TYPES OF INVESTMENTS

Why Invest?

Investing means purchasing securities such as stocks, bonds, mutual funds, precious objects, real estate, or banking certificates with the goal of increasing money over time. Investors can set aside and accumulate money for future income or future profit if they make wise investments. These purchases do not always gain wealth. Sometimes, they lose money. Each investment carries risk, and the amount of risk depends upon the types of investments that someone chooses.

Stocks

The most popular investments are stocks, bonds, and mutual funds. Stocks are certificates that state an investor has bought a share or stake in a company. That person then owns a small part of the company. Stock certificates represent the holder's share of ownership of the assets and earnings of a corporation or company. For example, the billionaire Warren Buffet owns 400,000,000 shares of Coca-Cola stock, which is around 9.4% of the company's entire stock (Frankel, 2017).

If the company is successful, like Coca-Cola, then the stock certificates or shares become more valuable and can be sold for a profit. On the other hand, if the company has problems, then the shares in the company might become less valuable and investors can lose money from their original investments. Some companies are less risky investments than others—that is, they are less likely to lose value.

Stocks are bought and sold on the stock exchange, or stock market. Two popular exchanges are the New York Stock Exchange (NYSE) and Nasdaq. The New York Stock Exchange is the oldest and largest stock exchange in the world. There are international stock exchanges as well, such as the Tokyo Stock Exchange in Japan. Stocks can be bought, traded, and sold online through Internet investment companies or over-the-counter markets. Usually, investors either research companies themselves or pay a fee to an investment company that does the research for them and recommends the best stocks to purchase. Brokers of these investment companies help clients buy or sell in the financial markets. Brokers are paid fees or commissions by the investor for their expertise in selecting the investments.

Regardless of which broker or company a person uses to purchase stocks, the value of those stocks can fluctuate or change due to what is happening in the country or around the world. Here is an example of how that can happen.

Say that you buy shares in the Alcoa Company, which is the parent company for Reynolds aluminum products. The corporation looks very profitable and has come out with a new line of products and advertising that are selling quite well. You buy 10 shares at $50.00 each. The stock shares are selling one month later for $55.00 each, and you are making a small profit on your investment. Then, an earthquake hits the coast of China and a large manufacturing company that makes aluminum cans for PepsiCo is destroyed. Workers are killed, and the company must rebuild the plant and pay insurance benefits and wages to families who lost their loved ones.

This setback for PepsiCo has caused your stock to become less valuable. PepsiCo must spend extra money to recover from the earthquake until their plant can reopen. Some aluminum manufacturers who sell their cans to PepsiCo to lose value in their stocks as well. The China plant alone used 10,000 cans per day. Without this contract, the Alcoa Company's stock has fallen to $40.00 a share. If you decide to sell your shares at this time, you will lose $100 from your original investment.

These up and down movements of stock values are called market fluctuations. The market is particularly sensitive to events that happen in our country. Imagine that the country is about to elect a new president, but the polls show that it is a close race, and no one is certain who might win. This uncertainty can cause the entire stock market to lose money because investors are not purchasing stocks while they wait to see what will happen. If no one is purchasing stocks to help companies grow, then stock values might fall slightly. This is another example of risk.

Bonds

A **bond** is a certificate representing the purchaser's agreement to lend money to a business or government on the promise that the debt will be paid back—with interest—at a specific time. The purchaser reaps the rewards of the loan through the interest money received. An excellent example of a bond is a municipal bond. Municipal bonds are created by a city that might need money to build something, such as a library or civic center. The investor purchases the bonds and promises to loan the money for a period of years. Bonds usually require that the investor loan the money for long periods of time—between 6 and 30 years. The city agrees to pay back the loan with interest at the end of the bonding period.

Treasury bonds, or T-bonds, are another type of bond. As an investor, you are loaning the United States Federal Government, through the U.S. Department of the Treasury, money to pay off its debts with the understanding that at the end of the bonding time you will receive your money back with interest. Your profit or return on your investment is the interest paid back to you along with the original investment.

Mutual Funds

It is sometimes safer to join a group of investors and pool your money to make greater profit or to have less risk. **Mutual funds** are a way to do that. Investment companies sell mutual funds as an investment tool that pools the money of many shareholders and invests it in a group of securities, such as multiple stocks and bonds. The purchase of multiple stocks and bonds grouped together is called **diversification.** Because you are investing in multiple stocks and bonds, even if one stock loses value, the others you own might be increasing in value. In that way, your loss is not significant because you still have made a profit overall.

Gold, Real Estate, and Precious Objects

Many investors like to own tangible investments. Gold, silver, and other precious metals are examples of tangible investments. These precious metals are in the form of bars or coins and could become more valuable over time. Precious metals, like other investments, carry risk because they can either increase or decrease in value. Real estate is another example of a tangible investment. Real estate can increase in value for a variety of reasons. The property might be land that a company wants to develop or that would be good for a new housing addition. The return on the investment comes from buying the property at a lower price and selling it for a higher price. An investor might also buy real estate properties such as houses, commercial buildings, or apartments to use for profit by renting or selling at a higher cost.

Other examples of special purchases or precious objects that are used as investments are paintings, jewelry, antique cars, and baseball cards. Purchases such as beds, TVs, audio systems, or your grandma's rocker might have cost a lot of money to buy at the time but are unlikely to increase in value in the long run.

One example of a special purchase investment from the 1990s was the Beanie Babies toys that were popular and considered by many to be collectible. A Los Angeles family purchased $100,000 worth of these small toys in the hope of making a profit for their children's future college educations. Instead, the Beanie Babies craze went away and there was no way to sell the toys to anyone, even at their original cost. The Beanie Babies toys went from a promising investment to worthless junk!

Investors must carefully research which precious objects will increase in wealth over time and what might be the "return" on their investment. With special purchases, you must know when to sell while your item still appears valuable and "precious" to the public.

Banking Investments

Banks are best known for providing savings and checking accounts, but they also have opportunities for investors. Banks offer high-yield savings accounts, certificates of deposit, and other securities and programs. Say you purchased a bank **certificate of deposit** with $10,000 for two years at a 2% interest rate. At the end of the two years, you would have $10,400. If you withdrew any part of your $10,000 before the maturity date of two years, you would pay a penalty for the withdrawal.

Because banks are considered safe and carry insurance to cover your money in case of failure, investors face little risk over time compared with other types of investments. However, investors typically do not gain as much profit through the accrued interest of a bank account as they might with other types of investments.

Portfolios and Diversification

Because the prices of stocks, gold, precious objects, and other investments rise and fall with events in the market while bank investments like certificates of deposit and municipal bonds accumulate interest very slowly, most investors choose diversification of their money. Diversification simply means that investors spread their money around into multiple and varied investments so that their risks overall become lower. This grouping of financial assets is called a portfolio, and the entire group of investments is managed for the investor's overall increases in wealth. While one or two companies in the portfolio might lose money in the stock market, other investments might be growing in wealth. Investors examine and manage their overall profit in the portfolio.

Sources

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