CHAPTER 11-SAVING AND INVESTING OPTIONS

11-2 Medium-Risk Choices

MUTUAL FUNDS

- A professionally managed group of investments bought using a pool of money from many investors
- Contains a variety of investments—making it diversified, which lowers risk
- A form of indirect investing

INDIRECT INVESTING

- Purchasing an asset that offers investment opportunities in a variety of companies, instead of one specific company.
- Example a mutual fund.
- Buying shares of a mutual fund instead of buying individual shares of stock in various companies
- Fund managers select the combination of investments they think is the best to meet the fund's goals
- **Asset allocation**—when you choose a combination of funds within a single mutual fund company for your investment.

RETIREMENT ACCOUNT

- An account that accumulates money to be used for retirement.
- Earnings gained on the account stay in the account which helps the principal grow faster
- Money is withdrawn in retirement
- Taxes will be paid at a lower tax rate on the withdrawals, because person withdrawing money will be in a lower tax bracket because they are no longer working.

IRA ACCOUNT

- Retirement account that allows individuals to deposit money into an account during their working years for withdrawal upon retirement.
- Can be set up at a bank or other financial institution
- Managed by the investor
- Provide good retirement income
- Maximum contribution limited based on your income
- Money can be withdrawn beginning at aged 59½
- If withdrawn early, there is a withdrawal penalty, unless withdrawals are for medical expenses or education

TRADITIONAL IRA

- An individual retirement account that allows individuals to contribute pretax income to an account that grows tax-deferred
- No taxes paid on contributions to the account
- No taxes paid on account earnings until money is withdrawn during retirement
- Contributions can be deducted from your gross income on Federal Taxes
- Withdrawals must begin at age 70½

ROTH IRA

- An individual retirement account in which contributions are taxed, but earnings are not.
- You select the types of investments in the Roth IRA
- No minimum distribution rules apply (don’t have to withdraw funds at a certain age)
- Earnings may be tax free if you meet income guidelines
- Can withdrawal funds without penalty for a down payment on a home

SPOUSAL IRA

- An individual retirement account set up to benefit a spouse who has no income
- Working spouse can contribute money to the non-working spouse's account
- To qualify, couples must file a joint tax return

SEP ACCOUNTS

- **Simplified employee pension:** A tax-deferred retirement plan for small business owners and their employees
- Employer chooses a financial institution and sets up an IRA for each eligible employee
- The employer makes a contribution to the IRAs of up to 25 percent of the employee's salary
- Employees choose how the money will be invested among the various investment options

KEOGH ACCOUNTS

- A tax-deferred retirement plan for self-employed professionals
- Employees can invest in this plan as well
- Up to $195,000 can be contributed each year
- Contributions are tax-deductible
- Account is managed by the investor

DEFINED-CONTRIBUTION PLANS

- An employer-sponsored retirement plan in which employees can receive a periodic or lump-sum payment based on their account balance and performance of investments
- Employees set aside a specific amount or percentage of their salary monthly
- When employees retire, they are paid a benefit based on contributions made to the account
- Example: 401(k) account and 403(b)

401(K) PLAN

- A tax-deferred retirement plan funded by employees of profit-seeking businesses
- Employees set aside money each month with a pretax payroll deduction
- Employees can choose investments
- Withdrawals are taxed as ordinary income
- Early withdrawal penalties apply
- Limits on amounts that can be contributed
- Employer money match helps account grow quicker
- Account grows tax deferred until money is withdrawn.
- Account has some risks for losing money, but limited based on investment choices.

403(B) PLANS

- A tax-deferred retirement plan funded by employees of government and nonprofit organizations.
- Teachers, school staff, nurses, doctors, professors, librarians and ministers are examples of people who qualify for this type of account
- Money is set aside through pretax payroll deductions
- Employees can choose investments for the money deposited
- Earnings and contributions are not taxed until money is withdrawn

DEFINED-BENEFIT PLANS

- An employer-sponsored retirement plan in which retired workers receive a set monthly or lump sum payment based on their wages earned and number of years of service
- Employees must work for a company for a set number of years to be vested
- Example: Pension Plan

PORTABILITY

- Portable-means you can take the account with you when you leave a job
- If vested you can also take your employer's contributions with you.

ROLLOVER

- Rollover-the process of moving a retirement account balance to another qualified account without incurring a tax penalty
- Taxes are deferred until withdrawals are made
- Rollovers have a time limit

DIFFERENCE BETWEEN SAVINGS AND WEALTH

- Savings is setting money aside for the future
- Wealth is the accumulation of assets over time.