3-3: Start Investing

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Cast List
- Darryl
- Terri
- Drew Murphy, 45-50 years old, white male
- Alicia Bianca, 40-50 years old, white female

Synopsis
- Darryl and Terri discuss investment options with Drew, a house painter thinking of his eventual retirement
- Alicia provides expert information

Location
- The rec room in Darryl's house

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A. Difference Between Savings Accounts and Investments
  a. May have higher returns
    i. Higher the risk, higher expected rate of return
  b. Not guaranteed
    i. Can lose all or part of amount invested
    ii. You should be able to afford to lose it
  c. Not insured
    i. Not deposit accounts, even though many banks sell them
    ii. Not insured by FDIC or NCUA
    iii. As in the news – can decline in value or be lost entirely
B. Types of Investments
  a. Stocks
    i. Definition, you own part of the company
  b. Bonds
    i. Definition, loaning to corp or government for term
  c. Mutual funds
    i. In between stocks and bonds
    ii. Definition – professionally managed collection of money from group of investors
C. Retirement Plans
  a. 401(k) and 403(b)
    i. A good way to start
    ii. Portable
    iii. Employer match
    iv. Penalty for early withdrawal
D. Evaluating an Investment Opportunity
  a. Learn as much as you can
  b. Past performance is no guarantee
  c. Don't invest if you don't understand

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Theme music up

DARRYL: Hello, and welcome to the "Money Smart Podcast Network, with Darryl and Terri."

Cross-fade music with indoor ambience

DARRYL: Today I have the best commute ever – we're coming to you from my rec room where our guest, Drew Murphy, is going to get smart investment information from personal finance expert Alicia Bianca.

TERRI: Alicia's been in banking almost 20 years. She's a Vice President with Second Community Bank.

DARRYL: And she teaches Money Smart classes for her bank.

ALICIA: That's right.

TERRI: Welcome Drew and Alicia!

DREW: *(overlapping somewhat with Alicia)* Glad to be here.

ALICIA: *(overlapping somewhat with Drew)* Thanks for inviting me.

TERRI: Drew's in need of investment advice because, well… Drew you have a very interesting and inspirational story – do you mind sharing?

DREW: Not at all. Well, I literally backed into the painting business.

DARRYL: What do you mean?

DREW: So, the summer after high school, I was speeding out of a family get-together in my uncle's truck… and had a run-in with a pretty sturdy fence. I swerved to avoid a family of ducks in the road.

TERRI: Oh, I love ducks! Good for you. You weren't hurt, though?

DREW: No, no. I was fine. Problem was, I did some major damage to my uncle's truck. I had to work for his painting business to pay off the deductible. Turns out I have a great eye for color. After I saved a builder from using the horrible colors a designer had picked out, we got a contract to paint *all* his model homes.

DARRYL: *(laughing)* "Horrible Colors" – sounds like a group from the '70s…

DREW: Laugh all you want… I started pitching to real estate agents next – pretty soon his business took off and I became a partner a couple of years later.

DARRYL: Yeah, I'm not laughing now. That's incredible!

ALICIA: So, Drew. Now you're interested in investing?

DREW: I am. I've managed to put aside a nice nest egg, but it's not earning much in my savings account. That's frustrating – I like the painting business but I don't want to do it forever. I want to be able to retire.

ALICIA: You're right that investments typically can earn more than savings accounts. In exchange for assuming the opportunity to possibly earn a higher rate of return, you assume the risk of losing some or all of your investment. Depending on your personal goals, there are a number of options.

DREW: I had a feeling.

TERRI: You really need to start with the understanding that investment includes risk – and usually the higher the potential returns, the greater the risk. Alicia, would you tell us a little more about the risks?

ALICIA: Sure. Well, checking and savings accounts at FDIC-member banks are secured to at least $250,000 per depositor per insured bank.

DARRYL: Right.

ALICIA: But while these same banks might have investment products, the investment products often *aren't* insured by the FDIC.

DARRYL: Ooooh.

ALICIA: You could lose some or even all of your investment. So first things first: I always advise my customers to keep that emergency savings – which, according to experts, should equal three to six months of living expenses – I strongly suggest that they keep this reserve in a savings account.

TERRI: Better safe than sorry.

ALICIA: Exactly. And, I always advise customers to do their research before investing.

TERRI: Can you help Drew and our audience with some of the basic investment options?

ALICIA: Sure, Be happy too. Basic investment types include stocks, bonds, and mutual funds.

DREW: You're definitely going to have to explain what each one is!

