CHAPTER 6

Saving and Investing

Why It's Important

Why should you save? What is the difference between saving and investing? This chapter will explain reasons for saving, as well as the various institutions and investments in which to put your money.

To learn more about investment strategies, view the **Economics & You** *Chapter 13 video lesson:* **Saving and Investing**

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ECONOMICS Online

Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 6—Chapter Overviews*** to preview chapter information.

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SECTION 1 Why Save?

Cover Story

The Columbus Dispatch, May 29, 1999

Money is burning a hole in consumers' pockets. Again last month, U.S. wage earners spent nearly as much as they made, contributing to record low savings.

But consumers have good reason to be out there spending. They've got jobs, their incomes are rising, confidence is high, and the stock market is booming.

This trend dragged down the savings rate—savings as a percentage of after-tax income—to a record low.

Reader's Guide

Terms to Know

- saving
- interest
- passbook savings account
- statement savings account
- money market deposit account
- time deposits
- maturity
- certificates of deposit

Reading Objectives

1. When should you save?
2. How do passbook, statement, and money market accounts differ?
3. What are the advantages of time deposits?

Economists define ***saving*** as the setting aside of income for a period of time so that it can be used later. You may already be saving some of your income for a future use, such as buying a DVD system or continuing your education. See **Figure 6.1** on page 142. As you read this section, you'll learn why saving is important to you and the economy as a whole.

saving: *setting aside income for a period of time so that it can be used later*

Deciding to Save

Any saving that you do now may be only for purchases that require more funds than you usually have at one time. When you are self-supporting and have more responsibilities, you will probably save for other reasons, such as having funds in case of emergencies and for your retirement.

Results of Saving When an individual saves, the economy as a whole benefits. Saving provides money for others to invest or spend. Saving also allows businesses to expand, which provides increased income for consumers and raises the standard of living.

FIGURE 6.1

Saving Goals Your saving goals will change as you move through life. Today you may be saving for a stereo, whereas in the future you may save for a college education. ***How does saving affect your future spending habits?***

interest: *payment people receive when they lend money or allow someone else to use their money*

Where to Save

Generally, when people think of saving, they think of putting their funds in a savings bank or a similar financial institution where it will earn interest. **Interest** is the payment people receive when they lend money, or allow someone else to use their money. A person receives interest on his or her savings plan for as long as funds are in the account.

You actually have many options regarding places in which to put your savings. As you learned in Chapter 4, the most common places are commercial banks, savings and loan associations, savings banks, and credit unions. Investigate the financial institutions in your area and the services they offer.

In comparison shopping for the best savings plan, you need to consider the trade-offs. Some savings plans allow immediate access to your money but pay a low rate of interest. Others pay higher interest and allow immediate use of your money, but require a large minimum balance.

Savings Accounts

passbook savings account: *account for which a depositor receives a booklet in which deposits, withdrawals, and interest are recorded*

statement savings account: *account similar to a passbook savings account except that the depositor receives a monthly statement showing all transactions*

Passbook savings accounts are also called regular savings accounts. With a **passbook savings account,** the depositor receives a booklet in which deposits, withdrawals, and interest are recorded. A customer must present the passbook each time one of these *transactions,* or business operations, takes place.

A **statement savings account** is basically the same type of account. Instead of a passbook that must be presented for each transaction, however, the depositor receives a monthly statement showing all transactions. The chief appeal of these accounts is that they offer easy availability of funds. The depositor can usually withdraw funds at any time without paying a *penalty*—forfeiting any money—but there is a trade-off. The interest paid on passbook and statement accounts is low compared to the interest on other savings plans.

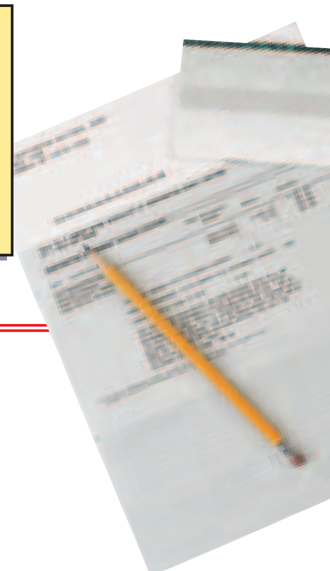
A **money market deposit account** (MMDA) is another type of account that pays relatively high rates of interest and allows immediate access to money through checks. The trade-off is that these accounts have a $1,000 to $2,500 minimum balance requirement. Customers can usually make withdrawals from a money market account in person at any time, but they are allowed to write only a few checks a month against the account.

Global Economy

Comparing Saving Rates

The percent of income that Americans save fell steadily in the 1990s. Today, the saving rate—the percentage of disposable personal income saved—stands well below 4 percent. How does this compare to the saving rates of other countries? Below are some recent statistics on saving rates for several industrialized nations. ■

Canada	4.6%
France	12.5%
Germany	12.4%
Great Britain	11.6%
Italy	13.4%
Japan	13.2%



Time Deposits

The term ***time deposits*** refers to a wide variety of savings plans that require a saver to deposit his or her funds for a certain period of time. The period of time is called the **maturity,** and may vary from seven days to eight years or more. Time deposits are often called **certificates of deposit** (CDs), or savings certificates. CDs state the amount of the deposit, the maturity, and the rate of interest being paid.

Time deposits offer higher interest rates than passbook or statement savings accounts. The longer the maturity, the higher the interest rate that is paid. For example, a CD with a short-term maturity of 90 days pays less interest than a CD with a two-year maturity. Savers who cash a time deposit before maturity pay a penalty.

Insuring Deposits When the stock market collapsed in 1929, the resulting crisis wiped out people's entire savings. Congress passed, and President Franklin Roosevelt signed, legislation to protect deposits. This legislation created the Federal Deposit Insurance Corporation (FDIC).

