Planning for the future

Class 25: Investments Introduction

NITWOM

News In The World Of Money

02/01/2023: Mortgages, car loans, student loans, and other debts are affected by U.S. Federal Reserve interest rate increases. The 0.25% interest rate increase caused mortgage rates to rise by ≈0.10%, which is roughly $9,360 over a 30-year mortgage, assuming the average home loan of $401,300. Paying 6% annual interest instead of 4% costs $2,672 more in interest over the life of a $40,000, 72-month car loan. Average private student loan fixed rates range from ≈4% to ≈15%. [Source]

What is a market?

Market

A physical or virtual place where buyers and sellers engage

Investing

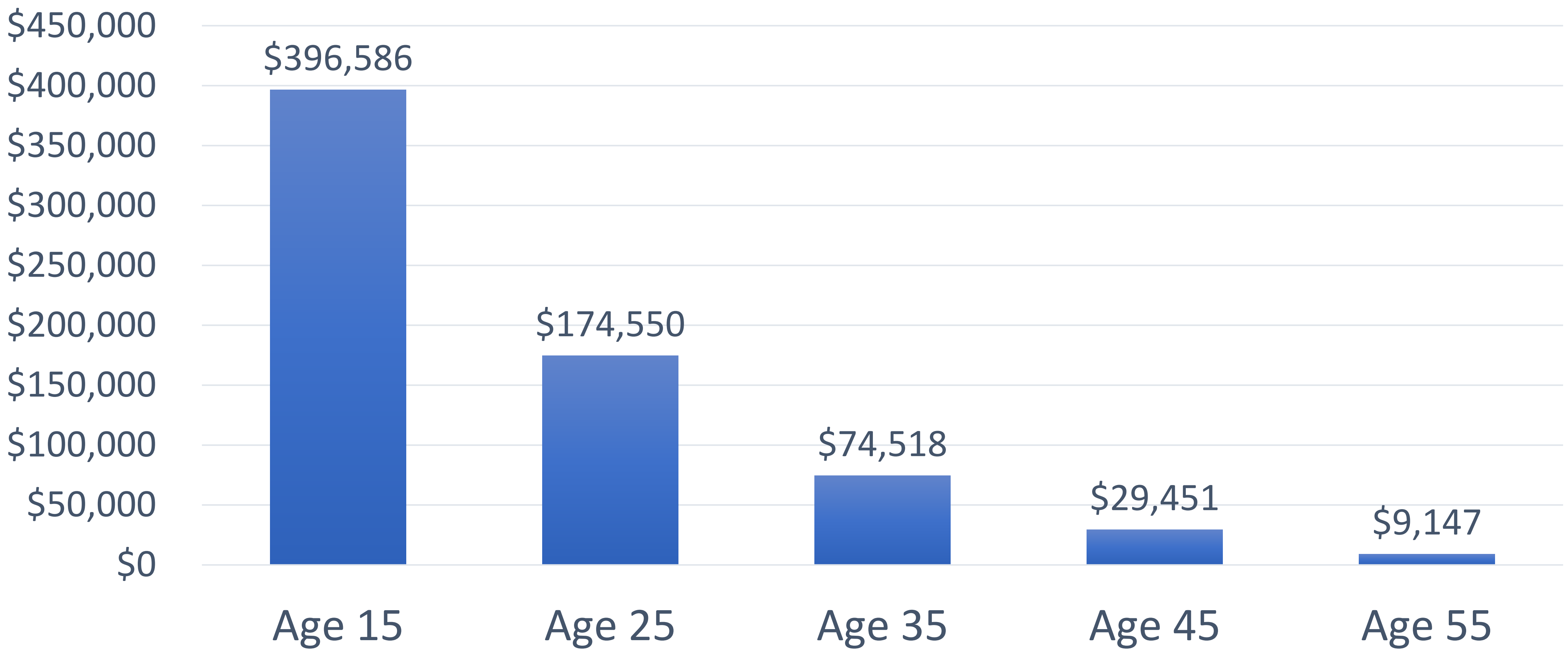
You transfer value today, in exchange for what you expect to have greater value to you in the future.

Why is investing for the future important?

