MARYLAND COOPERATIVE EXTENSION
UNIVERSITY OF MARYLAND
COLLEGE PARK•EASTERN SHORE

# Fact Sheet

Fact Sheet 694

# Investment Basics

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Most consumers want to achieve financial security. However, saving enough money and choosing appropriate financial products that provide both safety and growth is difficult. Consumers should understand both the opportunities and potential risks involved in investing to achieve their goals. This fact sheet discusses the factors involved in making investment decisions and describes the many investment opportunities that are available.

## Saving Versus Investing

Goals for saving and investing are not the same. Savings provide funds for emergencies and specific purchases. Therefore, funds in savings should be safe. In this case interest-bearing accounts, which are often insured, are a good place to store funds.

The goal of investing is to increase net worth or wealth. However, many investments risk the loss of principal (the original amount invested). To be financially secure, you must establish a solid savings program before you begin to invest.

## Setting Investment Goals

The first step to becoming an effective investor is to determine your goals. This helps you choose investments that fit your needs. For example, a common long-term investment goal is accumulating funds for retirement. To reach this goal you will need to give up immediate access to your funds and accept more risk for a higher return. Remember that an achievable investment goal has three parts: (1) what you are saving for, (2) how much it costs, and (3) when you will need it. For additional information on goals and a discussion of the time value of money, ask for Fact Sheet 693 “Savings Basics” at your county Extension office.

Gathering a large sum of money is overwhelming when you think of the amount as a lump sum. However, when you look at the amounts month by month, the amount you need to save is both possible and manageable. The longer you have to save, the less money you must set aside each month. Table 1 can help you determine how much to save monthly at a given interest rate. It is based on deposits made on the first day of the month. This table also assumes that all earnings will be reinvested, and that the account is either tax-deferred, or you will pay the taxes on the yearly earnings from other funds.

Suppose you wish to save $100,000 for retirement in 20 years. If you earn a 5 percent return in a money market account, you will need to save $243 per month. Note that you only have or set aside $58,320 ($243 x 12 months x 20 years = $58,320). You earn the rest of the $100,000 as earned interest. However, if you become a successful investor and increase your annual return to 9 percent in a mutual fund, you will only have to save $149 per month. You may find that watching your money grow gives you as much pleasure as spending money. If so, it will be easier to put off spending.

Look at your goals again—how long and what will it take to fulfill them?

## Making Investment Decisions

There are economic and personal factors that investors should consider when making financial decisions. This section discusses these factors. Although economic conditions change, the criteria for making good investment decisions remain the same. The factors to consider when making investment decisions include the following:

- type and degree of risk,
- diversification,

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**Table 1.** Monthly savings needed to reach a financial goal

| Savings goal | Years to achieve goal 5 | 10 | 15 | 20 | 25 |
|---|---|---|---|---|---|
| | Monthly savings ($) needed at a 5 percent rate of return, compounded monthly | | | | |
| 25,000 | 366 | 161 | 93 | 61 | 42 |
| 50,000 | 732 | 320 | 186 | 121 | 84 |
| 100,000 | 1,465 | 642 | 373 | 243 | 167 |
| 150,000 | 2,196 | 962 | 559 | 364 | 251 |
| 200,000 | 2,929 | 1,283 | 745 | 485 | 335 |
| 250,000 | 3,660 | 1,604 | 932 | 606 | 418 |
| | Monthly savings ($) needed at a 9 percent rate of return, compounded monthly | | | | |
| 25,000 | 329 | 128 | 66 | 37 | 22 |
| 50,000 | 658 | 257 | 131 | 75 | 45 |
| 100,000 | 1,316 | 513 | 263 | 149 | 84 |
| 150,000 | 1,974 | 770 | 394 | 223 | 133 |
| 200,000 | 2,632 | 1,025 | 525 | 298 | 177 |
| 250,000 | 3,290 | 1,283 | 656 | 372 | 222 |

- rate of return,
- liquidity and marketability,
- personal tax status, and
- freedom from care.

