Introduction to Investments: A Free Manual for Building Wealth

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM
THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Introduction to Investments: A Free Manual for Building Wealth

A Free Manual for Building Wealth

FRANK PAIANO

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Introduction to Investments: A Free Manual for Building Wealth by Frank Paiano is licensed under a Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License, except where otherwise noted.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM
THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Contents

Foreword: OER, Open Educational Resources - This Book is Free to Read vii

Preface: Welcome to Introduction to Investments ix

1. Chapter 1 - Introduction, Overview, and Risk versus Return 1

Chapter 1 - Introduction, Overview, and Risk versus Return

What Is an Investment? 3

Investment Characteristics and Attributes 6

An Overview of the Investment Universe 13

Short Term Investments Revisited – A Place to Park Your Money 30

Congratulations – You Have Finished Chapter 1 – Introduction, Overview, and Risk versus Return 44

About Introduction to Investments and the Authors 47

Bibliography - Books to Read 49

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM
THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Foreword: OER, Open Educational Resources - This Book is Free to Read

> *"An author is a fool who, not content with having bored those who have lived with him, insists on boring future generations." - Montesquieu*

This book is written as an Open Educational Resource (OER). It is licensed under the Creative Commons Attribution-NonCommercial-ShareAlike 4.0 International License. This means you can read it for free. If anyone is trying to get you to pay for this book, they are scam artists. If you have already paid the scam artists for this book, contact your credit card company and tell them you have been scammed and you want your money back. If you want to use this material for anything else other than for your own education, please read the above Creative Commons license agreement carefully. If you want to collaborate on this textbook as we keep it updated in the future, please contact me directly, especially if you are much smarter than I am. (We are setting the bar fairly low here, Folks.) We desperately need graphic artists and data experts. If you are a Technical Analysis expert, please contact us immediately! If you would like to translate this text to another language, please contact us immediately! We would love to have this become a group effort, especially for those teaching Introduction to Investments at the middle, high, and adult school, community college, and even university levels.

Okay, so why write a book about investing when there are already many great books about investing available? That's a great question. The reason is a bit complicated. Nothing is perfect and that includes the world of academia. I have taught BUS-123, Introduction to

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Investments, at Southwestern Community College for almost 20 years now and have been a Registered Representative, also known as a Stockbroker, since 1998. I have been investing for far longer than that. If it were up to me, I would use The Intelligent Investor by Benjamin Graham as our college textbook at Southwestern. It is the definitive work on investing written by none other than the teacher and mentor of Warren Buffett, the famed investor. But always remember our academia motto: If it makes sense, we don't do it. The Intelligent Investor is not a college-level textbook. It does not come from a college-level textbook publisher. A college-level textbook must cost at least US$340 for a book that is usually worth about US$29.95. In reality, The Intelligent Investor is far more rigorous than any college-level Introduction to Investments textbooks we have come across.

This is where Open Educational Resources (OER) comes in. Under their auspices, we can write a college-level textbook and have it blessed and kissed by the Academic Powers-That-Be. The reality is that this textbook is really just a restatement of the BUS-123, Introduction to Investments, class website. Websites also can not be used as college-level textbooks even though, in my humble opinion and the opinion of many of our students, our website is also far superior to any college-level Introduction to Investments textbooks available. Again, if it makes sense, we don't do it. So there! That is why we are writing this book.

The other reason is that, as the French philosopher, Montesquieu, points out above, I am very much looking forward to boring those who are living with me and all future generations to come.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Preface: Welcome to Introduction to Investments

> **"It is a gloomy moment in history. Never has the future seemed so dark and incalculable. The United States is beset with racial, industrial and commercial chaos, drifting we know not where. Of our troubles, no one can see the end."**

You have heard the predictions. The End of the World is Nigh! Doom and Gloom Await the Human Race! Global warming! Climate change! Rising sea levels! Pollution! Totalitarianism! Nuclear annihilation! Economic inequality! Earthquakes! Fires! Droughts! Tsunamis! Pestilence! Disco returning! Pretty scary stuff, eh? All you have to do is turn on the tele and watch the talking heads on Skunk News, ah, wait, Weasel News, no, I know, Fox News! When you ask people when they believe this quote was said or written, they will often say, "Great Depression," or, "World War II," or maybe even, "9/11," or "2008." This famous quote is actually from Harper's Weekly, the nation's oldest magazine. It was written in 1847. (A few sources claim it was actually 1857. So here is your first research assignment. See if you can definitely find the actual date. Have fun!)

Did the United States face tremendous problems in the 1840's and 1850's? Yes, indeed it did. The nation was about to tear itself apart over the issue of slavery, our original sin. Do we have tremendous problems now? Yes, indeed we do. The nation is still tearing itself apart over issues similar to those fought during the Civil War along with a host of other problems we are facing, locally, nationally and globally. However, so far, equating serious with fatal has been a bad choice. In fact, the last 200 years have been the most prosperous years in the history of recorded civilization. The last 100 years, the

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

last 50 years, the last 20 years, all of these have seen the global standard of living rise to levels never before seen by humankind. According to some sources, the global middle class reached over 50% in 2018 and is predicted to swell to over 5.5 billion people by 2030. Of course, there is much, much more that we need to do to bring all the people in the world into the global middle class so they have access to food, clothing, and shelter.

So what does this mean for those of us who want to become prudent, long-term oriented, successful investors? It means that the news is good! As hundreds of millions of people enter the global middle class for the first time, they want many of the same things that we in the West have taken for granted for a hundred years. They want clean water, healthy food, safe housing, shoes, toothpaste, diapers, electronics, entertainment, bicycles, scooters, cars, etc. This will create many new and tremendous opportunities for companies to profit from this rise in the standard of living and for us investors who want to partake in that success.

Oh, by the way, you won't see this is very good news on the nightly disasters, oops!, I mean, the nightly news. That is why it is a good idea to resolve to never again get your news from television. Start reading. You know what I am talking about, newspapers, magazines, books, libraries. You can download and read books, articles, and the news on your mobile phone. It's cool, really. You will feel better. And you will live longer, too. Trust me.

So are you ready to learn how to partake in the future success of the human race? We hope so. We will do our best to make you prudent, long-term oriented, successful investors. We want you to become the best investors the world has ever seen and become very wealthy! We also will do our best to make this class the best class you have ever taken! (I know. I know. This all sounds a bit over the top but it is sincere.) We want to emphasize that you don't need any previous investment experience. In fact, the less exposure to the talking heads in the media or the latest get rich quick schemes or your brother-in-law, the self-proclaimed investment expert, the

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

better. So let's get started with chapter 1. We start with a very simple question: What is an investment?

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

THIS BOOK WAS PRODUCED USING

PRESSBOOKS.COM

Easily turn your manuscript into

EPUB *Nook, Kobo, and iBooks*

Mobi *Kindle*

PDF *Print-on-demand and digital distribution*

PRESSBOOKS.COM

Simple Book Production

1. Chapter 1 - Introduction, Overview, and Risk versus Return

Chapter 1 - Introduction, Overview, and Risk versus Return

Learning Objectives

In this chapter and the chapter 1 Canvas module or class website , you will

- Be introduced to the definition of an investment and the basic characteristics of investments – We start from the very beginning! What is an investment?
- Review the major asset investment alternatives – An Overview of the Investment Universe
- Explore the relationship of risk and return
- Identify the differences between an investor and a speculator/trader
- Concentrate and investigate short-term "cash" investment alternatives – A Place to Park Your Money
- Discuss aspects of short-term "cash" investments with your fellow students

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

By the end of this chapter and the Canvas module or class website, you should be able to

- Given a typical investment, identify its characteristics including the cash flow (income) and capital gains (growth) components, and identify the advantages and disadvantages of the investment
- In a brief two- to three-sentence description, succinctly describe the major investment alternatives including stocks, bonds, mutual funds, and short-term "cash' investments
- Express the historical relationship of risk and return (Do you want to eat well or do you want to sleep well?)
- Research short-term "cash" investment alternatives including demand deposit accounts such as savings accounts, Certificates of Deposits, money market accounts and money market mutual funds, and Treasury Bills
- Describe institutional short-term investment alternatives such as corporate paper and bankers acceptance notes
- Optionally, calculate the future values of a lump sum principal investment and a series of investments

Don't worry if any or all of this sounds scary now. We will learn all these terms and concepts in good time. They really are not as hard as they sound. Again, not for the last time, we want you to remember that this is an Introduction to Investments class. You need no prior investment experience nor training.

THIS BOOK WAS PRODUCED USING PRESSBOOKS

What Is an Investment?

"In investing money, the amount of interest you want should depend upon on whether you want to eat well or sleep well." — J. Kenfield Morley

Welcome to Introduction to Investments. Do you want to be a successful investor? You can. You do not need any prior investment experience to take this class. You don't have to be a genius or a technology whiz. There is no advanced math, only simple arithmetic that any 99¢ calculator can perform, add, subtraction, division, and multiplication. The concepts, techniques, and skills, while extensive at times, are not difficult. The research is relatively easy but beware as it can become habit forming. As the famed investor, Mr. Warren Buffett, has been quoted as saying, "Investing is simple … but it ain't easy." What? Why? How? Mr. Buffett is referring to the fact that there are two parts to the world of investments. The simple part is the intellectual part, the cognitive part. Read, listen, watch, and study the material, spend some time doing the research, do the assignments, and you should find that the concepts, techniques, and skills are actually very straightforward. The "ain't easy" part is the emotional part of investing. We will spend a great deal of time doing our best to help you learn techniques, tricks, and tips that should help you succeed with the emotional part, but again, as Mr. Buffett says, "it ain't easy!"

