Objectives

- Discuss the importance of an emergency fund.
- Discuss the concept of paying yourself first.
- Compare types of savings accounts.
- Evaluate the costs and benefits of investing in stocks, bonds, and mutual funds.
- Discuss the importance of balancing risk and return.
- Explain ways to comparison shop for investments.
- Identify opportunity costs in saving and investment choices.
- Compare types of savings accounts.

Key Terms

appreciation  
bond  
capital gain  
capital loss  
diversification  
dividend  
investment  

liquidity  
market capitalization  
mutual fund  
portfolio  
price-to-earnings ratio  
prospectus  
return  

risk  
shareholder  
stock  
stock exchange  
stock index  
stock market  
volatility
You have a job, a good financial plan, and an account at a financial institution. You understand how to manage your financial account and how to file tax returns. You’re all set, right? Maybe for today, but what about tomorrow? Do you know how you’re going to financially manage any unexpected or future needs?

Remember the financial goals that you set earlier? Perhaps you are saving for a computer, college, or a home. Maybe you want to start a catering company or stay home with your children for their first couple of years. These things take money. What happens if your car breaks down or your apartment catches fire? What happens if the main financial provider for your family becomes seriously ill and can’t work? The unexpected sometimes happens. One thing that makes reaching goals and managing the unexpected easier is having a financial cushion—money that you have saved—available.

Saving and investing are two more tools that add to financial security. One way to look at saving is as future spending. Saving has the added benefit of earning account holders extra money through interest paid on the account. Another way to make your money grow is through investing. Investments allow an investor to make money for long term goals by putting money into stocks, bonds, mutual funds, real estate, annuities, or businesses. Investments have the potential for earning greater sums of money than savings accounts. Chad Foster, author of *Financial Literacy for Teens* (Rising Books, 2005), calls investing “making money while you sleep.”

**Emergency Fund**

Sawyer is a busy 20-year-old who works full-time as a receptionist in a law office about 30 minutes from her home. After work, she takes computer classes at a local technology school. Sawyer is working toward certification in Java and C++ programming. One day as Sawyer is leaving work for her computer classes, her car refuses to start. She has her car towed to an automotive repair garage. She is told that her alternator is bad and that it must be replaced. Sawyer is stunned when she receives a quote for $800. She looks at her checking account. The only way she can pay to fix her car is to either withdraw from her computer class and get her tuition back or be late with her rent. What would you do?
Life happens, and that means that things break down and emergencies happen. If you're not prepared, you could find yourself not having enough money in your checking account to pay your regular bills. Being financially prepared can also break the habit of living from paycheck to paycheck.

While no one is ever ready for a high dollar repair bill or losing a job, having an emergency fund in place can help with managing the unexpected. Experts recommend that an emergency fund contain at least three months of living expenses. An emergency fund needs to be highly liquid, that is, easily accessible in a savings account.

Emergencies happen, whether or not you're ready for them. Plan for the unexpected with an emergency fund that contributes to financial stability and peace of mind.

**Knowledge Check**

1. Why is having an emergency fund important?
2. What amount is recommended for an emergency fund?

**Pay Yourself First**

Few people would argue against the goal of saving money, and many people intend to save. But what usually happens is that the money runs out before a person has time to deposit it into a savings account or perhaps a person intends to start saving, but never gets around to it. That’s why you need to pay yourself first. As soon as you get paid and before you pay bills or buy groceries, deposit a pre-set amount into some type of savings that will grow. If your earnings vary from paycheck to paycheck, you might decide that saving a percentage of your earnings makes more sense than a specific amount.

Even if it’s only $5 or $10, it’s a start that adds up. Soon, saving becomes a habit, and with a little work, you can find more money to contribute to savings.

