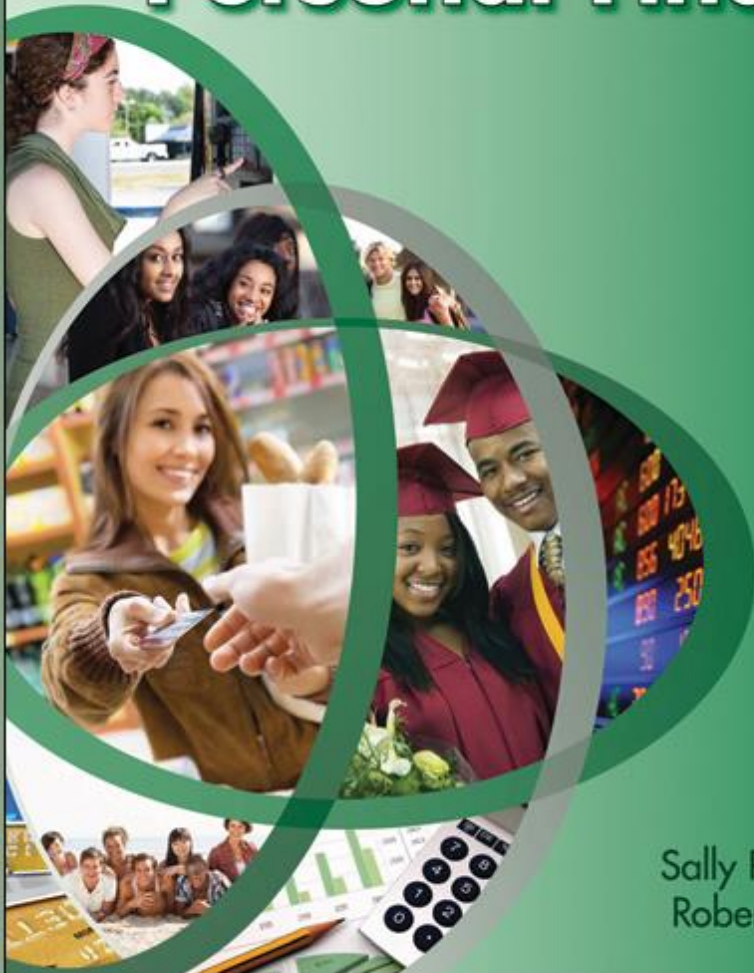


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Foundations of Personal Finance

Ninth Edition



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PowerPoint Presentations for

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Chapter 7

Investing and Estate Planning

Section 7.1

INVESTMENTS

Objectives

- Explain the role of investments in overall financial planning.
- Identify the various types of investment choices.

Terms

- investing
- capital gain
- capital loss
- stock
- dividend
- common stock
- proxy
- preferred stock
- stock trade
- securities exchange
- stockbroker
- bond
- mutual fund
- net asset value (NAV)
- money market fund
- bull market
- bear market

Deciding to Invest

- **Investing** is purchasing a financial product or valuable item with the goal of increasing wealth over time
- **Appreciation** is an increase in the value of an investment (growth)

Taking Advantage of Tax Benefits

- In a tax-deferred investment, taxes are not paid until withdrawals are made from the account (many retirement accounts are tax deferred)
- **Capital gain** occurs when the investment's selling price is higher than the purchase price
- **Capital loss** happens when the selling price is lower than the purchase price

Investment Factors

- *Volatility* refers to quick and unexpected changes in value (positive or negative)
- *Potential rate of return* is the expected earnings for a given period of time (percentage)
- *Risk* is the degree to which the investment may deviate from its expected return (high risk offers the possibility of big gains, or big losses)
- *Liquidity* is how easy the investment can be converted to cash without serious loss

Types of Investments

- A *security* is a type of investment issued by a corporation, government, or organization
- A **stock** is a share of ownership of a corporation
- A **dividend** is a portion of a corporation's earnings that is paid to stockholders

Did You Know?

Dividends are not guaranteed. They are paid only when the board of directors believes it is in the best interest of the corporation.

