

# INVESTMENT OPTIONS

CH

2

## What do other high school students know about investing?

We asked high school students to describe the weirdest get rich quick scheme they've ever heard of.

“Someone told me that I could **get rich selling food** door to door. After three days of **embarrassment**, I ended up **only \$5 richer**.”

Junior, Michigan

“I know about a chain letter where you put \$1 in an envelope, include six addresses and send it out to the top address. Eventually people are supposed to send you \$1 each.”

Junior, Alabama

“I've heard people say you can go to Alaska and work in a canning plant to get rich.”

Senior, Wyoming

“People think you can go to Hollywood and become a street performer until a big-time producer discovers you and you become a rich actor.”

Junior, Missouri

“Someone told me to hide my money where I would forget about it and wouldn't spend it.”

Senior, Tennessee

## 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



# BEFORE YOU BEGIN

## What do you know about investing?

Before watching the lesson, read each statement below and mark whether you agree or disagree in the “before” column. Then, after watching the lesson, do it again using the “after” column to see if you changed your mind on any question.

Before			After	
Agree	Disagree		Agree	Disagree
<input type="checkbox"/>	<input type="checkbox"/>	1. A mutual fund is a collection of money from different investors used to purchase stocks, bonds, and so on, and is managed by a fund manager.	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	2. Investing is for a minimum of three years—less than that is savings.	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	3. The more sophisticated the investment, the more money you get in return.	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	4. With virtually all investments, as the risk goes up, so does the potential return.	<input type="checkbox"/>	<input type="checkbox"/>
<input type="checkbox"/>	<input type="checkbox"/>	5. It’s hard to find an investment that will average 12% for 10 years or more.	<input type="checkbox"/>	<input type="checkbox"/>

List your initial thoughts about investing.

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What do you want to learn about investing?

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# CH 2 INVESTMENT OPTIONS

## KISS Rule of Investing

Keep it \_\_\_\_\_, \_\_\_\_\_!

Never invest purely for \_\_\_\_\_.

Never invest using \_\_\_\_\_ money.

## Diversification

\_\_\_\_\_ means to spread around.

Diversification \_\_\_\_\_ risk.

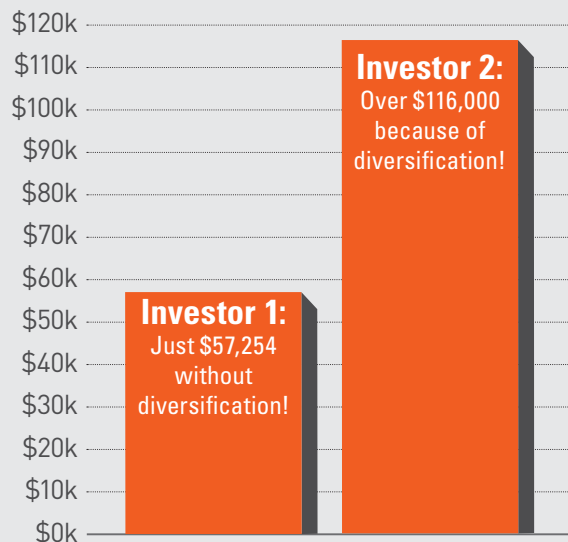
END OF VIDEO PART 1

### The Power of Diversification

What would happen if two people each invested \$10,000—one diversifies, the other does not—and left it alone for 25 years?

Investor 1 invests...  
\$10,000 for 25 years at 7%

Investor 2 invests...  
\$2,000 and loses it all  
\$2,000 under his mattress  
\$2,000 at 5% return  
\$2,000 at 10% return  
\$2,000 at 15% return



A difference of almost \$59,000!

## \$ MONEY FACTS

### \$12,356 trillion—

the combined assets of the Investment Company Institute's 8,015 mutual funds as of October 2007.

Investment Company Institute

Only **22%** of teens say they know how to invest money to make it grow.

Charles Schwab Survey

**51%** of teens report that their main reason for saving is to have enough money for long-term future plans, like college or a car.

Charles Schwab Survey

**12%** of teens have stocks and investments in an account that is held in their name.

Charles Schwab Survey

## + MORE INFO

Throughout the stock market's history:

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



## MORE INFO

The Securities Exchange Commission (SEC) 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.

## Risk Return Ratio and Liquidity

With virtually all investments, as the \_\_\_\_\_ goes up, so does the potential return.

