Investing 101

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Table of Contents

What is Investing.…………..……………………………………………………..3

Savings vs Investing………...…………...……………………………...………3

Why Invest……………...………………………………………………………4

Types of Investing……………...…………………………………………...……..4

How to know what is best for you……………………………………………..9

Sources………….……………...………………………………………...………..12

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What is Investing?

Investing is a tool for building wealth, but it is not only for the wealthy. Anyone can get started on an investing program, and various vehicles make it easy to begin with small amounts and add to a portfolio periodically

Investing is defined as "The act of committing money or capital to an endeavor with the expectation of obtaining an additional income or profit."

Legendary investor Warren Buffett defines investing as "… the process of laying out money now to receive more money in the future." The goal of investing is to put your money to work in one or more types of investment vehicles in the hopes of growing your money over time.

Investing is really about "working smarter and not harder." Investing is also about making priorities for your money. Spending is easy and gives instant gratification whereas investing requires prioritizing our financial futures over our present desires.

Investing is a way to set aside money while you are busy with life and let that money work for you so that you can fully reap the rewards of your labor in the future

Savings vs Investing

Saving is what you do with the money you're going to use to pay for short-term goals — ones in the next five years or so. That money belongs in an account where it's liquid and safe, such as a high-yield savings account or even a CD.

Investing is what you do with money earmarked for long-term goals like retirement. With a long time horizon, you can make growth, rather than liquidity, the priority.

So why is investing superior to investing? That's because over time, inflation erodes the purchasing power of cash. And savings cannot keep up with inflation.

Why Invest?

Investing is the trading of your money today for a lot more money in the future.

The investing we talk about revolves around the stock market. But there are people who are afraid of the market. One common approach of people who fear the market is that they put the majority of their money into a combination of ***checking*** and ***savings accounts.*** When you deposit your money in the bank, the bank turns around and invests that money at 7% a year or more. After they collect their profit, they give a tiny shaving of it to you.

For example, take $1,000 invested over 30 years. With an investment account on average, you this $1000 would be worth over $7000 in 30 years. However, the average checking account would be worth a little less than $1200 in 30 years.

You're better off keeping 90% of your money in a checking account and 10% in investments than 10% in a checking account and 90% in a savings account.

Investment Options

A wide variety of investment products exist to help you achieve your financial goals. Learn more about many investment products in the menu on the left.

The main categories of investment products are:

- Stock
- Bonds
- Mutual Funds and ETFs
- Insurance Products such as Variable Annuities

Every investment product has its own general set of features including level of risk and anticipated returns.

Risk and Return. Risk means how safe your money will be and return is how fast your money will grow. Generally, as investment risks rise, investors seek higher returns. Be careful, you can lose all the money you invest, including your principal.

Risk and return aren't the only considerations when deciding what types of investment products to invest in. You may also want to consider:

Fees. How much it costs to invest

Asset Allocation. Diversification of your overall financial situation.

Liquidity. How easy it is to buy and sell the product.

Fraud. Potential for investment fraud.

Types of Investments

Stocks

When you buy shares of a company's stock, you own a piece of that company. Stocks come in a wide variety, and they often are described based the company's size, type, performance during market cycles and potential for short- and long-term growth.

Buying shares of stock gives the buyer the opportunity to participate in the company's success via increases in the stock's price and dividends that the company might declare. Shareholders have a claim on the company's assets in the event of liquidation, but do not own the assets. Stocks sometimes earn high returns, but also come with more risk than other investments because companies can lose value or go out of business.

Holders of common stock have voting rights at shareholders' meetings and the right to receive dividends if they are declared. Holders of preferred stock don't have voting rights, but do receive preference in terms of the payment of any dividends over common shareholders. They also have a higher claim on company assets than holders of common stock.

Stocks are a type of security that gives stockholders a share of ownership in a company. Stocks also are called "equities."

Investors buy stocks for various reasons. Here are some of them:

- Capital appreciation, which occurs when a stock rises in price
- Dividend payments, which come when the company distributes some of its earnings to stockholders
- Ability to vote shares and influence the company

Companies issue stock to get money for various things, which may include:

- Paying off debt
- Launching new products
- Expanding into new markets or regions
- Enlarging facilities or building new ones

There are two main kinds of stocks, common stock and preferred stock.