Today there are several federal agencies that insure most banks and savings institutions. See **Figure 6.2** on page 144. Each depositor's money in a particular savings institution is insured up to $100,000. If an insured institution fails, each depositor will be paid the full amount of his or her savings up to $100,000 for each legally separate account.

money market deposit account: *account that pays relatively high rates of interest, requires a minimum balance, and allows immediate access to money*

time deposits: *savings plans that require savers to leave their money on deposit for certain periods of time*

maturity: *period of time at the end of which time deposits will pay a stated rate of interest*

certificates of deposit: *time deposits that state the amount of the deposit, maturity, and rate of interest being paid*

FIGURE 6.2 Savings Institutions' Services and Insurers

Institution	Savings Services Offered	Insured by	Number of Institutions*
Commercial banks	Passbook and statement savings accounts, certificates of deposit, money market accounts	Federal Deposit Insurance Corporation (FDIC)	8,080
Savings and loan associations (S&Ls)/savings banks	Passbook and statement savings accounts, certificates of deposit, money market accounts	S&Ls: Savings Association Insurance Fund (SAIF)/FDIC	1,533
Credit unions	Share drafts**, share accounts, share certificates	National Credit Union Share Insurance Fund	9,984

*Number of savings institutions changes often
**Interest-earning account similar to checking account

Practice and **assess** key skills with *Skillbuilder Interactive Workbook, Level 2.*

SECTION 1 Assessment

Understanding Key Terms

1. **Define** saving, interest, passbook savings account, statement savings account, money market deposit account, time deposits, maturity, certificates of deposit.

Reviewing Objectives

2. What are three reasons that people save?
3. **Graphic Organizer** Use a chart like the one below to explain the differences among passbook, statement, and money market savings accounts.

Type of account	Similarities	Differences

4. What are the advantages of time deposits?

Applying Economic Concepts

5. **Saving** Why is it more difficult for the beginning saver to open a money market deposit account than a passbook savings account?

Critical Thinking Activity

6. **Synthesizing Information** If your bank pays 5.5 percent interest on savings deposits, what is the simple interest paid in the third year on an initial $100 deposit? What is the total amount in the account after three years? What is the amount after three years if the interest was compounded annually? *For help in understanding interest rates, see page xxii in the Economic Handbook.*

Technology Skills

Using a Spreadsheet

People use electronic spreadsheets to manage numbers quickly and easily. Formulas may be used to add, subtract, multiply, and divide the numbers in the spreadsheet. If you make a change to one number, the totals are recalculated automatically for you.

- Vertical columns are assigned letters—A, B, C, AA, BB, CC, and so on.
- Horizontal rows are assigned numbers—1, 2, 3, and so on.
- The point where a column and row intersect is called a cell—C6, for example.
- The computer highlights the cell you are in. The contents of the cell also appear on a status line at the top of the screen.
- Spreadsheets use standard formulas to calculate numbers. To create a formula, highlight the cell you want the results in. Type an equal sign (=) and then build the formula, step by step. If you type the formula =B4+B5+B6 in cell B7, the values in these cells are added together and the sum shows up in cell B7.
- To use division, the formula would look like this: =A5/C2. This divides A5 by C2. An asterisk (*) signifies multiplication: =(B2*C3)+D1 means you want to multiply B2 times C3, then add D1.

Learning the Skill

All spreadsheets follow a basic design of rows and columns. To understand how to use a spreadsheet, follow the steps on the left.

Practicing the Skill

Study the spreadsheet on this page.

1. Which cell is highlighted? What information is found in the cell?
2. What formula would you type in which cell to calculate the average life expectancy of both males and females in Sri Lanka?
3. What formula would you type in which cell to find the GNP per capita of the South Asian countries listed?

Workbook1

	A	B	C	D	E
1	Nation	GNP Per	Population	Life	Life
2		Capita	mid-1998	Expectancy	Expectancy
3		(U.S. $)	(millions)	Male	Female
4	Bangladesh	260	123.4	59	58
5	Bhutan	390	0.8	NA	NA
6	India	380	988.7	59	59
7	Nepal	210	23.7	55	54
8	Pakistan	480	141.9	58	59
9	Sri Lanka	740	18.9	70	74
10	U.S.	28,020	270.2	73	79
11					

Application Activity

Use a spreadsheet to enter your test scores and your homework grades. At the end of the grading period, input the correct formula and the spreadsheet will calculate your average grade.

SECTION 2

Investing: Taking Risks With Your Savings

Reader's Guide

Terms to Know

- stockholders
- capital gain
- capital loss
- tax-exempt bonds
- savings bonds
- Treasury bills
- Treasury notes
- Treasury bonds
- broker
- over-the-counter market
- mutual fund
- money market fund

Reading Objectives

1. How do stocks and bonds differ?
2. What investment funds are available in stock and bond markets?

Cover Story

The Economist, January 30, 1999

"Some day we'll all invest this way," runs the slogan, while the screen shows a relaxed man on a yacht tickling his laptop computer. Hardly the traditional picture of how shares are bought and sold: on a crowded floor, full of jostling, shouting traders in lurid polyester jackets. But the soaring share prices of electronic brokers suggest that investors, at least, believe online trading is the way of the future.

People have savings plans because they want a safe rate of interest. If people are willing to take a chance on earning a higher rate of return, however, they can invest their savings in others ways, such as in stocks and bonds. Stocks and bonds offer investors greater returns, but with more risk. As you read this section, you'll learn what stocks and bonds are, and why they carry a risk.

Stocks and Bonds

Corporations are formed by selling shares of stock (also called securities). By issuing stock for sale, a company obtains funds for use in expanding its business and, it hopes, in making a large profit. Shares of stock entitle the buyer to a certain part of the future profits

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and assets of the corporation selling the stock. The person buying stock, therefore, becomes a part owner of the corporation. As proof of ownership, the corporation issues stock certificates. See **Figure 6.3.**

Stock Returns **Stockholders,** or owners of stock, make money from stock in two ways. One is through *dividends,* the money return a stockholder receives on the amount he or she originally invested in the company. The corporation may declare a dividend at one or more times during a year. Dividends typically are paid only when the company makes a profit.

stockholders: *people who have invested in a corporation and own some of its stock*

The other way people make money on stock is by selling it for more than they paid for it. Some people buy stock just to *speculate,* hoping that the price will increase greatly so they can sell it at a profit. They do not buy it for the dividends.

Capital Gains and Losses Suppose a person buys stock at \$20 a share and sells it for \$30. The profit of \$10 per share is called a **capital gain.** The person has had an increase in his or her capital, or wealth, of \$10 a share. Of course, the value of stock may also fall. If a person decides to sell stock at a lower price than he or she paid for it, that person suffers a **capital loss.** Money may be made or lost on bonds in much the same way.

capital gain: *increase in value of an asset from the time it was bought to the time it was sold*

capital loss: *decrease in value of an asset or bond from the time it was bought to the time it was sold*

Bonds Instead of buying stock, people with money to invest can buy bonds. A *bond* is a certificate issued by a company or the government in exchange for borrowed money. It promises to pay a stated rate of interest over a stated period of time, and then to repay the borrowed amount in full at the end of that time. A bondholder lends money for a period of time to a company or government and is paid interest on that money. At the end of the period, the full amount of borrowed money is repaid. The period of time is called the bond's maturity.

