LESSON 4

INVESTING FOR THE FUTURE

Be sure you know the condition of your flocks,
give careful attention to your herds;
for riches do not endure forever,
and a crown is not secure for all generations.
Proverbs 27:23-24

A television commercial depicts an elderly couple sitting in their rocking chairs on the front porch of their home, obviously enjoying their retirement. The smiles on their faces fade as their son, who appears to be in his forties, describes their bleak financial future. Then junior suggests job opportunities they might consider and ends with these words, "Now get out there, Mom and Dad, and make me proud!"

Although humorous, this commercial also has a ring of truth to it. As we have already learned, time, patience, and a little money is all that is needed to save for our retirement years. The sooner we begin to save for retirement, the less money it will take; but most Americans do not prepare adequately for their golden years. In annual surveys conducted by Career Builders and in conjunction with Harris Interactive, more and more Americans say they are living from paycheck to paycheck. Amidst the worst recession since the Great Depression, the numbers are growing.[21]

2007	43%	percentage of Americans who said they live paycheck to paycheck
2008	49%	percentage of Americans who said they live paycheck to paycheck
2009	61%	percentage of Americans who said they live paycheck to paycheck
2010	77%	percentage of Americans who said they live paycheck to paycheck

Americans spend enormous amounts of time and money getting a formal education to prepare for our careers. Then we dedicate ourselves to our work so that we can enjoy a better life for ourselves and with our children. The hard work usually pays rich dividends in terms of contentment with our work and financial rewards. It is regrettable, then, that we spend almost no time at all learning the financial facts of life.

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[21]Economicrot.blogspot.com, September 29, 2010.

It's not totally our fault, though. During our formal years in the education system, while we attended algebra and calculus classes, we were kept in the financial dark. Think back to your high school or college days. Did you ever complete a course in personal finance? For many of us, it was left up to our parents to teach us. And did they? In one poll of high school students, 92 percent cited their parents as being the leading personal finance instructors in their lives. This same group of students, however, said that they had learned nothing about money from their parents! Many of our parents viewed money matters in the same way they saw sexual matters—neither should be discussed with their children.

In their book, *You Have More Than You Think,* Gardner and Gardner remind us that personal finance is not like studying Babylonian history or quantum physics.

> Like horses wearing blinders, a whole generation of Americans has grown up focused only on meeting that 'minimum monthly payment' line, failing to recognize the implications of paying annual interest rates in excess of 15 percent….you have more than you think. You have a brain.[22]

From our earnings we must set aside savings for future needs, such as buying a car or a house, starting a business, paying for a college education, and/or making provision for our retirement. With only a little effort and time on our part, we should be able to retire at age 65 and enjoy our remaining years unfettered by financial worries. For most of us, we must also find the means to build wealth so that we can educate our children. The cost of a college education today is substantial. College expenses have grown at a higher rate than the rate of inflation. People who wait until children are high school age to begin saving for college will have to sacrifice their own financial future by borrowing or using their retirement savings. Your child's college education will not feed you during your retirement years!

In the house of the wise
are stores of choice food and oil,
but a foolish man devours all he has.
Proverbs 21:20

There are many types of savings programs. Some have low rates of return while others may earn at much greater rates of return; and some have tax-deferred or tax-free advantages. To get the most from your investments, you must select the savings program that will earn the best rate of return for your needs.

We have already discussed the first principle of money management—the power of compounding interest. This exponential growth of money can be shown by another financial principle:

The Rule of 72

The Rule of 72 demonstrates the significance of getting the most for your savings dollar. This rule says that any interest rate divided into 72 will give you the length of time it will take for an amount to

[22]Gardner, David and Tom. *You Have More Than You Think,* 1998.

double in value. If you invested $10,000 at an interest rate of 4 percent, it will take 18 years for it to grow to $20,000: (72 ÷ 4 = 18). The same amount of money invested at 8 percent will take only 9 years to double: (72 ÷ 8 = 9). In other words, the amount is not nearly as important as the rate of return and the time period. The earlier you start and the more you earn in interest, the less you need to start with.

He who gathers money
little by little makes it grow.
Proverbs 13:11

The only way to get the compounding of interest working for you instead of against you is to spend less than what you earn. We must learn the concept of *delayed gratification,* giving the long term priority over the short term.