**If Cade decides to stop buying a cola for a dollar each weekday, he can use that money instead for savings. He would save $5 a week, which comes to $260 a year, and possibly more with interest.**

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<th>2 years</th>
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<th>10 years</th>
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<td>$547</td>
<td>$1,478</td>
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<tr>
<td>$10</td>
<td>$1,094</td>
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Saving must be a priority for a successful financial plan. Some ways to make it easier include:

- **Automatic transfers**: Set it up with your bank to transfer a specific amount each month from your checking account to your savings account.
- **Direct deposit**: See if your employer will set up a direct deposit to your savings account, and then transfer only what you’ll need for a month’s worth of expenses.
Unit 5 — Saving and Investing

- **Payroll deduction**: Perhaps your employer already has a savings or investment opportunity in place. All you need to do is sign up to have an amount deducted from your earnings each pay period.

Even if you don’t think you can spare any money from your paycheck, you can still find ways to save money. Can you—

- Put a dollar plus leftover change in a jar each night before bed?*
- Bring your lunch to school or work instead of buying it?
- Deposit gift money received for birthdays and Christmas?
- Operate on a cash-only basis and carry only what you need each day?
- Borrow movies and books from the library instead of going to the theater, renting videos, or buying books?

**Knowledge Check**

1. What does “pay yourself first” mean?
2. Name some ways to make saving money easier.

### Savings Accounts

There are many considerations in selecting a type of savings account. Many accounts require a minimum amount to open an account. Others require a minimum balance. Some accounts have high liquidity, which means they can be quickly converted to cash. Other savings vehicles require that money stay put for a set period of time.

**Regular Savings Account or Passbook Account** — Regular savings accounts are a good choice when you don’t have a lot of money to save. A financial institution may require a minimum amount to open an account, but it can be as little as $100. The institution may limit savings accounts to those with other accounts at the institution. The money in a regular account is easily accessible; therefore it has high liquidity. It also has the lowest interest rate of any type of savings account.

**Money Market Account** — A money market account is a combination of savings and investment plan.Deposits are used to buy safe, liquid securities. Account holders earn an interest rate based on U.S. Treasury bill rates, which is typically higher than a regular savings account. A money market account requires a much higher deposit amount to open an account—$500 or more—and a minimum balance of $500 to $2500.

**Certificates of Deposit (CD)** — CDs are also called savings certificates, time deposits, or time accounts. Money remains in a CD for a specific period of time (at least six months) and earns a fixed rate of interest. This is an example of a less liquid savings account. Money can be withdrawn early, but there will be a penalty. At the end of the specified time, the owner of a CD can cash it in or purchase it.

#### SAVING $1 A DAY*

<table>
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<td>$365</td>
<td>$374</td>
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<tr>
<td>YEAR 5</td>
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<tr>
<td>YEAR 10</td>
<td>$3,650</td>
<td>$4,735</td>
</tr>
<tr>
<td>YEAR 30</td>
<td>$10,950</td>
<td>$25,415</td>
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</table>

*SAVING $1 A DAY*

What ways can you think of to save money?
Costs and Benefits of Investing in Stocks, Bonds, and Mutual Funds

Saving money is an important part of any financial plan because it helps you reach financial goals and be better prepared for financial emergencies. Earning money through compound interest is another benefit. Another way you can earn even more money for financial goals is by investing money in securities and ventures, such as real estate. Investments such as stocks, bonds, and mutual funds are known as securities.

**Stocks**

When companies expand or pursue product development, they need funding or capital to do this. Business loans are a way to borrow the funding, but companies must pay back the money with payments and interest. Another way to raise funds for a business is by selling shares or stock in a company. Shareholders or stockholders own part of the company. If the company does well, stockholders make money. If the company doesn’t do well, the value of the stock may go down, leaving the stockholder losing money.

The Securities Exchange Commission (SEC) protects investors by regulating companies that sell stock. One way is by requiring companies to disclose financial information to the public.

**Dividends vs. Capital Gains**

Investors make money on stocks in two different ways. One way is through payments from company earnings. These payments are known as dividends. Dividends are usually paid quarterly as taxable income. The rate that stock dividends are taxed fluctuates from tax year to tax year.

However, if a company isn’t doing well, dividends may be stopped in order to reinvest the money back into the business. Most companies that aren’t experiencing high growth try not to do this because they want to encourage investors to buy shares.

