FE-258

Taking Charge of Family Finances

Saving and Investing Today...For Tomorrow

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Why Save and Invest?

While personal and household income for North Dakota families have increased steadily through the years, real income, or the amount of goods and services that can be purchased with income, has been decreasing. North Dakota household income has not kept up with inflation in the past 30 years.

North Dakota families are spending more, saving and investing less and often substituting money for time. As a result, they may overspend and develop credit problems, and they are less prepared for financial emergencies.

Many North Dakotans have sought a second job or sent a second family member into the labor force. A second paycheck often provides a false sense of security, with most families expecting to rely solely on one paycheck in the event of an emergency. The truth is, they have developed a higher level of living and accumulated more debts. Both paychecks usually are necessary to meet their needs and obligations.

Saving can alleviate some of the most common types of financial problems. Accumulated savings can provide a cushion in times of emergency or for unforeseen situations such as a decrease or loss of income or an increase in debts. Saving and investing also will help reach those goals in life that require money, such as buying a home or car, putting oneself or a child through college, providing for a comfortable retirement and taking a vacation.

Everyone saves and invests for different reasons. One person may save for financial security in retirement and another may choose to save for a trip around the world. People have different needs, wants and values that will determine how much they need to save or invest.

Saving Vs. Investing

Saving and investing mean different things to different people. A savings to one person may be considered an investment to another. Generally, saving refers to putting aside a sum of capital or cash that remains constant while earning a low, guaranteed rate of interest. Investing refers to putting capital where it can increase or decrease in value, but where neither interest nor dividends are guaranteed.

How Much To Save

Americans reached a negative rate of savings in 2005, but the rate rose to more than 4 percent in the first quarter of 2009.

To determine your own saving strategy, you first will need to think through your reasons for saving and set specific goals to attain through saving (such as buying a home or car, paying for college, etc.). You will need to approximate the amount of money achieving each goal will take.

A rule of thumb is to have as much as two to six months of take-home pay in a savings account for emergencies. To reach your specific financial goals, be sure to add to your savings on a regular basis.

Another guideline for savings is to earmark 5 percent to 10 percent of take-home pay each month for savings. This may be unrealistic for some families, but it is extremely important to save on a regular basis. Other experts recommend saving 5 percent of net pay while in your 20s, 10 percent while in your 30s and 40s, and to aim for 15 percent in your 50s. This type of accelerated savings plan can help meet retirement needs.

In general, people who have an income that fluctuates, few benefits and little job security or who rely on a single income may need more. Families with two incomes and discretionary income may need less.

Saving and investing to meet financial goals.

TOTAL DOLLARS NEEDED	Years to Achieve Goal			
	5	10	15	20
	At 5% rate of return			
$ 5,000	$ 73.52	$ 32.20	$ 18.71	$ 12.16
$ 10,000	147.05	64.40	37.41	24.33
$ 20,000	294.09	128.80	74.83	48.66
$ 50,000*	735.23	321.99	187.06	121.64
$300,000**	4411.37	1931.97	1122.38	729.87
	At 9% rate of return			
$ 5,000	$ 69.68	$ 27.43	$ 14.19	$ 8.14
$ 10,000	139.35	54.86	23.38	16.29
$ 20,000	278.71	109.72	56.77	32.58
$ 50,000*	662.92	258.38	132.13	74.86
$300,000**	3977.51	1550.37	792.80	449.18

* The predicted cost of a four-year education at a public college in the year 2010.
** Approximately fifteen years of $20,000 (today's dollars) annual retirement income.

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Use the chart on the previous page as a guide to help you determine how much you will need to save each month to reach your financial goals.

Where To Save

Once you have decided how much to save, the next question is where. Savings options generally are characterized by low risk on the principal, high liquidity (ease in withdrawing your money) and fixed guaranteed returns.

For information on choosing financial advisers, contact your county office of the NDSU Extension Service and ask for publication FE-451, "What to Look for in a Financial Professional." Listed below are common savings alternatives.

Savings Accounts

Institutions such as commercial banks, savings and loan associations or credit unions offer the safest alternatives for savings. Government insurance programs such as FDIC (Federal Deposit Insurance Corporation) or NCUA (National Credit Union Association) guarantee the safety of your deposits up to certain amounts ($100,000 per depositor).

