It is important to know the difference between a mutual fund, an annuity, and an IRA. Why? It is important to start planning for retirement at a young age. Retirement is a stage of life that you want to enjoy. Proper financial planning now and through your work years will secure a stable retirement.

**Objective:**
- Describe various types of investments.

**Key Terms:**
- annuity
- defined benefit plan
- defined contribution plan
- individual retirement accounts
- Keogh plan
- liquidity
- municipal bonds
- mutual fund
- risk
- savings incentive match plan for employees
- Section 457
- simplified employee pensions
- tangible
- tax exemption
- treasury bills
- treasury bonds
- treasury notes
- 401(k) plans
- 403(b) plans

**Investments**

There are several forms of investments an individual can choose from to keep money safe, generate interest, or endow securities. It is important to understand the characteristics of the different investment types. Financial advisors evaluate investment characteristics to direct investors toward their financial goals.

**TYPES OF INVESTMENTS**

Investment types vary. The type that is right for an individual will differ, depending on his or her age and financial situation.
**Savings Accounts**

In savings accounts, interest is compounded and is usually credited monthly. In general, there are competitive rates among banks. Depending on the type of savings account, often there is no required minimum balance. Funds can be accessed through an ATM and online banking.

**Money Market Accounts**

In money market accounts (MMAs), interest is typically compounded and credited monthly. Generally, banks give above-average interest rates on these accounts, and competitive rates can be found online. A minimum balance is required to open a money market account. Some MMAs require a daily balance, and the majority of MMAs have restrictions on the number of withdrawals per month. As a result, it is less of a liquid investment. Consequently, it is considered a long-term investment.

**Certificates of Deposit**

Certificates of deposit (CDs) are specified sums deposited for a set period of time at a fixed rate of interest. They have a maturity date (date when money can be withdrawn without paying a penalty) and are considered a short- to medium-term investment. Certificates of deposit are protected by the Federal Deposit Insurance Corporation (FDIC).

**Savings Bonds**

Savings bonds offer a low $50 minimum and no credit check. The principal is secure, and lost bonds can be replaced. These are government backed, and there are no fees. With savings bonds, there is a solid return because they are inflation protected. The long-term design allows people to save for anything, and the funds can be accessed after one year. In addition, savings bonds can be given as gifts.

**Stocks**

Common stock can provide rights and powers (e.g., the right to receive dividend payments, sell stock, receive consideration during a merger, elect/vote for directors and approve fundamental transactions, and receive proportionate distribution of assets during a liquidation).

**Treasury Bills**

**Treasury bills** (T-bills) are non-interest bearing commitments issued by the U.S. government at a discount from the actual face value. They have maturities of three months and six months as well as one year. They are considered short-term investments and are exempt from state and local taxes. They are treated as ordinary income for federal tax, are very liquid, and have active primary and secondary markets.
**Treasury Notes**

Treasury notes (T-notes) are issued by the U.S. Treasury and are guaranteed by the U.S. government. They are considered an intermediate investment with maturities of one to 10 years. Treasury notes are taxed federally, not statewide or locally. They are sold through auctions using the bidding process and generate payment on fixed coupon rates of interest every six months.

**Treasury Bonds**

Treasury bonds (T-bonds) are issued by the U.S. Treasury and are guaranteed by the U.S. government. They are considered a very long-term investment with maturities greater than 10 years, and they pay interest semiannually. Treasury bonds are considered one of the safest of investments and are sold through auctions using the bidding process. They are taxed federally, not statewide or locally.

**Municipal Bonds**

Municipal bonds are issued by states, cities, counties, and various districts. These bonds are used to raise money to pay for projects (e.g., schools, power plants, airports, and hospitals). On most municipal bonds, the interest earned is not subject to federal taxes, which is considered tax exemption. The majority of municipal bonds are purchased by individual investors and are issued by $5,000 face-value denominations (or multiples of $5,000).

**Mutual Funds**

A mutual fund takes your money with other investors’ money and uses the capital for investment purposes. Investments can be made in a wide-range of securities. These funds are professionally managed to focus on the fund’s goal. A person with mutual funds becomes a shareholder of stocks, bonds, or money market investments. As a result, the individual/shareholder has the ability to receive capital appreciation, interest, or dividends.

