

Handout 5

Checking accounts in FDIC member banks are insured. Your principal will always be available to you, but you will receive little or no return. It may seem that holding cash would be just as prudent; however, cash in your home or on your person is vulnerable to loss or theft.

Savings accounts in FDIC member banks are insured up to \$250,000. You will never lose your principal, but your return will be relatively small.

Certificates of deposit are very safe and offer a greater return than on savings accounts, but instant access carries a penalty.

U.S. Government Bonds are backed by the full faith and credit of the U.S. Government. You will not lose your principal; there is no chance of default. The return is greater than savings accounts or Certificates of Deposit. When you buy a U.S. Government bond you are lending your money to the government.

Municipal Bonds or Special Purpose Bonds are not backed by the federal government. There is seldom a default on these bonds, but it can happen. The risk is low, and the return is relatively low. However, there are tax benefits.

Corporate Bonds are not insured. They are debt issued by corporations. If a company wants to borrow money to finance a project, it might borrow from the public by issuing a bond. The return will be greater than on a government bond because there is a risk of default.

Mutual Funds are pools of cash, bonds and/or stocks and provide a means of diversification. Some funds are more risky than others. That is to say some have a more uncertain future value. For example, income mutual funds invest in large, stable and profitable companies. Stock prices in these companies are high because the future value of these companies is considered to be high. Growth mutual funds invest in companies that are not quite as large or stable or profitable. Investors expect these companies to grow, but their future value isn't considered as certain. So, income mutual funds would be considered less risky than growth mutual funds. The return varies by fund; however, returns are generally higher than government bonds or insured savings.

Stocks are part ownership in a company. Some stocks are riskier than others. Generally, the lower the price, the higher the risk. For example, Blue Chip stocks are shares in what investors consider to be very stable and profitable companies. Those stocks trade at high prices. On the other hand, penny stocks are shares in companies that investors consider to be volatile and risky. Those stocks trade at low prices to attract investors. Potential returns on stocks are greater than those from bonds or insured savings.

Real estate is residential or commercial property. The recent housing bubble illustrated the risk in real estate. For those who sold before the bubble burst, the returns were quite high.

Collectibles vary greatly, and so do their potential for risk and return. Some art, coins, stamps... have provided very worthwhile returns while, say, Beanie Babies - not so much.

Commodities, such as gold and silver, are speculative. In general, their values grow in times of economic uncertainty but returns are relatively low during steady economic times.

Handout 7 – Answer Key

Name _____

Directions: Place the financial investments in order of risk by drawing a line from the financial investment to the appropriate cell on the pyramid. The lowest risk item is at the bottom and the highest risk item is at the top.

