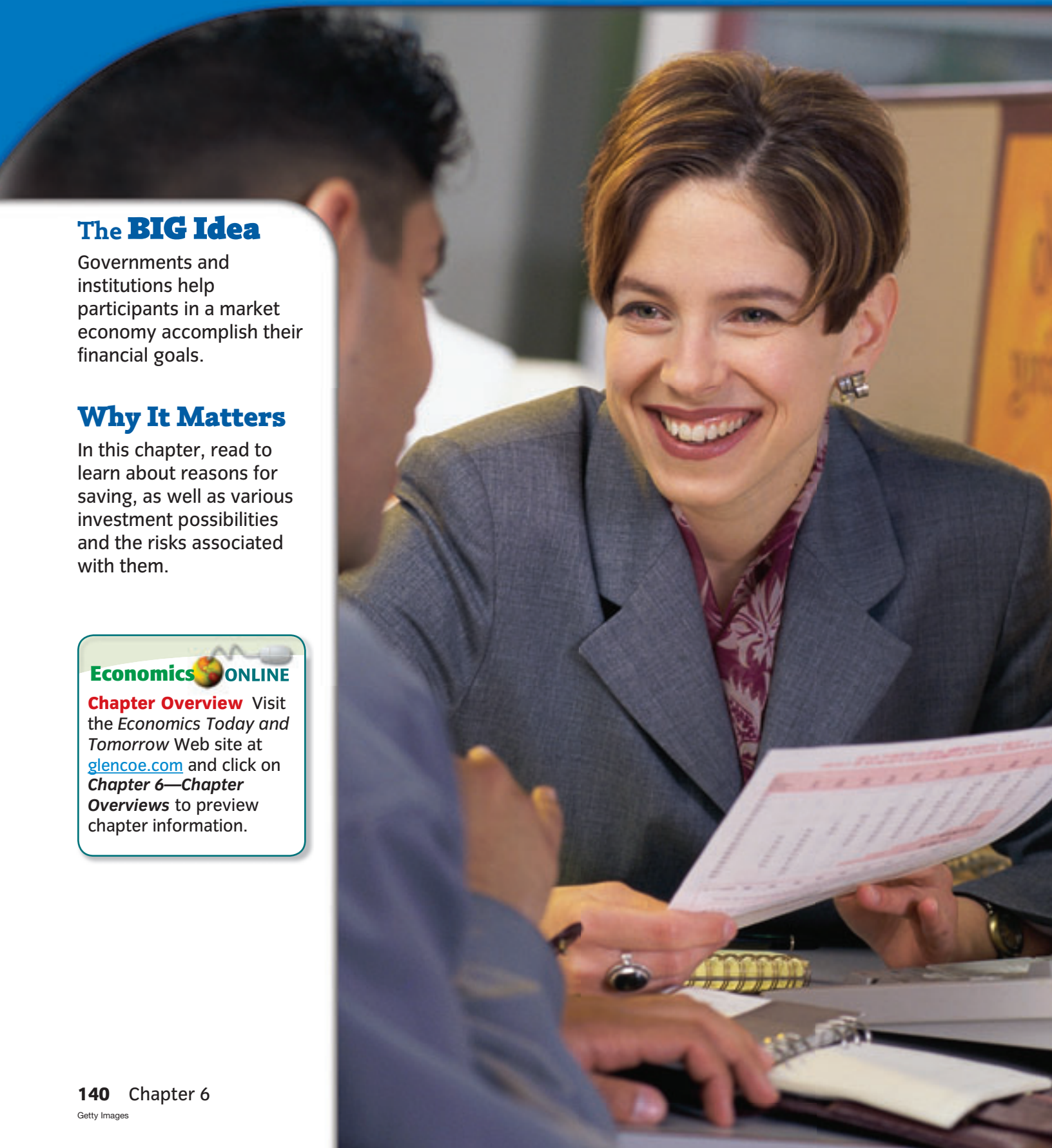
chapter 6 Saving and Investing



The BIG Idea

Governments and institutions help participants in a market economy accomplish their financial goals.

Why It Matters

In this chapter, read to learn about reasons for saving, as well as various investment possibilities and the risks associated with them.

Economics ONLINE

Chapter Overview Visit the *Economics Today and Tomorrow* Web site at glencoe.com and click on ***Chapter 6—Chapter Overviews*** to preview chapter information.

Getty Images

section 1 Why Save?

GUIDE TO READING

Section Preview

In this section, you will learn about the benefits of saving and the types of savings accounts available to you.

Content Vocabulary

- saving *(p. 142)*
- savings account *(p. 143)*
- money market deposit account *(p. 143)*
- time deposits *(p. 144)*
- maturity *(p. 144)*
- certificates of deposit *(p. 144)*

Academic Vocabulary

- require *(p. 142)*
- minimum *(p. 142)*

Reading Strategy

Identifying Complete a web diagram similar to the one below by identifying the different types of savings plans discussed in the section.

Interactive Graphic Organizer

ISSues In ThE NeWS

—from the *Seattle Times*

The Importance of Saving

Save your money.

Your parents and grandparents tried to teach you the concept when you were a kid. . . .

It's not a hard thing to understand. So why aren't more consumers doing it? No doubt, some consumers literally live hand to mouth financially. Every penny goes to pay for living expenses, and there's nothing left to stash away. But many others don't think enough about saving and aren't willing to slash unnecessary expenditures that could then translate into a fatter savings account. . . .

What most people don't realize is that they have more control than they think over their ability to save.

"I'm saying yes, you can [save], but I'm going against the grain, says Cynthia Nevels, executive director of the Jr. Finance Literacy Academy in Dallas, a financial-literacy program aimed at young people. "Too many people live in debt and worry about it later," she says.

If you have a part-time job, you may already be saving some of your income for a future use, such as buying the latest gaming system or continuing your education. Don't be discouraged if you can save only a small amount, as saving something is better than saving nothing. As you read this section, you'll learn why saving is important to you and the economy as a whole.

Don Farrall/Getty Images

Deciding to Save

Main Idea **Savings consist of income set aside for future use.**

Economics & You Think of a time you wanted something that you couldn't afford. Did you save to buy it? Read on to learn about the benefits of saving.

saving: setting aside income for a period of time so that it can be used later

Economists define **saving** as the setting aside of income for a period of time so that it can be used later. Any saving that you do now may be only for purchases that **require** more funds than you have at one time. When you are self-supporting and have more responsibilities, you will probably save for other reasons.

When an individual saves, the economy as a whole benefits. Saving provides funds for others to invest or spend. Saving also allows businesses to expand, which provides increased income for consumers and raises the standard of living.

Generally, when people think of saving, they think of putting their funds in a savings bank or other financial institution where it will earn interest. Interest is the payment people receive when they lend funds, or allow someone else to use their funds. A person receives interest on a savings plan for as long as funds are in the account.

You have many options regarding places in which to put your savings. As you learned in Chapter 4, the most common places are commercial banks, savings and loan associations, savings banks, and credit unions. In shopping for the best savings plan, you need to consider the trade-offs. Some savings plans allow immediate access to your funds but pay a low rate of interest. Others pay higher interest and allow immediate use of your funds, but require a large **minimum** balance.

Personal Finance Handbook
*See pages **R6–R9** to learn more about **saving.***

Reading Check **Predicting Consequences** What are three benefits of saving?

▼ Savings accounts, like checking accounts, can be accessed electronically.

