PUBLIC SPEAKING EVENT

The FBLA Public Speaking I Event and BPA Prepared Speech Event focus attention on current business topics. Students must prepare a 4-minute speech for FBLA and a 5- to 7-minute speech for BPA using an effective business style. Facts and working data that are used for the speech may be secured from any source. The speech should be well organized. Sources used for facts, quotes, or other data should be provided. Students may use notes to deliver the speech; however, no visual aids may be used. Points may be deducted if the speech does not keep to the set time frame.

Evaluation

Students who take part in these events are judged on their ability to:

- Clearly state the goal of the speech.
- Develop the topic thoroughly.
- Present a logical sequence of ideas or facts.
- Present accurate information backed by current sources.
- Demonstrate effective public speaking skills.
- Present an informative speech.

Sample Scenario

You have been asked to prepare a speech on identity theft. Identity theft occurs when someone uses your personal information without your permission to commit fraud or other crimes. The number of identity theft crimes in the United States is growing. The process for a victim to clear her or his name and credit report can be time-consuming and expensive.

Think Critically

1. What are two credible resources you can use to find information on identity theft?
2. Prepare a 4- to 5-minute speech on identity theft. Include these points in the speech along with others you think are important:
   - An explanation of identity theft
   - Types of crimes related to identity theft
   - Statistics about identity theft, such as the number of crimes or people affected
   - Strategies for consumers to use to avoid identity theft

www.fbla.org www.bpa.org

PART 4

Saving and Investing

OUTCOMES

After successfully completing this part, students should be able to:

* **List** reasons for savings and investing.
* **Explain** principles of saving and investing.
* **Describe** investment strategies.
* **Describe** investment options and how they relate to risk and return.
* **List** sources of investment information.
* **Explain** how to buy and sell securities.
* **Describe** the role of regulatory agencies in the investment industry.

IN PART 4, SAVING AND INVESTING, you will consider how saving and investing can help you achieve your goals. You will learn about saving and investing options and strategies. You will explore sources of data that can be helpful to investors. You will learn how to buy and sell securities. You will also learn about several agencies that protect and assist consumers and investors.

CHAPTER 10 Understanding Saving and Investing

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Chapter 10 focuses on saving and investing. Some aspects of saving and investing overlap. However, there is a difference between saving and investing. Saving and investing can help you accomplish short-term and long-terms goals. You will want to consider the risk involved and the amount you can expect to earn when choosing investments. In this chapter, you will learn the difference between saving and investing. You will also explore some reasons for saving and investing and some strategies for getting the most from your investments.

ONLINE RESOURCES

Personal Financial Literacy Web site:

- Data File
- Vocabulary Flashcards
- Beat the Clock: Saving and Investing
- Chapter 10 Supplemental Activity

Search terms:

- liquidity
- investment risk
- diversification
- dollar averaging
- bull market
- bear market

10-1

Reasons for Saving and Investing

OUTCOMES

- Explain the difference between saving and investing.
- Describe reasons for saving and investing.
- Describe the concept of financial security.
- Explain what is meant by retirement planning.

SAVING AND INVESTING

The purpose of saving is to accumulate money for future use. Saving money is important because it means you are planning for future needs and wants. When you are saving money, the emphasis is on safety. In Chapter 5, you learned about various methods for saving money. A savings account, a certificate of deposit, and a money market account are all good, safe ways to save. Because these types of accounts are insured by the FDIC, you can be assured that money you place in such an account is safe.

Investing money is another way to plan for future needs. The purpose of investing is to make your money grow. Investing is sometimes explained as using money to make more money. For example, you may use money to buy real estate such as a house. You might also buy **stocks**, which are shares of ownership in a corporation. Your hope is that the house and stocks will be worth more several years later when you sell them than when you bought them. If so, you will have more money when you sell the investments than when you bought them.

Money in a savings account or money market account that you plan to leave there for a long time can be considered a type of investment. However, the interest rate and the money earned in such an account are typically low compared to other types of investments. As mentioned earlier, safety is the primary advantage of a savings account. Other types of investments involve risk. The amount of money that can be made and the risk involved are issues of concern with investments.

With many investments, you do not know how much the money you invest will earn. You could even lose the money you invest. For example, when you buy stocks, you are buying a share of a corporation. The company may do well, and the value of the stocks may grow. However, the company could fail. In this case, you might lose the money you invested in stocks. When investors think the chances of making money are good, they accept the risk involved with investments.

The goals you want to accomplish with money you save may be short-term or long-term goals. Investments are often long-term and may be part of a plan to accomplish long-term goals. Some short-term and long-term reasons for saving and investing are discussed in the following sections.

SHORT-TERM NEEDS

Saving is a good way to have money to handle short-term needs or wants that are not part of your regular spending. For example, you may want to save money to pay for a trip or to purchase a home theater system. Savings can also be used to handle unexpected expenses, such as repairs to a roof that is damaged by a storm. Savings accounts are considered liquid assets. **Liquidity** is a measure of the ability to turn an asset into cash quickly.

Contingency Planning

Contingencies are emergencies or other unplanned or possible events. For example, suppose you are driving home from work and a tire blows out. You need money to pay for a new tire, towing, or other related expenses. You may not have enough cash on hand to pay these expenses. You need to get to money quickly without borrowing (using credit and paying interest charges).

Having enough savings available so that you can pay for emergencies is critical. An **emergency fund** is an amount of money you set aside for unplanned expenses. A fund of $500 is enough to cover many types of emergencies. You might keep this sum as the minimum in your checking account. In other words, you typically do not allow the account balance to fall below $500. However, you can spend that $500 in case of an emergency.

Vacations

Taking vacations is a healthy thing to do. Many people want a break from time to time—to get away from the usual stresses in life. A vacation also helps refresh tired minds and bodies so that people are ready to go back to school or work.

Vacations can be simple and inexpensive, such as going camping or hiking. Vacations can be elaborate and expensive, such as flying to Europe for a 2-week stay in a resort. Setting aside money for vacations allows you to plan for the kind of vacations you would like to take. One type of plan might involve taking short and inexpensive vacations for 2 or 3 years and then taking one expensive vacation every third or fourth year. As you earn more (and save more), you can plan more expensive vacations.

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Savings can be used to help pay for emergency expenses.

Meeting Goals

You may have short-term goals that saving money can help you accomplish. These goals may involve things you want to get done within the next few weeks or months. For example, you may wish to attend a wedding or go to a special event, such as a concert. You may want to buy a new car and need to save money for the down payment. To meet your goals, you may need to start setting aside money well ahead of the event.

LONG-TERM NEEDS

Both saving and investing can help meet long-term needs and wants. For example, parents may start investing money when a child is young to pay for the child's college education. Many people want to own a home. They may save money for a down payment and then buy a house as an investment. Everyone needs to think about retirement and how to pay for expenses when no longer working.

In Chapter 4, you learned about basic needs (such as food and shelter), other needs (such as education and transportation), and wants (such as a vacation trip). You also studied how to create a financial plan. Such a plan has personal goals that relate to your wants and needs. Your financial goals relate to the money or assets needed to achieve personal goals. The plan includes a timeline for each goal. Selecting saving and investment options can be an important part of creating a financial plan.

To think about your needs and goals, you could create a plan such as the one shown in Figure 10-1.1 on page 289. The plan should list short-term and long-term goals and set a timeline for meeting each goal. You should also think about how much money you will need and how to save or invest for each goal. The amount that an investment grows is called the return. You may need to choose investments with a high rate of return to meet your goals.

Education

College expenses can be met with a plan that includes loans, scholarships, spending savings or money from investments, and working. Many students work during the summers and save money to pay for some of their college expenses. Some students work part-time and go to school full-time. Others work full-time and go to school part-time. Working to help pay for college lowers the amount of money you may need to borrow. You could start saving now to have money for this need. Parents of young children can invest money that will grow while the children grow. Money from the investment can be used to pay for education when the children reach college age.

Buying a House

A house can be a good investment that grows in value over several years. Buying a house may require using savings. Savings may be used to buy a home or to make a down payment on a home. Many lenders require buyers to make a down payment of 5 percent or more of the purchase price when buying a house. For example, suppose you buy a house for $180,000. You may be required to have a down payment of $9,000 to get a loan for 95 percent of the purchase price. You may need to save money

FIGURE 10-1.1 *A financial plan should include saving and investing options to meet goals.*

Personal Goal	Financial Goal	Steps to Take	Timeline
Short-Term Goals			
Take a camping trip next summer	Own camping gear and have money for transportation and supplies	Save $50 per month	6 months
Attend a concert in a nearby city	Have money for a ticket, hotel room, food, and transportation	Save $75 per month	4 months
Long-Term Goals			
Travel in a motor home	Own a motor home and have money for gas and traveling expenses	Invest $200 per month at a high rate of return	10 years
Swim in my own pool	Have a swimming pool constructed at my home	Invest $125 per month at a high rate of return	6 years

for a few months or years to have the down payment amount. You may also need to save money to pay for closing costs on a home mortgage.

Providing for a Family

Many people plan to have children in the future. These people need to plan for the expenses involved in raising children. Housing, food, clothing, medical care, and child care are examples of expenses parents must meet for at least 18 years. According to a U.S. Department of Agriculture report, a parent in the United States can expect to spend about $130,000 or more to raise a child from birth through age 17.[1]

Having children will affect daily living expenses, vacations, and even how parents plan for retirement.

© Getty Images/PhotoDisc

Many people make investments to provide for future needs of their families.

[1] *Expenditures on Children by Families, 2005*, U.S. Department of Agriculture, Center for Nutrition Policy and Promotion, Miscellaneous Publication No. 1528-2005, April 2006, p. 12.

For example, when children are young, parents need life insurance to take care of their children's needs if something happens to the parents. As children get older, plans shift to providing the children with money for education and helping them get started living on their own. When children are adults and leave home, many people move into a new phase of their lives. This often involves retirement or part-time work, moving to a smaller house, or moving to a different area. Investments made during a person's working years can help provide money for activities in later life.

Financial Security

Financial security is the ability to prepare for future needs and meet current expenses to live comfortably. For most people, financial security is built on saving and investing. It means having enough resources so that you will have enough to eat, proper clothing, a safe and comfortable place to live, medical care, and other items that you need. Government agencies and other organizations provide information about financial security online, as shown in Figure 10-1.2.

People desire to be financially secure throughout their lives. For many people, however, financial security must be built over time. When you first begin working and living on your own, you may need to spend most of your earnings to cover current expenses. As you save and invest, you start to build the resources that will provide for your future security.

Retirement Planning

Many people want to retire from working full-time and enjoy more leisure time. They may want to take more vacations and see new places. They also want to be able to live comfortably without worrying about how their bills will be paid. Some people want to retire as soon as they can afford to do so. Others enjoy their work or need the money earned and want to work as long as they can.

FIGURE 10-1.2

Information about building financial security is provided online.

Source: U.S. Department of Agriculture, Cooperative State Research, Education, and Extension Service, Financial Security, http://www.csrees.usda.gov/ProgView.cfm?prnum=5379 (accessed July 18, 2006).

INVESTMENT EXAMPLES			
Amount Invested	Interest Rate	Investment Term	Maturity Value
$10,000 investment	6%	20 years	$ 32,071
$10,000 investment	6%	30 years	$ 57,435
$1,000 investment	8%	30 years	$ 10,063
$1,000 investment	8%	40 years	$ 21,725
$1,000 per year investment	5%	20 years	$ 33,066
$1,000 per year investment	5%	30 years	$ 66,439
$1,000 per year investment	5%	40 years	$120,800
$100 per month investment	7%	25 years	$ 81,007
$100 per month investment	7%	30 years	$ 121,997
$100 per month investment	7%	40 years	$262,481

FIGURE 10-1.3

The investment term and the interest rate have a big effect on the maturity value of an investment.

Retirement planning should begin the day you start working. You can begin thinking about retirement even earlier, as you choose a career. Think about what you would like to do and how you would like to live when you retire. Then think about the amount of monthly income you will need to support this lifestyle. Many people, especially the elderly, require long-term medical care at some time during their lives. Retirement plans should include how to pay for long-term care if it is needed.

You should begin saving and investing money for retirement at a young age. The sooner you begin investing, the longer your money will have to grow. Figure 10-1.3 shows comparisons of amounts invested at the same rate but for a different number of years.

Building Communications Skills

Good News Messages

A good news message is one that the reader will find favorable or be happy to receive. Good news messages are often written to inform people that their requests have been granted. Thus, the reader is looking for the answer and is expected to respond favorably. Often, the writer can use this opportunity to build goodwill with the reader. The reader will be feeling positive about the main message of the letter.

When writing a message that is good news, use a direct approach. The answer or main point of the message should be placed early in the message. Details should be presented in later paragraphs. For example, the opening of a good news letter might be, "Congratulations, Mr. Mendez. You have been selected to receive a $5,000 scholarship."

A good news message should be clear, leaving no doubt about the answer or point to be shared. The letter should be complete, giving all the details needed. The letter should also be concise. It should use enough words to sound friendly and courteous but not be too wordy.

10-1 REVIEW

10-1 Activity 1 Can You Recall?

Answer these questions to help you recall what you have read. If you cannot answer a question, read the related section again.

1. How is investing money different from saving money?
2. Why are savings accounts often safer than other investments?
3. List three short-term goals that could be reasons for saving.
4. What is an emergency fund, and why should you have one?
5. Why does meeting long-term goals often require saving and investing? Give two examples of long-term goals that can be met with money from investments.
6. What is financial security?
7. When should you begin retirement planning?

10-1 Activity 2 Goals for Saving and Investing

People have many purposes for saving and investing. These purposes can be defined in terms of goals, both short-term and long-term.

1. Create a table with four columns similar to the one shown in Figure 10-1.1. The column headings should be as follows:
   - **Personal Goals**
   - **Financial Goals**
   - **Steps to Take**
   - **Timeline**
2. List at least one short-term and two long-term personal goals in the table.
3. List a financial goal for each personal goal. Include steps to take and a timeline for each goal. Enter the total amount of money you think you will need to meet each goal.

10-2

Saving and Investing Principles

OUTCOMES

- Discuss the concept of risk versus return.
- List some types of risk that savers and investors may face.
- Describe the possible tax advantages of long-term saving and investing.

GROWTH OF PRINCIPAL

When money is set aside for savings, it should be growing. That is, the principal amount on which interest is computed should get larger over time. The principal grows when you deposit more money into the account. The principal can also grow through compounding interest. With compound interest, the interest amount is calculated for the first period. For example, the period might be 1 month or 1 year. The interest amount is added to the principal amount that was deposited in the account. This becomes the new, higher principal amount. Interest is calculated on the adjusted principal amount for the next period. This cycle continues, with the interest being added to the previous principal amount each time the interest is calculated. As the principal increases over time, the value of the investment grows. Figure 10-2.1 on page 294 shows interest compounded quarterly for 2 years.

RETURN ON INVESTMENT

When you put money into savings or an investment, you expect the value of the savings or investment to grow. The amount that the savings or investment grows is called the return. Return on investment (ROI) is a measurement of return given as a percentage. ROI tells how much you will receive, either in cash (such as interest on a savings account) or in increased value (such as with real estate). When you compare the ROI on several investment options, you can pick the one that has the highest return. Computing ROI is simple. To find the ROI, divide the amount you gained (either in interest or in increased value) by the amount you invested. The gain could also include other amounts you received, such as dividends. A dividend is money paid to stockholders when a corporation makes profits. Figure 10-2.2 on page 294 shows how ROI is calculated. When you compare the ROI for different investment choices, you can see which has the best return. Based on the return and the risk involved, you would choose an investment option.

FIGURE 10-2.1

COMPOUND INTEREST EXAMPLE

COMPOUND INTEREST (Annual Interest Rate 6%)				
Period (Quarterly)	Principal	Rate	Interest	Adjusted Principal
1	$5,000.00	0.015	$75.00	$5,075.00
2	$5,075.00	0.015	$76.13	$5,151.13
3	$5,151.13	0.015	$77.27	$5,228.39
4	$5,228.39	0.015	$78.43	$5,306.82
5	$5,306.82	0.015	$79.60	$5,386.42
6	$5,386.42	0.015	$80.80	$5,467.22
7	$5,467.22	0.015	$82.01	$5,549.22
8	$5,549.22	0.015	$83.24	$5,632.46

FIGURE 10-2.2

RETURN ON INVESTMENT EXAMPLE

RETURN ON INVESTMENT			
Purchase Price	Selling Price	Gain	ROI
$500.00	$525.00	$25.00	5.00%

Selling Price − Purchase Price = Gain
Gain/Purchase Price = ROI

RISK AND RETURN

When selecting an investment, the buyer must weigh the risk involved against the possible return expected. The higher the risk you are willing to take, the greater your possible return may be. If you are not willing to take much risk, then you cannot expect high returns. Risk-free investments are guaranteed by the U.S. government. For example, savings accounts that are insured by the FDIC have no risk. As a result, the guaranteed rate of interest is low compared to rates for other investments. Other ways of saving and investing have more risk. As the risk rises, so does the possibility of a high return. The ideal investment would have all of these features:

- The principal is safe (no risk).
- The rate of return (earnings) is high.
- The investment is liquid (you can get your money quickly without a penalty).
- You can invest quickly and easily.
- There are no costs of investing, and you can buy in with small amounts.
- The investment is tax-free (both the earnings and the long-term gains) or tax-deferred.

Unfortunately, there are no investments that meet all of these criteria. So you must decide how much risk you are willing to take and what rates of return will meet your goals.

Investment Risk

Investment risk is the potential for change in the value of an investment. For example, when you buy stock in a company, you risk having the stock price fall. If the company goes out of business, the stock may become worthless. In this case, you may lose the money you invested.

The value of an investment can go up and down over time. Poor management or unexpected events may affect how well a company performs. For example, a company may discover that a product must be recalled because it is defective. Replacing the product or paying consumers for the recalled product may cost the company a lot of money. When this happens, the price of the company's stock may fall. Your investment may temporarily lose value. The price of the stock may go up again when the company announces the release of a new product. These changes in stock prices are to be expected.

Natural disasters may also affect the value of an investment. When a storm, earthquake, hurricane, or flood occurs, it creates damage. The event may destroy crops, buildings, businesses, and lives. A disaster can cause prices to rise or fall. If crops are destroyed, stock prices for companies in that industry may fall. Shortages caused by these events may lead to prices rising in some industries. Other industries benefit because work is created in rebuilding or repairing damage.

Natural disasters, such as a hurricane, can damage investment properties.

Few investments go up in value all of the time. With investment risk, you are looking for investment choices that, on the whole, go up more than they go down. The goal is to have your investments be worth more at the end of the year than they were at the beginning of the year.

Inflation Risk

When prices are rising rapidly in the economy, your investment may lose value. **Inflation risk** is the chance that the rate of inflation will be higher than the rate of return on an investment. When this occurs, your investment loses value. For example, assume you bought a bond. A **bond** is a debt instrument that is issued by a corporation or government. The issuer must pay the bondholder the principal (the original amount of the loan) plus interest when the bond matures. Suppose the bond has a fixed interest rate of 5 percent. If inflation is lower than 5 percent, your investment is holding its value. If inflation rises to 7 or 8 percent, however, your investment is losing value. Even though you may have more dollars, you will not be able to purchase as many goods or services with those dollars.

Industry Risk

Industry risk is the chance that factors that affect an industry as a whole will change the value of an investment. For example, suppose you invest in a company that is in the oil industry. If oil prices and profits are rising, then your investment is likely to gain in value. If alternate energy sources

Technology Corner

Internet Investment Research

Investors can find information about investment choices on the Internet. Many companies have Web sites that give information about the company. Such a site is a good source of information for investors. The U.S. Securities and Exchange Commission (SEC) publishes data about companies that investors can view. A link to the SEC Web site is provided on the Web site for this textbook.

The latest news about companies and conditions affecting them is also available on the Internet. News sites provide articles about business and economic events. A wide range of topics, from hiring practices to fraud alerts, is covered. This data can be helpful to investors. Using keywords in a search engine, investors can locate data about many topics that may affect investments.

Information and advice about saving and investing are also available at many Web sites. At some sites, information is free. Other sites charge a fee for giving investment advice. Readers should consider the source of any investing advice found on the Web. Not all sites provide reliable information. Some sites may have offers that are investment scams. Always investigate offers or companies well before investing money with them.

are found, however, then investments in the oil industry could lose value. People might start buying other types of fuel, and the price of oil could drop. Industry risk occurs in all types of businesses.

Political Risk

Political risk is the chance that an event in politics (laws, policies, wars, or elections) will affect the value of an investment. For example, when a new President is elected in the United States, the stock market sometimes reacts positively, and stock prices go up. One political party may seem to be more pro-business than another. When candidates from this party are elected, stock prices may rise. The opposite may also be true.

