Investing — A Route to Long-Term Financial Fitness

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What is investing? How does it differ from saving?

Even though the words "saving" and "investing" are often used interchangeably, there is a difference between the two. **Investing** involves taking varying levels of risk and focuses on increasing one's net worth in order to accomplish mid-and long-term financial goals. Stocks, bonds and mutual funds are familiar investment products. In contrast, **savings** provide funds for emergencies and for specific short-term purchases. Savings dollars are usually held in safe, easy-to-access places such as savings accounts, money market accounts, or certificates of deposit (CD's) where there is little risk of losing money. Because of these characteristics, savings dollars generally yield a low rate of return.

Why is investing important?

The power of time and compound interest have the potential to help the dollars you put aside today grow to provide money to meet long-term financial needs. These might include retirement income, buying a home, or funding a child's education. Investing also makes it possible for you to counteract the loss of purchasing power due to inflation.

Savings $$$	Investment $$$
Safe	**Involve risk**
Easily accessible	**Volatile in short time periods**
Low return	**Offer potential growth and appreciation**
Used for short-term goals	**Used for mid-and long-term goals.**

Is investing for you?

"Yes" IF your financial foundation is solid. This means that you are able to pay your everyday expenses, have protection against major losses with insurance, and have savings equivalent to three to six months' income to cover unexpected expenses.

Investing lesson 1: Learn about return, risk, time, and asset allocation!

Several important concepts are involved in investing. They include return, risk, time, asset allocation, and diversification. Take time to understand their meaning and impact.

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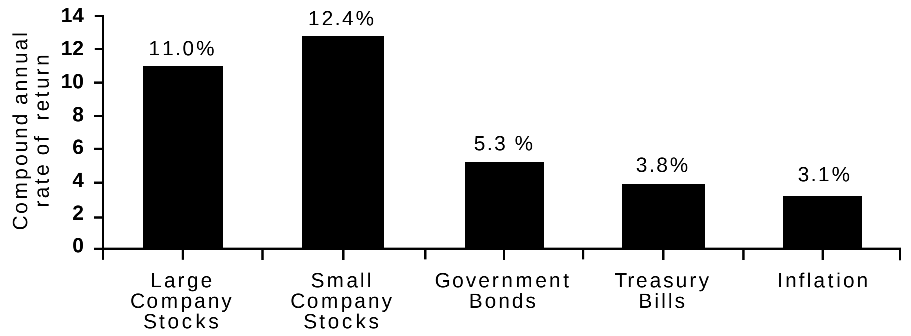
(Investing Lesson 1, continued from page 1.)

Return

Total return is the profit (or loss) on your investment. It is a combination of current income (cash received from interest, dividends, etc.) and capital gains or losses (the change in value of the investment between when it was bought and when it was sold).

Total investment return = current income + capital gain (or loss)

Compound Annual Rate of Return, 1925-2000.



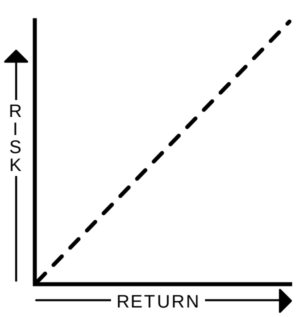
Source: Ibbotson Associates

Risk

All investments involve some risk because the future value of an investment is never certain. Risk, in simple terms, is the possibility that the ACTUAL return on an investment will vary from the EXPECTED return or that the initial principal will decline in value. Factors that affect the risk level of an investment include inflation, business failure, changes in the economy, interest rate changes, etc. It's generally necessary to take some risk to beat inflation year after year.

The relationship between risk and return

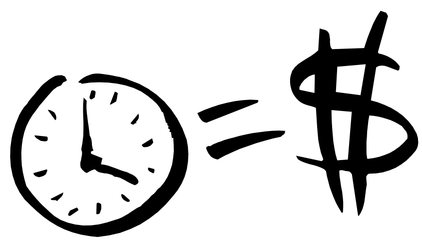
Most people would like an investment that yields a large return with very low risk of loss! However, the relationship between risk and rate-of-return is usually just the opposite. *Generally speaking*, risk and the rate of return are related. As the risk level of an investment increases, the potential rate-of-return usually increases as well.



The time-value of money

Now that you understand the concepts of risk and return, let's turn to an element that is at the heart and soul of building wealth and financial security — TIME. Time helps in two ways. First, the longer you invest, the more money you will accumulate. Second, the more money you have, the more it can grow thanks to the magic of compound interest.

In case you are wondering — compounding works like this. The interest earned on your investments is reinvested or left on deposit. At the next calculation, interest is earned on the original principal PLUS the reinvested interest. Earning interest on accumulated interest over time generates more and more money.



Diversification

This is a technique for reducing investment risk. If you invest in a single security or asset category, your return will depend solely on the performance of that choice. By acquiring assets in several asset categories, or several securities within a category, your loss will be less in general than when you've put "all of your eggs in one basket." Also, diversification can be achieved by staggering the purchase of securities over a period of time.