Unlike buying stock, buying a bond does not make a bondholder part owner of the company or government that issued the bond. The bond becomes part of the debt of the corporation or

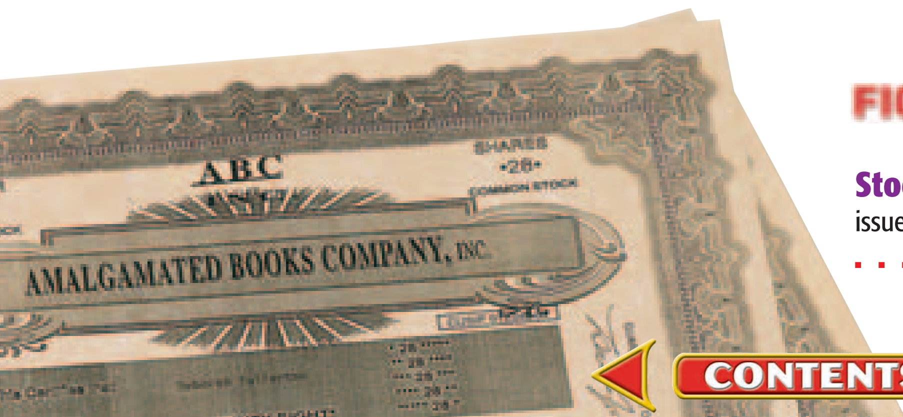

FIGURE 6.3

Stock Certificates Stock certificates like these are issued to people who have invested in a corporation.

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government, and the bondholder becomes a creditor. **Figure 6.4** lists these and some other differences between stocks and bonds.

tax-exempt bonds: *bonds sold by local and state governments; interest paid on the bond is not taxed by the federal government*

Tax-Exempt Bonds Local and state governments also sell **tax-exempt bonds.** The interest on these types of bonds, unlike bonds issued by companies, is not taxed by the federal government. Interest that you earn on bonds your own city or state issues is also exempt from city and state income taxes. Tax-exempt bonds are good investments for wealthier people who would otherwise pay high taxes on interest earned from investments.

FIGURE 6.4 Differences Between Stocks and Bonds

Stocks	Bonds
1. All corporations issue or offer to sell stock. That act is what makes them corporations.	**1.** Corporations are not required to issue bonds.
2. Stocks represent ownership.	**2.** Bonds represent debt.
3. Stocks do not have a fixed dividend rate (except preferred stocks).	**3.** Bonds pay a fixed rate of interest.
4. Dividends on stock are paid only if the corporation makes a profit.	**4.** Interest on bonds normally must always be paid, whether or not the corporation earns a profit.
5. Stocks do not have a maturity date. The corporation issuing the stock does not repay the stockholder.	**5.** Bonds have a maturity date. The bondholder is to be repaid the value of the bond, although if the corporation goes out of business, it does not normally repay the bondholders in full.
6. Stockholders (except those with preferred stock) can elect a board of directors who control the corporation.	**6.** Bondholders usually have no voice in or control over how the corporation is run.
7. Stockholders have a claim against the property and income of a corporation only after the claims of all creditors (including bondholders and holders of preferred stock) have been met.	**7.** Bondholders have a claim against the property and income of a corporation that must be met before the claims of any stockholders, including those holding preferred stock.

Savings Bonds The United States government issues **savings bonds** as one of its ways of borrowing money. They range in face value from $50 up to $10,000. The purchase of a U.S. savings bond is similar to buying a bank's certificate of deposit. A very safe form of investment, savings bonds are attractive to people with limited money to invest. Another attraction is that the interest earned is not taxed until the bond is turned in for cash.

A person buying a savings bond pays half the bond's face value. You could purchase a $50 bond, then, for only $25. The bond increases in value every 6 months until its full face value is reached. (The *Rule of 72* tells you how long it takes for the bond to mature: Divide the number 72 by the interest rate.) If you choose to redeem a U.S. savings bond before it matures, you are guaranteed a certain rate of interest, which changes depending on rates of interest in the economy.

savings bonds: *bonds issued by the federal government as a way of borrowing money; they are purchased at half the face value and increase every 6 months until full face value is reached*

T-Bills, T-Notes, and T-Bonds The Treasury Department of the federal government also sells several types of larger investments. **Treasury bills** mature in 3 months to 1 year. The minimum amount of investment for Treasury bills is $1,000. **Treasury notes** have maturity dates of 1 to 10 years, and **Treasury bonds** mature in 10 or more years. Notes and bonds are sold in minimums of $1,000. The interest on all three of these government securities is exempt from state and local income taxes, but not from federal income tax.

Treasury bills: *certificates issued by the U.S. Treasury in exchange for a minimum amount of $1,000 and maturing in 3 months to 1 year*

Treasury notes: *certificates issued by the U.S. Treasury in exchange for minimum amounts of $1,000 and maturing in 1 to 10 years*

Treasury bonds: *certificates issued by the U.S. Treasury in exchange for minimum amounts of $1,000 and maturing in 10 or more years*

Stock and Bond Markets

Stocks are bought and sold through brokers or on the Internet. A **broker** is a person who acts as a go-between for buyers and sellers. If an investor is interested in buying or trading corporate shares, he or she can contact a brokerage firm, which will perform the service for a fee.

Thousands of full-service brokerage firms throughout the country buy and sell stocks daily for ordinary investors. The fees they charge to perform the trades—up to $500—depend on the dollar amounts invested or traded. Today, however, if an investor has an account with an Internet brokerage firm, the cost for the same trade may be as low as $7.

broker: *person who acts as a go-between for buyers and sellers of stocks and bonds*

Savings Bond

There are well over 100 online brokerage firms, with more springing up on the Web every day. It is estimated that 20 million American investors use the Internet to make trades every year.

Stock Exchanges Brokerage houses communicate with the busy floors of the stock exchanges. See **Figure 6.5.** The largest stock exchange, or stock market, is the New York Stock Exchange (NYSE) in New York City. There are also supplemental stock exchanges and regional exchanges—such as the Midwest Stock Exchange in Chicago—and exchanges in other countries—such as the London and Tokyo stock exchanges.

