Name: ______________________________

Introduction to Investing

Asset Allocation
Asset allocation involves dividing an **investment portfolio** *(savings)* among different asset categories, such as **stocks, bonds, and cash**. The asset allocation that works best for you at any given point in your life will depend largely on your time horizon and your risk tolerance.

- **Time Horizon** - Your time horizon is the expected number of months, years, or decades you will be investing to achieve a particular financial goal. An investor with a longer time horizon should feel more comfortable taking on a riskier, or more volatile, investment because he or she can wait out poor economic cycles and the inevitable ups/downs of our markets. By contrast, an investor with a shorter time horizon such as saving up for a teenager's college education should take on less risk.
- **Risk Tolerance** - Risk tolerance is your ability and willingness to lose some or all of your original investment in exchange for greater potential returns. An aggressive investor, or one with a high-risk tolerance, is more likely to risk losing money in order to, hopefully, get better results in the long run. A more conservative investor, or one with a low-risk tolerance, tends to favor investments that will preserve their original investment but have less potential reward.

Risk versus Reward
When it comes to investing, **risk and reward** are inextricably entwined. You've probably heard the phrase "no pain, no gain" - those words come close to summing up the relationship between risk and reward. Don't let anyone tell you otherwise: All investments involve some degree of risk. If you intend to purchases securities - such as stocks, bonds, or mutual funds - it's important that you understand before you invest that you could lose some or all of your money.

Investment Choices: 3 Major Asset Classes

- ✓ **Stocks** - Stocks have historically had the greatest risk and highest returns among the three major asset categories. As an asset category, stocks are a portfolio's "heavy hitter," offering the greatest potential for growth. The stock market hits home runs over the long run, but often suffers losses in the short run *(less than 5 years)*. The volatility of stocks makes them unsuitable for short term investing. When you buy a stock you are buying "partial ownership" in a company. If that company can grow profits => their stock prices will rise over time.
- ✓ **Bonds** - Bonds are generally less volatile than stocks but offer lower investment returns. As a result, an investor with a shorter time horizon *(less than 5 years)* often invests in bonds despite their lower potential for growth. When you buy a bond you are lending a Government or Company money for specific period of time. You receive a yearly ***interest payment*** and your money back when the bond reaches maturity *(expiration)*. ***Warning:*** *some bonds offer high returns similar to stocks. But these bonds, also carry higher risk.*
- ✓ **Cash** - Cash and cash equivalents - such as ***savings accounts, certificates of deposit, treasury bills***, ***money market deposit accounts (funds)*** - are the safest investments, but offer the lowest return of the three major asset categories. The chances of losing money on an investment in this asset category are generally extremely low. Money needed in less than 2 years should generally be in cash.

Stocks, bonds, and cash are the most common asset categories. These are the asset categories you would likely choose from when investing in a retirement savings program or a college savings plan. But other asset categories do exist such as **real estate**, precious metals and other commodities. **Real estate** is a critical investment in your future. Buying a house requires you to compare the cost of "renting" versus buying a place to live. Investing in real estate has many tax benefits which we will cover this semester.