**Annuities**

An annuity, which comes in different types, can provide supplementary income during retirement. It allows an individual to accumulate tax-deferred savings and then receive periodic payouts for a set period of time. Interest earned is not taxed until the payments begin.
Precious Metals

Ruthenium, rhodium, palladium, silver, osmium, iridium, gold, and platinum are some of the most common precious metals used by investors. The precious metal market is complex. Some people buy shares in a mining company as a common form of precious metal investment. In addition, precious metals are used in the manufacture of jewelry, so some people invest in jewelry companies. One major advantage is that precious metals tend to retain value even during an economic crisis.

Ownership of Assets

Owning real estate can provide a steady income (e.g., rent payments received from tenants). It also can act like stock. For example, its value can fluctuate, and there is no fixed maturity. The investment is tangible—you can see/touch the investment and talk to tenants. It requires management. There can be inefficient markets and high transaction costs that lower liquidity. In addition, tenant quality is variable based on the location.

Liquidity and Risk

Liquidity is used in many ways within financial investments, markets, or financial institutions. Liquidity is the ease of converting an asset into cash without affecting the asset’s price. An asset/stock is liquid if the market is liquid. The market is liquid if the trading can easily be bought or sold without affecting market prices. A liquidity institution has the ability to access cash. Liquidity cannot be found with a formula; it is necessary to compare and study liquidity ratios. Investing in liquid assets, securities, or markets is safer because it is easier to get the money out of the investment. Therefore, liquidity can impact the types of investment decisions because of the ease of obtaining cash.

Some investments (e.g., a savings account) are considered to have a more constant liquidity. The cash in a traditional savings account is easily attainable through withdrawal or the use of an ATM. Money market accounts are typically used as a long-term investment and are a less liquid investment. CDs have maturity dates when the cash is attainable. Meanwhile, T-notes and T-bonds are treated as a low liquidity risk (with short-term maturities) or a moderate liquidity risk (with long-term maturities). T-notes and T-bonds have the largest, most liquid market in the world. T-bills represent a low liquidity risk with one of its greatest advantages being its liquidity. With maturities of three and six months or one year, T-bills are one of the most liquid securities.

With all financial investments, risks of money being lost or investments declining can be scary. Risk is the chance that loss may occur. Since no one can predict the future with perfect accuracy, reliable information must be gathered about trends and directions to make the best possible decision for the future of a business or for financial investments. Credit and market risk are two key elements when evaluating investment types. T-notes and T-bonds have a low credit risk because of the backing of the U.S. Treasury. However, market risks are high on long-term maturities because of the duration of the investment. T-bills have a low credit and
market risk. The short-term of the T-bill allows for less price volatility in contrast to stocks, which can be extremely risky due to the uncertainty of returns.

Mutual funds can be subject to different risks, volatility, fees, and expenses. It is important to remember that the greater the need for higher returns with mutual funds, the more risk there is to take. Aggressive funds may result in a higher long-term return, but they can also involve greater risk for an overall loss. Municipal bonds can be insured, thereby decreasing the risk factor involved. The Municipal Bond Insurance Association (MBIA) and the American Municipal Bond Assurance Corporation (AMBAC) are two municipal bond insurers.

RETIREMENT

One of the goals in retirement planning is to be financially stable during the later years of life. It is important to maintain a steady stream of funds during retirement. Individuals depending on Social Security payments will find themselves looking for additional funds. In today’s workforce, employers offer several different forms of retirement accounts and/or plans that allow individuals to save for retirement. Under the Employee Retirement Income Security Act (ERISA), there are two types of pension plans: defined benefit plans and defined contribution plans.

**Defined Benefit Plan**

A **defined benefit plan** provides a specified amount given monthly at retirement, such as $100 per month. Some benefit plans are calculated through a plan formula that considers salary and service during employment.

**Defined Contribution Plan**

A **defined contribution plan** does not promise a specific amount. These plans use contributions from employees or employers (or both) to be invested on the employee’s behalf. Contributions can be set at a rate, such as 5 percent of earnings annually. At retirement, the employee receives the account balance. The balance is based on the investment gains or losses.

FIGURE 2. Financial investments in the market involve taking a risk.
Examples of defined contribution plans are 401 (k) plans, 403 (b) plans, employee stock ownership plans, and profit-sharing plans.

