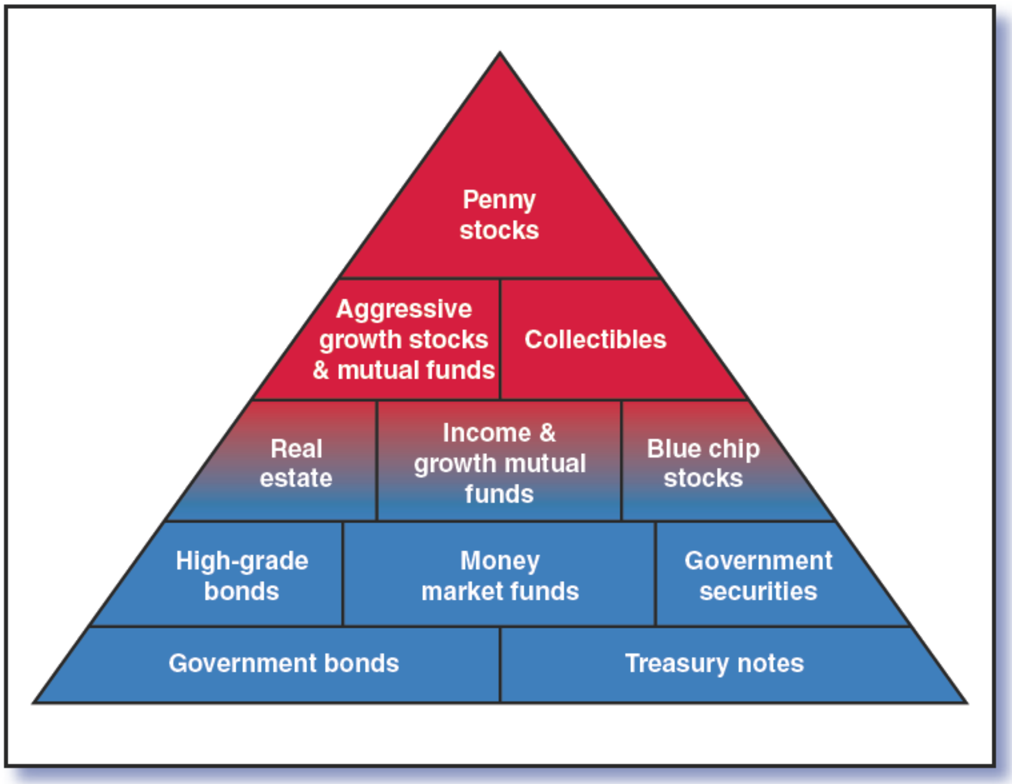
- ***Risks.*** This section spells out the ways an investor can lose money by investing in the security.
- ***Performance summary.*** This indicates how the investment has performed and how its performance compares with that of similar investments. Past performance does not necessarily indicate future results.
- ***Fees and expenses.*** This section outlines any fees or commissions you must pay when buying, selling, or redeeming shares.
- ***Management.*** This section identifies the qualifications and experience of the directors and officers of the company or fund.

Market Quotations

Stock, bond, and mutual fund quotations, or listings, contain important financial information, including records of past and current performance. Market information on securities appears in the financial section of *The Wall Street Journal* and other major newspapers. For up-to-the-minute information, review listings on the Internet.

Investment Strategies

Smart investing is a balancing act. It requires balancing risks against returns, 12-6. Younger investors can usually take more risks than older investors. A young investor has many wage-earning years ahead. However, as people get closer to retirement, they need to choose more conservative investments to preserve principal and provide income.



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High-risk investments, at the top of the pyramid, have a greater chance of earning high returns. Low-risk investments, at the base of the pyramid, usually have low returns.

Investing at an early age allows you to benefit from two common investment strategies: *buy and hold* and *dollar-cost averaging.*

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Buy and Hold

Buy and hold is the strategy of buying securities and holding them for long term gains as opposed to frequent trading. An investor using this strategy stays invested during market fluctuations. Investors who sell stocks when they drop in value lose money. Investors who hold onto stocks usually gain in the long run.

If your stock earns dividends, you will earn money over the years you own the stock. Also, if you hold a stock for a period of time, the company may split its stock, thus increasing your holdings.