In the quote above, Mr. J. Kenfield Morley encapsulates our predicament perfectly. "Do you want to eat well or do you want to sleep well?" If we may be so bold as to suggest a better rendition of this timeless advice, we would ask Mr. Morley to substitute the word reward for his choice of the word interest. Interest is just one type of investment reward; there are others. Nevertheless, the meaning shines through brilliantly. As we are introduced to the many investment choices, we are going to see that some of the choices will help us eat well. Some others will allow us to sleep well.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

However, there aren't any choices that can do both. Take heart! We will learn some techniques that should allow us to eat reasonably well and sleep reasonably well but as we will say over and over and over again, "There ain't no guarantees!"

Investing versus Speculating/Trading

We are going to introduce a distinction here that will run through our journey together. Do you want to be an investor or do you want to be a speculator, also known as a trader? Becoming an investor is something that we can definitely help you with. You will learn the most important and popular investment alternatives. You will learn the types of rewards we can expect from each and the levels of risks that we will have to accept to receive these rewards. We will also cover some important techniques and skills to help us deal with these risks. We will learn that building wealth through investments is a long-term process; it does not happen overnight. We can help you become a prudent, long-term investor. However, if you want to become a speculator or a trader and earn tremendous amounts of money quickly, then we are sorry to say that you will be very disappointed in this class. We are not able to help you to become a speculator or trader. Our sincerest apologies.

So let's get started. We start from the very beginning with a simple question: What is an investment? There are many definitions available. Here is the definition we will use in our class:

> *An investment is any vehicle into which resources can be placed with the expectation that it will generate positive income, or that its value will be preserved or increased, or both*

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

For the vast majority of us, the resources placed will be dollars, typically from our work-related income. There are many investment vehicles and, as mentioned, we will cover the most popular alternatives. We see that there are a few goals that we might seek with regard to our investments. One goal is to generate positive income, also known as cash flow. Another goal is to increase the value of our investment, also known as capital appreciation. At the very least, we want to preserve the value of our investments. Lastly, we could also seek both goals of cash flow and capital appreciation. As we introduce each investment alternative, we will discuss the goals associated with the alternative and the risks that each investment alternative carries.

Here is another important definition that revisits our distinction of being an investor or a speculator/trader:

> *"An investment operation is one which, upon thorough analysis, promises safety of principal and a satisfactory return. Operations not meeting these requirements are speculative." – Benjamin Graham*

This definition, Dear Readers, is very near and dear to Your Humble Author's heart. This quote is from The Intelligent Investor, written by Mr. Benjamin Graham. Mr. Graham was Mr. Warren Buffett's teacher and mentor. Eventually you will want to read The Intelligent Investor. (Don't read it as your first book! There are better books to read as your first book on investing. Please see the Bibliography for which books you should read first.) We will return again and again to this definition. If nothing else, we want you to understand the difference between prudent investing for the long term and speculating/trading in the short term.

Mr. Buffett is famous for boiling down Mr. Graham's concepts into very simple sayings. To illustrate this concept, Mr. Buffett famously said, "Rule #1: Don't lose money. Rule #2: Never forget Rule #1."

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Although we will see that investment values bounce up and down all the time, if you do your research and choose prudent, long-term investments that have done well over time and should continue to do well into the future – and you don't panic when the markets fall – you won't lose money in the long term. You won't be a speculator/trader. You will be an investor.

Investment Characteristics and Attributes

As you work through the material in this introductory chapter, remember that this is an Introduction to Investments class. Don't worry about all the jargon and buzzwords and proclamations and sexy graphics and silly antics that you may have heard or seen from the talking heads on the financial media outlets. Please forget anything and everything your brother-in-law, the self-appointed Expert-On-All-Things-Including-How-To-Invest, told you at the Thanksgiving dinner table. What follows is a list of general characteristics and attributes about investments. Study these terms, write them down, print the chapter 1 Study Guide, and watch and listen to the first lecture presentation for chapter 1 on the website or Canvas. This is all you need to learn and know for now.

Securities, Property, and Personal Investments

Security investment:

There are three broad categories of investments: securities, property, and personal. According to Wikipedia, a "security is a tradable financial asset." Investopedia goes into more detail and defines a "security as a fungible, negotiable financial instrument that

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

holds some type of monetary value." The fancy words fungible and negotiable mean that the security can be traded and its value can be negotiated. Another popular definition of security is "an investment that represents debt or ownership or the legal right to acquire or sell an ownership interest." This last definition introduces the three main categories of securities that we will detail later. The word security is an unfortunate term. Many people don't have a clear picture of what is meant by the word security. Our class used to be titled, "Investments and Securities." Students would think, "I'm not an Administration of Justice major. I don't need to take this class." No, not that type of security! For now, please understand that a security is a financial asset that can be traded and whose value changes over time.

Tradable financial assets such as stocks and bonds

Investments in property are sometimes referred to as hard assets or tangible assets. They include gold and other precious metals, art and other collectibles such as cars, commodities such basic foodstuffs and materials, and real estate. We will discuss property investments toward the end of our journey together. They are important options but for the vast majority of us, securities are the best choice for prudent, long-term investments.

Property investment: Tangible assets such as precious metals, art, real estate

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Personal investment: Endeavors taken to better oneself such as education, training, and travel

Personal investments are endeavors we undertake to better ourselves. Examples include education, training, and travel. Many say that their personal investments such as college or traveling the world were often the best investments they ever made. The text concentrates on securities.

Primary Assets versus Derivative Assets

Investments fall into either primary or derivative assets. For the vast majority of our time together, we will be covering primary assets. Primary assets fall into two categories: debt and equity. Debt investments are investments where we are lending our money to someone else. Examples of these include bonds and savings accounts. Debt investors are loaners. Equity investments are investments where we have full or partial ownership of the entity. We are owners. Examples include stocks, real estate, and partnerships

Derivatives are securities that derive their value from other assets. Examples of derivatives are options and futures. With derivatives, you can make a whole lot of money quickly and then lose a whole lot of money quickly. In fact, you can lose the whole value of your derivative investment overnight. Many in the industry do not categorize derivatives as investing. According to Mr. Graham's definition above, derivatives would certainly be regarded as speculative. As we will see, in the investment world, "speculative" is a euphemism for the word "gambling." We will discuss options and futures in detail at the very end of our journey together. Before

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

we impress upon you just how dangerous these speculations are, if anyone tries to entice you with riches beyond your wildest dreams trading in options or futures, please tell them you are waiting until the end of the Introduction to Investments class, before you make a decision one way or the other. (Spoiler alert: Stay away from derivatives of all forms! They are hazardous to your financial well-being.)

Direct Investments versus Indirect Investments

Direct investments are investments for which you have control of the underlying investment assets. Your name is on the title or the account. You are in control of the asset. Examples of these types of investments include stocks, bonds, real estate, and hard assets. With an indirect investment, someone else is making the decision about what underlying investment will be chosen. You may have some input into the decision but more often than not, you have no control of what assets will be chosen. Examples of these investments are mutual funds, limited partnerships, and Real Estate Investment Trusts (REITs). With indirect investments, you choose the mutual fund or limited partnership or REIT, and the manager or general partner chooses the underlying investments in stocks or bonds or real estate.

Investment Domesticity

Domesticity describes the location of an investment. There are three categories: domestic, global, and international. The first category is easy; a domestic investment is domiciled inside the United States. There is a subtle but important distinction with regard to the second two categories. A global investment means

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

that it could be based anywhere in the world; an international investment is based outside the United States. Please pay attention to this important difference. International investments are also often called foreign investment or overseas investments.

Until the 1970's, the differences between these categories were important. However, as globalization has evolved since the 1980's, the differences have become much less pronounced. Greg Ireland, a successful mutual fund manager with over 35 years of experience once said, "The world is a very small place economically." The influential magazine Forbes reported that, "Sixty-five percent (by value) of the parts in the Ford Mustang come from the U.S. and Canada. Ninety percent of the parts in the Toyota Sienna – which is built in Indiana – come from the U.S. and Canada." Which is the more American car, a Ford Mustang or a Toyota Sienna?

In the presentation, we list seventeen well-known companies and ask, "Which are domestic and which are foreign?" (Spoiler alert: They are all foreign.) In the United States, the issue of globalization has spilled into the political arena and elicited much controversy. At times, this controversy has taken the form of anger, fear, and loathing. This is unfortunate from our viewpoint as investors. Nothing is perfect and that includes our efforts to globalize the economy. However, on balance, globalization has been a tremendous positive for investors around the world and has helped bring hundreds of millions of people out of poverty and into the global middle class. The tricky part is ensuring that all enjoy the benefits of the expansion of the global economy.

Next in the presentation, we list the top 18 countries according to per capita gross domestic product. We then ask a simple question: Which country had the best average annual return between 1973 and 2013? (No spoiler here! Please watch or listen to the presentations on the class website or Canvas.) The world is indeed a very small place economically these days.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Time Horizon

One of the most important, if not the most important, characteristic that we must decide upon before we make an investment decision is our time horizon, also known as our time frame. When will we need to use the funds from our investment? Here are some popular guidelines:

Time Frame	Financial Industry	Life Insurance Industry
Short Term	Up to a year or so	1 to 3 years
Intermediate Term	2 to 5 years	3 to 5, 6, or even 7 years
Long Term	More than 5 years	More than 7 years

Before you make an investment, we must know our time frame. As we will learn, our time frame will dictate what types of investment we can and can not use.

Liquidity

No, not how much beer we need for the weekend! Liquidity refers to how easily your investment can be turned into cash. Liquid investments are easily and quickly converted into cash. There is a ready market to purchase the investment and change of ownership happens quickly. Examples include stocks and mutual funds. Go online or call your broker. You will have your money very quickly, usually within a day or two. Illiquid investments are the exact opposite. The market for the investment is small or the change of ownership happens slowly, or both. It usually takes some time – sometimes much time – to convert your investment into cash. The poster child for illiquid investments is real estate. Real estate usually takes at least two or three or more months to sell. Other examples

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

of illiquid investments include limited partnerships, fine art, and collectibles.

