Standard 5: The student will analyze the costs and benefits of saving and investing.

Saving and Investing Tools

Miley and Hanna are both turning 16 this year and entering their senior year in high school. The girls have been best friends since kindergarten.

Miley's parents started a savings account for her college education right after she was born. Each month, her dad has $50 automatically deposited in the account.

Hanna's parents opened a college savings plan on her first birthday. Her account is a mutual fund with a diversified stock portfolio. Her dad also has $50 a month automatically deposited in the account.

Which girl do you think has the most money in her college account?

Which parent made the best choice?

Lesson Objectives

⇒ Examine different savings and investment products available.

⇒ Compare the costs (risk) and benefits (rate of return) of different savings and investment products and strategies.

Personal Financial Literacy Vocabulary

Certificates of deposit: A certificate issued by a bank to a person depositing money in an account for a specified period of time (often six months, one year, or two years); a penalty is charged for early withdrawal from CD accounts.

Corporate bonds: A certificate representing the purchaser's agreement to lend money to a business on the promise that the debt will be paid, with interest, at a specific time.

Money Market Mutual Funds: A fund restricted by law to investing in the short-term money market. MMMFs provide low risk and low returns, but they maintain their investment value.

Mutual funds: An investment tool that pools the money of many shareholders and invests it in a diversified portfolio of securities, such as stocks, bonds, and money market assets.

Rate of return: How fast money in savings account or investment grows.

Risk: A measure of the likelihood of loss or profit the uncertainty of an investment's rate of return.

Savings accounts: A financial institution deposit account that pays interest and allows withdrawals.

Savings bonds: A document representing a loan of more than one year to the U.S. government, to be repaid, with interest on a specified date.

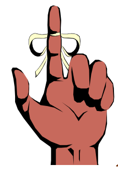
Stocks: An investment that represents shares of ownership of the assets and earnings of a corporation.

Introduction

The decision to save and invest is one of the most important choices a person can make. Once making the commitment to save, the next step is determining what do to with the money. Regardless of the amount, there are many options available. Deciding the best option depends upon how you plan to use the money and when you will need it.

Lesson

Congratulations! You have decided to start saving money for future needs. Now, you have more choices to make about the different financial products available. Your goals will determine the choices you want to make when planning your savings and investing strategies. Savings is generally used to meet short-term and medium-term goals of seven years or less, while investing is generally used to meet long-term goals.



Remember! The purpose of a savings account is to SAVE money. If you make a habit of withdrawing your money like a checking account, you will have no savings.

Saving Strategies

Because you are more focused on a few years when using savings, most financial products for saving have less risk than those for investing. Following are several options to consider when planning your savings strategy:

- **Savings Account**
  Savings accounts are interest-bearing accounts at banks and credit unions. They usually have low interest rates and are used to deposit small amounts of money and meet short-term goals. Savings accounts are a great tool for establishing an emergency fund. If you have money in a savings account, be sure the bank has FDIC insurance and/or the credit union has NCUA insurance. Both insurance programs protect your money if the bank or credit union should close.

- **Certificate of Deposit**
  Certificates of deposit (also called CDs) are offered by most banks and credit unions, and they are also covered by federal insurance. When you buy a CD, you usually have to wait a certain amount of time until the CD “matures” to get your money. CDs can mature in thirty days or many years, depending upon which CD you use. The longer the term of the CD, the higher rate of interest you receive. While CDs are less liquid than a savings account, they do tend to earn higher interest than a typical savings account.

- **Government Savings Bonds**
  Government savings bonds are backed by the United States government, so there is little or no default risk. **Default risk** is the potential that the bond issuer will not pay the interest or return your money when it matures. Savings bonds (EE/E or I bonds) are designed to be held for a minimum number of years before you cash them in to get your money and interest. Because of the length

of maturity, government bonds have a higher rate of return than savings accounts or CDs. However, they also have low risk, which reduces the potential earnings.

- **Money Market Mutual Funds**
  Money market mutual funds are designed to provide higher rates of return than savings accounts because the money is actually invested in very short-term investments with a low risk. Money market accounts are available at many banks and credit unions, but may also be offered by other financial service providers. The accounts at banks and credit unions are covered by federal insurance, while those offered by other financial service providers are not. To cover the additional risk of no insurance, money market accounts offered by other financial providers tend to pay higher interest rates on your savings.

- **Checking Accounts**
  The basic purpose of a checking account is NOT saving money. Instead, it provides a convenient way to handle personal and business transactions. However, many checking accounts earn a very small percentage of interest. Before opening a checking account (or another account), always ask about the rate of interest your money will earn.

Investing Strategies

When investing your money, you are really hoping for a higher rate of return than when you save. Investment options tend to have higher rates of risk than savings options, but they also tend to have higher rates of return. While savings products may guarantee a specific rate of return, there is no such guarantee when investing. As a young person, you may have many reasons for investing your money. Most adults, however, tend to focus their investments on retirement benefits. Regardless of how young or old you are, it is never too early to consider your investment strategies for long-term goals.