Common stock entitles owners to vote at shareholder meetings and receive dividends.
Preferred stockholders usually don't have voting rights but they receive dividend payments before common stockholders do, and have priority over common stockholders if the company goes bankrupt and its assets are liquidated.

Common and preferred stocks may fall into one or more of the following categories:

- Growth stocks have earnings growing at a faster rate than the market average. They rarely pay dividends and investors buy them in the hope of capital appreciation. A start-up technology company is likely to be a growth stock.
- Income stocks pay dividends consistently. Investors buy them for the income they generate. An established utility company is likely to be an income stock.
- Value stocks have a low price-to-earnings (PE) ratio, meaning they are cheaper to buy than stocks with a higher PE. Value stocks may be growth or income stocks, and their low PE ratio may reflect the fact that they have fallen out of favor with investors for some reason. People buy value stocks in the hope that the market has overreacted and that the stock's price will rebound.
- Blue-chip stocks are shares in large, well-known companies with a solid history of growth. They generally pay dividends.

Another way to categorize stocks is by the size of the company, as shown in its market capitalization. There are large-cap, mid-cap, and small-cap stocks. Shares in very small companies are sometimes called "microcap" stocks. The

very lowest priced stocks are known as “penny stocks.” These companies may have little or no earnings. Penny stocks do not pay dividends and are highly speculative.

Stocks offer investors the greatest potential for growth (capital appreciation) over the long haul. Investors willing to stick with stocks over long periods of time, say 15 years, generally have been rewarded with strong, positive returns.

But stock prices move down as well as up. There’s no guarantee that the company whose stock you hold will grow and do well, so you can lose money you invest in stocks.

If a company goes bankrupt and its assets are liquidated, common stockholders are the last in line to share in the proceeds. The company’s bondholders will be paid first, then holders of preferred stock. If you are a common stockholder, you get whatever is left, which may be nothing.

Even when companies aren’t in danger of failing, their stock price may fluctuate up or down. Large company stocks as a group, for example, have lost money on average about one out of every three years. If you have to sell shares on a day when the stock price is below the price you paid for the shares, you will lose money on the sale.

Market fluctuations can be unnerving to some investors. A stock’s price can be affected by factors inside the company, such as a faulty product, or by events the company has no control over, such as political or market events.

Stocks usually are one part of an investor’s holdings. If you are young and saving for a long-term goal such as retirement, you may want to hold more stocks than bonds. Investors nearing or in retirement may want to hold more bonds than stocks.

The risks of stock holdings can be offset in part by investing in a number of different stocks. Investing in other kinds of assets that are not stocks, such as bonds, is another way to offset some of the risks of owning stocks

Bonds

A bond is a loan an investor makes to an organization in exchange for interest payments over a specified term plus repayment of principal at the bond’s

maturity date. Bonds are issued by corporations, the federal government plus many states, municipalities and governmental agencies.

A typical corporate bond might have a face value of $1,000 and pay interest semi-annually. Interest on these bonds is fully taxable, but interest on municipal bonds is exempt from federal taxes and may be exempt from state taxes for residents of the issuing state. Interest on Treasuries is taxed at the federal level only.

Bonds can be purchased as new offerings or on the secondary market, just like stocks. A bond's value can rise and fall based on a number of factors, the most important being the direction of interest rates. Bond prices move inversely with the direction of interest rates.

Bonds are generally considered safer than stocks, but they also offer lower returns. The primary risk, as with any loan, is that the issuer could default. U.S. government bonds are backed by the "full faith and credit" of the United States, which effectively eliminates that risk. State and city government bonds are generally considered the next-safest option, followed by corporate bonds. The safer the bond, the lower the interest rate.

Bonds are a fixed-income investment, because investors expect regular income payments. Interest is generally paid to investors in regular installments — typically once or twice a year — and the total principal is paid off at the bond's maturity date.

A bond is a debt security, similar to an IOU. Borrowers issue bonds to raise money from investors willing to lend them money for a certain amount of time.

When you buy a bond, you are lending to the issuer, which may be a government, municipality, or corporation. In return, the issuer promises to pay you a specified rate of interest during the life of the bond and to repay the principal, also known as face value or par value of the bond, when it "matures," or comes due after a set period of time.

Investors buy bonds because:

- They provide a predictable income stream. Typically, bonds pay interest twice a year.
- If the bonds are held to maturity, bondholders get back the entire principal, so bonds are a way to preserve capital while investing.
- Bonds can help offset exposure to more volatile stock holdings.

