

Excerpt from Chapter 4:

Investments:

Understanding stocks, bonds, mutual funds,
and some stock market terminology

... Information on other investments and financial terminology can be found in later chapters but to begin with here are a few of the basics:

- ♥ Stocks
- ♥ Blue-chip stocks
- ♥ *Fortune* Five Hundred
- ♥ Bonds
- ♥ Mutual funds
- ♥ Managed money
- ♥ Asset allocation
- ♥ Risk tolerance

Stocks: (Also referred to as equities or shares)

Some stocks pay dividends; others do not.

Some stocks are bought as a long term investments (years) others for the short term (months), some, for just days.

A simple explanation of stocks: The newly formed ABC Oil Company, Incorporated, a publicly traded company, is a firm that owns oil wells in Texas and has opened its doors for business. There are 100 shares of stock available, each costing \$10.00 per share. Buying even one share in the company would make you a shareholder but in this example I am using 10 shares. So, if you buy 10 shares in the company you will become a shareholder with a one hundred dollar value [equity] part ownership in the corporation.

If there is greater demand and less availability in world oil markets as the price of oil rises, so too can the value of your 10 shares. If you heard on the news that the price of crude oil had risen steadily for days, it would be wise to check your stocks to find out if there has been an increase in their value. Depending on the length of time you had invested for – days, months, years – you might decide to hold onto the stock in the hope that the price would rise even more.

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If you had invested for the short term you may decide to sell and take a profit. Whenever you sell stocks at a profit, taxes are incurred; therefore, contact a tax advisor on profits or losses incurred when selling stock.

If the supply of world oil becomes greater and there is less demand, the price of oil may decrease and so may the value of your stocks. If the price of oil falls it is your decision on whether to continue to hold, or sell and take your losses.

It is not *necessary* to follow the price of your investments *daily* but it is definitely a good idea.

In addition to the stocks you own as a shareholder, you are entitled to voting rights, which gives you a proportional vote in some of the corporate decisions.

The following example gives a clear picture of how the value of stock fluctuates.

In **December 1998**, crude oil per barrel traded at **\$10.72**ⁱ

Less than 8 years later,

On **July 13, 2006**, crude oil per barrel traded at **\$76.70**.

"Blue Chip":

"Blue chip" is the term coined for those stocks that have formidable standing in the financial world. They are extremely stable, generally pay dividends and are the darlings of Wall Street. The Dow Jones Industrial Average is made up of thirty of these venerable stocks. These are just a few: Exxon Mobile, McDonalds, Coca Cola, and Procter & Gamble. The origin of "blue chip value" supposedly derives from poker chips, where the highest value was accorded to, what else but, the blue chip.

Fortune Five Hundred:

Published each year in *Fortune Magazine* is a listing of the top five hundred public corporations in the United States.

Bonds:

A Bond is, quite simply, an IOU. If you buy a U.S. Treasury Bond from the United States Government for \$100,000, a certificate of debt is issued to you in

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that amount. That \$100,000 in turn, becomes a loan to the government. You are then paid a guaranteed fixed interest rate (ranging anywhere from 4% to 6%) for a specific period of time. Bonds can be issued by governments: local - (Municipal Bonds), states, corporations, and other institutions. Certain Municipal Bonds are excellent for people in high tax brackets because they are not taxed by the federal government: some of these have absolutely *no risk*, but the return is extremely low.

Other than *junk bonds*, which are *highly risky*, most bonds are guaranteed and generally considered less risky than stocks. Corporate bonds are backed by the value of the corporation, whereas government bonds are backed by the U.S. government. Bonds are viewed more for safety while stocks are looked upon as the investment for growth and profit.

**Usually, bonds increase in value when stock prices fall,
and vice versa:**

If the stock market trends downward for several weeks, investors can become nervous and sell their stocks. This causes a further drop in the stock market. When this happens the investors may take the money they withdrew from the stock market and invest it in bonds (more conservative). If enough people do that, then bonds can trend higher. These movements show how volatility occurs in the markets.

So as you can see, bonds are usually safer than stocks, but if you have your money placed only in conservative investments, such as bonds, it is possible that you may not earn enough interest in those (conservative) investments to fulfill your financial requirements for your retirement.

Conversely, if you are considering investments for the *long term* such as ten, twenty or more years, then you can handle the volatility of stocks when the market has a correction (downturn) because, at the same time, your investments are also in place for any strong rallies in the market.

For information on U.S. Treasury bonds visit:

www.publicdebt.treas.gov

For buying U.S. savings bonds online visit:

www.treasurydirect.gov

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Mutual Funds:

The shrewdest money decisions are rarely based upon how much money you have to invest but upon *when* and *where* you invest that money. If you are not sure whether to place your money in stocks, bonds, or in other securities—*well-diversified mutual funds* could be the answer for you; this is a way of investing without having to putt all of your eggs in one basket.