## Type and Degree of Risk

There are four types of risk that can act together or separately to affect investment outcomes. They affect the security of both your principal and investment income.

**Financial risk.** The degree of financial risk on an investment depends on the ability of the issuer of the financial product to return your principal when the investment ends. For example, an investor lends money in exchange for a bond with the understanding that the borrower will be able to pay back the principal when the bond matures. If a company issues bonds to raise funds, its ability to repay the bondholders depends on the company's earning power and debt structure. A company with healthy earnings will expand and pay off its bondholders. On the other hand, a company with little or no earnings may go out of business. When the latter occurs, the bondholders receive all or a portion of their principal before stockholders are paid. Stockholders may lose their total investment if there are not enough funds.

**Market risk.** Changes in the national economy can cause increases or decreases in the demand for certain securities such as stocks or bonds. Sometimes an investor may find it necessary to sell when the market price of the stock or bond is down. This may cause a loss of some of the original principal. On the other hand, these economic forces can cause the price of a security to increase, which creates a profit when it is sold.

**Interest-rate risk.** Changing interest rates affect the value of bonds. When investors purchase bonds, they know the value of the bond at maturity (the face value of the bond), the amount of interest it will pay, and how often interest payments will be made. If an investor must sell a bond before maturity, current interest rates will affect the value of the bond. Depending on whether interest rates are rising or falling, the investor may earn a profit or sustain a loss. For example, if an investor buys a $1,000 bond at 8 percent and interest rates rise to 9 percent, the investor will have to accept less than the $1,000 paid to sell the bond. The new purchaser would not pay $1,000 for a bond paying 8 percent when he or she could earn 9 percent on a newly issued bond. Conversely, when interest rates drop, a bond would sell for a price higher than its face value because it is paying a higher interest rate than newly issued bonds.

**Purchasing power risk.** Inflation (a rise in consumer prices) lowers the purchasing power of the dollar. When inflation steadily grows, money saved today will not buy an equal amount of goods and services in the future. Few investments protect consumers from the effect of inflation. Although there is no guarantee, stocks exceed the increase in consumer prices over the long term. Fixed-interest investments, such as statement savings accounts, usually lose purchasing power when inflation increases.

## Diversification

Diversification is a technique for managing risk. In the simplest terms, it means that not all of your assets will be in any one investment. When purchasing stocks, diversification means that you own stock in several industries. When buying certificates of deposit (CD's) or bonds, it means you buy them with staggered maturity dates. A diversified portfolio may contain stocks, bonds, and money market accounts, in addition to regular savings accounts. As a result, if one investment fails to meet your expectations or if interest rates vary widely, your loss is less severe. This idea follows an old saying: Do not put all of your eggs in one basket. Additionally, avoid putting more than 20 percent of your investable funds in a single type of investment. Finally, do not invest more than you can afford to lose.

## Rate of Return

A primary purpose of investing is to make your money grow in value. Investors refer to the amount of growth as the rate of return. It may be a combination of interest (a return from lending), dividends (a share of the company's profits), and capital gains (an increase in market price of stocks, bonds, and mutual funds).

There is a tradeoff between risk and return. Investments that offer the highest rates of return increase the risk that the investor will lose part of his or her principal. The investment pyramid (Figure 1) shows the tradeoff between risk and return as it relates to particular investments. Investments at the bottom of the pyramid ensure that you will not lose your principal. As you move up the pyramid, you increase the chance of losing some of your principal, but the potential returns are greater.