Companies, governments and municipalities issue bonds to get money for various things, which may include:

- Providing operating cash flow
- Financing debt
- Funding capital investments in schools, highways, hospitals, and other projects

There are three main types of bonds:

- Corporate bonds are debt securities issued by private and public corporations.
- Investment-grade. These bonds have a higher credit rating, implying less credit risk, than high-yield corporate bonds.
- High yield bonds. These bonds have a lower credit rating, implying higher credit risk, than investment-grade bonds and, therefore, offer higher interest rates in return for the increased risk.
- Municpal bonds, called "munis," are debt securities issued by states, cities, counties and other government entities
- U.S. Treasuries are issued by the U.S. Department of the Treasury on behalf of the federal government. They carry the full faith and credit of the U.S. government, making them a safe and popular investment.

Bonds can provide a means of preserving capital and earning a predictable return. Bond investments provide steady streams of income from interest payments prior to maturity.

The interest from municipal bonds generally is exempt from federal income tax and also may be exempt from state and local taxes for residents in the states where the bond is issued.

As with any investment, bonds have risks. These risks include:

Credit risk. The issuer may fail to timely make interest or principal payments and thus default on its bonds.
Interest rate risk. Interest rate changes can affect a bond's value. If bonds are held to maturity the investor will receive the face value, plus interest. If sold before maturity, the bond may be worth more or less than the face value. Rising interest rates will make newly issued bonds more appealing to investors because the newer bonds will have a higher rate of interest than older ones. To sell an older bond with a lower interest rate, you might have to sell it at a discount.
Inflation risk. Inflation is a general upward movement in prices. Inflation reduces purchasing power, which is a risk for investors receiving a fixed rate of interest.
Liquidity risk. This refers to the risk that investors won't find a market for the bond, potentially preventing them from buying or selling when they want.
Call risk. The possibility that a bond issuer retires a bond before its maturity date, something an issuer might do if interest rates decline, much like a homeowner might refinance a mortgage to benefit from lower interest rates

Mutual funds

Mutual funds allow investors to purchase a large number of investments in a single transaction. These funds pool money from many investors, then employ a professional manager to invest that money in stocks, bonds or other assets.

Mutual funds are valued at the end of trading day and any transactions to buy or sell shares are executed after the market close as well.

Mutual funds can passively track stock or bond market indexes such as the S&P 500, the Barclay's Aggregate Bond Index and many others. Other mutual funds are actively managed where the manager actively selects the stocks, bonds or other investments held by the fund. Actively managed mutual funds are generally more costly to own. A fund's underlying expenses serve to reduce the net investment returns to the mutual fund shareholders.

Mutual funds can make distributions in the form of dividends, interest and capital gains. These distributions will be taxable if held in a non-retirement account. Selling a mutual fund can result in a gain or loss on the investment, just as with individual stocks or bonds.

When a mutual fund earns money it distributes a proportion of that to investors. When investments in the fund go up in value, the value of the fund increases as well, which means you could sell it for a profit.

Mutual funds follow a set strategy — a fund might invest in a specific type of stocks or bonds, like international stocks or government bonds. Some funds invest in both stocks and bonds. How risky the mutual fund is will depend on the investments within the fund.
A mutual fund is a company that pools money from many investors and invests the money in securities such as stocks, bonds, and short-term debt. The combined holdings of the mutual fund are known as its portfolio. Investors buy shares in mutual funds. Each share represents an investor's part ownership in the fund and the income it generates.

Mutual funds are a popular choice among investors because they generally offer the following features:

- Professional Management. The fund managers do the research for you. They select the securities and monitor the performance.
- Diversification or "Don't put all your eggs in one basket." Mutual funds typically invest in a range of companies and industries. This helps to lower your risk if one company fails.
- Affordability. Most mutual funds set a relatively low dollar amount for initial investment and subsequent purchases.
- Liquidity. Mutual fund investors can easily redeem their shares at any time, for the current net asset value (NAV) plus any redemption fees.

Most mutual funds fall into one of four main categories – money market funds, bond funds, stock funds, and target date funds. Each type has different features, risks, and rewards.

- Money Market Funds have relatively low risks. By law, they can invest only in certain high-quality, short-term investments issued by U.S. corporations, and federal, state and local governments.
- Bond funds have higher risks than money market funds because they typically aim to produce higher returns. Because there are many different types of bonds, the risks and rewards of bond funds can vary dramatically.
- Stock funds invest in corporate stocks. Not all stock funds are the same. Some examples are:

  Growth funds focus on stocks that may not pay a regular dividend but have potential for above-average financial gains.