Buy and hold does not mean buy and forget. You need to check your investments periodically to know how well they are performing. When an investment is not performing well it may be time to sell and reinvest in a more promising company. Consult an accountant or tax professional to evaluate the tax implications of selling.

Dollar-Cost Averaging

Dollar-cost averaging is a strategy of investing a fixed dollar amount at regular intervals, such as monthly, without regard to the price of the investment at the time you buy it. You end up buying more shares when the price is low and fewer when it is high. This buying strategy eliminates the risk of investing a lump sum when it may not be the best time to buy.

Linking to... Math

How Dollar-Cost Averaging Works

The following example illustrates dollar cost averaging. Investor A buys $1,000 worth of Stock X. At $25 a share, the chart shows that Investor A bought 40 shares. Using dollar-cost averaging, Investor B buys $250 worth of Stock X every month.

The stock's price drops over the next three months. By the fourth month, the 40 shares of Stock X purchased by Investor A would sell for $800—a loss of $200. However, after four months, Investor B owns 51.7 shares of stock. Investor B's shares would sell for $1,034—a gain of $34.

Month	Price/ Share	Investor A		Investor B	
		Investment	# Shares	Investment	# Shares
1	$25	$1,000	40	$250	10
2	$20			$250	12.5
3	$15			$250	16.7
4	$20			$250	12.5
Total		$1,000	40	$1,000	51.7

Finance

Brokerage Clerks
Brokerage clerks compute and record data pertaining to securities transactions. They may also take customer calls, create order tickets, record a client's purchases and sales, and inform clients of changes to their accounts.

Dollar-cost averaging offers the added advantage of convenience. You can set up an automatic payment and make it a part of your overall budget. It helps you make a habit of investing amounts of money you can afford. You can invest as little as $25 monthly. Brokerage firms, mutual funds, and retirement accounts all offer opportunities for dollar-cost averaging.

Buying Securities

Once you have decided on a few specific securities you wish to buy, there are several ways to acquire them.

Brokerage Firms

To buy stocks, bonds, and other securities, you may open an account with a brokerage or securities firm. The main mission of a brokerage firm is to buy and sell for its customers. The fee you pay for these services is called a commission.

You make an application to open an account with a firm. Once your application is accepted, you call your broker with your orders to buy and sell. Most firms also offer online services.

Full-service brokerage firms maintain research departments to follow market trends and individual securities. In addition, they provide investment advice, portfolio management, and other services. The commission you pay covers the cost of trading and support services provided by the firm. Both experienced and beginning investors can benefit from the expertise of full-service brokerage firms.

Discount brokerage firms execute orders to buy and sell securities, but offer few other services. For instance, a discount brokerage does not offer investment advice. The commission is considerably lower than that of a full-service broker. However, you will need to do your own research and investment planning when you buy from a discount broker. Some experienced investors may prefer to use discount brokers to save money on commissions.

Online brokerage firms have hundreds of online brokers available to help consumers buy and sell securities. Use the following guidelines when investing through an online brokerage firm:

- ***Check online brokers carefully before becoming involved.*** Make sure the people you deal with are reputable and legitimate. You can check out brokers and securities firms with your state securities regulator or the nearest SEC office.
- ***Print information on any investment you are considering.*** You also may want to obtain other written material, such as a prospectus, an annual report, and recent company news. Study this information carefully. Before placing an order, know exactly what you are buying and what risks are involved.
- ***Obtain and keep written confirmations of your buy-and-sell orders and their completion.*** File all your investment records and information in a safe place where you can locate them easily. You will need these records to file your tax returns.
- ***Follow your investments' performance.*** Prices can rise and fall swiftly in active markets. When you invest directly online, no one will be supervising your account. This makes it essential to follow market trends and prices of securities you own. You want to buy and sell at the most advantageous times.

When you buy and sell securities online or by phone, you will need to use certain types of orders to conduct your trades.

- A *market order* instructs your broker to buy or sell a stock at the best price available. The price may be higher or lower than when you placed the order. Stock prices can change between the time you place an order and the time it is executed.
- A *limit order* instructs your broker to buy or sell a certain stock at a set price or better. If the broker cannot buy or sell at the price you request, the order will not be executed.
- A *stop order* instructs your broker to buy or sell a stock when and if it reaches a specific price. It will be carried out only when stock reaches the target price. This type of order helps you protect your gains and limit losses.