Your actual rate of return will be reduced by inflation and income taxes. You can estimate the minimum rate of return (RR) you need to break even with the following formula. Divide the inflation rate by 100 minus your tax-bracket rate. For example, if the inflation rate is 4 percent and

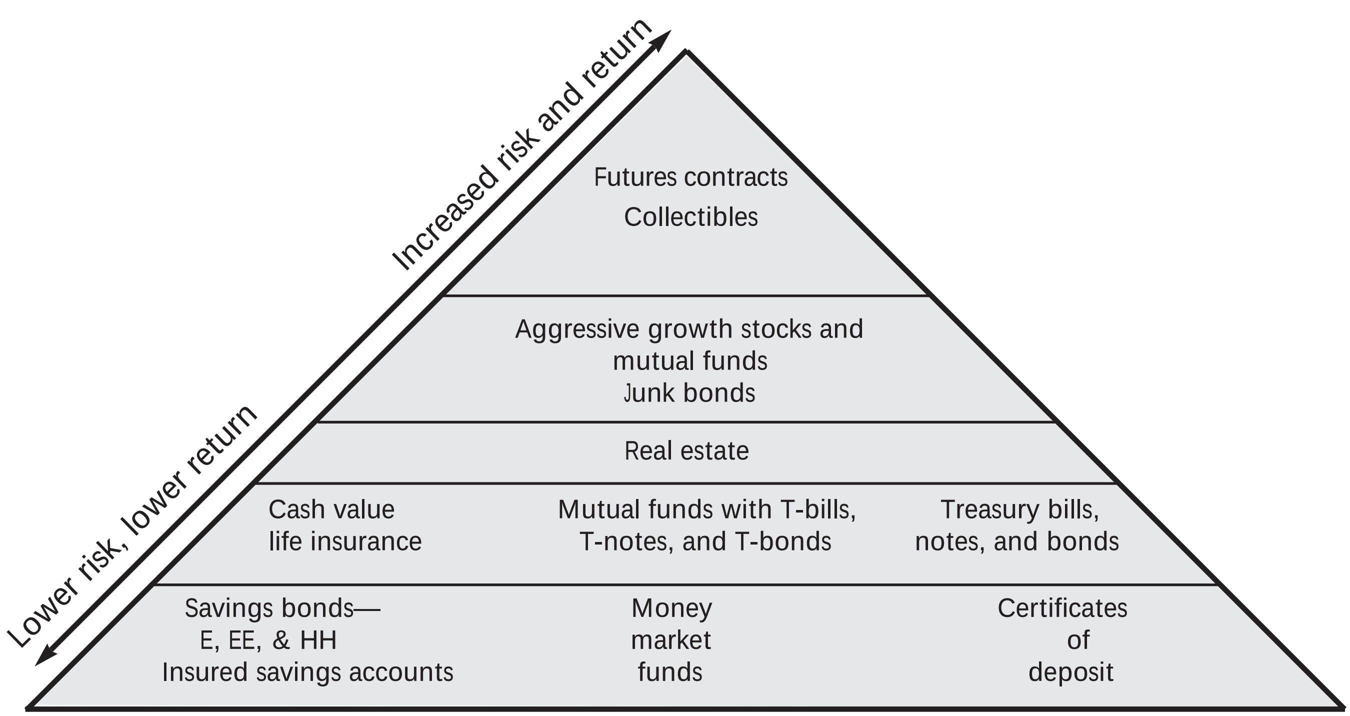


**Figure 1.** Investments at the bottom of the pyramid ensure that you will not lose your principal. As you move up the pyramid, you increase your chances of losing some of your principal.

you are in the 28 percent tax bracket, then you would calculate the minimum RR this way:

$$RR = \frac{4}{100 - 28} = 5.6\%$$

The minimum rate of return needed to break even is 5.6 percent.

### Liquidity and Marketability

Liquidity is the ability to turn an investment into cash at any time without losing any capital. Savings accounts and money market accounts are among the most liquid places to keep funds. Liquidity is important when you have an emergency and need money right away. It also is important to the management of your general investment portfolio (set of investments). Liquidity allows you to change your strategy as the investment climate changes. For example, when interest rates were at historic highs in the 1980's, many investors were not able to move funds from long-term investments. For example, investors could not move long-term bonds into the money markets without major financial losses.

