SAVING AND INVESTING

Making the change by keeping it

JIM CASEY YOUTH OPPORTUNITIES INITIATIVE

MODULE 7: SAVING AND INVESTING

Making the change by keeping it

Keys to Your Financial Future is designed to help you plan how to get, manage, and use money now and in the future so you can have the life you envision for yourself. The final module of ***Keys to Your Financial Future*** is about saving and investing.

You may be interested in learning about saving and investing options beyond the Opportunity Passport™ matched savings. This module covers a range of saving and investing opportunities as well as where to find unbiased information about these products to help you understand your options.

As a young person in foster care, you may not have had the opportunity to save money or invest it. You will learn about saving and investing through the Opportunity Passport™ financial education training and matched savings.

But there is so much more to learn. This module will provide you with an introduction to saving and investing.

Investing can help you grow your money and can be a big part of your financial plan. But before investing, you must save.

Saving versus Investing

Are saving and investing the same thing?
No. There are differences.

Before you invest money, you must save. Saving money means setting aside income today for use some time in the future. It means not spending a portion of the money you have now. This is the act of saving.

> *"Invest a few moments in thinking. It will pay good interest."*
>
> — AUTHOR UNKNOWN

When you finish this section of *Keys to Your Financial Future*, you will be able to do the following:

- ☑ **Explain the principles of investing (risk/return, diversification, and asset allocation).**
- ☑ **Match "next level" investment opportunities (treasury securities, exchange traded funds, bonds, stocks and mutual funds) for appropriateness and suitability for different personal and financial goals.**
- ☑ **Identify reputable, unbiased information about investment options in the community.**
- ☑ **Use some financial information available in newspapers and common online financial news sites to make decisions.**

The Role of Saving in Investing

KEY CONCEPT

People use the terms saving and investing interchangeably. Are they the same? No.

Whether you put money into a savings account or a mutual fund, you have to save money first. This means you have to decide to set it aside—not spend it on other things—for use later.

Saving can be hard. You may not have enough income to cover your current ***obligations***, ***needs***, or ***wants***. You may have never saved money before. Or, you may not want to save right now.

But before you invest, you have to save. Money that you have set aside is what you can put into savings or investment; you need to decide which is best for you. This module will provide you with information to help you consider where to put the money you save so that it helps you reach your goals.

> *"In the old days a man who saved money was a miser: nowadays he's a wonder."*
>
> **— AUTHOR UNKNOWN**

What is the difference between saving and investing?

Saving	Investing

When people put money they have saved into a savings vehicle, they know they will not earn big returns. ***They are trading the opportunity to earn returns for the safety of their money.*** Giving up the possibility of returns is an opportunity cost of savings.

With money in a federally insured bank or credit union, principal cannot be lost. Your principal is safe.

When people invest their money, they expect larger returns. ***For the opportunity to earn larger returns, they are generally taking on more risk.***

Common Terms in Saving and Investing

Although there are many technical terms used in the saving and investing profession, there are six you should know to start:

- ***Principal.*** Principal is the money you put into savings or investment vehicles. Principal comes from the money you have saved or set aside from your income.
- ***Returns.*** Returns are what you earn on the principal you put into a savings vehicle or investment. And there are three common types of returns:
  - ✓ ***Interest.*** Interest is the amount a bank, credit union, corporation or government agrees to pay you for the use of your money. This is expressed as a percentage.
  - ✓ ***Dividends.*** Dividends are a portion of a corporation's profits given back to shareholders. Dividends can be cash or more shares.
  - ✓ ***Increased share value.*** This is the amount you earn because the market value of your share is greater now than what you paid for it. Increases in share value increase your portfolio value, but only create income or cash if you sell them.
- ***Risk.*** Risk is a chance for loss or uncertainty. You will learn more about risk later in the module.

Where Do People Save and Invest

Where do people save? Where do people invest?

Saving	Investing

Where You Can Save

When you put money into a savings vehicle, your principal is safe as long as the financial institution is federally insured. This includes:

- ***Savings Accounts (also called Share Accounts in Credit Unions)***—Savings accounts are deposit accounts at banks or credit unions. You can withdraw money by going into the bank and using a withdrawal slip or by visiting an ATM (automatic teller machine) and using a debit or ATM card. You will earn interest on the principal you deposit and keep in a savings account, but currently the rate is very low (generally less than 1%).
- ***Certificates of Deposits (CDs)***—CDs are savings vehicles into which you deposit money for a fixed time (period) at a fixed return. The higher the amount you invest and the longer the money is kept in the CD, the higher the interest rate you will earn.
- ***Money Market Deposit Account***—A Money Market Deposit Account or Money Market Account is an interest bearing savings account with limited transaction privileges (6 withdrawals with no more than three as checks), higher minimum balance requirements and slightly higher rates of interest than a savings account.

FDIC and NCUA

KEY CONCEPT

Before opening an account at a bank or credit union, make sure it is federally insured.

If it is a bank, look for the FDIC logo:

If it is a credit union, look for the NCUA logo:

How Good is the FDIC Insurance

KEY CONCEPT

The FDIC was set up in1933 following the stock market crash of 1929. Since that time, not $1 deposited by a consumer has been lost even when banks have failed. (When a bank fails, it means the government has stepped in to manage it and protect depositors or closed it.)

How do you know if a bank or credit union is insured? If it is a bank, it will display the FDIC logo on its front door and all of its publications. FDIC stands for the Federal Deposit Insurance Corporation. Similarly, a credit union will have the NCUA logo on display on its door, throughout the branch and on all of its publications. NCUA stands for National Credit Union Administration, which administers the NCUSIF—National Credit Union Share Insurance Fund (credit unions).

Your deposits will be insured up to $250,000 per account ownership category at any one institution. This means your money cannot be lost due to fire, flood, theft, market fluctuations or mismanagement by bank personnel.

Where You Can Invest

The most common kinds of investment vehicles are:

- ***Money Market Mutual Fund***—A Money Market Mutual Fund is a mutual fund with underlying investments that include short-term debt investments (debt securities that mature in less than 13 months). The Securities and Exchange Commission (SEC) requires the average maturity of investments in a money market mutual fund be less than 90 days. This limits the risk of these funds. These are not FDIC insured, although they are generally considered low risk.

- ***Treasury Securities***—U.S. Treasury securities are debt instruments. The U.S. Treasury issues securities to raise the money needed to operate the federal government and to pay off its debt. They are generally considered safe because ***"the full faith and credit of the U.S. government"*** guarantees that interest and principal payments will be paid on time. Also, most Treasury securities are liquid, which means they can easily be sold for cash. Common Treasury securities are savings bonds, treasury bills, treasury notes, bonds and TIPS. (See **www.treasurydirect.gov** for more information on Treasury securities.)

- ***Bonds***—Bonds are issued when governments (federal, state, or city) or corporations need to borrow money. They agree to pay back money from you at a certain date in the future with interest. As interest rates increase, bond prices fall, and vice versa. When bonds are doing well, in general, stocks overall are not, and vice versa. Some bonds carry very little risk. Some bonds are risky depending on the strength of the organization that issued them.

- ***Stocks***—Stocks are investments that represent ownership in a company. When you invest in a stock, you are putting money into the company. When the company does well, you may get returns in the form of dividends or increase share value. When the company does not do well, your investment declines in value.

- ***Mutual Funds***—Mutual Funds are pools of money managed by professionals. The managers invest the money in stocks or bonds. Investors buy shares in the mutual fund. But, the risk is diversified. Diversified means spread around. This is because each share you buy in a mutual fund has a wide range of stocks of bonds that make it up. Mutual funds are actively managed by fund companies. Because of this, companies charge fees for the services they provide.

- ***Exchange Traded Funds (ETFs)***—ETFs are similar to mutual funds in that they are large pools of money invested in a diverse portfolio of stocks or bonds. An ETF is different from a mutual fund in that it tracks an index. ETFs are not actively managed like mutual funds and therefore should have lower operating and transaction costs compared with mutual funds. They can also be traded like stocks. The first ETF was created in 1993 by Standard & Poor's; it was called Standard and Poor's Deposit Receipt, which was abbreviated SPDR and referred to as "Spider".

What about Retirement Accounts?

KEY CONCEPT

You may be wondering why IRAs and 401(k)s are not listed with the securities. This is because retirement savings is a designation of your savings. Once you decide that you are going to put some of your savings away for retirement, you still have to choose the saving or investment vehicle for that money.