HI & LOIS

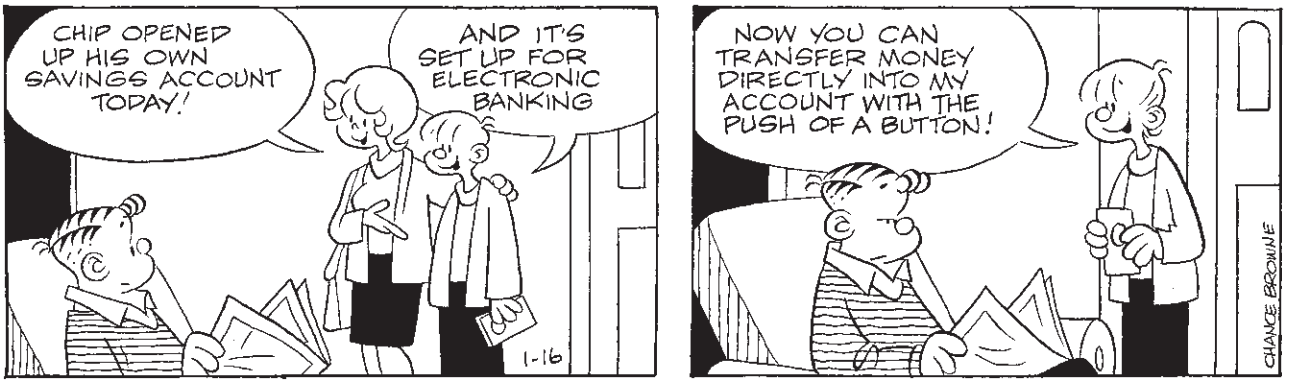


Figure 6.1 Savings Basics

■ Saving money can be difficult, but if you come up with a plan and stick with it, your overall financial situation will improve.

A. How to Save Following the steps listed here will start you on the road to saving.

Steps to Saving

- Determine reasons to save.
- Determine amount of funds to set aside.
- Decide what type of account you will use.
- Decide frequency of deposit.
- Decide when to invest a portion of what you have saved.

Where to Save?

Type of Account	Minimum Deposit?	Rate of Interest?	Availability of Funds?
Savings	No	Low	Immediate
Money market	$1,000 to $2,500	High	Immediate
Time deposit	$1,000	High	Depends on maturity; penalty for early withdrawal

B. Where to Save You have several choices about the type of savings account to open first.

Economic Analysis

Analyzing *What type of account should you open if you have at least $1,000 to put away and you will not need the funds for a long time?*

Savings Accounts and Time Deposits

Main Idea **Savings accounts and time deposits offer a variety of maturities and are insured by agencies of the federal government.**

Economics & You Where do you keep what you save? At home, or in a bank? Read on to learn about the different types of saving plans available to you.

Figure 6.1 above outlines several options for saving. A basic **savings account** is an interest-earning account that has no set maturity. Funds from such accounts can be withdrawn at any time without penalty to the account owner.

A **money market deposit account** (MMDA) is another type of account that pays relatively high rates of interest and allows immediate access to one's funds through checks. The trade-off is that these accounts have a $1,000 to $2,500 minimum balance requirement. Customers can usually make withdrawals from a money market account in person at any time, but they are allowed to write only a few checks a month against the account.

savings account: account that pays interest, has no maturity date, and from which funds can be withdrawn at any time without penalty

money market deposit account: account that pays relatively high rates of interest, requires a minimum balance, and allows immediate access to funds

time deposits: savings plans that require savers to leave their funds on deposit for certain periods of time

maturity: period of time at the end of which time deposits will pay a stated rate of interest

certificates of deposit: time deposits that state the amount of the deposit, maturity, and rate of interest being paid

Time Deposits

The term **time deposits** refers to a wide variety of savings plans that require a saver to deposit his or her funds for a certain period of time. The period of time is called the **maturity**, and it may vary from seven days to eight years or more. Time deposits are often called **certificates of deposit** (CDs), or savings certificates. CDs state the amount of the deposit, the length of time until maturity is reached, and the rate of interest being paid.

Time deposits offer higher interest rates than regular savings accounts. (See **Figure 6.2** below.) The longer the maturity, the higher the interest rate that is paid. For example, a CD with a short-term maturity of 90 days pays less interest than a CD with a 2-year maturity. Savers who cash a time deposit before maturity pay a penalty.

Skills Handbook

*See page **R57** to learn about **Understanding Interest Rates.***

Insuring Deposits

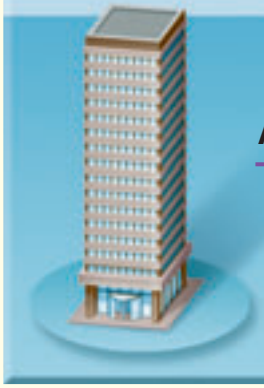
When the stock market collapsed in 1929, the resulting financial crisis wiped out many people's entire savings. Congress passed, and President Franklin Roosevelt signed, legislation to protect many types of deposits. This legislation created the Federal Deposit Insurance Corporation (FDIC). In addition to savings accounts, money market deposit accounts, and CDs, the FDIC also protects funds in regular checking accounts.

Figure 6.2 Savings Choices

Charts In MOtion See StudentWorks™ Plus or go to glencoe.com.

While a regular savings account allows you ready access to your funds, a time deposit, such as a CD, earns more interest income. If you have funds that you will not need for a while, you should choose a time deposit, as it will pay you more in the long run.

Money Now or Later?



Account	Amount invested	Interest rate	Original investment plus interest income after 12 months
Savings	$1,000.00	0.8%	$1,008.00
CD	$1,000.00	4.0%	$1,040.00

Economic Analysis

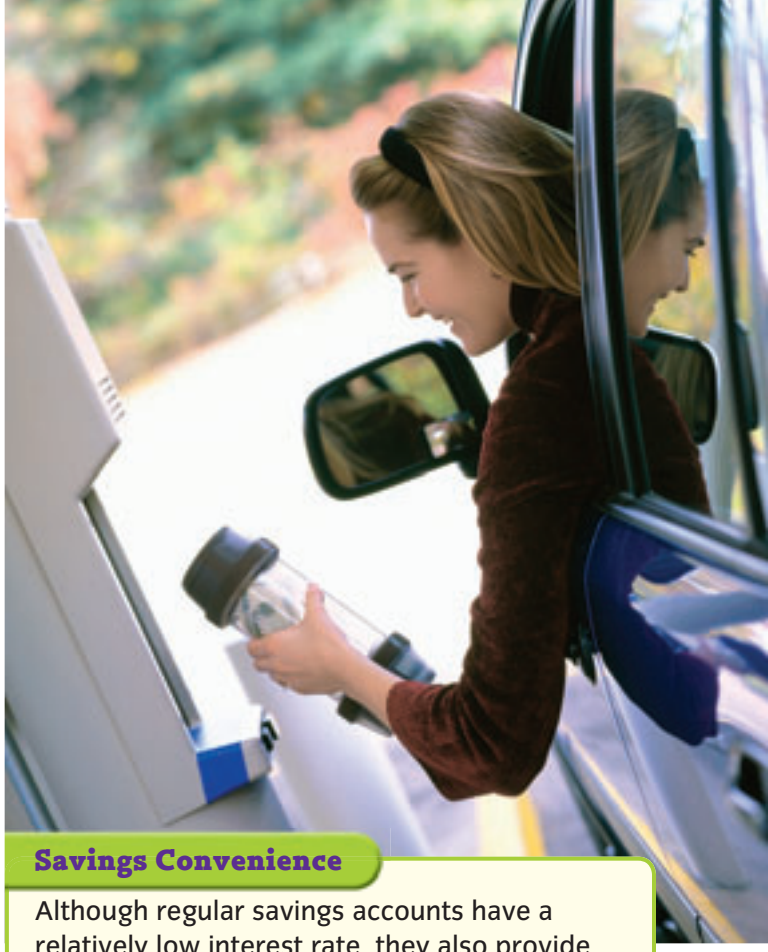
Using Charts *At the interest rates shown, at the end of a year, how much more will you have if you put your funds into a CD rather than a savings account?*

Owaki-Kulla/CORBIS

Today there are several federal agencies that insure most banks and savings institutions. The major one besides the FDIC is the National Credit Union Association (NCUA). Through these federal agencies, each depositor's funds in a particular savings institution are insured up to $100,000. If an insured institution fails, each depositor will be paid the full amount of his or her savings up to $100,000 for each legally separate account.