The brokerage firm keeps a record of your transactions. You should receive a statement outlining your account activity periodically, usually every month. You will also receive year-end statements and forms for filing income tax returns.

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Games of Chance

Investments, like games of chance, involve taking risks. However, your chances of being a winner are much better with an investment than with a game of chance.

In games of chance, players bet money on events, such as sports games, card games, and lottery drawings. They hope to win a prize—usually money, a car, or something else of value.

The odds of winning are slim. In some games of chance, skilled players may have an edge. However, chance or luck is the only usual determinant of who wins and who loses. Of the many thousands of people who buy tickets for a state lottery, for example, sometimes there are no winners. Losers, however, always lose money.

Games of chance, especially gambling, are restricted by law. Those who invest in extremely risky investments are called speculators. Speculation refers to taking high risks in the hope of making big profits.

However, choosing to invest carefully is a wise financial decision. When you buy an investment, you get something in return—a home, a stock certificate, or a treasury bill. Sound investments held over time tend to increase in value. Profiting from an investment depends on the investor's financial knowledge and discipline, not merely on chance.

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Investment Clubs

An *investment club* is a group of people who work together to learn about securities and to invest their pooled funds. Most investment clubs become legal partnerships for the purpose of filing income tax and meeting Internal Revenue Service requirements.

Members attend regular meetings (usually monthly), pay dues, and elect officers. The members decide by vote the amount of the dues each person will pay per month. Members research and follow stocks under consideration or in the club's portfolio. They also buy and sell securities by vote of the majority.

An investment club can be a good way to start investing. It offers the opportunity to invest on a small scale while learning. If you can find a few friends who are interested in learning to invest, you may want to consider forming an investment club.

The National Association of Investors Corporation provides information on starting and running a successful club. You also will find similar information from the Securities and Exchange Commission and Investment Club Central.

DRIPs

A Dividend Reinvestment Plan (DRIP) offers a way to bypass brokers and commissions and invest directly in a company. Dividends are automatically reinvested. Many companies offer DRIPs to the public.

To enroll in one of these plans, you need to become a stockholder by purchasing at least one share of stock in your own name. Once enrolled, most companies allow you to invest small amounts routinely. Some even offer a 3 to 5 percent discount from the current market price of the security. Automatic weekly or monthly stock purchases can often be made in amounts as little as $25.

When you wish to sell shares it may take a few days to complete the transaction. There may also be a fee for selling. You need to keep careful records of dividends, gains, and losses for income tax purposes.

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Investing for Retirement

Retirement planning is a key element of financial security. Recent trends indicate more people are retiring earlier and living longer. Early retirees could need income for as long as 20 to 30 years. Providing income for this many years requires early planning, careful investment, periodic review, and proper adjustments to meet changing needs. Starting a retirement investment plan early is the most effective way to provide enough money on which to live after retiring.

You may be able to draw on a variety of income sources for later years. Social Security is a government program financed by joint contributions from workers and employers. While Social Security is not intended to be your sole source of income, it will be an important piece of your retirement picture. For more detailed information on what you can expect from Social Security, see Chapter 7.

The other income sources you may rely on include retirement programs offered by employers, personal retirement plans, and annuities.

Employer-Sponsored Retirement Plans

Some employers sponsor retirement programs for their employees. These programs vary greatly, but all must meet the standards set forth in the Employee Retirement Income Security Act (ERISA). This 1974 law sets standards for pension and retirement plans to guarantee that workers receive entitled benefits.

Vesting requirements are an important part of this act. *Vesting* gives you a legal right to an increasing portion of the money your employer reserves in your name. Vesting schedules are usually gradual. Typically, after seven to ten years, you will be fully vested. It is particularly important if you leave the company for another job or if you are laid off.

401k

A *401k* is a well-known employer sponsored retirement plan. The plan is funded with your own before-tax salary contributions and often with matched contributions from your employer. Employer contributions can take different forms, such as employee stock ownership, profit sharing, deferred-compensation plans, or cash.

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Typical 401k plans offer several different investment options, including stocks, bonds, or money market funds. Diversifying investments will minimize risk. Financial experts usually recommend choosing more aggressive investments if you have many years before retirement. In later years, conservative investments should predominate.

Investing in 401k plans is one of the better ways to save for retirement, especially when employers match contributions. The great advantage of a 401k is the tax-deferred growth of your savings. Plans can vary greatly from employer to employer. They can also be affected by changing tax laws.