Marketability, on the other hand, is the ability to find a buyer when you want to sell, regardless of the potential loss involved. For example, in recent years many homeowners discovered that their homes did not sell quickly. The homes were much less marketable than the owners desired.

### Personal Tax Status

Your personal tax status is related to your income tax bracket, or marginal tax bracket. Your marginal tax bracket is the highest rate you must pay on some of your income. These rates are 15 percent, 28 percent, 31 percent, 36 percent, and 39.6 percent. This means that on the first dollars you earn, you may pay a rate of 15 percent, whereas the last dollars, including interest, dividends, and short-term capital gains, could be taxed at as much as 39.6 percent if your income is high enough. Fortunately, most workers are not in the highest tax bracket. However, when your marginal rate is high, you send more tax dollars to the government. This lowers the amount you have to save, spend, or reinvest. There is a tax break for investors who have long-term capital gains, this means that they do not sell their investments until they have owned them for at least 1 year. The maximum rate is 28 percent for long-term capital gains. Investors also can deduct net capital losses (losses of principal) in full up to a maximum of $3,000 per year.

### Freedom From Care

Freedom from care has two meanings. The first is the freedom to use time to increase your knowledge of investments and manage your investment portfolio. Those who have the time and enjoy the work involved in recordkeeping select stocks, bonds, and other investments. Those who lack time, energy, and extensive knowledge select mutual funds. Freedom from care also means freedom from worry about how well your investments are doing. To free yourself from worrying, be sure to figure out your personal risk tolerance. You should not lose sleep over your investment decisions.

## Where To Put Investments

Now that you are familiar with the criteria for successful investing, the next step is to consider where to put your dollars needed for future security. As you start to invest, you will want to maintain a part of your assets, including an emergency fund of 3 to 6 months living expenses, in liquid form at a local financial institution insured by the Federal Deposit Insurance Corporation. You are probably familiar with these types of accounts, so they are not discussed here. However, in addition to your local financial institution, there are two other options investors often use to keep dollars safe and liquid. These include money market funds and savings bonds. Once you have ample funds in the base of your investment pyramid, then you will be able to consider investing in bonds, stocks, mutual funds, and real estate. These investments are discussed in later sections. Even if you invest only small amounts of money, you may be able to increase your profits by changing your mix of savings and investments in step with the economy.

### Money Market Mutual Funds

Money market funds are investment companies who sell portfolios of short-term loans made to companies, banks, and the government. They compete with money market deposit accounts sold by banks and pay a higher interest rate. Commonly a fund requires an opening deposit of $1,000 although amounts may be more or less depending on the fund. Most funds require a minimum balance to maintain the account. Investors may withdraw funds by phone, cable, or check. Checks usually can be written for a minimum of $250 or $500. There is no limit on the number written per month. There is no insurance on money market funds. The safety of the money in the fund depends on the composition of the fund's portfolio of short-term government and commercial paper (loans). The funds containing only securities that are backed by the Federal government are safest. To increase the rate of return, investment companies often combine several types of short-term, fixed-interest rate investments. These include government and commercial paper and bank deposits. Money market funds are safe for several reasons. (1) By law the fund must keep 95 percent of their assets in the highest-grade of commercial paper (A-l or P-1). (2) The fund can keep no more than 5 percent in the next lower-grade paper, A-2 or P-2. No more than 1 percent can be in the same issue. (3) The fund must limit any issue to no more than 5 percent of the portfolio, except for government paper. (4) The average maturity on the portfolio cannot exceed 90 days. Because money market funds do not guarantee interest rates, you should watch interest rates. When interest rates are falling, be ready to remove funds if the rate dips below your desired limit. Investors buy shares of these funds from investment companies and brokerage houses.