Risk versus Return

Do you want to eat well or do you want to sleep well? In the investment world, risk is the chance that your actual investment returns will differ from your expected return from the investment. Wait a minute! That is not the typical definition of risk. When most people think of risk, they think of the possibility of suffering harm or loss. They think of danger. When they think of risk with regard to investing, they think of losing their investment. They think of losing all their money. Instead, in the investment world, when we endeavor to measure risk, we calculate the probability that what we receive from our investment will not match what we expect from our investment. It is an imperfect measurement but it can help us to keep a long-term perspective and can even help us to take advantage of the risks inherent in an investment.

In general, the higher the expectation of investment returns, the higher the risk level we will have to accept. There is no way to negate this relationship. If we want high returns, we are going to have to accept high risk. Here are two risk versus return spectrums:

	Post 2008 Global Financial Crisis	Pre 2008 Global Financial Crisis
Low Risk	1% to 3% or less	3% to 5%
Moderate Risk	3% to 5%	5% to 8%
High Risk	6% to 10%	8% to 12%
Speculative Risk	Greater than 10%	Greater than 12%

We will use the Post 2008 Global Financial Crisis risk versus reward spectrum in our class. Please note that speculation is not

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

considered investing by many in the industry, Your Humble Author included. As mentioned, we are going to do our best to help you learn how to handle the ups and downs of moderate to high risk investments and at the same time, generate reasonably moderate to high returns over the long term. We want you to eat reasonably well and sleep reasonably well!

It's time for some checking for comprehension. In the presentation, we list six examples of investments. We want you to ascribe the various characteristics and attributes we covered to the six investments. Again, only concern yourself with what we have covered so far. Relax and have fun. Give my regards to Uncle Harry!

An Overview of the Investment Universe

Let's become casually acquainted with the major investment asset classes. We will dispense with all the tedious details. Concern yourself with just what we cover here. Don't fret. There will be plenty of time later on to learn the many intricacies of these investments. As we introduce each investment asset class, we will also touch on the risk and return that we can expect from each.

Equity Securities, Also Known as Common Stocks, Stocks

In the investment world, equity refers to ownership. Equity securities, also known as common stocks, represent partial ownership in corporations. Most people just use the term stocks. The term stocks is a bit unfortunate. Your Humble Author prefers to refer to them as companies or better yet, businesses. You are investing in a business. Why invest in a business? When all goes

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

well, businesses grow and earn money. This creates two great opportunities for investors. When the business grows, your partial ownership of the business should also grow. That's capital appreciation, also known as capital gains. Also, the business can optionally distribute earnings to you in the form of dividends. (You can think of dividends like interest payments but they are legally two different forms of payments.) We invest in businesses for potential capital appreciation and potential dividends. We invest for growth and income.

Note that we said, "When all goes well." Obviously, all doesn't always go well in this wicked world of ours, does it? Both capital appreciation and dividends are optional and are not guaranteed. Therefore, we find that stocks are high risk investments. We say that stocks are volatile. Stocks exhibit high volatility. Volatility is a euphemism for, "I lost a whole lotta' money!" You might ask someone how that stock he or she bought is doing and they may sheepishly say, "Oh, it's been volatile." That means they bought it for $11.88 and sold it for 30¢. Do you know anyone who bought a stock for $11.88 and sold it for 30¢? I do. I have known him all my life. He's kinda' of a goofy guy who teaches Introduction to Investments at Southwestern … Look, it was a really good company and they were going to strike it rich making artificial blood and well, um, it just didn't turn out the way it was supposed to. Ahem. Stocks are volatile. Stocks are risky. In fact, to paraphrase Professor Burton Malkiel from his famous book, A Random Walk Down Wall Street discussed in our Bibliography, the 2008 definition of stocks is, "Stocks are equity investment instruments designed to lose value."

However, if we can learn to stomach the volatility that comes along with stock investing, history tells us that we can reasonably expect to receive the best investment returns available from the most popular investment alternatives. We like to say that stocks have an average annual return of 8%, 9%, or even 10% over the long term. The problem is that they almost never return 8% or 9% or 10% in any given year. The returns vary substantially, up and down. For this reason, when we want to invest in stocks, we must think long

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

term. We must give our stock investment enough time to reward us with 8% or 9% or 10% annually. As Warren Buffett is quoted as saying, “If you aren’t thinking about owning a stock for ten years, don’t even think about owning it for ten minutes.” Stocks are long term investments.

Disclaimers: The real estate fans are most likely jumping up and down and screaming that real estate has given investors better returns than stocks. Calm down and please accept my apologies. In one sense, they are correct. In another, they are not. The problem is how we measure investment returns and how different investments are typically purchased. We will deal with this thorny issue later on. Some stock fans might also be screaming saying that 8%, 9%, 10% is too low. Stocks have done better. This is actually true. Stocks as a whole have done better than 10% over the last 100 years and some stocks have done a whole lot better. However, some have done a whole lot worse. We prefer to keep new investors’ expectations muted, especially since there are long periods of time where stocks have done a whole lot worse than 8%, 9%, or 10%. Finally, a scant few stocks can be considered moderate risk and moderate return vehicles. In the presentation for the previous section – You have watched it already, right? – we discussed Nestlé, the world’s largest food company. Companies such as Nestle can be categorized as moderate risk and moderate return investments.

Fixed-Income Securities, Also Known as Bonds

Fixed-income securities are typically referred to as bonds. Bonds are long-term loans to corporations, state and local municipalities, and the Federal government. When you invest in a bond, you get to play the part of a bank. You lend your money to one of these entities. In return, they promise to repay the principal – the money you lent them – and along the way, they will pay you interest. Most people pay their debts to the banks. Likewise, most corporations

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

and state and local governments also pay their debts. The United States Treasury has always paid its debts. Hence, we find that bonds are far less risky than stocks. And subsequently, we find the long term return from bonds is far less than stocks. (Are you starting to see a pattern here, Dear Students?) What can we expect from bonds? Interestingly, the returns since the Global Financial Crisis of 2008 have been less than they were for many decades before the Global Financial Crisis. Investors used to be accustomed to receiving 4% to 8% from their bond investments. At the time of this writing, many bonds are paying 1% to 3%. Today, greater than 4% is unusual but not uncommon.

At first, it may seem a bit odd that the value of a loan could vary. However, remember that bonds are securities and bond prices change in the marketplace every day just like stocks. As mentioned, though, the volatility with regard to bonds is much less than what stocks exhibit. Yet there are times when the prices of bonds can fall hard, too. To repeat, it will typically be far less than stocks but it can still sting. For example, when some stocks lost well over 50% during the Global Financial Crisis of the late 2000's, many bonds lost between 10% and 20%. We again paraphrase Professor Malkiel by saying the 2008 definition of bonds is, "Bonds are fixed-rate investment instruments designed to lose value."

Short term Investments, Also Known as "Cash" - A Place to Park Your Money

Short term investments are often referred to as "cash." We usually see cash put in quotes because these investments are not dollar bills that we stuff under our mattresses. Many of these short term instruments are tradable securities so again, their prices do change. However, they are vehicles that are typically guaranteed by some governmental organization. And if they are not guaranteed, they are pretty darned close. If you have been paying attention, you should

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

be able to guess correctly that since these choices have very low risk, these investments will not give us much reward. Therefore, we say that short term investments are a place to park your money. You aren't going to lose your money, but you also aren't going to make much money. That is why we call them short term investments. If we need the money in the short term, we don't want to place our funds into the stock market. Even the bond market might be too risky for us. We need to park our money into a short term investment so that in three, six, or nine months, we know it will not have lost 10%, 20%, or more of its value. At the end of this introductory chapter, we will cover short term investments in detail. Our 2008 Definition? "Short term investments are instruments designed to accept what remains of investors' money after they have given up on stocks and bonds."

Mutual Funds, Also Known as Investment Companies - Investments for the Masses

Unless you live on a deserted island or somehow effectively have shut out all forms of mass media, you no doubt have been subjected to advertisements for mutual funds. There is a valid reason for this. Mutual funds are investments for the masses. Just as most of us workaday individuals don't build our own cars, make our own shoes, or grow our own food, most people will not dedicate the time to learn how to invest. (This is most unfortunate. Everyone should take Introduction to Investments. I am not biased, of course.) And education is just the beginning! They then need to spend many hours doing the necessary research to identify, choose, and monitor their individual stock and bond investments. You, Dear Readers, are going to make this a fun and profitable labor of love. Many other people are either not interested, too nervous or frightened, or just simply too busy living their lives. This is where mutual funds come into the picture.

The legal term for a mutual fund is an investment company. Now

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

doesn't that name make more sense? The term investment company tells you what the mutual fund does for you. You need a car? You go to a car company. You need shoes? You go to a shoe company. You need investments? You go to an investment company! Mutual funds / investment companies are companies that pool investors' money and invest in a diversified portfolio of securities, typically stocks or bonds or a combination of stocks and bonds. Investors receive two valuable benefits, diversification and professional money management. Because of the size of the typical mutual fund, they are not limited to 10 or 20 stocks or bonds as is common with an individual investor. More than 20 stocks and an individual investor often becomes overwhelmed with the necessary research to simply keep track of their holdings. A typical mutual fund will hold 100 or 200 securities. Some hold many more.