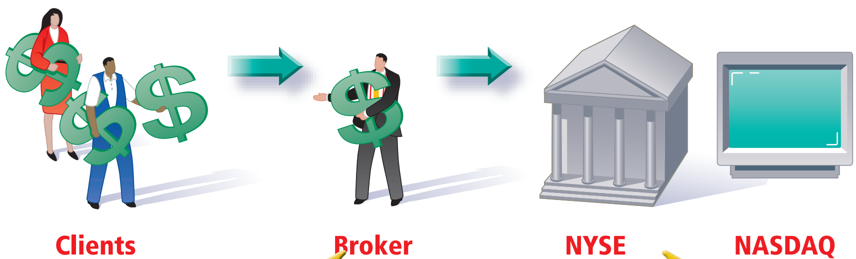
To be listed on these exchanges, a corporation offering stock must prove to the exchange that it is in good financial condition. Most of the companies traded on stock exchanges are among the largest, most profitable corporations in the country.

Over-the-Counter Markets Stocks can also be sold on the **over-the-counter market,** an electronic marketplace for stocks not listed on the organized exchanges. The largest volume of over-the-counter stocks are quoted on the National Association of Securities Dealers Automated Quotations (NASDAQ) national market system, which merged with the American Stock Exchange in 1998.

over-the-counter market: *electronic purchase and sale of stocks and bonds, often of smaller companies, which takes place outside the organized stock exchanges*

FIGURE 6.5

Buying Stocks or Bonds If you decide to buy stocks or bonds, you may wish to contact a broker (by phone or through the Internet). You pay the broker a fee to purchase the stock at one of the stock exchanges. The stock exchanges act as a market between buyers and sellers of securities, or stocks.



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Unlike organized stock exchanges, over-the-counter stocks are not traded in any specific place. Brokerage firms hold shares of stocks that they buy and sell for investors. For example, assume that XYZ Corporation is a company that sells computers. If an investor wanted to buy stock in it, he or she would check the NASDAQ listings in the local newspaper or on the Internet. This table of over-the-counter stocks would list XYZ Corporation, the number of shares of stock sold the day before, and the price at which shares were bought and sold that day. The investor would then call a broker or use the Internet to buy a certain number of shares. Usually stocks are sold in amounts of 100 shares, but some brokers will handle smaller amounts.

Careers

Stockbroker

Job Description

- Relay investors' stock orders to the floor of a securities exchange
- Offer financial counseling and advice on the purchase or sale of particular securities

Qualifications

- College degree
- Pass a state licensing exam and the General Securities Registered Representative Exam

Median Salary: $56,080

Job Outlook: above average

—Occupational Outlook Handbook, 2002–03

Bond Markets The New York Exchange Bond Market and the American Exchange Bond Market are the two largest bond exchanges. Bonds, including U.S. government bonds, are sold over-the-counter and on the Internet.

Mutual Funds Many people invest in the stock market by placing some of their savings in a **mutual fund**, an investment company that pools the money of many individuals to buy stocks, bonds, or other investments. See **Figure 6.6.** Most mutual funds hold a variety of stocks or bonds. Losses in one area are likely to be made up by gains in another.

mutual fund: *investment company that pools the money of many individuals to buy stocks, bonds, or other investments*

One popular mutual fund invests in stocks used in an index. An *index* is a measuring system that tracks stock prices over the long run. The Dow Jones Industrial Average (DJIA) and Standard & Poor's (S&P) are the two most common indexes. The DJIA tracks

FIGURE 6.6

Mutual Funds The small investor should find out how the mutual fund he or she may choose has performed compared to index funds over a period of several years. ***Why are index funds watched so closely?***

Economic Connection to... History

The Dow-Jones and S&P

The Dow was created in 1896 by Charles Dow, cofounder of Dow Jones & Co. It soon became a permanent feature in the company's newspaper, *The Wall Street Journal,* which is one of the world's most influential business publications. The Dow index grew from its original 12 stocks to 30 by 1928.

It wasn't until 1926 that Standard & Poor's introduced a broader stock index, which tracked the nation's 90 biggest companies. The now-familiar S&P 500 stock index expanded in 1957 to include the 500 biggest companies.

Although it may seem odd that the Dow uses only 30 companies to measure a market with more than 10,000 stocks, those 30 companies have a combined market value of over $2.5 trillion. The S&P's 500 companies have a combined market value of $10.5 trillion—more than three-fourths of the nation's publicly owned stocks. ■

the stocks of 30 of the largest American companies to measure the well-being of the stock market as a whole; the S&P 500 index tracks 500 companies.

Most mutual funds use the S&P 500 as the yardstick against which they compare their returns on stocks. The long-run return from index funds is higher than can be expected from almost any other investment. By investing in a broad-based index fund, investors will almost surely do better over the long run than by investing in individual stocks or in a managed mutual fund. A *managed mutual fund* is one in which the managers adjust the mix of stocks and move often in and out of the market to try to generate the highest yield.

money market fund: *type of mutual fund that uses investors' money to make short-term loans to businesses and banks*

Money Market Funds

One type of mutual fund, called a **money market fund,** normally uses investors' money to buy the short-term debt of businesses and banks. Most money market funds allow investors to write checks against their money in the fund. Any check, however, must be above some minimum amount, usually $500. The investor then earns money only on the amount left in the account.

Banks, savings and loan associations, and savings banks now offer a similar service, called *money market deposit accounts* (MMDA). A major advantage of MMDAs is that the federal government insures them against loss. Mutual funds and money market funds are not insured by the federal government.

Government Regulations

The stock market is heavily regulated today, both at the state and federal levels. The Securities and Exchange Commission (SEC), created by the Securities Exchange Act of 1934, is responsible for administering all federal securities laws. It has regulatory authority over brokerage firms, stock exchanges, and most businesses that issue stock. It also investigates any dealings among corporations, such as mergers, that affect the value of stocks.

Congress passed the Securities Act in an attempt to avoid another stock market crash like that of 1929. The act requires that all essential information concerning the issuing of stocks or bonds be made available to investors. To accomplish this, a registration statement must be filed with the federal government. A briefer description, called a *prospectus,* must be given to each potential buyer of stocks or bonds. It lists the amount offered, the price, and the company's projected use for the money raised by the stocks or bonds. Mutual funds must also distribute a prospectus describing the fund and the way in which the money will be invested.

States also have securities laws. These are designed mostly to prevent schemes that would take advantage of small investors.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 2 Assessment

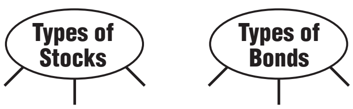
Understanding Key Terms

1. Define stockholders, capital gain, capital loss, tax-exempt bonds, savings bonds, Treasury bills, Treasury notes, Treasury bonds, broker, over-the-counter market, mutual fund, money market fund.

