Saving vs. Investing Lecture Notes

Why are saving and investing so important to you financial plan? For one saving or investing money for your financial goals makes you less tempted to spend it. It is in a totally different account for the one you pay your everyday expenses. And it's not just sitting there burning a hole in your pocket. But the best reason for investing is that your money is actually making money for your. This is known as compounding interest. Any interest or investment gains you earn get you that much closer to your financial goals. And you didn't have to do anything for it. It truly is making your money work for you!

The following is an article from Bank High School found at:

http://www.bankhs.com/teachers/money/banking/savings/saving_investing.html

Saving & investing

When you are saving for your goal, there are a few different things you can do with your money. Let's take a look at some of your options.

A Glass Jar in Your Room

A jar is an easy place for you to keep your money. You'll always have your money if you need it. A jar is also easy to use. All you have to do is drop the money in!

But there are some problems with putting your money in a jar. What would happen if someone broke into your house and stole your jar? All the money you had saved would be gone! Keeping your money somewhere else may be safer.

Another problem is that money in a jar doesn't earn interest. If you put your money into a jar on the shelf, it just sits there and collects dust. But if you put it somewhere else, like into a bank account, your money can earn more money. Interest will let you reach your goals sooner than if you kept your money at home.

An Account at the Bank

If you have a savings account at a bank, you could keep your money there. When you put your money into a savings account, you can earn interest, and the longer you keep your money there, the more interest it can earn. Let's see your glass jar do that!

A bank is a safe place to keep your money. If a bank ever went out of business and you kept your money in the bank, the government promises that you would get all of your money back if you had less than $100,000 in the bank. You shouldn't worry about keeping your money in the bank.

If you have your money in a savings account, you can get your money out of the bank any time it is open. And with ATMs and Internet banking, you can have access to your money even if the bank is closed!

Savings Bonds

You may decide to buy savings bonds with your money. When you buy a savings bond, you are loaning your money to the government. The government then promises to give you back your money plus some extra money. This extra money is interest.

If you buy savings bonds, your money is very safe. Just like with a savings account, the government promises you will always get back your money.

If you buy savings bonds with your money, you can usually earn more interest than you could with a bank account. This means that it could take you less time to reach your financial goals. But if you buy a savings bond, you may have to wait a few years before you can get your money back from the government. Buying a savings bond is a good idea if you can wait for a few years to reach your goals.

Stocks

You may want to take the money you are saving and buy stocks with it. If you own a stock, you own a part of a company. You get a say in how the company is run.

There are some really big benefits that come from owning stock. In the past, stocks have earned higher amounts of interest over a long period of time than banks or savings bonds. If you want to see your money grow fast, the stock market may be the best place to put your money.

But along with those benefits come some really big risks. Unlike having your money in a bank account or buying savings bonds, you have no guarantee that your money will be safe. If you buy stock in a company and the company goes out of business, you will lose the money you spent on the stock. If the company makes some bad decisions and the stock is not worth as much as it was when you bought it, you lose some money there too. So even though stocks can make more money than other places, buying a single stock can be risky.

Mutual Funds

There is a way to benefit from a higher interest rate without taking on all of the risk of stocks. You can take your money and invest it into a mutual fund. A mutual fund is a group of stocks from many different industries. Some of the stocks in a mutual fund may be from a toy company, some may be from a soft drink company, and some may be from a restaurant company. If you invest in a mutual fund, you are buying a little part of a lot of different companies.

When you invest in a mutual fund, you are taking on less risk than you would if you bought stock in one company. This is because of diversification.

To diversify means to spread risk. You've probably heard the saying, "Don't put all your eggs in one basket." This is the idea behind diversification. If you put all your eggs in one basket and the basket falls, you'll probably end up with a big mess and not a lot of eggs. Similarly, if you put all your money in one company's stock and the stock falls, you'll end up with a big mess and not a lot of money. Mutual funds give people a way out of keeping all their eggs - or money - in one risky basket.

Diversification means that you have less of a chance of losing your money. There is still a risk, but it is not as big. But because there is less risk, your money will probably earn less interest than it would if you invested in the stock market. If you want a balance between high risks and high interest, a mutual fund may be for you.

Saving versus Investing

In simple economies, there is little distinction between savings and investments. One saves by reducing present consumption, while he invests in the hope of increasing future consumption.

Most of the people probably have savings accounts with ATMs to access their hard-earned cash and be able to store away any extra cash in a bank account, much safer than your mattress. A few of you may even have some stocks or bonds.

If you open a savings account at the bank, it will pay you interest on your savings. So you think your savings are guaranteed to grow. But wait until you see what , which is the rise in price of goods and services, will do to your investment in the long-term.

The bank may pay you five percent interest a year on your money. If inflation is at four percent though, your investment is only growing at a mere one percent annually.

To stay even, you must invest at rates of return that at least match inflation rates. Your real rate of return, in terms of buying power of your money, is your savings or investments' rate of return, less the inflation rate.

Saving and investing are often used interchangeably, but they are quite different.

Saving is storing money safely, such as in a bank or money market account, for short-term needs such as upcoming expenses or emergencies. Typically, you earn a low, fixed rate of return and can withdraw your money easily.

Investing is taking a risk with a portion of your savings via buying stocks or bonds, in hopes of realizing higher long-term returns. Unlike bank savings, stocks and bonds over the long term have returned enough to outpace inflation, but they also decline in value from time to time.

The rate of returns and risk for savings are often lower than for other forms of investment. Return is the income from an investment. Risk is the uncertainty that you will receive an expected return and preservation of capital.

Savings are also usually more liquid. That is, you may quickly and easily convert your investment to cash.

Source: NEFE High School Financial Planning Program
Bank High School www.bankhs.com