So how does the mutual fund keep from becoming overwhelmed? The mutual fund is managed by professional money managers, the second major benefit of investing in mutual funds. The mutual fund portfolio managers are highly skilled and very well-paid professionals whose day-to-day job is to identify, choose, and then monitor the diversified portfolio of investments in the mutual fund. As we shall see, it is not an easy job and there is some controversy over whether these individuals are actually worth the high salaries they demand. We will explore this debate in our chapter dedicated to mutual funds.

Because of these two valuable benefits, diversification and professional money management, mutual funds have become extremely popular. Also adding to their popularity are the countless employer-sponsored retirement programs such as 401(k) and 403(b) plans. Mutual funds are the dominant investment choice for employer-sponsored retirement programs. Almost half of all American households own mutual funds. In our next chapter, because of their importance as investments for the masses, we will spend a great deal of time on mutual funds.

What kinds of risks and returns can we expect from mutual funds? Mutual funds will exhibit risks and returns similar to their

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

underlying investments. There are many mutual funds that fall into the short term investment category. These are called money market funds. Low risk, low return. However, most mutual funds are dedicated to stocks or bonds or both and they will exhibit the same risk versus return characteristics of stocks and bonds. Hence, what is their 2008 definition? "Yeah, them too." 2008 was a very difficult year for everyone.

Hybrid Securities – Preferred Stocks and Convertible Securities

Hybrid securities are designed to offer the stability of fixed-income investments (bonds) with the opportunity for capital growth of equity investments (stocks). With these investments, we are trying to get the best of both worlds. The pesky fly in the ointment with this approach is that along with the advantages of both stocks and bonds, you also get the disadvantages of both stocks and bonds. So, we get the best of both worlds … and we get the worst of both worlds.

Other annoying flies buzzing around the hybrid security worlds are the names of the major types of hybrid securities. The two major examples of hybrid investments are preferred stock and convertible securities. Don't they sound enticing? Wouldn't you really rather have "preferred stock" instead of just "common stock?" Well, actually, no, you and I and most individual investors don't really want preferred stock. They are typically owned by corporations. Plus anything that has to do with convertibles must be cool, right? You know, driving down the highway in your convertible car with the wind blowing through your hair? Well, convertible securities are nowhere near as sexy as that, as we shall see. For now, all you need to know is that hybrid securities are an attempt to combine the advantages of stocks and bonds together but also combine the disadvantages of stocks and bonds. We will postpone discussing

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

these oddities until much later in our class. By the way, they constitute a very small part of the investment universe.

Other Investment Alternatives – Real Estate, Physical Assets

Not everyone wants to invest in just stocks or bonds or mutual funds. For them, they may want to dabble in the world of real estate or try their hand at precious metals, art, collectibles, cars, or even enter the high-stakes world of commodities. Suffice to say, these investments are not for everyone. For many people, just scraping together the resources to purchase a home is enough real estate for a lifetime. Also, as we will see, some alternatives such as gold that get a great deal of attention have not necessarily been very good investments over the long term. At the very end of our journey together, we will touch on these alternatives. By the way, none of these choices were spared during the Global Financial Crisis in 2008.

Derivatives – Options, Futures

Derivative assets are speculative securities that derive their value from an underlying security or asset such as a stock or bond. "What? You are not buying the stock or bond?" No, you are buying a security that depends upon the price movements of a stock or bond. That sounds very confusing. Well, yes it is. Derivatives are very confusing. More importantly, they are immensely risky. You can make 100% in one day … and then lose it all the next day. For this reason, we do not categorize them as investments. They are speculations. (Throughout the class, when you see the words speculative or speculation, simply substitute the word gambling, okay?)

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Two major examples of derivatives are options and futures. Actually, to show you how confusing these things really are, their actual names are options contracts and futures contracts. Try saying those names three times fast. For now, this is all you need to know about derivatives: Derivatives derive their value from another asset, two major examples of derivatives are options and futures, and derivatives are extremely dangerous. In 2008, the derivative speculators did not feel so all alone. Usually, they are the only ones who are proud to have only lost 30%.

We have completed our Overview of the Investment Universe. Once again, we remind you that, for now, the material in this chapter is all you need to study and learn with regard to the investment alternatives discussed above. As you may have gathered by now, in this class, we will emphasize stocks, bonds, short term investments, and mutual funds. For the vast majority of us retail investors, these are the most popular and most important financial investment options. It is now time for us to delve deeply into the Eternal Struggle of Investing, Risk versus Return. But before we do that, we want you to review the investment alternatives we have just covered. Please make sure you watch the presentation on the class website or Canvas. There is a comprehension checking exercise at the very end of the presentation. Also, work through the Security Types Handout. Memorize this document for the first exam. (Hint, hint. Wink, wink. Nudge, nudge.)

Risk versus Return - The Eternal Struggle of Investing

Here it is, Dear Readers! This is the entire class in one presentation! Do you want to eat well or do you want to sleep well? By now, you should be seeing that there is a pattern in the world of investments. The more return you want from your investments, the more risk you will have to accept. In the previous section, we saw that stocks

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

have given us the best returns over time but have also subjected us to the most risk. Bonds are less risky but give us less return. Short term investments are risk-free or pretty darned close but they pay very little, currently almost nothing. Mutual funds will more or less reflect the underlying assets that they invest in. In the corresponding presentation on risk versus return, you will see how these various investment asset classes have done over very long periods of time. We see that stocks are the stars! Bonds are a distant second. And short term investments have barely kept up with inflation and currently are losing to inflation.

It is no accident that stocks and bonds have produced better returns than short term investments. If that were not the case, why would investors assume the higher risks of stocks and bonds? The answer is they would not. If short term guaranteed (or pretty darned close to being guaranteed) investments returned the same as stocks or bonds, investors would prefer those short term guaranteed investments. They would choose an investment for which there is no chance of losing money and they would be happy to accept the risk-free rate of return on their money. In theory, there is no investment with absolute zero risk. However, short term United States Treasury bills come as close to absolute zero risk as you can get in this world. Therefore, when investors want to know what the current risk-free rate of return is, they often look at the interest rate that three-month United States Treasury Bills are currently paying. (We will cover Treasury Bills in more detail in our next section dedicated to short term investments.)

To make prudent investment decisions, we investors need to know what the risk premium is for our potential investors. The risk premium is the reward for bearing risk. It is the extra return on a risky asset over the risk-free rate of return. As we would expect, the risk premium for stocks is the highest at over 8%. The risk premium for bonds is a bit less than 3%. These may not sound like much but over time, the effects of the higher returns are enormous as we saw in the graphics in the presentation. We find that investment returns are very easy to measure. How much did you start with? How much

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

did you end with? How long did it take you to earn this amount? That's your return.

Variance and Standard Deviation - Two Imperfect Measures of Risk

Investment risk, on the other hand, is much more difficult to measure. The reality is that risk is impossible to measure and predict. There is no measurement that accurately reflects the amount of risk that investors must accept when choosing an investment. That does not stop us from trying, though. Each year, the investment community measures the average annual return and the amount of variance from the average return. Using statistics, the resulting measures of risk are called variance and standard deviation. By far, the most popular measure of risk is standard deviation. Standard deviation is the measure we will use for our class.

I already know what you are thinking. "Aye, this is math! I need to drop this class!" Relax. Please don't drop the class. We don't do any variance or standard deviation calculations. We leave those calculations for your statistics class. We just do a quick library or Internet search and the investment community readily and happily gives us the results. Please. Don't drop the class.

It is important to understand what the variance and its more popular and important companion, standard deviation, can tell us about a potential investment. In general, the higher the variance and standard deviation, the riskier the investment. The higher the variance and standard deviation, the more the investment return will deviate from the average annual return of that investment. In other words, we said that stocks can give us an average annual return of 8%, 9% or even 10% over the long term but we also know that in any one year, the probability is very high that we won't get 8% or 9% or 10%. We might get +17% in one year, -9% the next

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

year, +22% after that, and then -4%. With stocks, the variances and deviations from the annual returns are extreme. A high standard deviation means the volatility is high. The investment is risky.

Please make sure that you have reviewed the graphics and the statistics in the presentation before continuing. There you will see that stocks are similar to Henry Longfellow's little girl with the little curl right in the middle of her forehead. When she was good, she was very, very good, but when she was bad, she was horrid. "Minus 20% in 2001, minus 30% in 2002, minus 40% in 2008!? No way! Not for me! I ain't gettin' involved in investing," is how some people react. Relax. Calm down. We are going to learn how to use this volatility to our advantage. We can make volatility our friend, not our enemy.

The lessons from history are that if we want high average annual returns, we are going to have to accept high risk and high volatility. There are going to be times when we lose money. There will be market downturns, corrections, crashes, etc. It is inevitable. As famed investor Peter Lynch says, "A stock market decline is as routine as a January blizzard in Colorado. If you're prepared, it can't hurt you. A decline is a great opportunity to pick up the bargains left behind by investors who are fleeing the storm in panic." The good news is that history also tells us, so far, the global economy and the stock markets around the world have always come back from those snowstorms.

Please note that there are charlatans and grifters and con artists aplenty in the shadows of the investment industry. They will brazenly – and illegally, by the way – tell you that they can guarantee, for example, a 12% risk-free average annual rate of return. They are lying, pure and simple. There is no such thing as a 12%, risk-free rate of return. It's a blue unicorn, a flying panda; it simply does not exist. Some crooks might even make claims of 300% or 3,000%. Check the website or Canvas for some examples. Or better yet, just type "100% return in 3 days using options" into any Internet search engine and see how many sharks want to separate you from your money.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Investing versus Speculating/Trading - Revisited

"But isn't someone doing it? Aren't there people who make tremendous rates of returns?" you may rightly ask. The answer is yes. There are individuals who make tremendous rates of return. But those people are not prudent, long term investors like us. They are speculators, also known as traders. Being a speculator/trader can be very profitable but it is also very stressful and perilous. Furthermore, you are up against the best in the world. Here is a quote from one of the famed speculators of the early 20th century, Jesse Livermore.