Another way stockholders earn money is through appreciation or when stock increases in value. High growth companies may elect to reinvest profits into the company. Investors receive income when they sell stocks for more than they paid for it. This profit is known as capital gain. Obviously, there is no guarantee that a stock will be worth more at a time of sale. If an investor decides to sell a stock for less than the original price, this is a capital loss.

**Purchase of Stocks**

Stocks are purchased in different ways. The first time that a company sells shares in a company, it is an initial public offering (IPO) through the company. Afterward, people buy, sell, and trade stocks on the stock market. The stock market works like an auction with people bidding on stocks. The place where stocks are traded is called a stock exchange.

The oldest stock exchange is the New York Stock Exchange (NYSE), located on Wall Street in New York City. It lists stocks for large,
established companies. The American Stock Exchange (AMEX) lists stocks for medium and small companies.

Stocks not listed on a stock exchange are over-the-counter stocks that are traded over the telephone and increasingly, the computer. The best known listing group for these stocks is the National Association of Securities Dealers Automated Quotations (NASDAQ), the first electronic stock exchange.

The two main types of stock are common stock and preferred stock. As the most common type of stock issued, common stock allows investors a vote in company decisions. The number of votes is determined by the number of shares owned. The primary way to earn money through common stock is capital gains. Owners of common stock have the right to be allowed to purchase more stock as it becomes available in order to maintain the same proportion of ownership of a company.

Investors with preferred stock usually don’t vote in company decisions and are more likely to receive dividend income from their shares over time. They may earn less than common stockholders. A company can purchase preferred stock back from stockholders at any time.

Other types of stocks are blue chip stocks—low risk stocks with a record of reliable earnings—and penny stocks—very high risk stocks that sell for under a dollar per share. A shareholder of a company takes on the risks and benefits of that company.

**Growth Stocks vs. Value Stocks**

Another way to look at stocks is whether they are considered growth or value stocks. Successful companies that are growing fast according to the market have a higher value, and are therefore known as growth stocks. Growth stocks are more expensive, and investors who purchase growth stocks expect to make money from capital appreciation, although some of the companies also offer dividends.

Other investors prefer to purchase the less expensive value stocks. Value stocks have decent earnings through dividends and sale, but they aren’t considered high growth. Unlike growth stocks, value stocks have a lower price-to-earnings ratio.

**Bonds**

Another type of investment security is bonds, issued by the government or corporations to raise money for operations. Generally a lower risk than stocks, bonds are similar to an IOU. The government or a corporation is selling debt with a promise to pay it back with interest to investors.

Bonds are generally sold in denominations of $1,000. An investor receives a note or certificate of debt with the amount loaned, the term of the loan, the interest rate, and how often interest will be paid. The term of the loan is the maturity date, and the date that the principal or money borrowed must be paid back to the investor. A maturity date
may be anything from 30 days to 30 years. If you sell a bond before the maturity date, you may lose some of the principal.

A zero-coupon or accrual bond doesn’t make interest payments. Instead, it’s sold at a big discount and then redeemed for its full value at the maturity date. Maturity dates tend to be long for accrual bonds.

Interest rates on bonds are usually fixed, but the value of the bond can be affected by inflation and market conditions. If interest rates rise, then the value of bonds drops. Different types of bonds may be exempt from taxation. The safety of bonds depends upon an issuer’s credit rating, with bonds issued by the federal government considered safest.

**Types of Bonds**

Three basic types of bonds are sold: federal, municipal, and corporate. The federal government sells Treasury securities known as bills, notes, and bonds through the U.S. Treasury. These securities are also referred to as Treasuries.

