### Think like an investor...

# Saving vs. Investing

Everyone tells you that saving is critical for the future, but is investing better when trying to generate long-term wealth?

This module explains the difference between investing & savings, how banks make money by taking risk, and why you can do the same by evaluating companies for their long-term growth potential in order to make your money work smarter for you than for a banker.

**POWERED BY**

# Key Takeaways From This Module

## Guiding Questions

- What is the difference between saving & investing?
- How do banks work?
- What happens in the market over the long term?

## Enduring Understandings

- The fundamental differences between savings & investing
- The ways in which banks use money
- The benefits of starting early in the market

# Key Terms About Saving

**Income:** Regular money earned. This could be from a variety of sources such as a salaried occupation, investments, entrepreneurship etc

**Interest:** In the context of saving, interest is the percentage by which your money grows when it's in a savings account. This causes compound growth.

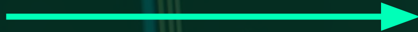
**Interest Rate:** The interest rate for borrowing is set by the Federal Reserve. This can affect the interest for savings accounts, generally called "yield".

**Disposable Income:** Personal money remaining after taxes, necessary expenses and savings.

# Your Order Of Financial Priorities

1. Establish a fund to pay for immediate obligations (e.g. rent,food, minimum debt payment)
2. Create an emergency fund to cover 3-6 months of living expenses
3. Contribute as much as your employer will match to your retirement plan
4. Pay off all high-interest debt (+7%), paying off the highest first
5. Invest the maximum allowed amounts in tax-advantaged accounts (401k or an IRA)
6. Pay off the rest of your debt
7. Invest your money in different accounts even if not tax-advantaged

# The Basics of Banks & Savings



Money is deposited with a bank at a predetermined fee and interest rate

Limits are placed on your ability to withdraw the money without penalty

While your money is in the account, it earns interest from the bank.

**Types of Saving Accounts**

**Traditional**

Most common kind of savings account and offers low interest rates

**High Yield**

Typically found in online banks and offers higher interest

**Money Market**

Allows for limited withdrawals and interest rates are variable

**Specialized**

Dedicated to specific purposes such as a house down payment

# How Do Banks Make Money?

In addition to providing Checking & Savings accounts, banks also provide services like loans.

Loans take many forms - car loans, mortgages, reverse mortgages - but in all cases, **the bank lends money in your account to others at an interest rate**.

**This interest rate is higher than the interest rate that the bank pays you to keep your money with them, because the bank has to refund your account if the borrower defaults on the loan. After accounting for people who don't pay them back, they keep the profits.**

That's why it's free to store your money with a bank. Because they want to use those deposits and loan them to others at a higher rate than  they pay you. In exchange? Well you don't have to carry cash around or store your life savings under a mattress.

**But is there something better than saving...?**

# Why Saving & Investing Are Not The Same

## What happens when you put $100 in savings?

**$100.00** Placed in a traditional savings account at the start of 2020

**$100.70** Is approximately what you'll have at the end of 2020

**These returns do not significantly change from year to year and the risk of losing all your money is negligible**

## What happens when you invest $100?

**$100.00** Invested in Amazon stock at the start of 2020

**$173.50** Is approximately your portfolio worth at the end of 2020

**However, these returns and the company's survival are not guaranteed. In 2014, for example, Amazon stock price fell by 22%**

We see that savings and investing are primarily differentiated by the **RISK** and **RETURN** they each offer. There are also more minor differences such as investing having greater transaction costs and requiring a brokerage instead of a bank

# Which Is More Important?

Saving and investing are both important parts of personal finance. Savings allow you to build a financial cushion for emergencies and achieve personal goals like saving for a down payment on a house. **Investing, however, is far more important for wealth creation because of a higher rate of return**. Here's how it works:

## What happens when you put $100 in savings for 5 years?

**Year 0:** 100
**Year 1:** 100.07
**Year 2:** 100.14
**Year 3:** 100.21
**Year 4:** 100.28
**Year 5:** 100.35

Assuming a traditional savings account with average interest rate 0.07%

## What happens when you invest $100 for 5 years?

**Year 0:** 100
**Year 1:** 165.57
**Year 2:** 231.27
**Year 3:** 407.47
**Year 4:** 482.69
**Year 5:** 564.13

Based on Amazon's stock price growth from January, 2015 - January, 2020

# Starting Early Is Crucial

The chart shows the accumulation of compound interest **using a contribution of $50 a year with a 5% interest rate.**

After about 62 years, **you will have deposited $3,150 but it will be worth $29,891!**

$35,000
$30,000
$25,000
$20,000
$15,000
$10,000
$5,000
$-

18 20 22 24 26 28 30 32 34 36 38 40 42 44 46 48 50 52 54 56 58 60 62 64 66 68 70 72 74 76 78 80

current value contributed

# You Gotta Risk It For The Biscuit

The saying goes, the greater the risk, the greater the reward. The same can be said for investing and that's why saving just doesn't cut it when trying to build wealth.

**When you place money into a savings account at a reputable bank, your money might not earn a lot of interest, but it is protected, even if the bank goes bankrupt**. This is because the government insures deposits up to $250,000 per account. The flip side, is that because there's no risk, your money won't earn more than 1%.

So if you want your money to grow & to leverage compound growth, that's where investing comes in. **For investing, you don't get government insurance against losses, so you need to become comfortable with risk**.