Federal deposit insurance has started to change with the times. Beginning on January 1, 2011, the $100,000 deposit insurance limit will be adjusted by the amount of inflation that occurred over the previous five years. Also, some special retirement accounts now have a limit of $250,000.

Reading Check **Comparing** What are the benefits and drawbacks of savings accounts? Of time deposits?



Savings Convenience

Although regular savings accounts have a relatively low interest rate, they also provide easy and convenient access to your funds.

section 1 Review

Vocabulary

1. **Explain** the significance of: saving, interest, savings account, money market deposit account, time deposits, maturity, certificates of deposit.

Main Ideas

2. **Summarizing** In a table like the one below, list one advantage and one disadvantage of each savings method listed.

Interactive Graphic Organizer

	Savings Account	CD	Money Market
Advantage			
Disadvantage			

3. **Describing** How does interest make money for savers?

Critical Thinking

4. **The BIG Idea** Why is it best not to invest more than $100,000 in one account?
5. **Comparing and Contrasting** What is the difference between a basic savings account and a time deposit?

Applying Economics

6. **Calculating Interest** With $1000 in the bank at 0.5% simple interest monthly, how much will you make in one year? With $1,000 debt on your credit card at 2% simple interest each month, what will you pay that year?

section 2

Investing: Taking Risks With Your Savings

Doug Benc/Getty Images

GUIDE TO READING

Section Preview

In this section, you will learn about different types of investments and the risks that they carry.

Content Vocabulary

- stockholders *(p. 147)*
- capital gain *(p. 147)*
- capital loss *(p. 147)*
- tax-exempt bonds *(p. 148)*
- savings bonds *(p. 149)*
- Treasury bills *(p. 149)*
- Treasury notes *(p. 149)*
- Treasury bonds *(p. 149)*
- broker *(p. 150)*
- over-the-counter market *(p. 151)*
- stock market indexes *(p. 151)*
- mutual fund *(p. 152)*
- money market fund *(p. 152)*

Academic Vocabulary

- design *(p. 153)*
- scheme *(p. 153)*

Reading Strategy

Comparing Use a chart like the one below to compare stocks and bonds.

Type of Investment	Definition	When Does It Pay?	Risks
Stocks			
Bonds			

Interactive Graphic Organizer

ISSues In ThE NeWS

—from *CNNMoney*

THINKING AHEAD In 1891, Asa Candler, an Atlanta entrepreneur, paid pharmacist John Pemberton $2,300 for the formula to his weird brown health drink named Coca-Cola. Last year the company had revenue of $22 billion.

Back in 1961, $2.7 million seemed like a lot of money for a hamburger stand and some golden arches—in today's dollars, that would be $16.8 million—but Ray Kroc took the plunge. Forty-four years later, there are more than 30,000 McDonald's franchises throughout the world, and the company grossed $19.1 billion last year.

▲ Tampa Bay Buccaneers

Malcolm Glazer was ridiculed when he paid $192 million for the hapless Tampa Bay Buccaneers in 1995. But after a 2003 Super Bowl win, the team is now valued at more than $700 million.

People keep their savings in banks and savings and loan associations because they want a safe rate of interest. If people are willing to take a chance on earning a higher rate of return, however, they can invest their savings in other ways. Stocks and bonds offer investors greater returns, but, at least for stocks, with more risk. As you read this section, you'll learn what stocks and bonds are, and why they carry a risk.

Stocks and Bonds

Main Idea **Stockholders are owners of a corporation, and bondholders are creditors of a corporation.**

Economics & You Would you rather save what you earn, or risk it in the hopes of earning more? Read on to learn about investing in different types of stocks and bonds.

Corporations are formed by selling shares of stock (also called securities). By issuing stock for sale, a company obtains funds for use in expanding its business. Shares of stock entitle the buyer to a certain part of the future profits and assets of the corporation selling the stock. The person buying stock, therefore, becomes a part owner of the corporation. As proof of ownership, the corporation issues stock certificates.

Personal Finance Handbook
*See pages **R6–R9** to learn more about **investing.***

Stock Returns

Stockholders, or owners of stock, benefit from stock in two ways. One is through *dividends,* the return a stockholder receives on the amount that he or she invested in the company. The corporation may declare a dividend at any time during a year. Dividends typically are paid only when the company makes a profit. The other way people benefit from stock is by selling it for more than they paid for it. Some people buy stock just to *speculate,* hoping that the price will increase greatly so they can sell it at a profit.

stockholders: people who have invested in a corporation and own some of its shares of stock

Capital Gains and Losses

Suppose a person buys stock at $20 a share and sells it for $30. The profit of $10 per share is called a **capital gain**. Of course, the value of stock may also fall. If a person decides to sell stock at a lower price than he or she paid for it, that person suffers a **capital loss**. Money may be made or lost on bonds in much the same way.

capital gain: increase in value of an asset from the time it was bought to the time it was sold

capital loss: decrease in value of an asset from the time it was bought to the time it was sold

William Thomas Cain/Getty Images

Stockholders' Meeting

Corporations hold annual stockholders' meetings, where all stockholders are invited to come together to discuss issues of interest to the company, including plans for the future. Often, elections are held to determine the membership of the board of directors.

Bonds Instead of buying stock, people with funds to invest can buy bonds. A *bond* is a certificate issued by a company or the government in exchange for borrowed funds. It promises to pay a stated rate of interest over a stated period of time, and then to repay the borrowed amount in full at the end of that time. A bondholder lends for a period of time to a company or government and is paid interest on that amount. At the end of the period, the full amount of the borrowing is repaid. This period of time is called the bond's maturity.

Unlike buying stock, buying a bond does not make a bondholder part owner of the company or government that issued the bond. The bond becomes part of the debt of the corporation or government, and the bondholder becomes a creditor. **Figure 6.3** below lists these and some other differences between stocks and bonds.

Tax-Exempt Bonds Local and state governments also sell **tax-exempt bonds**. The interest on these types of bonds, unlike bonds issued by companies, is not taxed by the federal government. Interest that you earn on bonds your own city or state issues is also exempt from city and state income taxes. Tax-exempt bonds are good investments for wealthier people who would otherwise pay high tax rates on interest earned from investments.

tax-exempt bonds: bonds sold by local and state governments; interest paid on the bond is not taxed by the federal government

Figure 6.3 Differences Between Stocks and Bonds

Stocks and bonds can both be good investments, but there are key differences between them that investors should be aware of before making any purchasing decisions. Be sure you have studied these differences before investing in either option.

Comstock Images/Alamy

Stocks
1 All corporations issue or offer to sell stock. That act is what makes them corporations.
2 Stocks represent ownership.
3 Most stocks do not have a fixed dividend rate
4 Dividends on stock are paid only if the corporation makes a profit.
5 Stocks do not have a maturity date. The corporation issuing the stock does not repay the stockholder.
6 Stockholders usually elect a board of directors who control the corporation.
7 Stockholders have a claim against the property and income of a corporation only after the claims of all creditors (including bondholders and holders of preferred stock) have been met.

Comstock Images/Alamy Images

Savings Bonds The U.S. government issues **savings bonds** as one of its ways of borrowing money. They range in face value from $50 up to $10,000. The purchase of a U.S. savings bond is similar to buying a bank's certificate of deposit. Savings bonds are attractive because they are very safe, and because the interest earned is not taxed until the bond is turned in for cash.

A person buying a savings bond pays half the bond's face value. You could purchase a $50 bond, then, for only $25. The bond increases in value every 6 months until its full face value is reached. If you choose to redeem a U.S. savings bond before it matures, you are guaranteed a certain rate of interest, which changes depending on rates of interest in the economy.

savings bonds: bonds issued by the federal government as a way of borrowing money; they are purchased at half the face value and increase every 6 months until full face value is reached

T-Bills, T-Notes, and T-Bonds The Treasury Department of the federal government also sells several types of larger investments. **Treasury bills** mature in a few days to 26 weeks. The minimum amount of investment for Treasury bills is $1,000. **Treasury notes** have maturity dates of 2 to 10 years, and **Treasury bonds** mature in 30 years. Notes and bonds are sold in minimums of $1,000. The interest on all three of these government securities is exempt from state and local income taxes, but not from federal income tax.

