Investing 101

We are getting close to the end of the year and I thought it might be a good idea to look at some basic information on investing. Many of us blindly follow someone else’s example and don’t really understand how investing works. This article will review some basic information that will help you plan for your future.

There are three basic types of investments: short term (savings accounts, money market accounts, CDs), bonds and stocks. Your mix of investments will depend on the amount you have to invest, how long you will leave it in an account and how much risk you are willing to stand.

Short-term investments such as savings accounts, money market accounts and CDs (certificates of deposit) are all relatively safe investments and are very unlikely to default. Typically, most accounts at a bank or credit union are federally insured, protecting you from any losses as long as you have less than $250,000 in the account. Because of this guarantee, the return offered on these investments is typically lower than what you'd get if you were to invest in bonds or stocks. Right now, savings accounts will earn from a .25 to .5 percent return on your investment. Money market accounts earn a little more, but certificates of deposit are the highest earners in this group.

Certificates of deposit are an agreement that you will put a certain amount of money in the bank or credit union for a certain amount of time. The longer the time, the higher the rate will be. Taking it out before the end of the period can result in a fee — sometimes a substantial one. I was looking at current rates and found some that required an investment of $5,000 to $25,000, but paid up to 1.5 percent on a two-year CD. We aren’t going to get rich this way, but if you can get some return on money you aren’t using, that is a good thing. For some of us, just putting that money in an account that you can’t touch is a good strategy. So, put your money in and fight the urge to spend it.
It is recommended that you have at least enough savings to cover six months of living expenses in any blend of these short-term investment vehicles to cover any emergency expenses that may come up unexpectedly, such as losing your job, a leaky roof or an unexpected car repair.

Buying a bond can be viewed as loaning out money to the corporation or government entity in return for a predetermined interest rate. Bonds are typically riskier than the short-term investments we already talked about. The one exception to this is federally issued bonds, which carry virtually no risk. Because of this, the typical return on bonds will be higher. Your rate of return will depend on the duration of your bond and the rating of the bond. The more risk you take, the higher the return, so usually a bond with longer duration and a lower quality rating will pay a higher interest. Bonds can be bought through an online or full service brokerage account.

When you buy stock, you are buying an ownership share of the company. As the earnings of a company rise, the stock price will typically rise as well. Stock prices are more volatile than the other forms of investments mentioned, but have historically had the highest rate of return over the long run; however, the risk and price fluctuations are also higher.

Most experts agree that you should have a mix of all three types of investments. The amount in each type of investment depends on your age and your willingness to risk the money. I don’t claim to be an expert on investing; I work with someone who helps me make decisions related to my long-term investments. I regularly look at my accounts and adjust the mix depending on the current economy and my future needs. Since we are approaching the end of the year, get out those statements and make sure your money is in the right place and is doing its job working for you.

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