<table>
<thead>
<tr>
<th>Treasury Security</th>
<th>Maturity date</th>
<th>Interest</th>
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<tbody>
<tr>
<td>Treasury bills (T-bills)</td>
<td>13 wks-1 year</td>
<td>Sold at discount; full amount at maturity</td>
</tr>
<tr>
<td>Treasury bonds (T-bonds; savings bonds; I-bonds)</td>
<td>1-30 years</td>
<td>Fixed rate every 6 months</td>
</tr>
<tr>
<td>Treasury notes (T-notes)</td>
<td>1-10 years</td>
<td>Fixed rate every 6 months</td>
</tr>
<tr>
<td>Treasury Inflation-Protected Securities (TIPS)</td>
<td>5-20 years</td>
<td>Adjustable by Consumer Price Index (CPI)</td>
</tr>
</tbody>
</table>

Other federal agencies that also issue bonds to fund home purchases, include:

- Federal Home Loan Mortgage Corporation (Freddie Mac)
- Federal National Mortgage Association (Fannie Mae)
- Government National Mortgage Association (Ginnie Mae)

Municipal bonds, also known as munis, are bonds issued by local and state governments. Municipal bonds are used to pay for the building of public works, such as schools and highways. General obligation bonds are secured, but revenue bonds are repaid from the revenue from a project that was funded.

Corporations also issue bonds to expand or fund big projects. These types of bonds are usually sold through brokers or banks. Companies can issue convertible bonds that can be converted to stock. If a corporation doesn’t have a very good credit rating, its bonds are known as high-yield or junk bonds.
Unit 5 — Saving and Investing

Mutual Funds

Katy’s parents invested all their money into AAA Corporation, thinking that the long-time car company was a stable investment. With severe market fluctuations from an economic downturn and difficult competition from other automobile manufacturers, AAA corporation went bankrupt. The stock that Katy’s parents owned is worth nothing now. Katy’s parents might have fared better if they had done what Katy is doing. Instead of investing her money in a single stock, Katy has an investment portfolio or a collection of investments.

A mutual fund is an investment portfolio of stocks, bonds, and other securities that is managed by a professional fund manager. A group of people pool their money together and buy shares of the fund. Different mutual funds share similar objectives. A money market fund is composed of short-term investments and is lowest in risk and returns. It is most likely to be an income fund that pays regular dividends. Growth funds are often composed of stocks with anticipated aggressive growth. A balanced fund may provide both income and growth.

Mutual funds have been growing since they first began in 1924. Today, there are approximately 8000 mutual funds available to investors. Generally, it costs less to invest in a mutual fund than in other securities, making it a good investment choice for beginning investors. The initial deposit varies, but is usually a minimum of $1000. Many investors like the idea of a day-to-day knowledgeable person taking care of their investment(s). A professional fund manager handles the buying, selling and trading of securities. He or she sends regular statements to fund investors that show how the fund is doing. The successful fund manager generates interest, dividends, or capital gains for the pool of investors. Like any other security, a mutual fund can also be worth less than its original price.

Mutual funds are sold by a prospectus. This document contains information about a mutual fund’s objectives, charges, risks, and the investment company. A prospectus should also address fees. The load is the sales fee that is based on a percentage of the transaction. No-load funds don’t have sales fees, but may have higher management fees. Investors should carefully read a prospectus before investing in a mutual fund.

1. Explain the function of the Securities and Exchange Commission.
2. What is a stock?
3. Describe the difference between the stock market and a stock exchange.
4. What is a bond?
5. What is a portfolio?
Balancing Risk and Return

Making smart investment decisions involves balancing the risk and the returns. Generally in investments, the higher the risk, the higher the return.

For example, Emily has $1000 to invest, and she is looking at two different investments: a Series I U.S. savings bond versus blue chip common stock. The stock has the potential for a greater return, but that is only if it’s worth more than the original price when she decides to sell it. The stock can also be worth less, which is why it has the higher risk.

The best way to approach investing is by looking at the risk and returns. An investor with limited funds or nearing retirement may not be comfortable taking much risk, and therefore be satisfied with less of a return. On the other hand, a single investor in his late 20s may be able to take a bigger risk. And finally, some people are predisposed to enjoying risks or playing it safe.

One consideration for investors is the liquidity of investments or how quickly they can be converted to cash. Unlike savings accounts that are highly liquid, many investments are not. When describing assets, liquidity can also show how easily assets can be traded. Highly liquid investments are easily traded by many investors. Because of the high turnover, it costs less to do business. Often, the return is also lower.