Political events in this country, as well is in other countries, affect markets. Wars, terrorist activities, and radical shifts in governments can affect markets significantly. When the news is good, stock prices tend to rise. When the news is bad, prices tend to fall. Political events are out of your control. However, you must consider how political events will affect your investment choices. Some investments are more vulnerable than others.

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Political events, such as elections, can affect the stock market.

Stock Risk

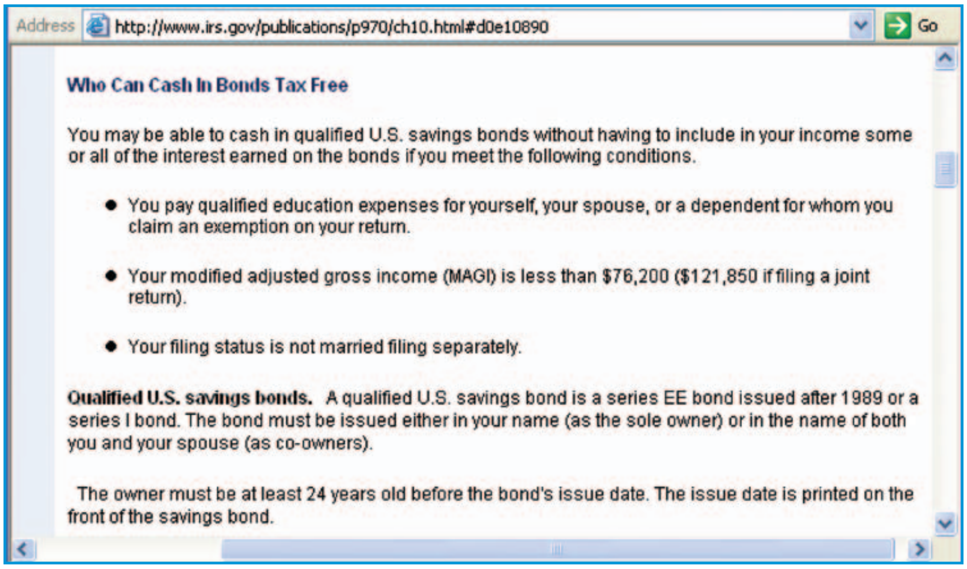
Stock in a company can go up or down in value. **Stock risk** is the chance that activities or events that affect a company will change the value of an investment. For example, the employees of a company might go on strike. When this happens, fewer products may be produced than planned. Sales and income may be lower than expected. This may cause the price of the company's stock to fall. During later periods, the company may do well, and stock prices may increase. Many companies do not perform well all of the time. Companies that show steady growth and strong overall performance over time are good investments.

TAX ADVANTAGES

When you set aside money for future retirement, such as in an IRA (individual retirement arrangement), the money may be tax-deferred. **Tax-deferred** means that there are no taxes on gains until the money is taken from the account. Also, you may not have to pay taxes on the amounts placed in the account until later. This tax advantage allows your investment to grow for years without being taxed. When you retire and take money from the account, you may be in a lower tax bracket. You are taxed only on the portion you take out of the account.

Some savings and investments are tax-free. For example, interest earned on Series EE and Series I U.S. savings bonds is tax-free in some instances if it is used for education. Information about the tax benefits of U.S. savings bonds is provided online, as shown in Figure 10-2.3. Interest earned on municipal bonds (bonds issued by local cities and counties) may be free from federal income tax. Tax-free choices protect your gains and earnings.

People with higher incomes may choose tax-deferred or tax-free investments because their tax rates are high. Suppose a person is in a



Address http://www.irs.gov/publications/p970/ch10.html#d0e10890 Go

Who Can Cash In Bonds Tax Free

You may be able to cash in qualified U.S. savings bonds without having to include in your income some or all of the interest earned on the bonds if you meet the following conditions.

- You pay qualified education expenses for yourself, your spouse, or a dependent for whom you claim an exemption on your return.
- Your modified adjusted gross income (MAGI) is less than $76,200 ($121,850 if filing a joint return).
- Your filing status is not married filing separately.

Qualified U.S. savings bonds. A qualified U.S. savings bond is a series EE bond issued after 1989 or a series I bond. The bond must be issued either in your name (as the sole owner) or in the name of both you and your spouse (as co-owners).

The owner must be at least 24 years old before the bond's issue date. The issue date is printed on the front of the savings bond.

FIGURE 10-2.3

Some U.S. savings bonds are good choices for saving to pay for education.

Source: U.S. Department of the Treasury, Internal Revenue Service, *Publication 970 (2005), Tax Benefits for Education*, http://www.irs.gov/publications/p970/ch10.html#d0e10890 (accessed July 20, 2006).

FIGURE 10-2.4

A tax-free investment may be the better choice, even though it pays a lower interest rate.

INVESTMENT COMPARISON	
Taxable	**Tax-Free**
Corporate Bond at 7% Interest	Government Bond at 5% Interest
The investor pays federal tax at a rate of 35%. For the interest earned, 7% × 65% is the amount the investor keeps. The rest is paid in tax.	The investor keeps all the interest earned at 5%.
0.07 × 0.65 = 0.0455 = 4.55%	

35 percent tax bracket. That means each dollar earned is taxed at this rate. If $1,000 is earned on an investment, $350 is paid in tax. If, however, this person invests in a tax-free bond and earns $1,000 in interest, there is no tax. Thus, interest rates on tax-free choices are often lower than market rates. However, the tax-free investment may be the better choice, as shown in Figure 10-2.4.

Success Skills

Lifelong Learning

Lifelong learning means acquiring new skills and knowledge throughout your life. Information is growing more rapidly than our ability to keep pace. While you may not be able to keep pace with all there is to know, you can stay current in areas that are of interest to you.

One area in which lifelong learning is especially important is your career. In past decades, many people worked for the same company and even in the same job for their entire careers. That situation is no longer common. Today, many people are employed by several different companies and in several types of jobs during their working years. Continuing education is essential to be prepared for career changes.

Lifelong learning can also help you as you save and invest in an effort to build financial security. Being aware of changes in technology, science, medicine, political events, the environment, and business practices can help you make better investment decisions.

By practicing lifelong learning, you will:

- Be a more valuable employee.
- Be prepared for career changes.
- Be better prepared to make saving and investing decisions.
- Be more interesting to others.
- Know more about protecting yourself from all kinds of risk.

Lifelong learning involves reading about new and different things. It means being aware of events happening in your community, your country, and the world. It often involves learning new skills. You may take continuing education classes or college courses to learn skills. Training may be provided by your employer to teach new job skills. Whatever methods you use, lifelong learning can help you achieve financial success.

10-2 REVIEW

10-2 Activity 1 Can You Recall?

Answer these questions to help you recall what you have read. If you cannot answer a question, read the related section again.

1. Explain how risk and return are related to each other.
2. Describe the ideal investment.
3. What is investment risk? What are some factors that can affect investment risk?
4. What is a bond?
5. What is inflation risk?
6. Name some events that might affect political risk.
7. How are tax-free earnings different from tax-deferred earnings?
8. Describe the possible tax advantages of long-term saving and investing.

10-2 Activity 2 Investment Criteria

The criteria for an ideal investment appear in the following list. For each situation below, tell which two criteria you think would be the most important for choosing a savings plan or an investment.

- The principal is safe (no risk).
- The rate of return is high.
- The investment is liquid (you can get your money quickly without a penalty).
- You can invest quickly and easily.
- There are no costs of investing, and you can buy in with small amounts.
- The investment is tax-free (both the earnings and the long-term gains) or tax-deferred.

1. Joshua plans to create an emergency fund to pay for unexpected expenses.
2. Maria wants to see her money grow over several years. She has a separate fund for emergencies that is in a liquid, no-risk account.
3. Chin wants to save money for retirement. He has a separate fund for emergencies that is in a liquid, no-risk account. He has other investments to help achieve other long-term goals.
4. Ellen wants to save money to pay for a college education for her daughter, who is now 3 years old.

10-3

Saving and Investing Strategies

OUTCOMES

- Explain how to use a systematic strategy for saving and investing.
- Explain the dollar-cost averaging strategy.
- Explain how a diversification strategy can lower risk.
- Explain the difference between a bull market and a bear market.
- Discuss buying and selling strategies in times of economic growth and decline.

SYSTEMATIC SAVING AND INVESTING

Systematic means regular, orderly, or done according to a plan. Systematic saving is a strategy that involves regularly setting aside cash that can be used to achieve goals. Once money is set aside in savings, ideally it should remain there until used to meet a planned goal. The amount should be the most you can comfortably afford to save each pay period. Some people find it convenient to have a set amount withheld each month from their paychecks. Others make a monthly payment to a savings plan, just like paying a bill. Some people find that they can set aside a portion of any raise they receive at work. That way, the amount is not money they depend on to meet current expenses.

Systematic investing is a strategy that involves a planned approach to making investments. For example, when you first start investing, you may wish to buy safe and liquid investments. In later years, you may want to take more risk so your principal can grow faster over time. When you get extra cash, such as a bonus, you might wish to buy a high-risk investment in the hope of getting high returns. Systematic saving and investing is important for building financial security in the long term.

Long-Term Focus

A saving and investing plan is designed for growth in the long run, not for short-term results. Investors may need to hold investments for 20 or more years to get the returns they want. In any given year, investments may actually lose money. Over time, however, gains exceed losses on sound investments. For example, suppose investments in the stock market have grown at an annual rate of more than 7 percent over any 20-year period of time. This does not mean that, in any given year, stocks earned 7 percent. In fact, in some years, the return may have been very low. In other years, the return may have been more than 20 percent. Investors must plan to hold investments for the long term to achieve substantial growth over time. As a young person, you should set investing and savings goals that focus on the future.

You can track prices of stocks and other investments using Internet sites. Stock prices are also shown in many newspapers. You might want to track a stock that interests you for several weeks to see how much the price changes. The chart in Figure 10-3.1 shows changes in the price of a stock over a period of 12 years.

Achieving financial goals requires training and discipline, just as preparing for a marathon does.

Dollar-Cost Averaging

One strategy for buying stocks or other investments is dollar-cost averaging. With **dollar-cost averaging**, a person invests the same amount of money on a regular basis, such as monthly. The amount is invested regardless of whether prices are high or low. Sometimes the investor pays more and gets fewer shares. Sometimes the price is low and more shares are purchased. Overall, the dollar cost per share may be less than the average price. Using this strategy, investors do not have to study the stock market and try to determine the best time to buy stocks.

FIGURE 10-3.1

Stock prices may go up or down over the long term.

DIVERSIFICATION

Diversifying is a very important saving and investing principle. **Diversification** is holding a variety of investments for the purpose of reducing risk. When one type of investment goes down in value, there may be others that go up. Thus the losses of one area are offset by the gains in others. It is important for investors to choose more than one type of investment. This is to avoid "having all your eggs in one basket." If a company fails, the investor could lose everything if he or she has only that one investment.

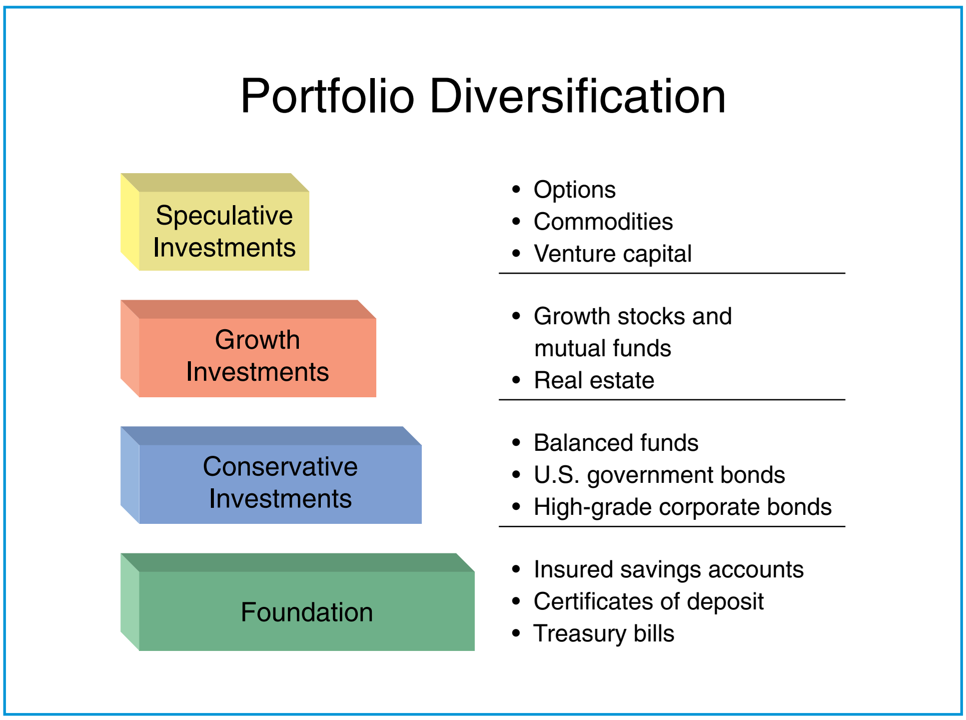
All of a person's savings and investments make up that person's investment portfolio. An **investment portfolio** is a collection of assets, such as certificates of deposit, stocks, bonds, real estate, and other holdings. In order to lower risk over time, the portfolio should be diversified. A portfolio should have a strong foundation of safe investments. For example, insured savings accounts and certificates of deposit are safe investments. The portfolio should have some relatively safe, low-risk investments. These might include U.S. bonds and conservative mutual funds. A mutual fund is operated by a professional investment firm. The firm sells shares in the mutual fund and invests the money in a variety of stocks, bonds, and other investments. Mutual funds have specific objectives, such as growth (high earnings) or balance (good earnings with acceptable risk). Mutual funds allow investors to have diversified holdings within one investment.

A portfolio could include some higher-risk choices that have the potential for high returns. Growth stocks and real estate are examples. Some people also include speculative investments. These options have high earnings potential. However, they are also high-risk. For this reason, some people include only a few or no speculative investments in their portfolios.

Over time, the portfolio should gain in value at a rate greater than the rate of inflation. Each investor must decide how much of each type of investment to include. A sample portfolio is shown in Figure 10-3.2.

FIGURE 10-3.2

An investment portfolio may contain several types of investments.



Investment choices will vary based on the person's age, income, family situation, goals, and attitude toward risk. You will learn more about various types of investments in Chapter 11.

UNDERSTANDING THE MARKET

Having a basic understanding of the market will help you make better investing decisions. The **market** refers to any place where investments are bought and sold. There are stock markets and bond markets. There are real estate markets and markets for precious metals such as gold and silver. For most things that an investor may want to buy or sell, a market exists. The term *market* is also used to refer to price levels or other market conditions. For example, the statement "The market was off today" may mean that prices in the stock market were low compared to prices on other recent days.

Bull Market

A **bull market** exists when stock prices are steadily increasing. A bull market may last a few months to a few years. During a bull market, price advances are often followed by profit-taking. Profit-taking occurs when people who own stocks that have increased in price sell those stocks. This selling activity may cause prices to drop for a while. The bull market does not end, however, because a few stocks drop in price. As long as the general trend is toward increasing stock prices, it is still considered a bull market.

When prices are rising, this may be a good time to sell certain stocks. Suppose a company in which you have stock has been performing poorly in recent months. This could be a sign that the company is poorly managed. It could mean that the demand for products that this company makes is falling. There could be some other problem that you do not know about. If stock prices in the market overall are rising, the price of this one stock may also go up. This could be a good time to sell a stock that you expect to do poorly in the future.

Bear Market

A **bear market** exists in the stock market when prices are steadily decreasing. Bear markets may last from a few months to a year or more. This is a good time to buy stocks that are sound investments because prices are lower. At times in a bear market, there is a lot of buying activity. This can cause a temporary rise in stock prices. The bear market does not end, however. As long as the general trend is toward declining stock prices, it is still considered a bear market.

Economic Conditions

Investors should consider economic conditions when forming an investment strategy. There will always be the rising and falling of the economy that causes prices to rise and fall. It is a normal part of the market and how it works.

Focus on . . .

Market Timing

In investing, the old saying goes, "Buy low, and sell high." The question is, How do you know when prices have reached their lowest point (so you can buy)? How do you know when prices have reached their highest point (so you can sell)? The answer is simple. You do not know; you can only make an educated guess.

To be good at investing, you have to choose timing principles that you follow. For example, you may own a certain stock or another investment and check it every day or week to see what its price is. When you see a downward trend in price, it might be the time to sell. Some experts say, however, that when prices are falling, that is the time to buy stocks that you think are a sound investment. You can get more shares of stock for less money when you "buy low."

When prices for stocks that you own are rising, this may be the time to sell. If you have owned the stocks for a long time and they have gained in value, you can take some of the profits by "selling high."

When to buy and when to sell is up to each investor. Some people leave those decisions to the experts. They buy shares in a mutual fund rather than buying individual stocks or other investments. Experts at the investment firm decide when to buy and sell the individual investments that make up the fund.

When the economy is in a period of general growth, the market for many investments is growing. Economic growth is often defined as a period of time when people are working (low unemployment rate), profits are good, wages are rising, and people are optimistic. When a company's profits are rising, its stock prices often rise as well. When this happens with many companies, overall prices in the market rise. Investors who think that the market will continue in a growth trend may choose this time to buy stocks. They think the stocks will grow in value. Investors who think the growth trend is about to end may choose this time to sell stocks. They want to sell at the current high prices before the market begins a downward trend.

When the economy is in a period of general slowdown, the market for investments is declining. Prices may be falling. Economic decline can be a good time to buy stocks that you think are sound investments. You can buy while prices are low. This increases your chance of making profits when you sell at some future date. Some investors think it is important not to spend (or invest) everything during an economic growth period. Instead, they wait for a period of decline and buy then, taking advantage of lower prices.

Ethics

Price Gouging

Economic conditions can change quickly in times of emergency. For example, when a natural disaster occurs, there are inevitable shortages. If a flood occurs, people may desperately need clean water to drink. They may need gasoline, food, and other necessities. Businesses that have these essential goods have two choices—they can keep their prices the same, or they can raise their prices. If they raise prices to what is considered an unfair amount, this is known as price gouging.

Some people think it is good business to raise prices when demand is high. They view this process as simply supply and demand forces at work. Others think that price gouging is unethical. They believe businesses are taking advantage of people who are unable to buy elsewhere or do without the product. Some states have laws against price gouging in times of declared civil emergencies.

What can you do to avoid being a victim of price gouging? The best strategy is to plan ahead. Prepare for emergencies by having essential items on hand. Keep a supply of clean drinking water and food packaged to prevent spoilage to feed your family for several days. Gather blankets, flashlights, a portable radio, and batteries ready for use. Have a corded phone on hand. A cordless phone may not work if electrical power is out. Buying essential items ahead of time will allow you to avoid paying higher prices during an emergency.

Buy essential items ahead of time to avoid paying high prices during an emergency.

10-3 REVIEW

10-3 Activity 1 Can You Recall?

Answer these questions to help you recall what you have read. If you cannot answer a question, read the related section again.

1. Explain how to save and invest using a systematic strategy.
2. Why is having a long-term saving and investment strategy important?
3. What is dollar-cost averaging? What is the advantage to using this investment strategy?
4. How does diversification lower investment risks?
5. What is an investment portfolio?
6. What types of investments should be the foundation of an investment portfolio?
7. What are some factors that will affect the types of investments a person may need in an investment portfolio?
8. How is a bull market different from a bear market?
9. When the economy is growing and stock prices are rising, why might an investor sell stocks?
10. When the economy is slowing down and stock prices are falling, why might an investor buy stocks?

10-3 Activity 2 Systematic Saving and Investing

Allison is 24 years old. She works part-time while going to school. She is able to save $50.00 a month. She now has $600.00 in savings. She would like to buy some type of investment that will give her more return than the 1.5 percent she is able to earn on a savings account. Allison is able to save systematically. She can set aside this money for 10 years or more and can continue to set aside $50.00 per month.

1. How should Allison plan to invest (in terms of risk and liquidity) at this point in her life?
2. Open the *Excel* file *CH10 Future Value* from the data files.
3. Look at the example problem provided in the worksheet. This investor is making an initial investment of $500.00. An additional $100.00 per month will be invested for 30 years (360 payments). The interest rate is 7 percent. The value of the investment after 30 years will be $126,055.35.

4. Use the Calculator section of the worksheet to enter data for Allison's investment. Enter **0.08** for an 8 percent annual interest rate.
5. Allison wants to leave her investment in place for 10 years. Multiply 10 years times 12 months per year to find the total number of payments. Enter this number in the worksheet.
6. Enter **50.00** as the amount of the monthly payments.
7. The present value of the investment is $600.00, the initial amount she will invest. Enter the present value amount **600.00** in the worksheet.
8. The maturity value will be calculated automatically. What will be the value of Allison's investment after 10 years?