Treasury bills: certificates issued by the U.S. Treasury in exchange for a minimum amount of $1,000 and maturing in a few days up to 26 weeks

Treasury notes: certificates issued by the U.S. Treasury in exchange for minimum amounts of $1,000 and maturing in 2 to 10 years

Treasury bonds: certificates issued by the U.S. Treasury in exchange for minimum amounts of $1,000 and maturing in 30 years

Reading Check **Explaining** What are two ways that investors can benefit from stocks?

Bonds

1. Corporations are not required to issue bonds.
2. Bonds represent debt.
3. Bonds pay a fixed rate of interest.
4. Interest on bonds normally must always be paid, whether or not the corporation earns a profit.
5. Bonds have a maturity date. The bondholder is to be repaid the value of the bond, although if the corporation goes out of business, it does not normally repay the bondholders in full.
6. Bondholders usually have no voice in or control over how the corporation is run.
7. Bondholders have a claim against the property and income of a corporation that must be met before the claims of any stockholders, including those holding preferred stock.

Economic Analysis

Comparing *Of stocks and bonds, which investment option involves less risk?*

Stock and Bond Markets

Ramin Talaie/CORBIS

Main Idea **Ownership of stocks and bonds can be transferred on centralized exchanges or in decentralized markets.**

Economics & You If you had $500 to invest in stocks or bonds, how would you decide what to do? Read on to learn about different investment markets.

broker: person who acts as a go-between for buyers and sellers of stocks and bonds

Stocks are bought and sold through brokers or on the Internet. A **broker** is a person who acts as a go-between for buyers and sellers. If an investor is interested in buying or trading corporate shares, he or she can contact a brokerage firm, which will perform the service for a fee.

Thousands of full-service brokerage firms throughout the country buy and sell stocks daily for ordinary investors. The fees they charge to perform the trades—up to $500—depend on the dollar amounts invested or traded. Today, however, if an investor has an account with an Internet brokerage firm, the cost for the same trade may be as low as $7.

Careers Handbook

*See pages **R76–R80** to learn about becoming a **broker.***

There are well over 100 online brokerage firms, with more springing up on the Web every day. It is estimated that 20 million American investors use the Internet to make trades every year.

Stock Exchanges Brokerage houses communicate with the busy floors of the stock exchanges. The largest stock exchange, or stock market, is the New York Stock Exchange (NYSE) in New York City. There are also supplemental stock exchanges and regional exchanges—such as the Chicago Exchange—and exchanges in other countries—such as the London and Tokyo stock exchanges. To be listed on these exchanges, a corporation offering stock must prove to the exchange that it is in good financial condition. Most of the companies traded on stock exchanges are among the largest, most profitable corporations in the country.

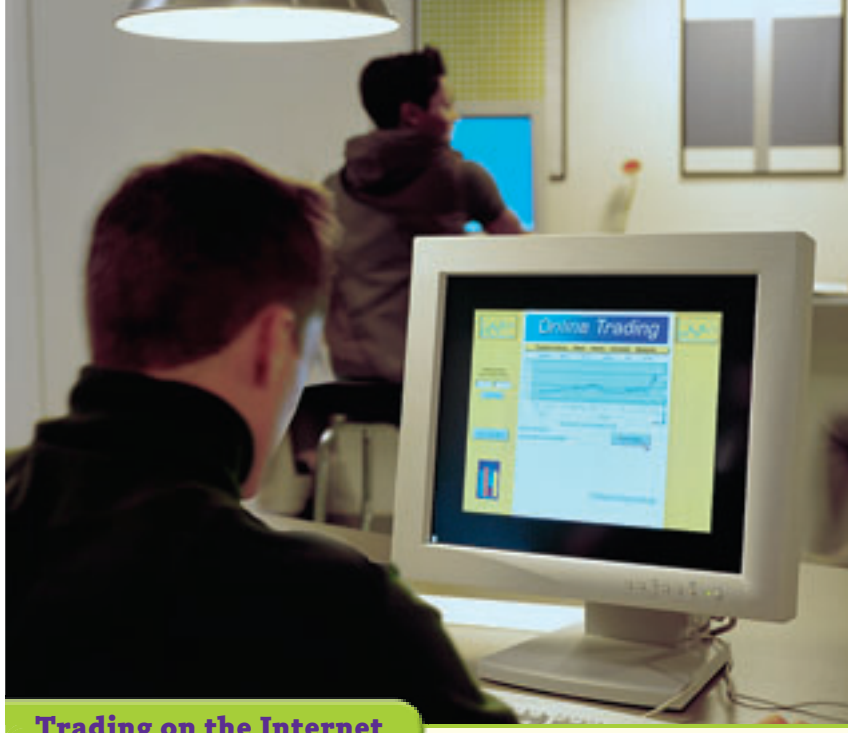
Buying Stocks or Bonds

If you decide to buy stocks or bonds, you will need to contact a broker. You pay the broker a fee to purchase the stock at one of the stock exchanges.

Over-the-Counter Markets

Stocks can also be sold on the **over-the-counter market**, an electronic marketplace for stocks not listed on the organized exchanges. The largest volume of over-the-counter stocks are quoted on the National Association of Securities Dealers Automated Quotations (NASDAQ) national market system, which merged with the American Stock Exchange in 1998.

Unlike organized stock exchanges, over-the-counter stocks are not traded in any specific place. Brokerage firms hold shares of stocks that they buy and sell for investors. For example, assume that XYZ Corporation is a company that sells computers. If an investor wanted to buy stock in it, he or she would check the NASDAQ listings in the local newspaper or on the Internet. This table of over-the-counter stocks would list XYZ Corporation, the number of shares of stock sold the day before, and the price at which shares were bought and sold that day. The investor would then call a broker or use the Internet to buy a certain number of shares. Usually stocks are sold in amounts of 100 shares, but some brokers will handle smaller amounts.



Ryan McVay/Getty Images

Trading on the Internet

Today, many people choose to use the Internet to buy and sell stocks and bonds rather than calling a broker on the phone. Many investors who trade this way assume they have a direct connection to the market in which they're trading, but this is not the case. The orders of Internet traders still go through a broker, just as call-in orders do.

over-the-counter market: electronic purchase and sale of stocks and bonds, often of smaller companies, which often takes place outside the organized stock exchanges

Stock Market Indexes

Almost every weekday, there is news about what happened to the **stock market indexes**, of which there are many. Such indexes are based on what happened to the stock prices of various listed companies. The most well known is the Dow Jones Industrial Average—often called "The Dow." This index involves 30 major industrial companies in the United States. There is also the Standard & Poor's 500 (S&P 500). The S&P 500 index tracks the stock prices of 500 companies.

stock market indexes: measures of what is happening to a given set of stock prices for a specified list of companies; the most well known is the Dow Jones Industrial Average

Bond Markets

The New York Exchange Bond Market and the American Exchange Bond Market are the two largest bond exchanges. Bonds, including U.S. government bonds, are sold over-the-counter and on the Internet.

There is an enormous variety of individual bonds to choose from. If you decide to invest in bonds, you will probably want to contact a financial adviser to help you find a bond that matches your needs and expectations.

mutual fund: investment company that pools the funds of many individuals to buy stocks, bonds, or other investments

Mutual Funds

Many people invest in the stock market by placing some of their savings in a **mutual fund**, an investment company that pools the funds of many individuals to buy stocks, bonds, or other investments. Most mutual funds hold a variety of stocks or bonds. Losses in one area are likely to be made up by gains in another.