For example, if you set up an IRA, Individual Retirement Account, with a bank, a mutual fund company or a brokerage firm, you still have to decide where to put that money: into a savings account, a certificate of deposit or a specific mutual fund.

Who sells investment products? They are sold directly by corporations, brokerage firms, financial advisors, the federal government, and mutual fund companies.

Where is your principal at risk? Technically every investment vehicle carries the risk of principal loss. Some investment vehicles like U.S. Savings Bonds have very little risk, though.

If you invest through a brokerage and it *fails* AND it is insured by SIPC (Securities Investor Protection Corporation) you may be able to recover some of your losses. Generally, maximum is $500,000 with $100,000 for cash claims. However, you can never recover principal lost from changes in the market.

Opportunity Passport™ Matched Savings

So where does the Opportunity Passport™ matched savings fit?
Is it a savings vehicle or an investment vehicle?

Some people would say it is a savings vehicle because it is called ***matched savings***. Others may say that because of the returns—you may earn $1 for every $1 you save—it is like an investment vehicle.

Is earning $1 for every $1 you save a good deal?

It is a good deal. In fact, it is a great deal! Compare the 100% returns you get in the Opportunity Passport™ matched savings to stocks on average. “Between 1883 and 2008, the stock market averaged a 7.6 percent return after inflation, according to the Center for Retirement Research at Boston College.” [1]

The Opportunity Passport™ matched savings offers returns far beyond what you could expect from any other saving or investing vehicle. So, whether you call it savings or investing, understand you will likely never see returns this high on any money you put into a savings or investing vehicle now or in the future.

So, if you have decided to save money, consider investing first in the Opportunity Passport™ matched savings. Take advantage of returns you are never likely to experience again!

[1] *Should investors over age 50 own stocks?* By Steve Santiago. Bankrate.com. August 25, 2009.

Saving, Investing, and Asset Building

When you put money you have saved into a savings or investing vehicle are you building assets?

If yes, what kind of assets?

In fact, when people think about assets they often think first of financial assets. These can include savings accounts, certificates of deposit, mutual fund shares, ETF shares, and more.

How Saving and Investing Builds Wealth

What do you think of when you hear the term "wealth"?

How are wealth and wealthy related?

Wealth is a term used a lot. People associate it with having lots of things and lots of bling. But, wealth is really about financial independence. Wealth comes from building assets and equity in those assets.

Equity is the difference between the value of an asset and what you owe on that asset. It is what you would be left with if you sold an asset and paid off any debt you owed on it.

Net worth is all of the equity from all of your assets added together. More commonly, it is the value of all of your assets minus the value of all of your liabilities. This is your net worth. Net worth is one of the best measures of financial health and wealth. Net worth is what you would have to fall back on if you didn't have income.

KEY ACTIVITY

Calculate Fatima's Net Worth

Fatima was in care from the age of 11 to 18. Now, at 25 she is a licensed practical nurse and getting ready to return to school to get her registered nursing degree. She wants to figure out her net worth since she has been focused on building assets. Here is a list and value of her assets:

LPN Degree	Unknown value; increased her employment opportunities and income.
Community of Faith	Unknown value; very strong network and base of support.
Cohort from Youth Board	Unknown value; ongoing connection to young people she has known for 9 years. Gives her a group to spend holidays with and go to for support.
Automobile	$4,570 based on valuation found on Kelly's Blue Book website.
Condo	$85,950 based on estimate from realtor.
Emergency	$850 (balance as of today)
Checking Account	$1,200 (balance as of today)
Mutual Fund	$530 (balance as of last statement)

Here is a list of her liabilities—or the money she owes:

Credit Card	$980 (balance as of last statement) Used credit card to cover some living expenses while going to school. Paying down a balance that was up to $1,900.
Automobile Loan	$676 (4 payments left)
Mortgage for Condominium	$76,230 (balance as of last month)

What is Fatima's net worth?

Assets	Value	Total
Checking Account		
Emergency Savings Account		
Mutual Fund		
Automobile		
Condo		
	Total Assets	

Liabilities	Value	Total
Credit Card		
Automobile Loan		
Mortgage for Condominium		
	Total Liabilities	
	Net Worth	

Is her net worth good? ○ YES ○ NO

How could she increase her net worth?

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Why would she want to increase her net worth?

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How do saving and investing affect net worth? Remember the way to calculate net worth is the value of your assets minus your liabilities. When you save and invest, you are generally not creating a liability (unless you borrow to invest, which is generally discouraged). So the value of the asset contributes directly to your net worth.

KEY ACTIVITY

How Does Saving and Investing Affect Net Worth?

Hayden is 21 years old. He has transitioned from care. He wants to find out his net worth.
He has the following assets:

- A savings account with $570.
- An Opportunity Passport™ matched savings worth $700 ($350 of his money; $350 of earned match).
- A Roth IRA worth $2,250.

Use this information and the table below to figure out his net worth.

Asset	Asset Value	minus	Liability	equals	Net Worth
Savings Account	$570.00	–	$0	=	$570.00
Opportunity Passport™ Matched Savings	$350.00	–	$0	=	$350.00 (although once invested will be worth $700)
Roth IRA	$2,250.00	–	$0	=	$2,250.00
Total					**$3,170.00**

Saving and investing is asset building. And remember, money you put into savings or investments does not generally create a liability. As a result, it directly increases your net worth, your wealth and your financial security.

> *"Education is not only a ladder of opportunity, buy it is also an investment in our future."*
> — **ED MARKEY**

Investing in Yourself, Your Own Business and Your Community

There are other ways to invest, too.
For example, you can invest in yourself.

What does it mean to invest in yourself?

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Investing in Yourself

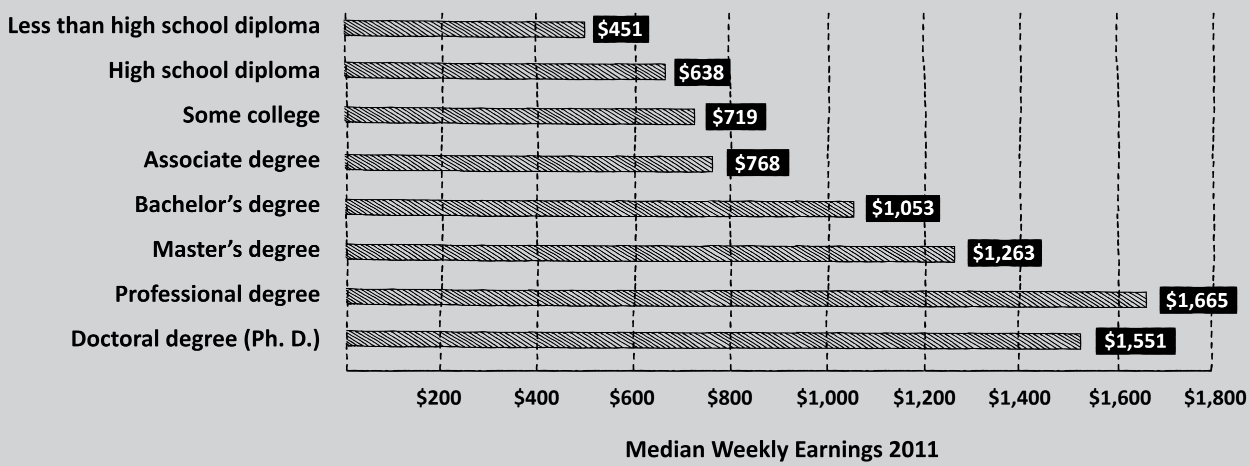
KEY CONCEPT

There are many ways to invest in yourself. One of the best ways to invest in yourself is through your education.

If you are in high school, finish. With a high school diploma you are likely to earn 50% to 100% more during your lifetime over someone who does not graduate from high school.

If you have finished high school, consider public vocational school (public career technical school) for a trade certificate, community college for an associate degree or college for a bachelor's degree.

This table based on data from the Current Population Survey from the Bureau of Labor Statistics, shows the median weekly earnings in 2011 associated with different levels of education attainment.



Enrolling in Opportunity Passport™ is one way you have invested in yourself. You will be learning new information and skills that will help you transition from foster care to financial independence. The knowledge and skills you gain will help you to manage your money throughout your whole life.

You will also be making new social connections—through the Opportunity Passport™ you will have the chance to build your social capital. Taking time to build your social capital is another way you can invest in yourself. Building social capital takes time and resources. But often investments in building social capital provide returns far beyond what you invest. Having social capital provides you with connections to friends, families, volunteer opportunities and employment.