EXPLORING CAREERS IN MARKETING, SALES, AND SERVICE

Do you like to work with people? Are you good at persuading others to take action? If the answer is yes, a career in marketing, sales, and service might be right for you. Jobs in this career area are varied. Some jobs involve advertising and promoting products. Others involve buying, merchandising, or direct selling. Storing and shipping products and customer support provide many jobs in this area. E-marketing, or selling and promoting products on the Internet, is also part of this career area.

Jobs in marketing and sales are found in businesses and government. This job area also includes entrepreneurs such as small business owners. The need for jobs in marketing, sales, and service is expected to grow over the next few years. The outlook varies somewhat by job.

Skills Needed

Some of the skills and traits needed for a career in marketing, sales, and service include the following:

- Knowledge of products
- Communications skills
- Computer/technology skills
- Leadership skills
- Ability to work with others showing patience and tact
- Decision-making skills
- Problem-solving skills

Job Titles

Many jobs are available in marketing, sales, and service. Some job titles for this career area include the following:

- Customer service representative
- Graphic designer
- Information systems manager
- Marketing manager
- Market researcher
- Merchandise buyer
- Retail salesperson
- Sales manager
- Shipping/receiving clerk

Explore a Job

1. Choose a job in marketing, sales, and service to explore further. Select a job from the list above, or choose another job in this career area.
2. Access the *Occupational Outlook Handbook* online. A link to the site is provided on the Web site for this textbook.
3. Search for more information about the job you selected to answer these questions:
   - What is the nature of the work this job involves?
   - What is the job outlook for this job?
   - What training or qualifications are needed for this job?
   - What are the median annual earnings for this job?

Review

CHAPTER 10

Summary

- The purpose of saving is to accumulate money for future use with an emphasis on safety of the money. The purpose of investing is to use money to make more money. The emphasis is on growth with acceptable risk.
- Saving and investing begin with meeting short-term needs, such as emergencies, vacations, and current goals.
- Liquidity is the ability to turn an asset into cash quickly and without penalty.
- To meet long-term needs, such as building financial security, you must plan carefully for saving and investing.
- The principal amount of an investment can grow when you add more money to your investment. It can also grow through compounding interest.
- Return on investment (ROI) is a measurement of return given as a percentage. Looking at ROI allows you to compare investment choices.
- Risk and return are related: the more risk you are willing to accept, the higher the return you may be able to earn.
- All investors take risks such as investment risk, inflation risk, industry risk, stock risk, and political risk.
- Saving and investing can provide tax advantages when gains are tax-free or tax-deferred (taxed later).
- Systematic saving is a strategy that involves regularly setting aside cash that can be used to achieve goals according to a planned investment schedule.
- A saving and investing plan is designed for growth in the long run, not for short-term results.
- Using a dollar-cost averaging strategy, a person invests the same amount of money on a regular basis regardless of market conditions or prices.
- Diversification means owning a variety of investment choices to lower risks. A portfolio is a collection of these choices.
- The market refers to any place where investments are bought and sold.
- In a bull market, prices are steadily increasing over time. In a bear market, prices are steadily decreasing over time.
- Economic growth often leads to rising prices and increased buying. Economic decline often leads to falling prices and decreased buying. Both conditions can present good opportunities for investors.
- Price gouging is charging unreasonably high prices for essential goods, such as food and fuel, at certain times when demand is high, such as in times of emergency.

Key Terms

bear market
bond
bull market
contingencies
diversification
dollar-cost averaging
emergency fund
financial security
industry risk
inflation risk
investment portfolio
investment risk
liquidity
market
political risk
stock risk
stocks
tax-deferred

ACTIVITY 1
Review Key Terms

Use the key terms from Chapter 10 to complete the following sentences:

1. Shares of ownership in a corporation are called ____________.
2. A measure of the ability to turn an investment into cash quickly is called ____________.
3. Unplanned events, such as emergencies, are called ____________.
4. When taxes are not levied against gains until the money is taken from the account, the investment is said to be ____________.
5. The chance that factors that affect an industry as a whole will change the value of an investment is called ____________.
6. A(n) ____________ is a collection of investments, such as stocks, bonds, and real estate.
7. Saving and investing the same amount of money each month regardless of market conditions is using the ____________ strategy.
8. A(n) ____________ is a debt instrument issued by a corporation or government that requires the issuer to pay the bondholder the loan principal plus interest at maturity.
9. When stock prices are steadily decreasing over time, this type of market is called a(n) ____________.
10. The potential for change in the value of an investment is called ____________.
11. Holding a variety of investments in order to reduce risk is called ____________.
12. The chance that an event in politics will affect the value of an investment is called ____________.
13. ____________ is the ability to prepare for future needs and meet current expenses to live comfortably.
14. The chance that activities or events that affect a company will change the value of an investment in that company is called ____________.
15. When stock prices are steadily increasing over time, this type of market is called a(n) ____________.
16. An amount of money set aside to handle expenses related to unplanned events is called a(n) ____________.

17. The chance that the rate of inflation will be higher than the rate of return on an investment is called ___________.
18. Any place where investments or assets are bought and sold is called a(n) ___________.

ACTIVITY 2
Math Minute

Round your answers to the nearest percent.

1. Jerry bought stock for $350.00. A year later, he sold it for $385.00. What is his return in dollars? What is his return on investment?
2. Brandy sold her collection of model cars for $600.00. She had purchased them for $520.00 a year earlier. What is her return in dollars? What is her return on investment?
3. Pablo bought 25 shares of a stock for $150.00 a share. He received dividends of $3.00 per share each year for 5 years. After 5 years, Pablo sold the stock for $155.00 a share. What is his return in dollars? What is his return on investment?
4. Keiko bought 46 shares of stock for $22.12 each. She sold the stock for $17.00 per share a year later. What is her return in dollars? What is her return on investment?

ACTIVITY 3
Investment Strategies

Work with a classmate to complete this activity.

1. Read each of the following scenarios.
2. Describe the saving and investing strategy you would advise for each scenario. Give reasons why you selected this strategy.

Scenario A
Ben Fong has saved $1,000. Currently, the money is earning 0.5 percent interest in a checking account. Ben works part-time and goes to high school. He plans to start college in 4 or 5 years. Ben does not have any other savings or investments.

Scenario B
Bill and Barbara Wilson are a married couple. Both of them are working, and they pay taxes at a high rate (35 percent). They have saved $5,000 and wish to invest it for the future. They have other savings and retirement plans, including both low-risk and high-risk investments.

Scenario C
Gloria Vega just inherited $1,500 from her uncle. She is single, 25 years old, and living with her parents. Gloria works full-time while attending college part-time. She has some savings ($2,500) and no investments.

ACTIVITY 4
Portfolio Diversification

Critical Thinking

An investment portfolio is a group of assets, such as certificates of deposit, stocks, and bonds. The portfolio should be diversified to lower risk. Investment choices will vary based on the person's age, income, family situation, goals, and attitude toward risk. They will also vary depending on the amount of money to be invested. In this activity, you will think about how to select types of investments for a diversified portfolio.

Assume that you are 28 years old. You have completed college and have a job that pays $40,000 a year. You have no debt. You have no dependents that you help support. You have savings of $30,000. You have decided to create a diversified investment portfolio.

Answer the following questions to help you think about how to structure your portfolio. Refer to Figure 10-3.2 on page 302 for examples of each part of a portfolio. However, you should select amounts for each category based on your own ideas about investing and how comfortable you are with taking risks.

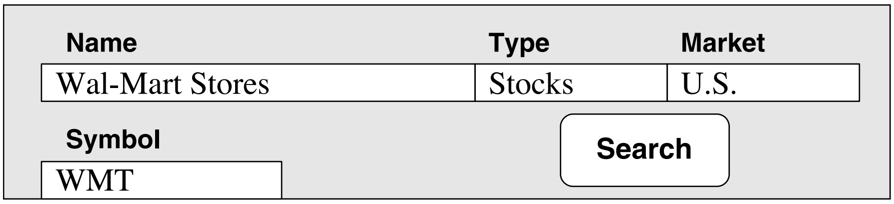
1. What percentage of your savings will you place in the foundation portion of the portfolio? What will this amount be in dollars? What types of investments will be in this part of the portfolio?
2. What percentage of your savings will you place in the conservative investments portion of the portfolio? What will this amount be in dollars? What types of investments will be in this part of the portfolio?
3. What percentage of your savings will you place in the growth investments portion of the portfolio? What will this amount be in dollars? What types of investments will be in this part of the portfolio?
4. What percentage of your savings, if any, will you place in the speculative investments portion of the portfolio? What will this amount be in dollars?
5. What amount of money will you plan to invest each coming month or year to help build your portfolio?
6. What long-term goals will you keep in mind as you choose your investments?

ACTIVITY 5
Track Stock Prices

Internet www.thomsonedu.com/school/pfl

Tracking a stock's price for several weeks or months before buying the stock is a common investment strategy. If the stock price rises and falls often, you may be able to buy when the price is low. Stock prices are available online and in many newspapers. Typically, the user must enter or find a symbol (a series of letters) that represents the company. For example, the symbol for Wal-Mart Stores is WMT. If you do not know the symbol for a company, you can find it online. In the following sample symbol search screen, the user enters the name of the company; selects a type of investment, such as Stocks; and chooses a market. When the search is complete, the symbol appears.

Sample Symbol Search Screen



Depending on the Internet site or newspaper, various information is provided about the stock. The opening price of the stock, the closing price (also called Last Trade), and any change in the stock price are usually shown, as in the following example:

Wal-Mart Stores, Inc. (WMT)	
Date	7-21-06
Close (Last Trade)	43.72
Change	⇩ 0.57
Previous Close	44.29
Open	44.51

1. Select a large corporation with which you are familiar.
2. Access the Internet and find a site that gives stock quotes. Links to several such sites can be found on the Web site for this textbook. You can find other sites by entering **stock quotes** in a search engine.
3. Search to find the market symbol for this company if you do not know it.
4. Find the Close (Last Trade) price for the stock for the current date. Record the date and the price.
5. Continue to find and record the Close (Last Trade) price of the stock every 1 to 3 days for the following 2 or 3 weeks as your teacher directs.
6. Create a line chart to show the changes in the stock price. Use Figure 10-3.1 on page 301 as an example for your chart. Use **Days** or **Weeks** instead of Years for your chart.

CHAPTER 11

Savings and Investing Options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Chapter 11 presents savings and investing options that have low, medium, or high risk. Some of these investment options are more liquid than others. Some can be purchased for a small amount of money. Others can be bought only with larger investments. No one investment is likely to meet all your needs. You will learn to consider risk, liquidity, and rate of return as you choose investments for various purposes.

Online Resources

Personal Financial Literacy Web site:

- Data Files
- Vocabulary Flashcards
- Sort It Out: Investment Options
- Chapter 11 Supplemental Activity

Search terms:

- discount
- tax shelter
- annuity
- mutual funds
- direct investing
- indirect investing

11-1

Low-Risk Investment Options

OUTCOMES

- Discuss the importance of having liquid savings.
- Give examples of savings options that are liquid.
- Give examples of low-risk savings and investment options.
- Explain how corporate bonds are different from government bonds.
- Discuss how annuities can be used to provide for financial security.

SAVINGS

Saving is setting aside money to meet future needs. Having savings to handle short-term needs is especially important. When you have enough savings, you will not need to borrow money to handle unexpected expenses. Savings should be in a form that is liquid. This means that savings should be in cash or in a savings or investment option that can quickly be changed into cash.

A checking account or savings account in a bank that has no restrictions on withdrawals is an example of a safe, liquid savings option. Interest earned on the account may be very low. Low return is acceptable because the purpose of the account is to have funds available when needed. Keeping a certain minimum balance in a checking or savings account may have other advantages. For example, you may not have to pay bank service fees for the account.

Some investments cannot be quickly changed into cash. Others can be changed quickly but require payment of a penalty for doing so. These investments are **illiquid**. Investors choose these options because they typically pay higher returns than those that are liquid. Many investors seek to balance their investments. They want to have some options that give high returns. They want to have other savings or investments that are liquid and that can be changed to cash quickly when needed.

Savings Accounts

A savings account in a bank, credit union, or other insured financial institution is a good option to choose for meeting short-term needs. Savings accounts in banks are low-risk. They are insured by the FDIC up to the legal limit of $100,000 per depositor per bank. Savings accounts usually do not have withdrawal penalties. Some or all of the money can be withdrawn at any time. Thus, savings accounts are liquid. However, the account may have some restrictions. For example, the depositor may be able to write only a limited number of checks per month on the account. A savings account typically pays a low interest rate. The rate is usually higher, though, than for a checking account.

© Comstock Images

Having enough cash to pay your bills is important.

Money Market Accounts

A money market account is another good option to choose for liquid savings. This type of account pays the market rate of interest on the money deposited. A money market account is liquid. You can withdraw some or all of the money at any time. Money market accounts may have some restrictions. For example, the number of checks you can write in a month may be limited. A minimum balance, such as $1,000 or $5,000, may be required to open a money market account.

Money market accounts are low-risk if they are insured. You can open an insured money market account at a bank or credit union. Because they are low-risk, these accounts pay a low rate of interest compared to some other investments. You can also open a money market account at a brokerage firm or other investment business. These accounts are not insured. They often pay a higher rate of interest than insured accounts. However, they carry a higher risk. When interest rates start rising in the economy, money market account rates will also rise. Thus, a money market account is a better cushion against inflation than a savings account.

Certificates of Deposit

A certificate of deposit, also called a CD, is a time deposit. This means that the money you deposit is set aside for a fixed amount of time at a set interest rate. A typical CD is not a liquid investment. You must pay a penalty if you withdraw the money before the stated time. CDs purchased at banks and credit unions are safe because they are insured by the FDIC. Thus, a CD is a low-risk investment, but it is not liquid.

Interest rates paid on CDs are typically higher than rates paid for savings accounts or money market accounts. The higher rate is paid because you agreed to leave the money for a stated period of time. You may get a higher rate by agreeing to leave the money on deposit for a longer time period. For example, the interest rate for a CD with a term of 6 months may be 2.75 percent. The interest rate for a CD with a term of 36 months may be 4.25 percent.

WITHDRAWAL PENALTIES

If you redeem a CD early, you will typically pay a penalty. Be sure to ask about the penalty if you buy a CD. Early withdrawal penalties are meant to discourage depositors from withdrawing the money before the stated time period. The penalty may be 6 months' interest or more. In such cases, you can lose part of your principal if you withdraw money early. Figure 11-1.1 on page 317 shows an example of the penalty terms for a CD.

FIGURE 11-1.1

EARLY WITHDRAWAL PENALTY ON A CD

Certificate of Deposit
Amount Deposited: $5,000.00
Interest Rate: 5% yearly
Term: 5 years

Penalty for Early Withdrawal
If the money is withdrawn before 5 years, the penalty imposed will equal 365 days' interest, whether earned or not.

Sample Scenario
The money is withdrawn after 180 days.

$5,000.00 × 0.05 × 180/365 = $ 123.29 Interest Earned
$5,000.00 × 0.05 × 365/365 = $250.00 Penalty
$5,000.00 Amount Deposited
+ 123.29 Interest Earned
$ 5,123.29
− 250.00 Penalty
$ 4,873.29 Amount Received

SPECIAL FEATURES

CDs pay higher interest when money is set aside for a long period of time. They also pay higher interest for large amounts. A jumbo CD is a CD for a large sum of money, usually $100,000 or more, with a term of a year or longer. CDs that pay higher rates of interest often have higher withdrawal penalties. You can earn good interest on this type of CD if you are able to leave your money on deposit for the full term.

INVESTMENTS

Investments vary in term, risk, rate of return, and relative liquidity. Options that are low-risk typically pay a lower rate of return than those with higher risk. Options that are long-term typically pay higher rates than those that are short-term.

To be liquid, an investment must be easily converted to cash. There should also be no significant loss of the amount invested. Whether or not an investment is liquid depends on several factors. If there are investors who are willing to buy when you wish to sell an investment, then the investment can be turned into cash quickly. However, there is no guarantee that the selling price will be higher than the price you paid for the investment. Thus, you could lose part of the amount invested. If there are no investors who are willing to buy the investment when you want to sell it, you will not be able to get cash quickly.

Some investments are considered very safe because they are insured. Others that are not insured are also considered fairly safe. This is because the company or government body issuing them is financially sound.

Savings Bonds

A bond is basically a loan that a buyer makes to a bond issuer. The bond issuer may be a government or a corporation. A U.S. savings bond is issued by the federal government. The bond is designed to be a long-term

FIGURE 11-1.2

The TreasuryDirect Web site provides tools to help investors.

Source: TreasuryDirect, Tools, http://www.treasurydirect.gov/indiv/tools/tools.htm (accessed August 8, 2006).

investment. Some U.S. savings bonds are issued at a **discount**. That means you pay less than face value. For example, you can purchase a $100 (face value) Series EE paper savings bond for $50. As interest is earned on the bond, it will grow to be worth $100 (the maturity value). Thus, when you **redeem** or cash in the bond, you will receive $100.

Series EE Bonds pay a guaranteed rate if they are not redeemed early. When a savings bond reaches maturity, interest may continue to compound for several years. This type of bond is low-risk because it is guaranteed by the U.S. government. Because it is low-risk, however, the rate of return is lower than for some other investment options.

While you can get your money quickly (cash the bonds when you want), you will forfeit the interest you would have earned if you cash the bond early. Thus, a savings bond is not considered a liquid investment. Some savings bonds can be a good way to save for a child's education. Interest is not taxable until the bond is cashed. If the bond is used for education expenses (for you or your children), then the interest may not be subject to federal taxes when the bond is cashed.

U.S. savings bonds can be purchased through banks or at the TreasuryDirect Web site. This site also provides tools to help you create a savings plan using bonds. You can access the TreasuryDirect Web site, shown in Figure 11-1.2, using the link provided on the Web site for this textbook.

Corporate and Government Bonds

Bonds are issued by companies and governments. Some bonds are sold at face value. Others are sold at a discount or a premium. When you buy a bond at a discount, you pay less than face value for the bond. For example, if the face value of the bond is $5,000, you pay less than that. Bonds may be sold at a discount to increase the overall profit from the bond and make the bond more attractive to investors. Bonds sold at a premium sell for more than the face value. Some bonds are very attractive to investors, perhaps because they have a high coupon rate. These bonds may sell at a premium for more than the face value.

You may receive regular interest payments from a bond. Many bonds pay interest twice a year (semiannually). The annual rate of interest paid

Corporate Bond
Face Value: $5,000.00
Discount Rate: 4%
Coupon Rate: 4% yearly (paid semiannually)
Term: 5 years with 2 years remaining until maturity

Purchase Price:
$5,000.00 × 0.04 = $200.00 Discount Amount
$5,000.00 − $200.00 = $4,800.00 Discounted Purchase Price

Semiannual Interest:
$5,000.00 × 0.04 = $200.00 Interest per Year ($100.00 each semiannual payment)
$200.00 × 2 years = $400.00 Total Interest Received

Return on Investment:
At the end of the second year, the bond is redeemed for $5,000.00.
$5,400.00 Total Amount Received
−4,800.00 Amount Invested
$ 600.00 Total Profit in Dollars

$600.00/$4,800.00 = 0.125 = 12.5% Total Return on Investment

FIGURE 11-1.3

RETURN ON A SHORT-TERM INVESTMENT

on a bond is called the coupon rate. The rate is set at the time the bond is issued and typically does not change. When you redeem the bond, you exchange it for the face value. Bonds are redeemed when they have matured. Figure 11-1.3 illustrates how you can make money buying a corporate bond at a discount.

A callable bond has a clause that allows the issuer to repay the bond early (before the maturity date). The bond will be redeemed at a set amount. The amount is typically higher than the face value of the bond. However, the total amount of interest received will be less than if the bond was held until its maturity date. If interest rates have been falling, you may not be able to reinvest the money you receive from the bond at the same rate. Only investments at lower rates may be available. The amount you receive for the bond could also be less than the price for which you could sell the bond. Because of these risks, callable bonds typically pay a higher coupon rate than other similar bonds.

A zero coupon bond does not pay yearly interest. The bond is sold at a deep discount and grows in value over time. You receive the face value of the bond at maturity. For example, you might buy a zero coupon bond for $12,000. In 10 years, at the maturity date, you might redeem the bond for $19,000. This type of bond can be a good way to invest for a particular long-term need, such as paying for a child's education.

CORPORATE BONDS

Corporate bonds are issued by corporations to raise money. Bonds are a form of borrowing for the company. The money is used for various purposes, such as building new factories or buying equipment. Corporate bonds pay a fixed coupon rate. The interest is subject to income tax. Any amount you gain when you redeem the bond is also taxed. In Figure 11-1.3, you would pay taxes on the $400 interest earned. You would also pay taxes on the $200 gain you realized when you redeemed the bond.