Stock Classifications

- **Common stock** is stock that is issued when a corporation issues only one type of stock
- A **proxy** is a shareholder's written authorization to have someone else cast a vote on his or her behalf at the annual meeting
- **Preferred stock** is a type of stock that:
 - Pays a regular dividend at a fixed rate
 - Preferred dividends get paid before common stock

Other Stock Categories

- *Blue-chip stocks* are issued from large, well-established companies with a history of paying regular dividends
- *Income stocks* have a history of paying above-average dividends to investors
- *Growth stocks* are stocks issued by companies that focus on long-term growth which put profits back into the company

Other Stock Categories (Continued)

- *Defensive stocks* are stocks of companies with relatively stable sales, which often sell necessities (food, health items, utilities)
- *Cyclical stocks* are stocks from companies that consumers buy from when the economy is up, but spend less on when the economy is down
- *Penny stocks* are inexpensive, risky stocks from companies with questionable sales forecasts (range from a few cents to \$10 per share)

Stock Trading

- A **stock trade** is the purchase or sale of a stock
- *Primary market*, also called the *new-issues market*, is for the *initial public offering (IPO)* of a company's stock
- *Secondary market* is the place where the majority of stock market activity occurs

Stock Trading (Continued)

- **Securities exchange** is a secondary market where securities are bought and sold
- A **stockbroker** is an agent who executes stock trades for clients on the securities exchange
- Over-the-counter (OTC) markets are stocks that are not listed on securities exchanges that can be bought and sold in virtual markets

Stock Trading (Continued)

- A **bond** is a certificate of debt issued by a corporation or government.
 - Corporations issue corporate bonds
 - Municipalities issue municipal bonds
 - US Government issues bonds from the US Treasury
 - Treasury bills
 - Treasury notes
 - Treasury bonds
 - All sell in increments of \$100

Mutual Funds

- **Mutual funds** pool money of many people and invest it in a collection of securities
- Advantages:
 - Professional management
 - Diversification
 - Liquidity
 - Management fees deducted from the fund's earnings

Mutual Funds (Continued)

- A *load* is a sales commission:
 - A *front-end load* is deducted when you invest
 - A *back-end load* is deducted when you sell
 - A *no-load fund* is sold with no sales commission
- Lack of control is when investors give up control over the selection and timing of investments
- Minimum investment of \$1,000 or more is required by many funds

Types of Mutual Funds

- **Net asset value (NAV)**, also called *current market value*, is determined by taking a mutual fund's assets minus its liabilities
- Mutual fund types include:
 - Income funds
 - Balanced funds
 - Growth funds
 - Specialized funds

Money Market Fund

- A **money market fund** deals only in high-interest short-term investments (US Treasury securities, certificates of deposit, and commercial paper)
 - Advantages: high yields when interest rate is high, no maturity date or penalties for early withdrawals
 - Disadvantages: the rate paid changes daily, large minimum investment

Stock Market Fluctuations

- **Bull market** is when investors are confident in the economy and stock prices are rising
- **Bear market** is when investors feel insecure and stock prices fall

Other Investments

- Real estate
- Real estate investment trusts (REIT)
- Valuable goods
 - Collectibles
 - Precious metals
 - Precious gemstones

Review 7.1

- What do stocks, bonds, and mutual funds all have in common?
 - They are all securities
- What is the term for the ease with which an investment can be converted to cash without serious loss?
 - Liquidity

Section 7.2

INVESTMENT STRATEGIES AND ESTATE PLANNING

Objectives

- Describe an investment portfolio.
- Explain investment strategies to consider.
- Describe ways to buy securities.
- Identify retirement investment options.
- Explore the basics of estate planning.