When discussing investments, \_\_\_\_\_ is availability.

As there is more liquidity, there is typically \_\_\_\_\_ return.

END OF VIDEO PART 2

## Types of Investments

### 1. Money Markets

A C.D. is a \_\_\_\_\_, typically at a bank.

**“I am 19 years old and working in my family’s business. I live at home with my parents and my car is completely paid for. How should I start saving for a house and retirement? I want to make sure I am doing everything I can to avoid financial problems in the future. What do I need to do?”**

**DAVE’S ANSWER:** Your first goal should be to save 3-6 months of your income (since you don’t really have any expenses). This will be your full emergency fund. Then you should save for anything you plan on doing in the next few years, like getting married or buying a home.

On top of that, you should invest into a Roth IRA. The contribution limit for 2008 is \$5,000 per year, which comes out to about \$416 per month. You can do less than that, but not more. If you start that now, you will be extremely wealthy when you retire.



Money market mutual funds are \_\_\_\_\_ risk money market accounts with check writing privileges. These are great for \_\_\_\_\_.

## REAL LIFE

Harry, a bright young 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? He would now have \$22,469.

## 2. Single Stocks


Single stock investing carries an extremely \_\_\_\_\_ degree of risk.

When you buy stock, you are buying a small piece of \_\_\_\_\_ in the company.

Your return comes as the company increases in \_\_\_\_\_ or pays you, its owner, some of the profits ( \_\_\_\_\_ ).

## 3. Bonds

A bond is a \_\_\_\_\_ instrument by which the company owes \_\_\_\_\_ money.

Your return is the fluctuation in price and the \_\_\_\_\_ rate paid. Few individuals do well with \_\_\_\_\_ purchases. 

## 4. Mutual Funds

Investors pool their \_\_\_\_\_ to invest.

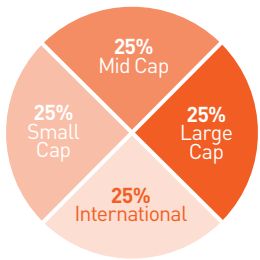
Portfolio managers manage the pool or \_\_\_\_\_.

Your \_\_\_\_\_ comes as the \_\_\_\_\_ of the fund is increased. 

## MORE INFO

Mutual funds that are properly diversified will have investment dollars spread equally among four different classes of financial assets.

- 25% International
- 25% Aggressive Growth (Small Cap)
- 25% Growth (Mid Cap)
- 25% Growth and Income (Large Cap)



## WISE GUYS

“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

Mutual funds are good \_\_\_\_\_  
term investments.

END OF VIDEO PART 5

## 5. Real Estate

Least \_\_\_\_\_ consumer investment.

You should have lots of \_\_\_\_\_ before using real estate as an \_\_\_\_\_.

## 6. Annuities

Annuities are \_\_\_\_\_ accounts with an \_\_\_\_\_ company.

\_\_\_\_\_ annuities are at a low interest rate of around 5%, aren't really fixed, and are a \_\_\_\_\_ investment.

\_\_\_\_\_ annuities are mutual funds sheltered by the annuity covering, thereby allowing the mutual fund to grow tax-deferred.

## Horrible Investments

Gold

\_\_\_\_\_ & Futures

Day \_\_\_\_\_

Viaticals

END OF VIDEO PART 6

**“I’m 21 and currently in college. Next month, I’ll be receiving an inheritance of about \$40,000. I don’t know anything about stocks, mutual funds or C.D.s, but I don’t want to lose all this money. I don’t have any debt, so what should I do?”**

**DAVE’S ANSWER:** I’m glad you’re asking questions. One of the fastest ways to lose money is to put it into an investment that you don’t understand.

You don’t need to change your major to Finance to make this happen, but you do have a \$40,000 responsibility that you didn’t have before. For now, a simple savings account is fine. I’d park \$30,000 in there and just forget about it for a while. Then use \$5,000 to set up an emergency fund and maybe blow \$5,000 on some things just for you. After all, spending and having fun with money is still important!

But here’s something to think about once you’ve educated yourself on investing. If you put that remaining \$30,000 in a good growth stock mutual fund, by the time you’re ready to retire you’ll be looking at about \$10 million. Talk about being able to retire with dignity and change your family tree!



## 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 teach someone else how it works, don’t buy it.

Building wealth takes time. It is not like a microwave; it’s like a crock pot.