"The speculator is not an investor. His object is not to secure a steady return on his money at a good rate of interest, but to profit by either a rise or a fall in the price of whatever he may be speculating in." – Jesse Livermore

So do you want to be an investor or a speculator/trader? As we mentioned at the beginning, we can help you learn how to become a patient, prudent, successful long term investor. We cannot help you learn how to become a successful short term speculator. Sorry. We can't do it ourselves; how could we possibly teach anyone else to do it? If we have not convinced you yet to renounce any dreams you may have had of making riches quickly day trading surrounded by two computers and four monitors while simultaneously on the phone with two different companies, please take some time to listen to the story of John Gutfreund and John Meriweather from the book Liar's Poker by the accomplished investment author Michael Lewis. You never, ever want to play Liar's Poker with John Meriweather, let alone try to outtrade him.

It's really very simple. When the task is immensely difficult and the competition is ferocious, as it is in speculating/trading or in sports or the arts, for that matter, it is only natural that a select few will rise to the top. Can you throw or hit a fastball at 98 miles per hour? If you successfully can hit a fastball at 98 miles per hour three times out of ten tries, you can snag yourself a contract for

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

tens of millions of dollars each year. Can you dunk a basketball? Can you sing the lead part in a five-act opera? Can you write or direct or act in a movie with a $100+ million dollar budget? Can you hit a tiny white ball 350 yards down the fairway in just three shots? The average person can't accomplish any of these. But that does not mean there aren't people who can't. There are. Are you going to compete with them in their venue? I think not.

One of the best observations ever about investing versus speculating/trading was made by John Bogle, the founder of the Vanguard Group mutual fund company. He was interviewed by Steve Forbes, the Editor-in-Chief of Forbes magazine, back in 2009. The interview used to be available on the magazine's website but was taken down long ago. I contacted them and begged them to make it available again. I never got a response. So, please, Dear Folks at Forbes, if you are reading this, please make it available again and I promise to delete the following passage from this text.

"Well, the first thing you have to think about is, and this is an issue that I've almost never heard discussed, Steve, and that's the first question you have to ask yourself is: Am I an investor, or am I a speculator? An investor is a person who owns business and holds it forever and enjoys the returns that U.S. businesses, and to some extent global businesses, have earned since the beginning of time. They have capital, they earn a return on their capital and that capital grows over time. It's not complicated. That's the business of investing.

Speculation is betting on price. I think I can buy this for 10 and sell it for 12 or 14 or 20 or 100. Speculation has no place in the portfolio or the kit of the typical investor. Speculation leads you the wrong way. It allows you to put

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

> *your emotion first, whereas investment gets emotions out of the picture. You own these businesses, they're still sound, if the market doesn't think they're worth as much as they were, well, pity, the market doesn't know everything." – John "Jack" Bogle, Founder and former CEO of the Vanguard Group*

When the video was still available, we would show this segment in the face-to-face class and I would call out, "We do, Mr. Bogle! We emphasize the distinction between investors and speculators/traders in our Introduction to Investments class!" The entire interview is over 30 minutes and highly informative and enterprising. Let's hope Forbes resurrects it.

Observations about the End of the World

Some readers will ask, "Well, what if stock prices all go to zero? What if the economy and the stock market don't come back?" This is a very probing question. It speaks to our justifiable fears about investing, especially in stocks. Let's rephrase the question: What if the world ends? The truth is someday the world is going to end. There are numerous scenarios. For example, we know that in about 1 or 2 billion years, the sun will expand and swallow Mercury and Venus and maybe even the Earth. However, it won't need to swallow the Earth for our world to end. By the time it gets to Venus, temperatures on the Earth will be hot enough to melt tin and lead and copper. Thankfully, we have a long time to prepare for this scenario. But what about all the other disasters looming on our horizon? Global warming, climate change, income inequality, rising

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

sea levels, pandemics, tsunamis, earthquakes, fires, floods, disco returning!

As we said at the beginning, there will always be proclamations of doom and gloom, especially from charlatans ready to sell you their sure-fire method for surviving the end times. Don't listen to them! If the world does end, if our technologically-based civilization cracks and falls and dissolves into a pool of tears, if there is no food at the grocery store, no gas at the gas station, no clothes at the mall, the cell phones aren't working, the utility companies are not pumping out electricity or natural gas, the trash isn't being picked up, the sewers are clogged, the hospitals, schools, fire departments, police stations, banks are all boarded up, etc., your stock portfolio will be the last thought on your mind. You will be digging for beetle grubs and boiling bark for dinner. Let's meet at the beach. You bring the marshmallows. I'll bring the vodka. We can get drunk and watch the world burn.

Take heart, Dear Students! This scenario is not going to happen! Failure is not an option! As I have already told you, Your Humble Author is firmly convinced that the next 20, 30, 50 years are going to be the most prosperous years in the history of our civilization. There is no doubt that we have tremendous hurdles to overcome, some might say they are insurmountable. But never underestimate the innovative power of our species. Just look at what we did with Covid in 2020. A vaccine usually takes at least 4 years and often up to 10 years to develop. Multiple groups around the world created safe and effective vaccines in a matter of months! We will overcome climate change. We will phase out fossil fuels. We will have driverless cars and some will be able to fly. We will cure cancer. We will colonize Mars. We will have universal language translators. We will have domestic robots. We will see the day when close to 100% of the citizens of our world are connected to the Internet. Economically, I am very confident of this and more. (Politically, I am very scared. But that discussion is for another class in another department. Thank goodness this isn't Kindergarten where all the

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

disciplines are taught in the same classroom. Go take up our political woes with your Political Science professor.)

So What Is a Realistic Rate of Return for Me?

After you have taken this course, you will have a strong foundation of the most popular types of securities investments: stocks, bonds, "cash," and mutual funds. You will also know what levels of returns and what levels of risks you should reasonably expect to receive. And if you are a patient, long-term investor, I believe it is realistic to expect 8% to 10%. I am certainly working on it myself. So far, so good. Of course, as we will reiterate time and time again, there are no guarantees.

You are now most likely thinking, "But is 8% or 9% or 10% good enough for me?" It turns out the answer to this question is a resounding, "Yes!" There are some caveats we need to add, though. If you start early, if you invest patiently and consistently, if you do not get cocky or greedy, if you do not chase after every "Next Big Thing" that comes along, and most importantly, you do not panic when the market swoons, as it inevitably will do from time to time, then – unless the world ends – we believe it is entirely reasonable and realistic to expect 8% or 9% or 10% over the long term. As mentioned, some investors have done better. The trick is to take advantage of the time value of money, also known as the compound annual return or the compound annual growth rate.

The time value of money is the amount to which a sum you invest now will increase based on a specified rate of return and time period. Calculating amounts into the future is called compounding. The result is the future value of money. Future value can be computed for a single amount, also known as a lump sum, a principal, or a single payment. Future value can also be determined for a series of deposits, also known as a stream of investments or an annuity. (In our class, we usually don't use the term annuity

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

because an annuity is also an insurance product. We discuss annuity insurance products at the end of the class. We do not have kind words for them.)

There is a future value handout available on the class website and Canvas. We leave the calculations to you as an optional exercise. Quite possibly you have already taken our Financial Planning and Money Management class at Southwestern. We spend a good deal of time learning future value calculations in Financial Planning and Money Management. At the very least, please review the answer key and listen to the commentary to see the kinds of wealth that one can reasonably build over the working careers. The news is good!

The future value calculations allow us to move from the present into the future. Later on, when we learn how to assign valuations to stocks and bonds, we will use the inverse of future value, present value, to move from the future back to the present. ("Huh? What?" Relax. Study what is in this chapter. We have a long road ahead of us.)

So are you ready to start your journey to become a prudent, long term investor? Are you excited? I know I am! Well, before we do get to the good stuff, we are going to take a small detour. We will now revisit short term investments, vehicles that we use if we need the money in three, six, or nine months or even a year or two, depending upon the importance of the uses for the short term funds. Short term investments aren't very exciting. They aren't supposed to be. We don't want excitement with money that we need in the short term. We want certainty.

Short Term Investments Revisited - A Place to Park Your Money

To review, short term investments are vehicles that we use when we need the money to be safe because we are going to be using

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

it soon. For example, we are setting aside our financial aid for living expenses for the coming semester. We are building a down payment fund for a car or house. Hence, we often say that short term investments are a place to park your money. We don't want the value to decrease. We don't want to lose the money. We want the money to be there when we need it. For this reason, short term investments are typically guaranteed or pretty darned close. Short term investments are also very liquid; we can get our money very quickly, usually within a day. Some even allow us to write a check. These are the advantages and benefits of short term investments.

What are the disadvantages of short term investments? As we have seen, the returns from short term investments are very low. Low risk? Low return! In fact, as of this writing, many short term investments are paying almost nothing and have been paying miniscule amounts since the 2008 Global Financial Crisis. Short term interest rates started to climb very slowly starting in 2015 and were actually approaching respectable amounts in 2019 as the economy was finally shaking off the lingering effects of the economic devastation a decade earlier. And then Covid-19 hit and short term rates again fell close to zero. (Darned, stupid microbe!)

Stated Rate of Interest versus Discount Basis

As we explore the various short term investment alternatives, we will see that some offer the stated rate of interest method of paying interest and some offer the discount basis method. The stated rate of interest is the method that we are already familiar with if we have ever opened a savings account. The bank will tell us that they will pay us 1% on our money. If we deposit $100, after one year, we will earn 1% of $100 or $1. This is very straightforward.