When you take care of your health you are investing in yourself, too. When you feel good, you are able to do more—go to school, go to work, volunteer, or give back and engage with your social network. Taking time to exercise, eat well, get adequate sleep, and just relax as well as avoid things that take away from your health will provide you with very high returns now and throughout your life.

When you take the time and use financial resources to get more training or education after high school you are investing in yourself. In fact, some people see this as the most important investment you can make. Why? Education and training increase opportunities for employment and earnings throughout your life. And you can't ever lose your education to stock market fluctuations.

In addition to investing in yourself, you can invest in your own business.

What does it mean to invest in your own business?

When you start your own business you will invest time and money to make it happen. In addition to the potential financial rewards of investing in a business, small business owners experience other returns too. People feel that working for themselves and not someone else is a return for investing in a small business. People also find that working for themselves allows them to use all of their skills and talents—another return on their investments. Finally, you can invest in your community.

What does it mean to invest in your community?

When you use your time, talent and financial resources to help your neighborhood, community of faith, youth board or school—all examples of communities—you are investing in your community. Why do people invest in their communities? They want to help make their communities better in some way. A lot of people also just want the opportunity to give back or to contribute in a meaningful way. The returns from investing in your community can be:

- ***Financial***—You live in a community where your house will retain its value or where businesses want to locate.
- ***Social***—You have new social connections because of the time and talent you invest.
- ***Emotional***—You feel great about having contributed to your community.

Keys to Your Financial Future Step 7.1: **Investing in Your Community (Optional)**

You may not be at a place where you can think about giving back yet, but giving back to communities that are important to you can provide positive returns. Use the following worksheet to begin to think about how you could invest in communities that are important to you.

Which communities are important to you?	What would you be willing to invest?	What do you anticipate to be the returns?

This module will only focus on financial savings and investment options. But remember, some of the greatest returns you will get from your time and money are investments you make in yourself—your health, your education and training, your social networks, and your community.

> *"Goodness is the only investment that never fails."*
> — HENRY DAVID THOREAU

Starting a Business: A special section if you are considering business ownership

Having your own business may sound like a great option. For some young people, starting a business can provide enough income to support them. Other young people may start a business to add to the income they earn from another job.

But starting and operating a business is hard work. Many people starting businesses believe their success is all but guaranteed. They are motivated. They are enthusiastic. They have vision. But statistically, only 30% to 50% of small businesses make it to five years. And depending on the industry, the odds may be even more stacked against them.

One thing you can do if you have a business idea is begin to examine the feasibility of your idea. This isn't about crushing your dreams. It's about helping you examine whether you have the experiences, skills and drive to run your business. Feasibility also helps you determine whether your business is based on sound concepts.

Feasibility is about determining the answers to these questions:

- Are you the right person to run this business?
- Is this the right business?
- Does it offer the right products and services?
- Is it the right time? Do people want and need this service? Is no one else meeting this need?

Feasibility Self-Assessment

To determine whether you are the right person to start a business right now, take this quick self-assessment. This tool is based on materials developed by *Montana State University Extension Service and Small Business BC*.

Question	Rating Scale		
Do you make decisions easily and quickly?	Very much like me	Somewhat like me	Not at all like me
Do you like being in charge?	Very much like me	Somewhat like me	Not at all like me
Do you like initiating a project and seeing it through until the end?	Very much like me	Somewhat like me	Not at all like me
Are you organized?	Very much like me	Somewhat like me	Not at all like me
Can you work independently?	Very much like me	Somewhat like me	Not at all like me
Are you willing to work longer and harder than you would work for someone else?	Very much like me	Somewhat like me	Not at all like me
Can you handle rejection? Do you bounce back quickly when something does not work out for you?	Very much like me	Somewhat like me	Not at all like me
Did you come from a family that had its own business? Own farm?	Very much like me	Somewhat like me	Not at all like me
Can you find people to cover areas of your business where you do not have strengths?	Very much like me	Somewhat like me	Not at all like me
If the business is a skills-based (landscaping business, consulting business, etc.), do you have those skills? Do you have experience in this line of business?	Very much like me	Somewhat like me	Not at all like me
Can you adapt to changing conditions?	Very much like me	Somewhat like me	Not at all like me
Are you prepared to potentially lower your standard of living while your business gets going?	YES	NO	
Are you willing to do an in-depth feasibility analysis and/or develop a business plan?	YES	NO	

Most of the responses should be “very much like me” or “yes”. If they are not, you may want to think about whether starting a small business is for you at this time.

Having the personal traits to work independently, make decisions, and bounce back quickly from setbacks as well as having the experience and skills central to the business concept are foundational to successfully running a small business.

You may find that you need to get more experience or expand your contacts before you can start your business. Get the education and training you need now to start your business in a few years.

To get more help on figuring out the feasibility of your business idea, look for these resources in your community:

- Small Business Development Center.
- Women's Business Center.
- Community College with a Small Business Development Department or Center.
- Microenterprise Development Program.
- SCORE—Senior Corps of Retired Executives.
- Financial Institutions.

The Key to Saving and Investing

Whether you put money you have saved into a savings vehicle or an investment vehicle, it is important to think about the reason you are saving or investing. In fact, your reason or goal is one of the keys to successful saving and investing.

Why do goals matter in saving and investing? Goals help you determine how much money you need. Go back to the goals you wrote in Module 1. These are your reasons for saving and investing.

Second, you will need to determine when you need the money. This is your time frame. If you have written SMART Goals, your time frame is included in the goals.

Finally, your risk tolerance will screen in or out certain kinds of saving and investment vehicles. If you are not comfortable at this point in time with risking the money you invest, you may want to go with saving vehicles. How do you find your risk tolerance? There are many online instruments that can help you assess your risk.

Your goals, the time frame within which you need the money and your risk tolerance help you determine the right saving and investing vehicle.

> *“An investor without investment objectives is like a traveler without a destination.”*
>
> **— RALPH SEGAR**

Keys to Saving and Investing

KEY CONCEPT

Before putting your money in a savings or investment vehicle, answer these questions:

1. What are you saving or investing for and how much do you need? This is your **goal**.
2. When do you need that money? This is the **time frame**.
3. How much risk can you take? This is your **risk tolerance**.

The answers to these questions help determine where to save or invest your money.

KEY ACTIVITY

Understanding Risk Tolerance

Read the following case study and answer the questions that follow it.

Alejandro is 18 years old and in foster care. He wants to save for trade school—his goal is to become an oil field welder. He has estimated that the Chafee ETV program plus some additional state funding will cover his tuition, fees and books. He wants to save for his own welding equipment as well as living expenses while studying.

He has taken a risk tolerance assessment and knows he has an above average tolerance for risk.

He will graduate from high school in fifteen months. Through his part-time job, he thinks he can save about $200 per month. He is trying to decide between a savings account and shares of Facebook stock. A savings account will earn 1%. He can buy Facebook stock for $31 per share. He figures it will only go up—it's Facebook after all—and that he can sell it in fifteen months for a tidy profit.

What is his goal?

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When does he need the money?

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What is his tolerance for risk?

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Where should Alejandro put his $200 savings each month?

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Generally speaking, if you have a high-stakes goal and a short time frame, a savings vehicle will ensure that the money you save is there when you need it.

The market can fluctuate a lot in a short-term. Stock prices can go up or down substantially in one day. Therefore, many financial advisors recommend thinking about investment vehicles for longer terms goals—where you may not need the money for years. If the market falls and stocks (or mutual funds or other investment vehicles) decline in value, you have time to make up the loss.

In Alejandro's case, he needs that money in 15 months—a relatively short time. And he will spend it to purchase the tools he will use to learn his trade and make a living. This is a very high-stakes goal. Even though he has an above average tolerance for risk, he may want to consider options where he does not risk losing his principal.

Investing Under 18

KEY CONCEPT

As with accounts at banks and credit unions, you cannot invest unless it is through a parent, guardian or another adult before you are 18 or the age of majority in your state.

Keys to Your Financial Future Step 7.2: **Assessing Your Risk Tolerance (Optional)**

With a partner or on your own, visit this website and complete the risk assessment:
njaes.rutgers.edu/money/riskquiz

Once you have completed the assessment, check the result you got from taking the assessment.

- ○ You have a high tolerance for risk.
- ○ You have an above-average tolerance for risk.
- ○ You have an average/moderate tolerance for risk.
- ○ You have a below-average tolerance for risk.
- ○ You have a low tolerance for risk.

Do you think this accurately reflects your risk tolerance? ○ **YES** ○ **NO**
Why or why not?

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How will you use this information about yourself?