Most mutual funds use the S&P 500 as the yardstick against which they compare their returns on stocks. The long-run return from *index funds* is higher than can be expected from almost any other investment. By investing in a broad-based index fund, investors will almost surely do better over the long run than by investing in individual stocks or in a managed mutual fund. A *managed mutual fund* is one in which the managers adjust the mix of stocks and move often in and out of the market to try to generate the highest total return.

money market fund: type of mutual fund that uses investors' funds to make short-term loans to businesses and banks

Money Market Funds

One type of mutual fund, called a **money market fund**, normally uses investors' funds to buy the short-term debt of businesses and banks. Most of these funds allow investors to write checks against their account. Any check, however, must be above some minimum amount, usually $500. The investor then earns interest only on the amount left in the account.

Banks and savings and loan associations offer a similar service, called *money market deposit accounts* (MMDAs). A major advantage of MMDAs is that the federal government insures them against loss. Mutual funds and money market funds are not insured by the federal government.

Reading Check **Describing** What is a mutual fund? Name three types of mutual funds.

Mandel Ngan/AFP/Getty Images

Bull and Bear Markets

When listening to news about the stock market, you may have heard the terms "bull market" and "bear market." A bull market refers to a period of time when stock prices move up steadily. Investors expect this trend to continue, and they buy stock. In a bear market, stock prices have been dropping for a period of time, and investors sell stock in expectation of lower profits.

This famous bull statue stands near Wall Street in New York City.

Government Regulations

Main Idea **Securities markets are heavily regulated to protect investors.**

Economics & You Do you feel more comfortable investing, knowing that the federal government is able to regulate the stock market? Read on to learn about some of the laws controlling the stock market.

The stock market is heavily regulated today, at both the state and federal levels. The Securities and Exchange Commission (SEC), created by the Securities Exchange Act of 1934, is responsible for administering all federal securities laws. It also investigates any dealings among corporations, such as mergers, that affect the value of stocks.

Congress passed the Securities Exchange Act in an attempt to avoid another stock market crash like that of 1929. The act requires that, to inform investors, any institution issuing stocks or bonds must file a registration statement with the federal government. Also, a briefer description, called a *prospectus*, must be given to each potential buyer of stocks or bonds. It lists the amount offered, the price, and the company's projected use for the amount raised by the stocks or bonds.

States also have securities laws. These are **designed** to prevent **schemes** that would take advantage of small investors.

Reading Check **Identifying** What are the responsibilities of the SEC?

section 2 Review

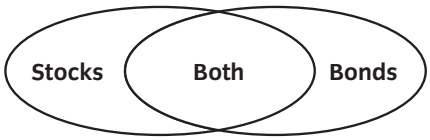
Vocabulary

1. **Explain** the significance of: stockholders, capital gain, capital loss, tax-exempt bonds, savings bonds, Treasury bills, Treasury notes, Treasury bonds, broker, over-the-counter market, stock market indexes, mutual fund, money market fund.

Main Ideas

2. **Comparing** Use a Venn diagram like the one below to compare stocks and bonds.

Interactive Graphic Organizer



Critical Thinking

3. **The BIG Idea** Explain why stocks are riskier than bonds.
4. **Comparing** List five investments you could make if you had $10,000 in available funds. Rank them from highest to lowest in potential risk and return.

Applying Economics

5. **Stocks** In a newspaper or on the Internet, find the list of stock quotes in the NYSE and the NASDAQ. Analyze the quotes, and then choose a stock from each listing that you would buy if you had the available funds. Explain your choices.

People and Perspectives

INVESTMENT MANAGER
(1941–)

Lilia Clemente

- **Founder, Chairperson, and CEO of Clemente Capital, Inc.**

- At age 28, the first woman investment manager and youngest officer ever of the Ford Foundation
- Author of *Achievement and Leadership for Women of Color in a Global World* (1986) and *Asian Capital Markets* (1996)

Marianne Barcellona/Time Life Pictures/Getty Images

Lilia Clemente has been called the Woman Wizard of Wall Street, and for good reason. In 1976 she invested savings of $25,000 to launch her own financial consulting company. Today, through her offices in New York and half a dozen Asian capitals, she controls funds totaling more than $7.5 billion.

Clemente was born to a wealthy family in the Philippines and traveled widely throughout Asia as a child. Her father, a well-connected lawyer, was involved in the drafting of the new Philippine constitution, and her mother, in addition to being a psychology professor and provincial governor, was the first female holder of a seat on the Manila Stock Exchange.

"My mother was a real role model. I thought it was natural for women to go into business and politics."

Following her mother's example, she was active in politics at the University of the Philippines while earning a bachelor's degree in business administration. Later, at the University of Chicago, she was granted a master's degree in agricultural economics and international trade. In her academic department, she was one of only seven women among 400 students.

> **"In a male world like finance, you have to think of yourself as a very special person. Each person has her own pluses and minuses. You have to turn your negatives into your own positives."**

Her intimate knowledge of Asia was certainly a positive. She realized early on that countries such as China, Thailand, and the Philippines would develop into important economic markets.

Checking for Understanding

1. **Explaining** What kind of impact did Clemente's mother have on her life?
2. **Hypothesizing** Do you think Clemente would have achieved the same degree of financial success if she had been born poor? Explain your answer.

section 3

Special Savings Plans and Goals

GUIDE TO READING

Section Preview

In this section, you will learn about special types of investment plans and how to decide what portion of your income to save and invest.

Content Vocabulary

- pension plans *(p. 156)*
- Keogh plan *(p. 156)*
- individual retirement account (IRA) *(p. 157)*
- Roth IRA *(p. 157)*
- diversification *(p. 159)*

Academic Vocabulary

- portion *(p. 156)*
- contribute *(p. 157)*
- overall *(p. 159)*

Reading Strategy

Organizing As you read the section, complete a diagam like the one below by listing five ways to invest for retirement.

Interactive Graphic Organizer

ISSues In ThE NeWS

—from the *Columbus Dispatch*

PLANNING AHEAD If a teenager has a paying job outside the home—as do 40 percent of high-school students—it makes sense to put her earnings into a . . . retirement fund. This could pay off big later on.

There is no minimum age for contribution to an IRA. So as soon as [a teenager] has earnings from work—baby-sitting, helping [a parent] at the office, or mowing lawns—she can open an account.

"At a hypothetical annual return of 8 percent, four years of $4,000 contributions during high school ($16,000) could be worth over $750,000 when the child turns 65," says Kevin McKinley, author of *Make Your Kid a Millionaire—11 Easy Ways Anyone Can Secure a Child's Financial Future*.

. . . Of course, it's not always easy to get a teen to think about retirement, let alone persuade her to agree to save, rather than spend, her earnings.

One of the many reasons that people save is to send their children to college. Another is to make a down payment on a home. Yet another is for those years after people stop working. There are different methods of saving for retirement, each having different risks. As you read this section, you'll learn about special savings plans and the amount of risk involved in these investments.

Kwame Zikomo/SuperStock

Investing for Retirement

Skills Handbook
*See page **R41** to learn about **Evaluating Information.***

Main Idea **Retirement is a major reason for saving and investing.**

Economics & You Do you think much about retirement? Read on to learn ways to save for this time of life.

Although most people are eligible for Social Security when they retire, this plan does not provide enough income to live comfortably. It is important, therefore, for a person to save for and invest in his or her own retirement.

pension plans: company plans that provide retirement income for their workers

Many individuals have company-supported **pension plans** to save for retirement. One of the most common types is a 401(k) plan, in which a **portion** of your paycheck is withheld and the company matches the amount. A major benefit of such a plan is the tax savings. As long as your contribution does not exceed a certain amount, you do not have to pay federal income tax on the amount you put in—or on the amount the plan earns—until you withdraw funds from the plan at retirement.

Keogh plan: retirement plan that allows self-employed individuals to save a maximum of 15 percent of their income up to a specified amount each year, and to deduct that amount from their yearly taxable income

Individual Pension Plans

The Keogh Act of 1962 was passed to help self-employed people set up their own pension plans. The **Keogh plan** allows those people who are self-employed to set aside a maximum of 15 percent of their income up to a specified amount each year, and then deduct that amount from their yearly taxable income.