Savings accounts are very liquid and require very little or no minimum balance. However, the rate of return for passbook accounts is often below the rate of inflation.

Certificates of Deposit

Certificates of deposit require a larger initial investment than a savings account but yield a higher return. To get the specified return, the money must be kept in the account for a specific period — usually six months or longer. The longer the deposit length, the higher the interest will be. In times of rapidly increasing interest rates, this may be a disadvantage. When interest rates are on the decline, a certificate of deposit is advantageous.

Interest-Bearing Checking Accounts

Major changes in checking accounts occurred when financial institutions were allowed to pay interest on them. The NOW (Negotiable Orders of Withdrawal) account is a checking account that earns interest and usually requires a minimum balance.

SuperNOW accounts benefit customers who keep large amounts in their checking accounts by offering competitive market interest rates on amounts above a certain balance.

Share draft accounts are interest-bearing accounts at a credit union. Credit union members write credits, called share drafts, against their account balance. Share draft accounts usually have fewer restrictions than other types of interest-bearing accounts.

Be sure to check out minimum balance and other requirements to see if this type of account may fit your situation.

Money Market Deposit Accounts

A money market account is a savings plan with a required minimum balance and a floating interest rate based on market interest rates. Savers are permitted to write a limited number of checks to make large payments or to transfer money to other accounts. Deposits are insured.

Money Market Mutual Funds

This type of fund is a combination savings/investment plan in which the investment company uses your money to purchase a variety of financial instruments. Your earnings are based on the interest received by the investment company. Money market funds usually pay higher interest rates than most other savings plans but are not insured, although most are quite safe due to the nature of the investments. Some check writing is allowed.

U.S. Government Securities

U.S. government securities offer low-risk saving options. Series EE and HH bonds, treasury bills, notes and bonds, and federal agency bonds reach maturity within a stated number of months or years. Interest yields and minimum investments will vary greatly. Contact your financial adviser, banker, broker or the nearest branch of the Federal Reserve for information.

Series EE bonds are the simplest to acquire and often are available in small denominations through convenient payroll deduction. These bonds can have additional benefits and tax advantages if used for college savings.

Evaluate Savings Options

No one savings alternative is always "best" for a particular family. A combination of options may best help you meet your savings objectives. Some characteristics about saving options may be more important to you than others.

To help you find out, here are some questions to consider:

- SAFETY— Is the principal safe?
- RETURN— Is the return guaranteed? At what rate?
- LIQUIDITY— How long will receiving the funds take? Can funds be withdrawn without penalty or loss of interest?
- EFFECTS OF INFLATION/ DEFLATION? — How will inflation/ deflation affect the purchasing power of dollars saved?

You need to balance the risk and return that you are willing to assume. Always remember that no single option will meet all of these considerations.

TIPS FOR SAVING

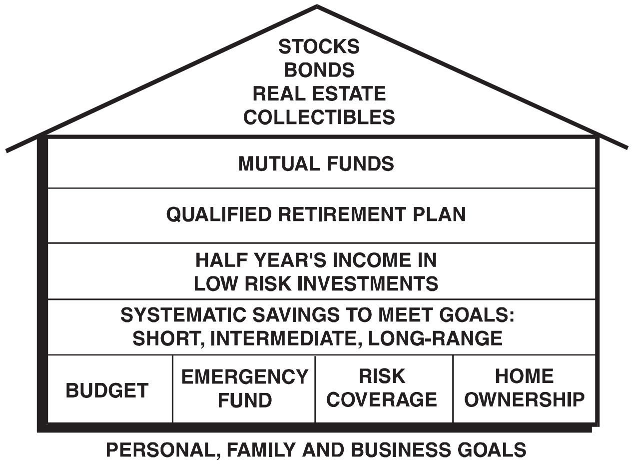
- Pay yourself first. Consider savings as a fixed expense similar to your house or car payment. Put the money away before you have time to think about spending it. One alternative is to have an amount automatically deducted from your paycheck and put into a savings plan. If you wait until the end of the month, chances are you won't have anything left to save.
- Save windfall income. The theory is simple. You got along without the unexpected bonus, tax refund, overtime pay or gift, so why not keep on that way and save the extra money?
- Try frugality. Cutting back on eating out, entertainment or pleasure drives can save money quickly, even though it might cause some sacrifices and might even change your lifestyle.