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Remember that before putting money into a savings or investment instrument, you need to save it—set it aside instead of spending it. After you've set it aside, you can put it in a savings account, the Opportunity Passport™ match savings, or a mutual fund.

Keys to Your Financial Future Step 7.3: Keys for Saving and Investing

Do you want to put some of your money into savings or investing? Now that you know your risk tolerance, complete the other keys to saving and investing. Consider revisiting the SMART goals you developed in Module 1 as part of your asset-building plan.

What are you saving for?	How much do you need?	When do you need the money?

Investing and the Opportunity Passport™ Matched Savings

One of the allowable uses of your Opportunity Passport™ matched savings is investing. You can use the Opportunity Passport™ matched savings to invest your savings into:

- Certificates of Deposits (CDs)
- Stocks
- Bonds
- Mutual Funds
- Exchange Traded Funds

You cannot use the Opportunity Passport™ matched savings for:

- Administrative Costs

If investing is your asset goal for Opportunity Passport™, be sure you do more research to understand more clearly what you are investing in. The information in this module will get you started. Visit with Opportunity Passport™ site staff for help on getting more information or a referral to someone in the community that can help you further.

Keys to Your Financial Future Step 7.4: Opportunity Passport™ Matched Savings for Investing

Do you plan to use your Opportunity Passport™ matched savings for investing?

- ○ **YES** ○ **NO**

If yes, how do you plan to use the Opportunity Passport™ matched savings? (check those that apply)

- ○ Certificates of Deposit (CDs)
- ○ Stocks
- ○ Bonds
- ○ Mutual Funds
- ○ Exchange Traded funds

Savings Goal and Potential Value of Your Opportunity Passport™ Matched Savings

Amount you will save in your Opportunity Passport™ matched savings	**$**
Match Rate	**×**
Total potential value of your Opportunity Passport™ matched savings	**=**

Risk and Return

One key to saving and investing is understanding the relationship between risk and return. Remember that risk is the chance for loss or uncertainty. When something is high-risk, it has a high chance for loss or a high degree of uncertainty. Return is what you get for investing your principal. Getting high returns means you earn more for investing your principal. When it comes to saving and investing, high returns usually means high-risk.

Think about a time you took a risk. What did you do? What made what you did a risk?

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What rewards did you get from taking the risk?

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What in life is risk-free?

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If you answered “nothing”, to the last question you are right! ***Everything you do has some degree of uncertainty. Everything you do has some chance for loss.*** When considering anything, you assess the possible risks and the potential rewards and make your choice. Sometimes you may underestimate the risks. Or you may overvalue the rewards. This may result in taking a big risk and not seeing the rewards anticipated.

The weighing of risks and rewards happens in many situations in life, including saving and investing. Learning about risk and rewards as they relate to saving and investing and your keys to investing—your goals, timeframe, and tolerance for risk—can help you make better choices regarding where you put the money you work so hard to save.

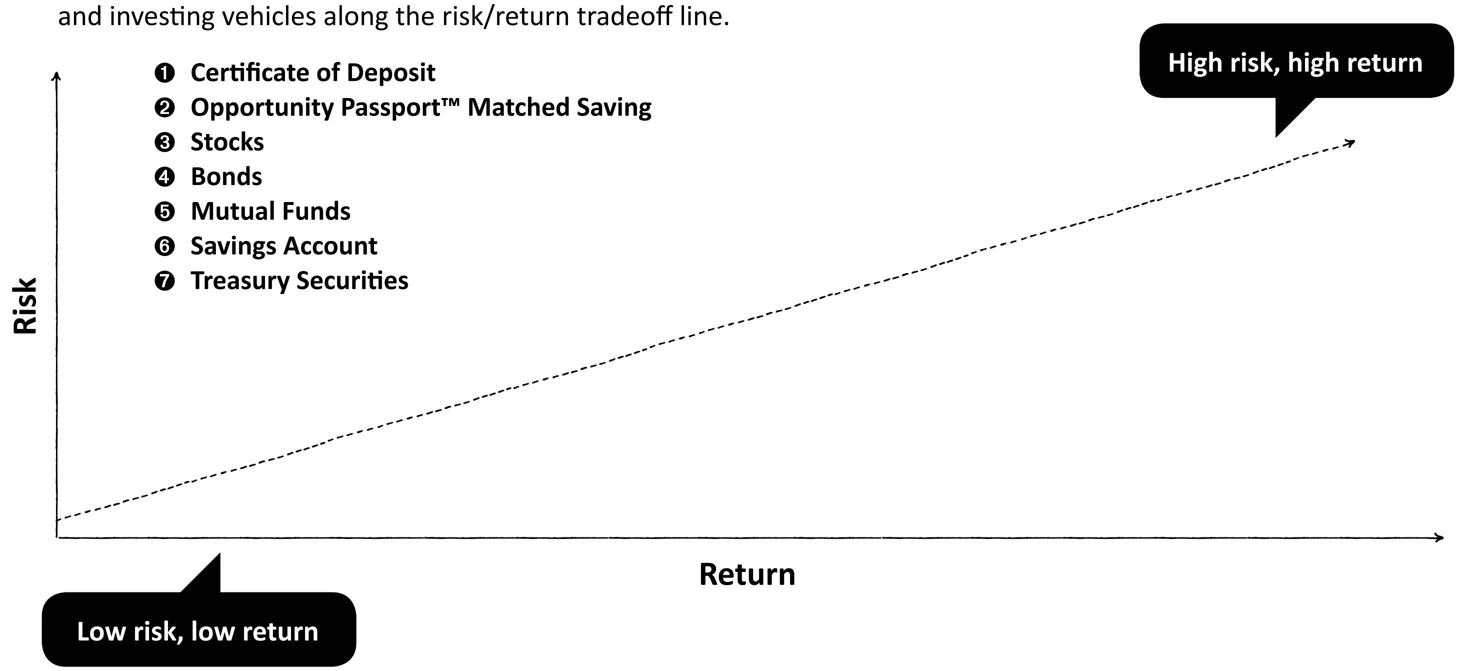
When it comes to putting money you have saved into a savings or investing vehicle, there is a relationship between what you can expect to get in terms of returns and risk. Generally the lower the risk, the lower the potential returns. And, the higher the risk, the higher the potential returns.

KEY ACTIVITY

Risk/return Tradeoff

Working with a partner or your group, plot the savings and investing vehicles along the risk/return tradeoff line.

1. **Certificate of Deposit**
2. **Opportunity Passport™ Matched Saving**
3. **Stocks**
4. **Bonds**
5. **Mutual Funds**
6. **Savings Account**
7. **Treasury Securities**



Mitigating Risk

There are things you do to mitigate the risk. To mitigate risk means to lessen risk. To mitigate risk means that you identify specific ways to reduce chance for loss or uncertainty.

KEY ACTIVITY

Mitigating Risk

Look at the opportunities for loss or risk listed below. What are ways you can think of to mitigate the risk for each example? There may be many things you can do to mitigate the risk—include as many ideas as you can.

Opportunity for Loss—Risk	Ways to Mitigate the Risk
Fail a test in school	
Get injured in an automobile accident	
Lose a job	
Have cash stolen from you room, apartment or home	
Have identity stolen	
Have more debt than can be handled	
Not earning the match through the Opportunity Passport™ matched savings	

The same kind of thinking applies to saving and investing. You will use different strategies to mitigate risk when it comes to saving and investing, but the process for thinking about ***how*** to mitigate risk is the same.

Before you examine ways to reduce risk when it comes to saving and investing, you are going to learn about the different kinds of risk.

Different Kinds of Risk

When you think of risk, you probably think of market risk. Market risk is the chance that you will lose some or all of the money you have saved (and then invested) because of changes in the market. People tend to be most familiar with this kind of risk. This is because it is reported on every ***single day*** in the news. And some websites, television stations, and radio programs dedicate 100% of their site or time to covering this information! But you will also experience other kinds of risks when you save and invest.

KEY ACTIVITY

Different Kinds of Risk

With a partner, match the kind of risk with its definition.

1.	**Market risk**		The risk that your rate of return does not keep up with inflation.
2.	**Inflation risk**		The risk that interest rates will change in a way that is not favorable for investments you may have.
3.	**Interest-rate risk**		The risk that you will lose money due to poor management of a firm.
4.	**Socio-political risk**		The risk that a corporation or government does not do a good job of managing its debt and gets a poor credit rating.
5.	**Liquidity risk**		The risk that you can lose some or your entire principal (the money you invest) caused by changes in the market.
6.	**Management risk**		The risk that you will not be able to turn your investment into cash when you need it.
7.	**Credit risk**		The risk that you could lose investments because of war, economic policy or other political issues.

