UNIT SIX

Investing Essentials (Part A)

LEARNING OBJECTIVES

At the end of this Unit, students will be able to:

- *Clarify the difference between Saving versus Investing.*
- *Explain the concepts of 'interest' and 'compounding interest'.*
- *Explain growth through investing and the risks involved.*

BIG IDEA – Investing in securities is one means whereby individuals can make their money grow. Risk is always involved when investing in securities. There are no guarantees when investing in the securities market.

INTRODUCTION

This Unit reviews the core concepts from Unit three, Saving and Investing. It positions the concepts within the context of a process towards investing in the securities market.

Class Discussion

Ask students what is the difference between saving and investing. Write the answers on the board.

Indicate to students that they are both different concepts and should not be used interchangeably.

Saving is the act of putting aside money you earn, or receive as gifts, for another day usually in the short term.
Investing is the act of choosing products and strategies to make that money (savings) grow in the long term.

Indicate to students that people save and invest so that they can have enough money at some point in the future, to pay for the things they want or need.

Although the term ***"saving"*** is used generically to mean putting money aside for the future — as in the expressions ***"retirement savings"*** or ***"saving for a rainy day"*** — a particular characteristic of saving is that it's especially appropriate for short-term goals, those that you hope to accomplish in a year or two. In this case, you don't want to risk losing what you have accumulated.

In contrast, investing is usually more appropriate for mid-term and long-term goals, which are usually costlier. You invest in order to:

- **INCREASE YOUR NET WORTH** *(the amount of money you're worth – accumulation of your money and assets, for example: land, property, vehicles, etc.)*

- **GENERATE EXTRA INCOME**

- **MEET LONG-TERM GOALS**

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If you have specific financial goals that will cost money — such as purchasing a car, a home, paying for tertiary education or building a secure retirement — saving and investing can be the keys to achieving those goals.

Two of the key ways in which investments differ from savings accounts are:

- Investments have an element of risk and therefore can lose value. Additionally while bank deposits, up to $125,000 are covered by the Deposit Insurance Corporation, investments are not.
- Investment earnings are not guaranteed. If you choose your investments carefully and if the financial markets perform in your favour, your return — or what you get back on the amount you invest — can be higher than if you put your money in a simple savings account or lower risk investment opportunity.

When you invest, you buy something that you expect will grow in value and provide a profit, either in the short term or over an extended period.

Share this diagram with students.

SAVING AND INVESTING HAVE DIFFERENT CHARACTERISTICS

CHARACTERISTICS	SAVINGS	INVESTING
TIMEFRAME	Short-term goals 3 years or less	Long-term goals
ACCESSIBILITY	Easily accessible	Can be sold but may result in loss
RISK	Safe	Involves risk. Many lose principle if the investment must be sold at a lower price than it was purchased
RETURN	Low	Potentially high

**Adjustment to be made to the (3rd block under 'Investing') - Involves Risk. An individual may make a loss on their investment if the principal investment is sold at a lower price than it was purchased.*

Refer students to Activity 6.1A in the Workbook.

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Saving for the future

There are various ways to save. Ask students how many of them save – show by hands. Where do they save their money?

Indicate to students that one way is to open one or more deposit accounts, such as a chequing or savings account, in a bank or credit union — a financial institution. Deposit accounts give you ready access to your money, and your account balances are typically insured by the Deposit Insurance Company (DIC) up to $125,000, should a financial institution fail.

NOTE - *The DIC does not insure credit unions, and while bank deposits, up to $125,000 are covered by the Deposit Insurance Corporation, securities investments are not.*

The Deposit Insurance Corporation (DIC) was established by the Central Bank and Financial Institutions (Non-Banking) (Amendment) Act, 1986. The DIC plays a critical role in contributing to the continued stability of Trinidad and Tobago's financial system as a whole. Its main function is to manage a Fund to provide insurance protection for depositors against the potential loss of their deposits should a member financial institution fail. A list of financial institutions insured by the DIC can be found in the following link http://dictt.org/deposit-insurance/insured-financial-institutions/.

Indicate to students that saving and investing can be the keys to achieving specific financial goals - that will cost money — such as purchasing a car or a home, paying for tertiary education or building a secure retirement. Once you get into the savings habit and you've got a pool of money set aside, you need to put your money to work for you, to grow your savings. That is what we call investing.