## MORE INFO

**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.

# CHAPTER 2: MONEY IN REVIEW

## Vocabulary

Aggressive Growth Stock Mutual Fund  
Annuity  
Bond  
C.D.  
Commodity  
Diversification  
Dividend  
Fixed Annuity  
Futures  
Investments  
Growth Stock Mutual Fund  
Large-Cap Fund  
Liquidity  
Mid-Cap Fund  
Money Market  
Mutual Fund  
Portfolio  
Rental Real Estate  
Risk  
International Stock Mutual Fund  
Risk Return Ratio  
Savings Account  
Share  
Single Stocks  
Small-Cap Fund  
Speculative  
Track Record  
Variable Annuity

## Matching

- a. rental real estate
- b. risk return ratio
- c. 3-5 year track record
- d. 5-10 year track record
- e. annuity
- f. risk
- g. small-cap
- h. large-cap
- i. diversification
- j. share
- k. portfolio

- \_\_\_ 1. Growth and Income Funds
- \_\_\_ 2. Always check this record when investing
- \_\_\_ 3. Spread around the risk
- \_\_\_ 4. Piece of ownership in company stock
- \_\_\_ 5. List of your investments
- \_\_\_ 6. Least liquid of all investments
- \_\_\_ 7. Degree of uncertainty of the return on an investment
- \_\_\_ 8. Aggressive Growth Funds
- \_\_\_ 9. Savings account within an insurance company
- \_\_\_ 10. Risk goes up, return goes up

## Multiple Choice

- 11. Liquidity means to spread around and lower risk.
  - a. true
  - b. false



12. A single stock is the best place to keep your emergency fund.
- true
  - false
13. A certificate of deposit is the best place to keep an emergency fund.
- true
  - false
14. Diversification lowers your risk with investing.
- true
  - false
15. Commodities and futures are extremely speculative and carry a high risk.
- true
  - false
16. \_\_\_% of any 10-year period in the stock market has made money.
- 53
  - 97
  - 75
  - 100
17. Long-term investments properly diversified include the following mutual funds:
- growth, growth and income, bond, aggressive growth
  - growth, balanced, international, bond
  - international, bond, aggressive growth, growth
  - growth, growth and income, international, aggressive growth
18. What is the KISS rule of investing?
- Keep It Simple Stocks
  - Keep It Simple Stupid
  - Keep It Solo Situated
  - Keep It Somewhere Safe
19. Which of the following is not a good investment?
- gold
  - viaticals
  - futures
  - all of the above
20. Which statement is true about liquidity?
- the less liquid the investment, the less return
  - the more liquid an investment, the more return
  - the more liquid an investment, the less return
  - both a and b
21. Which one is not a type of annuity:
- variable
  - stable
  - fixed
  - none of the above
22. A savings account with a certificate is a:
- bond
  - annuity
  - C.D.
  - viatical

### Short Answer

23. Why do you look at the long-term track record with a mutual fund?
24. What are some investments that don't give you a high rate of return?
25. List four types of investments that you should always avoid.
26. How do you go about finding the right person to help you invest?
27. What was the most important fact or idea about investing that you learned in this lesson?

28. Name one thing from this lesson that you could apply to your life right now.
29. Daniel just graduated from college and wants to invest 15% of his income into mutual funds. He earns an annual salary of \$32,000 but is \$21,000 in debt with his car and student loan. He has \$500 in savings. What steps does Daniel need to take?
30. How are single stocks different from mutual funds and which is the better investment?

## Case Studies

31. John is 63 years old, owns his house and is a little bit anxious about whether he has enough money for retirement. He is considering borrowing \$20,000 against his home to invest in a series of aggressive growth stock mutual funds. The track record for these funds over the last 3 years has been an average growth rate of 21.2%. The interest rate on the loan would only be 7.5%. Should John do this to help with his retirement?
32. Candace and Mike just inherited \$25,000 from a relative and are really excited about investing it and watching it grow. However, they still have \$10,000 worth of debt to pay from credit cards. Before Dave gives them financial advice, he asks them one question. What question does he ask them? What financial advice does he then give them?
33. Brooke's friend has been bugging her to invest in gold. She says it has been trading really high and will only continue to go up in value. Brooke has \$1,000 that she is ready to invest. She knows you listen to Dave's show and wants to know what he would say. What would you tell her?