A mutual fund is a company with money from many investors and this money is held collectively in what is referred to as a pool. The money is generally invested in a combination of stocks bonds, short-term money market instruments, or other types of securities. The fund is managed by a professional (investment) manager.

Millions of people invest in them. Here are a couple of reasons why: let's say that you wish to buy stocks from 'blue chip' companies such as: Procter and Gamble, Exxon Mobil, and Coca Cola. However, *you have a limit on how much money you can invest*. The cost of the individual 'blue chips' is *far more than you can afford*. But with a mutual fund you get *part interest* in many stocks, therefore you are more diversified, hence spreading your investment risk.

If you wanted to buy a corporate *bond*, it could cost you \$5,000 for a single bond; in a mutual fund you could own a *part interest in many bonds* for that same \$5,000. Keep in mind that you are taxed yearly on mutual funds. The increase in the popularity of mutual funds as an investment is revealed in the numbers below:

In 1996 mutual fund assets totaled: \$3.5 trillion



In 2005 mutual fund assets totaled: \$8.9 trillion

There are numerous types of mutual funds, and your choice of which to invest in depends upon your age and investment objectives. Most women (and men) do not realize just how *simple* mutual funds can be. **So when it is time to choose a**

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fund – don't panic! First, learn the terminology. Most funds usually have a goal. Following is an example of some of the different types of Mutual Funds:

- ♥ **Income:** Income-oriented funds focus their portfolios on a mixture: *bonds* (government, corporate, or municipal) *Treasury securities*, (these can be, Treasury bonds, Treasury notes or Treasury bills), all of which are considered one of the safest investments since they are backed by the U. S. government. Additionally, other *income-oriented securities* can be included in the mutual fund, such as, stocks which yield high dividends. The mixture of investments in this type of fund is considered conservative and is for investors who want income (dividends) paid at regular intervals.
- ♥ **Growth:** Growth-oriented funds principally invest in the common stock of well-established companies: small or large, some of which can be aggressive. However, because these equities (stocks), have greater potential for appreciation they also have greater potential for risk. These funds may be suitable for investors who are looking for long-term growth but generally they do not pay dividends.
- ♥ **Sector:** Sector funds invest in a specific industry or section of the market such as healthcare, technology, or telecommunications.
- ♥ **Balanced:** Balanced funds concentrate their portfolios on that which will provide both income and growth so, generally, the investments are a combination of equities (stocks) and debt securities (bonds.)
- ♥ **Value:** Value funds invest in undervalued stocks of large and mid-size companies and are geared to pay dividends (income.)
- ♥ **Bond:** Bond funds invest primarily in debt securities such as municipal bonds, government bonds, and corporate bonds. These mutual funds are chosen to balance out the level of risk in your portfolio and provide income paid at regular intervals. This type of mutual fund is popular for a person close to retirement.
- ♥ **Global:** Global funds invest in International and U.S. stocks.
- ♥ **Foreign:** These funds focus their portfolios on investments principally outside of the U.S.

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- ♥ **Socially Responsible:** Socially responsible funds invest in nothing that is harmful to society such as: tobacco, or funds that respect the environment or responsible causes.

Mutual Funds provide:

- ♥ Accessibility to cash
- ♥ Affordability
- ♥ Management by a professional money manager
- ♥ Diversification

To help you choose the mutual funds best suited for your investment purpose, keep in mind these considerations:

- ♥ Does the goal of the fund match *your* investment goal?
- ♥ Can you handle the ups and downs associated with the market movement of this investment?
- ♥ Have you examined the type of investor services associated with this fund?
- ♥ Carefully evaluate the performance of the fund over a 10-year period then, compare several other well-known funds much like the one you are considering.
- ♥ Find out if the same money manager has been at the helm of this fund for the past ten years. If not, find out *how long the person in charge has been the manager of the fund and what results have come about from her/his guidance.*

Keep in mind that *just as bank fees are automatically deducted monthly, so are the fees on your mutual funds.* The difference between the two is that bank fees are clearly visible on your monthly statement, whereas *mutual fund fees are not as easily identifiable.* However, you can keep track of them on the Internet, or in the prospectus of your company.

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When you are ready, and plan to handle investments *yourself*, determine an investment-plan based upon:

- ♥ Your age
- ♥ Your risk tolerance
- ♥ Your specific financial goals

For information on mutual funds visit:

www.morningstar.com 1-800-735-0700

www.oppenheimer.com

www.fidelity.com

www.troweprice.com

www.vanguard.com

For information on advisors and brokers, visit the website provided by the United States Securities and Exchange Commission (the federal body that governs the industry):

www.sec.gov

ⁱ U.S. Bureau of Energy