The importance of investing

- Money today is worth more than the same amount of money in the future, because of inflation and interest rates. People need to grow income faster than the inflation rate to keep up. Income from investments helps.
- Investing helps prepare for important life events, such as paying for college, purchasing a home, starting a business, planning for retirement, etc.
- Investing helps build wealth over time, which creates a more secure financial future and can enable financial independence.
- Most people plan to stop working in the future (ex. retire), so investments will need to supplement their income. **Young people have a major advantage. They have a longer time horizon. This means young people have more years to allow investments to compound and grow.**

Invest **$50 per month** starting at various ages **until age 65** in a portfolio earning **8% annual returns**, compounded monthly



KISS Principle: Two <u>Basic Categories</u> of Investments

1 Fixed Income

Investing in what others owe – **<u>their</u> liabilities**

Example: **Bonds**

2 Equity

Investing in others' net worth – **<u>their</u> equity**

Example: **Stocks**

Assets = Liabilities + Equity

Primary Markets v. Secondary Markets

Primary Market

- Organizations raise capital by **issuing debt** (ex. bonds) or **selling equity** (ex. stock).
- The debt or equity issuance becomes as a **security**.
- Investors buy the security in exchange for **money**.
- The investor's money **transfers** to the organization.
- The security becomes an **asset** of investors.