Stock in small companies is limited. The volume that is traded each day is lower, making this type of stock lower in liquidity. The smaller market results in a higher cost to investors. The number of investors plays a part in the price of the stock. Real estate is rarely a liquid market because the number of properties changing hands is usually lower and it takes time to see a return for your investment.

Investment Fraud

Lying or misrepresentation regarding investments is against the law, yet it happens often. Watch for regular or electronic mail that promises big rewards or no risk. If you are getting pressure to invest, that may be a warning sign. Also be wary of calling “900” area codes or dealing with penny stocks.
A stock tends to be more liquid than real estate, but not as much as a savings account or even a mutual fund. When an investor sells a stock, he or she must wait three business days for the money to be released.

Investments are affected by many things—the economy, industry trends, even world events. When interest rates are low, investors buy stock. However, during a recession, interest is high and stocks fall. National and world events like an unstable government in a foreign country can cause prices of stocks to change rapidly. If the price of a security changes dramatically in a short period of time, it is considered to be volatile. The volatility or degree that an investment’s value changes is another consideration for investors.

Diversification

Have you ever heard the phrase, “don’t put all your eggs in one basket”? That’s what diversification is—spreading around those eggs, which represent your investments. If you diversify your investments in a variety of stocks, bonds, and other securities and in a variety of industries, you spread the risk. With a diversified portfolio, one stock may lose value while another may increase in value. Diversification helps investors weather market fluctuations.

Mutual funds have built-in diversification, which is part of their appeal. A good fund manager has anticipated this and balanced the securities so that if the value of one drops, the other securities in the fund will offset that drop. A mutual fund isn’t the only way to have a diversified portfolio, however. The serious investor can also create a diversified portfolio through research and comparison shopping.

Knowledge Check

1. Why is it important to balance risk and returns?
2. What is the main benefit to diversifying investments?
Comparison Shop for Investments

When you buy a car or a computer, you might comparison shop by looking at different models and weighing the advantages and disadvantages. You might even check consumer reports on features, reliability, and safety.

Where do you get information about investments? The same places where you get your information now—newspapers, magazines, television, and the Internet. Make certain that your sources of information are reliable.

Larger newspapers have business sections, which may feature articles about publicly traded companies, market fluctuations, and the economy in general. More specifically, business pages list information about how various securities are performing. National newspapers like The Wall Street Journal and Barron’s are read by many interested investors.

Several magazines concentrate on financial news, including Kiplinger's Personal Finance, Money Magazine, Business Week, and the Economist.

Television cable news stations such as CNBC provide more in-depth investment news than your local news station. Additionally, stations like CNBC run feeds along the bottom of the screen that show how particular securities are performing.

Everything you can find in your newspaper, magazine, or television, you can most likely find on the Internet. Many media outlets have Internet versions, such as The Wall Street Journal (www.wsj.com), Kiplinger's Personal Finance (www.kiplinger.com), and CNBC (www.cnbc.com). Some are easily accessible; others require a subscription. There are also financial advisors and investor services that provide information on websites like www.moodys.com and www.standardandpoors.com to help investors comparison shop for investments.

Investors also have access to brokers and certified financial planners (CFP) locally, by telephone, and online. Some financial services offer weekly or monthly investment newsletters that investors can subscribe to.

Ratings Systems

Securities also have ratings, although with stocks, they’re called stock indexes. These ratings allow investors to see how stocks perform over time, in addition to the stability of a company.
Stock Index

In 1884, a man named Charles Henry Dow averaged the closing prices of almost a dozen stocks to present a glimpse of the economy. Today, investors and non-investors alike have heard of the Dow Jones Industrial Average. It is the oldest and most well-known of stocks indexes, showing the performance of 30 blue-chip stocks, such as Coca-Cola, Microsoft, and Walmart.