Following are several investment tools you may want to consider:

- **Mutual Funds**
  Mutual funds provide an opportunity for investors to pool their money together to buy shares of a fund that invests in many different financial products, such as stocks, bonds and securities. They are a great way for people with limited money and limited knowledge about investing to get started. Mutual fund accounts have a professional

money manager who monitors the account closely to ensure it is earning the maximum amount possible.

At the same time, mutual funds may go through periods of time where they do not earn a high rate of return, and in fact, may even lose money. Their rate of return is based on a variety of economic factors, which fluctuate from time to time. However, if you are investing for a long-term goal, you generally have time to recover from any losses. Most financial experts highly recommend mutual funds for anyone interested in investing because the potential benefits of gain are greater than the potential costs of losing.

- **Stocks**
  Buying stocks allow you to own part of a company. For example, if you buy a share of stock in Merger, Inc, you are a shareholder in that company. Purchasing a single company can be exciting if you are interested in what the company does, but it does provide more risk than if you purchased a mutual fund. Putting all of your money into one company is similar to the old saying of "putting all your eggs in one basket." If you drop the basket, there go your eggs! And, if the company fails, there goes your investment.

  When buying stocks, it is generally advisable to buy a variety of stocks and diversify your portfolio. Diversifying you portfolio means you would own stocks in more than one company, spreading your risk. Or, putting your eggs in multiple baskets! To diversify a portfolio, an individual investor should own at least ten different single stocks in different industries. Buying and selling stocks can be exciting and profitable; however, it is more risky and more expensive than owning a mutual fund.

- **Corporate Bonds**
  When you own a corporate bond, you basically make a loan to the company. You allow them to use your money and they pay you interest. The interest you receive is the value of your investment. Buying bonds for a single company is much like owning stocks in a single company; if something happens to that corporation, you can lose most, or all, of your investment. Buying into bond mutual funds is an alternative for individual investors because it spreads your risk. While bond mutual funds can lose money as interest rates increase, they tend to offer greater protection from losses. In general, investing in bonds is a lower risk option with lower returns than stocks.

In the box below, list three things you learned about saving and investing strategies.

1.

2.

3.

Rates of Return

Because risk levels are different for the various saving and investing options, the rates of return also vary. The **rate of return** is the amount of money you can earn when saving or investing. The higher the average return, the more risk you are taking as an investor.

Below is a chart showing different types of investments and their average returns. As you can see, different kinds of investments have historically provided different rates of return. Average rates of return do not guarantee what you will earn; they only show what has happened in the past with that type of investment.

Asset Class	Rate of Return*
Common stocks	10%-13%
Stocks of smaller companies	14%-16%
Long term corporate bonds	6.5%-8%
Long term US government bonds	5%-7.5%
Short term US Treasury bills	3.5%-5%

***Average rate of return since 1926, Ibbotson and Associates**

COMPLETE: SAVING AND INVESTING STRATEGIES – Activity 5.3.1

Ask your teacher to review your answers before continuing this lesson.

What did you learn from completing this activity?

Do you feel more confident in making decisions about saving and investing money? Why or why not?

Conclusion

Choosing the best savings or investment product will help you meet your personal and financial goals. Your choices will also depend upon when you need to use the money. Short-term goals are best for savings and long-term goals are best for investing. Building a diverse portfolio will help you better manage your saving and investing risk, adding to your overall rate of return. After all, the goal of saving and investing is to EARN money — not lose it!

So, who has the most money for college: Miley or Hanna? If you said Hanna, you are correct! Her parents made the best choice for reaching their long-term goal.

Miley's savings account earned an average of 3% interest for the past 16 years.

Hanna's mutual fund earned an average of 12% for the past 15 years.

How much did each account earn?

Which was the better investment?

Name: ___________________________ Class Period: __________________________

Savings and Investing Tools
Review Lesson 5.3

Answer the following questions and give the completed lesson to your teacher to review.

1. List one short-term goal and explain a savings or investing strategy to help you reach that goal.

2. List one long-term goal and explain a savings or investing strategy to help you reach that goal.

3. Explain the difference in risk to saving versus investing. Does savings or investing have the higher rate of return?

4. Discuss your reaction to this statement: Even though you have long-term goals, it is still important to have short-term savings.

Name: ____________________________ Class Period: ___________________________

Saving and Investing Strategies – Activity 5.3.1

Use the following terms to complete the questions on this handout.

Certificates of deposit
Corporate Bonds
Money market mutual funds
Mutual funds
Savings accounts
Savings bonds
Stocks

1. Categorize the above terms in the appropriate columns.

Savings	Investing

2. Each of the above strategies has both costs and benefits. Give a basic explanation of the strategy and identify the costs and benefits of choosing that option.

   a. Certificate of Deposit

   Description: ____

   ____

   Benefits: ____

   ____

   Costs: ____

   ____

b. Corporate Bonds

Description: ____

____

Benefits: ____

____

Costs: ____

____

c. Money Market Mutual Funds

Description: ____

____

Benefits: ____

____

Costs: ____

____

d. Mutual Funds

Description: ____

____

Benefits: ____

____

Costs: ____

____

e. Savings Account

Description: ____

____

Benefits: ____

____

Costs: ____

____

f. Savings Bonds

Description: ____

____

Benefits: ____

____

Costs: ____

____

g. Stocks

Description: ____

____

Benefits: ____

____

Costs: ____

____