A $1000 Question

David Rodriguez, a high school junior, has just inherited $1,000 from a distant relative. Although David would like to spend the money now, he has decided to put it away for college. At a family gathering, five of his relatives offer David the following advice about the best way to save or invest his money.

AUNT ANDREA

David, I highly recommend that you invest your money in the stock market. When you buy a stock, you are buying ownership in a corporation. You earn money if the stock pays a dividend, or if you sell the stock for more than you paid for it. Of course, investing in stocks can be risky and you could lose money in the stock market too. (Risk refers to how likely you are to gain or lose money.) When you sell the stock, if its price has fallen below what you paid for it, you would lose part of your $1,000. If the stock becomes totally worthless, you would lose your whole $1,000. Whether you gain or lose depends on how well your stocks perform, which depends to a large extent on how well the company is doing. According to The Wall Street Journal, since 1926 your chances of losing money in the stock market in any one year are about 30%. However, over a ten year period, your chances of losing money are only about 4%! This means that the vast majority of people who purchase stocks as a long-term investment gain, and some gain a lot. Because there are so many different stocks to choose from (over 34,000), I suggest that you consult with a reputable stockbroker to help you decide how to invest your $1,000 in stocks. In general, you have to go through a stockbroker in order to buy or sell shares of stock. Your broker can tell you how your stock is doing or you can keep track of its progress through the stock market pages in the daily newspaper. You have to pay a commission to the broker.

SISTER SARA

David, I think you should keep your money in a traditional savings account at our local bank. These are often called "passbook accounts" because the bank will give you a small book to record your deposits and withdrawals. I know that passbook savings accounts generally earn lower interest than other types of savings accounts or other types of investments. But these accounts have advantages, too. For one thing, there is virtually no risk of losing any of your money because these accounts are insured by the FDIC for up to $250,000. Also, you can withdraw your money any time you want to without an interest penalty. It is really easy to open a passbook savings account, and easy to keep track of what's going on in your account. There are no fees to open a savings account.

UNCLE ALLEN

David, my suggestion is that you invest in a good mutual fund. A mutual fund company will pool your money together with that of thousands of other investors and buy many different securities (stocks and/or bonds). That way, if one stock or bond in the fund does poorly, the loss can be balanced by gains of other stocks or bonds in the fund. This allows you to diversify (distribute your investment among different types of securities to minimize risk). Mutual funds are managed by professionals who research what securities should go into the funds. Why not let experts make decisions for you? Of course, you have some decisions to make. You have to decide which fund you want to buy into, and there are over 3,000 funds to chose from. You can limit your choices by deciding if you want a very safe mutual fund or if you're willing to take more risk. Investors usually earn more profit from the riskier funds, but some people do not want to take the risk of losing their money. An example of a mutual fund that is usually relatively safe would be one that invests mainly in U.S. government bonds. A risky fund might invest in stocks of new companies that stand to either win big or lose big. And there are lots of choices in between. Although there is no guarantee of making a profit, in general mutual funds have strong payout and safety records, especially for long-term investors. You will receive statements that tell you how your mutual fund is doing, or you can read the tables in the newspaper. You may purchase mutual funds and learn about them through reputable brokers or financial planners, and you would have to pay them a commission for their services. If you do your own research and decide what fund you want to buy, you may usually call the fund directly and avoid the commission charge.

GRANDMA BETTY

David, I think you should consider investing in bonds. A bond is like an I.O.U. For example, if you bought a municipal bond with your $1,000, you would be lending a state or local government $1,000. You could also buy a corporate bond or a U.S. government bond. You would earn a specified amount of interest on your bond while you own it. . You could either keep the bond until it matures, at which time you would be paid back your $1,000, or you could sell the bond to another

investor whenever you want. The price for which you would sell the bond would be determined by supply and demand in the bond market, and is related to interest rates on similar bonds. In other words, if you bought a $1,000 bond that matured in 10 years but you wanted to sell it in five years, you might sell it for more or less than $1,000. Some bonds work a little differently: you would pay less than $1,000 for them, and receive $1,000 when they mature. The difference between the purchase price and the maturity price would reflect the interest you have earned. As with other types of investments, in general, the safer the bond, the lower the rate of return. For example, a new company may promise very high rates of return on a $1,000 corporate bond, but if the company fails they would not be able to pay back the $1,000. U.S. government bonds are a very safe investment, but have relatively low rates of return. It's easy to buy some types of bonds. U.S. Savings Bonds can be purchased at your local bank. People who live close to a Federal Reserve Bank can buy U.S. Treasury bonds there without paying any commission fees. Treasury bonds may also be purchased by mail from the Federal Reserve Bank of New York. In many cases, people buy bonds through brokers and pay a commission for the broker's services.

BROTHER TOM

David, in my opinion you should look into putting your $1,000 into a CD. No, no, not a compact disk! I mean a certificate of deposit. You have to have at least $500 to buy a CD, but that's no problem for you since you have $1,000. You earn higher interest than you would in other types of bank accounts. CDs are easy to buy; you just have to make a deposit into a CD account at almost any bank. When you make the deposit, you agree to leave the money in the account for a certain amount of time, usually between one month and five years. Generally, the longer you leave your money in, the higher the interest. However, if you withdraw your money early, you lose a lot of the interest. Also, if interest rates go up and you're locked into a long-term CD, you may wish you could switch your money into a different account. You have virtually no risk of losing your money, because your investment would be insured up to $250,000. There are no commission charges if you buy the CD at a bank.

Decision-Making Grid: What Should David Do?

Using a Decision-Making Grid like the one below could help David decide what to do with his $1,000.

1. Review the table below. Each of David's alternatives are listed down the left side of the table. The criteria that David may find important are listed across the top.

2. Next evaluate the criteria for the different alternatives, using pluses and minuses. For example, a "+" has been placed in the row next to stocks under the criterion "Return on Investment," because stocks meet this criterion well.

Alternatives for David's $1,000	**CRITERIA (Goals)**			
	Return on Investment	Safety of Investment	Liquid (easy to get cash)	Inexpensive (no commissions)
Stocks	+			
Savings Account	-			
Mutual Fund	+			
Bonds	+			
CD	-/+			

If you were David, what would you do with your $1,000? Why?