## Savings Bonds (Series EE, E, and H)

Series EE savings bonds are bonds issued by the U.S. Treasury. These bonds differ from regular Treasury bonds (discussed later) in several ways. First, they come in smaller denominations. The smallest bond has a face value of $50 and costs $25. Second, EE bonds accumulate interest but do not pay the interest until maturity when the bond doubles in value.

EE bonds issued since May 1995 have a new two-tier variable interest-rate structure that eliminates the guaranteed rate of previously issued EE bonds. For bonds held fewer than 5 years, the rate is 85 percent of the 26-week Treasury bill rate. After 5 years, the rate rises to 85 percent of the 5-year Treasury note rate. The second-tier rate is no longer retroactive to the original purchase date. Interest is credited semiannually throughout the holding period. Interest rates change every 6 months, in May and November.

Bonds purchased before May 1995 have a variety of minimum guaranteed rates and continue to conform to the rules in effect at the time they were issued. Bonds issued between March 1, 1993, and April 30, 1995, earn a minimum 4 percent rate for the first 5 years after purchase, and interest is credited monthly after 6 months. Thereafter, they earn the second-tier rate discussed previously, which is retroactive to the original purchase date. The minimum rate is 6 percent for bonds issued between November 1, 1986, and February 28, 1993, and 7.5 percent for bonds issued before November 1, 1986. Savers do not pay taxes until they cash in the bonds. The bonds pay interest for 30 years. After 30 years, the bonds no longer earn interest. Series EE bonds are the successors to Series E bonds. Series E bonds also earn a variable interest rate if held for 5 or more years. Those in a high tax bracket may want to defer Federal taxes for more than the term of the bond. This can be done by converting Series EE and E bonds to H bonds. H bonds pay interest semiannually. Savers pay taxes on the interest in the year they receive the interest. EE, E, and H bonds are exempt from state and local taxes.

## Government and Corporate Bonds

Bonds are often the mainstay of investment portfolios. A bond is a certificate that shows you have lent money to a corporation or the government. The certificate states the amount of the debt, which is the face value of the bond, and the interest rate. It also states the frequency of interest payments and the maturity date, or time when the corporation returns your principal. Bonds may be safe or risky depending on the creditworthiness of the institution issuing the bond. Consider the potential loss of current face value if interest rates rise (refer to interest-rate risk). U.S. Government bonds are the highest quality bonds. Investors compare all other bonds to them. Investors measure the safety of bonds by looking at their ratings. “AAA,” “AA,” “A,” and “BBB” ratings are called investment-grade ratings, and they are the safest. “BB” and lower ratings are more risky. Be aware that the prices of bonds vary as much or more than stocks. As with any other investment, investors trade bonds at intervals to make a profit. Most investors do not buy bonds with the idea of keeping them until the maturity date, which can be 20 to 30 years into the future.

**Federal government bonds.** The Federal government raises money to pay the interest on the national debt through the sale of Treasury bills (or T-bills). Treasury bills mature in 13, 26, or 52 weeks. They require a minimum investment of $10,000. Once the Treasury auctions the bills and sets the interest rate, you receive an interest check in the mail. You may then reinvest this amount to earn a higher return. T-bills pay interest at a lesser rate than corporate bonds. When the T-bill matures, you receive a check for the full $10,000. Interest is exempt from state and local taxes but not Federal taxes. The Treasury also issues Treasury notes (or T-notes) with a fixed term of 2 to 10 years. You can buy Treasury notes for $5,000 for maturities up to 4 years and $1,000 for longer maturities. T-notes pay interest at a lesser rate than corporate bonds. T-notes are easy to resell. They also have the excellent credit rating of the Federal government. They are a good choice for the average investor who assumes a moderate amount of risk. Treasury bonds are the longer term counterparts of Treasury notes. The

U.S. Government issues these bonds for 10 to 30 years. Normally, interest rates will be higher on these because of their longer term. You assume more risk of principal loss when interest rates rise and you try to sell the bonds than if you hold the bond to maturity. Investors can buy Treasury bills, notes, and bonds directly from the U.S. Treasury or Federal Reserve Banks in person or through the mail without charge. They can also be purchased from your local banker or broker for a fee.