Ways to Reduce Risk

Different kinds of saving or investment vehicles lessen exposure to some kinds of risk. But they may expose you to other kinds of risk. You should try to balance the risk in your portfolio.

KEY ACTIVITY

Different Kinds of Risk

Working with your group, identify the risk(s) that are lessened by each saving or investing vehicle and the risk(s) that an individual may be exposed to as a result of the savings or investing vehicle.

What is a Portfolio?

KEY CONCEPT

A portfolio is the word used to describe your collection of assets. If you have a savings account and 10 shares of Walmart stock, your portfolio would include your savings account and 10 shares of Walmart stock.

What is Inflation?

KEY CONCEPT

Inflation is something you may understand from having purchased things from year to year. But you may not have ever really understood the definition of it. Inflation is the gradual increase in prices. In the U.S., the inflation rate on average is 3% a year. The result of inflation is that each year one dollar buys less than it did the year before.

Using the inflation calculator at the U.S. Bureau of Labor Statistics, if I bought something in 2006 for $10, that same item today would take $11.41. With inflation, it takes more money to buy the same item each year. From year to year it may not feel like much but over time (6 years in the example) it can add up!

Inflation is measured by the Consumer Price Index (CPI) and the Producer Price Index (PPI). The PPI measures changes in wholesale prices—this is what businesses sell goods and services to one another for. Generally, this will increase before the CPI. The CPI measures the average change in price of a bunch of consumer goods.

What is behind inflation? Many things. One key reason has to do with the price of raw materials. For example, if the prices of barrels of oil go up, then the cost of gasoline will rise, then every business that uses gasoline to make or move their products will experience an increase in costs, so rather than eat this cost, they increase the price of what they sell to the end consumer. Because things increase in price, workers need to earn more to afford the things they used to be able to afford. This puts an upward pressure on wages businesses must pay. Because labor costs more, the price of the products and services must increase.

This cycle continues with one thing influencing another, but the result is a gradual increase in the costs of everything over time.

	Risk you have lessened (mitigated)	Risk you may experience
Savings Account		
Certificate of Deposit		
Stock		
Mutual Fund (Stock)		

Asset Allocation and Diversification

The primary way people mitigate risk in their portfolio is by spreading around the risk.
There are two strategies used to do this:

- ➜ Asset allocation.
- ➜ Diversification.

Asset Allocation

Asset allocation is about dividing your savings and investment portfolio among different asset classes.

What are asset classes? As an introduction to this topic, think about asset classes as being:

- ➜ ***Cash***—In this case, cash does not mean money in your pocket. It means things that have a low chance of principal risk: savings deposits, certificates of deposit, treasury bills, money market deposit accounts, and money market mutual funds.
- ➜ ***Stocks***—Stocks are shares of ownership in corporation or shares in Mutual Funds and ETFs.
- ➜ ***Bonds***—Bonds mean lending money to corporations or government for the promise of full repayment and interest in the future.

Why these groupings? Historically, these groups have generally performed differently. For example, stocks have generally provided the highest returns. But, they come with the highest risk. When the stock market is falling or not doing well, generally (not always) bond returns tend to rise.

How do you choose your asset classes? By going back to the keys to saving and investing:

- ➜ Your goal.
- ➜ Your time frame.
- ➜ Your tolerance for risk.

If you are a young person in foster care who is saving for your own education, putting that money into the ***stock asset class*** could expose you to unnecessary risk. Why? Because you need that money quite soon. And, if the stock market drops, these investments may not have time to catch up by the time you need the money. You may not only lose returns, but the drop in value might also erode (hopefully temporarily) the principal you invested.

As a young person, if you are saving for your retirement, the time frame is quite far off. In this case, taking on a bit more risk may make sense (if you have the risk tolerance for it).

Finally, as people get close to their goals, they tend to move assets from one asset class to another. In general, they move assets from stocks to cash.

Why do people move their assets from stocks to cash?

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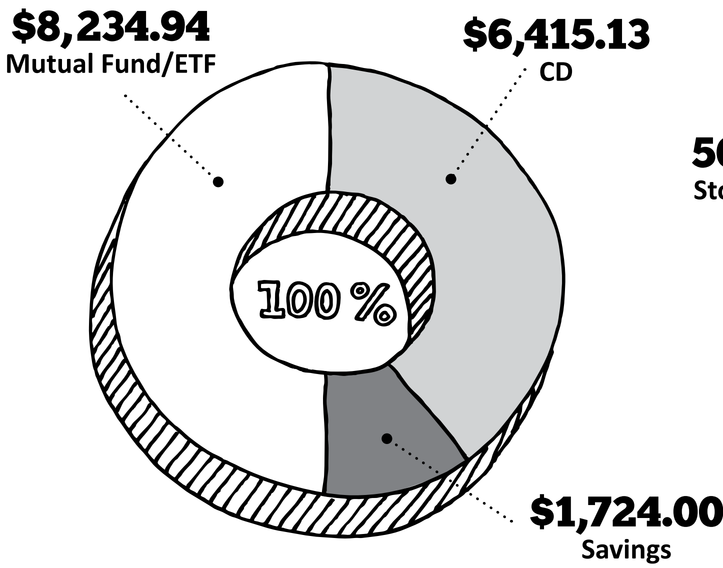
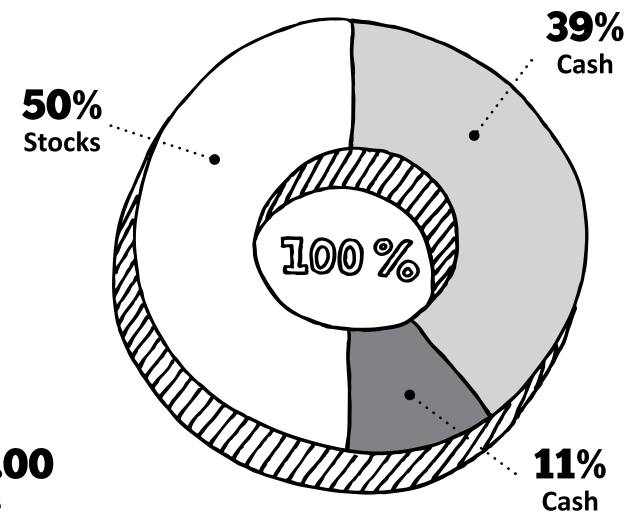
Key Activity

More on Asset Allocation

Jasmine has been saving for her long-term goals since she was sixteen. Her foster parent opened a custodial savings account for her. Every month, she deposited what should could into this account. By the time she left care at age 18, she had close to $1,500 in her savings account. She then started putting $25 per month into an ETF (an exchange traded fund) and another $25 per month into a mutual fund, while continuing to deposit money into her savings account. She was earning about 6% on these funds after fees. Finally, at nineteen she deposited $5,000 into a certificate of deposit at 2% with her Opportunity Passport™ matched savings. She has reinvested her CD every year. At 29, her portfolio looked like this:





She now wants to buy a home. She will need $10,000 for the down payment and closing costs. And she wants to have her emergency savings (savings account) at $5,000 to cover the likely new and unexpected expenses that come with homeownership.

How should she change her asset allocation?

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How should she continue to save and invest once she has her home?

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Diversification

What does "don't put all of your eggs in one basket" mean?

It's an old-fashioned saying that sums up diversification. Diversification is about making sure your money is invested in more than one place within a particular asset class. For example, you may have money in a savings account for short-term goals, money in a money market deposit account for emergencies and money in a checking account for paying your bills. This is diversification of your cash.

When applied to stocks, the saying would mean having stocks in different industries. An industry is a grouping of like business in the economy. Examples of industries include the automobile industry, food services industry, and the oil and gas industry.

What other industries can you think of?

Why does having stocks in different industries help you diversify? If one industry should suffer a setback, money invested in other industries may continue to earn for you.

Key Activity

Diversification

Theo owns Walmart stock. He wants to diversify in the stock asset class by buying stock in three other companies.

Which companies' stock shares might help him diversify?
Explain why these stocks would help him diversify.

Mutual funds and exchange-traded funds do some of the diversification for you. When you buy a share in a mutual fund or ETF, you are diversified through the underlying investments in the funds. You can be further diversified by having more than one kind of mutual fund or exchange-traded fund.