ALICIA: I hear you. Well, when you buy a stock, you're purchasing shares of ownership in the company. In return for being a shareholder, the company will give you payments called "dividends." Dividends are basically a share of the company's profits. Over time, the company may do really well, and you can sell your shares for a profit. Of course, if the company doesn't do well, you can lose some or all the money you invested.

DREW: So…buying stock is like buying a piece of a company?

DARRYL: You mean, if I bought stock in Barker's Choice – they make Vesuvius' favorite food – I'd actually *own* part of a dog food company?

SFX: Vesuvius lets out a gentle sound that goes up at the end, as though saying, "do you mean me?"

ALICIA: Pretty much, yes.

SFX: patting of a dog's stomach with happy dog noises/panting

DARRYL: *(to Vesuvius)* Hear that? I can buy you a dog food company!

DREW: So, what about bonds?

ALICIA: When you buy a bond, you're loaning money to a government organization or to a company. In return, the organization or company promises to pay you back within a certain period of time, typically with a fixed rate of interest. That time, or the "term" of the bond, can be anything from a few months or up to 30 years.

TERRI: So are bonds less risky?

ALICIA: Well, it's an investment, so there's still going to be risk. It depends on the type of bond. With company bonds, for example, if the company goes out of business or does poorly, they may be unable to repay you.

DREW: And government bonds?

ALICIA: Well many government bonds – particularly federal bonds – have less risk, but that means the interest rate you earn on them is lower than the rate on other types of bonds.

DREW: Wait. My grandparents used to give me U.S. savings bonds for my birthday. Is that the same thing?

ALICIA: Yes, It's one kind of government bond. You can still buy them, you know. It can be a great option for someone who wants to start investing on a small scale.

DARRYL: Uh… how small?

ALICIA: You can buy savings bonds in denominations for as low as $25.

DARRYL: Not bad. How would I do that?

ALICIA: You can buy them through an automatic payroll deduction, or electronically through a Treasury Direct account. You can find out more at www.treasurydirect.gov/.

TERRI: What types of savings bonds are there?

ALICIA: Two types of low-risk government bonds you might consider are "I Bonds" and "EE Bonds." Unlike some other savings bonds, they're both purchased at face value – so you'd pay 50 dollars for a 50 dollar bond.

DREW: If that 50 dollar bond you bought gets you 50 dollars when you cash it in, how is that an investment?

ALICIA: Good question! The government adds interest onto I Bonds and EE Bonds while you hold them. When you cash them in, you'll get back the 50 dollars you paid for the bond, plus whatever interest you've earned. You're encouraged to hold on to them for at least five years.

DARRYL: Encouraged?

ALICIA: Well, you can cash them in after 12 months. However, you won't get all of the interest earned unless you hold them for at least five years.

DARRYL: That would encourage me to hold on to them.

TERRI: Both types are low-risk bonds.

ALICIA: Right. They're low risk because they are backed by the full faith and credit of the U.S. government. They also earn interest and protect you from inflation while you own them.

TERRI: So that brings us to mutual funds.

ALICIA: Yes it does! With mutual funds, many investors pool their money, and a professional fund manager purchases a combination of stocks, bonds, and other investments on their behalf. The nice thing about mutual funds is that you don't need a lot of money to get diversification.

TERRI: Diversification is when you have a mix of different kinds of investment products. It can be a good thing because it tends to lower your risk.

ALICIA: That's exactly right. With a diversified portfolio, some of your investments do well when others may not do so well. So things balance out. Compare that to putting all of your investment money into Barker's Choice. Vesuvius may love it, but say the company isn't managed well or more dogs seem to like another brand.

DREW: So their stock goes down and Darryl's lost a lot of the money he invested.

ALICIA: Right. But if he diversifies – maybe buys shares in a mutual fund that includes shares of Barker's Choice…as well as shares in other types of companies and several types of bonds—

TERRI: —when Barker's goes out of business, other parts of that portfolio are probably doing well. So, overall, Darryl does ok.

SFX: sound of Vesuvius getting up and running out of the room – we hear the rattling of his collar, jumping to his feet, paws against the floor

DARRYL: Well, everyone, thanks for scaring my dog!

DREW: So how do I figure out the best investment approach for me?

ALICIA: As always I encourage customers to do a lot of research. There are many good articles and resources online, which is a good place to start. Of course, specific investment choices also depend on what your individual needs are. Are you investing for a specific goal?

DREW: I'm looking at a couple of things. I'm hoping to get that nest egg growing faster, so I can buy out my uncle in a few more years. But longer term, I want to plan for retirement. Like I said, I don't want to paint forever.

ALICIA: As a small business owner, you have a number of retirement options, Drew. Your company could sponsor a 401(k) plan, which would allow you and your employees to set aside money on a tax-deferred basis.