TYPES OF INVESTMENTS

This lesson will review the different savings programs available and the advantages and disadvantages of each with a discussion of the importance of tax-deferred growth. There are many types of investments, including real estate and life insurance. The following investments will be broken down into four groups: (1) short-term investments, (2) stocks, (3) bonds, and (4) tax-deferred investments.

SHORT-TERM INVESTMENTS	Passbook Savings Account
	Certificate of Deposit
	Money Market Account
	Negotiable Order of Withdrawal (NOW Account)
STOCKS	Common Stock
	Preferred Stock
	Mutual Fund
BONDS	Corporate Bonds
	Municipal Bonds
	U.S. Savings Bonds
	Treasury Bonds, Notes, and Bills
	Ginnie Maes, Fannie Maes, and Sallie Maes
TAX-DEFERRED INVESTMENTS	Tax-Deferred Fixed Annuity
	Tax-Deferred Variable Annuity
	403(b) Tax-Sheltered Annuity (TSA)
	457(b) Deferred Compensation Section
	401(k) Pre-Tax Savings Plan
	Traditional Individual Retirement Account (IRA)
	Roth Individual Retirement Account (Roth IRA)
	Thrift Savings Account
	Keogh Plan
	Educational Savings Account (ESA)

SHORT-TERM INVESTMENTS

A **Passbook Savings Account** is a simple savings account where a record of your account is kept in an account passbook. This type of account offers the lowest rate of interest, but your money can be withdrawn at any time.

A **Certificate of Deposit (CD)** offers a higher interest rate than passbook savings, but your money must be kept on account for a set amount of time, such as three months, six months or two years. Interest rates depend on the length of time the money is left in the account, and there are substantial interest penalties for early withdrawal.

A **Money Market Account** pays a variable interest rate based on rates paid to holders of short-term government debt, namely U.S. Treasury bills. Money market accounts do not require long-term deposits but normally have a minimum deposit and balance requirements.

A **Negotiable Order of Withdrawal** (NOW account) is simply a checking account that earns interest or a savings account on which a check can be written. Banks usually require a minimum balance.

There is risk involved in any investment. The risk is extremely low that the money you place in a passbook savings account or CD at your bank will be lost through mismanagement or theft. As long as your savings are in a federally insured bank (and 99 percent of commercial banks are insured by the FDIC), your deposits are probably safe. However, if we experience another financial collapse like the one that occurred in 1929 when there was a run on banks, even "safe" investments like these will be jeopardized. There is no one hundred percent foolproof investment.

One of the best reasons for getting the highest rate of return possible has to do with inflation. In the United States, inflation is measured by the Consumer Price Index (CPI). According to the U.S. Department of Labor, over the last 90 years inflation averaged 3.3 percent; but since 1972, inflation has averaged 4.78 percent.[23] We can reasonably expect, then, an inflation rate between 3 and 5 percent per year. It only takes a 4 percent inflation rate to lose half of your purchasing power in 18 years.

As a young girl I remember my mother giving me 25 cents to go to the movies. The price for a theater ticket was 15 cents, leaving a dime for the popcorn and soda. By the time I graduated from high school in 1966, it took 15 cents to purchase a McDonald's hamburger, 10 cents for a soda (up from 5 cents), and 10 cents for a bag of french fries. Television commercials showed a consumer buying a whole meal at McDonald's and getting change back from 50 cents.

The point is that our savings must earn significantly more than the rate of inflation if we hope to have our investments grow. One popular means of short-term savings, which has been used for long-term savings, is the Certificate of Deposit (CD). CDs earn a higher rate of interest than passbook savings accounts because the money must be kept on deposit for a pre-determined length of time, such as three

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[23]Lussenheide, Bill. "Inflation: A Historical Perspective," *Investment Warrior Report,* 2003.

months, six months, one year, etc. Historical data on CD rates, as published by the Federal Reserve, show that during the last decade three-month CDs have paid between 0.278 and 6 percent.

The rate of inflation for the first five months of 2011 ranged from 1.6 to 3.6 percent with an average of 2.65 percent. The Bureau of Labor Statistics reported inflation for the month of May 2011 as 3.6 percent.[24] The three-month CD rates published by the Federal Reserve showed the return on CDs as 0.305 percent, or less than one-third of 1 percent.[25] During May 2011, therefore, an investment in a three-month CD would have lost over 2 percent. If you use CDs to invest for long-term needs and factor in the cost of inflation, you will be lucky just to break even. A wise investor, then, must consider both kinds of investment risk—the risk that you will lose your principal (the amount invested) and the risk that inflation will erode your savings.