A stock index can track individual stocks and also provide a glimpse of the market as a whole. Changes in the value of stocks are reflected by percentage or net changes. Investors can measure their own investment portfolios against similar stocks. The stocks in an index share something in common. They may trade on the same stock exchange or share similar market capitalizations. Market capitalization is when a stock that influences the market more is given more weight.

Besides the Dow Jones, some of the best known stock indexes are the Standard & Poor 500 (S & P 500) and the NASDAQ. The S & P 500 tracks 500 of the most widely owned stocks, while the NASDAQ Composite Index tracks the more than 3000 stocks that it lists. Starbucks and many technology companies are found on the NASDAQ.

Columns 1 & 2: 52-Week High and Low — These are the highest and lowest prices at which a stock has traded over the previous 52 weeks (one year). This typically does not include the previous day’s trading.

Column 3: Company Name & Type of Stock — This column lists the name of the company. If there are no special symbols or letters following the name, it is common stock. Different symbols imply different classes of shares. For example, “pf” means the shares are preferred stock.

Column 4: Ticker Symbol — This is the unique alphabetic name which identifies the stock. If you watch financial TV, you have seen the ticker tape move across the screen, quoting the latest prices alongside this symbol. If you are looking for stock quotes online, you always search for a company by the ticker symbol. If you don’t know what a particular company’s ticker is you can search for it at: http://finance.yahoo.com/.

Column 5: Dividend Per Share — This indicates the annual dividend payment per share. If this space is blank, the company does not currently pay out dividends.

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<tr>
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</tbody>
</table>

56
Column 6: Dividend Yield — The percentage return on the dividend. Calculated as annual dividends per share divided by price per share.

Column 7: Price/Earnings Ratio — This is calculated by dividing the current stock price by earnings per share from the last four quarters.

Column 8: Trading Volume — This figure shows the total number of shares traded for the day, listed in hundreds. To get the actual number traded, add “00" to the end of the number listed.

Columns 9 & 10: Day High and Low — This indicates the price range at which the stock has traded throughout the day. In other words, these are the maximum and the minimum prices people have paid for the stock.

Column 11: Close — The close is the last trading price recorded when the market closed on the day. If the closing price is up or down more than 5 percent from the previous day’s close, the entire listing for that stock is bold-faced. Keep in mind, you are not guaranteed to get this price if you buy the stock the next day, because the price is constantly changing (even after the exchange is closed for the day). The close is merely an indicator of past performance, and except in extreme circumstances serves as a ballpark of what you should expect to pay.

Column 12: Net Change — This is the dollar value change in the stock price from the previous day’s closing price. When you hear about a stock being “up for the day,” it means the net change was positive.

Bond Ratings

Bond ratings are a measurement that tells investors the financial condition of a company that issues bonds. Bond ratings predict the likelihood that investors will receive their investment at the time of maturity.

There are several bond rating services, including Standard and Poor and Moody’s. The ratings tend to go from A through C or D. Standard and Poor uses AAA while Moody’s uses Aaa.

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<th>BOND RATINGS</th>
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While an AAA rating assures an investor that the risk is low, it also means that the returns are lower than a lower-rate bond would be.

Knowledge Check

1. What is Barron’s?
2. Which stock index can tell an investor something about Microsoft?
3. What information is provided by a bond rating?
Opportunity Costs in Savings and Investments

When you put $100 in a savings account each month, that is $100 that you can’t spend on eating out, going to the movies, or buying shoes. But the payoff is that some day, you will have saved up money that you will use to buy a house, travel, pursue higher education, or retire. Giving up something now (money to spend on entertainment or other items) for the benefit of having something later (home, vacations, college degree, early retirement) is the opportunity cost. Opportunity costs may sound similar to delayed gratification. You may not be happy about what you’re giving up now, but think about how happy you will be later that you did.

When making savings and investment decisions, investors must consider the opportunity cost, not only of using money for saving and investing, but also between investments.

Taylor can put $10,000 that she inherited from her grandfather in a money market savings account that earns her a guaranteed fixed rate of 0.5%. She can also invest it in a seven-year CD that will pay 3%. The difference or opportunity cost is 2.5%. Taylor can obviously increase her earnings more with the CD, but that will mean not touching that money for seven years. What would you do?