TERRI: You could even provide a partial match for your employees' contributions.

ALICIA: Sure. Many employers will match a specific percentage, such as 2 or 3 percent of annual salary, when the employee saves and invests that amount through a 401(k) or a 403(b), which is a similar kind of retirement plan sponsored by certain kinds of employers, like non-profit groups. These can be good options for retirement.

DARRYL: What are some of the benefits?

ALICIA: Well, a 401(k) – and I'm actually including 403(b)s here – these retirement accounts are portable – so if you leave an employer, you can take your money and roll it over to another employer-sponsored plan. Or you could roll it into an individual retirement account, or IRA, which I'll explain in a minute.

TERRI: A 401(k) also potentially allows you to save and invest a larger amount of money than you could with an individual plan.

DREW: What do you mean?

ALICIA: Well, for example, in 2013, a worker can invest up to $17,500 in a 401(k). Participants who are 50 or older can also make "catch up" contributions of up to $5,500 per year. That's in contrast to IRAs, where the limit is $5,500 per person annually in 2013.

DREW: And what do you invest in, exactly?

ALICIA: With either the 401(k) or an IRA, you're typically offered several different options among stocks, bonds, mutual funds and other investments.

DREW: Ok, and what are the downsides?

TERRI: With these retirement accounts, you're getting money withheld "pre-tax" – the good news is that lowers the amount of income tax you pay the year you earn that money.

DREW: That sounds good to me.

ALICIA: Except…if you do withdraw your money from these retirement accounts early, you have to pay federal and state income taxes – *plus* a 10 percent penalty if you withdraw funds prior to age 59 1/2.

DREW: Hmmm. How else is an IRA different from a 401(k)?

ALICIA: There are several different types of individual retirement arrangements, or IRAs, which you can set up with a bank, insurance company, or other financial institution. Funds in certain retirement accounts, including IRAs, at an insured financial institution are insured up to the maximum allowed by law.

DARRYL: There are three main types of IRAs, right?

ALICIA: Yes! There's a traditional IRA, which can be tax deductible based on the amount of your contribution and your income. Your earnings or interest are not taxed until they're distributed. Your pre-tax contributions also aren't taxed until they're distributed. Another option is a Roth IRA.

TERRI: A Roth is a good choice for people who think their taxable income will be higher in retirement than their current income. With a Roth IRA, taxes are deducted at the time of investment, rather than at distribution.

TERRI: Because it's not sponsored by an employer, you can choose the institution you prefer to manage your IRA.

DARRYL: And the third type?

ALICIA: That's a payroll deduction IRA. An employee establishes an IRA (traditional or Roth) with a financial institution. The employee authorizes a payroll deduction for the IRA, as an easy way to make consistent investments into the account.

DREW: Okay – I think I have a lot of research to do. You can talk to your tax advisor for more details, and also look at IRS Publication 590, Individual Retirement Arrangements (IRAs).

TERRI: What about annuities? I keep seeing ads and articles – are they a good choice?

ALICIA: Well, as with any investment option, you have to do your homework. Variable rate annuities can have heavy fees and overhead expenses – often 50 to 100 percent higher than mutual funds.

TERRI: That's a huge difference.

ALICIA: They're also for the long-term, so they're a good choice only if you're going to hold them for at least 10 to 20 years.

DARRYL: We've given Drew a whole lot to think about. I would take your time on this.

TERRI: Look who's telling someone else not to rush in!

DARRYL: It just seems like there are so many decisions to make with investing – and things to know about all of these investments.

ALICIA: Darryl's absolutely right, Drew. The best advice I can give you is to take your time. Learn as much as you can about any investment you're interested in, from the prospectus, financial magazines, and the plan administrator. Talk to your bank's customer service representative about investment options – consider talking with a reputable personal financial advisor. But before doing so, consult resources at www.investor.gov to help you.

TERRI: I'd add that you should consider how long you plan to keep your money in any particular investment.

ALICIA: Right. And if you invest over time, you can ride out the ups and downs of the stock market easier. Diversification is smart, too. You need a mix of investment products that reflect your needs for return, safety, and long-term savings.

TERRI: Finally, don't invest what you can't afford to lose.

DREW: Well that's really good advice.

ALICIA: It certainly is. I would say one more thing: *never* invest if you don't understand the product.

DARRYL: Yeah, I somehow managed to close up the company that makes Vesuvius' favorite food and I didn't know I'd even invested in it!

Theme music up

TERRI: Thank you Drew and Alicia for being with us. This has been the "Money Smart Podcast Network, with Terri and Darryl."

DARRYL: Drew, hey, man, thanks for that color recommendation for the rec room. You ARE good!

Music fades