When job hunting, one important area to explore is the type of retirement plan(s) offered to employees. Having a job you love plus a reliable retirement plan is the ideal combination.

Personal Retirement Plans

You may also place part of your earnings in a personal retirement fund. You can start a personal retirement plan at most financial institutions.

When opening a personal retirement account, it is important to choose a sound, reputable financial institution. This institution should provide personal counselors and easy-to-understand guides that inform you of the many issues to consider. Money deposited in a personal retirement plan is usually invested in stocks, bonds, and mutual funds.

IRAs

An *Individual Retirement Account (IRA)* is a personal retirement investment account with tax benefits. There are many types of IRAs. Traditional and Roth are two common types. By contributing money to a traditional IRA, taxpayers avoid paying taxes on contributions and earnings until they withdraw the funds at retirement. Some IRA contributions can be deducted from current taxable income. Contributions to a Roth IRA are taxed, but withdrawals are usually tax free.

Self-Employed Plans

Self-employed individuals can open a Simplified Employee Pension (SEP) plan. Tax-deductible contributions are limited to a percentage of earned income. Earnings grow tax deferred until money is withdrawn at retirement.

A *Keogh plan*, also called an *H.R. 10*, is another type of personal retirement plan for the self-employed. Tax-deductible contributions are limited to a set percentage of earned income. The allowable percentage changes periodically. The interest earned on Keogh accounts is not taxed until retirement. Retirement may begin as early as 59½.

For the latest information and regulations on these personal retirement plans, visit the Internal Revenue Service Web site at www.irs.gov.

Annuities

An annuity is another form of personal retirement planning. An **annuity** is a contract with an insurance company that provides regular income for a set period of time, usually for life. Some annuities also provide death benefits. Investors make payments into an annuity over many years or in one large payment. Both the money invested and the interest it earns accumulates in the annuity.

The principal and earnings on an annuity are not taxed until money is either withdrawn or paid out at a future time. Annuities with reputable insurance companies are considered safe, reliable investments. However, investors should shop around and compare costs, fees, and interest rates.

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Estate Planning

Estate planning is part of an overall financial plan. An **estate** refers to the assets and liabilities a person leaves when he or she dies. It includes property, savings, investments, and insurance benefits. *Estate planning* is the active management of these assets with directives for managing and distributing them when the owner dies.

Goals of an Estate Plan

An estate plan allows people to

- decide long before their death how they want their assets managed afterward.
- provide for their dependents.
- minimize tax liabilities.
- name an executor to oversee the management of their affairs upon their death. An **executor** is a person appointed to carry out the terms outlined in their will. If a person dies without naming an executor, the court will appoint one.
- assign a *power of attorney*, which is a legal document giving the person they choose the power to act for them regarding their financial and legal matters.
- prepare a will.

Wills

A **will** is a legal document stating a person's wishes for his or her estate after death. In most states, people must be at least 18 to make a will and must be "of sound mind." This means they must know what they are doing and be mentally competent.

A will guarantees disposal of an estate according to the wishes of the deceased person, 12-7. This makes settling an estate simpler for beneficiaries, usually family members. Friends may be listed as beneficiaries, as well as a favorite charity, a college, or some other organization.

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A copy of your will should be easily available when needed. Another copy may be kept in a safe-deposit box.

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What Wills Should Include

Generally, it is wise to ask a lawyer for advice on what to include in a will and to draw up the document. A will should do the following:

- *Name beneficiaries*, the people or groups who will receive assets. Assets include personal property and real estate, money, securities, jewelry, and family heirlooms. It should clearly outline a person's wishes for the transfer of his or her property.
- *Name an executor*, the person who will manage the affairs of the estate. He or she pays off funeral expenses, medical bills, taxes, and other liabilities. The executor also performs other duties outlined in the will.
- *Name a guardian*, the person responsible for the care of any beneficiaries who are young children. A guardian may also manage an estate on behalf of the dependents, or a trustee may be named to do this. A **trustee** is a person or institution named to manage assets on behalf of the beneficiaries.

A will must be signed in the presence of witnesses. If you change your will after it has been signed, an amendment called a *codicil* is added. The codicil must also be signed in the presence of witnesses. If you need to make major changes in an existing will, you may wish to write a new will. In this case it is important to add a clause that cancels all previous wills and codicils.