Income funds invest in stocks that pay regular dividends.

Index funds track a particular market index such as the Standard & Poor's 500 Index.

Sector funds specialize in a particular industry segment.

- Target date funds hold a mix of stocks, bonds, and other investments. Over time, the mix gradually shifts according to the fund's strategy. Target date funds, sometimes known as lifecycle funds, are designed for individuals with particular retirement dates in mind.

Mutual funds offer professional investment management and potential diversification. **They also offer three ways to earn money:**

- Dividend Payments. A fund may earn income from dividends on stock or interest on bonds. The fund then pays the shareholders nearly all the income, less expenses.
- Capital Gains Distributions. The price of the securities in a fund may increase. When a fund sells a security that has increased in price, the fund has a capital gain. At the end of the year, the fund distributes these capital gains, minus any capital losses, to investors.
- Increased NAV. If the market value of a fund's portfolio increases, after deducting expenses, then the value of the fund and its shares increases. The higher NAV reflects the higher value of your investment.

All funds carry some level of risk. With mutual funds, you may lose some or all of the money you invest because the securities held by a fund can go down in value. Dividends or interest payments may also change as market conditions change.

A fund's past performance is not as important as you might think because past performance does not predict future returns. But past performance can tell you how volatile or stable a fund has been over a period of time. The more volatile the fund, the higher the investment risk.

Index funds

An index fund is a type of mutual fund that passively tracks an index, rather than paying a manager to pick and choose investments. For example, an S&P 500 index fund will aim to mirror the performance of the S&P 500 by holding stock of the companies within that index.

The benefit of index funds is that they tend to cost less because they don't have that active manager on the payroll. The risk associated with an index fund will depend on the investments within the fund.

Index funds may earn dividends or interest, which is distributed to investors. These funds may also go up in value when the benchmark indexes they track go up in value; investors can then sell their share in the fund for a profit. Index funds also charge expense but these costs tend to be lower than mutual fund fees.
An "index fund" is a type of mutual fund or exchange-traded fund that seeks to track the returns of a market index. The S&P 500 Index, the Russell 2000 Index, and the Wilshire 5000 Total Market Index are just a few examples of market indexes that index funds may seek to track.
A market index measures the performance of a "basket" of securities (like stocks or bonds), which is meant to represent a sector of a stock market, or of an economy. You cannot invest directly in a market index, but because index funds track a market index they provide an indirect investment option.

Index funds may take different approaches to track a market index: some invest in all of the securities included in a market index, while others invest in only a sample of the securities included in a market index.

Market indexes often use a company's market capitalization to decide how much weight that security will have in the index. Market capitalization (or "market cap") is a measure of the total value of the company's shares. The total value is equal to the share price times the number of shares outstanding. In a market-cap-weighted index, securities with a higher market capitalization value account for a greater share of the overall value of the index. Some market indexes, such as the Dow Jones Industrial Average, are "price-weighted." In this case, the price per share will determine the weight of a security.
Some index funds may also use derivatives (like options or futures) to help achieve their investment objective.

Index funds have generally followed a passive, rather than active, style of investing. This means they aim to maximize returns over the long run by not buying and selling securities very often. In contrast, an actively managed fund often seeks to outperform a market (usually measured by some kind of index) by doing more frequent purchases and sales.

Because index funds generally use a passive investing strategy, they may be able to save costs. For example, managers of an index fund are not actively picking securities, so they do not need the services of research analysts and others that help pick securities. This reduction in the cost of fund management could mean lower overall costs to shareholders. *However, keep in mind that not all index funds have lower costs than actively managed funds. Always be sure you understand the actual cost of any fund before investing.*

Like any investment, index funds involve risk. An index fund will be subject to the same general risks as the securities in the index it tracks. **The fund may also be subject to certain other risks, such as:**

- *Lack of Flexibility.* An index fund may have less flexibility than a non-index fund to react to price declines in the securities in the index.
- *Tracking Error.* An index fund may not perfectly track its index. For example, a fund may only invest in a sampling of the securities in the market index, in which case the fund's performance may be less likely to match the index.
- *Underperformance.* An index fund may underperform its index because of fees and expenses, trading costs, and tracking error.