Reviewing Objectives

2. How do stocks and bonds differ?

3. Graphic Organizer Use a diagram like the one below to list at least three investment funds available in stock and bond markets.



Applying Economic Concepts

4. Financial Markets List five possible investments you could make if you had $10,000 in available funds. Rank them from highest return to lowest return.

Critical Thinking Activity

5. Synthesizing Information Analyze the stocks on the New York Stock Exchange and over-the-counter market by checking the NYSE and NASDAQ quotes listed in the newspaper. Find a stock from each listing that had a net change of more than 2 percent. What corporations were they? *For help in reading the financial page, see page xxiii in the Economic Handbook.*

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People & Perspectives

John W. Rogers, Jr.

ENTREPRENEUR (1958–)

- **Founder and president of Ariel Capital Management, Inc., a Chicago-based money management firm**
- **Manages over $10 billion in assets**
- **His mutual funds are ranked among the best investments by *Fortune Magazine***

John W. Rogers, Jr., is one of the country's best managers of stocks of small and medium-sized companies. Beginning in 1983 with money from associates and his parents, Rogers founded Ariel Capital Management, Inc.

Rogers explains what researchers look for in an ideal stock for the Ariel Fund, the first of their three mutual funds:

> *"Our ideal stock-investment characteristics are really four things. The most important is that the company is in the kind of industry where they have barriers to entry to stop the competition from coming in, and the kind of strong brand-name and customer awareness that brings back customers time and time again. . . .*
>
> *The second thing is the quality of the product and the quality of the management. . . .*
>
> *And the third thing is valuation, and how many other people understand the stock as well as we do. If a stock is cheap, we want to understand why its future is going to be better. . . .*
>
> *The final thing is size. We are always looking at smaller companies with new ideas, $1.5 billion or less."*

Ariel Capital Management, Inc., fund portfolios contain a wide array of companies—from drugstores to book publishers. Ariel has favored newspaper stocks. Rogers explains why:

> *"These are wonderful businesses to have, because they are basically little monopolies. . . . You have a lot of pricing power because you're the only game in town, both with how much it costs to buy the newspaper, and also what your advertisers have to pay to put their ads inside the newspaper."*

Checking for Understanding

1. What characteristics does Rogers look for in an ideal stock?
2. Why does Rogers favor newspaper stocks?

SECTION 3

Special Savings Plans and Goals

Cover Story

Kiplinger's Personal Finance Magazine, August 2000

With two medical degrees in the family— and lots of education debt—Paul and Heidi Geis know how expensive college can be. No wonder their 18-month-old, Aiden, already has a college fund. But what may be surprising is that his tuition kitty resides 2,000 miles away from the Geises' home in Pittsburgh—in Utah's college-savings plan....

Utah is among several states that have dramatically improved their college-savings plans over the past year.

Reader's Guide

Terms to Know

- pension plans
- Keogh Plan
- individual retirement account (IRA)
- Roth IRA
- diversification

Reading Objectives

1. What kinds of retirement investments are available?
2. How much should you save and invest?

One of the reasons that people save is to send their children to college. Another reason is to have income to spend when they retire. In addition to their savings, most Americans will need additional sources of income for the years after they stop working. As you read this section, you'll learn what those additional sources of income are, and the amount of risk involved in these investments.

Investing for Retirement

Many individuals have company retirement plans called **pension plans** that provide retirement income. One of the most common types is a 401(k) plan, in which you allow a certain portion of

pension plans: *company plans that provide retirement income for their workers*

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your paycheck to be withheld, and the company matches that amount. Also, most people are eligible for Social Security payments when they reach retirement. Social Security by itself, however, will not provide enough income to live comfortably. It is important, therefore, for a person to provide for his or her own retirement by saving and investing in private retirement plans.

A major benefit of a private or personal pension plan is the tax savings. You do not have to pay federal income tax *immediately* on the earned income that you invest in one of these retirement plans, or on the interest that the plan earns if it does not exceed a certain amount. Should you need to take money out of the plan early, however, you have to pay a tax penalty. Otherwise, you pay income tax only as you withdraw money from the plan at retirement. Because your yearly income will likely be less then, your tax rate will be lower.

ECONOMICS Online

Student Web Activity Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 6—Student Web Activities*** to learn more about Roth IRAs.

CLICK HERE

Individual Pension Plans

The Keogh Act of 1962 was passed to help self-employed people set up their own pension plans. The **Keogh Plan** allows those people who are self-employed to set aside a maximum of 15 percent of their income up to a specified amount each year, and then deduct that amount from their yearly taxable income.

Keogh Plan: *retirement plan that allows self-employed individuals to save a maximum of 15 percent of their income up to a specified amount each year, and to deduct that amount from their yearly taxable income*

Another form of retirement plan is the **individual retirement account (IRA).** A single person earning less than $30,000 can contribute up to $3,000 a year and deduct those contributions from taxable income. There are other income limits for married couples and those covered by employer pension plans, however. The benefit of an IRA is that the income you contribute to the IRA is not taxed in the year it is contributed. In addition, the interest you earn on that income is not taxed either. You pay the tax only when you take out funds from your IRA account, usually after age 59½.

individual retirement account (IRA): *private retirement plan that allows individuals or married couples to save a certain amount of untaxed earnings per year with the interest being tax-deferred*

A new form of IRA is called the **Roth IRA.** Again, you are allowed to put up to $3,000 a year in a Roth IRA. You do not get to deduct your contributions from your taxable income, however. The benefit is that all of the interest you earn on your contributions to a Roth IRA is tax-free forever. Thus, when you take out funds from your Roth IRA account while you are retired, you pay no additional taxes.

Roth IRA: *private retirement plan that taxes income before it is saved, but which does not tax interest on that income when funds are used upon retirement*

Real Estate as an Investment

Buying real estate, such as land and buildings, is another form of investing. For the past

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50 years or so, buying a home, condominium, or co-op has proven to be a wise investment in many parts of the country. Resale values have soared at times, especially during the late 1970s. In the early 1980s and again in the early 1990s, however, the growth in the price of housing slowed in some areas, particularly in California and parts of the Northeast. By the end of the 1990s, values everywhere were once again on the upswing.

Buying raw, or undeveloped, land is a much riskier investment. No one can guarantee that there will be a demand in the future for a particular piece of land. The same is true for housing, but most people do not buy housing for the purpose of reselling it.