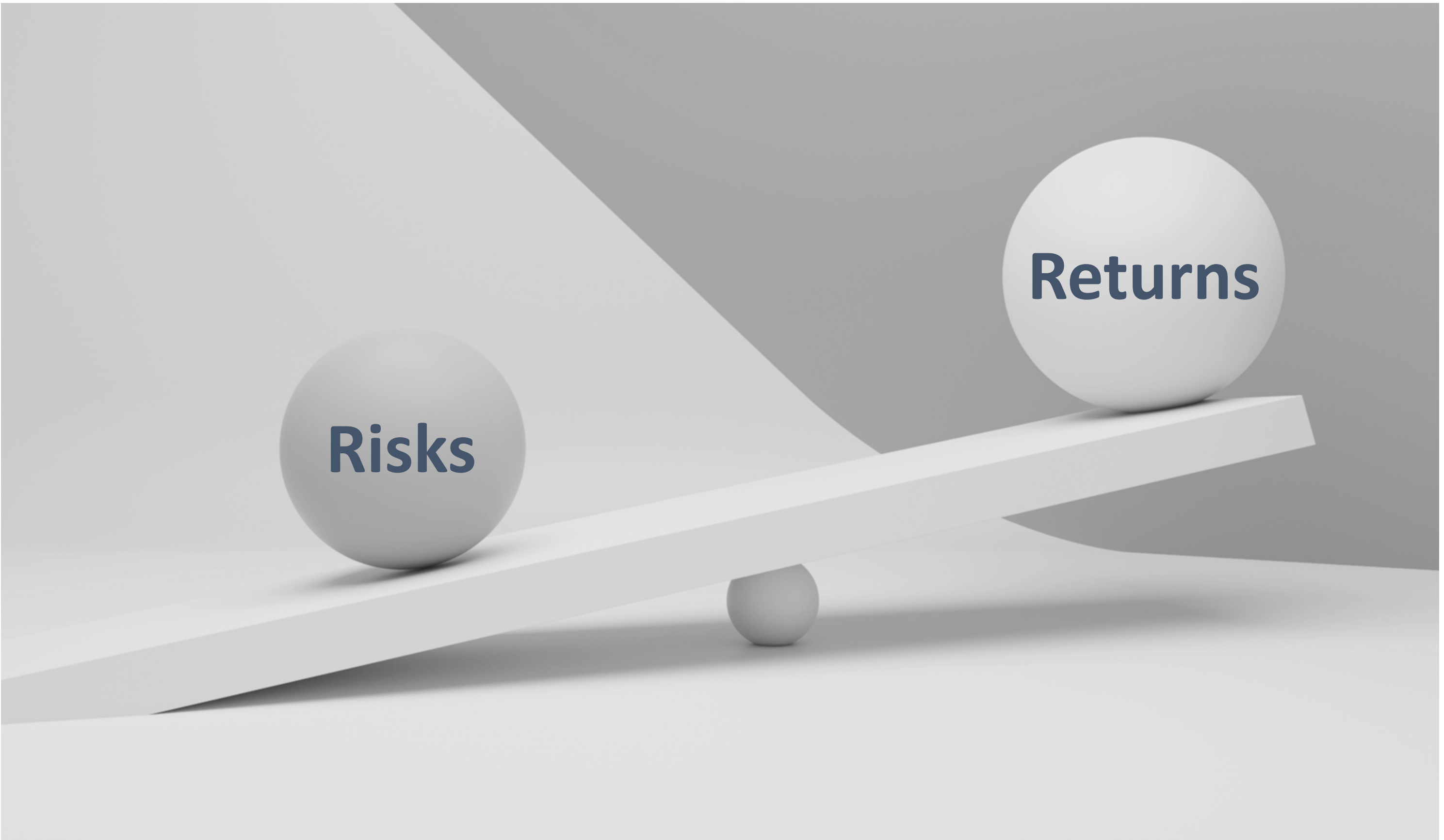
Secondary Market

- Investors buy or sell securities from other investors.
- When **buying,** investors **transfer money** to other investors **in exchange for the security**.
- When **selling,** investors **transfer securities** to other investors **in exchange for money**.
- When people think about the "stock market," they typically think about the Secondary Market.

In a Nutshell…

Primary Market is where securities are *created* and purchased by investors.

Secondary Market is where securities are *traded* by investors.



Risk and Return Tradeoffs

- **Risk** means the potential to **lose principal** on investments
- **Returns** mean the **financial gains** on investments
- Equities, such as stocks, *generally* provide opportunities for **higher returns,** but carry **heavier risks**
- Fixed income, such as bonds, *generally* carry **lighter risk**, but provide opportunities for **lower returns**

Why do you think stocks are generally riskier than bonds?

Risk Premium

Excess returns required by an investor to compensate for being subject to an increased level of risk

Mutual Funds Overview

Mutual funds are investment companies that pool money from shareholders to invest in securities such as stocks, bonds, and other assets.

Investors buy mutual fund units or shares in exchange for transferring money into the mutual fund.

The added cash gives the mutual fund’s professional asset managers money to invest, based on the mutual fund's objectives.

All mutual fund investors share in the gains (or losses) of the mutual fund based on the number of shares each investor owns.

If stocks or bonds represent groceries at a market, then think of a mutual fund as a professional shopper, who decides which groceries to buy.

The world’s largest Mutual Fund is the Vanguard Total Stock Market Index (Ticker: VTSAX) with $276 Billion in assets and operating expenses of 0.04%

Exchange Traded Fund (ETF) Overview

An ETF is a "basket" of securities (ex. stocks or bonds) that trades on an exchange, just like stocks do.

ETF share prices fluctuate during each trading day, as ETFs are bought and sold by investors. In contrast, mutual funds trade only once each trading day, after markets close.

If stocks or bonds represent groceries at a market, then think of an ETF as a basket of vegetables from the produce section -- another ETF might be a basket of breads from the bakery section.

The world's largest ETF is the SPDR S&P 500 ETF Trust (Ticker: SPY) with $379 Billion in assets and operating expenses of 0.09%.

Financial Objectives Overview

- Setting measurable goals based on time horizon should guide **<u>all</u>** investment strategies
- Examples:
  - I start my first full time job after graduating next month. I want to invest towards my retirement.
  - I want to purchase a house in 5-years and want to invest towards a down payment.
  - I just had a child and want to invest for my child’s college education in 18-years.
  - I have extra room in my budget and want to set aside money for a family vacation next summer.
  - I no longer work and need my investments to provide me with additional income.

Financial Questionnaire

Individual and Large Group Exercise

How familiar are you with investing?

a. Not familiar at all

b. Somewhat familiar

c. Very familiar

d. Prefer not to answer

Have you ever invested in stocks, bonds, or other investment products?

a. No

b. Yes

c. Prefer not to answer

What are your future financial goals? *(Select all that apply)*

a. Saving for a down payment on a home

b. Paying for college education

c. Retiring comfortably

d. Building an emergency fund

e. Other (please share)

f. Prefer not to answer

What concerns you about investing? *(Select all that apply)*

a. Lack of knowledge about investments

b. Uncertainty about market conditions

c. Fear of losing money

d. Difficulty understanding investment products and fees

e. Other (please discuss)

f. Prefer not to answer

How confident are you in making money decisions?

a. Not confident at all

b. Somewhat confident

c. Very confident

d. Prefer not to answer

Horizon class schedule on investments

1. Introduction,
2. **Financial Objectives,**
3. Managing Risk
4. Equities (Stocks),
5. Fixed Income (Bonds),
6. Mutual Funds & ETFs, &
7. Putting it All Together.

Key Takeaways

- Investing for the future can help to attain financial goals -- **young people have a major advantage**!
- Some common investments vehicles are stocks, bonds, or groups of securities through mutual funds and exchange traded funds
- Financial objectives should guide all investment strategies