# Become Financially Literate

**Knowledge is power!**

While you don't have to become a financial expert, you should develop an understanding of financial concepts such as these:

- **The difference between saving and investing:** Some people think these are one and the same, but they're not. The focus in saving is on preserving money that you accumulate over time. Money that is saved is typically "stored" in low-risk vehicles, such as bank savings accounts, CDs and money market accounts, which offer a relatively low return, but guarantee the principal and interest. A savings approach is appropriate for shorter-term needs that generally require a higher degree of liquidity, but is generally not the best approach for accomplishing your longer-term financial objectives. Investing, on the other hand, emphasizes accumulation through growth. Investment vehicles, such as stocks, bonds and mutual funds, involve a greater risk to principal than do savings vehicles, but also offer a higher return potential and may better guard against inflation. Most financial plans reflect a combination of savings and investments.

- **The "magic" of compound growth:** Compound growth is simply earnings paid on previous earnings. The "magic" appears over time. To illustrate, let's say we have one person who invests $100 per month for 20 years, from age 25 to age 45, and then invests nothing more for the next 20 years. Assuming an 8% annual return, this person's initial $24,000 investment would grow to almost $275,000 by age 65. Another person, however, waits to begin investing until age 35 and then also invests $100 per month but for 30 years, from age 35 to age 65. Assuming this person realizes the same 8% annual return, the amount available at this person's age 65 would be about $149,000. The second person invests more ($36,000 over 30 years vs. $24,000 over 20 years), but ends up with a good bit less at age 65 ($149,000 vs. $275,000). **The moral here is to start saving and investing early, because the person who waits can never catch up to the person who starts at a younger age!**

- **Risk and reward:** First off, let's understand that there is risk in saving and investing…it can't be avoided. You could keep your savings in a mattress and the mattress could catch on fire! The key is to understand the different types of risk and the relationship of risk and reward. For example, savings vehicles typically have no risk of loss of principal (**market risk**) or lack of a ready market when you need the money (**liquidity risk**). Without these risks, however, they produce a relatively low return, which means that they may not grow at a rate to keep pace with inflation (**purchasing power risk**). Investment vehicles, however, do come with both market risk and liquidity risk, including the risk of losing your principal investment. With these risks, however, investment vehicles offer the potential to produce a higher return and greater accumulation over time. The objective is not to eliminate risk. Rather, the objective is to balance risk and return in a way that is consistent with your temperament and financial goals.

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- **Diversification:** Diversification is an investment technique designed to minimize losses from the inevitable market downturns that will occur. When you diversify, you mix a variety of saving and investment vehicles in your portfolio, thus minimizing the impact of a single investment on the overall performance of your portfolio. The objective of diversification is to ensure that gains offset losses and the portfolio continues to grow in value.

- **Dollar cost averaging:** Regardless of what the markets are doing, a constant amount is invested each month, buying more shares when prices are lower and fewer shares when prices are up, resulting in a lower average per share cost over time. Dollar cost averaging enables you to invest through market cycles, flattening out the see-saw effect and taking advantage of a long-term upward trend.

  **NOTE:** Diversification and dollar cost averaging strategies do not guarantee positive investment performance, or eliminate the investment risk, including the potential loss of principal, associated with investing.

- **Understand saving and investment vehicles:** Take the time to understand what you're saving and investing in…the potential risks and rewards, the fees and expenses, the advantages and disadvantages.

- **Investment resources:** Know where you can turn for advice. Decide whether you want to actively manage your investment portfolio or whether you'd prefer to pay an advisor to recommend specific investments, as well as make market timing and asset reallocation decisions.



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