Investment Objectives

Many people want to jump into investing before they have a sound financial base. The Suggested Financial Plan is an indication of what kinds of basic emergency, savings and risk coverage should be considered before incurring the added risk involved with investing.

The first step in investing is to identify your investment goals. Do you want more income right now? How much time do you have to meet your objectives? Do you want fairly reliable growth of capital or are you willing to be speculative? Speculators are investors who take great risk to earn high returns quickly. More conservative investors make money grow during the long haul with a diversified, high-quality investment program.

Suggested Financial Plan



SEEK ADVICE

The adage "investigate before you invest" is old but not out of date. Consider these sources of information on savings and investment options:

- Most large libraries have extensive information on saving and investing. Newsletters, periodicals and magazines frequently are in a special business and finance section. Research the company and the type of investment you are considering. Look at past performance, current financial standing and future prospects.
- A reputable brokerage house or advisers at your financial institution are good sources of information. Use that information to make your own decision based on your goals.
- Examples of sources for mutual fund information are *Morningstar* or *Weisenberger*. For general financial information use *Money* or *Kipplingers Personal Finance* magazines. *The Wall Street Journal* features timely economic and financial information as well.

If an investment opportunity sounds too good to be true, it probably is. Check with the Consumer Protection and Antitrust Division of the North Dakota attorney general's office (State Capitol building, Bismarck, ND 58505) to see if any complaints have been filed against the company. The toll-free phone number is (800) 472-2600.

Choosing An Investment

You have numerous investment alternatives. You'll want to investigate each one completely before choosing the best ones for you. Investments usually are evaluated according to the following seven criteria:

Degree of Risk

Whenever you make an investment, you run the risk that you won't make any money and may even lose some. Saving investments insured by the FDIC or NCUA are about as risk-free as any alternative. In comparison, consider an investment of stock in a small company whose future depends heavily on an upswing in the economy. Certain events might lead to either bankruptcy for the company or to a dramatic increase in the stock's value.

Rate of Return

Returns usually are expressed as an annual percentage rate of the original investment. The total return from an investment includes earnings from the principal plus growth of principal.

Liquidity

Liquidity is the ease with which an investment can be converted into cash. For example, savings accounts are liquid assets, but an investment in real estate generally is not. Selling property can take considerable time. Funds in stock or mutual funds are liquid assets and can be traded anytime. However, the market price may be depressed at the time you need the cash.

Management Requirements

Certain investments, such as an apartment building or a portfolio of common stocks, require time and skills to manage. For these investments, you can hire a professional manager. Other investments require little time or skill after the initial investment decision is made.

Maturity

Many investments take a certain time period before reaching the expected rate of return. Certificates of deposit, often called "time" certificates, are an example. Other investments such as real estate or common stocks won't have a specified maturity date, but time is needed to generate earnings and increase the capital value.

Inflation Hedge

The degree of protection an investment provides against inflation is an important consideration. Equity investments — where you own something such as common stock or land — historically have shown a growth of principal that has outpaced the rate of inflation.

In contrast, putting your money in bonds, a savings account or a cash-value life insurance policy typically offers a fixed rate of return but no increase in the value of the principal.

Tax Consequences

The higher your tax bracket, the more attention you will want to give the tax consequences of an investment. People in high tax brackets minimize the tax liability by seeking tax-exempt investments or investments providing long-term capital gain income.

Where To Invest

After you have decided what your investment objectives are, you must decide where to invest. Below are some common investment options.

Investment Clubs

An investment club is a nonprofit organization formed by a group of people, usually up to 15. Each club member sets aside approximately $25 monthly and selects stocks for purchase at monthly meetings. Club members are chosen to report at meetings on economic trends, special groups of stocks, bonds or other topics of interest to the group.

Investing money through an investment club is primarily an educational experience. The risk involved and the profit to be gained are limited. Many investors, beginning as well as experienced, consider investment clubs an excellent and enjoyable way of learning how to invest money.

For information on starting an investment club, see NDSU Extension publication FE-583, "Starting an Investment Club."

Mutual Funds

When buying mutual funds, your money is pooled with the money of a large number of other investors, and each investor owns shares in a number of different types of securities. Each mutual fund is managed by professional staff who invest the funds and carry out all business transactions of the fund to meet the purposes of the fund. Individual investors receive statements that declare the terms of their ownership as well.