Figure 6.4 Retirement Plan Options

■ Today people have several choices in retirement plans.

Types of Retirement Plans

401(k)	Keogh	IRA	Roth IRA
◆ Company plan	◆ Self-employed plan	◆ Individual/married couple's plan	◆ Individual/married couple's plan
◆ Portion of pay withheld and matched by company	◆ Up to 15% of yearly income set aside	◆ Tax-deferred contributions	◆ Contributions taxed
◆ Tax deferred on income and interest	◆ Amount is tax deductible	◆ Tax-deferred interest income	◆ Interest income never taxed
◆ Maximum contribution limit	◆ Maximum contribution limit	◆ Maximum contribution limit	◆ Maximum contribution limit

Economic Analysis
Comparing *What do these retirement plans have in common?*

Another form of retirement plan is the **individual retirement account (IRA).** A person earning less than $30,000 can **contribute** up to $4,000 a year and deduct those contributions from taxable income. The benefit of an IRA is that the income you contribute to the IRA is not taxed in the year it is contributed. In addition, the interest you earn on that income is not taxed either. You pay the tax only when you take out funds from your IRA account, usually after age 59½.

A relatively new form of IRA is called the **Roth IRA.** Again, you are allowed to put up to $4,000 a year in a Roth IRA. You do not get to deduct your contributions from your taxable income, however. The benefit is that all of the interest you earn on your contributions to a Roth IRA is tax-free forever. Thus, when you take out funds from your Roth IRA account while you are retired, you pay no additional taxes. See **Figure 6.4** on the previous page for a summary of the major points of all of these retirement plans.

Noel Hendrickson/Masterfile

A Good Bet

Buying a home is usually a good investment in the future, even if you have to spend money on repairs and improvements along the way.

individual retirement account (IRA): private retirement plan that allows individuals or married couples to save a certain amount of untaxed earnings per year with the interest being tax-deferred

Roth IRA: private retirement plan that taxes income before it is saved, but which does not tax interest on that income when funds are used upon retirement

Real Estate as an Investment

Buying real estate, such as land and buildings, is another form of investing. For the past 50 years or so, buying a home, condominium, or co-op has proven to be a wise investment in many parts of the country. Resale values have soared at times, especially during the late 1970s. Although the housing market fluctuates, buying a home is usually a good investment in the long run. Buying raw, or undeveloped, land is generally a much riskier investment. No one can guarantee that there will be a demand in the future for a particular piece of land.

Real estate, either as raw land or as developed land, is not very easy to turn into cash on short notice. Sometimes real property for sale stays on the market for long periods of time. This difficulty in getting cash for your investment is one of the trade-offs involved when investing in real estate. You cannot get your funds as quickly as you could if you had invested in stocks, bonds, a bank CD, or some other savings plan.

Reading Check **Contrasting** What is the difference between a 401(k) and an IRA?

Economics ONLINE

Student Web Activity Visit the *Economics Today and Tomorrow* Web site at glencoe.com and click on ***Chapter 6—Student Web Activities*** to learn more about Roth IRAs.

How Much to Save and Invest?

Main Idea **How much to save and invest is determined by each individual's income, risk tolerance, and values.**

Economics & You If you have money saved, would you be willing to invest it even if it meant risking losing it? Read on to learn how to decide how much of your money you should save and invest.

Saving involves a trade-off like every other activity. The more you save today, the more you can buy and consume a year from now, 10 years from now, or 30 years from now. You will, however, have less to spend today. Keep in mind that if you have debt, especially on a high-interest credit card, you may want to pay that off before diverting funds into savings. Also consider that if you expect to make a much higher income in the future than you do now, you have less reason to save a large percentage of today's income. (See **Figure 6.5** below.)

Amount of Risk So, how much of your savings should you risk in investment? When making this decision, remember that if you put a lesser amount in the more risky types of investments, you will have some security with your savings, and you will have some funds readily available should you need cash in a hurry. You may also have a chance of making high returns, but the higher the promised return, the greater the risk. Indeed, it's impossible to obtain higher returns without taking more risk.

Figure 6.5 Savings Considerations

Periodically, you should reevaluate how much of your income you are saving. If you are at a point where you have accumulated debt on a credit card, for example, you may want to pay off your debt before putting funds into savings. At another time, if interest rates rise, you may want to save more and earn more interest.

How Much Should You Save?

Ask yourself the following questions when you are deciding how much of your income to save:

1. How much do I spend on fixed expenses?
2. What are my reasons for saving?
3. How much interest can I earn on my savings, and how fast will my savings grow?
4. How much income will I be earning in the future?
5. What degree of risk am I willing to take?
6. How important is it that my savings be readily available in case I need immediate cash?
7. Will my standard of living at retirement depend largely on my accumulated savings?

Economic Analysis

Explaining *From what sources other than savings might you get funds for retirement?*

Spreading Out Your Investments

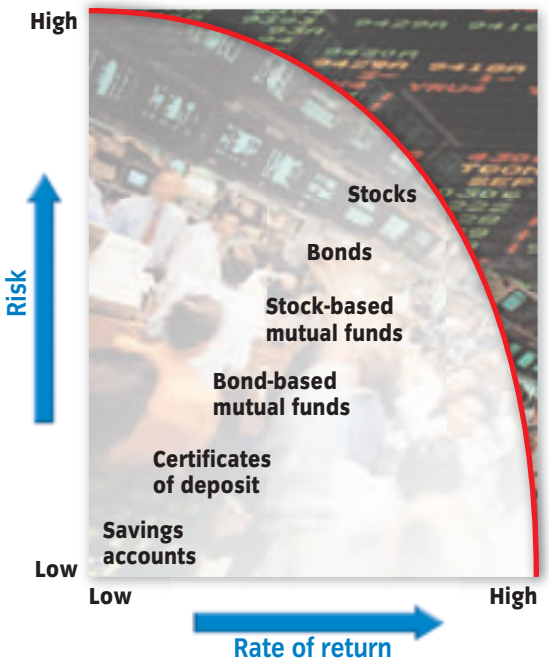
Investing your savings in several different types of accounts lowers the **overall** risk. If one investment turns sour, the others may do better. Financial planners call spreading out your investments **diversification**. Mutual funds, for example, help you diversify.

When you have very little income and cannot afford any investment losses, you should probably put your savings in insured accounts in a local bank or savings and loan association, or you should buy U.S. government savings bonds. The greater your income and the more savings you have, the more you can diversify into stocks, corporate bonds, and so on.

Values Your values may also determine where you invest your savings. If you believe that your community needs more development, you might choose to put your savings in a local savings and loan that guarantees that a large percentage of its investments are made in community loans. You may also choose to invest in stocks issued by environmentally responsible companies or companies that have aggressive equal opportunity programs.

Reading Check **Evaluating** What questions should you ask yourself when deciding how much to save and invest at any given time?

Risk and Return



Digital Vision/Getty Images

diversification: spreading of investments among several different types to lower overall risk

section 3 Review

Vocabulary

1. **Explain** the significance of: pension plans, Keogh Plan, individual retirement account (IRA), Roth IRA, diversification.

Main Ideas

2. **Summarizing** Copy the chart below, and for each investment option listed, give one advantage.

Interactive Graphic Organizer

Investment Method	Advantage
Pension plan	
Keogh plan	
IRA	
Roth IRA	

Critical Thinking

3. **The BIG Idea** How does the federal government help people invest for retirement?
4. **Comparing and Contrasting** What is one advantage and one disadvantage of investing in real estate?

Applying Economics

5. **Evaluating Investment Options** Imagine you have $15,000 of funds to invest. Which type of funds or investments discussed in this section would you choose? Explain your answer.

BusinessWeek SPOTLIGHT on the Economy

FOLLOW MY MONEY

Sifting through the blogosphere for financial advice.

