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G93-1160 Investment Basics...For The Beginner

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Investment Basics...For The Beginner

Investing is a complex and ever-changing field. Consequently, most of us, even those involved in the investment field, occasionally are confused. This publication defines the difference between saving and investing, considers some financial requirements you need to meet before you start to invest, helps you define just what type of investor you are, gives advice on choosing an investment adviser, and offers some investment tips for beginning investors.

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Savings and Investments

To help clarify just what is being discussed when talking about investing, let's define two terms. Saving is money set aside for future **use** while investing is money set aside for future **gain**. The difference is not a large one, but the implications are many. Keeping these two definitions in mind, let's look at some financial requirements you probably need to meet before you start to invest.

Before You Invest

1. ***Emergency Fund.*** Financial experts say you need the equivalent of three to six months' living expenses set aside for emergencies. This is money that will not be used for long-term investing, and, according to the definition of savings and investing is more saving than investing. The exact amount that you need to have in an emergency fund depends on your situation. For example, you need less in an emergency fund if you have adequate insurance coverage.

   Why do you need an emergency fund before you start to invest? You need an emergency fund so you do not have to cash in investments to cover a financial emergency. Should such an emergency occur, it may not be the best time to cash in those investments, or you may have to pay a penalty to get your money. An emergency fund provides you with cash to cover financial emergencies.

   Emergency funds should be kept liquid. Liquidity means such funds are in the form of cash or easily converted to cash. Examples of where you may want to keep your emergency fund include passbook savings, short-term certificates of deposit, or money market accounts.

2. ***Adequate Insurance.*** Having adequate insurance for your situation is a second prerequisite to investing. You'll need **health insurance** with good major medical and catastrophic coverage, **disability income** insurance for breadwinners, **life insurance** as income protection for dependents, **property and vehicle insurance** for your possessions, and **liability coverage**. Exactly what type of insurance and how much is needed is determined by your situation.

3. ***Pension Plan.*** Through an employer or on your own with an Individual Retirement Account, Keogh, or similar type of plan, make regular contributions for retirement.

4. ***Equity in a Home***. This requirement depends on one's values. If home ownership is important, some equity in a home is needed before starting to invest. If home ownership is not important or home ownership is the reason for investing, meeting this requirement is not necessary before starting to invest.

Investment Considerations

1. ***Investment Goals***. Who do you want to invest? What do you hope to achieve with your investments? Most specific investment goals fall into three groups:

   a. ***Present Income***. You need to receive current income from your investments. People who are retired or who have children in college are examples of those with present income as an investment goal.

   b. ***Capital Growth***. You want to increase the value of what you invest, usually over a long period of time. If retirement is several years away or a child is young and many years from post-secondary education, capital growth will be a major investment goal.

   c. ***Capital Preservation***. You want to be sure what you invest keeps its value in the future. Retirement, or when inflation is racing along in double-digits, are situations where capital preservation would be an investment goal.

   d. ***Tax Considerations***. You want to shelter present income from taxes. This is a valid consideration no matter what your income level.

   You need to know your investment goals because the investments alternatives you choose depend on your goals. If you work with an investment adviser, that person also will need to know your investment goals.

   Another important consideration when discussing investment goals is priority. Most people have goals which fall in two or more of the above categories. Depending on their situation, one goal will have priority.

2. ***Time Available For Working With Investments***. Investments take different amounts of time to manage. Even a C.D. sitting in a safe deposit box takes management time. Are you willing to devote a great deal of time to managing investments? Or do you want an investment that will take a minimal amount of time?

3. ***Your Knowledge of Investment Alternatives***. How much do you know, or are you willing to learn, about the different investment alternatives? How much research are you willing to do to keep up with your investments? Investment advisers recommend investing in what you know about or are willing to learn about. Even if you work with an investment advisor, you will need a certain amount of knowledge so you can ask questions.

4. ***Amount to Invest***. Realistically, how much money do you have to invest? Is money available for investment a one time occurrence such as $5,000 from an inheritance, or do you expect to have a certain amount for a each specific time period such as $50 per month from current cash flow.

5. ***Amount to Lose***. What amount, if any, can you afford to lose? If that figure is zero, you will choose different investments from someone who could afford a loss.

6. ***Present Asset Situation***. What is your present asset situation? What do you own? How do your assets match your investment goals? Are your assets diversified enough to spread your investment risk?

7. ***Temperament***. How comfortable are you with risk? We all have different temperaments and different tolerance levels when it comes to risk. If an investment causes you to lose sleep or not eat, you are involved with an investment with a higher risk level than those included in your personal risk-comfort zone.

Are You A Risk Taker?

The following questions may help you analyze your own risk-comfort zone.

1. Do you prefer to work by yourself, and be your own boss?

2. If you received an unexpected "windfall", would you prefer to invest in a somewhat speculative investment where the potential return is likely to be great but the potential loss is also great?

3. When you lose something, do you spend little time searching for it?

4. When you make decisions, is knowing immediately what the outcome will be unimportant to you?

5. Do you feel other people do a worse job of handling their finances than you do?

6. Does the thought of traveling to a foreign country by yourself exhilarate you?

7. Do you believe in yourself, have confidence in your decisions, and feel good about who you are most of the time?

The more yes's you had, the more of a risk taker you probably are. However, only you can decide your tolerance for risk.

Another element involved with temperament is the emotional attachment you feel for a particular investment. Experts caution not to become too emotionally involved with investments. Keep them on a business basis. Emotional attachment prevents you from being objective. For this reason your home is not a true investment.

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