Why Asset Allocation Is So Important

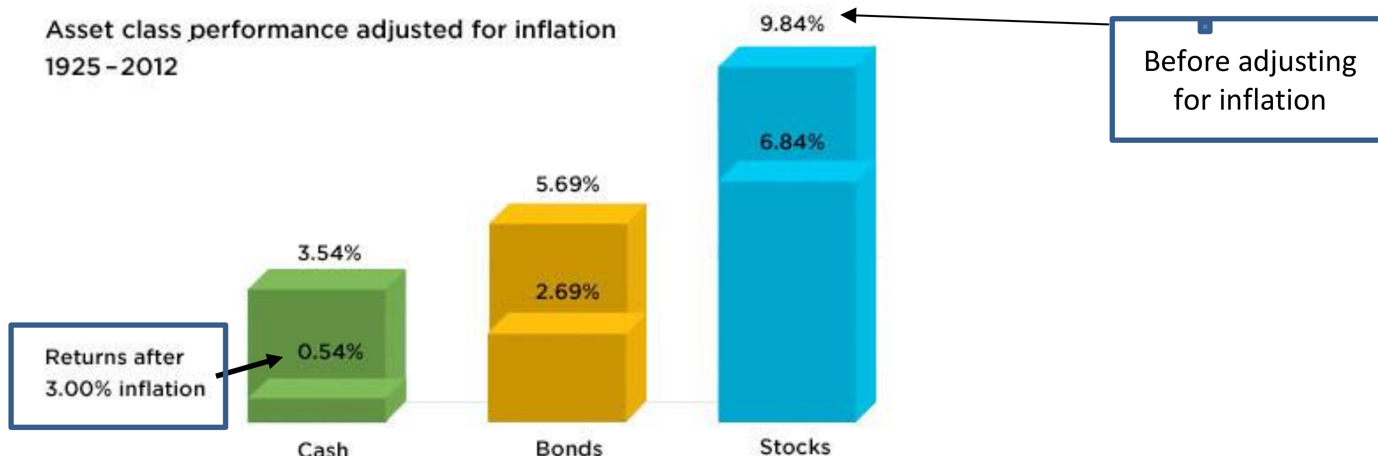
By including asset categories with investment returns that move up and down under different market conditions within a portfolio, an investor can protect against significant losses. Historically, the returns of the three major asset categories have not moved up and down at the same time. By investing in more than one asset category, you'll reduce the risk that you'll lose money and your portfolio's overall investment returns will have a smoother ride.

The Magic of Diversification:

The practice of spreading money among the **3 different asset classes** to reduce risk is known as ***diversification*****.** By picking the right group of investments, you may be able to limit your losses and reduce the fluctuations of investment returns without sacrificing too much potential gain.

Too little risk: If you don't include enough risk in your portfolio, your investments may not earn a large enough return to meet your goal. For example, if you are saving for a long-term goal, such as retirement or college, most financial experts agree that you will likely need to include at least some stock or stock mutual funds in your portfolio.

Too much risk: On the other hand, if you are saving for a short term goal and include too much risk in your portfolio, the money for your goal may not be there when you need it. A portfolio heavily weighted in stock or stock mutual funds, for instance, would be inappropriate for a short-term goal, such as saving for a car or vacation.



1) The order of risk from **low risk to high risk** is:
   a. Bonds, cash, stocks b. cash, bonds, stocks c. stocks, bonds, cash

2) The order of historical investment returns from **high return to low return** is:
   a. Bonds, cash, stocks b. cash, bonds, stocks c. stocks, bonds, cash

3) If a family is investing money for college for their ***2-year old daughter***, which investment would be most appropriate:
   a. Only cash accounts b. only bonds c. stocks & some bonds

4) If a family is investing money for college for their ***17-year old son***, which investment would be most appropriate:
   a. Only cash accounts b. cash accounts & some bonds c. stocks & some bonds

5) If a family is saving money for a vacation next year, which investment would be most appropriate:
   a. Only cash accounts b. only bonds c. some stocks & bonds

6) If a 24 year old is saving money for retirement, the most proper investment would be
   a. primarily cash accounts b. primarily bonds c. primarily stocks

7) You earn 4% return per year for 10 years. The inflation rate during that time is 3%. How much has your money grown in **purchasing power?**
   a. 4% per year b. 3% per year c. 2% per year d. 1% per year