# The Odds Are Stacked In Your Favor

Every year, the global population increases and those people are contributing to the global economy.

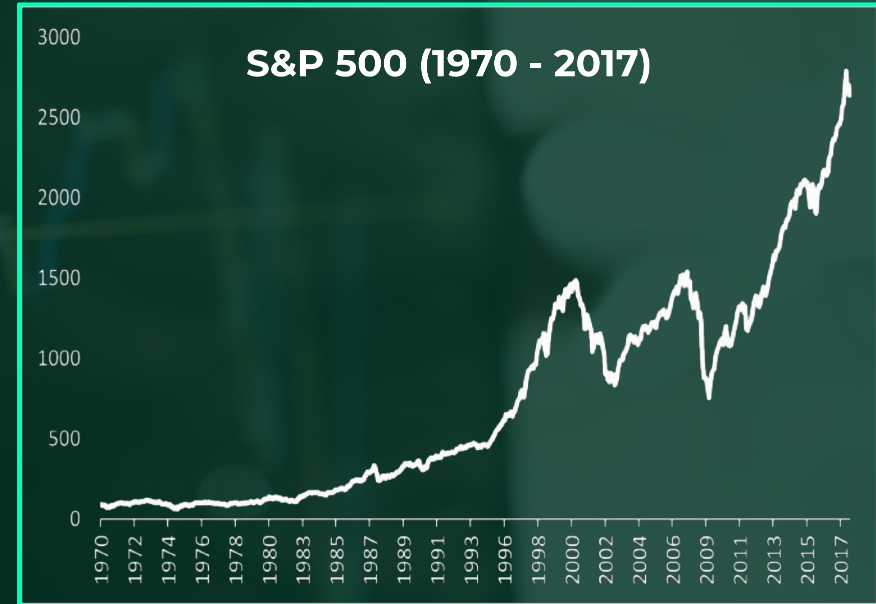
Over the long-term, financial markets grow, because the economy continues to expand as more people get jobs, buy houses, and consume products produced by businesses.

**What does that mean?**

Well, if you look at the chart, there has never been a 20 year period where the S&P 500 has decreased!

**Why does this matter?**

This means that investing in a well-diversified basket of stocks that is exposed to the entire financial market, over the long-term, can be one of the most powerful investment strategies on the planet.




***Remember the idea of buying the market? Well, there are Exchange Traded Funds which allow you to "buy" the S&P 500 so you can easily capture these returns.***

# The Value of Dollar Averaging

**Dollar cost averaging** is an investment strategy that involves committing to investing a fixed amount of money into a stock, regardless of share price, over regular time intervals.

For instance, if you were going to buy the market and had $10,000 to invest, would you do it all at once? Or is it better to invest $1,000 per week or per month until you've invested all of your money. Warren Buffett says dollar-average, so we listen.

**Lower Volatility**
Regardless of how the market fluctuates, your cost / risk is stagnant

**More Flexibility**
When stock prices are low, lump sum investing could bring greater returns

**Improved Discipline**
For beginners, this is a good way to take the emotion out of investing

**Closer To The "True" Price**
When going through a brokerage, you have to pay a fee for each transaction

# Impact of Dollar-Averaging Over The Long-Term

Let's say an investor decides to invest $50 into a company every 6 months.

**0 months**
**Share price: $5**
Investor purchases 10 shares

**6 months**
**Share price: $10**
Investor purchases 5 shares

**12 months**
**Share price: $50**
Investor purchases 1 share

**18 months**
**Share price: $2**
Investor purchases 25 shares

**24 months**
**Share price: $5**
Investor purchases 10 shares

**30 months**
**Share price: $25**
Investor purchases 2 shares

Here, we see that the stock saw significant fluctuations in pricing but the risk undertaken by the investor remained the same.

Although they bought shares as expensive as $50, their **average cost per share is $5.66**

If they had purchased all 53 shares when the share price was $50, the investor would have paid hundreds of dollars more and be down 50%.

Instead, the investor is up over 400% by persevering and buying consistently at regular intervals.

# What Makes A Good Investment?

Very few investments are objectively good or bad, otherwise, if people knew an investment were good, people would buy it until the price became too high. This is a concept known as **efficient markets**, where we assume the stock market's price has been determined by all the publicly available information at that specific moment in time.

*That's why **good investments are individually dependent upon risk tolerance and investment objectives**. For example, high risk stocks may be better for a hedge fund or younger investor than someone in their late 50s saving for retirement.*

**RISK PROFILE**

Investments must meet your risk tolerance. This varies with age, goals and capital

**TARGET RETURN**

Investors have a desirable return rate which usually correlates with risk appetite

**LIQUIDITY**

Depends on your investment horizon. Shorter horizon requires more liquidity

**VALUATION**

Underlying value should be your focus instead of temporary market excitement

# Key Takeaways From This Module

## CORE & FUNDAMENTALS

- Saving conserves your money, investing grows your money.
- Banks make money by charging interest on loans.
- Financial markets grow over time.

## APPLIED KNOWLEDGE

- There are better ways to accumulate wealth than putting money in a savings account.
- Long-term investing can reduce risk and lead to higher eventual returns.
- Dollar cost averaging is a good strategy for beginner investors.

## RELEVANCE FOR YOU

- Saving is important, but investing makes your money work for you.
- Thinking about risk tolerance, target returns, liquidity and value can help you put your best foot forward in the market.
- Dollar cost averaging and starting early can return the most gains.