ETFs

ETFs or Exchanged Traded Funds are like mutual funds in many respects, but are traded on the stock exchange during the trading day just like shares of stock. Unlike mutual funds which are valued at the end of each trading day, ETFs are valued constantly while the markets are open.

Many ETFs track passive market indexes like the S&P 500, the Barclay's Aggregate Bond Index, and the Russell 2000 index of small cap stocks and many others.

In recent years, actively managed ETFs have come into being, as have so-called smart beta ETFs which create indexes based on "factors" such as quality, low volatility and momentum.

ETFs are a type of exchange-traded investment product that must register with the SEC under the 1940 Act as either an open-end investment company (generally known as "funds") or a unit investment trust.

Like mutual funds, ETFs offer investors a way to pool their money in a fund that makes investments in stocks, bonds, or other assets and, in return, to receive an interest in that investment pool. Unlike mutual funds, however, ETF shares are traded on a national stock exchange and at market prices that may or may not be the same as the net asset value ("NAV") of the shares, that is, the value of the ETF's assets minus its liabilities divided by the number of shares outstanding.

ETFs are not mutual funds. Generally, ETFs combine features of a mutual fund, which can be purchased or redeemed at the end of each trading day at its NAV per share, with the intraday trading feature of a closed-end fund, whose shares trade throughout the trading day at market prices.
Unlike with mutual fund shares, retail investors can only purchase and sell ETF shares in market transactions. That is, unlike mutual funds, ETFs do not sell individual shares directly to, or redeem their individual shares directly from, retail investors. Instead, ETF sponsors enter into contractual relationships with one or more financial institutions known as "Authorized Participants." Authorized Participants typically are large broker-dealers. Only Authorized Participants are permitted to purchase and redeem shares directly from the ETF, and they can do so only in large aggregations or blocks (*e.g.*, 50,000 ETF shares) commonly called "Creation Units."

Other investors purchase and sell ETF shares in market transactions at market prices. An ETF's market price typically will be more or less than the fund's NAV per share. This is because the ETF's market price fluctuates during the trading day as a result of a variety of factors, including the underlying prices of the ETF's assets and the demand for the ETF, while the ETF's NAV is the value of the ETF's assets minus its liabilities, as calculated by the ETF at the end of each business day.

Types of ETF's
Index-Based ETFs

Most ETFs trading in the marketplace are index-based ETFs. These ETFs seek to track a securities index like the S&P 500 stock index and generally invest primarily in the component securities of the index. For example, some ETFs which seek to track the S&P 500 stock index, invests in most or all of the equity securities contained in the S&P 500 stock index. Some, but not all, ETFs may post their holdings on their websites on a daily basis.

Actively Managed ETFs
Actively managed ETFs are not based on an index. Instead, they seek to achieve a stated investment objective by investing in a portfolio of stocks, bonds, and other assets. Unlike with an index-based ETF, an adviser of an actively managed ETF may actively buy or sell components in the portfolio on a daily basis without regard to conformity with an index.

1) INDEX FUNDS

An "index fund" is a type of mutual fund or exchange-traded fund that seeks to track the returns of a market index. The S&P 500 Index, the Russell 2000 Index, and the Wilshire 5000 Total Market Index are just a few examples of market indexes that index funds may seek to track.
A market index measures the performance of a "basket" of securities (like stocks or bonds), which is meant to represent a sector of a stock market, or of an economy. You cannot invest directly in a market index, but because index funds track a market index they provide an indirect investment option.

Index funds may take different approaches to track a market index: some invest in all of the securities included in a market index, while others invest in only a sample of the securities included in a market index.

Market indexes often use a company's market capitalization to decide how much weight that security will have in the index. Market capitalization (or "market cap") is a measure of the total value of the company's shares. The total value is equal to the share

Options

An option is a contract to buy or sell a stock at a set price, by a set date. Options offer flexibility, as the contract doesn't actually obligate you to buy or

sell the stock. As the name implies, doing so is an option. Most options contracts are for 100 shares of a stock.

When you buy an option, you're buying the contract, not the stock itself. You can then either buy or sell the stock at the agreed-upon price within the agreed-upon time; sell the options contract to another investor; or let the contract expire.

Optons can be quite complex, but at a basic level, you are locking in the price of a stock you expect to increase in value. If you're right, you benefit by purchasing the stock for less than the going rate. If you're wrong, you can forgo the purchase and you're only out the cost of the contract itself.