The cost of a will varies. The more complex the estate, the more expensive the will may be. You can write your own will. A do-it-yourself kit that contains basic information and sample formats may cost less than $20. However, this is unwise for large estates, situations with many tax issues, or when there are complicated instructions for distributing assets.

Since legal requirements for wills vary from state to state and may change with new laws, consulting an attorney is a wise choice. This is especially true for people who own their own businesses or have estates that total more than $1 million. Attorney fees vary and consumers can usually arrange a free consultation with a lawyer. Your local American Bar Association can refer you to an attorney who can help.

When people die without a will, it is called dying *intestate*. When there is no will, property is divided according to state laws. This is not ideal because it can take a lot of time and the government decides how to distribute assets.

The Living Will or Healthcare Proxy

The **living will**, or *healthcare directive*, is a statement of instructions for specific medical treatment if a person becomes unable to make medical decisions. The primary purpose is to make known what medical treatments you do or do not wish to receive in the face of terminal injury or illness. It outlines your desires about medically prolonging your life. This is a serious and very personal step to take. It needs to be discussed with family members, loved ones, and your physician.

Trusts

In addition to a will, you may need one or more trust agreements, particularly if your estate is complicated or if you wish to make special arrangements for its settlement. A **trust** is a legal document that gives a named trustee the authority to manage the assets in an estate on behalf of the beneficiaries.

When you create a trust, you become the *grantor*. As grantor, you transfer assets to the trust. You name a trustee to manage the assets according to terms outlined in the trust. You also name the beneficiaries who are to receive the assets.

You can establish either a living trust or a testamentary trust. A *living trust*, set up during your lifetime, can provide for the management of your assets before your death and for the distribution of assets as directed after your death. Prior to death you may serve as grantor, trustee, and beneficiary of the trust.

A *testamentary trust* is set up under the terms of your will and becomes effective when you die. Normally, drawing up a trust agreement calls for the services of a competent lawyer who is familiar with estate planning.

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Purposes of Trusts

Trusts are used to achieve different goals. People can use a trust to

- provide income and asset management for beneficiaries
- set forth specific provisions for the support and education of minor children or dependents with disabilities
- have a plan in place for managing financial affairs if they should become incapacitated or unable to manage for themselves
- minimize estate and gift taxes
- protect their privacy and avoid probate court

Probate court is the government institution that processes a deceased individual's will and estate. The probate procedure requires

- proof the will is valid
- an inventory and identification of the deceased person's assets and property
- property appraisals
- settlement of debts and taxes
- distribution of property according to terms of the will

Probate can be a costly and time-consuming process that involves paperwork, court appearances, and lawyers. Probate fees are paid out of the estate before assets are distributed. The process can take several months, a year, or longer. The executor of the estate must manage the assets during this period. These proceedings are a matter of public record. You can establish a trust to avoid this lengthy and costly process.

Case Study: Making Plans

Final Decisions

Kelly and Jerome owned a very successful office supply business. Over the years, they made enough money to buy a house, raise two children, travel, and retire in comfort.

Sadly, Jerome died just a few years after they retired. Not only had Kelly lost her husband, she also faced a sea of financial confusion. Neither Kelly nor Jerome could face the thought that one of them would die, so they had not planned accordingly.

Since there was no will, Jerome's estate was divided according to state law. Half of his property went to their children. The amount Kelly received did not allow her to live comfortably for long. She had no legal right to the money the children inherited. Since Kelly and Jerome also did no tax planning, Kelly had to pay taxes that could have been avoided.

Case Review

1. When does it become important to draw a will and look to estate planning?
2. Why is a will important even to those who do not have large amounts of money or property?
3. What are some estate planning steps that can ease financial burdens following the death of a loved one?
4. What are some consequences of dying without a will when one leaves young children behind?
5. What advice would you have given to Jerome and Kelly before they reached retirement age?

Chapter Summary

Investing money offers the opportunity to accumulate more money to meet future needs and goals. Investment choices include stocks, bonds, and mutual funds. Higher risk investments frequently offer the possibility of greater gains—and greater losses than less risky choices. No matter where you put your money, it is smart to investigate before you invest.

Real estate is another way to invest. It can bring handsome profits but also involves considerable risks. Investing in real estate is not for amateurs. You need to do your homework and seek the advice of reliable professionals.