THE STOCK MARKET

Could you afford to spare $3 a day toward your retirement? How many times have you stopped at McDonald's on your way to work to buy a cup of coffee and an Egg McMuffin? Your $3 may seem like small change, but it could fund your retirement. Historically, the stock market has returned an average of 12 percent. If you invested $3 a day from age 25 until age 65 at the same rate of return, you would have saved $381,437 before taxes. If you started as a 16-year-old, you could save $789,896 before taxes.[26]

One means of saving for long-term needs is to invest in the stock market. Because of its risk factors, it is seen as a form of gambling by some people. Investing in the stock market may or may not be a risky venture depending on how it is done. Speculating in stocks involves trying to manipulate their returns by buying low and selling high. Speculators make frequent trades hoping to make extremely high returns on their investments. For every success story of investing in this way, there is probably another sad story of an investor who has lost all of his investment. This type of investment is high risk, and research has shown that those who speculate in the stock market do no better than people who invest their money and leave it for the long term.

In 2008, *Forbes* magazine named Warren Buffett the world's richest billionaire. His company, Berkshire Hathaway, has operated for over forty years in the securities market and has averaged over 22 percent return on its stock investments. Buffett has some excellent advice: "Unlike the Lord, the market does not forgive those who know not what they do."

Better to meet a bear robbed of her cubs
than a fool in his folly.
Proverbs 17:12

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[24]usinflationcalculator.com, July 3, 2011.
[25]moneycafe.com, July 3, 2011.
[26]Kennon, Joshua. "Pay for Retirement with a Cup of Coffee and an Egg McMuffin," about.com, July 1, 2011.

The stock market is the best performing investment strategy of this century. It has returned an average annual rate of 11.67 percent for the past 80 years. Suffering through a 67.6 percent decline from 1928 to 1932, the stock market crashed and ushered in the Great Depression. During 1973-74, the market declined 45 percent, and in October 1987 it lost 26 percent in two days. In 2008 the stock market took another enormous hit. Despite these losses, the American stock market has always rebounded and still has maintained an overall growth rate between 11 and 12 percent.

A faithful man will be richly blessed,
but one eager to get rich will not go unpunished.
Proverbs 28:20

A great example of a patient investor is Anne Scheiber, who used her life's savings to purchase $5,000 in common stocks in 1945 through a full-service broker. When Scheiber died 50 years later, she was virtually unknown; but her name achieved instant recognition on Wall Street when Scheiber's will was read. Her estate, valued at $22.3 million, was left to Yeshiva College in New York. Scheiber maintained an average annual return of 18.3 percent with an asset allocation of 60 percent stocks, 30 percent bonds, and 10 percent cash. She believed that frequent trading in and out of the market only brought high commissions for the brokerage firm and large capital gains taxes for her, so she held on for decades with the companies she bought. Scheiber recognized the importance of buying strong businesses, and her stock portfolio included companies such as Coca-Cola and Pepsi, Paramount and Columbia, and Schering-Plough and Bristol Myers Squibb.

The prudent see danger and take refuge,
but the simple keep going and suffer for it.
Proverbs 27:12

When you invest in a stock, you become a part owner of a business. You can earn money in two ways with stock: ***Dividends*** are quarterly payments of profits from the business paid to shareholders. ***Capital gains*** are the monies you make when the stock goes up in value. ***Common Stock*** does not have a stated dividend rate. Some companies, such as Microsoft, don't pay dividends; stockholders expect a return of capital gains on their investments. ***Preferred Stock*** is less risky than common stock because it has a guaranteed dividend rate. Since preferred stock offers regular dividend payments, it is less volatile than common stock; but that guarantee virtually eliminates the possibility of large capital gains.

Investors can purchase stocks directly with the companies themselves, through discount brokers like Charles Schwab or Scottrade, or from full-service brokers. The three largest stock exchanges in the U.S. are the New York Stock Exchange (NYSE), which has stock holdings in the largest and oldest companies in the U.S., the NASDAQ, and the American Stock Exchange (AMEX). The Dow Jones industrial average is based on the average value of 30 large industrial stocks in the U.S. while Standard & Poor's (S&P) index is composed of the 500 largest companies in the U.S. Both of these indices closely reflect the stock market's performance.