The discount basis is a bit trickier. This method of earning interest entails purchasing the security at a price below its redemption value, also known as the par value, maturity value, or face value.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

The difference between the purchase price and redemption value is the interest earned. Since the securities are negotiable, the value of the investment grows as it approaches its maturity date. We say the interest "accrues" on the short term investment. On the date of maturity, the current owner of the security receives the maturity value. An example: You purchase a security now for $4,800 that will be redeemed for $5,000 in ten months. Your interest would be $200. If you were to sell the security in five months, – one half the time until maturity – the value would likely have accrued to $4,900. One half of the $200 would be $100 of interest and that would be added to the price of the security.

Risks of Short Term Investments

"Risks of short term investments!? Wait a minute! You told me that these investments were risk-free!" Yes, short term investments are risk-free with regard to the loss of principal, also known as the risk of default. We are not going to lose our money. However, there are other risks when investing. There is the risk that we may lose purchasing power. Over time, short term investments have barely kept up with inflation. Currently, they are losing to inflation. There is also the risk of lost opportunity cost. Opportunity cost is a rather nebulous concept that you would discuss in detail in your ECON 101 class. It is real, though. Whenever we make a choice, we must think about the opportunities that we forego by making that choice. What else could we have done with our money? If we choose short term investments for money that we won't need for the long term, we will almost certainly have done much worse than by carefully researching and choosing prudent, long term investments. You first saw this in the graphics discussing the returns of stocks versus bonds versus short term investments in the previous presentation and we will see examples of this throughout the semester.

Sadly, you will sometimes come across individuals who have

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

placed all their investable savings into short term “cash” investments. This is usually money that they are saving for long term goals such as retirement. These people need to take Introduction to Investments! In time, Dear Readers, you will be the Investment Gurus for your friends, family, and co-workers. You will gently but firmly educate and guide them in choosing prudent, long term oriented investments that will clobber the meager returns they were getting from their short term investments. You will speak with authority. They will thank you profusely. We will be proud of you. You may even decide that you want to pursue a career in the investment services industry.

That’s just the first of many pep talks. Stay tuned for more because the industry needs you. For now, it is time to run through the various types of short term investments. Don’t do this before bed time … unless you are prone to insomnia. Again, these choices are not very exciting but then again, they are not meant to be exciting. They are meant to ensure safety of principal. With short term money, boring is good.

Demand Deposit Accounts

Demand deposit accounts are offered by commercial banks and credit unions. The name comes from the fact that depositors can withdraw the funds at any time; the funds are available upon demand, although there are sometimes certain restrictions such as when you want to withdraw a large amount of money in cash. Demand deposit accounts at banks and credit unions have a very important benefit: They are typically guaranteed by an agency of the Federal government. You may have heard of the Federal Deposit Insurance Corporation (FDIC) or the National Credit Union Administration (NCUA). Your money is safe. Practically all banks and credit unions belong to these entities. If you are unsure if your bank or credit union belongs, just ask. For each account at each bank or

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

credit union, you are currently insured up to $250,000. If you have more than $250,000, you can simply distribute that amount into separate banks or credit unions. (If you have more than $250,000 and this is not short term money, you need to take Introduction to Investments and learn where to allocate your investable assets more effectively and prudently for long term growth of capital and income. Excuse me? You have heard this before. My apologies but it bears repeating. The opportunity cost of keeping long term money in short term investments is very high.)

Common examples of demand deposit accounts are checking accounts and savings accounts at banks and share-draft accounts and share accounts at credit unions. Those of you who use credit unions have probably never heard of share-draft or share accounts. That is because no one at the credit union uses those terms; they just use the same terms that the banks use, checking and savings. Even though there are legal differences, as far as we retail customers are concerned, there are no differences. They both work the same way. For many years, the regulators would not allow checking accounts to pay interest. For this reason, banks and credit unions offered Negotiable Order of Withdrawal (NOW) accounts. Again, no one called them that; they just called them checking accounts that paid interest. That restriction was removed in 2010 so now, NOW accounts are not as popular as they once were. (And no, that is not a double word typo.) Lastly, banks and credit can offer money market accounts, also known as money market demand accounts. Money market accounts typically pay more than checking and savings accounts. These accounts are very similar to the money market mutual funds. In fact, the banks and credit unions simply copied the concept from the mutual fund industry. The main difference between money market accounts and money market mutual funds is that the money market accounts at banks and credit unions have the same guarantee as other demand deposit accounts; money market mutual funds at mutual fund companies do not have this guarantee. We will discuss money market mutual funds a bit later on.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

We mentioned that there may be some restrictions on your ability to withdraw your funds upon demand. An example of this would be if you were to walk into your neighborhood bank and ask to withdraw the entire $187,000 in your savings account – in cash! The bank would most likely ask you to wait until tomorrow because they simply don't keep that much cash on hand. (There's over $250,000 in the ATM next door, though. Shows you how safe and secure the banks believe their ATMs are.) The bank would also contact the FBI and report a "suspicious transaction." This is courtesy of the Patriot Act, hurried through Congress within a month after the attacks on the World Trade Towers on September 11th, 2001. Some people will tell you that a deposit or withdrawal of $5,000 or $10,000 triggers the "suspicious transaction." This is not true. There is no specific dollar amount. The bank or credit union must determine what is a "suspicious transaction," depending upon the circumstances. Kinda' creepy, huh? The FBI will check up on you for carrying around your own money.

Certificates of Deposits (CDs)

Certificates of Deposits (CDs) are also offered by banks and credit unions and have the same guarantees as demand deposit accounts, namely the $250,000 deposit insurance guarantee. Unlike demand deposit accounts, though, CDs are time deposit accounts, also known as term deposits. They have a maturity date. You agree to keep your money on deposit for a certain time, anywhere from seven days to several years. Typically, the longer the time period, the higher the rate of interest a CD investor will receive. The rate of return is usually better than demand deposit accounts such as savings accounts or money market accounts. What are the disadvantages? If you need to withdraw the money before the maturity date, there will be a penalty. Also, your rate of return is fixed and typically does not change. If interest rates rise, your CD

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

will not rise with them. For this reason, many banks and credit unions offer Bump-Up CDs. If interest rates have risen, the Bump-Up CD allows an investor to "bump up" their initial interest to the current interest rate. CD investors need to be aware of the rollover or renewal provision of some CDs. Some banks or credit unions will automatically renew your CD at the end of the time period. The bank or credit union is required to notify you of the upcoming renewal. You typically have the option of requesting that the funds be automatically deposited into your savings or checking account. It definitely pays to shop around for the best CD interest rates. CD rates vary widely and as long as your bank or credit union belongs to the FDIC or NCUA, you can do business with institutions in the United States and its territories and have the same guarantee of principal.

Some brokerage firms and some banks offer Brokered CDs. The brokerage firm has invested a great deal of money with a bank and that generates more income than a typical retail investor will receive. The brokerage firm then can offer these higher rates to their customers. Also, unlike typical CDs, they can be bought and sold on the open market as are other securities. An investor does not have to wait until the maturity to receive their principal. The downside is that Brokered CDs are not FDIC-insured. For this reason, it is important to ensure that Brokered CD investors deal with a reputable brokerage firm.

Money Market Mutual Funds

Money market mutual funds are short term investments offered by mutual fund companies. Recall that a mutual fund is a company that pools the capital of a large number of investors. A money market mutual fund uses their investors' capital to invest exclusively in short term securities. They are also known as mutual money funds, or more simply and more typically, money markets. Because they

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

are offered by mutual fund companies and not banks or credit unions, they do not have the same protections that money market accounts at banks and credit unions have, namely the $250,000 principal protection guarantee. However, in practice, they are considered essentially as safe as their counterparts at banks and credit unions. Why? There is a long history of the government and the industry doing their parts to ensure that money market clients do not lose a penny! In practice, that is exactly what can happen. Your money money fund can "break the buck." When that happens, the whole world sits up and takes notice. Just type "breaking the buck" into any Internet search engine and see how many millions of results you get. There are tremendous forces allied against any money market ever breaking the buck.

Money markets are very versatile and popular. Virtually every mutual fund company offers one or sometimes several different types of money market funds. Many money markets allow you to write checks, although in practice, most investors simply link their money market funds to their checking and savings accounts at their banks and credit unions and electronically withdraw funds as needed. Money markets allow you to easily exchange funds to and from your stock and bond mutual funds at your mutual fund company. Money market funds typically pay interest rates higher than checking and savings accounts and only a bit less than CDs. However, unlike CDs, the interest rates on money market funds change daily. Therefore, if interest rates rise, your money market interest rate will rise with them. There is much to like about money market mutual funds.

Series EE, HH, and I Savings Bonds

Savings bonds are short term investments that are offered by the United States Treasury. The Treasury currently offers both Series EE and Series I savings bonds. The Series HH bonds were

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

discontinued in 2004 and will all mature and disappear by 2024. The Series EE savings bonds use the discount basis of accruing interest. In other words, for example, you might buy a Series EE savings bond for $50 and it will pay its maturity value of $100 in 20 years. Currently, though, Series EE bonds purchased online electronically are purchased at face value and earn interest in the stated rate of interest manner. Savings bonds are exempt from state income taxes. (We will discuss more about the tax relationship of the Federal government and the state and local governments later in the class.) If you use the proceeds from your savings bond for qualified higher education expenses, then the interest is also exempt from Federal income taxes.

The "I" in Series I savings bonds stands for Inflation. Series I bonds were introduced in 1998 to cater to those investors worried about inflation. Like Series EE savings bonds, Series I bonds do come with a fixed rate of return but that rate of return is far less than other types of short term investments, including Series EE bonds. Instead, Series I bonds add an inflation-adjusted interest amount every six months that varies with the rate of inflation. Hence, Series I bonds are guaranteed to keep pace with inflation. Series I bonds are very popular with those who are worried about inflation returning.