Annuities

An annuity is a contract between you and an insurance company in which you make a lump sum payment or series of payments and, in return, obtain regular disbursements beginning either immediately or at some point in the future.

The goal of annuity is to provide a steady stream of income during retirement. Many aspects of an annuity can be tailored to the specific needs of the recipient. In addition to choosing between a lump sum payment a series of payments to the insurer, you can choose when you want to annuitize your contributions - that is, start receiving payments. The duration of the disbursements can vary.

Annuities come in three main varieties - fixed, variable and indexed. Fixed annuities pay out a guaranteed amount based on the balance of your account. The downside of this is a return generally slightly higher than a CD.

You have the opportunity for a higher return, accompanied by greater risk, with a variable annuity. In this case, you pick from a menu of mutual funds Here, your payments in retirement are based on the performance of investments in your sub-account. But variable annuities tend to come with higher fees.

Indexed annuities are somewhere in between when it comes to risk and potential reward. You receive a guaranteed minimum payout, although a

portion of your disbursements is tied to the performance of a market index such as the S&P 500.

An annuity is a contract between you and an insurance company that requires the insurer to make payments to you, either immediately or in the future. You buy an annuity by making either a single payment or a series of payments. Similarly, your payout may come either as one lump-sum payment or as a series of payments over time.

People typically buy annuities to help manage their income in retirement. **Annuities provide three things:**

- Periodic payments for a specific amount of time. This may be for the rest of your life, or the life of your spouse or another person.
- Death benefits. If you die before you start receiving payments, the person you name as your beneficiary receives a specific payment.
- Tax-deferred growth. You pay no taxes on the income and investment gains from your annuity until you withdraw the money.

There are three basic types of annuities, fixed, variable and indexed. Here is how they work:

- Fixed annuity. The insurance company promises you a minimum rate of interest and a fixed amount of periodic payments. Fixed annuities are regulated by state insurance commissioners.
- Variable annuity. The insurance company allows you to direct your annuity payments to different investment options, usually mutual funds. Your payout will vary depending on how much you put in, the rate of return on your investments, and expenses.
- Indexed annuity. This annuity combines features of securities and insurance products. The insurance company credits you with a return that is based on a stock market index, such as the Standard & Poor's 500 Index.

Some people look to annuities to "insure" their retirement and to receive periodic payments once they no longer receive a salary. **There are two phases to annuities, the accumulation phase and the payout phase.**

- During the accumulation phase, you make payments that may be split among various investment options. In addition, variable annuities often allow you to put some of your money in an account that pays a fixed rate of interest.

- During the payout phase, you get your payments back, along with any investment income and gains. You may take the payout in one lump-sum payment, or you may choose to receive a regular stream of payments, generally monthly.

A variable annuity is a contract between you and an insurance company. It serves as an investment account that may grow on a tax-deferred basis and includes certain insurance features, such as the ability to turn your account into a stream of periodic payments. You purchase a variable annuity contract by making either a single purchase payment or a series of purchase payments.

A variable annuity offers a range of investment options. The value of your contract will vary depending on the performance of the investment options you choose. The investment options for a variable annuity are typically mutual funds that invest in stocks, bonds, money market instruments, or some combination of the three.

Each variable annuity is unique. Most include features that make them different from other insurance products and investment options. *Keep in mind that you will pay extra for the features offered by variable annuities.*
First, variable annuities have insurance features. For instance, if you die before the insurance company starts making income payments to you, many contracts guarantee that your beneficiary will receive at least a specified amount. This is typically at least the amount of your purchase payments. It may also offer additional insurance features such as promising you a certain account value or the ability to make withdrawals up to a certain amount each year for the rest of your life.
Second, variable annuities are tax-deferred. That means you pay no federal taxes on the income and investment gains from your annuity until you make a withdrawal, receive income payments, or a death benefit is paid. You may also transfer your money from one investment option to another within a variable annuity without paying federal tax at the time of the transfer. When you withdraw your money, however, you will pay tax on the gains at ordinary federal income tax rates rather than lower capital gains rates. Under certain circumstances, the death benefit may not be subject to federal estate tax. In general, the benefits of tax deferral may outweigh the costs of a variable annuity only if you hold it as a long-term investment.
Third, variable annuities let you receive periodic income payments for a specified period or the rest of your life (or the life of your spouse). This process of turning your investment into a stream of periodic income payments is known as

annuitization. This feature offers protection against the possibility that you will outlive your assets.