One of the best ways to invest is with an automatic investment plan. You can authorize a mutual fund company to automatically withdraw money from your checking account each month, and many

employers also offer this option through payroll deductions. Investing the same dollar amount on a regular basis is called ***Dollar Cost Averaging.*** Dollar cost averaging reduces risk because your investment is made during both up and down markets, which gives you an average price over the course of time. This eliminates the disappointment of getting into the market at a bad time.

There are two basic types of stock purchases. You may either buy stocks in individual businesses or in mutual funds. A ***Mutual Fund,*** as the name implies, is an investment that is mutually funded. Numerous investors pool their monies into a fund that contains from 50 to 200 stocks. It is possible to invest in some mutual funds directly through the fund itself, or it may be handled through a broker.

Mutual funds have become immensely popular in the U.S., especially during the last 30 years, and have performed quite well since their inception compared to other types of investments. However, they usually do not perform as well as the stock market's average return. There are two strong advantages for purchasing mutual funds. First, a mutual fund is managed by either one professional or a team of professionals who purchase stocks in large, stable companies. Probably the best-known mutual fund manager was Peter Lynch (, who managed Fidelity Magellan fund, which earned annual returns of more than 29 percent for its investors from 1977 to 1990. Secondly, mutual funds offer ***diversification.*** An investor who diversifies doesn't put all his eggs in one basket but divides the investment among several companies, which reduces risk. Mutual funds have diversified holdings in dozens of well-known, respected corporations.

Sir John Templeton is a legend in the securities industry. A devoutly religious man, he was one of the most successful mutual fund managers in the history of the stock market. He offered some excellent advice to people who invest in the stock market:

> Invest—don't trade or speculate. The stock market is not a casino, but if you move in and out of stocks every time they move a point or two...or if you continually sell short…or deal only in options…or trade in futures…the market will be your casino. And, like most gamblers, you may lose eventually—and frequently.[27]

Templeton gives five steps for successful investing: (1) Be careful. Watch out for schemes. (2) View your investments as long term. Buy investments you want to own for five years, not five months. (3) Look at how the investment has done over long periods of time. What is its history over 10 to 20 years, not just last year. (4) Ask what the economic reason is for these returns. (5) Quit trying to get rich quick. Get rich slowly. Work hard, save, give back, invest diligently.[28]

BONDS

A ***Bond*** is a printed certificate with a promise to pay a specific amount of money at a stated interest rate on a specified maturity date. When you buy a bond, you are making a loan to the

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[27]Moore, Gary D. *Ten Golden Rules for Financial Success,* 1996.
[28]Armey, Doug. "Fourteen Laws of Successful Investing," newwealthparadigm.com, July 4, 2011.

organization selling the bond. The ***face value*** is the amount being borrowed by the seller of the bond and is paid to the bond holder upon the bond's maturity date. Interest is paid periodically to the bond holder. The main consideration you should make in deciding which type of bond to purchase is how much you get to keep after taxes.

Bonds allow the seller to raise large sums of money for a specific purpose. ***Corporate Bonds*** are issued by corporations and increase or decrease in value according to the performance of the company and current interest rates.

Local and state governments issue ***Municipal Bonds.*** They are considered safer investments but pay lower interest rates than corporate bonds. Their main advantage is that federal and state income taxes may not be assessed on interest earned on the bonds. If a bond pays 5 percent and you are in a 30 percent income tax bracket, you would have to get a 7.14 percent interest rate on a CD to match it after taxes.

U.S. Savings Bonds are popular for people with small amounts to invest and come in denominations of from $25 up to $30,000. They pay a fixed rate of interest semi-annually to the investor. Many investors purchase savings bonds through payroll deductions.

The U.S. government issues ***Treasury Bonds*** and ***Treasury Notes.*** Both are issued in varying denominations. The federal government also borrows money for immediate cash needs through short-term ***Treasury Bills.*** In addition to bonds issued directly by the government, there are government agency bonds, such as ***Ginnie Maes, Fannie Maes,*** and ***Sallie Maes.***

TAX-DEFERRED INVESTMENTS

Investments that offer tax deferments are some of the best vehicles for long-term savings. They offer a real advantage over other types of investments. The money you owe for income taxes is being held in your account, and you are getting the advantage of seeing this money multiply while the government waits until you withdraw to get its share.