Fees and Investing

When buying ETFs and mutual funds you may be charged fees. Mutual funds are more likely to have more fees because they are actively managed. The following are common mutual fund fees:[2]

- ***Management fees.*** These fees pay the fund's portfolio manager.
- ***12b-1 fees.*** These fees, capped at 1 percent of your assets in the fund, are taken out of the fund's assets to pay for the cost of marketing and selling the fund, for some shareholder services, and sometimes to pay employee bonuses.
- ***Other expenses.*** This miscellaneous category includes the costs of providing services to shareholders outside of the expenses covered by 12b-1 fees or portfolio management fees. You also pay transaction fees for the trades the fund makes, though this amount is not reported separately as the other fees are.

The following fees are based on actions you may take, so it may or may not pay the following fees:

- ***Account fees.*** Funds may charge you a separate fee to maintain your account, especially if your investment falls below a set dollar amount.
- ***Redemption fees.*** To discourage very short-term trading, funds often charge a redemption fee to investors who sell shares shortly after buying them. Redemption fees may be charged anywhere from a few days to over a year. It's important to understand if and how your fund assesses redemption fees before you buy, especially if you think you might need to sell your shares shortly after purchasing them.
- ***Exchange fees.*** Some funds also charge exchange fees for moving your money from one fund to another fund offered by the same investment company.
- ***Purchase fees.*** Whether or not a fund charges a front-end sales charge, it may assess a purchase fee at the time you buy shares of the fund.

The Time Value of Money

The basic idea behind the time value of money is that money today is worth more than money in the future. Specifically $100 today is better than $100 a year from today.

What are the reasons money today is better than money in the future?

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Because of inflation, $100 will buy more today than it will one year from now. For example, if something cost $100 in 1994, that same item would cost around $145 today. Alternatively something that costs $100 today could have been purchased for $68 in 1994.[3]

Another reason money today is better than money next year is that you have a whole year to put it into savings or invest it and earn money on those funds received today. And those earnings can be reinvested one year from now.

[2] Taken from *Mutual Funds* by FINRA on www.finra.org

[3] Calculated using the inflation calculator at www.westegg.com/inflation

Compound Your Money

Returns reinvested earn more; returns can be reinvested to earn more returns. That is what is meant by the term compounding. Compounding works for you when you save and invest. (It's the opposite when carrying a balance on a credit card!) Compounding interest or returns and time earns money in investing.

When you save or invest, you can choose to have the interest or returns you have earned added back into the principal. Then your principal plus the interest or returns you earned earn more. The longer you leave your money in savings or an investment account (time), the more the interest or returns compound. This is how money makes money.

Finally, the more often money compounds and the earlier the money is put into savings or investments to compound, the better. Money can compound on a daily, monthly, or quarterly basis. Money that compounds monthly will earn more than money that compounds quarterly. And money that compounds daily (or continuously) will earn more than money compounded monthly.

KEY ACTIVITY

The Power of Compounding

Jordan and Jeremiah each have $1,000 to deposit into an account. Jordan found a savings account that earned 2% with quarterly compounding. Jeremiah found a savings account that earned 2% with monthly compounding. Compare their returns after 12 months.

Who earned more? How much more?

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What could make the amount earned increase?

____

Jordan's Savings Account

$ Principal	$ Earnings	$ Total
1,000.00	12.50	1,012.50
1,012.50	12.66	1,025.16
1,025.16	12.81	1,037.97
1,037.97	12.97	1,050.95
	$ 50.95	

Jeremiah's Savings Account

$ Principal	$ Earnings	$ Total
1,000.00	4.17	1,004.17
1,004.17	4.18	1,008.35
1,008.35	4.20	1,012.55
1,012.55	4.22	1,016.77
1,016.77	4.24	1,021.01
1,021.01	4.25	1,025.26
1,025.26	4.27	1,029.53
1,029.53	4.29	1,033.82
1,033.82	4.31	1,038.13
1,038.13	4.33	1,042.46
1,042.46	4.34	1,046.80
1,046.80	4.36	1,051.16
	$ 51.16	

The more times money compounds, the more it will earn. Also, money invested earlier has more opportunities to compound and will earn more.

KEY ACTIVITY

The Power of Saving and Investing Early

Katrel and Hailey both participated in the Opportunity Passport™ Financial Education Training. Katrel started investing right away at age 18. Hailey wanted to take care of other things, and she didn't start investing until she was 30. They each invested $500 per year and earned on average after fees 5%.

Katrel			
Age	**$ Principal**	**$ Earnings**	**$ Total**
18	500.00	25.00	525.00
19	1,025.00	51.25	1,076.25
20	1,576.25	78.81	1,655.06
21	2,155.06	107.75	2,262.82
22	2,762.82	138.14	2,900.96
23	3,400.96	170.05	3,571.00
24	4,071.00	203.55	4,274.55
25	4,774.55	238.73	5,013.28
26	5,513.28	275.66	5,788.95
27	6,288.95	314.45	6,603.39
28	7,103.39	355.17	7,458.56
29	7,958.56	397.93	8,356.49
30	8,856.49	442.82	9,299.32
31	9,799.32	489.97	10,289.28
32	10,789.28	539.46	11,328.75
33	11,828.00	591.44	12,420.18
34	12,920.18	646.01	13,566.19
35	14,066.19	703.31	14,769.50
36	15,269.50	763.48	16,032.98
37	16,532.98	826.65	17,359.63
38	17,859.63	892.98	18,752.61
39	19,252.61	962.63	20,215.24
40	20,715.24	1,035.76	21,751.00
	$ 11,500.00	**$ 10,251.00**	
	Total Principal	**Total Earnings**	

Hailey			
Age	**$ Principal**	**$ Earnings**	**$ Total**
18			
19			
20			
21			
22			
23			
24			
25			
26			
27			
28			
29			
30	500.00	25.00	525.00
31	1,025.00	51.25	1,076.25
32	1,576.25	78.81	1,655.06
33	2,155.06	107.75	2,262.82
34	2,762.82	138.14	2,900.96
35	3,400.96	170.05	3,571.00
36	4,071.00	203.55	4,274.55
37	4,774.55	238.73	5,013.28
38	5,513.28	275.66	5,788.95
39	6,288.95	314.45	6,603.39
40	7,103.39	355.17	7,458.56
	$ 5,500.00	**$ 1,958.56**	
	Total Principal	**Total Earnings**	

How much did Katrel invest (principal)?

___

How much did he earn?

___

How much did Hailey invest (principal)?

___

How much did she earn?

___

It may seem that the difference in earnings is because of the amount of principal invested. That does have an impact. But suppose Hailey invested at 30 the same amount that Katrel had invested up to that point in time—$6,000. ***Would their earnings be the same then?***

How much more did Katrel earn even though Hailey invested the same amount of money (principal)?

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Why is there a difference?

___

___

___

Hailey			
Age	$ Principal	$ Earnings	$ Total
18			
19			
20			
21			
22			
23			
24			
25			
26			
27			
28			
29			
30	6,500.00	325.00	6,825.00
31	7,325.00	366.25	7,691.25
32	8,191.25	409.56	8,600.81
33	9,100.81	455.04	9,555.85
34	10,055.85	502.79	10,558.65
35	11,058.65	552.93	11,611.58
36	12,111.58	605.58	12,717.16
37	13,217.16	660.86	13,878.01
38	14,378.01	718.90	15,096.92
39	15,596.92	779.85	16,376.76
40	16,876.76	843.84	17,720.60
	$ 11,500.00	$ 6,220.60	
	Total Principal	Total Earnings	

An additional $6,000 invested to "catch up"

Money Doubles by the Rule of 72

You can figure out how long it will take your money to double at any given rate of return. This is because of the "rule of 72." This equation can help you figure out quickly the time or rate you need to earn to increase the money you save and invest.

Divide 72 by the rate of return. This tells you how many years it would take any amount of money to double at that rate of return. For example, at 10%, your money would double in 7.2 years.

This means that it would take 7.2 years for:

$1 to become $2
$100 to become $200
$1,000 to become $2,000

if you earn a 10% return.

You can also use this to figure out what interest rate you need to get on an investment for it to double in a certain time period. To find out the interest rate, divide 72 by the number of years in which you want your money to double. For example, if you want your money to double in 6 years, you would need to get a 12% rate of return.

KEY ACTIVITY

Using the Rule of 72

With other members of your group, complete the following exercise.

How long will it take your money to double? Use the Rule of 72 to find out:

Rate of Return:	3%	2%	6%	12%
Years to double	**72/3 = 24** If you invest at 3%, it will take 24 years for your money to double.			

