Investment Terms You Should Know

National Employee Benefits Day
April 2
www.ifebp.org

What is an investment?

An investment is a way to make your money work for you—someone pays you for the use of your money. You may invest in your sister's new business, both to help her get started and to share in her profits as she succeeds. You may invest in a fund to earn extra money for your child's education. You may invest the money you're saving for retirement in a company that will pay you dividends.

Here are some key investment terms you should know:

Asset: Something valuable that you own, like money or property.

Asset Allocation: An investment strategy that splits assets according to your goals, the length of time until you need the money (like buying a house or retirement), and how much risk you're willing to take. Allocation typically involves selecting different types of investments that have different levels of risk and return, like stocks versus bonds.

Bond: A bond is similar to an IOU. Borrowers, like a company or the government, issue bonds to raise money from investors willing to lend them money for a certain period of time. The borrower promises to pay you a certain amount of interest during the life of the bond, and also promises to repay the original amount of the loan at the end of the loan period. As an investment, bonds are considered less risky than stocks. They provide a regular amount of interest income (typically bonds pay interest twice a year) and, if you keep them until the end of the period, they repay you the full amount of the bond.

Diversification: Strategy of mixing a wide variety of investments to reduce risk levels. Diversification may involve different types of investments, geographic regions and investment companies. With diversification, you hope that the positive performance of some investments will balance or outweigh the negative performance of others. *Mutual funds* are seen as a way to diversify.

Dividend: Share of profits paid to investors. Dividends are usually paid in cash, but can instead be paid in the form of additional stock.

Interest: The money you earn for lending your money to someone else (e.g., a person, a bank, a company) is called interest. You then earn money on both the original amount saved or lent, and also on the interest that money earns. This is called compound interest. Over time, this means that even a small amount of money saved can grow into a large amount. This is called compounding.

Investment Return: Money gained or lost on an investment. The return may be money as interest income, or an increase or decrease in value.

Investment Risk: The chance of loss on an investment.

Mutual Fund: With this type of fund, an investment company raises money from investors and uses this money to purchase a variety of assets. Individual stocks, bonds and other types of investments are purchased, depending on the objectives of the fund. A fund may have thousands of investors, each sharing in the investment gains and losses. This type of fund helps you diversify and reduce your investment risk.

Risk-Reward Tradeoff: In theory, though riskier investments can result in losses, they can also result in greater returns. On a risk-reward scale, lowest-risk investments (e.g., cash, short-term government obligations, bonds) are at one end, and riskiest investments (e.g., emerging market stocks and alternative investments) are at the other end.

Risk Tolerance: The extent to which you, as an investor, are willing or unwilling to accept uncertain investment returns. If you're more comfortable with the idea of less risk and a lower but more certain return, you're more likely to invest in cash or bonds. If you'd rather have the chance at earning more income and are comfortable with the possibility of suffering losses, you're more likely to invest in riskier vehicles like emerging market stocks or venture capital.

Stock: With stock, you share in the ownership of a public corporation. A company issues stock as a way to raise money to cover start-up or expansion costs. Depending on the type of stock you own, you may be given the right to vote on major corporate issues and you may receive stock dividends, capital gains and—if the corporation is dissolved—a claim upon assets remaining after all creditors have been paid. Stocks are also called equities.

Target-Date Fund: This type of mutual fund invests in a mix of assets (stocks, bonds and cash). The mix is automatically reset as a specific date approaches (usually a retirement date). The idea is to make the investments less risky over time, so you will have more stable returns and a more stable account balance when it's time to start taking your money out of the fund.

Definitions developed by International Foundation staff using *Benefits and Compensation Glossary*, 12th edition (International Foundation) and government resources.

MK140171

PDF/214