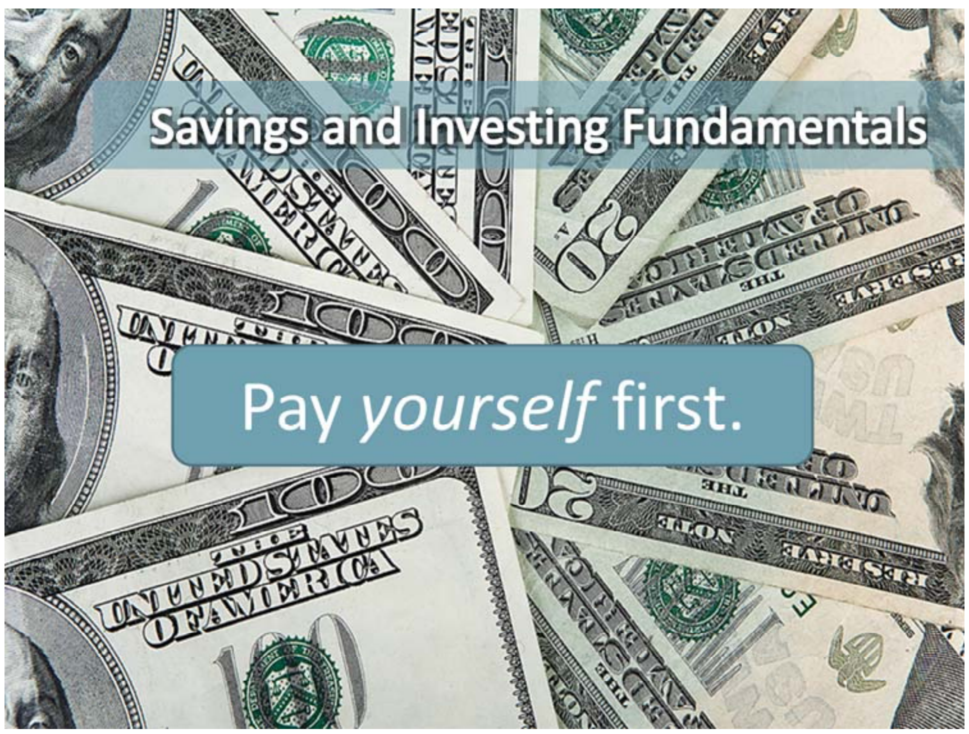
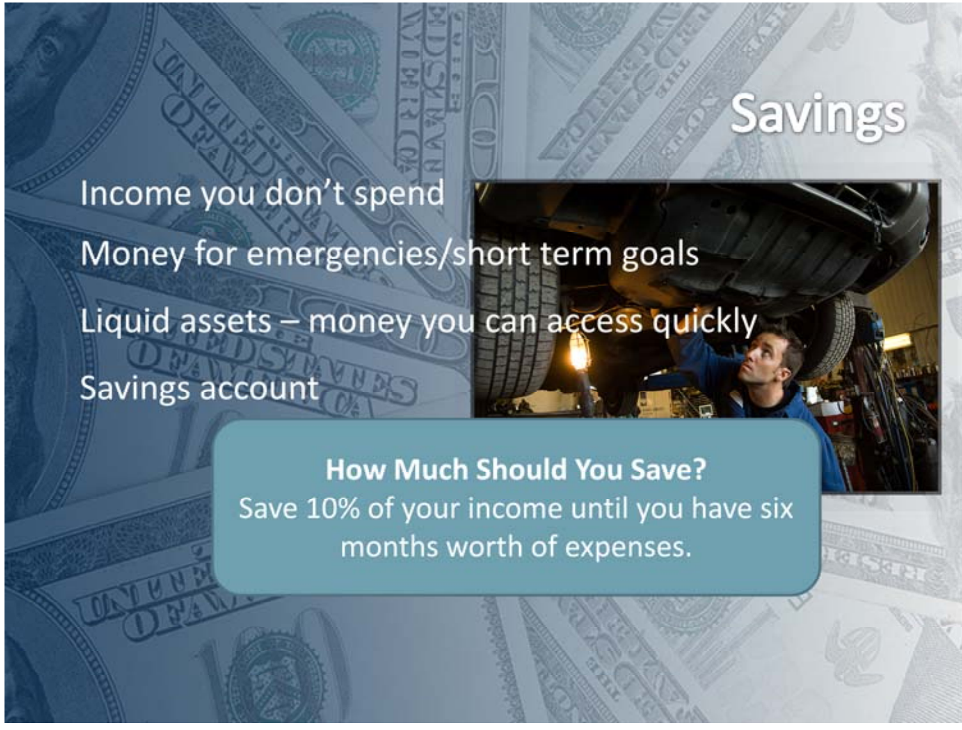