CERTIFICATES OF DEPOSIT (CDS)

A certificate of deposit (CD) is a savings account that holds a fixed amount of money for a fixed period of time, such as six months, one year, or five years, and in exchange, the issuing bank pays interest. When you cash in or redeem your CD, you receive the money you originally invested plus any interest. Certificates of deposit are considered to be one of the safest savings options. A CD bought through a federally insured bank is insured up to $250,000. The $250,000 insurance covers all accounts in your name at the same bank, not each CD or account you have at the bank.

As with all investments, there are benefits and risks associated with CDs. The disclosure statement should outline the interest rate on the CD and say if the rate is fixed or variable. It also should state when the bank pays interest on the CD, for example, monthly or semi-annually, and whether the interest payment will be made by check or by an electronic transfer of funds. The maturity date should be clearly stated, as should any penalties for the "early withdrawal" of the money in the CD. The risk with CDs is the risk that inflation will grow faster than your money, and lower your real returns over time.

Alternative investments

Beyond stocks, bonds, mutual funds and ETFs, there are many other ways to invest.

Real estate investments can be made by buying a commercial or residential property directly. Real estate investment trusts (REITs) pool investor's money and purchase properties. REITS are traded like stocks. There are mutual funds and ETFs that invest in REITs as well.

Hedge funds and private equity also fall into the category of alternative investments, although they are only open to those who meet the income and net worth requirements of being an accredited investor. Hedge funds may invest almost anywhere and may hold up better than conventional investment vehicles in turbulent markets.

Private equity allows companies to raise capital without going public. There are also private real estate funds that offer shares to investors in a pool of properties. Often alternatives have restrictions in terms of how often investors can have access to their money.

TIPS are treasury-inflation protected securities. These are bonds backed by the US Treasury, specifically designed to protect against inflation. When your TIPS investment matures over time, you'll get your principal and interest back, both indexed for inflation.

How to know what is best for you?

Goals

What are your objectives for the money that you will be investing? Is safety of principal with some level of return sufficient? Are you trying to accumulate money for a longer-term goal such as a college education for your kids or perhaps a comfortable retirement for yourself?

You might even have different investments for different goals. The point is that before you decide to invest any money it is important to understand why you are investing and the end result that you are seeking.

Goals and objectives should not be created in a vacuum. You also need to know your risk tolerance and time horizon as part of the goal-setting process.

Risk tolerance

Risk can mean a lot of things, but in the context of investing it means the risk of losing money. In other words, the risk that the amount of money invested will decrease in value.

All investing involves risk in one way or another. Stocks can and often do go down in value over certain periods of time—in 2008, the S&P 500 dropped by 37%. While this decline in the stock market was one of the worst in history, less severe market corrections are not uncommon.

How much of a drop in value for your investments can you stomach? Your risk tolerance will likely be in part a function of when you need the money—known as your time horizon—which is usually a function of age. Someone in their 20s or 30s who is saving for retirement shouldn't give too much thought to fluctuations in the value—known as the volatility—of their investments.

In contrast, someone in their 60s likely will and should have a lower risk tolerance if for no other reason than they don't have the time to fully recoup a major loss in the value of their investments.

Your investments should be aligned with the time horizon in which you will need the money, especially if some or all of your investments are targeted for a specific goal.

For example, if you are young parents investing for your newborn's college education, your long time horizon allows you to take a bit more risk in the initial years. When your kid gets to high school, you might adjust the investment mix to help ensure that you don't suffer any major losses in the years leading up to the start of college.

Knowledge and comfort

Some investment vehicles require sophisticated knowledge and monitoring, while others are more set-and-forget. Your investment decisions should be based on your comfort level and your willingness to devote time to researching your choices.

An easy route is to choose a variety of low-cost index funds that cover various parts of the markets such as bonds, domestic stocks and foreign stocks. Another alternative to consider are professionally managed vehicles such as target date mutual funds, where the manager allocates portfolio over time. These funds are designed to gradually reduce their exposure to equities as the target date of the fund gets closer

Investors with more knowledge and experience might consider actively managed mutual funds, individual stocks, real estate or other alternative investments.

Understand what you don't know

It is important that investors understand what they do and don't know. They should never be talked into investing in something that they don't understand or are uncomfortable with.

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