Terms

- investment portfolio
- diversification
- prospectus
- dollar-cost averaging
- rollover
- traditional IRA
- Roth IRA
- annuity
- estate
- executor
- will
- trustee
- codicil
- probate
- living will
- trust

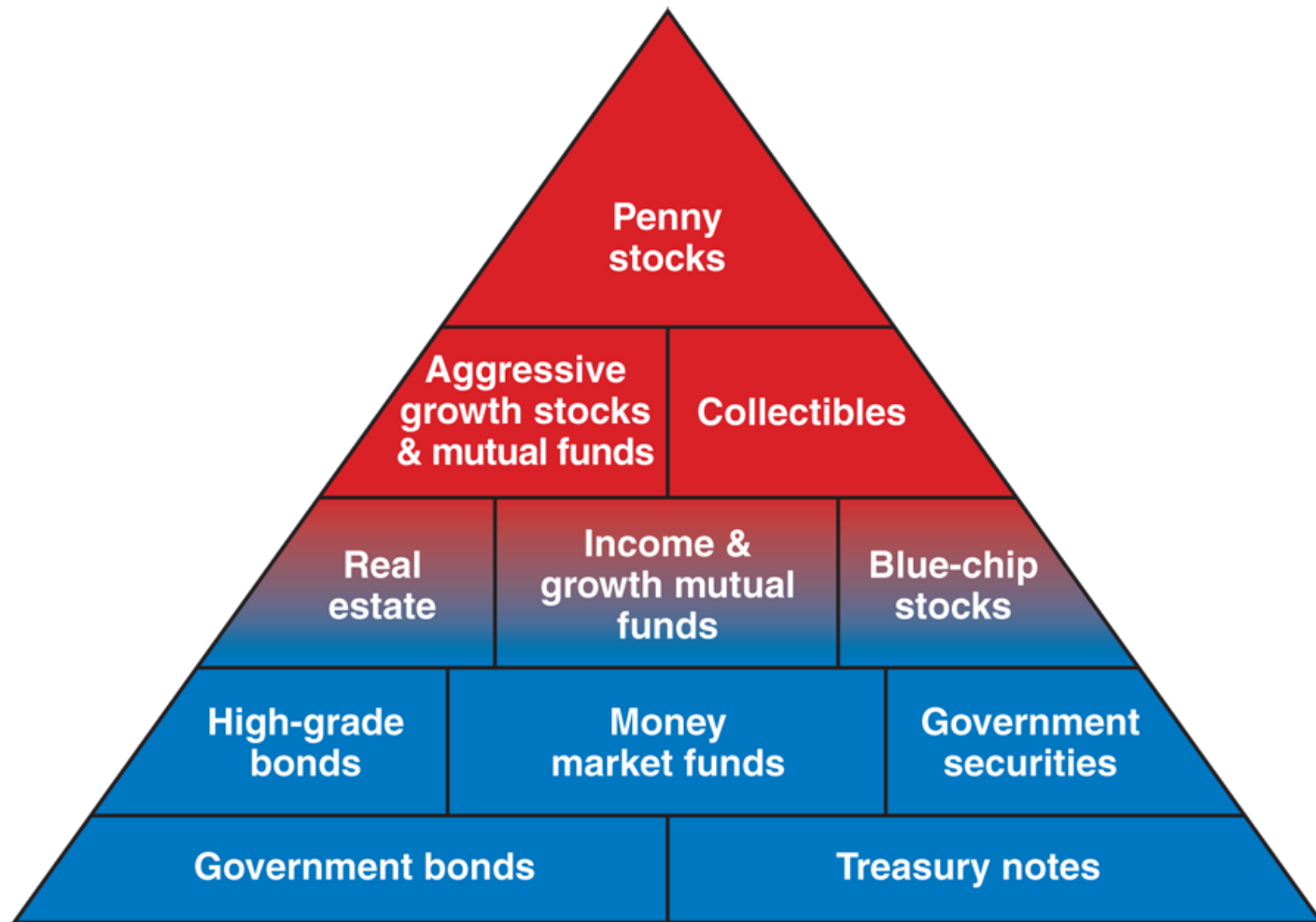
Choosing Investments

- An **investment portfolio** is the collection of securities and assets a person owns
- **Diversification** refers to spreading the risk by putting money in a variety of investments
- **Prospectus** is a required legal document that includes:
 - Risks
 - Performance summary
 - Fees and expenses
 - Management

Investment Strategies

- *Buy and hold* investments for long-term gains
- **Dollar-cost averaging** is investing a fixed dollar amount at regular intervals without regard to price (set up automatic payment)

Investment Strategies (Continued)



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Buying Securities

- Brokerage firms charge a *commission* to buy and sell for customers
- *Investment clubs* are groups of people who work together to learn about securities and invest their pooled funds
- A *dividend reinvestment plan (DRIP)* allows one to invest directly in a company and dividends are automatically reinvested

Discussion

How can you relate the following expression to a person choosing investments?