Check It Out! In this chapter you learned about saving and investing. In this article, read to learn about a new way young people are helping one another save and invest for the future.

Jonathan Ping is not a financial guru. He's not a certified financial planner. And he's not a millionaire (yet). He's simply a 27-year-old engineer living with his wife and dog in a rented house in Portland, Ore. Within the next 18 months he hopes to scrape up $100,000 for a down payment on a home, and he wants to build a net worth of $1 million by age 45. So far he's at $88,953.

How do I know this? It's in bold type in the top right-hand corner of his Web log, MyMoneyBlog.com, where Ping keeps a daily tally of his progress. He's one of more than 150 bloggers, mostly 22 to 35, who have adopted an open-source approach to personal finance. Most keep their names secret, but that's about all they hide. In stark contrast to their parents' generation, for whom comparing incomes can be awkward, if not downright taboo, bloggers list financial information down to the dollar in retirement, brokerage, and savings accounts. They recommend investments, decry credit-card debt, and wallow together over high taxes, commenting on one another's postings and leaving behind a road map for financial voyeurs. Ping writes: "If I mess up, you'll know. If I come across a neat way to make or save money, you'll read about it here. . . hopefully we'll learn from each other and meet up in the Caymans some day."

Tim Fuller

Checking out MyMoneyBlog.com

Information Shared on Financial Blogs
What mistakes should I avoid when investing?
What credit cards offer the best incentives?
Should I first pay off debt or build up savings?
Which online savings accounts offer the best rates?
Where should I invest my 401(k)?

—Reprinted from BusinessWeek

Think About It

1. **Summarizing** What financial information can bloggers provide?
2. **Contrasting** How are young financial bloggers different from their parents?

chapter 6 Visual Summary

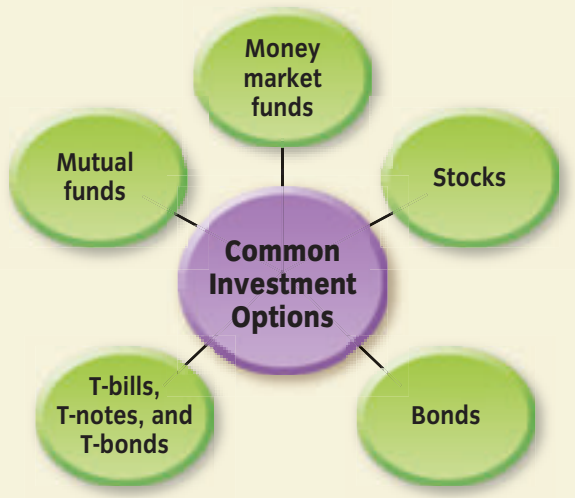
Study anywhere, anytime! Download quizzes and flash cards to your PDA from glencoe.com.

- **Saving** some of your income allows you to earn interest and put away funds for future purchases.

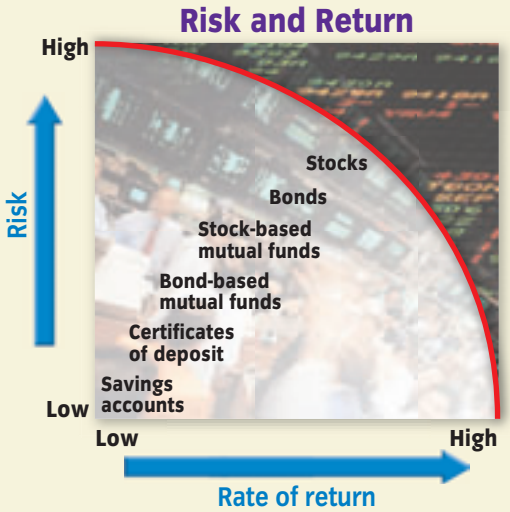
Steps to Saving

- Determine reasons to save.
- Determine amount of funds to set aside.
- Decide what type of account you will use.
- Decide on frequency of deposits.
- Decide when to invest a portion of what you have saved.

- After you have accumulated savings funds, you may want to **invest** some of it to try to earn greater returns.



- It is important to **diversify** your saving and investing, especially when looking toward retirement. In general, the greater the risk involved in any venture, the greater the potential return.



Review Content Vocabulary

1. *Write a paragraph or two explaining some methods a person might choose to save or invest a $10,000 inheritance. Use all of the following terms.*

savings account	stockholder
interest	broker
money market deposit account	savings bonds
time deposit	mutual fund
certificates of deposit	Treasury bills

2. *Write a paragraph or two explaining some of the special methods a person might choose to save for retirement. Use all of the following terms.*

pension plan	Roth IRA
Keogh plan	diversification
individual retirement account (IRA)	

Review Academic Vocabulary

Choose the letter of the term that best completes each sentence.

a. require	e. portion
b. minimum	f. contribute
c. designed	g. overall
d. schemes	

3. Saving helps people prepare for expenses that _____ more money than they usually spend.
4. Special retirement plans are _____ to encourage people to save for the future.
5. One must keep a _____ balance in some types of savings accounts to avoid paying fees.
6. Having a variety of types of savings and investments lowers one's _____ risk.
7. It is a good idea to save a _____ of every paycheck for the future.
8. A person can _____ several thousand dollars to an IRA each year.
9. Securities laws help prevent _____ that try to take advantage of investors.

Review the Main Ideas

Section 1 (pp. 141–145)

10. What is interest on savings accounts? Why do banks pay interest?
11. Why is a bank certificate of deposit (CD) called a time deposit?
12. Why are deposits of up to $100,000 in banks and savings institutions often considered very safe?

Section 2 (pp. 146–153)

13. What is the basic difference between a stock and a bond?
14. What are two advantages of United States savings bonds?
15. What kind of investment company hires professionals to manage the investments of a pool of investors?

Section 3 (pp. 155–159)

16. What are three common types of retirement plans for individuals?
17. What are some of the factors one must consider when deciding how much to save in what kind of plan?
18. Fill in the graphic organizer below to show how a person might diversify (spread out) his or her retirement investments.

Type of Investment	Description

Economics ONLINE

Self-Check Quiz Visit the *Economics Today and Tomorrow* Web site at glencoe.com and click on ***Chapter 6—Self-Check Quizzes*** to assess your knowledge of chapter content.

Problem Solving

Imagine that you are out of school and have started working and saving. You want to keep from using credit cards or unnecessary loans as much as possible, so you make savings plans for major purchases and expenses.

19. Write down a short-term savings goal, such as saving to buy a new portable MP3 player. Explain the typical ways in which you can save for such a purchase.
20. Now write down a long-term savings goal, such as saving for college, a house, or retirement. Explain some methods you might use to achieve this goal.
21. What is the major difference between the two ways of saving?
22. Why is saving up for major purchases and expenses better than using credit cards or taking out loans?

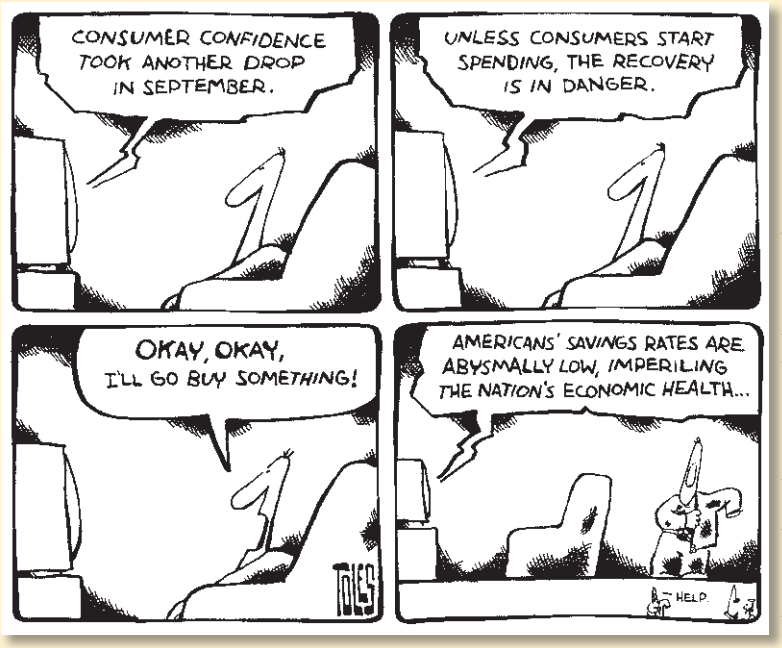
Critical Thinking

23. **The BIG Idea** Suppose you have $300,000 that you want to save. The FDIC only insures up to $100,000. What can you do to make sure all your funds are insured by the FDIC?
24. **Determining Cause and Effect** How does buying a U.S. savings bond increase the U.S. government's debt?
25. **Synthesizing** Assume that you have $100,000 in savings. Create a chart like the one below to list the investments you might make and what percentage of the $100,000 you would invest in each. In the last column, explain how your choices will achieve investment diversification.