**Federal agency debt.** Various Federal agencies also issue debt instruments. These are similar to Treasury notes and bonds but pay a slightly higher interest rate. These bonds are exempt from state and local taxes. Investors can buy them from large banks and national brokerage houses. You can also buy them as unit trusts and mutual funds (see Funds That Diversify Your Investments). Ginnie Mae bonds, Fannie Mae bonds, and Freddie Mac bonds are particularly good for investors who desire current income. The Government National Mortgage Association, a division of the U. S. Department of Housing and Urban Development, issues Ginnie Mae bonds. Ginnie Mae bonds consist of mortgages issued by the Federal Housing Administration (FHA) or Veterans Administration (VA). As with Federal government debt, the government backs Ginnie Mae bonds by its "full faith and credit." These bonds, therefore, are safer than corporate bonds. The Federal National Mortgage Association (FNMA) issues Fannie Mae bonds. Although stockholders own FNMA, the Federal Government sponsors FNMA. Fannie Mae securities consist of FHA and VA mortgages and other mortgages. They are not as safe as Ginnie Mae securities but still quite safe as FNMA buys Federally insured mortgages. The Federal Home Loan Mortgage Corporation (FHLM) issues Freddie Mac bonds. The Federal Home Loan Bank owns FHLM. Freddie Mac securities consist of conventional mortgages. As conventional mortgages they may be insured by private mortgage insurers, but this is not always the case. Thus, the safety of these bonds depends on homeowners paying their mortgage principal and interest on time. Because they are not insured by the Federal government, they pay a higher interest rate.

**Zero coupon bonds.** Both corporations and local governments issue zero coupon bonds. They differ from other bonds in that investors buy zero coupon bonds at a fraction of their face value. Investors call this buying at a deep discount. For example, a $1,000 bond might cost $200. Interest due builds up each year. However, the investor does not receive interest payments until the bond matures. Taxes are due on the interest from corporate zero coupon bonds even though the investor does not receive the interest. This tax requirement causes these bonds to be useful for tax-deferred retirement funds such as Individual Retirement Accounts. Municipal zero coupon bonds offer the tax advantage of being tax-exempt. The price of zero coupon bonds varies widely during their term. Therefore, it is wise to hold them to maturity to get the stated return.

**Municipal bonds.** Tax-exempt municipal bonds finance state and local government projects. State and local governments make interest payments from one of three sources. These include the taxing power of state and local governments, revenues from a project such as bridge tolls, and special taxes. The safest bonds receive at least an "A" rating. Their primary advantage to investors is that there is no Federal tax on the interest. If you are a resident of the state issuing the bond, there are no state or local taxes either. Sometimes municipal bonds default. You can remove the risk of default by buying insured bonds. Both the American Municipal Bond Assurance Corporation and the Municipal Bond Insurance Association insure municipal bonds. Investors buy municipal bonds in required lots of $10,000 or more or as mutual funds.

**Corporate bonds.** Corporations issue bonds in several varieties each with their own advantages and disadvantages. The following are four well-known types of corporate bonds, but this list is not exhaustive.

**Mortgage bonds.** Corporations issue mortgage bonds to purchase fixed assets. Utility companies issue mortgage bonds to build plants. The resulting buildings secure the bond and the resulting cash-flow pays the principal and interest.

**Equipment trust certificates.** Railroads, airlines, and other companies issue equipment trust certificates to purchase railroad cars, airplanes, and other equipment. The equipment secures the bond. The equipment not only generates cash-flow, but also has a large resale value.

**Debentures.** Corporations also issue unsecured debt called debentures. Specific assets do not secure these bonds. Instead, the general credit-worthiness of the firm secures these bonds. They are riskier because if the company defaults, the company pays all secured debt first.