Corporate bonds are typically offered for sale in multiples of $1,000 or $5,000. They have various terms to maturity. Corporate bonds with terms of up to 2 or 3 years are short-term bonds. Bonds with terms of from 2 or 3 to 10 years are medium-term bonds. Bonds with terms of more than 10 years are long-term bonds.

Some corporate bonds are considered low-risk investments; others are not. The risk depends on the issuing company's ability to make interest payments and repay the bond. Bond rating services study the financial health of bond issuers. They assign risk ratings to the bonds offered for sale. Investors can use these ratings to judge the risk of buying a bond. Standard & Poor's Corporation is an example of a company that provides ratings for bonds, as well as other services.

Investment-grade bonds have high ratings and are considered fairly low-risk. Speculative-grade bonds have lower ratings. These bonds are sometimes called junk bonds or high-yield bonds. They are not considered low-risk. However, they are attractive to some investors because they pay higher rates than investment-grade bonds.

GOVERNMENT BONDS

Government bonds are issued by the U.S. Treasury or by U.S. government agencies. These bonds are low-risk when held to maturity. You do not have to pay state and local taxes on the income from some government bonds. These bonds make a good tax shelter. A **tax shelter** is an investment that allows you to legally avoid or reduce income taxes.

Municipal bonds are issued by states, counties, cities, and towns. They are used to pay for projects such as roads or public buildings. You do not have to pay federal, state, or local taxes on the income from many municipal bonds. Municipal bonds are rated to help investors consider the risk involved. Many municipal bonds are considered low-risk. Although it is possible for a government unit to go bankrupt, it is not very likely. The tax shelter feature also makes these bonds attractive.

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Municipal bonds are often issued to pay for projects such as public buildings.

Brokerage Accounts

You can open an account at an investment company. This account may pay interest like a savings account, or it may be a clearing account. A **clearing account** is an account used to buy and sell investments. Money is taken from the account to buy them. When they are sold, money is put back into the account. Brokerage accounts are not insured. However, they are considered low-risk when placed with a reputable investment company. The accounts work a lot like a checking account. The account is liquid. However, there may be restrictions such as a limit to the number of checks you can write in a month or year. Interest earnings are usually higher than for checking or savings accounts in banks, but the risk is higher as well.

Annuities

An **annuity** is a contract purchased from an insurance company. It guarantees a series of regular payments for a set time. To buy an annuity, you would pay a monthly payment into the account for a set number of years (such as 20). You could also invest a lump sum. Then, at the end of the set number of years, the annuity would start paying you monthly payments. Many people who buy annuities use them as a source of retirement income. They are fairly safe, but only as safe as the company you invest your money with. Annuities are not insured. When you pay into an annuity, the interest that is growing is not taxed. Annuities are tax-deferred, which means the interest will be taxed when you receive the monthly payments.

Life Insurance Plans

When you buy a life insurance plan (other than term insurance), the policy gains in cash value. Life insurance provides a low rate of return on your money. However, it also provides death benefits. Many life insurance policies allow you to borrow money. If the loan is not repaid, the life insurance death benefit is reduced by the amount of the loan. This type of investment is illiquid. Some people think it is a good choice because it forces them to save while they also buy insurance. Like annuities, these investments are only as safe as the company from which you buy. The plans are not insured.

Building Communications Skills

Bad News Messages

A bad news message is one that the reader will not find favorable or will not be happy to receive. When writing a message that is bad news, use an indirect approach. With an indirect approach, the writer attempts to break the news gently and keep the reader's goodwill.

In the first paragraph, state or refer to the issue or decision to be made. Give facts or logical reasoning to support the denial or other unfavorable news. Your goal is to convince the reader that the decision is the right one even before the decision is stated. The bad news comes only after the reader is prepared to hear it.

In the second paragraph, state the denial or other bad news. Bad news can often be cushioned by talking about what can be done, rather than just stating what cannot be done. Make the explanation clear and logical. Give details as needed. Use a positive tone throughout the letter.

In the third paragraph, state action you want the reader to take, if that applies to the situation. Close the letter on a positive note. For example, thank the reader for his or her business, or mention a project you will work on together in the future. The message should make the reader should feel important and think that her or his concerns have been heard. Your goal is to have the reader accept the news and keep the reader's goodwill.

11-1 REVIEW

11-1 Activity 1 Can You Recall?

Answer these questions to help you recall what you have read. If you cannot answer a question, read the related section again.

1. Explain why having liquid savings is important.
2. Give three examples of options for liquid savings.
3. Why is a savings account considered a low-risk savings option?
4. How is a money market account different from a regular checking account?
5. Explain the purpose of early withdrawal penalties for CDs.
6. Why do some CDs pay higher interest rates than other CDs?
7. List several examples of low-risk savings and investing options.
8. When a bond sells at a discount, do you pay more or less than the face value of the bond? Why might a bond sell at a discount?
9. How are corporate bonds different from government bonds?
10. What is the purpose of a clearing account?
11. Explain how an annuity can help provide financial security during retirement.
12. How can an investment be considered low-risk if it is not insured?

11-1 Activity 2 Low-Risk Investing

Many people start investing with short-term and low-risk choices. They want the investments to be liquid so that they can get their money quickly if needed. In the two cases below, consider the risk and liquidity of savings and investing options. Give advice to each of the investors.

1. Antonio is working full-time. He started his first job 6 months ago. He pays his bills and has $300 a month remaining. Rather than spend this money, Antonio has decided to set it aside for the future. He has signed an annuity contract whereby he will pay $300 a month for the next 20 years. Then he will start receiving payments from the annuity, or he can leave the money there to gain more earnings until he retires. He has no savings account or other investments at this point. Has Antonio made a good investment choice? Are there other options that might be better for him to consider for his portfolio at this time?

2. Emiko is working part-time while she goes to college. Because she has a scholarship, she is able to save $50 per month. Emiko has decided to leave the $50 she saves each month in her checking account. While the account does not pay interest, she is able to avoid a monthly service fee of $8 because she has enough money to meet minimum deposit requirements. What do you think of Emiko's decision? Are there other good options that she might consider for saving or investing her money?

11-2 Medium-Risk Investment Options

OUTCOMES

- List the various kinds of retirement plans that can be opened by an individual.
- Describe retirement account options provided through employers.
- Discuss the importance of portability for retirement plans.
- Describe mutual fund investing and give advantages of investing in mutual funds.

RETIREMENT ACCOUNTS

Some savings and investments are held in retirement accounts that are not taxed until the money is withdrawn. These accounts are tax shelters. This allows the money in the account to grow faster because earnings are computed on the entire balance.

Retirement accounts are a good way to save for the future. Some types of accounts are insured and have very low risk. Other options are not insured and have higher risk and higher potential returns. You can choose the types of savings or investment options in some retirement accounts. For example, you could include CDs or stocks. If the plan is provided by an insured bank, a retirement account invested in CDs would be insured. Money invested in stocks and bonds is not insured even if the account is held in an insured bank. These accounts are not liquid but are long-term investments.

Individual Plans

You can open retirement accounts as an individual. This means you must also manage them, or make choices about how to save or invest the money. Many individual plans allow you to deposit money pretax. This lowers your taxes now, while you are working. If money is withdrawn before age 59½, it is taxed at regular rates. Withdrawals are also subject to a 10 percent penalty. There are exceptions, such as withdrawals for medical expenses or education. Also, there comes a time when the money must be taken out of the account. Currently, money must be withdrawn from some retirement accounts at age 70½, even if you are not retired.

IRA ACCOUNTS

An IRA (individual retirement arrangement) allows individuals to deposit money into an account during their working years. The money deposited may be tax-deductible. Taxes are paid on the money and interest earned when the money is withdrawn during retirement.

Money set aside for a traditional IRA can be deducted from gross income if you meet certain requirements. This lowers your income tax. IRAs are tax-deferred, which means you will not pay taxes on the money earned until it is withdrawn. IRA accounts can be set up at banks and other financial companies. You can choose the types of investments. If you choose a CD rather than stocks, you will take less risk, but you will also have lower returns. IRA accounts are managed by the investor. They are a good long-term plan for providing retirement income. Money must be taken from the accounts at age $70\frac{1}{2}$, even if you are not retired.

© CORBIS

You can open an IRA at banks and other financial institutions.

With a Roth IRA, you cannot make pretax contributions. In other words, you cannot deduct the amount you contribute from your gross income. However, if you meet certain requirements, the earnings on a Roth IRA are tax-free. Thus, when you retire, the money you withdraw will not be taxable. You can choose the types of investments for a Roth IRA. No minimum distribution rules apply. You do not have to withdraw money from a Roth IRA at age $70\frac{1}{2}$.

A Spousal IRA is set up to benefit a spouse who does not work outside the home. To qualify, you must file a joint tax return. The amount that can be set aside is limited, based on your income. After 2008, the maximum IRA contribution per year is $5,000 ($4,000 until then).

SEP ACCOUNTS

The SEP (simplified employer plan) is similar to an IRA. It is for self-employed small business owners and their employees. SEPs work like IRAs, except that the amount of money that can be set aside is higher. SEP contributions are deducted from gross earnings. This money is not taxed until it is withdrawn. As with an IRA, the investor chooses how the money is invested.

Often called the SEP-IRA, the SEP is a simple plan for those who are fully or partly self-employed. There are no IRS filing or paperwork requirements. However, there is a limit as to how much can be set aside by small business owners.

KEOGH ACCOUNTS

A Keogh account is similar to a SEP, but it has more complex filing rules. It also has higher limits and is available to self-employed professionals and their employees. Up to $40,000 can be deposited each year. Doctors, lawyers, accountants, and others set up these plans to provide for retirement. Contributions are deducted from taxable income. The money is not taxed until it is withdrawn. Like other retirement accounts, a Keogh account is managed by the investor. It can include low-risk or high-risk investments.

Employer-Sponsored Plans

Many employers provide some type of retirement plan for their employees. Often it is part of the employee's benefits package. These plans are sometimes very good options for workers. You can set aside money pretax. In some cases, the money you set aside may be matched by money contributed by the employer. Although you will pay taxes when you withdraw the money, the plan is a good option for providing retirement income.

401(k) ACCOUNTS

A 401(k) plan is a tax-deferred plan for employees. The employee sets aside money each month with a pretax payroll deduction. There is a limit to the amount the employee can contribute. In 2006, the amount was $15,000. The amount can change each year. These accounts and their earnings are not taxed until the money is withdrawn. At retirement, they are taxed as ordinary income.

Employer contributions are optional. Sometimes companies match a certain percentage of employee deposits. The match may range from 25 to 100 percent. For example, suppose a company does a 30 percent match. For every dollar saved by the employee, 30 cents is added to that account by the company. Employers do a match in order to encourage employees to save for retirement. The 401(k) is also a part of benefits packages of many large companies. Employees can choose investments for their 401(k) fund, based on their willingness to take risk.

403(b) ACCOUNTS

A 403(b) account is a retirement plan for employees of nonprofit organizations or educational institutions. Teachers, school staff, nurses, doctors, professors, librarians, and ministers are examples of people who may qualify for a 403(b) plan. Some employers offer tax-sheltered annuities for their 403(b) retirement plans. Money is set aside by workers through payroll deduction. It is not matched by employers. The employee is allowed to choose investments for the money deposited. As in other retirement accounts, earnings and contributions are not taxed until the money is withdrawn.

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Many employees have retirement accounts as part of their benefits package.

PENSION PLANS

Some employers offer retirement accounts that are paid for entirely by the employer. These accounts are called defined benefit plans or simply pension plans. Pension plans provide payments to retired workers. Typically, employees must work for the company for a certain number of years to qualify. The payment amounts vary depending on the number of years worked, the worker's salary, and other factors.

Pension plans are offered by fewer companies now than in the past. Employees do not make choices about investments. When the employees receive payments (at retirement), they must pay tax on the money.

PORTABILITY

Many retirement accounts are portable. This means you can take the account with you when you leave a job. **Rollover** is the process of moving an investment balance to another qualified account. For example, you may be working for a company that has a 401(k) or a 403(b) retirement account. If you leave your job at the company, you can take the money you contributed with you. Once the account is vested, you can also take with you

Ethics

BREAKING COMMITMENTS

Some companies provide retirement pensions as part of their benefits package for employees. This benefit represents a commitment by the employer. Employees count on the pension plan to help provide money for their retirement. There is no problem as long as the company does well and pays in the required amount to fund the pension plan.

Many companies have stopped offering pension plans. Some companies that still provide the plans have not funded them at the level needed to pay the promised benefits. This means the plans may not have enough money to pay workers when they retire. Other companies have changed the rules that govern their pension plans; for example, to reduce benefits. The company might go bankrupt and be unable to provide the promised benefits. These actions often leave employees without some of their promised retirement benefits.

The Pension Benefit Guaranty Corporation (PBGC) is a federal corporation created by the Employee Retirement Income Security Act of 1974. Its mission is to protect retirement incomes of millions of American workers with defined benefit pension plans. When a pension plan fails, workers may receive some benefits from the PBGC. However, they may not get some benefits that they have been promised, such as health care benefits.

Although the company's actions may not be illegal, some people think it is unethical to deny retired workers the benefits they were promised. In discussing a new law to regulate pension plans, U.S. President George W. Bush said, "You should keep the promises you make to your workers. If you offer a private pension plan to your employees, you have a duty to set aside enough money now so your workers will get what they've been promised when they retire."[1] The Pension Protection Act of 2006, signed on August 17, 2006, sets new rules about how and when pension plans must be funded. The new law may help fix problems with existing pension plans. However, it also encourages employers and workers to use other types of retirement plans, such as 401(k)s.

Workers should not rely solely on a pension plan provided by an employer. There is also no guarantee that the government will continue to provide retirement benefits. Workers should save and invest to provide for their retirement income.

[1] The White House, "President Bush Signs H.R. 4, the Pension Protection Act of 2006," August 17, 2006, http://www.whitehouse.gov/news/releases/2006/08/20060817-1.html (accessed August 21, 2006).

money your employer contributed to the account. An account is **vested** when the employee has met certain requirements, such as time of employment. When you are vested, you have rights to the account. Vesting often occurs after 3 to 6 years of continuous employment. When you leave that job, you can roll over your 401(k) to an IRA account. You may also be able to roll over the account to an account provided by a new employer. Rollovers have a time limit and other rules.

INVESTMENTS WITH MEDIUM RISK

In order to earn a higher return, some people are willing to take some risk. Medium-risk investments will increase your return without raising the risk beyond reason. With many medium-risk choices, the investor can choose how much risk he or she is willing to take.

Mutual Funds

A **mutual fund** is operated by a professional investment firm. The firm sells shares in the mutual fund and invests the money in a variety of stocks, bonds, and other investments. Mutual funds are focused on a chosen investment strategy. Mutual fund companies manage many different types of mutual funds. If you invest with one of these companies, you can pick the type of investment strategy that appeals to you. If you choose a higher-risk fund, you might make more money. However, you could also lose money, including your principal. Mutual funds are often thought of as a good way to get started investing.

Mutual fund companies sell shares to many investors. These investors are pooling their money with that of other investors to reduce risk. The mutual fund company is in the business of buying and selling. Its advisors are watching companies and markets. When you invest your money with a mutual fund company, you are paying for the firm's expertise. This allows you to spend your time doing other things. It also lowers your risk because your investment is diversified.

Buying mutual funds is a form of **indirect investing**. With this indirect investment, you invest in the mutual fund company. The company makes the investment purchases and sales. You are investing indirectly in the choices of your mutual fund company. In other words, you own shares of the mutual fund company, not shares of stock in the companies in which it invests. When you choose a certain type of fund, the mutual fund company will select the combination of investments its analysts think is best to meet the fund's goals. Figure 11-2.1 on page 329 describes various types of mutual funds.

With mutual funds, the investor can also choose a combination of funds. This is called **asset allocation**. The investor could pick investments that have a variety of risks. An example of asset allocation is shown in Figure 11-2.2 on page 329.

Family Home

Most financial experts believe that buying your own home is the best investment you will ever make. They also agree that home ownership is not always liquid. You must be willing to wait to sell when the market

FIGURE 11-2.1

Investors can choose from several types of mutual funds.

MUTUAL FUNDS	
Fund Type	**Description**
Balanced funds	Invest in a diversified portfolio that includes some low-risk, some medium-risk, and some high-risk stocks. These funds strive for balance between growth and income. The objective is to reduce overall risk while maximizing return.
Bond funds	Invest primarily in bonds. If the bonds are tax-free, this advantage is passed along to investors.
Global funds	Invest in international companies, new industries in foreign countries, and companies in the world marketplace.
Growth funds	Invest in companies that will grow over the long run. Gains will be made when companies reach their potential. These are often considered high-risk investments in the short run.
Income funds	Invest in bonds and stocks that produce steady and reliable dividends. These dividends are passed along to investors.
Index funds	Invest in securities to match a market index with the goal of having returns similar to those of that index.
Money market funds	Invest in short-term securities that go up or down with current interest rates and the economy.
New venture funds	Invest in new and emerging businesses and industries. These are considered high-risk (but also high-return) choices.
Precious metal funds	Invest in companies that are associated with precious metals, such as gold, silver, and platinum.
Stock funds	Invest primarily in stocks. They could be categorized into types of stocks—blue-chip, technology, medical, etc.

FIGURE 11-2.2

ASSET ALLOCATION WITHIN A MUTUAL FUND

ASSET ALLOCATION		
Percent of Holdings	**Type of Fund**	**Reason for Choice**
25%	Bond fund	For stability and to offset risk of other funds
25%	Growth fund	To invest in high-risk choices that could grow greatly over time
25%	Global fund	To benefit from world economic growth
25%	Money market fund	To provide liquidity and short-term gains

is rising. Because the costs of buying are so high, it usually takes several years to make a profit. When you own your own home, you should take good care of it to protect your investment. Over the long run, home ownership is a fairly safe investment, with value that often grows faster than the rate of inflation.

Technology Corner

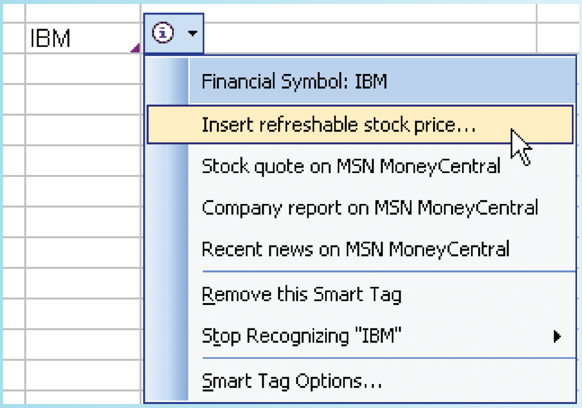
Tracking Investments in a Spreadsheet

People who buy investments should check the progress of their investments often. A good way to do this is to set up a spreadsheet that shows purchase price, monthly or yearly change in value, percentage change in value, and ending value. This allows you to track each investment over time. It also allows you to compare investments. Most importantly, it helps you to decide when it is time to change your investment strategy. If one type of investment is going steadily down in value over time, or not increasing as fast as others, it may be time to make a change.

Microsoft Excel has a feature that allows you to get updated stock quotes in a worksheet. If you want to see the prices of several stocks or mutual funds each day or week, this feature can save you time. Simply enter the recognized symbol for a stock in the worksheet. Click outside the cell, and then click the **Smart Tag** that appears. (Smart Tags must be turned on.) Choose **Insert refreshable stock price** from the menu, as shown in Figure 11-2.3. Select a location for the quote and related information to appear and click **OK**. You must be connected to the Internet to access stock quotes.

FIGURE 11-2.3

Excel *provides a feature to insert refreshable stock quotes.*



11-2 REVIEW

11-2 Activity 1 Can You Recall?

Answer these questions to help you recall what you have read. If you cannot answer a question, read the related section again.

1. List three types of retirement accounts that can be opened by an individual.
2. How are traditional IRAs and Roth IRAs similar? How are they different?
3. What types of retirement accounts are available for people who are self-employed?
4. Describe three types of employer-sponsored retirement plans.
5. What is the advantage to having a tax-deferred investment account?
6. Why is having a retirement account that is portable important?
7. Explain why mutual funds are a form of indirect investing.
8. Give two advantages of buying mutual funds rather than individual stocks or bonds.
9. What is asset allocation?
10. Which type of mutual fund has a better potential for high returns: a bond fund or a stock fund? Which of these two funds has a higher risk?

11-2 Activity 2 Compare Returns on Mutual Funds

Investors who buy mutual funds have many funds to choose from. Some funds have the potential for high returns but also have high risk. Other funds have lower risk but also provide lower returns. In this activity, you will create a chart to compare returns for funds that have low, medium, and high risk. The three funds are described below.