Real estate, either as raw land or developed land, is not very easy to turn into cash on short notice. As shown in **Figure 6.7,** sometimes real property for sale stays on the market for long periods of time. This difficulty in getting cash for your investment is one of the trade-offs involved when investing in real estate. You cannot get your funds as quickly as you could if you had invested in stocks, bonds, a bank CD, or some other savings plan.

How Much to Save and Invest?

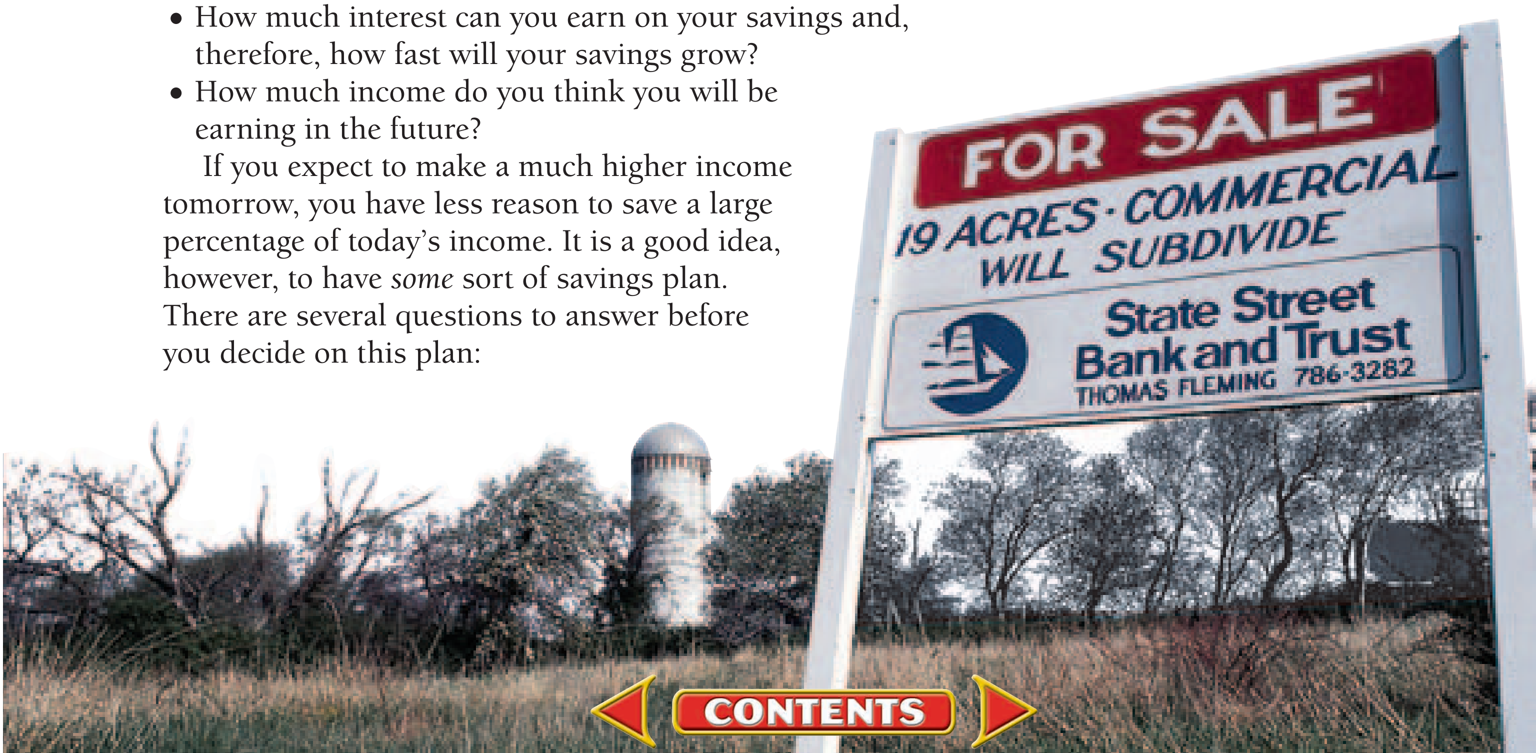
Saving involves a trade-off like every other activity. The more you save today, the more you can buy and consume a year from now, 10 years from now, or 30 years from now. You will, however, have less to spend today. Deciding what percentage of income to save depends on the following factors:

- How much do you spend on your fixed expenses?
- What are your reasons for saving?
- How much interest can you earn on your savings and, therefore, how fast will your savings grow?
- How much income do you think you will be earning in the future?

If you expect to make a much higher income tomorrow, you have less reason to save a large percentage of today's income. It is a good idea, however, to have *some* sort of savings plan. There are several questions to answer before you decide on this plan:

FIGURE 6.7

Real Estate as an Investment Buying real estate—whether as developed or undeveloped land—is risky. Variations in supply and demand produce different prices for houses and commercial land in different parts of the country.



- What degree of risk are you willing to take?
- How important is it that your savings be readily available in case you need immediate cash?
- Will your standard of living at retirement depend largely on your accumulated savings?

Amount of Risk Such questions are difficult to answer because there are so many ways to save and invest. Perhaps the most important factor to consider is the amount of risk that you are willing to take with your savings.

If you put a lesser amount in the more risky types of investments, you will have some security with your savings and have some funds readily available should you need cash in a hurry. You may also have a chance of making high returns, as risk and return are directly related. **Figure 6.8** ranks various investments according to risk.

Spreading Out Your Investments Investing your savings in several different types of accounts lowers the overall risk. If one investment turns sour, the others may do better. Financial planners call spreading out your investments **diversification.** See **Figure 6.9.** Mutual funds, for example, help you diversify.

diversification: *spreading of investments among several different types of accounts to lower overall risk*

FIGURE 6.8

Risk and Return The lower the risk, the lower the return. Perhaps the most risk-free investment is an insured passbook savings account. You could also invest your savings in the stock or bond market directly, although these are the riskiest investments. The market value of stocks can rise and fall dramatically and so, too, can the value of your investment. ***Why do bond-based mutual funds carry a risk?***