**Convertible bonds.** These are a cross between a bond and a stock. They are like bonds in that they pay interest, have a maturity date, and are a liability of the company. Owners of convertible bonds have the right to convert them into a certain number of stock shares. The price of the bond depends on the interest rate of the bond and the market price of the stock. This provides the investor with an opportunity for capital gains if the stock increases in value.

## Stocks

This short introduction to stocks provides a background for investing in mutual funds discussed later and for investing directly in company plans. Successful stock investing requires time and analytical skill. Rather than earning interest, stockholders seek to earn a share of a company's profits, or dividends, if the company does well. Investors also seek to make profits from the growth of the value of their stock when they decide to sell them. These profits are known as capital gains. The total return form stock is a combination of the two.

**Common stock.** A common stock is a certificate that shows ownership in a corporation. As an owner, you have limited liability and the right to vote. You also share in dividends, and in remaining assets in case of bankruptcy. Most investors who are new to investing do not invest directly in common stock. However, they may invest in their employer's stock through their company's pension or profit sharing plans. A special note to employees in this situation: If your company offers its stock as well as some other investment choices, be sure to diversify your retirement money for safety.

**Growth stocks.** Investors often classify common stocks on the basis of growth or income. Growth stocks are those of the companies that are growing faster than the economy. Frequently, they are small companies that are developing a new technology or selling innovations. Dividends from these companies will be small or nonexistent. Rapidly growing companies reinvest profits back into the company to increase growth. These stocks also may increase in value twice as fast as the total market. They can decrease as fast, thereby increasing their risk.

**Income stocks.** At the other end of the scale are income stocks. Income stocks focus on dividends rather than growth, which makes their prices more stable. Utilities are an example of well-paying income stocks.

**Blue-chip stocks.** Stocks of large well-established companies are called blue-chip stocks. These companies are financially secure. Blue-chip stocks combine the advantages of growth and income stocks. They often provide goods and services for everyday use. Blue-chip stocks become the main parts of the portfolios of bank trust departments, pension funds, and insurance companies. They also serve the needs of smaller investors.

**Preferred stocks.** A preferred stock is a cross between a stock and bond. Changes in the price of preferred stock depend more on changes in bond interest rates than on stockmarket factors. Preferred stocks have fixed dividends that are more generous than those of the company's common stock. If an investor buys preferred stock, his or her aim is to receive interest or dividend income rather than to rely on company growth and capital gains.

## Hard Assets

Hard assets are tangibles such as real estate, precious metals, precious gems, rare coins, stamps, antiques, and fine arts. All except real estate depend on price appreciation for a return. Investing in hard assets requires the investor to be an expert. Investors who are not experts should seek professional advice. Investors who have a small net worth usually do not buy hard assets. Therefore, this publication does not discuss them further. Again, real estate is the exception.

In addition to capital appreciation, investment in real estate and business real estate provides tax advantages. Possible income tax deductions from real estate investments include depreciation, real estate taxes, and mortgage interest. If you decide to become a landlord, your investment will require physical maintenance. If you do not want to be responsible for the repair of buildings, consider an indirect investment through a real estate investment trust (discussed later).

## Funds That Diversify Your Investments

Many consumers have neither the time, interest, nor knowledge to manage individual stocks and bonds. Professionally managed portfolios provide a good option. These portfolios provide similar economic rewards to owning individual investments, such as stocks, bonds, and real estate. Included in these choices are mutual funds, unit trusts, and real estate investment trusts.

**Mutual funds.** Mutual fund investment companies pool their shareholders' money and invest their funds in stocks, bonds, and other securities. Each investor buys shares of the total portfolio and shares the risk. Each type of mutual fund has a specific objective.