Self-employed or small business individuals have options in retirement plans, such as Keogh plans, simplified employee pension plans (SEPs), or savings incentive match plan for employees (SIMPLE). These are tax-deferred plans.

401 (k) Plans

401 (k) plans are for employees in private corporations. They can contribute a portion of their salary, before taxes. Sometimes the employer matches the contributions. This plan allows employees to have some responsibility for their retirement by contributing part of their salary and by directing their own investments.

403 (b) Plans

403 (b) plans are similar to 401 (k) plans. However, the participants are commonly public employees (e.g., teachers or employees of non-profit organizations). Few of these employers will match contributions.

Section 457

Section 457 is similar to 401 (k) and 403 (b) plans, but this retirement plan is for state and local government employees.

Keogh Plan

The Keogh plan is available to anyone with self-employed income or income from any unincorporated business. Money added to a Keogh plan is not taxed. The funds grow in value until withdrawn. Keogh plans can be started through a bank, mutual fund, or other financial institutions.

Simplified Employee Pensions

Simplified employee pensions (SEP) allow employees to make contributions into individual retirement accounts (IRAs). Employers may contribute, but employees must have an IRA set up to accept contributions. An SEP is much simpler to get started than a Keogh plan.
Savings Incentive Match Plan for Employees

The savings incentive match plan for employees (SIMPLE) is designed for owners of businesses that employ 100 employees or less. It is designed to cover all employees and owners. The employer’s contribution to the plan decreases the business’s taxable income. The employee’s contribution decreases his or her taxable income.

Individual Retirement Accounts

Individual retirement accounts (IRAs) are another way for individuals to set aside money for retirement. Individuals can use an IRA to take advantage of the tax-deferred growth of funds. IRAs can be established at banks, mutual fund companies, or brokerage firms. The types of IRAs are traditional or Roth. Roth IRAs are not tax-deductible and accumulate like whole life insurance. The funds enter into a Roth IRA after tax, and funds accumulate tax-deferred. Then the funds are tax-free at the point of withdrawal.

Retirement plans are subject to penalties if early withdrawal occurs. Some accounts have exceptions to the rules. For instance, if the funds are going to be used as a first-time home buyer, a penalty may not be applied. In addition, depending on the type of investment, there are contribution limits. For example, the maximum IRA contribution for 2009 is limited to $5,000. It is important to know the consequences, requirements, and responsibilities of these types of accounts.

FURTHER EXPLORATION…

ONLINE CONNECTION: Roth IRAs

The details and rules of IRAs are challenging to follow and can be complicated. The IRS spells out the facts, reminders, and limitations every year through publications. As a holder, it is important to understand the characteristics of an IRA as well as the location to research and learn more about your investment.

Take a look at the IRA publication to learn more about traditional IRAs and Roth IRA accounts. To find out more, visit the link below:

http://www.irs.gov/retirement/article/0,,id=137307,00.html

FIGURE 4. IRAs are another way for individuals to plan for retirement.
The types of investments for an individual to choose from are numerous: savings accounts, money market accounts (MMAs), certificates of deposit (CDs), savings bonds, stocks, treasury bills (T-bills), treasury notes (T-notes), treasury bonds (T-bonds), municipal bonds, mutual funds, annuities, precious metals, and ownership of assets.

Liquidity is the ease of converting an asset into cash without affecting the asset’s price. Liquidity cannot be found with a formula; it is necessary to compare and study liquidity ratios. Investing in liquid assets, securities, or markets is safer because it is easier to get the money out of the investment. Risk is the chance that loss may occur. Credit and market risk are two important key elements when evaluating investment types.

Employers offer several different forms of retirement accounts and/or plans that allow individuals to save for retirement. Self-employed or small business individuals also have options in retirement plans.

Checking Your Knowledge:

1. What are the characteristics of savings bonds?
2. What is the difference between T-notes and T-bonds?
3. How does liquidity and risk impact investment decisions?
4. Why is retirement planning important?
5. What is a 401 (k)?

Expanding Your Knowledge:

Research The Pension Protection Act of 2006. Discover how the law provides economic security to U.S. citizens. Share your findings with your class.

Web Links:

Retirement Planning
http://personal.fidelity.com/planning/retirement/retirement_planning.shtml

Precious Metal Investment
http://www.preciousmetalinvestment.com/

Agricultural Career Profiles
http://www.mycaert.com/career-profiles