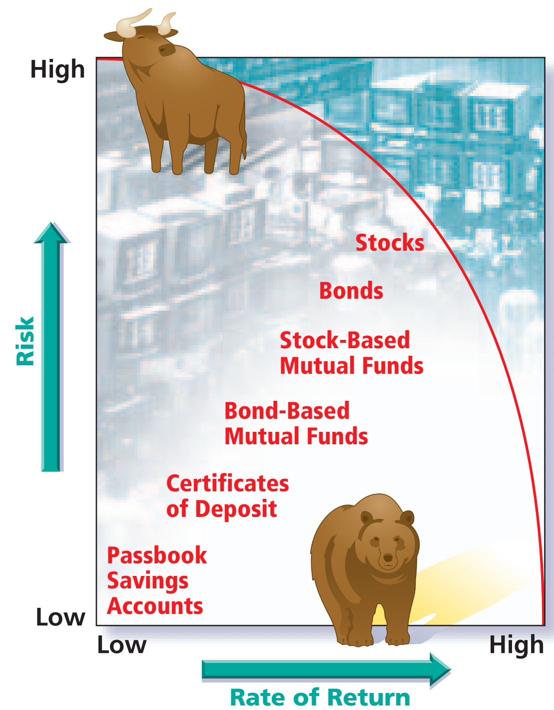


FIGURE 6.9

Lowering Risk "Don't put all your eggs in one basket" is a phrase you have certainly heard before. The theory behind it can be applied to how a person chooses to invest. ***What is the most risk-free investment?***

When you have very little income and cannot afford any investment losses, you should probably put your savings in insured accounts in a local bank or savings and loan, or you should buy U.S. government savings bonds. The greater your income and the more savings you have, the more you can diversify into stocks, corporate bonds, and so on.

Values Your values may also determine where you invest your savings. If you believe that your community needs more development, you might choose to put your savings in a local savings and loan that guarantees that a large percentage of its investments are made in community loans. You may also choose to invest in stocks issued by environmentally responsible companies or companies that have aggressive equal opportunity programs.

Practice and **assess** key skills with ***Skillbuilder Interactive Workbook, Level 2.***

SECTION 3 Assessment

Understanding Key Terms

1. **Define** pension plans, Keogh Plan, individual retirement account (IRA), Roth IRA, diversification.

Reviewing Objectives

2. What are three ways of investing for retirement?
3. **Graphic Organizer** Use a diagram like the one in the next column to explain how a person should determine the amount to save and the amount to invest.

Amount of savings depends on

Applying Economic Concepts

4. **Risk-Return Relationship** If you had money to invest, in which type of account would you invest? Why?

Critical Thinking Activity

5. **Drawing Conclusions** Bonds yield a more certain return than stocks. Why do individuals, nonetheless, invest in stocks?

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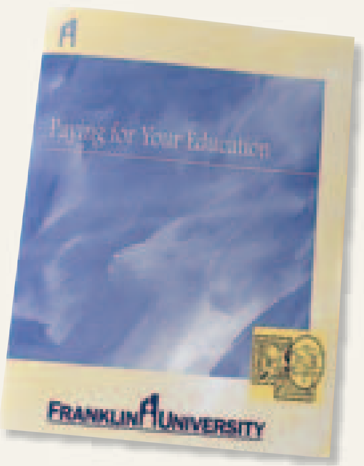
BusinessWeek

SPOTLIGHT ON THE ECONOMY

Intro to Haggling

Check It Out! In this chapter you learned about saving and investing for the future, including paying for college. In this article, read to learn how your savings can go even further by lowering the cost of college tuition.

It pays to be astute. Tuition and fees have risen 94% since 1989, nearly triple the 32.5% increase in inflation. The sticker price–tuition, fees, and room and board–for a year of undergraduate education ranges from $33,000 at Ivy League schools down to $10,500 at state universities.



The good news is that rising financial aid, now at $60 billion nationally, is softening the blow. The first thing to do when investigating aid packages is to head for the Internet. A few days of pointing and clicking can have a lifelong payoff. You'll learn such tips as:

- Don't go the early-admission route if you want aid. Your commitment means they know they've got you.
- If you have stock set aside for college, sell it before January 1 of your child's junior year in high school. After that date, any capital gains will reduce aid eligibility.
- Apply to at least six colleges, from dreams to sure bets. Then, with offers in hand, negotiate.

If you are set on a specific college, it helps to have strong offers from direct competitors. Negotiations can be done face-to-face, by phone, or by faxing other offers with a polite cover letter. A well-spoken student may get better results than a pushy parent.

Cash-strapped students are also saving thousands by enrolling at a public college and later transferring to a private school or starting at a junior college (average tuition of $1,500 a year) and moving on to a state university.

Think About It

1. **What three actions should you follow when applying for college aid?**
2. **What is another alternative for cash-strapped students?**

CHAPTER 6 Summary

ECONOMICS Online

Chapter Overview Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 6—Chapter Overviews*** to review chapter information.

CLICK HERE

SECTION 1 Why Save?

- Economists define ***saving*** as the nonuse of income for a period of time so that it can be used later.
- Saving done by an individual provides money for others to invest or spend and allows businesses to expand.
- Individuals have many places to invest their savings, including **savings accounts** and **time deposits.**
- With a **passbook savings account,** the depositor receives a booklet in which deposits, withdrawals, and interest are recorded.
- A **money market deposit account (MMDA)** is another type of account that pays relatively high rates of interest and allows immediate access to money through checks. The trade-off is that these accounts have a $1,000 to $2,500 minimum balance requirement.
- Time deposits, such as **certificates of deposit (CDs),** offer higher rates of **interest,** but you must leave your funds on deposit for longer periods of time.
- The FDIC insures deposits up to $100,000 in commercial banks and savings banks.

SECTION 2 Investing: Taking Risks With Your Savings

- Shares of stock entitle the buyer to a certain part of the future profits and assets of the corporation selling the stock.
- **Stockholders** make money from stock through dividends and by selling their stock for more than they paid for it.
- Companies and all three levels of government sell bonds to borrow money. These include **tax-exempt bonds; savings bonds;** and **Treasury bills, notes,** and **bonds.**
- Stocks are bought and sold through **brokers** or on the Internet.
- Stocks of large corporations are usually traded on the organized stock exchanges, whereas stocks of smaller, new corporations usually are sold on the **over-the-counter market.**
- Many people invest in the stock market by placing some of their savings in a **mutual fund,** an investment company that pools the money of many individuals to buy stocks, bonds, or other investments.

SECTION 3 Special Savings Plans and Goals

- When they retire, most Americans will need additional sources of income besides their savings.
- **Pension plans,** the **Keogh Plan,** and **individual retirement accounts (IRAs)** are ways to increase your retirement dollars.
- Buying real estate is another form of investing for your retirement, but it carries a much higher risk.
- When deciding how much and what to invest in, consider **diversification** in order to spread out your investment risk.