*Aggressive growth funds.* Also known as capital appreciation funds, these funds invest in the stock of companies that pay maximum capital gains and pay little or no dividends. Stocks in these portfolios are often new companies, new industries, and companies than are struggling to survive. The value of these funds can rise and fall very rapidly.

*Growth funds.* These funds invest in companies with the potential for growth that is faster than average. Many growth funds pay modest dividends.

*Growth and income funds.* Growth and income funds purchase common stocks that have potential for both growth and income (dividends). They are a middle-of-the-road approach.

*Equity income funds.* These funds purchase stocks that have paid high dividends in the past and expect to continue to do so in the future. Growth in value is of lesser importance.

*Bond funds.* Bond funds focus on interest-earning securities. The value of these funds can vary with changes in interest rates. Investors must watch the direction of interest rates carefully to avoid losses.

*Balanced funds.* These funds are made up of up to 60 percent bonds with the remainder invested in stocks.

*Other fund types.* Other funds specialize in convertible bonds, high-yield (high-risk) or junk bonds, specific stockmarket sectors, international stocks, and municipal bonds.

Mutual funds have many advantages, including professional management and constant supervision of the portfolio. Also, purchase costs are reasonable. However, all funds charge a yearly management fee. Funds offered by an investment company either charge no sales fee or a very low fee. Brokerage-house fees vary from about 4 percent to 8 percent. Some funds charge an advertising, marketing, and distribution fee, which is commonly called a 12b-1 fee. (12b-1 is the name of a Security and Exchange Commission rule.) A 12b-1 fee lowers the return for all investors.

Another issue to investigate is the fund manager's investment strategy. Some funds stay fully invested regardless of market conditions. Other funds move to a cash position when the market is down. Open-end mutual funds create shares as investors buy them (the fund grows). Closed-end funds create a limited number of shares that investors trade on the market like stocks. For more information on mutual funds, request Fact Sheet 656 "Mutual Funds" from your county Cooperative Extension Service office.

**Unit trusts.** Unit trusts are similar to mutual funds. The difference is that the trust manager fixes the number of investments in the portfolio at the beginning. This is in contrast to mutual funds in which the manager adds investments over time. Unit trusts last for a term of 3 to 30 years. Most unit trusts invest in bonds, including corporate, municipal, and Ginnie Mae. A few also are available for stocks and CD's. They are sold in $1,000 units. You can sell your shares to the company at any time during the term. The price you get depends on the current price of the underlying bonds, which varies with interest rates. Funds containing Ginnie Mae bonds also return interest as well as a share of the principal as the bonds mature. Some investors depend on these trusts for income and need the principal in the future to generate income. They must remember to reinvest the return of their principal. Unit trusts are long-term investments. Investors should buy them with the intention of keeping them until maturity.

**Real estate investment trusts (REIT's).** REIT's allow indirect investment in real estate through purchase of shares in a closed-end fund. Because investors trade these shares like stock, they are highly marketable, unlike most real estate investments. REIT's invest in property leased to other firms or in mortgages used to finance development and buildings. Earnings of REIT's vary each year. This causes dividends to vary, which could be a hardship for those who need steady income. Although capital appreciation is possible, investors should be aware that rental property trust earnings can suffer from high vacancy rates. Mortgage trust earnings can suffer from contractors defaulting on their loans if their buildings do not sell.

## Create Your Investment Plan

Now that you are aware of the many choices, investigate each option further. Set up a savings and an investment plan based on your goals and the amount of risk you can assume. Also consider your current resources and the types of products that will meet your needs. If you are a new investor, consider employing a professional to help execute your plan. Procrastination is a common mistake that investors make. Knowledge is of no use without action.

This fact sheet is an introduction to investments. You will probably want to learn more. Due to space limitations, only the most common investments for new investors have been discussed. There are many good books in your public library on investments. In addition, articles on investments in current periodicals specializing in money management provide valuable information to help keep you current. Some useful choices are *Money*, *Kiplinger's Personal Finance* magazine, and *Forbes* magazine.

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