What You Need to Know Before You Invest

1. **Stocks aren't just pieces of paper**.
When you buy a share of stock, you are taking a share of ownership in a company. Collectively, the company is owned by all the shareholders, and each share represents a claim on assets and earnings.
2. **There are many different kinds of stocks.**
The most common ways to divide the market are by company size (measured by market capitalization), sector, and types of growth patterns. Investors may talk about large-cap vs. small-cap stocks, energy vs. technology stocks, or growth vs. value stocks, for example.
3. **Stock prices track earnings.**
Over the short term, the behavior of the market is based on enthusiasm, fear, rumors, and news. Over the long term, though, it is mainly company earnings that determine whether a stock's price will go up, down, or sideways.
4. **Stocks have historically been your best shot for getting a return over and above the pace of inflation**.
Since the end of World War II, the average large stock has returned, on average, more than 10 percent a year - well ahead of inflation, and the return of bonds, real estate and other savings vehicles. As a result, stocks have been the best way to save money for long-term goals like retirement. However, keep in mind that the stock market indices today stand virtually where they were ten years ago—no gain at all—so there are no guarantees.
5. Individual stocks are not the market.
A good stock may go up even when the market is going down, while a stinker can go down even when the market is booming.
6**. A great track record does not guarantee strong performance in the future.**
Stock prices are based on projections of future earnings. A strong track record bodes well, but even the best companies can slip.
7. You can't tell how expensive a stock is by looking only at its price.
Because a stock's value depends on earnings, a $100 stock can be cheap if the company's earnings prospects are high enough, while a $2 stock can be expensive if earnings potential is dim.
8. Investors compare stock prices to other factors to assess value.
To get a sense of whether a stock is over- or undervalued, investors compare its price to revenue, earnings, cash flow, and other fundamental criteria. Comparing a company's performance expectations to those of its industry is also common -- firms operating in slow-growth industries are judged differently than those whose sectors are more robust.
9. A smart portfolio positioned for long-term growth includes strong stocks from different industries.
As a general rule, it's best to hold stocks from several different industries. That way, if one area of the economy goes into the dumps, you have something to fall back on.

EXCHANGE TRADED FUNDS (ETFs)

An **exchange-traded fund** (or **ETF**) is an investment vehicle traded on stock exchanges, much like stocks. An ETF holds assets such as stocks or bonds and trades at approximately the same price as the net asset value of its underlying assets over the course of the trading day. ETFs may be attractive as investments because of their low costs, tax efficiency, and stock-like features.

Most ETFs are index funds that hold securities and attempt to replicate the performance of a stock market index. An index fund seeks to track the performance of an index by holding in its portfolio either the contents of the index or a representative sample of the securities in the index. The first
ETF, SPDR Trust, was listed in 1993 with an underlying portfolio designed to replicate the performance of the S&P 500 Index.

Examples:	DIA	Dow Jones Index
	SPY	SPDR Trust Series S&P 500 Index
	VV	Vanguard Large Cap ETF
	XLK	Select Sector SPDR Fund--Technology

Exchange Traded Commodities (ETCs) are investment vehicles that track the performance of an underlying commodity index based on a single commodity. ETCs trade just like shares, are simple and efficient and provide exposure to an ever-increasing range of commodities and commodity indices, including energy, metals, and agriculture.

Examples:	USO	United States Oil Fund
	GLD	SPDR Gold Trust

Name ____

Of the Nine Things you need to know before you invest, what in your opinion are the most important five? Rank them from most important to fifth most important. Then discuss why you ranked them as you did.

1. ____
2. ____
3. ____
4. ____
5. ____

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In your own words, explain what an ETF is. What are the advantages of buying ETFs as opposed to shares of stock in a single company?

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A Tale of 2 Companies:

Company A:
Automobile Parts Business.
Has been in business for 15 years
Has been profitable every year
Earned $1.5 million in profits per year for the past 5 years

Company B:
Technology-startup company
Has been in business for 3-years
Has reported the following profits or losses since inception:

Year 1: -$500,000 loss	Year 2: +$500,000 profit	Year 3: +$1.5 million profit

1. Which company would YOU rather invest in? (explain why!)

2. Which company would the stock market value with a higher market capitalization? (i.e. which would be worth more money) Explain why.

3.Which company has more risk? (explain why)