Building an investment portfolio begins with defining objectives and gathering information. Choosing where to invest is an important step. Finally, consulting a reputable financial advisor can help you make sound decisions.

Early planning for retirement is the key to living comfortably in the later years. Today, people are living longer and retiring sooner, which makes early retirement planning even more important.

Estate planning is a part of financial planning that requires careful consideration. This includes drawing up a will and possibly a trust to direct the distribution of assets upon one's death.

Review

1. Define *investing*.
2. List three reasons people choose to invest.
3. What are the key characteristics to consider when choosing an investment?
4. Where are stocks bought and sold?
5. What information on a stock quotation helps investors determine the value of the investment?
6. What is the main difference between a bond and a stock?
7. What are the three main types of bonds?
8. Why do mutual funds offer more diversity than buying individual stocks and bonds?
9. Name and describe one factor affecting investment returns.
10. Name and describe two ways to indirectly invest in real estate.
11. What is a prospectus and what should it tell you?
12. Explain the purpose of brokerage firms and describe three types.
13. Name two sources of retirement income.
14. What retirement plans are designed for self-employed persons?
15. Name the primary objectives of estate planning.

Critical Thinking

16. If you were going to invest in stocks, would you buy common or preferred stock? Which is more likely to increase in value? Which do you think is the better investment? What are the advantages and disadvantages of each?
17. Research and discuss the pros and cons of international securities exchanges.
18. Compare the three types of bonds. Which type of bond would you prefer to buy? Why?
19. What are the advantages and disadvantages of investing in a mutual fund?
20. What should you consider before buying shares in a mutual fund?
21. Name five reliable sources of information on stocks, bonds, and mutual funds.
22. Compare the advantages and disadvantages of buying and selling investments through brokerage firms, investment clubs, and DRIPs.
23. Describe employer sponsored and personal retirement plans, their characteristics, and their tax advantages.
24. Describe the possible consequences of dying without a valid will.
25. If you were to write a will today, what would it contain? How might it change if you were 30 years old, single, and earning $60,000 annually? if you were 30, earning the same amount, and married? with children?

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Academic Connections

26. **Financial literacy, writing.** Choose two mutual funds. Review their prospectuses. Write a paper comparing their objectives and historical rates of return.
27. **Financial literacy, math.** Assume you have $2,500 to invest in any way you choose. Establish goals and objectives for your investments. Interview a stockbroker or an investment adviser for information on the types of securities and investment strategies available. Choose the securities you would buy and locate the quotes in a financial newspaper or online. Develop a system for charting their ups and downs in the market. Explain your choices in terms of your objectives and follow your "investments" for at least two months. At the end of that period, evaluate your choices in terms of performance and meeting your investment goals.
28. **Financial literacy.** Form a team of classmates and develop a plan for investing $5,000 over the length of this course. Use the Internet, current financial publications, and books on financial planning for information on developing your plan. Factors to identify and consider include your objectives, types of investments, expected returns, risk tolerance, liquidity, and diversification. Describe your plan in terms of these factors. In the final week of class, compare your team's plans with those of other teams in the class.
29. **Research, speech/writing.** Go online to investigate one of the following topics. Give an oral or written report on what you learn.
    - Stocks
    - Mutual funds
    - Government bonds
    - Security exchanges—NYSE Euronext and NASDAQ
    - Investment clubs

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30. **Research, speech.** Interview an officer in a financial institution about retirement accounts. Find out what types of accounts are available. Discuss the advantages of opening a retirement account when you are in your early twenties. Report your findings to the class.
31. **Social studies.** Investigate the laws in your state regarding persons dying without a will. Report on the laws related to distribution of assets, naming of an executor, naming of a guardian, taxation of assets, and other specifics stated in the law.
32. **Research, writing.** Write a three-page report on retirement planning, the living will, or wills and trusts in estate planning. Use at least five reliable sources of information.

Math Challenge

33. How many shares of stock would you own at the end of one year if you invested $1,000 each quarter at the following stock prices? Use dollar-cost averaging and round your answer.

First quarter	$20/share
Second quarter	$25/share
Third quarter	$30/share
Fourth quarter	$35/share

Tech Smart

34. Look up a publicly traded stock on www.nasdaq.com or www.nyse.com. Record the daily closing value for two weeks. Compare the value on day one with the value on day 14. How did the stock perform?

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