Balanced Fund
This fund seeks current income, long-term growth of capital and income, and preservation of capital. This is a low-risk fund.

Index Fund
This fund seeks above-average returns by investing at least 80 percent of its assets in equity securities, which are primarily stocks. The fund's risk profile is similar to that of the Standard & Poor's 500 Index. This is a medium-risk fund.

Growth Fund
This fund seeks long-term gains by normally investing at least 80 percent of its assets in stocks of companies with above-average earnings growth. This is a high-risk fund.

Returns for each fund for a period of 8 years are shown in the following table:

Year	Balanced Fund	Growth Fund	Index Fund
1998	14.01%	6.53%	28.84%
1999	3.89%	58.17%	12.37%
2000	−1.83%	−13.52%	−7.75%
2001	−5.23%	−33.59%	−10.87%
2002	−18.91%	−24.88%	−22.85%
2003	18.21%	34.83%	23.67%
2004	6.78%	4.94%	8.78%
2005	6.84%	11.82%	7.60%

1. Open the *Excel* file *CH11 Funds Data* from the data files. This file contains the returns data for the three mutual funds as shown in the table.
2. Create a line chart or a column chart to compare the returns data for the three funds. Note that the returns for some years are negative numbers. (If you do not have *Excel* or other spreadsheet software, create a chart manually using graph paper.)
3. Key **RETURNS COMPARISON** for the chart title. Include a legend to identify the line or column for each fund.
4. Adjust the scale and format the chart as needed to make the data easy to understand.
5. Which fund had the highest return in any 1 year? Which fund had the lowest return in any 1 year?
6. Which fund had the smallest amount of change over the years?
7. Which two funds had similar returns?
8. Which fund would you choose if you were planning to invest in one of these funds? Why?

11-3

High-Risk Investment Options

OUTCOMES

- Describe several high-risk investment options.
- Compare common stock with preferred stock.
- Describe direct investing and the risk it involves.
- Discuss trading futures contracts for commodities.
- Explain why indirect investing options reduce risk.

STOCKS

When you buy stock in a corporation, you become a stockholder. A stockholder owns shares of the company. Stockholders make money in two ways. One way is by receiving dividends. The other way is by selling the stock at a price that is higher than the price paid for the stock. This increase in selling price is referred to as growth (in value). A stock that pays annual dividends is attractive to an investor who needs the income (such as at retirement). Buying stocks and holding them for growth is a long-term strategy. You are betting that the value of the stock will go up over time.

The number of shares a stockholder owns may increase due to stock splits. In a stock split, the number of shares a company has sold is divided into a larger number. For example, in a two-for-one split, each person who owned 100 shares of stock will now own 200 shares. If the stock price before the split was $100, the price will now be $50. However, the stock may increase in price over a few years back to $100 per share. An investor who bought 100 shares at $75 per share would have 200 shares to sell at $100 per share.

Stocks are considered risky because an individual company could fail regardless of how big it is or how long it has been in business. There are many risks faced by businesses, from inflation risk to political risk. Stocks can be sold at any time as long as there is a buyer willing to purchase the stocks. However, if the stock price is low, the investor may want to hold the stock until the price rises. Otherwise, the investor will lose money on the investment.

Common Stock

Many companies have two types of stock: common stock and preferred stock. Owners of **common stock** may share in the profits of the company through dividends. They have voting rights in decisions made by shareholders,

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When you own stock, you have an ownership interest in a corporation.

such as who the company directors will be. They take a higher risk than owners of preferred stock. Common stock has no guaranteed dividends. If the company does well, the stockholder shares in the profit in the form of dividends. The directors of the corporation decide if a dividend payment is to be made. Stock dividends are taxable. There is no guarantee that the value of the stock will go up. Investors should review the selling prices of stocks they own often to see whether the prices are going up or down. If the price of a stock keeps going down over time, the investor may want to sell the stock and invest in another option.

Preferred Stock

In many companies, owners of **preferred stock** have a guaranteed dividend rate. This rate is paid before common stockholders get paid a dividend. Because there is less risk, preferred stock costs more than common stock. Preferred stockholders do not have voting rights. If the company goes bankrupt, they get paid before common stockholders.

Direct Investing

Buying investments directly from companies and holding them individually is known as **direct investing**. If you buy the stock of a company and hold that stock, you are taking a high risk. That is because you have a lot of money in one place. This plan does not spread risk. You can, however, lower your risk by buying many different types of stocks and other direct investment options. You can learn more about direct investing in stocks at the U.S. Securities and Exchange Commission Web site, as shown in Figure 11-3.1.

FIGURE 11-3.1

Investors can buy stocks directly from some companies.

Source: U.S. Securities and Exchange Commission, Direct Investment Plans: Buying Stock Directly from the Company, http://www.sec.gov/answers/drip.htm (accessed August 14, 2006).

Focus on . . .

DAY TRADERS

Day traders are individuals who attempt to make money by buying and selling stocks and bonds. These investments are not held for long-term growth. They are held just long enough to make a profit. When the day trader sees a stock's price rising, the stock is sold for a quick profit. When the day trader sees prices dropping for stocks that are good values, the trader buys. As soon as prices come up again, the trader takes the profit by selling. If the price does not rise again, the trader takes a loss.

Day traders must be aware of general market conditions. They also must be familiar with companies, products, and industries in which they trade. By carefully watching the market and keeping track of trends, day traders can make considerable profits over time. Of course, they are bound to make mistakes at times. They might sell before the stock hits its peak price or select a stock that loses value. Because they trade so often, day traders must also consider trading fees and expenses when calculating actual profits.

BUSINESS VENTURES

You may decide to start a small business. You could also loan money to someone so that person can start a business. More than half of all small businesses fail each year, making this a very risky investment. If the business succeeds, however, it can be a profitable investment. A **business plan** is a document that outlines how a business plans to succeed. It includes the company mission, the financing needs, the marketing plan, the management plan, and the operating plans for the company. The plan attempts to show how the business will make a profit. Before you invest in a business venture, be sure to read and understand the business plan. You could make a lot of money, or you could lose your investment.

COLLECTIBLES

Collectibles are art objects, coins, decorative plates, books, baseball cards, or other items bought for their investment value. Some collectible items will go up in value over time. Others will not. The investor must decide which items she or he thinks will go up in value. Coins are a commonly collected item. When coins are rare, they gain in value. Buying collectibles is a very risky investment choice. When collecting, have a clear goal in mind. Decide whether you are collecting items as an investment or whether you are simply buying items that you like for your own enjoyment. If you are buying items as an investment, do market research to learn which items may increase in value. Also, do research to learn about the items so you can tell whether an item is authentic or a replica. Being able to prove that an item is authentic is especially important for art objects and sports memorabilia.

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Rental property can be a profitable investment.

RENTAL PROPERTY

Individuals can buy real estate beyond a family home. If you buy a house and rent it to tenants, you will receive rent for income. Buying rental real estate has risks and responsibilities. The tenant (renter) takes possession of a valuable piece of property. The tenant must take reasonable care of it. You, the owner, are responsible for repairs and maintenance. This may mean fixing or replacing the roof, painting, and other upkeep. The property may increase in value over time. Thus, an investment in rental property can provide current income and long-term growth. Other forms of rental property besides a single-family home include duplexes, apartment complexes, and vacation property.

FUTURES CONTRACTS AND COMMODITIES

Futures contracts are another type of high-risk investment. A **futures contract** is an agreement to buy or sell a specific commodity or currency at a set price on a set date in the future. A **commodity** is a specific item of value that is bought and sold in a marketplace. It could be soybeans, silver, live cattle, coffee, or other items.

Buying and selling a futures contract does not transfer ownership. It spells out the terms under which the commodity or currency will be bought or sold at a later date. Futures contracts are often used by sellers and buyers as a way to hedge, or reduce the likelihood of losing money in the future. For example, suppose a company has agreed to buy fuel in the future at a set price. The company might also want to buy some fuel futures contracts. If the price of the fuel rises, then the company may make enough money on the futures contracts to pay for the increased price of the fuel itself.

As you have probably guessed, investing in this category is very risky. You will have no control over what happens to prices for commodities. For example, the weather during the growing season may have a big effect on the price for products such as corn or orange juice. Investors who have an in-depth knowledge of how the market for a particular product fluctuates may be able to do well trading commodities. For example, suppose a farmer has grown corn for 20 years. This farmer has studied the conditions that affect corn prices, such as weather and the amount of corn already in storage from previous years. This farmer may have the knowledge needed to do well trading futures contracts for corn. However, the same farmer might know little about currency markets and might not do well trading currency. Investors in futures contracts should realize that you could make—or lose—a lot of money in a short time.

Success Skills

Managing Stress

Stress is a state of mental or physical tension. Many types of changes in life can cause stress. The change can be good, like getting a new job, or bad, like being ill. Stress is not always harmful. Sometimes stress can cause a person to take actions or learn new ways to handle a situation that can be helpful. In other instances, stress can cause problems. Emotional upset, trouble sleeping or concentrating, and even disease can be caused by too much stress.

Everyone experiences stress in daily life. Because too much stress can be harmful, you need to learn to manage factors that cause stress and take steps that will help you cope with stress. Stress is unique to each person. What is relaxing to one person may be stressful to another. The key to stress management is finding things that will work for you. Follow these guidelines to help you control and cope with stress:

- Identify situations that cause negative stress in your life. Take whatever steps you reasonably can to avoid or change these situations.
- Seek counseling to help you deal with serious stressful events.
- Schedule work and other activities to allow time to complete them without rushing, if possible.
- Find activities that help you relax, such as a hobby, a sport, or volunteer work.
- Spend time with family or friends in relaxing settings. Remember the value of laughter to help relieve tension and put situations in perspective.
- Get enough rest and sleep, and eat a healthy diet. These steps will help you be more physically fit and better able to cope with stress.
- Exercise and stay active throughout life. Physical activity can also help you stay fit and be better able to cope with stress.

FIGURE 11-3.2

REITS invest in real estate and mortgages secured by real estate.

Address http://www.sec.gov/answers/reits.htm Go

Home | Previous Page

U.S. Securities and Exchange Commission

Real Estate Investment Trusts

Real estate investment trusts, known as REITs, are entities that invest in different kinds of real estate or real estate related assets, including shopping centers, office buildings, hotels, and mortgages secured by real estate. There are basically three types of REITS:

- Equity REITS, the most common type of REIT, invest in or own real estate and make money for investors from the rents they collect;
- Mortgage REITS lend money to owners and developers or invest in financial instruments secured by mortgages on real estate; and
- Hybrid REITS are a combination of equity and mortgage REITS.

The Internal Revenue Code lists the conditions a company must meet to qualify as a REIT. For example, the company must pay 90% of its taxable income to shareholders every year. It must also invest at least 75% of its total assets in real estate and generate 75% or more of its gross income from investments in or mortgages on real property.

Source: U.S. Securities and Exchange Commission, Real Estate Investment Trusts, http://www.sec.gov/answers/reits.htm (accessed August 15, 2006).

REAL ESTATE INVESTMENT TRUSTS

REITs (real estate investment trusts) are also known as real estate stocks. A REIT is a corporation. It may own and operate income-producing property. An apartment building that rents to families and a factory building that rents to a business are examples of income-producing properties. A REIT may lend money to real estate developers. It may also invest in securities backed by real estate mortgages.

Buying shares in a REIT is a form of indirect investing, similar to buying shares in a mutual fund. When REITs make profits, the profits are distributed to shareholders. You own shares of stock in the REIT. You do not own the individual pieces of property purchased by the REIT. Your money is invested indirectly in the real estate market. Many REITS are publicly traded. You can buy shares of these REITs on the stock exchanges. Because of the nature of real estate, REITs outperform many other investment funds over the long run. You can learn more about REITs on the U.S. Securities and Exchange Commission Web site, as shown in Figure 11-3.2.

INVESTMENT CLUBS

An investment club is a group of people who pool their money together to buy and sell investments. The group may be small—just a few people who work together to buy something they could not afford as individuals. For example, three or four couples may jointly buy a vacation home and share the time using it. The group may also be hundreds of people who do not know each other. Investment clubs may buy stocks, bonds, or other investments. Clubs may take part in direct investing, as in buying stocks, or indirect investing, as in buying mutual funds. An investment club usually has stated goals and buys certain kinds of investments to reach those goals.

11-3 Activity 1 Can You Recall?

Answer these questions to help you recall what you have read. If you cannot answer a question, read the related section again.

1. Describe two ways to make money from stocks.
2. Compare common stock with preferred stock.
3. Why are common stocks considered a risky direct investment? Why do common stockholders take more risk than preferred stockholders?
4. What is a business plan? Why is studying the business plan important when considering a business venture investment?
5. Why are collectibles considered high-risk investments?
6. What risks are associated with owning rental property?
7. What are two ways in which an investor can make money on rental property?
8. What is a futures contract? Give three examples of commodities.
9. How does a REIT work? Why is it safer than direct investment in real estate (owning rental property)?
10. What is an investment club?

11-3 Activity 2 High-Risk Investing

Suppose your investment portfolio is well balanced, with short-term investments, stocks, bonds, and mutual funds. You own your own home. Recently, you unexpectedly received a large sum of money. You want to take some risk and invest the money in hopes of making a high return.

1. Consider the investment options listed below. Select the option you would buy.
2. Give an advantage and a disadvantage of your choice. Give reasons you chose that option.
   - Buy rental real estate.
   - Pool your money with others in an investment club.
   - Invest in a small business venture.
   - Buy futures contracts for a commodity.
   - Buy a large number of shares in one corporation.
   - Buy a painting by a well-known, popular artist.

EXPLORING CAREERS IN HOSPITALITY AND TOURISM

Do you love to cook? Are you good at dealing with the public? Would you enjoy planning events such as meetings and parties? Do you want to own a bed-and-breakfast inn someday? If the answer to any of these questions is yes, a career in hospitality and tourism might be right for you. This career area includes a wide variety of jobs. Hotel managers and workers, theme park and resort workers, travel agents, tour guides, chefs, and other restaurant workers are all part of this career area.

Jobs in hospitality and tourism are found in government and in businesses. This job area also includes entrepreneurs. Many caterers, inn owners, and event planners handle the daily work and management of their own companies. The need for jobs in this area is expected to grow in the next few years. The outlook varies somewhat by job.

Skills Needed

Some of the skills and traits needed for a career in hospitality and tourism include the following:

- Management skills
- Communications skills
- Ability to work well with others
- Math skills
- Computer skills
- Decision-making skills
- Problem-solving skills
- Leadership skills

Job Titles

Many jobs are available in hospitality and tourism. Some job titles for this career area include the following:

- Executive chef
- Flight attendant
- Hotel desk clerk
- Hotel manager
- Meeting planner
- Restaurant owner or manager
- Theme park manager or worker
- Travel agent
- Zookeeper

Explore a Job

1. Choose a job in hospitality and tourism to explore further. Select a job from the list above, or choose another job in this career area.
2. Access the *Occupational Outlook Handbook* online. A link to the site is provided on the Web site for this textbook.
3. Search for more information about the job you selected to answer these questions:
   - What is the nature of the work this job involves?
   - What is the job outlook for this job?
   - What training or qualifications are needed for this job?
   - What are the median annual earnings for this job?

Review

CHAPTER 11

Summary

- Investors should consider risk, return, and liquidity when making savings and investing choices.
- Savings accounts are low-risk and liquid, but the return is low.
- A money market account is a good option to choose for liquid savings.
- A certificate of deposit is a low-risk investment, but it is not liquid. Withdrawal penalties may apply if you withdraw money from a CD before the set time period.
- A U.S. savings bond is designed to be a long-term investment. Bonds can be purchased through banks or at the TreasuryDirect Web site.
- Bonds are issued by companies and governments. Government bonds and investment-grade corporate bonds are considered low-risk.
- Annuities are low-risk, illiquid investments. Some people purchase them to provide retirement income.
- Individual retirement plans include IRAs, SEPs, and Keoghs. Some of these plans are tax shelters because they lower tax liability.
- Employer-sponsored retirement accounts include 401(k), 403(b), and employer-provided pension plans. These are often part of an employee's benefit package.
- When you are vested, you can take your retirement account with you when you leave a job. A rollover is the process of moving an investment balance to another qualified account such as an IRA account.
- Mutual funds are a form of indirect investment with medium risk. You choose the types of funds to increase or reduce risk through asset allocation.
- Buying a home has risks but can provide good returns when home values rise faster than inflation.
- Buying individual stocks is a high-risk investment choice. Common stock is more risky than preferred stock.
- Business ventures, collectibles, and rental property have high risk, but they also have the potential for high returns.
- Futures contracts for commodities are considered speculative, or at the highest level of risk.
- Buying shares in a REIT is a form of indirect investing, similar to buying shares in a mutual fund. When REITs make profits, the profits are distributed to shareholders.
- An investment club is a group of people who pool their money together to buy and sell investments.

Key Terms

annuity	**common stock**	**mutual fund**
asset allocation	**direct investing**	**preferred stock**
business plan	**discount**	**redeem**
clearing account	**futures contract**	**rollover**
collectibles	**illiquid**	**tax shelter**
commodity	**indirect investing**	**vested**

ACTIVITY 1
Review Key Terms

Use the key terms from Chapter 11 to complete the following sentences:

1. Buying stock in a mutual fund or REIT is a type of ______________.
2. ______________ is the process of moving a retirement account balance to another qualified retirement account.
3. A(n) ______________ is a contract purchased from an insurance company that guarantees a series of regular payments for a set time.
4. Shares of ______________ may pay a guaranteed dividend to shareholders.
5. A(n) ______________ is a document that outlines how a business plans to succeed.
6. When an employee is ______________, he or she has legal rights to a retirement account.
7. Buying stocks or bonds directly from companies and holding them individually is known as ______________.
8. A(n) ______________ is an item of value that is bought and sold in a market, such as corn or silver.
9. Items bought for their investment value, such as art objects or coins, are called ______________.
10. Choosing a combination of stocks, bonds, mutual funds, or other investments to limit risk and increase returns is known as ______________.
11. When an investment cannot be turned into cash quickly without a penalty, it is said to be ______________.
12. A(n) ______________ is used to deposit money from stock sales and to pay for stocks when they are purchased.
13. An investment that allows investors to legally avoid income taxes is called a(n) ______________.
14. The difference between a bond's selling price and its face or maturity value is the ______________.
15. A(n) ______________ is an agreement to buy or sell a specific commodity or currency at a set price on a set date in the future.
16. Shares of stock that represent ownership interest and give stockholders voting rights in the company are called ______________.

17. When you cash in a bond at maturity, you ____________ the bond.
18. An investment fund that consists of stocks, bonds, and other investments focused on a strategy, such as balance or growth, is called a(n) ____________.

ACTIVITY 2
Math Minute

1. You have a CD for $1,000. The interest rate is 5 percent annually, and the term is 5 years. The CD has an early withdrawal penalty. If the money is withdrawn before 36 months, no interest is paid, and a penalty of 6 months' interest is levied. If you withdraw the money after 12 months, what penalty will you pay? How much money will you get?
2. You have a CD for $1,000. The interest rate is 5 percent annually, and the term is 5 years. The CD has an early withdrawal penalty. If the money is withdrawn before 36 months, interest is paid for the time the money is in the account, but a 6-month interest penalty is deducted. If you withdraw the money after 12 months, what penalty will you pay? How much money will you get?
3. You purchased a house for $125,000. You spent $15,000 for repairs and redecorating, property taxes, and other expenses. You sold the house 1 year later for $160,000. How much profit did you make on the house? What is your return on investment?
4. You purchased 100 shares of stock at $125 per share. One year later, the price of the stock has risen to $150 per share. What is the percentage increase in the stock price?
5. You own 75 shares of stock in a corporation. The company issues a three-for-one stock split. How many shares do you now own?

ACTIVITY 3
Risk and Liquidity

TEAMWORK

Critical Thinking

Work with a classmate to complete this activity.

1. Open the *Word* file *CH11 Grid* from the data files. This file contains the grid shown on the following page.
2. Complete the grid of investments based on risk, return, and liquidity. In each square of the grid, write one or more investments that fit the criteria. For example, in the first square, write the name of a savings or investing option that is liquid and has low risk. Write **None** in a square if no investment meets both the criteria.
3. Pick one type of investment from each column (one that has low risk, one with medium risk, and one with high risk) that you would consider having in your portfolio. Give an advantage and a disadvantage of each one.

	Low Risk	Medium Risk	High Risk
Liquid			
Low Return			
Medium Return			
High Return			

ACTIVITY 4
Research Mutual Funds

INTERNET www.thomsonedu.com/school/pfl

Indirect investing is a good way to have a diversified portfolio and to reduce risk. Mutual funds offer expert management and are available for various investment strategies, such as growth or a balance of good return with reasonable risk. In this activity, you will research one mutual fund on the Internet.