Growth of a $50 monthly deposit at 8% interest

Time	Principal & interest left in account	Principal only left in account	Interest distributed monthly
2 years	$1,306	$1,200	$ 96
5 years	$3,700	$3,000	$240
10 years	$9,210	$6,000	$480
20 years	$29,650	$12,000	$960
Total	**$29,650**	**$22,200**	**$1,776**

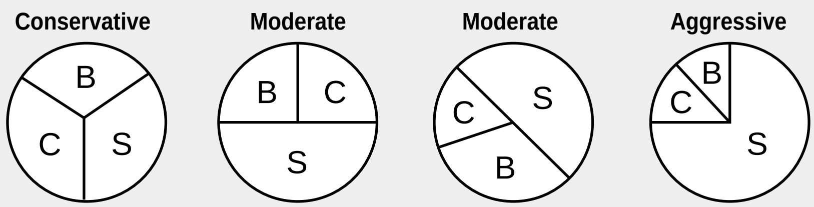
Note the difference in accumulation due to compounding — $29,650 minus $23,976 *($22,200 + $1,776)* = $5,674.

(Investing Lesson 1, continued from page 2.)

Asset allocation

An investor's accumulation of investments, referred to as an investment portfolio, is usually allocated or divided among different categories of assets; the most common are stocks, bonds, and cash. The percentage of assets from each category accounts in large part (about 90 percent) for the return that you can expect. The factors that you need to consider in determining the ideal asset allocation for you are discussed in the lessons that follows.

Asset Allocation Options



(S = Stocks B = Bonds C = Cash Management)

Investing lesson 2: Know thyself.

Before you can determine what investment — or combination of investments — is right for you, it is very important to know yourself and where you want to go financially. Take time to think about:

Factors that influence YOUR ideal asset allocation
YOUR investing goals YOUR risk tolerance YOUR time horizon YOUR tax bracket YOUR life stage

Your situation in each of these cases will help you decide on the best way to allocate your assets.

YOUR investing goals and return needs

Each goal will define the amount and liquidity (ability to turn investments into cash) of the money you need as well as the number of years available for the investment to grow. No single investment can provide high income, protect your principal, and offer high potential for growth. As you move through life stages, your needs and financial goals change.

YOUR risk tolerance

Risk tolerance is your emotional and financial capacity to ride out the ups and downs in the investment market without panicking when the value of your investments goes down. Risk tolerances vary widely and often change as you go through stages in the life cycle. For example, young adults who have potential for a growing income may be comfortable taking greater risk. If they make a financial mistake, there is time to make a correction. Those nearing retirement may feel uncomfortable with risk since time for financial recovery is short. Regardless, it's important to realize that it's necessary to take some risk just to maintain purchasing power in times of inflation or over the long term.

YOUR time horizon

The amount of time you have between when you invest money and when you need it directly affects your ability to reduce risk. Those with a long time horizon may choose investments with wider price swings, knowing that time is available for the fluctuations to average out. Those nearing retirement and those who need to depend on investment income to cover daily expenses may wish to select investments that lock in gains and provide a guaranteed income stream.

YOUR tax situation

The return on any investment is influenced by your federal, state, and local tax situation. Remember, what counts is not what you make on an investment, but what you get to keep both now and in the long run.

Time and skill to manage your portfolio

Some investments require little or no time commitment or special knowledge. Others require constant monitoring and management. How much time are you willing and able to spend?

YOUR life stage

Your investment profile will likely change over time. Risk tolerance, for example, often decreases as time horizons become shorter. Income needs often increase.

Investing lesson 3: Use a “heads-up approach” when looking for investment advice.

On your own

Learning about investments on your own reduces your dependence on others and helps your knowledge and confidence grow along with your investments. Good places to seek information include your local public library, the Internet, your local bookstore, magazines, pamphlets, workshops, seminars and local community education or community college classes.

The tough part is sorting through the amazing volume of information that is available and feeling certain that you have used reliable, unbiased sources. Several Internet resources are listed at the end of this bulletin.

Getting help

You may be among those people who are short on time to wade through stacks of information or are uncomfortable making financial decisions alone. Identifying and using a professional financial team to help you could be a positive step in defining and achieving your long-range goals.

Local professionals who can serve as team members include the human resources consultant at your workplace, bankers, accountants, insurance agents, stockbrokers, attorneys and financial planners and counselors. You’ll need to do some shopping to select a team that fits your needs.

Web Resources

www.cfp-board.org
(Certified Financial Planners Board of Standards). Look under “consumers” for help in selecting a financial planner or call 1-888-237-6275.

www.sec.gov
(Securities and Exchange Commission). Look under “investor information” for numerous educational resources regarding investing or call 1-800-SEC-0330.

www.financenter.com
Select the area where you are looking for solutions. This is a commercial site offering numerous financial calculators for your use.

www.investing.rutgers.com
(Rutgers University). *See Investing for Your Future*, a home study course developed by the Cooperative Extension system.

For further information, please contact your Michigan State University county Extension office found under local government in your telephone book, or on the Internet at: **http://www.msue.msu.edu**.

Steps in selecting your financial team members

Team members might include your banker, attorney, insurance agent, stock broker, financial planner, tax preparer, etc.

- Create a list of names. You can check the yellow pages in your phone book. However, getting referrals from friends, co-workers, or a professional organization frequently works better.
- Call and request all available information about team members. Check references.
- Meet with the person and ask questions:
  - What are your professional credentials and affiliations?
  - What is your investing philosophy?
  - How will we work together, e.g., by phone, in person?
  - What services do you offer?
  - What will it cost me and how are you paid?
  - What can I expect from you?
- Ask yourself if you feel comfortable with this person.
- Decide and proceed.

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