Seeking growth through investing

If you are willing to take a certain amount of risk with the money you have saved, you can use it to make investments that you expect to be worth more in the future. Indicate to students that when you invest, there is an element of risk. Investments are volatile – the value of the investment rises and falls over time.

There are three major types of investments:

- *Investment in securities - Shares in a company (stocks, mutual funds that invest in stocks, etc.)*
- *Property (real estate, art, precious metals, etc.)*
- *Direct investment in a business*

Investment in Securities

There are three main types of securities products which are regulated by the Trinidad and Tobago Securities Exchange Commission and offered to the investing public in Trinidad and Tobago. These include:

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1) **Stocks**, or **equities**, which give you part ownership or shares in a corporation or company.

2) **Bonds**, which when purchased, are a loan to a specific entity, which promise (but usually don't explicitly guarantee) repayment of the money you invest plus interest for the use of that money. The 'issuer' or the entity selling the bond agrees to pay the buyer of the bond a specified rate of interest for a pre-determined length of time. The issuer will repay the face value of the bond (the principal) when it ***"matures,"*** or comes due.

3) **Mutual funds**, which are pooled investment vehicles that invest in stocks, bonds or other financial instruments.

These investment products are known as securities instruments. These terms and concepts will be further explained in the following Unit.

NOTE - *That over a long period (five or more years) investments tend to grow faster than savings. You should never invest until after you have adequate savings (at least three to six months of income to cover your living expenses).*

There are many products and services of value that one might choose to buy because one expects them to provide a profit, but the term ***"investment"*** can describe products that are traded in an organised and regulated marketplace. By investing, there is the risk that the investments chosen may not live up to desired expectations, or that volatility in the marketplace may depress investment prices. Of note, higher expected returns are accompanied by risk. There is also the possibility of loss if one decides to sell an investment for less than the price at which it was purchased. In a worst-case scenario, an investment can also lose all of its value. One can limit his/her risk, however, by choosing a well-diversified mix of investments.

Return on investment

Investment return is what you get back (the profit) on an investment you made.
Ideally, the return will be positive, your initial investment or principal will remain intact, and you will end up with more than you invested. But because investing typically involves risk, your returns can be negative, and you can wind up with less money than you initially invested.

For example, let's say you buy a stock for $30 a share and sell it for $35 a share. Your return is $5 a share minus any commission or other fees you paid when you bought and sold the stock. If the stock had paid a dividend of $1 per share while you owned it, your total return would be a gain of $6 a share before expenses.

However, if you bought the stock at $35 and sold it at $30, you would have lost $5 on your investment, not counting expenses. If you earned a dividend of $1 per share, your actual loss would be reduced to $4 a share.

Total return = gain or loss in value + investment earnings (dividend)

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Time and your portfolio

Time helps you to withstand the risks that accompany higher expected returns from investing in stocks, bonds or mutual funds. Most importantly, time allows you to recover from the potential short term losses.

Time can be important in several ways. Time can:

- Give you the freedom to take risks.
- Let your investments compound, or grow in value.
- Make it possible to plan for long-term investment goals, which are often the biggest and most challenging to meet.

Compounding

Compounding is what happens when your investment earnings or income are reinvested and added to your principal, forming a larger base on which earnings can accumulate.

The larger your investment base, or principal, grows, the greater the earnings your investment can potentially generate. So the longer you have to invest, the more you can potentially benefit from compounding.

Example. Your parents give you a cheque for $1000. You forget it or do nothing with it for a year. At the end of the year the cash value is still $1000.

If you deposit it, in an account paying 5% interest, at the end of the year you should have – $1,050. If you left the money at a fixed rate of 5 %, for 5 years, you would have $1,276.28 at the end of five years. You would have earned - $276.28 - Which is your compounded interest.

YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5
$1,050 (1000 x 5%)	$1,102.50 (1050 x 5%)	$1,157.63 $1102.50 x 5%	$1,157.63 $1,157.63 x 5%	$1,276.28

Reflection and Summary

Have students individually or in groups:

Write the three most important things they learned about Investing.

Review the objectives with the class.

Points should include:

- Differentiating between Saving versus Investing; 'interest' and 'compounding interest'
- Understanding growth through investing and the risks involved
- The securities industry as part of the financial landscape in T&T
- Types of investment instruments
- Key players in the Securities Industry