Mutual funds provide consumers with professional management, diversification and research. Because mutual funds offer diversification by investing in large numbers of different stocks, bonds and government securities, and because diversification spreads the risk of loss for the consumer, mutual funds often are recommended for small investors. People usually cannot achieve this diversification when investing by themselves because of the large amounts of capital needed. Funds vary by their objective (growth or income), the fee structure (some are no-load with no up-front costs and others are load funds, with up front charges), and all have some annual management fees. Mutual funds will define their investment objectives in their prospectus, which describes the characteristics of each stock and their company.

Commercial banks have begun to offer mutual fund products. While they may be a convenient source from which to buy mutual funds, consumers need to realize that mutual funds purchased through a bank are not federally insured as deposits are.

Bonds

Bonds generally are considered a very secure form of investing based on safety of principal and interest. Bonds can be issued by the federal, state or local government, or by corporations or utility companies. Beware of "junk" bonds, which are neither safe nor secure.

The issuer of bonds promises to the bond holder that money borrowed will be repaid to the holder in full at maturity. In addition, the bond holder receives a fixed, predetermined amount of income called interest.

Stocks

Stocks represent ownership. Buyers of stock receive stock certificates as evidence of their ownership in a company. You, as an investor, hope you will get a fair return on your purchase of stock and that the company will grow and expand.

Stocks have no maturity or expiration date. The company you purchase stock in does not guarantee repayment of your investment at any time or the payment of dividends. However, because you become a part owner when you purchase stock, if the company makes a profit, so do you.

Some stocks are called "blue chip." They are for the investor who wishes to have dividends and a higher degree of safety. Other stocks carry greater risks but have a potential for higher future return.

Income stocks are stocks that pay higher than average dividends and are offered by corporations that have a steady, predictable source of income. Investors purchase these stocks for their income potential and not necessarily because they will increase in price.

Growth stocks, on the other hand, are stocks issued by a corporation that is earning above-average profits when compared with other firms in the economy. Most investors purchase growth stocks in the hope that the market price of the stock will grow or increase. These stocks may not pay dividends as large or as frequently as other stocks; earnings often are reinvested into the company.

Real Estate

Real estate consists of four major types: property (such as a home), income-producing property, investment trusts and undeveloped land. Investing in real estate has been profitable for many people. Ownership of a home is the single largest lifetime investment for most individuals. During the past decade, however, the return on home ownership has been declining.

Investing in land and income-producing property (for example, an apartment house) is for the knowledgeable buyer. Real estate is difficult to turn into cash quickly without a loss. On the other hand, it is considered an excellent hedge against inflation.

Gold and Silver

Consumers who wish to diversify their assets, or those who are afraid of the possibility of war or international economic upheaval, sometimes choose to purchase gold, silver or other precious metals. Be aware that not all coins will increase in value, including those that are labeled and sold as "collectors' items." Read about and become familiar with coin values before you decide to collect them as an investment.

Collectibles

Collectibles can be works of art, diamonds, antiques, stamps, rare coins, paintings, sculptures, old toys, snuff boxes, oriental rugs, musical instruments, paperweights, etc. Individuals seek out investments in these areas to diversify their holdings.

Art is not considered a liquid investment. Investment counselors recommend the purchase of superior quality works (oil paintings, drawings or prints) and the work of well-known artists as the best collectible investments.

Nevertheless, public taste changes and painters can gain and lose popularity.

Professional appraisers or art specialists should be consulted before purchasing. Educate yourself before buying by reading journals in the field and keeping up with trends in public taste.

Antique Furniture

Many specialists consider antique furnishings a good investment if the pieces are bought for personal use and enjoyment. Since the supply of genuine antique furniture in good condition is limited, consumers eventually can expect to sell a piece for more than the purchase price. This contrasts with new furniture, which depreciates in value from the moment it leaves the store.

Final Word Of Caution

Many people have become disillusioned and have become skeptical of all types of savings and investments. They don't know how to invest or when to buy or sell. Success with any of the above investments can be difficult to achieve. Develop a long-term acquisition plan that ensures you can take advantage of "dollar-cost averaging." This means that you will sometimes buy high, sometimes low, but through diversification, on the average, you will gain in the long run.

In addition, you will need to keep informed on what the economy, the government and the market are doing. The more informed you are, the better the decisions you will make.

For more information on this and other topics, see: www.ag.ndsu.edu

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