Investment Type	% of Funds	Diversification

Analyzing Visuals

26. Study the cartoon on the right, and then answer the following questions.
    a. According to the cartoon, what will the effect be of the drop in consumer confidence?
    b. What effect will consumer spending have on savings rates? Why?
    c. What is the relationship between consumer spending and saving?



Debating Economic Issues

Should colleges and universities ban credit-card companies from campuses?

Imagine being 30 years old and still paying off a slice of pizza you bought when you were in college. Sounds crazy, but for many people, credit-card debt built up in college stays with them for many years to come. Could the problem be solved by preventing credit-card companies from marketing to college students?

YES! Credit card providers use methods that take advantage of students.

When students arrive on college campuses across our nation, they are bombarded with credit card applications. . . Credit card companies have card table displays, offering free hats, T-shirts, or other token gifts for the student to sign the application. Some students have no interest in a credit card but can't refuse a free T-shirt or the peer pressure to do what "everyone is doing." When the credit card arrives in the student's campus mail, some are generally surprised and start using the card.

One student's story [shows] the problem. This student didn't believe he signed up for a credit card. He thought he'd entered a drawing when he filled out a small card in exchange for a T-shirt. . . . When the credit card arrived, he thought he'd won. He used it and was very surprised when a bill arrived.

He ignored the bill, and with interest, collection fees, and penalties, the student now has a considerable amount of debt. . . . When the student discussed the issue with the credit card issuer, they suggested he ask his parents for assistance—something they should have suggested when he signed up for the card. We should ban them!

— Linda Chuhran, faculty member, Schoolcraft College, Livonia, Michigan

Spencer Grant/PhotoEdit

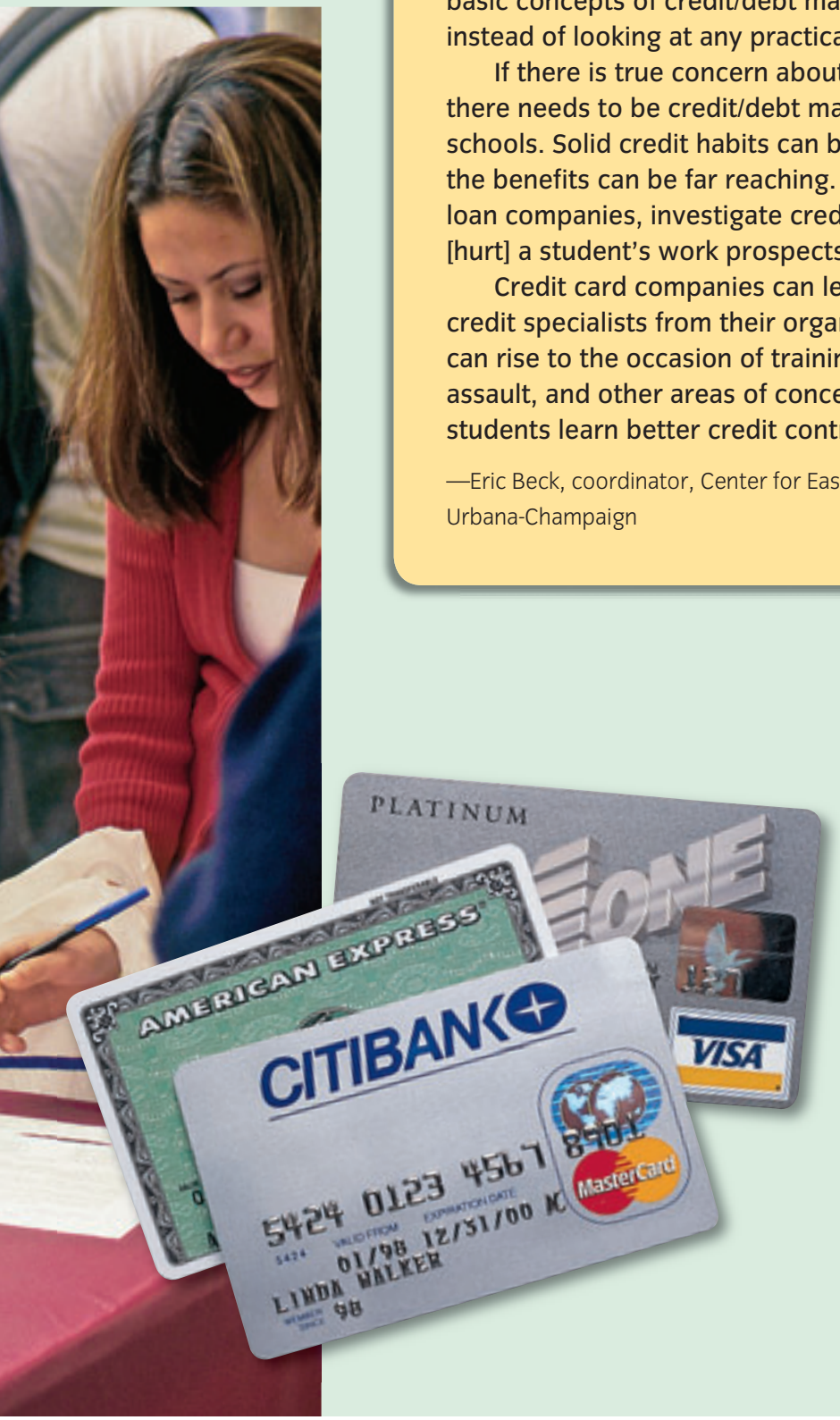
NO! Credit cards are a reality our students must learn to live with.

Credit card vendors have been on my campus since at least 1989, when I was a freshman. There has to be some reason they were invited to campuses in the first place. . . . But now that there has been half a generation of former college students let loose on the world without the basic concepts of credit/debt management, everyone wants to yell "foul" instead of looking at any practical solutions or realities.

If there is true concern about stemming the tide of student debt, there needs to be credit/debt management initiatives established by schools. Solid credit habits can be built, with help, during college, and the benefits can be far reaching. Employers, as well as mortgage and loan companies, investigate credit histories. A poor credit rating can [hurt] a student's work prospects more than a poor grade point average.

Credit card companies can lend support to this effort by providing credit specialists from their organizations to provide training. If schools can rise to the occasion of training about alcohol consumption, sexual assault, and other areas of concern, then they should be able to help students learn better credit control.

—Eric Beck, coordinator, Center for East Asian and Pacific Studies, University of Illinois, Urbana-Champaign



Debating the Issue

1. **Explaining** How do many credit-card companies get college students to sign up for credit cards?
2. **Choosing Sides** The two writers disagree on whether or not college students are mature enough to handle credit cards. Which writer do you agree with? Why?

Find Out More!

3. **Synthesizing** Use the Internet or other resources to find out the average credit-card debt of a student graduating from college today. Does this information change your opinion on whether credit-card companies should be banned from campuses? Why or why not?

Geoff Butler