You may have heard of the old adage "pay yourself first." What does it mean? Take out a portion of every paycheck to save or invest first before you spend anything. Well that's all well and good, but what do you do with that money once you have it? You could stuff it under the mattress, but that's not very safe, and if you want to put it to work making money for you, you'll need to save it in a financial institution or invest it. Let's look at the fundamentals of saving and investing and see how it all works.



The first question you might ask is what's the difference between saving and investing? Let's look at saving first.

Your savings refers to the amount of income that you are not consuming, in other words, what you don't spend. This would be money you put aside to cover emergency expenses like repairing your car or what you plan to save for any short term goals, like a class trip. Any money you save for things like this should be kept extremely liquid, meaning that you can access it quickly and easily in case you need it. Your savings account is a perfect example of a highly liquid savings tool. It's almost like cash in that you can access the money usually within a day or so. A savings bond is an example of something that is not very liquid, since you may have to wait until a certain date before you can cash it in. That's not very good when your mechanic wants to get paid now.

Savings can help you pay for the unexpected, but how much should you have? Generally speaking, many financial planners suggest that you have six months worth of expenses saved. If you can, put away 10% of your income each month until you have saved up this amount. It's important to have a savings nest egg immediately available if you lose your job or have unexpected expenditures.

Depositing money in a savings account is a great option because both the amount that you deposit and the interest you earn are guaranteed. You don't have to worry whether the money will be there, or that it won't be accessible when you need it.

Because you are guaranteed a certain interest rate, however, the money that you earn on a savings account is generally low. In addition, if you earn over a certain amount, currently five hundred dollars, the interest is taxed as income.

Think of three of your most valuable assets. How liquid are they? Could you turn them into cash easily? You might think that guitar is worth a lot of money, but check what others are selling for on eBay© before you imagine how much it's worth. Then, think how long it will be before you get the money for it.

Most assets are not very liquid, so they aren't considered savings, and they often depreciate, or lose value over time, so they aren't good investments. Put your money in a savings account or some other guaranteed account.

Investing involves purchasing assets in order to increase your future income, normally for long term goals or reasons. One major difference between saving and investing is often the liquidity of the assets you hold. Let's say you invest in Apple® by buying the company's stock. The value of the stock changes on a daily basis, so the price might be higher than you paid one day, and lower than you paid another. When you go to sell the stock, you'd want to do it on a day when the price is higher than you paid so you would make money off your investment. If you had to sell the stock one day to get back the money, then you might have to take a loss. For this reason, stocks aren't very liquid, even though you can go online, or through your broker, and sell them anytime the stock market is open.

What about a five year Certificate of Deposit that pays a high rate of interest? You'll have to wait five years before you can access that money, or you'll probably have to pay a penalty to the bank. This is definitely not a highly liquid asset that you would want to count on in case of an emergency.

When you invest your money, it’s possible to make higher returns than you do on most of the places you commonly save money. You might even be able to generate income that you can use to support your retirement.

Investing is a long term process. Although you can make more money, you can also lose it, so you need to invest your money for much longer periods to be sure that your money will grow. Again, you can’t count on being able to access your money immediately because it may be tied up in an investment that is worth less that what you paid for it, or you would be penalized by the bank or the government for withdrawing funds. Only invest money that you don’t need to access right away.

Whenever you make a financial investment, there is risk involved. Risk is the uncertainty that you will receive the expected return, or possibly even lose your money. That risk may be very low as it is with a savings account or a savings bond. The risk may be very large, as it is with stock. In return for taking the risk, you expect a return on your investment. The higher the risk, the more money you might make, or lose with your investment.

