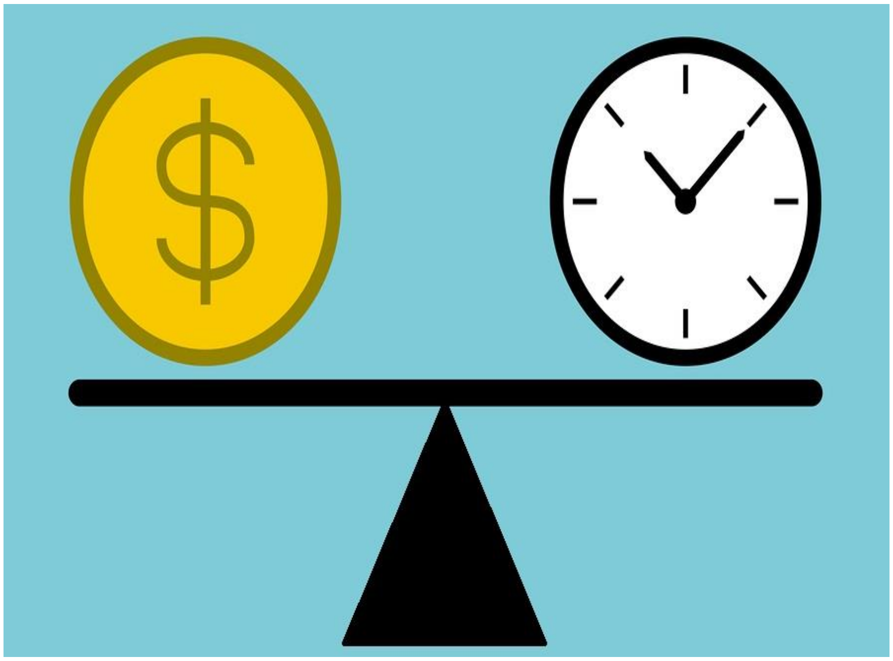

LESSON 5.4: SAVING AND INVESTING

# Time is Money

## *Standard 5*

*The student will analyze the costs and benefits of saving and investing.*

## Lesson Objectives

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

## Personal Financial Literacy Vocabulary

Asset class:  A group of investments with similar characteristics.

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

Equities:  A group of investments involving ownership of assets.

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

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

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

# Introduction

***Izzy's grandparents are having dinner with her family, and they discussing their retirement plans. Her grandpa says he is concerned about the economy and wants to move his money into something "safe" because he's getting close to retirement.  Her mom says she has 15 years until retirement, so she is waiting to see what happens with the economy before making changes in his retirement account at work.  Because Izzy is taking an investment course this semester, they ask her what she thinks – and she says they are both right.***

***What do you think about Izzy's answer?***

# Lesson

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

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

Saving and investing is much the same. Even though some basic principles of saving and investing apply to everyone, you still have numerous choices when deciding how to manage your money.  These choices are based on many factors, but four of the most important ones are time horizon, risk tolerance, and shortfalls in funding future needs.

### *Time Factors*

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

An asset class is defined as a specific kind of investment. Different asset classes have different risk levels, and it is important to match your time horizon to the asset classes. Following is a list of asset classes, from least risky to more risky:

### *Fixed Income Items*

| | |
|---|---|
| Bank Accounts | Immediate access to cash; insured by the FDIC |
| Certificates of Deposit | Time varies based on contract; insured by FDIC |
| Government Bonds | Money loaned to the U.S. government |
| Municipal Bonds | Money loaned to a municipality (often a city) |
| Corporate Bonds | Money loaned to a business corporation |
| Equity Items | |
| Large Cap Stocks | Ownership in large companies |
| Small Cap Stocks | Ownership in small companies |
| International Stocks | Ownership in foreign companies |
| Commodities | Ownership of hard assets such as gold or oil (usually in a mutual fund) |
| Microcap Stocks | Ownership in very small companies with a high rate of failure |

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

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

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

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

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

## *Risk Factors*

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

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

REMINDER

*Fixed income items are associated with "loaning" your money to someone else. Banks use your money to make loans while it is in savings and pay you interest for using it.*

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

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

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

## *Inflation Factors*

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

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

# Conclusion

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

FINAL NOTE: If you agree with Izzy, then you are right! As a person gets closer to retirement, they generally want to be more cautious with their investment decisions because they will soon be relying on those investments for their income. So, it makes sense that her grandpa might want to consider some of the safer investment strategies. Her mom, however, can take the time to see what might happen before making changes because she is further away from retiring and needing to use her retirement funds.

This lesson was written and created by Oklahoma educators in partnership with

Oklahoma CEE Council on Economic Education

Name: ______________________________ Class Period: ____________________________

# Time is Money Review 5.4

Answer the following questions and give the completed lesson to your teacher to review.

1. List one short-term goal and explain a savings or investing strategy to help you reach that goal.

2. List one long-term goal and explain a savings or investing strategy to help you reach that goal.

3. Explain the difference in risk to saving versus investing. Does savings or investing have the higher rate of return?

4. Discuss your reaction to this statement: Even though you have long-term goals, it is still important to have short-term savings.

Name: ___________________________ Class Period: __________________________

# Financial Planning: You Decide Activity 5.4

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

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

___________________________________________________________________________

___________________________________________________________________________

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

___________________________________________________________________________

___________________________________________________________________________

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

___________________________________________________________________________

___________________________________________________________________________

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

___________________________________________________________________________

___________________________________________________________________________