Savings Accounts

There are many considerations in selecting a type of savings account. Many accounts require a minimum amount to open an account. Others require a minimum balance. Some accounts have high liquidity, which means they can be quickly converted to cash. Other savings vehicles require that money stay put for a set period of time.

Regular Savings Account or Passbook Account — Regular savings accounts are a good choice when you don’t have a lot of money to save. A financial institution may require a minimum amount to open an account, but it can be as little as $100. The institution may limit savings accounts to those with other accounts at the institution. The money in a regular account is easily accessible; therefore it has high liquidity. It also has the lowest interest rate of any type of savings account.

Money Market Account — A money market account is a combination of savings and investment plan. Deposits are used to buy safe, liquid securities. Account holders earn an interest rate based on U.S. Treasury bill rates, which is typically higher than a regular savings account. A money market account requires a much higher deposit amount to open an account—$500 or more—and a minimum balance of $500 to $2500.

Certificates of Deposit (CD) — CDs are also called savings certificates, time deposits, or time accounts. Money remains in a CD for a specific period of time (at least six months) and earns a fixed rate of interest. This is an example of a less liquid savings account. Money can be withdrawn early, but there will be a penalty. At the end of the specified time, the owner of a CD can cash it in or purchase...
a new CD. Certificates of Deposit usually require at least $100 to purchase. The interest rate grows with larger deposits and longer time frames.

**Savings bond** — Savings bonds are non-transferrable debt certificates issued by the U.S. Treasury. Savings bonds are held until maturity, typically 30 years, with a fixed interest rate that is paid every six months. The minimum amount to buy a savings bond is $100. They are exempt from state and local tax, but are taxed by the federal government.

Angela receives $1000 from her grandparents. She won’t need the money for two years, when she wants to transfer from community college to a university. How can she best maximize her savings?

**Unit Summary**

Saving and investing are important parts of a financial plan. Both can earn you financial rewards for both your short-range and long-range goals. Saving can not only help you attain financial goals, it can also help you better withstand emergencies as they arise. Investing is a way to build wealth because it often focuses on long range growth, making it perfect for long-range goals such as retirement planning. But investments have advantages even in the short-range. They can help an investor beat inflation while providing some tax advantages. An investment that provides three to four percent over the inflation rate is a promising investment.

Investments like stocks, bonds, and mutual funds are known as securities. Other investments include real estate and businesses. Each investment has advantages and disadvantages, and it’s to an investor’s benefit to do the homework before investing.

Starting young with saving and investing is a major factor in building wealth. So is making saving a habit. Start small with conservative investments. As you’re able to invest more, aim at diversification and as much risk as you can handle. Well-thought out higher risk equals higher returns. However, with any investment, an investor must take it one day at a time and remember to evaluate the financial plan at regular intervals.
REVIEW

1. Describe why having an emergency fund is important.
2. How much should an emergency fund contain?
3. Explain what “pay yourself first” means and why it’s important.
4. Discuss ways to make saving a habit.
5. Describe the difference between “saving” and “investing.”
6. Name advantages of saving and investing early.
7. Distinguish stocks from bonds.
8. Compare and contrast the different types of savings accounts.
9. What is the difference between an income investment and a growth investment?
10. What is price-to-earnings ratio?
11. Name examples of government securities.
12. Explain the difference between municipal and corporate bonds.
13. Discuss the advantages of mutual funds as an investment.
14. Explain the purpose of a prospectus and why it is important to read it.
15. Discuss the advantages and disadvantages of highly liquid investments.
16. Describe important factors in considering investments.
17. Sum up the relationship between risk and returns.
18. Give examples of low risk, low return investments. Moderate risk and return investments? High risk and high return investments?
19. Discuss why diversification is important in investing.
20. Describe what causes market fluctuations.
21. What are some of the sources of investment information that can be helpful when comparison shopping?
22. Distinguish between the various stock indexes.
23. What does a bond rating tell an investor?
24. Describe opportunity cost.