Saving and Investing

There are two main reasons people invest their money –to offset the effects of inflation and to build wealth over time.

Here's a secret about money that too few of us fully understand – it always loses value. In fact, just over your lifetime, a dollar has probably lost between 50% and 90% of its value. So if you received a $100 bill when you were born and never spent it, that $100 would now buy just a fraction of what it once did. If you held on to the $100 bill for another 40 or 50 years, it might just buy lunch for four at McDonalds – if you're lucky.

Money buys less now than it did last year because of inflation, which is the general level of price increase of goods and services in an economy over a period of time. Every year, things cost just a little bit more – averaging around 3% per year over the past 10 years. In other words, a dollar buys about 30% less today than it did just 10 years ago. You can imagine the difficulty of saving for a distant goal – like retirement – when the dollars you save are worth less and less.

To keep up with inflation and to build wealth over time, people turn to investing. Investing involves the purchase of an asset that ideally, but not always, increases in value over time. Examples of investments are stocks, bonds, certificates of deposit and money market funds. Investments can also include gold and other precious metals, real estate, or collectables such as art or antiques.

Investing also allows you to earn money without "working" for it. Stock dividends, interest payments, and other gains all happen without your day-to-day involvement. And the magic of compounding means that not only does your investment earn money, but the earnings from your investments earn even more.

Risk and Reward

The potential to make money from an investment is usually tied to the amount of risk involved. For example, certificates of deposit are low risk - they tend to offer a very low rate of return relative to inflation, but the return is guaranteed. On the other hand, a share of stock in a company has greater risk - it could increase in value by thousands of times over a decade or the company could go bankrupt and the stock may become worthless. The willingness of someone to take risks with investments is known as *risk tolerance*.

Most people invest to build wealth over many years. Younger people have longer to save before retirement, so their risk tolerance tends to be higher than those approaching retirement. So it may make sense for a

young person to have an investment portfolio of 100% stocks, maximizing both risk and potential reward.

On the other hand, those nearing retirement would want to preserve savings above all since they will not have the opportunity to replace any losses by earning more money. As the result, those investors may invest in a portfolio consisting mainly of cash investments and bonds.

Saving Versus Investing

The main different between "saving" and "investing" is the amount of risk and time involved. If you are saving money for a goal that's just 3 or 4 years away (like a down payment for a home), cash and cash investments like bank CDs make the most sense – you won't make a lot, but you won't risk any money that you will need soon.

Professional Advice

Investing can be a complicated topic, and many people make money by offering investment advice and services. When considering your investment decisions, keep one thing in mind – almost no one, not even the most highly paid investment manager, can consistently beat the overall market (that is, do better than the total yearly return of *all* stocks averaged together). In fact, in any given year, only about 15% of professionally managed stock funds manage to beat the market.

When evaluating investments, you will want to remember that that past performance does *not* equal future results. One mutual fund may have a great year, but that does not mean the next year will also be great.

Investing is a valuable tool for reaching your financial goals, but unless you choose in low-return cash investments, there is no such thing as a "sure thing" when it comes to investing.