What rate of return do you need for your money to double? Use the Rule of 72 to find out:

Number of Years:	2 years	5 years	12 years	24 years
Rate of return for your money to double	**72/2 years = 36%** If I want my money to double in 2 years, I need to invest it at 36%—this is a very high return.			

Understand Your Investments

Before you invest, get more information. Do not invest in what you do not understand. Some experts would say this is the most important principle of investing. If you want more general information about savings and investing, go to unbiased sources of information first.

How can you tell if saving or investing information is unbiased?

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Consider starting with these websites. You cannot buy products or services on these websites, which may be a good indicator that the information is unbiased:

- **www.mymoney.gov** (check out popular topics, saving and investing)
- **www.finrafoundation.org** (check out the resources section)
- **www.investoreducation.org**
- **www.sec.org**

For more information on rates on savings, CDs, and money market deposit accounts, try:

- **www.bankrate.com**

For more information on stocks, visit:

- **www.nyse.com**
- **www.nasdaq.com**
- **www.valueline.com**

To find out more about mutual funds and ETFs including ratings of specific funds, check out:

- **www.morningstar.com**

If you do select a fund, be sure to order and read the prospectus. A prospectus is basically a mutual fund or ETF user's manual. It explains the objective of the fund, the securities (stocks or bonds) held in the fund and fees.

Does Investing = Gambling?

You may hear someone say that investing is just like gambling. Is this true? Both involve risk, but there are some important differences.

When someone gambles they hope to win money by playing a game or betting on the outcome of a game. Generally, this involves a guess—picking the right number on the roulette wheel, picking the right lottery number, holding onto the right cards, or picking the right slot machine or the right horse in a race. Research does not generally help. And most people gamble for entertainment and expect the returns to happen quickly. Finally, in gambling, the odds are generally stacked against you. This means, you have a remote chance of gaining anything from the money you are gambling.

When someone invests, they do not hope to win money by playing a game. They hope to earn money by buying a share in a company. As the business and profits grow, so does your investment. This takes time—most investors do not expect to double their money overnight. In investing, the odds are not stacked against you because:

- You can research the company or investment you are considering.
- The goal of most places you can invest is to ***earn money for you*** NOT ***win it from you***.
- There are many laws to protect you.

Sometimes people do take big risks when it comes to investing and it starts to look more like gambling. They invest based on a "hot tip" they've heard on the radio. Or they put all of their money into one "sure thing" investment. In most cases, these get rich quick investment schemes end badly, like most gambling adventures. So gambling and investing are different. ***But investing can become gambling if you do not follow the principles of investing.***

Getting Professional Assistance

While getting professional assistance for saving, investing or financial planning may seem far off, it's important to understand this market so you can find the right people to help you.

KEY ACTIVITY

Who Can Help?

Put a check mark by those titles that are "official designations" for investment or planning professionals?

✓	Official Designation
	Financial Analyst
	Financial Planner
	Certified Financial Planner
	Financial Consultant
	Accredited Financial Counselor
	Investment Consultant
	Registered Financial Gerontologist
	Wealth Manager
	Certified Divorce Financial Analyst
	Financial Adviser
	Certified Money Manager
	Financial Educator

People in the financial services field use many different titles. Understanding what each titles means, and if anything makes finding the right person a challenge. In some cases, titles are self-conferred, which means an individual gives it to himself or herself. In others, the holder of the title has completed years of formal schooling, passed a credentialing exam, and commits to ongoing education and minimal levels of practice annually to continue the certification.

Here is a broad overview of investment professionals:[4]

1. **Broker-Dealer**
   Although broker-dealer is not a specific, credentialed title, it means something very specific. This individual (or firm) buys and sells securities on behalf of the customer (broker) or herself/himself/itself (dealer). People who work for broker-dealers are known as registered representatives. Broker-dealers must be registered with the Securities and Exchange Commission (SEC), and they may be members of FINRA. Registered representatives may be financial consultants, financial advisers, or investment consultants. If they also have a Series 6 license, they can sell mutual funds, variable annuities, and similar products. If they also have Series 7 license, they can sell an even broader range of securities.

   To check the background of a Broker-Dealer, visit:
   www.finra.org/Investors/ToolsCalculators/BrokerCheck
   www.sec.gov/investor/brokers.htm

2. **Investment Adviser**
   Investment advisers are paid for providing advice about securities to clients and manage portfolios for customers. The SEC regulates Investment Advisers who manage more than $25 million in client assets. Investment Advisers that manage less than that amount must register with the state agency.

   To check the background of an Investment-Adviser, visit:
   www.adviserinfo.sec.gov/(S(4zligiqzra1rru55vgdls245))/IAPD/Content/IapdMain/iapd_SiteMap.aspx

3. **Accountant**
   Accountants focus on tax planning, financial planning, tax implications of financial decisions, tax reporting, auditing and management consulting. Many states now require practicing accountants to become Certified Public Accountants (CPAs). Some CPAs are also Personal Financial Specialists. They also provide financial planning services that include assessment of financial situation, develop budgets, setting goals for savings and investing, and develop a plan for monitoring progress and reaching goals.

   To find out more about a CPA, visit:
   www.aicpa.org

4. **Lawyer**
   Lawyers are licensed to give legal advice. They are able to analyze and provide advice on the legal impact one financial planning or investment decision may have on another.

   To find out more about the qualifications of a lawyer, visit:
   www.abanet.org

5. **Financial Planners**
   Many professionals who have specific credentials are also financial planners—brokers, investment advisers, insurance agents, and accountants. Some financial planners may have no credentials at all. There is no regulator that has jurisdiction over financial planners. Organizations that provide credentials, however, have standards that they enforce among those individuals they have credentialed. An individual that is an Investment Adviser and a financial planner is regulated by the SEC or the state.

[4]Information from FINRA.

Retirement

> *An investment in knowledge pays the best interest.*
>
> — **BENJAMIN FRANKLIN**

Retirement may seem like it is a million years away! You may not have even started working yet! But retirement is an important part of saving and investing. And the younger you start saving and investing for retirement, the more compounding period you can take advantage of. This means that your money has a lot more time to grow.

Ask middle aged people about what they wish they had known when they were younger and they are likely to say (among many other things): *"I wish someone had encouraged me to save for my retirement earlier."*

This is your first encouragement to think about saving for retirement. It may not be something that is actionable today, but understanding it as something to consider will hopefully get you thinking about it earlier.

If you feel this part of the module is not important for you, skip it for now. Come back to it, though in a year or two. The earlier you start saving for retirement, the better off you will be.

Do you feel that learning some basic information about retirement savings now is valuable? Why or why not?

How Much Do You Need to Save for Retirement?

In general, financial planners coach people to count on needing between 60 % and 100% of their current income to meet everyday expenses when they retire. This means that if you earn $28,000 today, you will need between $16,800 and $28,000 per year. Remember, that estimates made in today's dollars are a starting place. Because of inflation, everything will cost more.

Why do experts give such a large range? What expenses may be different when you retire?

All of this common wisdom, however, depends on what you want to do during retirement. One thing commonly missed in articles about saving for retirement is the notion of simplifying before retirement. Are there expenses that you can cut back on to give you more flexibility in the future?

For example, can you work hard to pay off your debt before you retire—credit card debt, student loan debt, and mortgages? Paying off debt would limit your housing expenses to property taxes, insurance and home repairs. Can you ensure you have a good quality car paid off in advance of retirement? Or does relocating to a less costly area make more sense—one that includes a robust public transportation system eliminating your need for a car.

This is the reason planning is so important. There are so many variables. One big variable is the actual cost of everything in the future. Because of inflation, you can expect things to cost more money.

If you are 18, the same $500 apartment today is likely to cost $2,325.44 in 52 years from now (assuming an annual inflation rate of 3%) when you retire. As you work on your retirement estimates, you will need to factor in inflation, too.

Decrease Your Overhead, Increase Your Options—Now and When You Retire

KEY CONCEPT

What does it mean to simplify before you retire? It means the following and more:

- Getting rid of debt.
- Moving to a small home or even an apartment.
- Paying off your car or relocating to where you can walk or take public transportation.

And so on.

Why? Because when you decrease your financial obligations and recurring expenses, you have more financial flexibility. You can deal with unexpected situations better because you have money left over

Retirement Savings and Investing Instruments[5]

There are two types of retirement plans—those offered through your job and those you set up individually. If you work for someone who offers a retirement plan, consider saving through it as soon as you can. Remember, the earlier you invest, the more times your money has to compound.