CHAPTER 6

Assessment and Activities

ECONOMICS Online

Self-Check Quiz Visit the *Economics Today and Tomorrow* Web site at ett.glencoe.com and click on ***Chapter 6—Self-Check Quizzes*** to prepare for the Chapter Test.

CLICK HERE

Identifying Key Terms

Write the letter of the definition in Column B that correctly defines each term in Column A.

Column A

1. mutual fund
2. savings bond
3. capital gain
4. statement savings account
5. time deposit
6. diversification
7. pension plan

Column B

a. an increase in wealth realized when a person sells an asset
b. a less risky way to invest in stocks and bonds
c. a government security attractive to small investors
d. savings plan that issues a monthly summary of your transactions
e. retirement plan organized by a company
f. savings plan that requires savers to leave their funds in a financial institution for a specified length of time
g. spreading of investments among several different types of accounts to lower overall risk

Recalling Facts and Ideas

Section 1

1. What is the main advantage of passbook and statement savings accounts?
2. Why is a bank certificate of deposit called a time deposit?
3. Why are deposits of up to $100,000 in banks and savings institutions often considered very safe?

Section 2

4. What is the basic difference between a stock and a bond?
5. What are two advantages of United States savings bonds?
6. What terms describe the difference between the purchase price of a stock and the sale price of a stock?
7. What kind of investment company hires professionals to manage the investments of a pool of investors?
8. What government agency regulates stock and bond markets?

Section 3

9. What are three common types of pension plans for individuals?
10. What are some of the ways you can decide how much you should save?
11. "Don't put all your eggs in one basket." This quote is an example of what principle of investing?

Thinking Critically

1. **Identifying Alternatives** Suppose you have $300,000 that you want to save. The FDIC only insures up to $100,000. What can you do to make sure all your funds are insured by the FDIC?
2. **Understanding Cause and Effect** How does buying a U.S. savings bond increase the United States government's debt?
3. **Categorizing Information** Assume that you have $100,000 in savings. Create a chart like the one below to list the investments you might make and what percentage of the $100,000 you would invest in each. In the last column, explain how your choices will achieve investment diversification.

Investment Type	% of Funds	Diversification

Applying Economic Concepts

Scarcity and Choice List your short-term savings goals, such as saving to buy a new portable DVD player. Explain the typical ways in which you can save for such a purchase. Then list your long-term savings goals, such as saving for a house or retirement. Explain how you can achieve these goals. What is the major difference between the two ways of saving?

Cooperative Learning Project

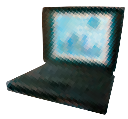
Working in groups of four, research what $100,000 placed in each one of the following investments 10 years ago would be worth today. Rank and compare the rates of return. Obtain your information in the library, on the Internet, or through a securities brokerage firm.

- One particular stock
- A mutual stock fund
- U.S. Treasury bonds
- Residential real estate
- Commercial real estate
- Gold
- Diamonds

Reviewing Skills

Using a Spreadsheet Contact at least five financial institutions in your area. Ask them for the interest rate they offer for a passbook savings account, a certificate of deposit, and a money market deposit account with a minimum balance of $1,000 and a maturity of 16 months. Use the information you obtain as the basis for a spreadsheet showing interest rates in your community. Then prepare a bar graph of the interest rates available and present your information to the class.

Technology Activity



Using the Internet Choose two stocks on the New York Stock Exchange, and follow their prices for two weeks in the financial pages of a newspaper or on the Internet. You will need to read only the last column of figures. Note the daily closing prices for each stock, and then make a line graph showing the stocks' performance over the two-week period.

Analyzing the Global Economy

Use the Internet or business magazines to research what stocks are in demand in Italy, Finland, Israel, and Japan. Present the results of your research to the rest of the class.

Economics Lab

Making a Budget

From the classroom of Joanna Ackley, John F. Kennedy High School, Taylor, Michigan

In Unit 2 you learned how trade-offs shape consumer decisions regarding credit, food products, clothing, automobiles, housing, and saving. In this lab, you will design a strategy for earning, spending, saving, and investing your resources.

STEP A Tools Needed

- ✔ Copies of Tables 1 and 2
- ✔ Newspapers with advertisements for apartment rentals and auto sales
- ✔ Ads from local grocery stores
- ✔ Magazines with photos of apartments, automobiles, and furniture
- ✔ Pencil
- ✔ Calculator

STEP B Procedures to Follow

1. You will be sharing living quarters with another person. Annually you make $16,640, of which $1,800 goes to pay taxes. Monthly you earn $1,236.66. Your total expenditures will include the items listed in Table 1.
2. Analyze the newspaper ads to select an apartment to rent. List the rental fee in Table 1.
3. Plan your weekly menus in Table 2, then multiply these by 4 to budget your food expenses for 1 month. Use the ads from grocery stores to select and price the food products needed for your menus.
4. Decide on a type of car to buy. Analyze the newspaper ads to obtain the monthly payment for an automobile.
5. From the magazines, select items of furniture to furnish your apartment.
6. Visit or call the following places to obtain prices or monthly fees for other necessities: phone company, electric company, gas company, auto insurance, furniture store, and medical insurance. Optional costs include IRA deductions and purchases of stocks and bonds.
7. Fill in your costs in Table 1.

Table 1

CATEGORIES OF EXPENDITURES	MONTHLY COST
Rent	
Rental insurance	
Telephone	
Electricity	
Gas heat	
Car payment	
Car insurance	
Car expenses (gas and repairs)	
Furniture expenses	
Clothing expenses	
Food (Eating in)	
Eating out	
Medical insurance	
Medical expenses	
Credit card bill	
Savings account	
Checking account	
Stocks and bonds	
IRA or Roth IRA	
Entertainment	
Laundry and Toiletries	
Other	
TOTAL OF EXPENSES	

Table 2

MENUS	PRICES OF ITEMS
Monday	
Tuesday	
Wednesday	
Thursday	
Friday	
Saturday	
Sunday	
	TOTAL

STEP C Creating an Economic Model

Use the results of your cost analyses in Table 1 to draw a bar graph visually showing how your income compares to your expenditures. Draw your graph on poster board to use in a presentation to the rest of the class. In your presentation you should also include visuals of the type of apartment you chose to rent, the furniture you selected, the type of automobile you bought, evidence of car and medical insurance costs, and your calculations for credit card interest fees.

STEP D Lab Report Analysis

1. What was your largest monthly expense?
2. How much money did you have left over at the end of the month?
3. What expense(s) surprised you the most? Why?
4. What expenditures did you have to reduce in order to meet your other monthly expenses?

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