“Don’t put all of your eggs in one basket.”

Investing for Retirement

- Starting a retirement plan early is the most effective way to provide enough money on which to live after retirement
- Social Security is not intended to be your only source of retirement income

Employer-Sponsored Retirement Plans

- 401(k)
 - Funded with your pretax earnings for tax-deferred growth
 - Contributions are often matched by the employer
- 403(b)
 - Available to employees of nonprofit organizations
 - Similar to a 401(k), but it does not allow investing in individual stocks
- A **rollover** is the process of moving retirement savings from one account to another without penalties or taxes

In Your Opinion

Should all employees take advantage of an employer's matching program?

Personal Retirement Plans

- *An individual retirement account (IRA)* is not an investment, but it holds the investments you choose, such as stocks, bonds, mutual funds, real estate, etc.
 - **Traditional IRA**
 - contributions tax deductible when you file your income taxes
 - amounts withdrawn when you retire are taxable
 - **Roth IRA**
 - contributions are made with after-tax earnings (not deductible)
 - amounts withdrawn when you retire are tax free

Personal Retirement Plans (Continued)

- Self-employed individuals can open a simplified employee pension (SEP) plan
 - Allows tax-deductible contributions limited to a percentage of income
 - Earnings grow tax deferred until withdrawn at retirement
- Keogh plans are another option for the self-employed
 - Allow tax-deductible contributions limited to a set percentage of income
 - Interest is not taxed until retirement

Personal Retirement Plans (Continued)

- An **annuity** is a contract with an insurance company that provides regular income for a set period of time, usually for life
 - Some annuities provide death benefits
 - Principal and earnings are not taxed until money is withdrawn or paid out

Estate Planning

- Estate planning is part of an overall financial plan
- **Estate** refers to the assets and liabilities a person leaves when he or she dies
- A **power of attorney** is a legal document giving a person the power to act for another person regarding financial and legal matters

Wills

- A **will** is a legal document stating a person's wishes for his or her estate after death
- The will should name:
 - Beneficiaries who will receive assets
 - The **executor**, a person who carries out the terms of the will and manages the estate
 - A **guardian**, a person responsible for the care of beneficiaries who are young children

Wills (Continued)

- A **trustee** may be named to manage assets on behalf of the beneficiaries
- An amendment to a will is called a **codicil**, which must also be witnessed

In Your Opinion

If you make a new will, is it important to add a clause canceling all previous wills and codicils?

Wills (Continued)

- **Probate** is the legal process of winding up the affairs of the estate, paying final expenses, and distributing the balance of money and property to beneficiaries
- *Probate court* is the government institution that processes the will and estate

Did You Know?

If you die without a will, the state will decide who gets your property and who will have custody of your minor children.

Living Will

- A **living will**, or *health-care directive*, is a statement of instructions for specific medical treatment if a person is unable to make medical decisions
 - Indicates which medical treatments you do or do not want to receive in case of terminal injury or illness
 - Outlines your wishes about medically prolonging your life

Trusts

- A **trust** is used to transfer assets; it does not have to be probated
- When you create a trust, you become the *grantor* and decide which assets to transfer
- You name a trustee to manage the assets according to the terms outlined in the trust
- You name the beneficiaries and when they will receive the assets

Trusts (Continued)

- A *living trust* is set up to manage your assets before death and for their distribution after death
- You may serve as grantor, trustee, and beneficiary of the trust
- A *testamentary trust* is set up under the terms of your will and goes into effect when you die

Trusts (Continued)

- *Irrevocable trust* means you cannot change the terms or end it
- *Revocable trust* means you can revoke it by changing terms, or ending it

Review 7.2

- What is the term that refers to spreading the risk by putting money in a variety of investments?
 - Diversification
- What is the name of a document that gives a person authority to act on behalf of another person?
 - Power of attorney