The yearly purchase limits are currently $10,000 for Series EE bonds Series I bonds. For decades, United States savings bonds were popular gifts to newborns. Grandparents and aunts and uncles would buy them at their local bank for the new arrival to the family. The bonds would be tucked away in a drawer somewhere and promptly forgotten about until the parents passed away and the adult kids and adult grandkids were tasked with clearing everything out of the house. The Treasury has done away with paper savings bonds for Series EE bonds and are phasing out paper savings bonds for Series I bonds. All bonds are now available for purchase and safekeeping at www.TreasuryDirect.gov. TreasuryDirect.gov is the subject of one of your chapter 1 assignments.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Treasury Bills

Treasury Bills are short term investments that are also offered by the United States Treasury. They are often informally referred to as T-Bills. T-Bills all have maturities that are less than one year. The most typical periods are one month (4-week), three months (13-week), and six months (26-week), although two months (8-week) and twelve months (52-week) are also available. Treasury Bills are often considered the safest of all investments. As mentioned, when the investment community wants to report the current risk-free rate of return, they often use the rate for three month Treasury Bills.

T-Bills are usually sold in $1,000 increments and use the discount basis method for paying interest. For example, you may purchase a six-month $1,000 Treasury Bill for $990 that will mature at $1,000. The $10 difference would be your interest received. Along the way to the six month maturity date, because these are securities, you could sell your Treasury Bill, again, at a discount to the $1,000 maturity value. As the date of maturity becomes nearer, your Treasury Bill will increase in value. The price would depend upon the prevailing market rates but any volatility would be close to zero. Remember, Treasury Bills are very safe. At the date of maturity, the T-Bill would be worth the full $1,000.

Like the Series EE and I savings bonds, interest from Treasury Bonds is tax-exempt at the state and local level. Unlike Series EE and I savings, though, the interest is not tax-exempt if used for the qualified higher education expenses.

Also like the Series EE and I savings bonds, Treasury Bills are available for purchase at www.TreasuryDirect.gov. TreasuryDirect.gov offers you and me, the common retail investors, the same prices as the big boys and girls on Wall Street. It is a very well done website and, as mentioned, the subject of one of your chapter 1 assignments. The Mexican government has a website very similar to TreasuryDirect.gov. It is called Cetes Directo. Your Humble Author had the good fortune to meet the project manager.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

He acknowledged that they essentially copied TreasuryDirect.gov verbatim. We love to complain when our government screws up. Hence, we should rightly praise them when they do something well. Thanks, United States Treasury!

Commercial Paper and Banker's Acceptance Notes

Commercial paper investments are short term, unsecured promissory notes (IOUs) issued by corporations with very high credit standings. Corporations typically use these vehicles when they need a very short term loan for payroll or maybe for the large purchase of goods in anticipation of a coming increase in business activity such as major retailers preparing for the Christmas surge. Instead of going to a bank, the corporation can go to the investment community and get a much better rate than the bank would charge. Like Treasury Bills, commercial paper investments use the discount basis and are sold at a discount to their maturity face value and have short term maturity periods of one, three, six, and nine months. Unlike Treasury Bills, commercial paper investments are typically denominated in $100,000 increments and commercial paper dealers normally want you to buy many of them at one time. Hence, they are usually purchased by financial institutions such as life insurance companies and pension funds. Money market mutual funds are also eager buyers of commercial paper. You and I are not going to buy commercial paper except indirectly through our investments in money markets. (If you are indeed in the market for commercial paper and can afford multiples of $100,000 denominations, then congratulations but I have a sneaking suspicion that you have your own private broker.)

Banker's acceptance notes are cousins to commercial paper investments. They, too, are sold at a discount, are tradable securities, are typically denominated in $100,000 increments, and

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

mature quickly. Banker's acceptance notes usually mature in 90 days but the maturity date can be up to 180 days. They are often used to facilitate domestic and international trade for companies that do not have the prestige and financial wherewithal to issue their own commercial paper in the marketplace. The company petitions the bank for help and the bank issues the acceptance notes which the company can sell on the open market. The company then uses the proceeds to facilitate the trade. The company must pay the bank the face value at the maturity date so that ultimate holders of the notes can be paid. If the company defaults, the bank must make good on the notes.

By keeping the maturity periods to less than one year, the issuers of corporate paper and banker's acceptance notes are not required to register their securities with the Securities and Exchange Commission. This helps keep the fees associated with these short term investments low.

Which Short Term Investment Is Right for Me?

We have explored the various short term investment alternatives. It is time for you to answer the question, "Which short term investment is right for me?" Everyone is different and so that question can only be answered by you. Here are our observations: Because of their costs, commercial paper and banker's acceptance notes are usually only suitable for institutional investors. Savings bonds used to make cute gifts for newborns in paper form but now that they are all electronic, will the proud new parents still coo and awe when the card is opened only to say that their newborn's savings bond is safely tucked away at TreasuryDirect.gov? Many savvy investors purchase Treasury Bills directly from the Treasury at www.TreasuryDirect.gov. Certificates of Deposit are okay for those that are sure that they will not need the money until maturity. In our opinion, their flexibility and ease of use make money market

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

mutual funds and money market deposit accounts the preferred choice of most investors, especially since every bank, credit union, brokerage firm, and mutual fund company offers them. Sadly, many uninformed savers still use a passbook savings account from a bank or credit union. (They have not taken this course yet. Such a shame!)

Emergency Fund Debate

If you watch the financial media outlets and listen to any of the talking heads with their perfect hair and immaculate dental implants, they will vehemently insist that you have an emergency fund. An emergency fund is essentially a liquid, short term investment in which you place three, six, nine, or even twelve or more months of income. This is a self-insurance program in case of losing your source of income or another costly emergency arises. Some experts, most notably David Chilton, author of The Wealthy Barber, do not agree with this strategy. Of course, no one is advocating that you have $17.87 in your rainy day savings account; some substantial amount socked away for that rainy day is obviously a great benefit to your financial well-being. However, for those still working, assuming you have a marketable skill that would allow you to find gainful employment in a reasonable amount of time, there can be better uses for that money. You can use those funds to pay down expensive debt or increase your monthly retirement or investment contributions. There are exceptions, though. Anyone who works in sales or has their own business or works in a seasonal industry definitely needs a substantial emergency fund. We would be remiss to forget to ask one last thing: You do have proper and adequate insurance, yes? For more about an emergency fund, take Financial Planning and Money Management at Southwestern Community College.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

The Federal Reserve Bank and Short Term Interest Rates

We mentioned that short term interest rates change over time. You may be wondering, "Well, who sets these short term interest rates?" For a more thorough investigation, you will want to take an Introduction to Economics class. The short answer, though, is that the Federal Reserve Bank is responsible for setting short term interest rates in the United States. It is often referred to as the Fed. They are the nation's central bank and are often called the bankers' bank since the banks of our nation use the Fed as their bank. The Fed has major two objectives. They are charged with keeping the nation's economy at full employment while at the same time, keeping inflation under control. These two objectives are often at odds with one another. The Fed has tremendous power and the Chairperson of the Federal Reserve Bank is often called, "the second most powerful person in the nation." The Fed was designed to be independent and not subject to political pressures. That does not stop politicians and other high-profile individuals from criticizing their actions. In fact, many vocal critics even claim that the Federal Reserve Bank is unconstitutional. Suffice to say that no system we humans have ever created is perfect, and that includes the Fed. However, for over 100 years, the Fed has bumbled along and sometimes has executed brilliantly and sometimes has failed miserably. We don't call Economics the "Dismal Science" for nothing.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Congratulations - You Have Finished Chapter 1 - Introduction, Overview, and Risk versus Return

Learning Objectives

You have reached the end of chapter 1, Introduction, Overview, and Risk versus Return. In this chapter and the chapter 1 Canvas module or class website, you have

- Been introduced to the definition of an investment and the basic characteristics of investments – You now know what a prudent investment is! An investment is any vehicle that we can place resources into with the reasonable expectation of income, a.k.a. cash flow, or growth, a.k.a. capital gains, or both
- Reviewed the major asset investment alternatives – Overview of the Investment Universe
- Explored the relationship of risk and return – Do you want to eat well or do you want to sleep well?
- Identified the differences between an investor and a speculator/trader
- Concentrated and investigated short-term "cash" investment alternatives – A Place to Park Your Money
- Discussed aspects of short-term "cash" investments with your fellow students

You should now be able to

1. Given a typical investment, identify its characteristics including the cash flow (income) and capital gains (growth) components, and identify the advantages and disadvantages of the investment
2. In a brief two- to three-sentence description, succinctly describe the major investment alternatives including stocks, bonds, mutual funds, and short-term "cash" investments
3. Express the historical relationship of risk and return – Do you want to eat well or do you want to sleep well?
4. Research short-term "cash" investment alternatives including demand deposit accounts such as savings accounts, Certificates of Deposits, money market accounts and money market mutual funds, and Treasury Bills
5. Describe institutional short-term investment alternatives such as corporate paper and bankers acceptance notes
6. Optionally, calculate the future values of a lump sum principal investment and a series of investments

We told you not to worry, right? It was not that hard, was it? If you are still a bit fuzzy on some topics, that is okay. Go back and read the text and listen and watch the presentations again. Much of the task of learning about investments is just getting past the odd and strange names that we hear all the time on the television but don't really know what they are talking about. Well, now you know more about what they are talking about, don't you?

Your Feedback, Please

Are you getting an education about investments? We hope so! Our goal is for this class to be one of the few classes that you remember 10 or 20 or more years from now. We hope that you can say to yourself, “Ya' know, that Introduction to Investments class really helped me.” Again, enrolled students should comment in the Strength-to-Go-On Bar & Grille Canvas discussion forum. Perhaps you might want to start your own journal to help you organize your learning process. You can use the [Syllabus] menu option in Canvas to jot down everything you do each day in this class. Or just use the [Notes] or [Keep] app on your mobile device. Everyone can, of course, always contact me directly if you have any questions, comments, criticisms, suggestions, complaints, etc.

