Personal financial plan - part iv

Finance

Savings and investments are two different financial concepts. Savings involves putting money aside usually in a bank. The bank pays a small annual interest rate on your savings. Investing involves the purchase of security instruments such as common stocks, preferred stocks, bonds, or derivatives. The purchase of real estate is also considered an investment. Investments have higher risk than savings. Return on investment is the amount of money you earn after a year on your investment. For instance if a common stock goes up from $100 to $112 at the end of the year the investor made a return on investment of 12%. Acting in an ethical manner is important when dealing with investments. An example of an unethical and illegal act in the investment world is insider trading. Insider trading occurs when a person receives privileged information and uses that information to gain an advantage in the stock market (Teweles, Bradley, Teweles, 1992). Investing has risk and rewards. Investments that have higher risk also have higher reward. Risk adverse investors avoid risk and are satisfied with a small return on investment. Opportunity cost refers to the opportunity forgone when choosing a decision. For example a person that works as a hot dog vendor has the opportunity cost of the amount of money he could make working for the private industry. Savings and investments are impacted by the time value of money. The time value of money is a concept that quantifies the depreciation of money over time. Money loses value over time due to inflation. The present value of $1000 at a 4% rate after ten years is $675. 60.

References

Teweles, R., Bradley E., Teweles, T. (1992). The Stock Market (6th ed.). New York: John Wiley & Sons.