Chapter 2: Investment Options

Learning Outcomes:

Explain the KISS rule of investing

Examine the relationship between diversification and risk.

Compare and contrast different types of investments: money markets, bonds, single stocks, mutual funds, rental real estate, and annuities.

Key Terms: Diversification, Liquidity, Mutual Fund, Risk, Risk Return Ratio, Share

**KISS Rule of Investing:**

Keep it Simple, Silly

Never invest purely for Tax Savings

Never invest using Borrowed money.

**Diversification:**

Diversification means to spread around.

Diversification Lowers risk.

End of Video Part 1

![The Power of Diversification](image)

**Risk Return Ratio Liquidity**

With virtually all investments, as the Risk goes up, so does the potential return.
When discussing investments, **liquidity** is availability.

As there is more liquidity, there is typically **low** return.

*End of Video Part 2*

The SEC – The securities exchange commission – is the government agency responsible for regulating the stock market. It was created in 1934 to increase public trust after the 1929 stock market crash and the years of the Great Depression.

Through stock market’s history:

- 97% of five-year periods made money
- 100% of 10-year periods made money

**Types of Investments**

1. **Money Markets**
   - A C.D is a **Certificate of Deposit** typically at a bank.
   - Money market mutual funds are **low** risk money market accounts with check writing privileges. These are great for **emergency funds**.

2. **Single Stocks**
   - Single stock investing carries an extremely **High** degree of risk.
   - When you buy stock, you are buying a small piece of **ownership** in the company.
   - Your return comes as the company increases in or pays you, its owner, some of the profits (**dividends**).

3. **Bonds**
   - A bond is a **debt** instrument by which the company owes **you** money.
   - Your return is the fluctuation in price and the **interest** rate paid. Few individuals do well with **single bond** purchases.

*End of Video Part 3*

4. **Mutual Funds**
   - Investors pool their **money** to invest.
   - Portfolio managers manage the pool or **fund**.
   - Your **return** comes as the **Value** of the fund is increased.
d. Mutual funds are good long term investments.
   • Mutual funds that are properly diversified will have investment dollars spread equally among four different classes of financial assets.
     a.  25% international
     b.  25% Aggressive Growth – Small Cap
     c.  25% Growth – Mid Cap
     d.  25% Growth and Income – Large Cap

End of Video Part 5

5. Real Estate
   a. Least liquid consumer investment
   b. You should have lots of cash before using real estate as an investment.

6. Annuities
   a. Annuities are savings accounts with an insurance company.

Fixed Annuities are at a low interest rate of around 5% aren’t really fixed, and are a bad investment.

Horrible Investments

Gold

Commodities & Futures

Day trading

Viaticals - pertaining to a financial transaction in which a company buys life insurance policies from the terminally ill at less than their face value and may sell the policies to investors:

End of Video Part 6

“October. This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, November, May, March, June, December, August, and February.” Mark Twain

Real Life:

Harry is a bright you man, was fresh out of college when Bob approached him with an investment opportunity that sounded too good to pass up. “I’ve got some property on a potential oil field,” Bob said. “for only $750 you can buy a share of the land. You’d be crazy not to get in on this investment.” Bob, an expert salesman, promised Harry would become rich, and sealed the deal with a simple appeal: “Harry, this is a great way to diversify your portfolio.”
Thirty years later, after all the oil was pumped out, Harry still hadn’t seen any money from his “investment.” It turns out that Bob was offering rights to land that he didn’t have the right to sell, scamming people by selling “phantom shares.” Harry’s risky attempt to diversify cost him $750.

What would have happened if he put that money in a mutual fund at 12% interest instead?

Recap and Review:

Start investing now.

Diversify. Don’t put your money in only one place. Spreading out your money lowers your risk.

NEVER put money into something that you don’t understand. If you do not understand an investment well enough to each some else how it works, don’t buy it.

Building wealth takes time. It is not like a microwave; it’s like a crockpot!

Growth and income funds are very stable and known as large-cap funds.

Growth funds are sometimes known as mid-cap funds and are still growing.

Aggressive growth funds are wilder and known as small-cap funds.

Key Terms:

Diversification: to spread around one’s investment dollars among several different classes of financial assets and among the securities of many issuers; results in lowered risk.

Liquidity: quality of an asset that permits it to be converted quickly into cash without loss of value; availability of money; when there is more liquidity, there is typically less return.

Mutual Fund: pool of money managed by an investment company and invested in multiple companies bonds, etc; offers investors a variety of foals depending on the fund and its investment charter; ofttern used to generate income on a regular basis or to preserve an investor’s money; sometimes used to invest in companies that are growing at a rapid pace.

Risk: Degree of uncertainty of return on an asset; in business, the likelihood or loss or reduced profit.
Risk Return Ratio: relationship of substantial reward in comparison to the amount of risk taken.
Share: piece of ownership in a company or mutual fund.