1. Access the Internet. Use a search engine to find sites that tell about mutual funds. Use the term **mutual fund list** for the search. You could also include other words in the search box, such as **bonds, growth**, or **stocks**, to find a particular type of mutual fund.
2. Review two or three Web sites that tell about mutual funds. Choose one fund. For that fund, record this information:
   - Fund name
   - Fund trading symbol
   - Strategy of the fund (such as balance or growth)
   - Holdings (list of investments the fund contains)
   - Performance in recent years (percent of return each year)
3. Find the selling price of a share in the mutual fund. You may have to visit a different Web site that provides market quotes to find the price. The price will likely be labeled NAV (for net asset value). The NAV is the price of one share in the fund at the close of trading on a particular day.
4. What do you think is the risk level of this mutual fund—low, medium, or high?

ACTIVITY 5
Rental Property Return on Investment

Buying real estate to rent is an option that has higher risk than some other investments. However, the returns can be good. Assume you have purchased a single-family home that you intend to rent. The house will rent for $750 per month. You will have the following expenses:

Monthly mortgage	$390
Monthly insurance	$60
Taxes every 6 months	$340
Repairs (yearly estimate)	$500
Monthly lawn care or snow removal	$100

1. Calculate the total yearly expenses you will have for the rental property.
2. Calculate the total rent you will receive in a year. Assume the house is rented for the full 12 months per year.
3. What is your return on investment for the property?
4. Some of your expenses have increased, as shown below. Calculate the total yearly expenses you will have for the rental property after the cost increases.

Monthly insurance	$70
Taxes every 6 months	$380
Yearly lawn care or snow removal	$1,400

5. What is the new return on investment for the property?
6. What might you do to increase your return on investment?

CHAPTER 12 Buying and Selling Investments

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Chapter 12 covers the basics of buying and selling investments. You will learn about doing research before you invest to help you make better choices. Much information about investing is available. Some information is free; some is very costly. You will also learn about many regulatory agencies. They are designed to protect you, the investor, when you buy and sell securities.

ONLINE RESOURCES

Personal Financial Literacy Web site:

- Data Files
- Vocabulary Flashcards
- Beat the Clock: Buying and Selling Investments
- Chapter 12 Supplemental Activity

Search terms:

- auction market
- discount broker
- over-the-counter market
- market order
- stock split
- stockbroker

12-1

Researching Investments

OUTCOMES

- Describe the types of financial information found in magazines, newspapers, and newsletters.
- Describe the type of data found in company reports.
- Explain how to find investing information on the Internet.
- List figures that can be used to compare the performance or value of companies.
- Explain how investment professionals help investors.

SOURCES OF INFORMATION

Some people hire a stockbroker or financial planner to help them choose investments. Other people do research and make choices on their own. Either way, investors need a basic knowledge of financial markets. Keeping informed about current market conditions helps investors make better choices.

Magazines

Business magazines, such as *BusinessWeek, Fortune*, and *Forbes*, contain information that can be helpful to investors. In these magazines, you can read business articles and get experts' opinions on various topics related to investing and the economy. For example, suppose the experts say that the economy is growing. As a result, you can expect interest rates to rise. Knowing this, you may want to avoid buying a CD or bond with a low, fixed rate. Reading business magazines can help you understand the economy and the markets. This, in turn, will help you choose the right investments at the right times.

You can also find good information in news magazines such as *Time, Newsweek*, and *U.S. News & World Report*. Read these magazines to study world events that affect the economy and investments. The magazines also have regular features that include financial advice.

Several magazines give information about saving, investing, and personal finance. Examples include *Money, Consumer Reports*, and *SmartMoney*. You can read articles in these magazines about people who have been successful. The articles can help you can learn from their mistakes and profit from their successes.

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Staying informed about the economy can help you make better investment choices.

Newspapers

One of the best sources for current information is the financial sections of newspapers. You will find articles about business triumphs and failures. You can read about new products and services. You will also see articles about the latest business scandals and frauds. Price quotes for securities are provided in many newspapers. The word *securities* refers to stocks, bonds, mutual funds, and other investments. The information you learn can help you make better investment choices.

The *Wall Street Journal* and *Barron's* are two national newspapers that report financial news and other events that affect markets. They provide market price quotes and articles about national and world events. These articles discuss market data and predict how it will affect the stock market. For example, when the Fed raises interest rates, different parts of the market are affected in different ways. (The credit industry will benefit, and stock prices will rise.) These newspapers are geared to the business world, but consumers can benefit from reading them as well.

Investor Newsletters

Many financial advisors prepare free newsletters for their clients. The newsletters contain data about economic events and trends. The advisors may also make comments about certain stocks, bonds, or mutual funds. They may recommend that investors buy or sell securities. This data can help investors decide how to manage their portfolios.

Investors can subscribe to newsletters that give financial advice. Examples of these newsletters are *Standard & Poor's Stock Reports, Moody's Investor Service*, and *Value Line Investment Survey*. The newsletters may discuss how to reduce risk, changing market conditions, stocks to watch, and other information related to investing. Subscriptions to newsletters may cost from $50 to $1,000 per year.

Company Reports

All companies that sell stock to the public must publish yearly annual reports. An **annual report** is a company's report to shareholders about the financial position of the company. It also tells about profits or losses and plans for the future. These reports are free, and many are available online as well as in print. A page from an annual report is shown in Figure 12-1.1 on page 349. This page gives information about the company stock and dividends. Annual reports include information that investors can use to compare one company to another. You can see how each company is doing over time. If you are considering investing in a company, learn as much as you can about the company.

The Internet

Investors can find information about companies, products, and market trends on the Internet. One of the best ways to find information is to

FIGURE 12-1.1 *A company annual report contains information that is useful to investors.*

THE THOMSON CORPORATION
2005 ANNUAL REPORT

Corporate Information

Corporate Headquarters

Metro Center One Station Place
Stamford, Connecticut 06902
United States

tel 203.539.8000

generalinfo@thomson.com

Stock Exchange Listings

Common shares (symbol: TOC):

- Toronto Stock Exchange (TSX)
- New York Stock Exchange (NYSE)

Series II preference shares

(symbol: TOC.PR.B):

- Toronto Stock Exchange (TSX)

Capital Stock

Shares outstanding as of December 31, 2005:

- Common: 648,948,992
- Series II preference: 6,000,000

Controlling shareholder:
Kenneth R. Thomson
(approximately 69% of common shares)

2005 Financial Calendar

Year end: December 31

Quarterly results: announced on April 27 (Q1), July 27 (Q2) and October 26 (Q3).

Common Share Dividends

At the discretion of the directors. Paid on March 15/June 15/September 15/December 15 or on the first business day thereafter. Declared in U.S. dollars but can be paid in Canadian dollars or U.K. pounds sterling at the holder's option (see also note 15, page 86).

Further information is available from the registrar.

Dividend Reinvestment Plan

Eligible common shareholders may elect to have cash dividends reinvested in common shares. Further information is available from the registrar.

Employees

As of December 31, 2005, we had approximately 40,500 employees.

Annual and Special Meeting of Shareholders

Wednesday, May 3, 2006, 12:00 p.m. at
Roy Thomson Hall
60 Simcoe Street
Toronto, Ontario, Canada

Transfer Agent and Registrar

Computershare Trust Company of Canada 100 University Avenue, 9th Floor

Toronto, Ontario M5J 2Y1

Canada

tel 1.800.564.6253 (United States, Canada) tel 514.982.7555 (outside North America)
www.computershare.com

Auditors

PricewaterhouseCoopers LLP Suite 3000, Box 82

Royal Trust Tower

Toronto-Dominion Centre Toronto, Ontario
M5K 1G8 Canada

Further Information

Please visit www.thomson.com for corporate and management news and more detailed information on individual Thomson businesses, products and services.

Source: Thomson Corporation, Annual and Quarterly Reports, http://www.thomson.com/corp/investor_relations/ir_annquarterly_reports.jsp (accessed August 22, 2006).

FIGURE 12-1.2

Internet sites provide valuable information for investors.

INTERNET SITES	
Site Name	**Information Provided**
Bloomberg.com	News articles; market data for stocks, bonds, currency, mutual funds, commodities, and other securities; investment tools; online tutorials for investing; and other features
CNNMoney.com	Current financial news and information to help investors make better decisions
Kiplinger	Tools to help beginners get started. Investors can use this site to track investments in both stocks and mutual funds.
Morningstar®	Articles related to investments, stocks in the news, research reports, newsletters, a feature to track and analyze a portfolio, and other tools
Reuters®	Business and investing articles, stock quotes, bond and currency news, and a feature to track investments

use a search engine. Google, Yahoo!, AltaVista®, and other search engines allow users to search for data on almost any topic. Users can find out about companies, stocks, bonds, mutual funds, brokerage firms, and banks. Many businesses provide company data on their Web sites. You can find a company Web site by entering its name in a search engine. Figure 12-1.2 lists some Internet sites that investors might find helpful. Links to the sites are provided on the Web site for this textbook. Some sites allow investors to set up a free account and monitor investments.

Using Research Data

A great deal of information about investing is available in print and online. Investors need to know about the economy and current market trends. They also need to learn about specific companies or funds in which they may want to invest. News articles are a good source of information on the economy and markets. Annual reports and online profiles are good sources of data about specific companies or mutual funds.

Web sites such as Yahoo! Finance allow the user to enter a company symbol to find data about the company. The current stock price for the company is given. News articles related to the company or industry may also appear. A history of stock prices, stock splits, and dividend data is available. Key numbers and financial statements are provided. Much of the same data can be found in company annual reports. Data is also available for mutual funds. All this data can help investors evaluate the company or mutual fund.

With so much data available, investors may feel overwhelmed. They may not understand all the data or know how to compare companies or funds. Figure 12-1.3 on page 351 describes a few key figures that investors can use to compare companies. Investors who plan to choose stocks or mutual funds on their own may want to take classes or read books to learn more about investing. Many investors seek advice from experts when deciding how to invest.

COMPARISON FIGURES	
Figure	**Description**
Current stock price	This price is the amount investors are willing to pay for a share of ownership in the company.
Number of employees	Increases or decreases in the number of employees can reflect growth or downsizing.
Market cap (capitalization)	The total value of a company in the stock market (total shares outstanding times price per share). This figure, along with revenue, indicates the size of a company.
Revenue	The amount of money received from business activities. This may be mostly from sales of products and/or services to customers.
Net income or profit	The amount of money earned after deducting all the business's expenses. To investors, this number is more important than revenue.
Profit margin	Profit shown as a percentage. It is the net income divided by revenue for the same period.
P/E ratio	The price earnings ratio compares the selling price of a company's common stock to the annual profits per share. Fast-growing or low-risk companies may have higher P/E ratios than slow-growing or low-risk companies. This ratio is an important measure of a stock's value.
Current ratio	A measure of a company's ability to pay its current debts from current assets. It indicates a company's liquidity and financial strength. The current ratio is calculated by dividing the total current assets by the total current liabilities.

FIGURE 12-1.3

Key figures can be used to compare the value or performance of companies.

ADVICE FROM PROFESSIONALS

Choosing which stock, bond, mutual fund, or other investment to buy is an important decision. Many investors seek advice from experts in the investing field. A fee is typically charged for investment advice or for making a sale or purchase for an investor.

A **stockbroker** is a person who buys and sells securities on behalf of others. Stockbrokers may also provide advice on which products to buy. The broker will make commissions on the items the investor buys.

A financial planner is an advisor who helps people make investment decisions to meet stated goals. Typically, investors are asked to give data about assets owned and income earned. They also list their goals, such as saving for retirement or paying for a child's college education. The planner considers this information and suggests options that will help meet the investor's goals. Some financial planners also sell securities, such as stocks and bonds. They may make a commission on products they sell.

Investors may go to some banks and credit unions for financial advice. Employees at these companies are licensed to sell securities that are endorsed by the company. They make a commission on products they sell. Some banks offer their own brand of securities. Rather than investing directly, investors can choose the bank's investment account. This is similar to owning shares of a mutual fund.

Choose advisors that you can trust to help you make the right choices. Be sure that they have proper licenses, bonds, and certifications. Ask how long they have been working for the bank or investment company. Also ask if they are members of the NASD (National Association of Securities Dealers). The NASD Web site provides a Broker Check feature. This feature allows you to learn about the background and license status of firms and brokers. Many state governments also provide similar data. Ask how your confidential and personal data will be protected by the broker or company. Deal only with advisors and companies that you think are properly licensed and qualified and have your interests in mind.

Building Communications Skills

Persuasive Messages

The goal of a persuasive message is to convince the reader to take (or not take) some action. For example, you may want the reader to buy a product or donate money to a charity.

It is tempting to write a very long message to persuade someone to do as you think they should. However, long messages are often discarded without being read. People may not read a long and detailed message unless they have asked for it. Thus, the message must be concise as well as clear and convincing.

You must gain the reader's attention and give solid reasons for the person to take action. The reader may have an opinion or bias that you must overcome. Your arguments must be logical and appealing. In the first paragraph, give one good reason why the reader should keep reading. In the middle paragraph(s), explain your position and give evidence to support it. In the final paragraph, give the reader a reason to take action or accept your position. Use a positive tone throughout the message.

12-1 Activity 1 Can You Recall?

Answer these questions to help you recall what you have read. If you cannot answer a question, read the related section again.

1. Describe the types of financial information found in print items such as magazines, newspapers, and newsletters.
2. List three magazines that give information and advice about spending and investing.
3. List two newspapers that provide information helpful to investors.
4. Explain why an investor might be willing to pay for a subscription to an investor newsletter.
5. Describe the type of information available in a company annual report.
6. Give two examples of Internet search engines you could use to find information about companies or investments.
7. Explain ways you can find investing information on the Internet.
8. List several figures that can be used to compare the performance or value of companies.
9. How do investment professionals, such as stockbrokers or financial planners, help investors?
10. What steps can you take to be sure a stockbroker is qualified to give investing advice or make purchases for an investor?

12-1 Activity 2 Research Companies

INTERNET www.thomsonedu.com/school/pfl

1. Choose three large corporations to research. Choose companies from the list below or others approved by your teacher.

Company	Trading Symbol	Company	Trading Symbol
Allstate Corp.	ALL	Johnson & Johnson	JNJ
Boeing Co.	BA	Kroger Co.	KR
Chevron Corp.	CVX	Mattel Inc.	MAT
Dow Chemical	DOW	Merrill Lynch	MER
Humana Inc.	HUM	Tyson Foods	TSN

2. Access the Internet. Use a search engine to find the Web site for each company you chose, or find data about the company on sites such as Yahoo! Finance. A link to this site is provided on the Web site for this textbook. For each company, find the following information:
   - Industry sector or primary business
   - Current stock price
   - Revenue for last year
   - Net income for last year
   - Profit margin for last year
   - P/E ratio for last year
   - Current ratio for last year
3. Create a table that compares the three companies. Use the table that follows as an example. Enter the data you found in columns 2, 3, and 4.

Company name			
Industry or primary business			
Current stock price			
Revenue			
Net income			
Profit margin			
P/E ratio			
Current ratio			

4. Which company had the highest revenue?
5. Which company had the highest net income?
6. Which company had the highest P/E ratio?
7. Did each company have a current ratio of 1 or above? If not, which ones did not?
8. Have you heard or read any current news reports about this company or its industry? If so, what were the main points of the reports?
9. Would you consider one or more of these companies a good investment? Why or why not?

12-2

Buying and Selling Securities

OUTCOMES

- Explain the difference between the primary market and the secondary market for securities.
- Compare buying stock on a securities exchange to buying in the over-the-counter market.
- Describe the steps in a buy transaction on a stock exchange.
- List advantages of direct investing.
- Compare a full-service stockbroker to a discount broker and an online broker.
- Discuss types of stock market orders.
- Explain the purpose of market timing strategies.

TRADING SECURITIES

Securities are stocks, bonds, and other financial investments. When securities are bought or sold, they are said to be traded. Investors can trade directly or use the services of a broker. Investors can trust a professional to manage the investments, or they can be involved in all the decisions.

Primary Market

The **primary market** is one in which new issues of securities are sold. Proceeds of sales go to the issuer of the securities sold. New security issues (stocks and bonds) are issued through investment banks. An investment bank is a company that helps corporations raise money by selling stocks and bonds. A fee is charged for this service. The process takes many months to complete. New security offers are often in the form of initial public offerings. An **initial public offering** (IPO) is a company's first sale of its stock to the public. IPOs are often made by small or young companies seeking to expand their business. They can do this with the money raised by selling stock. In 1999, in one of the largest IPOs in Wall Street history, UPS (United Parcel Service) raised $5.27 billion in its IPO.[1]

[1] UPS, "UPS Launches Class A-1 Tender Offer," February 4, 2000, http://www.pressroom.ups.com/pressreleases/archives/archive/0,1363,3544,00.html (accessed August 28, 2006).

UPS raised more than $5 billon in its IPO.

Secondary Market

The **secondary market** is one in which securities are bought from current investors. A buyer is trading with someone who already owns the stock. After stock is sold in the primary market, it can be resold many times in the secondary market. Many securities are listed on securities exchanges. Some can also be found in the over-the counter market.

SECURITIES EXCHANGES

A **securities exchange** is a place where brokers buy and sell securities for their clients. Securities listed on the exchange have been accepted for trading at that exchange. The New York Stock Exchange (NYSE) is one of the largest security exchanges in the world. It lists more than 3,000 stocks. The exchange has 1,366 stockbroker members. These members can buy and sell securities. The American Stock Exchange (AMEX) and various regional stock exchanges are smaller. They have less strict requirements for companies to be listed than does the NYSE. Securities exchanges are auction markets. An **auction market** is one in which a stock is sold to the highest bidder. Both buyers and sellers compete with others for the best price. The steps in a transaction to buy stock are shown in Figure 12-2.1 on page 357.

THE OVER-THE-COUNTER MARKET

The **over-the-counter market** is a network of dealers who buy and sell stocks and other securities. These stocks are not listed with a securities exchange. Stocks issued by several thousand companies are traded this way. NASDAQ is an electronic marketplace for over-the-counter stocks. This computerized system allows investors to buy and sell stocks through their brokers. More than 5,000 stocks are listed on NASDAQ. When stock is traded, offers to buy are matched with offers to sell.

STEPS IN A STOCK BUY TRANSACTION

The following are steps an investor would take to buy stock traded on the New York Stock Exchange:

1. The investor calls or e-mails the broker and asks him or her to buy shares of stock.
2. The broker relays the order electronically to a representative at the stock exchange.
3. A clerk for the broker at the exchange receives the message and gives it to a floor broker.
4. The floor broker goes to the trading post at which this stock is traded.
5. The floor broker negotiates a buy from the floor broker of the stock being sold.
6. After the trade is made, the floor broker relays a message to the clerk and to the consolidated ticker tape.
7. The sale appears on the ticker tape.
8. A confirmation is sent to the investor's broker.
9. The broker notifies the investor that the transaction is complete.
10. The investor's account reflects money exchanged for stock at the price and quantity agreed upon.

FIGURE 12-2.1

Stocks are traded by brokers on the New York Stock Exchange.

DIRECT INVESTING

Many companies have direct investing plans. Direct investing allows you to buy stock directly from a corporation. You do not use a brokerage company. Direct investing allows you to reinvest dividends as well. With this option, cash dividends are used to buy more shares of stock. People who do direct investing can use a spreadsheet to keep track of their investments, as shown in Figure 12-2.2 on page 358.

Direct investing can be risky. When you buy stock in only one company, you have not diversified. However, you could use direct investing to buy stocks in several companies. Buying U.S. government savings bonds is also a form of direct investing. This type of investment is low-risk.

Direct investing offers many advantages. One advantage is avoiding taxes. When cash dividends are converted to new shares of stock, they are not taxed. Investors can acquire many shares this way. Interest on U.S. savings bonds is not taxable until the bond is cashed. If the bond is used for education expenses, then the interest may not be subject to federal taxes when cashed.

With direct investing, there are no brokerage fees to pay. This advantage makes direct investing attractive to some investors. Another advantage is that you know which securities you have at all times. When you buy direct, you make the decisions about the items to buy and sell and the timing of the transactions.

Sometimes corporations issue a stock dividend instead of a cash dividend. A **stock dividend** is a dividend paid in the form of new shares of stock instead of cash. Stockholders have more shares of stock for future growth. A **stock split** occurs when a company issues more stock to current stockholders in some proportion. For example a two-for-one split means that for every share you own, you get an additional share of stock. Stock dividends and stock splits involve no brokerage fees or costs to investors, and they are not taxable income.

FIGURE 12-2.2

People who do direct investing should keep track of the performance of their investments.