Suppose you earn $50,000 and contribute 10 percent of your salary, or $5,000, into your 401(k). Your taxable salary then drops to $45,000. If you pay federal and state taxes at a rate of 30 percent, you will receive an immediate tax savings of $1,500 (30% x $5,000). Your cost of participating in the plan, therefore, is $3,500 rather than $5,000.

Annuities are issued by life insurance companies, which operate under their own tax laws. A ***Tax-Deferred Fixed Annuity*** guarantees a specific rate of return to the account holder. With a ***Tax-Deferred Variable Annuity,*** you choose how your fund will be invested with no guaranteed rate of return.

A ***403(b) Tax-Deferred Annuity*** is offered to certain groups of employees, such as teachers and hospital workers. A ***457(b) Tax-Deferred Annuity*** is available to groups of employees, such as local and state government workers. Investments are made through payroll deductions in one of three ways: fixed rate accounts, variable rate accounts, or mutual fund accounts. Of course, investments in mutual fund accounts are subject to the rise and fall of the stock market.

One of the most popular retirement programs for employees of businesses is the ***401(k) Pre-Tax Savings Plan***. You may defer part of your salary by having your employer place it into a 401(k) account. Often the company matches the employee's contribution. For example, if your company contributes 50 cents for every dollar you invest, you will make at least a 50 percent return on your investment!

In 2010, the maximum contribution to a 403(b), 457(b), or 401(k) was $16,500 with a greater catch-up contribution for employees who were over 50 years of age. Most of these retirement plans allow you to borrow money at a fixed rate of interest. To withdraw money before age 59½ (with certain hardship exceptions), you must pay a 10 percent penalty plus income taxes on the money withdrawn.

Unfortunately, there are people who never consider the consequences of borrowing or early withdrawal. I have seen my fellow co-workers—teachers with college degrees—withdraw money from their retirement accounts in December to pay for Christmas presents. Ignorance is expensive! Retirement funds should never be touched except in extreme emergencies. If you choose to withdraw your money today, you will lose the money plus the potential growth of it for your retirement years.

Another retirement plan is called the *Individual Retirement Account (IRA).* As of 2011, individuals under the age of 70½ could contribute up to $5,000 per year (per person) into individual retirement accounts. There are two types of IRAs: the ***Traditional IRA,*** which is tax deductible, and the ***Roth IRA,*** which is not tax deductible. Although contributions are not tax deductible with a Roth IRA, all earnings are 100 percent tax free. Young investors should consider having the bulk of their savings in a Roth account. Suppose at age 25 you contribute $5,000 per year for 40 working years into a Roth IRA, which earned an average of 8 percent per year. Your total investment is $200,000, your total return is $1,507,527.81, but your net earnings of $1.3 million is totally tax free.

Other types of tax-deferred investments include the ***Thrift Savings Account*** for civil service employees, the ***Keogh Plan*** for the self employed, and the ***Educational Savings Account (ESA)***. An ESA, nicknamed the Education IRA, is a good way to save for your child's college education. Contributions are not tax deductible, but earnings grow tax free.

CONCLUSION

How do you decide which type of savings is right for you? That question can best be answered by a qualified financial adviser. Select a reputable, licensed broker with a lot of experience and a clean working record. Interview at least three planners, arrange a face-to-face meeting with each, and get answers to these five questions: (1) What training and experience have you had? (2) Do you work with clients who are like me? (3) How are you compensated? (4) What will it be like to work with you? and (5) What can I expect in your reports?

There are two types of investment risk: the risk that you will lose your principal (the amount of your investment) and the risk that inflation will consume the profitability of your investment. To experience real growth with savings, one must look to investments that surpass the rate of inflation. To build wealth, an investor must recognize and use three financial principles: the power of compound interest, time, and rate of return. These principles form the building blocks for accumulating wealth.

SCRIPTURES TO LOOK UP THIS WEEK

Directions: Look up the following scriptures and write a summary for each.

I Timothy 6:17-18 ____
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Proverbs 15:22 ____
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Proverbs 14:15 ____
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Proverbs 3:13-15 ____
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Proverbs 16:9 ____
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Joshua 24:1-28 ____
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