401(k) Plans

Corporations and nonprofit organizations sometimes offer 401(k) plans. An employer may offer just a traditional plan or both a traditional 401(k) and a Roth 401(k). Each employer's plan differs in some ways from other plans, but the basic elements are the same. Among the most important are that contributions are deducted directly from your earnings and deposited into your account, you select the investments from the menu your plan provides, and you enjoy tax benefits for participating.

Some employers now offer plans with automatic features, including enrollment at pre-set contribution levels into a pre-selected fund. These features can help increase participation rates and allow companies to better help their employees save for retirement. Although automatic features change the defaults so that a new hire doesn't have to remember to sign up, an employee who does not wish to contribute can choose to opt out.

[5] This section is based on materials that were developed by FINRA Investor Education Foundation. For more information see: www.finrafoundation.org/resources/education/index.htm

403(b) Plans

Nonprofit employers, including educational institutions, hospitals, museums, and foundations, may offer 403(b) plans to their employees. Traditional 403(b)s are tax-deferred salary reduction plans and Roth 403(b)s are tax-free plans to which you contribute after-tax income. These plans resemble 401(k)s in many respects although they may allow larger catch-up contributions, are less likely to offer matching contributions, and their investment menus are typically limited to annuities and mutual funds.

457 Plans

State and local governments may offer 457 plans to their employees. For the most part, these savings instruments work very much like traditional 401(k)s—they allow you to set aside pretax income in a tax-deferred account. However, there's no Roth version of a 457 plan, and employers do not match contributions.

Thrift Savings Plan

If you work for the federal government as a civilian or military employee, you can save for retirement through a Thrift Savings Plan, usually abbreviated as TSP, as part of either the Federal Employees' Retirement System (FERS) or the Civil Service Retirement System (CSRS).

How Much Will You Have When You Retire

KEY CONCEPT

The amount you have when you retire will be determined by the following:

- The amount you contribute to or invest.
- The way in which the money was invested.
- The return those investments provided over time.
- When you take your money out of your account.

As with all investing, there is risk that what you put in may not be what you take out. This is the reason most people often move their retirement savings to lower risk, lower return investments as they age.

Individual Plans

If you don't work for an employer that offers a retirement plan, you can still save for retirement on your own starting at age 18!

Individual retirement plans, as the name suggests, are accounts you open on your own. With an individual plan, you decide where and how to invest. That involves decisions about your asset allocation, which means spreading your investments around among different asset classes, such as stocks, bonds, cash, and other investment categories. You must also decide how to diversify your investments within each class to help reduce investment risk, and decide when to sell one investment and buy another one.

When you're ready to stop working and start withdrawing, the value of your account depends on how much you've invested, the investments you chose, and how those investments performed. That gives you a lot of authority to make decisions, but also the responsibility for making good ones. That's one of the reasons you might decide to work with an investment professional who has the expertise to help you make decisions.

The following is a brief overview of ***some*** individual retirement options:

IRAs

Perhaps the most widely known personal retirement plan is the individual retirement account (IRA). An IRA may be either an individual retirement account you establish with a financial services company, such as a bank, brokerage firm, or mutual fund company of your choice, or an individual retirement annuity that's available through an insurance company.

Your IRA provider acts as custodian for your account, investing the money as you direct and providing a regular accounting of your account value. Once your account is open, you can select any of the investments available through the custodian. In fact, one of the things to think about in choosing a custodian is the type of investments you are planning to make.

To participate in an IRA, you must earn income, and you can contribute up to the annual limit that Congress sets. That cap is $5,000 in 2012. However, you can't contribute more than you earn. So, for example, if your total earned income is $2,500 for the year, that's the amount you can put into an IRA.

You can put money into your IRA every year you're eligible, even if you are also enrolled in another kind of retirement savings plan through your employer.

When IRAs were first introduced, there was just one basic type, which was open to anyone with earned income. But since then, IRAs have evolved to include a number of variations:

- ***Traditional—***You can subtract the amount you contribute to your IRA when you file your tax return for the year, reducing the income tax you owe. If you don't qualify for the deduction, the contribution is made with after-tax income.

  Earnings on investments in a traditional IRA are tax deferred for as long as they stay in your account. When you take money out—which you can do without penalty when you turn 59 ½, and which you are required to begin doing once you turn 70 ½—your withdrawal is considered regular income so you'll owe income tax on the earnings at your current rate.

- ***Roth—***Contributions to a Roth IRA are always made with after-tax income, but the earnings are tax free if you follow the rules for withdrawals—you must be at least 59 ½ and your account must have been opened for at least five years. What's more, with a Roth IRA you're not required to withdraw your money at any age—you can pass the entire account on to your heirs if you choose. And you can continue to contribute to a Roth as long as you have earned income.

Taking Money Out

One important thing is true of all IRAs: ***taking out money early is discouraged.*** In fact, you generally cannot make IRA withdrawals before age 59 ½ without paying an early withdrawal penalty. That penalty is 10% of the amount you withdraw.

There are exceptions, however. You can take IRA money out to:

1. Meet certain medical expenses.
2. Purchase your first home.
3. Pay college tuition bills.
4. For certain other reasons listed in the federal tax laws.

In any event, before you make any early IRA withdrawals, you should check with a tax or legal adviser to be sure you're following the rules. Even if you do not face a penalty, you will have to pay income tax on any withdrawal you make. ***The only exception is that you can take up to $10,000 in earnings from your Roth IRA tax free to buy a first home for yourself or a member of your immediate family.***

There is a reason why withdrawing early from your IRA is difficult. ***These savings vehicles are specifically designed to help you set aside money for retirement, not for other purposes.*** By imposing penalties for the early use of these funds, the government hopes that most people will leave their money alone. That way, the money will have time to compound, and will be available to support you in your retirement.

You should be aware, too, that unlike certain employer plans, you're not allowed to borrow against your IRA balance.

When you open an IRA, you should name a beneficiary for your account. A beneficiary is the person you want to receive the assets you have accumulated when you die.

Saving for Retirement as a Young Person

As a young person in foster care or transitioning from foster care to independent living, saving for retirement may seem impossible. If you are not working, revisit this information from time to time over the coming years so you'll be ready to save and invest for retirement when you have income. If you are working, think about the best way to save and invest your money now. A retirement account may be an option for you.

Remember that starting retirement savings when you are young puts you at an advantage—you have more compounding periods to take advantage of. The biggest mistakes most people make when saving or investing for retirement are:

- Not doing it.
- Waiting until they are in their 40s or 50s to get started.

You now have the keys to avoid this all too common mistake.

Taxes on Retirement

KEY CONCEPT

Do you pay taxes on money in retirement accounts? The short answer is, yes. How you pay taxes depends on how you saved the money for retirement.

If you saved using income that was not taxed—in a 401K or IRA—you will be taxed when you withdraw the money in retirement. But you will not pay FICA. And you are likely to be at a lower tax rate. If you saved in a Roth IRA (and it was set up correctly), your contributions to the account were made from income were already taxed. So withdrawals from a Roth IRA including the money you earned are not taxed at withdrawal.

MODULE 7:

Saving and Investing:
Making the change by keeping it

Take time to gather up the past so that you will be able to draw from your experience and invest them in the future.

— JIM ROHM

Congratulations on finishing this module of ***Keys to Your Financial Future***. You have learned about saving and investing! This is the final module in ***Keys to Your Financial Future***.

You now know some of the basic principles of saving and investing. You understand the risk/return tradeoff. And you know the Opportunity Passport™ matched savings is an exception to the high return, high risk relationship—the Opportunity Passport™ matched savings is high return, low risk.

You also learned about risk—the chance of loss. There are many kinds of risk and your job when saving and investing is to figure out how to mitigate (lessen) it.

You learned about two key strategies for risk mitigation:

- ☑ **Asset allocation.**
- ☑ **Diversification.**

You also learned about the time value of money, compounding, and the "Rule of 72."

Finally, while you may have covered a section in the training on retirement. This section provides you with an introduction to saving and investing for retirement.

To continue the development of your financial plan, you completed the following *Keys to Your Financial Future* Steps:

- ☑ ***Keys to Your Financial Future Step 7.1: Investing in Your Community (Optional)***
- ☑ ***Keys to Your Financial Future Step 7.2: Assessing Your Risk Tolerance (Optional)***
- ☑ ***Keys to Your Financial Future Step 7.3: Keys to Saving and Investing***
- ☑ ***Keys to Your Financial Future Step 7.4: Opportunity Passport™ Matched Savings for Investing***

Use this time to go back and review the work you have done. Use it to inspire you to use your money to make the life you want for yourself, the people you love, and for your community.