	A	B	C	D	E	F	G
1	STOCK RECORD						
2							
3	**Stock A**						
4	**Purchase Date**	**No. of Shares**	**Price Paid per Share**	**Sold Date**	**No. of Shares**	**Price Received per Share**	**ROI**
5	12/2/20--	500	$55.25				
6	3/30/20--	100	$58.45	12/28/20--	100	$68.00	21.9%
7							
8							
9	**Date**	**Closing Price**		**Average Price Paid**		$55.78	
10	1/3/20--	$55.00					
11	2/1/20--	$57.25					
12	3/1/20--	$58.95					
13	4/1/20--	$52.50					
14	5/1/20--	$53.78					
15	6/1/20--	$57.50					
16	7/1/20--	$59.32					
17	8/1/20--	$59.25					
18	9/1/20--	$60.35					
19	10/1/20--	$65.50					
20	11/1/20--	$70.65					
21	12/1/20--	$68.50					
22							
23	**Average Price**	$59.88					
24	**Highest Price**	$70.65					
25	**Lowest Price**	$52.50					
26							
27							

At some companies, employees can buy stock in the company. Some companies give shares of stock to employees as part of a benefits package. There are no brokerage fees or other costs for the employee in these transactions.

BROKER SERVICES

When you use the services of a stock agent or broker, you pay this person to buy or sell securities on your behalf. From some brokers, you also get advice about what and when to buy and sell. Although these services cost money, they can help you invest wisely.

Full-Service Brokers

If you buy securities through a full-service stockbroker, you will receive advice about what to buy. A stockbroker is a licensed professional who buys and sells securities for her or his clients. Stocks, bonds, mutual funds, and commodity futures contracts are examples of securities traded through stockbrokers. The broker will consider your investment goals. He or she will try to help you achieve those goals through your investment choices. You will be charged a commission or fee for the services provided. You will receive regular reports of activity and account balances.

The stockbroker will consider the information you provide. You should clearly state your financial goals. Be honest about your tolerance for risk. Be realistic in what you expect for returns on the money you invest. This information, along with her or his knowledge about the market and securities, will be used to select stocks or other investments for you. The broker will recommend securities to buy and sell and the timing of those trades. Merrill Lynch and A.G. Edwards are examples of full-service brokerage firms.

Ethics

Churning

Brokers earn fees for buying and selling securities for clients. Some may charge as much as $75 for a single trade. The more trades they make, the more money they earn. When a broker is constantly buying and selling stocks, the client may or may not be making profits. Trading securities primarily to make money from sales commissions is called churning.

Churning is illegal under rules of the Securities and Exchange Commission (SEC). However, it can be hard to prove. Brokers are not liable for losses when they buy and sell for their clients. Investors sign a waiver that states brokers are not responsible for losses in stock trades.

Securities trading should be done with the intent to benefit clients. Trading for the purpose of generating fees for the broker is unethical. How will you know if this is happening? It may be hard for the average investor to know that he or she is being taken advantage of. If you think you have been a victim of churning, you can report the problem to the SEC using an online form. Visit the SEC Web site, shown in Figure 12-2.3, to learn more.

FIGURE 12-2.3 *Churning can be reported online at the SEC Web site.*


Address http://www.sec.gov/answers/churning.htm Go

Home | Previous Page

U.S. Securities and Exchange Commission

Churning

Churning refers to excessive buying and selling in your account by your broker. For churning to occur, your broker must exercise control over the investment decisions in your account, either through a formal written discretionary agreement or otherwise, and must engage in excessive trading in light of the financial resources and character of the account for the purpose of generating commissions.

The major securities industry self-regulatory organizations have rules prohibiting churning. You'll find the NASD's churning rule – Rule 2310-2(b)(2) – in the "NASD Manual." To request a copy of the New York Stock Exchange's churning rule – Rule 408(c) – please call the NYSE at (212) 656-2744.

If you believe your broker has churned your account or engaged in another sales practice abuse, please send us your complaint using our online complaint form.

Source: U.S. Securities and Exchange Commission, Churning, http://www.sec.gov/answers/churning.htm (accessed August 28, 2006).

Discount Brokers

A **discount broker** works for a firm that buys or sells securities on behalf of investors. The term *discount broker* is also used to refer to the brokerage firm. The fees or commissions charged by a discount broker are much lower than those charged by a full-service broker. The firm may charge a flat fee for its services of buying and selling. An amount such as $12.95 per transaction is a typical fee. Discount brokers offer limited services. They do not give advice or help manage assets. However, some firms do offer free research reports. A discount broker has the same qualifications as a full-service broker. Fidelity Investments is an example of a discount brokerage company.

Online Brokers

Many brokerage firms offer their services online. Online brokers charge low fees. They also give the least amount of service. They do not provide investment advice or manage assets. Some firms do offer free research reports. You must make your own decisions about buying and selling. Once you decide, you set up an account with an online broker. Different types of accounts are available. Investors can make single trades. Some sites also offer automatic investment plans that help users invest on a regular basis. Sharebuilder and TD Ameritrade are examples of online brokerage services.

Commissions and Fees

Stockbrokers make money when stocks are bought and sold for clients. Some brokerage firms have minimum commissions of $25 to $60. Additional fees may be charged based on the number of shares and on the value of the stock being traded. On the trading floor of a stock exchange, stocks are traded in round lots or odd lots. A **round lot** is 100 shares or multiples of 100 shares of stock. An **odd lot** is fewer than 100 shares. When you buy less than a round lot, there is an additional fee.

Discount brokers usually charge a flat fee, such as $8.95 per transaction. However, for odd lots or small amounts, they often have higher fees. For example, when the trade amount is less than $1,000, the transaction fee may be higher.

STOCK TRANSACTIONS

Once you have decided to buy or sell a stock, there are four types of transactions, called orders, that you can request.

- A **market order** is a request to buy (or sell) a stock at the current market value. In an auction market, the broker will try to get you the best price as soon as possible. There is no guarantee of what you will pay or receive. The stock will be auctioned to the highest bidder, and you may or may not buy or sell the stock at the price you hoped to get.
- A **limit order** is a request to buy (or sell) a stock at a specific price. When you are buying, a limit order ensures that you will not pay more than a set dollar amount. When you are selling, the order

Focus on . . .

Full-Service or Discount Brokers?

There is a healthy competition between full-service brokers and other types of brokers. A smaller fee for services is one reason people choose discount or online brokers. There are other factors to consider as well. One factor is the amount of information available and how much it costs. If you have to pay extra to get the information you need to make good choices, then discount brokers may not save you money in the long run.

Another factor to think about is the amount of help you will need to make wise investment choices. If you do not have the time or expertise to study the market, you may find that your choices are not very profitable. You may be better off paying higher fees for sound investment advice from a full-service broker.

Investors should also look at how easy it is to buy and sell. Investors must compare services in terms of the type of trading they want to do. For example, do you want to trade online or by phone? Where is the nearest office? How often do investors receive statements? What is the charge for services such as research? What are all the fees that will be charged for having an account? Are there minimum deposits? Consider all these factors carefully to help decide which type of broker is right for you.

ensures that you will not get less than a specific dollar amount if the stock is sold.

- A **stop order** is a request to sell at the next available time after the price reaches a certain amount. This type of order protects an investor from a sudden drop in price.
- A **discretionary order** is an order to buy (or sell) a stock that lets the broker get the best possible price. The broker also determines the best time to buy. This type of order may involve a range of shares, such as buying odd numbers of shares if they are available. Discretionary orders give the broker the power to use her or his experience and judgment to make good decisions.

MARKET TIMING

A market timing plan is a strategy used to increase profits and reduce costs. There are several timing plans you can use, regardless of the type of securities you buy and sell.

Selling short is selling stock that has been "borrowed" from a brokerage firm and must be replaced at a later date. You are hoping to make a sell agreement today for more money than you will have to pay for the stock at a later time. This is a lawful thing to do (if the brokerage firm allows it), but it is highly risky. You are hoping that prices will drop. If prices for the stock do not drop, you will lose money.

Buying on margin is a transaction in which you borrow part of the money to buy stock. The cash you use to pay for the rest of the purchase is called the margin. The margin amount is set by the Fed. This is a form of leverage, or borrowing money to make a profit on a stock transaction. You may make less than if you paid for the stock yourself. However, you can buy more stocks with less money and thus possibly make more profits.

In some cases, the value of the stock purchased may drop by an amount equal to the margin. When that happens, the investor may be given a margin call. The investor must immediately provide more money or sell the stock in order not to default on the loan. Buying on margin is a risky strategy. Figure 12.2-4 illustrates buying on margin.

Buy and hold is a long-term plan in which investors make money in three ways. First, they will receive dividends over the years. Second, the price of the stock will go up (giving them long-term capital gains). Third, the stock may split. When a stock splits, they gain additional shares of stock. They do not have to pay commissions on the stock gained, and there is no tax to be paid on the added shares.

Regardless of your investment plan, you will find market timing important. You want to sell at prices that are higher than the amount you pay for investments. Understanding the economy and its signals can help you do this. You will not always earn profits, but with careful timing, you may be able to gain more than you lose.

FIGURE 12-2.4

Buying on margin involves borrowing part of the money to buy stocks.

BUYING ON MARGIN EXAMPLE

1. Marijen invests $5,000 and borrows $5,000 from a brokerage firm. She buys 500 shares at $20 per share ($10,000 purchase price). She uses the stock certificates as security for the loan (as required by the Fed) at 5% annual interest.
2. Six months later, the stock has increased in value to $30 per share. Marijen sells the stock for $15,000 (500 × $30 = $15,000). She pays commissions and fees of $150.
3. From her net proceeds of $14,850, Marijen repays the $5,000 loan plus $125 interest ($14,850 − $5,125 = $9,725). When she subtracts the $5,000 she originally invested, Marijen has made $4,725 net profit.

Note: There is no guarantee that the stock price will rise. If the stock price drops, Marijen has to pay interest on the loan and wait to sell the stock. If she sells when the price has dropped, she will lose money (principal).

Technology Corner

BLOGS

A ***blog*** (a shortened form of *Weblog*) is an online place where you can find short articles or comments on a particular subject area. Blogs usually include text messages. However, some blogs contain photos, videos, or sound. Blogs may read like a journal, and they are often shown with the most recent entry first. A blog may be posted by one individual. Some blogs are posted by companies or organizations. Several people may write the postings in a blog. Access to many blogs is free. Some blogs charge a fee for access.

Many blogs that deal with investing are available. Fidelity Investments' Amazon blog is one example. It contains articles related to many areas of investing. Retirement pensions, the market for gold, and increasing your investment knowledge are examples of the topics covered. Seeking Alpha™ is a network of blogs with articles posted by people such as portfolio managers, research analysts, and financial advisors.

Investors may find the articles and comments posted on blogs helpful when making investment decisions. They should be careful, however, about accepting the information posted on all blogs. Some blogs give comments on the investing strategy and ideas of one person. This person may or may not be qualified to give investing advice. Consider the source of the posting when deciding on its value. Is the article written by a person trained to give investing advice? Are sources listed so facts can be checked? Does the advice make sense when you think about other articles you have read? Answering these questions can help you tell the value of a blog posting.

12-2 REVIEW

12-2 Activity 1 Can You Recall?

Answer these questions to help you recall what you have read. If you cannot answer a question, read the related section again.

1. What is the difference between the primary market and the secondary market for securities?
2. What is an IPO? What is its purpose?
3. How does buying stock on a securities exchange differ from buying in the over-the-counter market?
4. List the steps in a buy transaction on a stock exchange.
5. List three advantages of direct investing.
6. What services do investors receive from a full-service broker?
7. What is an advantage of using a discount broker or an online broker rather than a full-service broker? What is a disadvantage?
8. What is a round lot in a stock order? What is an odd lot in a stock order?
9. Describe four types of stock market orders.
10. Explain the purpose of a market timing plan, and list three market timing plans.

12-2 Activity 2 Track Stock Performance

When investors use a full-service broker to buy stocks, they receive regular reports about the stocks. Investors who use direct investing or a discount broker should track their stocks regularly. In this activity, you will record stock purchases and related data in an *Excel* spreadsheet.

1. Open the *Excel* file *CH12 Stocks* from the data files. This file contains information about a stock purchased earlier. (A real stock name has not been used in this activity as it would be when you track stock you actually own.)
2. You purchased Stock A on December 2 last year. You have recorded the closing price for the stock at the beginning of the month for 6 months. Record the following closing prices in the worksheet:

Date	Closing Price
7/1/20--	$ 71.86
8/1/20--	$80.92
9/1/20--	$83.91
10/1/20--	$85.45
11/1/20--	$88.50
12/1/20--	$85.00

3. Enter a formula in cell B24 to find the average price of the stock for the prices recorded.
4. Enter a formula in cell B25 to find the highest price of the stock for the prices recorded.
5. Enter a formula in cell B26 to find the lowest price of the stock for the prices recorded.
6. On March 30 of the current year, you bought another 100 shares of Stock A at $69.00 per share. Record this data in the worksheet. (You can use the real current year instead of 20--.)
7. On December 28, you sold 100 shares of the stock at $86.00 per share. Enter this data in the worksheet.
8. Enter a formula in cell F9 to find the average price per share for the stocks you purchased. (Multiply the price by the number of shares for each purchase. Add the two amounts. Divide by the total number of shares purchased.)
9. Enter a formula in cell G6 to find the return on investment for the 100 shares you sold. You use a discount broker with very low fees, so you will not include the trade fees in the ROI calculation. Use the average price per share for the stocks you purchased in the ROI formula. (Reminder: ROI = total amount received − total amount paid/ total amount paid)
10. Create a line chart to show the closing price for Stock A for each of the 12 prices recorded. Use **STOCK A PRICES** for the chart title. Do not include a legend. Save the chart on a separate sheet in the workbook. Format the scale and other features for an attractive chart.
11. When could you have sold to receive a higher price than you received for the 100 shares you sold?
12. When would have been the best time (lowest price) to buy more of this stock between May 1 and September 1?

12-3

Regulatory Agencies

OUTCOMES

- Describe independent agencies that regulate and supervise the securities industry.
- Describe government agencies that regulate and supervise the financial industry.
- Explain the purpose of the Sarbanes-Oxley Act.

INDEPENDENT AGENCIES

Banks, brokerage companies, and other financial businesses are limited and controlled by a number of agencies. These agencies make or enforce rules and regulations. They act to protect consumers in many ways.

Federal Deposit Insurance Corporation

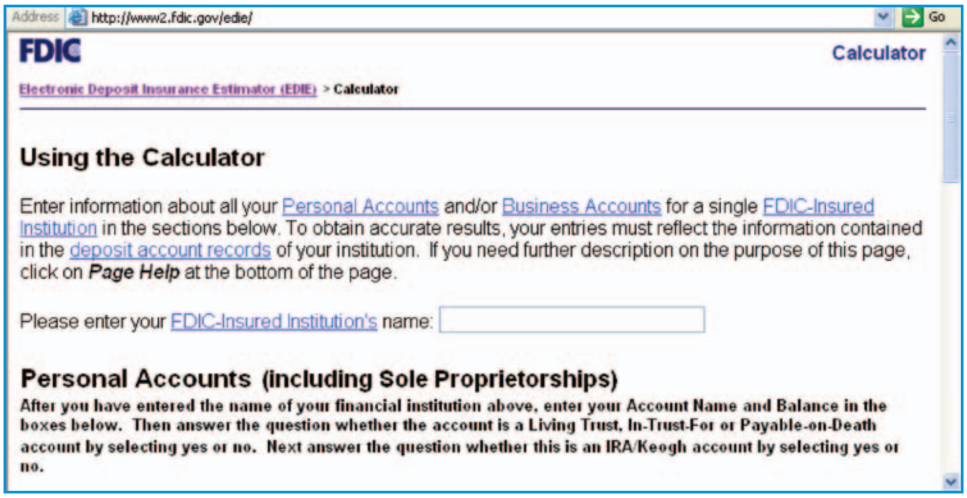
The Federal Deposit Insurance Corporation (FDIC) is an independent agency created by Congress in 1933. Its purpose is to promote public confidence in the banking system. It also supervises banks and other financial institutions to maintain a stable and sound banking system. The FDIC monitors advising, investment accounts, and practices at banks. These activities assure consumers that lawful and ethical practices are being used.

The FDIC insures deposits in banks and other financial institutions, such as savings and loan companies. Checking accounts, savings accounts, and other deposits, up to $100,000 per depositor per bank, are covered. Generally, separate coverage is provided for retirement accounts. This means that accounts such as an IRA held in an insured bank may be covered for up to $250,000. The FDIC provides an Electronic Deposit Insurance Calculator for consumer use. This calculator, described in Figure 12-3.1 on page 367, allows you to find the insurance coverage of your accounts at each FDIC-insured bank.

The FDIC also provides other consumer resources. At the FDIC Web site, you can find information about many topics related to investing. Other topics of interest to consumers are also discussed. For example, your right to financial privacy and how to avoid being a victim of identify theft are discussed.

National Credit Union Administration

The National Credit Union Administration (NCUA) is a federal agency that charters and supervises federal credit unions. It also supervises state-chartered credit unions across the country. The NCUA insures savings



Address http://www2.fdic.gov/edie/ Go

FDIC Calculator

Electronic Deposit Insurance Estimator (EDIE) > Calculator

Using the Calculator

Enter information about all your Personal Accounts and/or Business Accounts for a single FDIC-Insured Institution in the sections below. To obtain accurate results, your entries must reflect the information contained in the deposit account records of your institution. If you need further description on the purpose of this page, click on ***Page Help*** at the bottom of the page.

Please enter your FDIC-Insured Institution's name:

Personal Accounts (including Sole Proprietorships)

After you have entered the name of your financial institution above, enter your Account Name and Balance in the boxes below. Then answer the question whether the account is a Living Trust, In-Trust-For or Payable-on-Death account by selecting yes or no. Next answer the question whether this is an IRA/Keogh account by selecting yes or no.

FIGURE 12-3.1

The FDIC provides a calculator to help depositors find their insurance coverage for accounts.

Source: Federal Deposit Insurance Corporation, Electronic Deposit Insurance Estimator (EDIE), http://www2.fdic.gov/edie/ (accessed August 30, 2006).

deposits in federal credit unions and other member credit unions. Most share accounts in federally insured credit unions are insured for up to $100,000. Retirement account insurance protection is separate from coverage on other credit union accounts. Retirement accounts, such as an IRA, at insured credit unions are covered for up to $250,000.

The NCUA provides resources for its credit union members. It also provides resources for consumers, including workshops and financial advising. The NCUA Share Insurance Estimator is available on the NCUA Web site. It is an educational resource that gives a detailed explanation of insurance coverage.

National Association of Securities Dealers

The National Association of Securities Dealers (NASD) is a private, nonprofit organization. It is responsible for self-regulation of the securities industry. The NASD monitors trading on the NASDAQ stock market and other selected markets. Almost all securities firms that do business with the U.S. public are members of the NASD. It registers member firms and has rules to govern their behavior. It also checks to see that firms follow the rules. Firms breaking the rules may be charged high fines.

Protecting investors is a primary goal of the NASD. The NASD looks at advertising related to securities. Its goal is to see that ads are accurate and do not mislead the public. The NASD also licenses stockbrokers. Investors can find information about licensed brokers on the NASD Web site. The NASD provides materials in print and on its Web site to educate the public about investing. Its Investor Alerts give current news about investment scams and problems.

© Digital Vision

NASD sponsors continuing education programs for stockbrokers.

Pension Benefit Guaranty Corporation

The Pension Benefit Guaranty Corporation (PBGC) is a federal corporation. Its mission is to protect retirement incomes of workers with defined benefit pension plans. These plans are designed to pay a monthly benefit to retired workers. The amount is commonly based on the person's former salary and years spent on the job.

The PBGC collects insurance payments from companies that offer pension plans to their workers. It also earns money from investments. When a covered pension plan ends or fails for some reason, the PBGC pays some benefits to the retired workers. However, retirees may not get some benefits promised by the company. For example, health care benefits may not be covered. The maximum benefit is set by law. It depends, in part, on the year in which your plan ended. Your age at the date you begin receiving benefits is also a factor. Monthly maximum benefits tables are provided on the PBGC Web site. A link to the PBGC Web site is provided on the Web site for this textbook.