In our next chapter, we will investigate Mutual Funds, Investments for the Masses. The chances are very high that you will have a job with a company that offers you some kind of employer-sponsored retirement plan. That plan will almost certainly have mutual funds as the investment alternatives. As we will see, there are more mutual funds in the investment universe than visible stars in the night sky. (There are about 2,000 visible stars in the sky. There are approximately 12,000 mutual funds.) Choosing a mutual fund is extremely difficult, especially for those who have had no training or experience whatsoever. You, Dear Students, are going to be the Investment Guru for your family, friends, and fellow co-workers. You Can't Let Them Down! See you in our next chapter.

Notes: To listen or watch the presentations, go to the class website. As of July 9th, 2021, the Fall 2021 class website is just getting started. The Spring 2021 class website is still available. The graphics are in the presentations. The graphics will be eventually incorporated into the textbook when we have decided upon a platform such as Pressbooks to create the finished textbook. Onward and upward!

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

About Introduction to Investments and the Authors

BUS-123, Introduction to Investments, is a three-unit class offered by Southwestern Community College in Chula Vista, California. It is offered by our School of Business and Technology. If you want to learn about the full range of choices in the investment universe, this is the class for you. You do not need any prior investment experience! We start from the very beginning. By the end of the class, you will have a strong foundation in the most popular investment alternatives available to the general public. Our goal is to make this class the best class you have ever taken! We want this class to be one of the few classes that you can look back 5, 10, 20, or more years and can honestly say, "That class really helped me in this strange, beautiful, sad, absurd, joyful, scary, bizarre adventure that we call life." Oh, by the way, we want you to become very wealthy at the same time. We want you to be the best investors the world has ever seen!

This class is also the cornerstone class for our Certificate of Achievement in Financial Services, our Certificate of Achievement in Financial and Investments Services Specialty, and our Associate in Arts Degree in Business Management – Finance. Although we at Southwestern would love for you to subscribe and earn any and all of the above certificates and degrees, it is not a requirement for this class. As we will learn in the class, the financial and investment services industry needs you! Over the next 5 to 10 years, tens of thousands of professionals will be retiring. The industry also knows that they desperately need more diversity. They are actively seeking women and minorities, ex-military, bilingual speakers, and immigrants. Think about it! (Ah, did we mention that the salaries in our industry are higher than the national averages? Hmmm?)

Frank Paiano is the first author of what we hope will be many

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

more who will join our Open Educational Resource (OER) effort to make this information available to the world. He is the Luckiest Guy in the World. Frank has taught at Southwestern for a million years and has finally retired and is now teaching part-time. He is a licensed Registered Representative (a.k.a. Stockbroker) and California Insurance Agent. He and his wife have also gotten involved in real estate investing in the San Diego area with the next target being México. After threatening to write an OER textbook for several years, he has finally begun the process. It's about time!

<Insert Your Name Here> – Would you like to get involved in this OER project? If you have any expertise in the investment world, especially with Technical Analysis, you are welcome to join. We desperately need graphics artists and data experts. Eventually, we want to translate the text into other languages. Spanish, Arabic, Tagalog, and Vietnamese would be the first choices as we at Southwestern have sizable populations of students who speak these languages. Chinese, Hindi, Russian, and French would also be important languages as this will make the information available to the largest numbers of peoples of the world. Everyone needs to learn how to invest wisely, prudently, with an eye toward long-term growth of capital and income. (I'm not biased, of course.)

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

Bibliography - Books to Read

There are dozens and dozens of books about investing. However, only a few stand the test of time. If you are going to read any book or books before beginning your investing journey, the first three books are the best choices, in Your Humble Author's opinion. The rest are books that either are dedicated to investing or financial planning and literacy, except for the last book. The last book is something very special and unusual. You can get all these books at your local library. You can even download them to your mobile device. Do it. Read!

One Up On Wall Street, Peter Lynch

We will discuss Mr. Peter Lynch in the text and in the class. He was the portfolio manager of the Fidelity Magellan Fund from 1977 to 1989. During those 12 years, he posted average annual returns of 29% – unbelievable! When his first book was released the critics were ready to pounce on it as a self-idolizing piece of fluff. Nothing could be further from the truth! In this easy-to-read and thoroughly enjoyable book, Mr. Lynch makes a strong case for owning stocks and "buying what you know." He has a delicious sense of self-deprecating humor that puts the reader at ease. Everyone should read this book!

A Random Walk Down Wall Street, Burton Malkiel

Professor Burton Malkiel was one of the pioneers in the academic research that produced the Efficient Market and Random Walk theories of investing. He eventually served on the board of Vanguard Funds and was involved in the creation of the famous Vanguard 500 index fund in the mid-1970's. Like Mr. Lynch, Professor Malkiel has a wonderful sense of humor and takes no prisoners! He skewers the Fundamental theory of investing, the Technical Analysis theory of investing, and even his own Efficient Market and Random Walk theories. Everyone is fair game! If you don't want to read One Up On Wall Street as your first book, this is the next best choice.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

The Intelligent Investor, Benjamin Graham with commentary by Jason Zweig

Eventually, every prudent, long-term investor must read The Intelligent Investor. However, don't make this your first book to read. I am warning you! Mr. Graham's prose is very difficult to penetrate at times. That is why starting with the most recent editions, after every chapter, the very capable finance and investment writer, Jason Zweig, offers a commentary on Mr. Graham's concepts and recommendations. We will quote from this book often. Mr. Graham was Warren Buffett's teacher and mentor. We will see that Mr. Buffett has taken the teachings to heart and used them to become one of the best investors the world has ever seen.

Security Analysis, Benjamin Graham and David Dodd

Mr. Graham and Mr. Dodd wrote Security Analysis before Mr. Graham wrote The Intelligent Investor. It is often credited with creating the concept of "value investing." Indeed, Mr. Graham is often called the "Father of Value Investing." Once you have digested The Intelligent Investor, you can dig into this scholarly tome.

Wall Street People, Charles D. Ellis with James R. Vertin

Who doesn't like a good story?! Although this book is a bit outdated, it contains a treasure trove of stories about the men and women – mostly men but we are changing this situation, right, Ladies? – that populate the investment world. Some are heroes, some are villians, some are just regular folks trying to do the best they can in a high stress world, all are interesting. In addition, please note that anything that Charles Ellis writes is worth reading.

Beating the Street, Peter Lynch

Mr. Lynch's second book is not as groundbreaking as his first. However, it still is chock full of good stories and tips and techniques from the master.

Learn to Earn: A Beginner's Guide to Investing and Business, Peter Lynch

We may have the story wrong but our understanding is that the folks at BetterInvesting.org asked Mr. Lynch to create a "how-to

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

manual" using his concepts and techniques that he introduced in his first two books. BetterInvesting.org is the organization that sponsors investment clubs.

Any Book Written By, Michael Lewis

Michael Lewis is an awesome writer. Anything he has written is worth your time and attention. I am especially fond of Flash Boys. His most famous books are The Big Short and Moneyball. Again, read anything this man has written.

How to Make Money in Wall Street, Louis Rukeyser

Before CNBC and TheStreet.com and Marketwatch.com, and Yahoo Finance, the only widely broadcast show about investing was Wall Street Week with Louis Rukeyser. For over 30 years, it aired on that Socialist, Communist, Pinko, LIBERAL network known as PBS. This book is fun to read. Not only does Mr. Rukeyser discuss important investing concepts with great clarity, you also get a history lesson of what it was like to invest before the Internet.

Extraordinary Popular Delusions and the Madness of Crowds, Charles McKay

This classic opus was published in the 1840's. However, Extraordinary Popular Delusions and the Madness of Crowds is still as shocking now as it was almost 200 years ago. Mr. McKay discusses some of the financial picadillos of the previous centuries along with some of the other insane misadventures of humanity such as witchcraft and the Crusades. As one student put it, "It is easier to fool a million people than it is to fool one." QAnon, anyone?

The Wealthy Barber, David Chilton

The next two books are more about personal financial planning and literacy although they have a bit about investing. The Wealthy Barber is still the easiest to read and most enjoyable personal financial planning book Your Humble Author has ever come across. The numbers are all out of date but the concepts are timeless. Most importantly, Mr. Chilton's jokes are even worse than mine. Who could ask for more?

The Millionaire Next Door, Thomas Stanley & William Danko

When this book was first published in the mid-1990's, it shattered

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM

many of the myths about millionaires. It also spawned a whole host of copy-cat books, none of which have the clarity and weight of The Millionaire Next Door. Learn about how millionaires really build their wealth. Those of you starting young and following the concepts, techniques, and skills in our class will be joining their ranks eventually … unless the world ends. (If that happens, oh, well! Meet you at the beach. I'll bring the vodka. You bring the marshmallows.)

The Hero with a Thousand Faces, Joseph Campbell

If there is one book you should read in your lifetime, it is this one. Mr. Campbell has created a "how-to" manual for humans. In The Hero with a Thousand Faces, we learn that we are all heroes on an adventure. That adventure is what we call life. We see how the world's major religions are calling to us from thousands of years ago. They hope we learn how not to waste this precious gift that we have been given. And if that does not pique your interest, it is also the book that George Lucas used to create Star Wars. Mr. Campbell was on the sets of the first three Star Wars movies as a consultant. Oh, by the way, although they won't acknowledge it publicly, Disney has stolen from Mr. Campbell many times, the most egregious being The Lion King.

THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM
THIS BOOK WAS PRODUCED USING PRESSBOOKS.COM