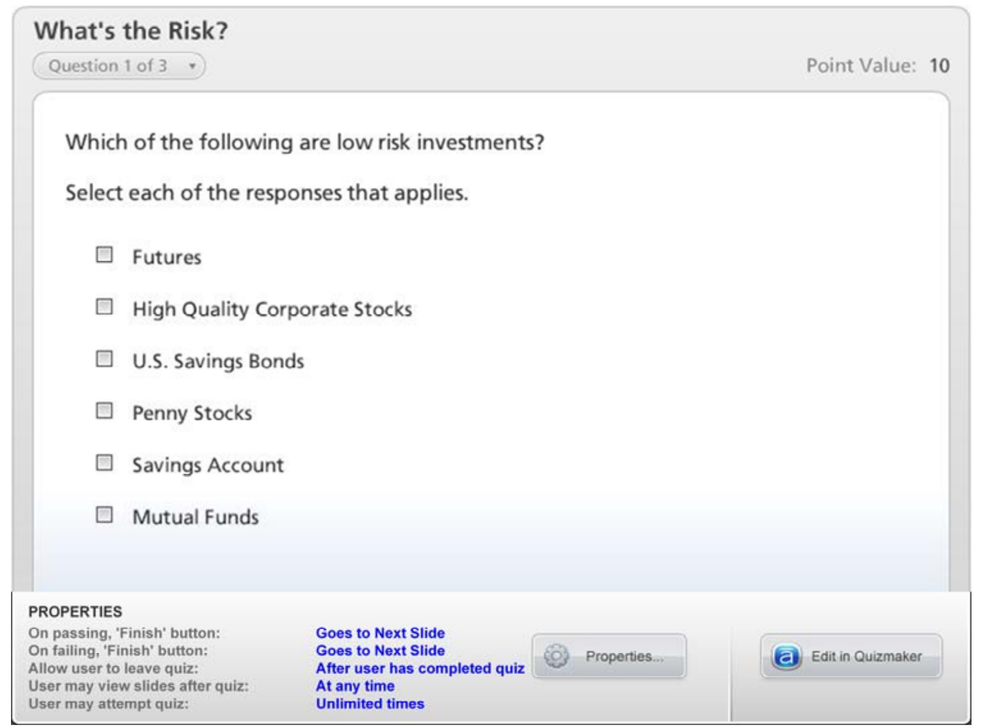
Risk and investing go hand and hand, but you can manage your risk by selecting the right mix of investments that maximize your potential to earn income at a level of risk that you are comfortable with.

Understanding risk is important. Choosing how much risk to take depends on a variety of factors, but one of the most important is how long you are going to invest your money. If you are just starting out as an investor, you have a long time to weather the ups and downs of your retirement investments, so you'll have a higher amount of risk tolerance.

Before you decide where to invest your money, you need to understand to understand what types of risks you'll face. Playing it safe can be risky, too. You can't just put your money in a savings account because it's guaranteed and hope that it will be enough to meet your retirement needs.

The question isn't whether to take a risk, but what kind to take. Let's look at five of the most common investment risks you'll face:
financial, market price, liquidity, inflation, and fraud.

Financial Planning Pyramid - Levels of Risk
Overview
How do you manage risk? Let's look at the risk levels associated with different types of investments. Don't worry if you don't understand all of the terms, we'll cover them later.
The financial planning pyramid is a visual representation of investment risks and rewards and a way to help you balance out your investments to minimize risk. The higher an investment is on the pyramid, the greater the risk. This means that the potential returns are greater, as well as the losses. Select each layer for a description.
Throughout your life, the
High Risk
Medium Risk
Low Risk
PROPERTIES
Allow user to leave interaction: After viewing all the steps
Show 'Next Slide' Button: Show upon completion
Completion Button Label: Next Slide
Properties...
Edit in Engage


What's the Risk?
Question 1 of 3
Point Value: 10
Which of the following are low risk investments?
Select each of the responses that applies.
Futures
High Quality Corporate Stocks
U.S. Savings Bonds
Penny Stocks
Savings Account
Mutual Funds
PROPERTIES
On passing, 'Finish' button:
On failing, 'Finish' button:
Allow user to leave quiz:
User may view slides after quiz:
User may attempt quiz:
Goes to Next Slide
Goes to Next Slide
After user has completed quiz
At any time
Unlimited times
Properties...
Edit in Quizmaker