The PBGC Web site provides news releases related to pension plans, as shown in Figure 12-3.2 on page 369. It also offers helpful information about topics such as the following:

- How to learn if your pension plan is insured by PBGC
- How a pension plan may end
- Benefits likely to be provided to workers in the plan
- Survivor benefits
- How to start collecting pension benefits

Success Skills

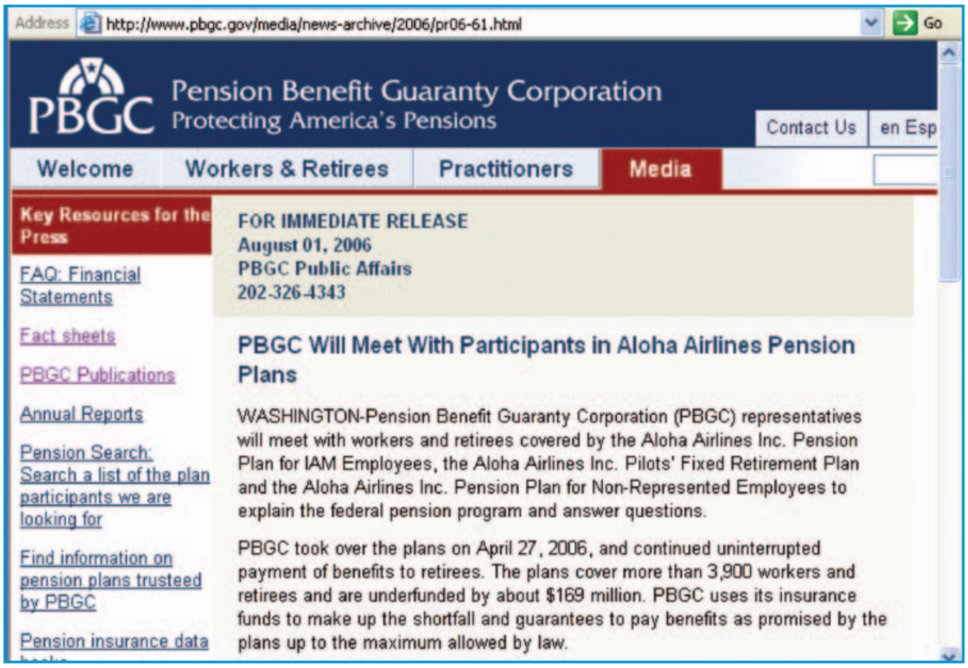
Leadership

Leadership is often defined as the ability to influence others. Leaders are those who accept responsibility and take the lead. They are often known by their roles, such as coach, manager, or mentor. Every leader has a unique leadership style. This style reflects the leader's actions and ways of communicating to motivate people and achieve goals.

Creating plans and motivating others to get work done are important tasks for a leader. Leaders are able to inspire others. A leader does not do all the work but is able to achieve goals by managing a team. A good leader builds strategic alliances—friendships with the right people who help get things done.

Leaders often have to deal with people in difficult situations and overcome obstacles to achieving goals. Leaders face many challenges, but they do not give up. They learn and grow. They earn the respect of others, who willingly follow.

Developing leadership skills can help you be successful at school and at work. At school, you can use leadership skills in clubs, sports, and other teams. At work, leadership skills can be important even if you are not in a management position. You may need to lead a committee, work group, or project team. Success at work contributes to job security and promotions. These, in turn, can help you build financial security.



Source: Pension Benefit Guaranty Corporation, "PBGC Will Meet With Participants in Aloha Airlines Pension Plans," August 1, 2006, http://www.pbgc.gov/media/news-archive/2006/pr06-61.html (accessed September 1, 2006).

FIGURE 12-3.2

The PBGC uses insurance funds to pay pension benefits.

GOVERNMENT AGENCIES

The U.S. government has agencies that seek to protect consumers. One role of these agencies is **oversight**. Through oversight, or supervision, they help protect investors from unlawful actions. States also have agencies that help protect investors.

Securities and Exchange Commission

The Securities and Exchange Commission (SEC) is the primary overseer and regulator of the U.S. securities markets. It oversees securities exchanges, brokers and dealers, investment advisors, and mutual funds. The SEC works with other federal and state agencies and with private organizations.

The SEC tries to maintain fair and orderly markets and foster business growth. It also enforces securities laws. Typical law violations include insider trading, accounting fraud, and giving false information about companies or securities.

A primary goal of the SEC is to protect investors. The SEC requires public companies to give meaningful and accurate data to the public. This data includes financial reports. Having the data helps investors make informed decisions.

Department of the Treasury

The U.S. Department of the Treasury is the primary federal agency responsible for the economic security of the United States. It has a wide range of duties related to financial issues. It seeks to help citizens by fostering an economy with growth and job opportunities.

Focus on . . .

SARBANES-OXLEY ACT

The Sarbanes-Oxley Act of 2002 (SOX) was passed in July 2002. The act is also known as the Public Company Accounting Reform and Investor Protection Act of 2002. This law created new and stronger standards for U.S. public companies and for accounting firms. The law was created in response to scandals in large companies. These scandals involved fraud or misconduct by company officers. They resulted in losses for investors and company employees.

SOX requires improved financial reporting, audits, and accounting services for public companies. The SEC has adopted rules that require companies to comply with the law.

The law established a new agency, the Public Company Accounting Oversight Board. The agency's purpose is to oversee and regulate accounting firms in their roles as auditors of public companies.

Information about many saving and investing topics is available online at the Department's Web site. The Department of the Treasury is a member agency of the U.S. Financial Literacy and Education Commission. The commission provides a Web site called MyMoney.gov. The site allows consumers to order a free *My Money* tool kit. The site also provides

FIGURE 12-3.3

The MyMoney.gov Web site offers valuable information for consumers.

Source: MyMoney.gov, http://www.mymoney.gov/ (accessed September 2, 2006).

consumers with information about topics such as saving and investing, privacy, retirement planning, and starting a business. A link to the Web site is provided on the Web site for this textbook.

Internal Revenue Service

The Internal Revenue Service (IRS) is a bureau of the U.S. Department of the Treasury. Its role is to help taxpayers understand and meet their tax responsibilities. It also seeks to ensure that those who owe taxes pay them.

In Chapter 2, you learned about paying taxes and completing simple IRS tax forms. When you own, buy, or sell securities, you may need to report this activity as part of your tax return. Figure 12-3.4 shows a portion of Form 1040A. This form has several lines on which taxpayers report interest, dividends, and capital gains.

Form 1040EZ is the simplest tax form to complete. Form 1040A allows more options for income and deductions to be entered. Some sections require the filer to attach additional forms, often called schedules. For example, Form 1099-INT shows interest income earned during the year. This form is sent to individuals by the bank that pays the interest. Taxable interest must be reported on your tax return. If a taxpayer sells stocks or bonds during the tax year, that activity must be reported on Schedule D of Form 1040.

Taxpayers should read the tax form instructions carefully to be sure all investing activity is properly reported. Taxpayers who have many investments and several transactions during the year may want to hire a trained tax preparer to complete the forms.

The Federal Reserve

The Federal Reserve System is the central bank of the United States. Its purpose is to provide the nation with a safe and flexible financial system. Its activities are in four general areas as follows:

- Conducting monetary policy
- Providing financial services to the U.S. government, financial institutions, and the public
- Supervising and regulating banking
- Keeping the country's financial systems and markets stable

The Federal Reserve is covered in more detail in Chapter 5, Banking Procedures.

Income					
Attach Form(s) W-2 here. Also attach Form(s) 1099-R if tax was withheld.	**7**	Wages, salaries, tips, etc. Attach Form(s) W-2.			7
	8a	**Taxable** interest. Attach Schedule 1 if required.			8a
	b	**Tax-exempt** interest. **Do not** include on line 8a.	8b		
	9a	Ordinary dividends. Attach Schedule 1 if required.			9a
	b	Qualified dividends (see page 25).	9b		
	10	Capital gain distributions (see page 25).			10
If you did not get a W-2, see page 24.	**11a**	IRA distributions.	11a	**11b** Taxable amount (see page 25).	11b
Enclose, but do not attach, any payment.	**12a**	Pensions and annuities.	12a	**12b** Taxable amount (see page 26).	12b
	13	Unemployment compensation and Alaska Permanent Fund dividends.			13
	14a	Social security benefits.	14a	**14b** Taxable amount (see page 28).	14b
	15	Add lines 7 through 14b (far right column). This is your **total income.** ▶			15

Source: Internal Revenue Service, 2005 Form 1040A, http://www.irs.gov/pub/irs-pdf/f1040a.pdf (accessed September 2, 2006).

FIGURE 12-3.4

Data related to investments must be reported on tax forms.

12-3 Activity 1 Can You Recall?

Answer these questions to help you recall what you have read. If you cannot answer a question, read the related section again.

1. What is purpose of the FDIC? How does it benefit consumers?
2. What is the NCUA? What does it do?
3. What is the NASD? What does it do?
4. What organization is responsible for protecting the retirement incomes of workers with defined benefit pension plans?
5. What is meant by government oversight of the securities industry?
6. What does the SEC do to protect investors?
7. What prompted passage of the Sarbanes-Oxley Act of 2002? How does this law help protect consumers and investors?
8. What is the primary federal agency responsible for the economic security of the United States? How does it help citizens?
9. What organization provides the MyMoney.gov Web site? What types of information are available on the site?
10. How does the IRS help consumers? What tax form is used to report details of stock trades?

12-3 Activity 2 Tax Reporting for Investments

Investors who sell stocks and bonds (except for retirement investment accounts) will need to fill out tax Form 1040. They will also need to complete Schedule D to find the amount of capital gain or loss on sales. If you buy and sell stocks using a broker, the broker should supply the information needed to prepare Schedule D.

1. Open the PDF file *CH12 Schedule D* from the data files. Print the form. This form is Schedule D, which is used to report investment activity for Form 1040.
2. Write your name and Social Security number on the first line of the form. If you do not have a Social Security number or want to keep your number private, use 000-22-1111 as the number.
3. You had the investment activity shown in the following table. Part I of the form is used to report the sale of assets held for 1 year or less. The *Sales Price* is the amount you received less any trading fees. The *Cost or Other Basis* is the amount you paid for the stock plus

trading fees. Enter the data in Part I, line 1, of the form. (If you were actually completing a tax return, you would use real stock names instead of Stock A, Stock B, etc.)

Description of Property	Date Acquired	Date Sold	Sales Price	Cost or Other Basis
Stock A, 100 shares	4/1/2005	9/30/2005	$ 1,050.00	$ 900.00
Stock B, 300 shares	3/20/2005	11/3/2005	$3,000.00	$2,500.00

4. Calculate the amount of gain or loss for each stock. Enter the amount in Part I, column F, of the form.
5. Total the short-term sales price amounts. Enter the amount on line 3.
6. Leave lines 4, 5, and 6 blank. Find the total of Part I, column F, and enter the amount on line 7, column F.
7. Part II of the form is used to report activity for assets held more than 1 year. Enter the following data in Part II on line 8:

Description of Property	Date Acquired	Date Sold	Sales Price	Cost or Other Basis
Stock C, 200 shares	5/15/2002	8/30/2005	$3,000.00	$2,400.00
Stock D, 100 shares	6/20/2004	7/31/2005	$ 900.00	$ 1,000.00

8. Find the total of the sales prices in column D. Enter this amount on line 10.
9. Calculate the amount of gain or loss for each stock. Enter the amount in Part II, column F. Enter an amount that is a loss in parentheses.
10. Leave lines 11, 12, 13, and 14 blank. Calculate the total amount of gain or loss from the amounts in Part II, column F. Enter this amount on line 15.
11. Total the amounts from lines 7 and 15. Enter the amount on line 16.
12. On line 17, check the *Yes* box. Leave lines 18 and 19 blank.
13. On line 20, check the *Yes* box.
14. Leave lines 21 and 22 blank. You have now completed Schedule D. Information from this form would be used to complete Form 1040.

EXPLORING CAREERS IN AGRICULTURE, FOOD, AND NATURAL RESOURCES

Do you like to work outdoors? Are you good at making plants grow? Is caring for animals something you like to do? If the answer is yes, a career in agriculture, food, and natural resources might be right for you. Jobs in this area are varied. You might choose to be a farm or ranch worker, growing crops or caring for livestock. You might choose to be a farm owner or manager, directing the work of others. You might also work in one of the many areas related to processing or marketing food or natural resources.

Jobs in this career area are found in government and businesses. The need for jobs in the agriculture, food, and natural resources career area is expected to grow. Job outlook varies by job.

Skills Needed

Some of the skills and traits needed for a career in agriculture, food, and natural resources include the following:

- Math and science skills
- Communications skills
- Computer/technology skills
- Management skills
- Decision-making skills
- Problem-solving skills

Job Titles

Many jobs are available in the agriculture, food, and natural resources field. Some job titles for this career area include the following:

- Botanist
- Farm supply store manager
- Farmer or rancher
- Forest worker or logger
- Greenhouse manager
- Mining engineer or technician
- Produce buyer
- Veterinarian
- Water quality manager

Explore a Job

1. Choose a job in the agriculture, food, and natural resources field to explore further. Select a job from the list above, or choose another job in this career area.
2. Access the *Occupational Outlook Handbook* online. A link to the site is provided on the Web site for this textbook.
3. Search for more information about the job you selected to answer these questions:
   - What is the nature of the work this job involves?
   - What is the job outlook for this job?
   - What training or qualifications are needed for this job?
   - What are the median annual earnings for this job?

CHAPTER 12 Review

Summary

- Investors should do thorough research before buying stocks, bonds, or other investments.
- Investors can find helpful information in magazines, newspapers, and newsletters related to investing.
- Corporate annual reports are free, and many are available online. They provide information about the company that can be helpful to investors.
- Investors can find information about companies, products, and market trends on the Internet.
- Investors can use key figures, such as revenue, net income, and P/E ratios, to compare companies.
- Professionals, such as stockbrokers, financial planners, and investment advisors, can help investors choose securities to buy or sell.
- When buying stocks in the primary market, investors buy directly from the issuer. When buying stocks in the secondary market, investors buy from another investor who owns the stock.
- Securities exchanges are auction markets, where stocks are sold to the highest bidder.
- The over-the-counter market is a network of dealers who sell stocks not listed on an exchange.
- Direct investing is buying stock directly from a corporation or bonds directly from the issuer. Direct investing allows investors to avoid transaction fees.
- Both full-service and discount brokers buy and sell securities for clients. Full-service brokers also provide investing advice and other services. Many brokers offer their services online through Web sites.
- Brokers charge fees or commissions for their services.
- Different types of stock market orders can be placed when trading on a securities exchange. Market orders and limit orders are two examples.
- Market timing strategies can be used to help investors decrease losses and increase profits.
- Many independent and governmental agencies regulate and control the investing industry. They seek to protect consumers by providing stable markets and fair trading practices.
- The Sarbanes-Oxley Act of 2002 helps protect consumers with new and stronger standards for U.S. public companies and for accounting firms.

Key Terms

annual report
auction market
blog
buy and hold
buying on margin
discount broker
discretionary order
initial public offering
limit order
market order
odd lot
oversight
over-the-counter market
primary market
round lot
secondary market
securities exchange
selling short
stock dividend
stock split
stockbroker
stop order

ACTIVITY 1
Review Key Terms

Use the key terms from Chapter 12 to complete the following sentences:

1. A licensed person who buys or sells stock for clients at fees much lower than a full-service broker charges is called a(n) ______________.
2. When you buy a(n) ______________, you are buying 100 shares or multiples of 100 shares of stock.
3. When a company issues shares of stock to shareholders instead of a cash dividend, this is called a(n) ______________.
4. A(n) ______________ is a request to buy stock at the current market price.
5. A company's report to stockholders, called a(n) ______________, tells about the financial position of the company.
6. A network of dealers who buy and sell stocks (not as part of a securities exchange) is the ______________.
7. Selling stock that has been borrowed and must be replaced later is called ______________.
8. ______________ is a long-term timing plan whereby you hold stock for many years.
9. A(n) ______________ is a request to sell stock when the price reaches a certain amount.
10. An order to sell stock that allows the broker to get the best possible deal is a(n) ______________.
11. Buying shares of stock from current owners of the stock takes place in the ______________.
12. Buying shares of stock directly from the issuer of the stock takes place in the ______________.
13. ______________ is the process of buying stock with a partial loan and repaying the loan when the stock is sold.
14. A(n) ______________ takes place when a company issues more stock to shareholders in proportion to the stock they already own.
15. A market in which stock is sold to the highest bidder is a(n) ______________.

16. A company's first sale of its stock to the public is called a(n) __________.
17. Supervision of the markets by government, called __________, is for the purpose of protecting investors from unlawful actions.
18. A(n) __________ is a licensed person who buys and sells securities for investors.
19. An online place where you can find short articles or comments on a particular subject area is called a(n) __________.
20. A(n) __________ is a request to buy or sell stock at a set price.
21. Fewer than 100 shares of stock is known as a(n) __________.
22. A(n) __________ is a place where brokers buy and sell stock for their clients.

ACTIVITY 2
Math Minute

1. You plan to buy 100 shares of stock for $45.00 per share. If you use a full-service broker, the fee will be a 2 percent commission on the purchase price. Investment advice is included at no extra cost. What will be the amount of the commission you must pay? If you use a discount broker, you will pay a fee of $9.95 for this round lot purchase. No investment advice is provided. You have already paid $100.00 for an investing newsletter to help you decide which stock to buy. Which broker would you use and why?
2. You plan to buy 35 shares of stock for $22.18 per share. If you use a full-service broker, you must pay a 2 percent commission on the purchase price. You must also pay $10.00 for an odd-lot sale and $15.00 because this is a small purchase. What is the total amount you must pay? If you use a discount broker, you will pay a fee of $34.95 for this odd lot purchase. You have already paid $100.00 for an investing newsletter to help you decide which stock to buy. Which broker would you use and why?

ACTIVITY 3
Research a Company

TEAMWORK INTERNET www.thomsonedu.com/school/pfl

Before buying stock in a company, investors should learn about the company, its history, and its outlook for the future. Work with a classmate to research a company that interests you.

1. Choose a company to research. It can be a company with which you are familiar, such as Coca-Cola, General Motors, or Wal-Mart. It can be a company you find listed on the NYSE or NASDAQ.

2. Do research to learn all you can about the company. Look for information in magazine and newspaper articles and on the Internet. If possible, get a copy of the company's annual report. Keep a record of the source information for all the articles you read, whether in print or online.
3. Write a report or give an oral report to present what you have learned about the company. Include several of the following points and others that you think would help an investor decide whether to buy stock in the company.
    - Company name and trading symbol
    - Industry that the company is a part of
    - Major products or services the company sells
    - Location of the company headquarters
    - Number of employees
    - Brief history of the company
    - Plans for expansion or new product areas
    - Other topics in the news related to the company
    - Current stock price
    - Range of stock prices over the last year
    - Revenue for last year
    - Income for last year
    - P/E ratio and current ratio
    - Dividends paid
    - Stock splits
    - Risk level for the company stock

ACTIVITY 4
Stocks and Strategy

Critical Thinking

Before buying a stock, you must select an investing strategy. For example, you may plan to buy medium-risk growth stocks and hold them for several years. You might decide to buy income stocks that pay high dividends. Your choices will reflect your needs and what you think about the economy and the future of certain companies. They will also reflect the risks you are willing to take.

1. Open the *Word* file *CH12 Stock Descriptions* from the data files. Read the descriptions of various types of stocks found in this file.
2. Miquel is making his first stock purchase. He has some other investments, mostly safe and liquid ones. Which type of stock do you think Miquel should buy? Why do you recommend this choice?
3. Hanae is seeking more risk and larger returns for 20 years from now. Which type of stock do you think she should buy? Why do you recommend this choice?
4. Larry is retired. Which type of stock do you think he should buy? Why do you recommend this choice?
5. Linda has inherited a large amount of money. She wants to invest it and is willing to take moderate risk. Which type of stock do you think she should buy? Why do you recommend this choice?

Business Ethics Event

The FBLA Business Ethics event allows students to respond to ethical situations. Students work in a team of two or three members. A situation is given that presents ethical questions. Students must prepare a presentation to respond to the situation.

Evaluation

Students who take part in this event are judged on their ability to:

- Define clearly the ethical issue(s) involved in the situation.
- State clearly the team's position about the ethical issue(s).
- Present an effective ethical solution to the issue.
- Organize thoughts and solutions clearly.
- Show self-confidence and poise while presenting.
- Involve all team members in the presentation.

Sample Scenario

Mario applied for a job as an accounting clerk in a local company. On his resume and application, Mario overstated his qualifications for the job. He stated that he had worked in a similar job for 5 years. Mario had worked for his previous employer for 5 years. However, he worked for only 2 years as an accounting clerk. For 3 years, he worked as a cashier. Mario has a Bachelor's of Business Administration degree. His major area of study was economics. The job ad requested that the applicant have a degree in accounting. Mario stated that his college major was accounting. Mario was hired for the job.

Think Critically

1. What might be some negative outcomes for the employer that result from Mario's overstating his qualifications?
2. How might Mario's actions affect other applicants for the job?
3. What may happen if the employer discovers that Mario was not truthful on his resume and application?

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