Lcbs-2023-06-14-BackToBasics.pdf

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Back to Basics – History from Cash to Mutual Funds

The years 2022 and 2023 have been quite a trip regarding Investments. In early 2022, the S&P 500 was down over 30%. To say there were challenges in investing in 2022 is a vast understatement.

The purpose of our blog is to help investors get started in investing. Several of you have mentioned that my most recent articles on investing have become a bit complex covering tougher subjects like Preferred Stocks, BDC (Business Development Companies), and CEFs. (Closed-End Funds.) The complexity certainly has not been on purpose. My goal is to help everyone find the niche they need to make money consistently. Like all endeavors, we must continue to grow and expand our knowledge so that we can apply what we have learned to gain the maximum returns.

This is not something you learn once and never need to expand or grow for the rest of your life. So for those of you who are not ‘seasoned investors’, this week is for you. We are going to take a historical view of money and how we got to where we are today. We won’t go back to Genesis 1:1 where God spoke the earth and man into existence, but we will begin talking about the simplicity of cash.

The original method of exchanging money for goods was done simply with cold hard cash. If a horse cost $10 in the olden days, you pulled out ten one-dollar bills and made the purchase. Banks came along and allowed people to store their money safely and later started savings accounts where they paid you money for the use of your savings dollars. As banks got into making loans, they then started offering CDs. (Certificate of Deposits). This tied up your money for terms of a few months to five years. If you took the money out before the maturity date of the CD, you paid a penalty which is still how it is done today.

The first stock market began in the 1400’s, but the New York Stock Exhange began in 1790. So early on, companies began selling stock certificates to allow people to invest in their company. Back then it was a physical certificate, but today computers keep up with who owns the many shares of stock.

Many companies began paying dividends on their profits, making it more profitable to own the stocks. Dividend-paying stocks are still one of the best investments out there. The high-quality companies began to be known as Blue Chip companies (where the term blue chip stocks originated.) They pay 1% to 15% in quarterly dividends. A stock is simply a unit of ownership in the company. If you own IBM stock, you own a part of the IBM Corporation.

There are many elements to the stock market. Stocks are very liquid and also fluctuate in price a lot. In one day they might go from $95 a share to $120 and then close the day at $90. The 3 main indices of the stock market are the DOW (Top 30 stocks), the NASDAQ consisting mainly of 100 technology stocks, and the S&P 500 which are some of the largest 500 stocks. Different rules apply on who makes up these 3 lists and changes do happen year to year as to which companies make up those indices.

One of the great things about stocks is they can theoretically go up and up, but the most you can ever lose is the amount you paid for the stock. There is no liability associated with owning stock, so you will never be sued for corporate wrongdoing when you own stock.   You can lose your full investment (which is rare), but that is the maximum loss.

[Some of the Investment Categories]

Soon another monetary element came along called a bond. A bond was an IOU from the company paid to the bondholder.   It was a debt the company was to pay the bondholder and had various maturity dates such as one to 5 years.   A bond is an IOU from the company to you the bond holder. Again in the early days, there were bonds with coupons to cut out to get your monthly or quarterly interest.   Today computers keep up with the ownership of the bonds and no real coupons exist.

The bond market is even bigger than the stock exchange.   Bonds are not as volatile in price as stock, but as interest rates change, they can move up and down rapidly in price.   A Treasury bond that has 30-year maturity will go down substantially in price when interest rates rise but will go up in value when interest rates drop. All maturities fluctuate, but the 30-year maturities move the most due to the time they have to be held until maturity.

[What is a bond?]

The Pros of bonds are they are less volatile and offered in many different maturities.   You can buy 90-day Treasury bills and notes, and go out to 30 years on Treasury Bonds.   Corporate bonds typically are not for more than 10 years.   So bonds offer less volatility and more stability.   As a person nears retirement age, owning more bonds gives your portfolio more stability.   One of the better investments in 2022 was the I-Bond.

These are inflation-protected treasury bonds that are tied to a 30-year bond rate plus the inflation rate. In April of 2022, these were paying 9.62%, but have since dropped each six months to the current rate of 4.3%.   But still not too shabby for a government backed security.

[Information on I-Bonds and How to buy at treasurydirect.gov]

The Cons of bonds are that they normally pay less than what Stocks will pay you over time.

Since stocks are volatile, it means you must have holdings in many companies to diversify. That is when Mutual Funds were created. By buying into a mutual fund, you are buying a portion of many stocks and/or bonds. When you buy a share of a mutual fund, it automatically gives you a lot of diversification.

Some mutual funds are just for specific types of stocks, some just for bonds of various maturities, and then some that are called balanced funds that own both Stocks and Bonds. These sort of became the marketplace gems in the early years of the 70s and 80s. You paid the manager of the fund a fee to manage your investments. These fees could be as low as 2% but some much much higher. Today most are sold as no-fee mutual funds, but while no upfront fee is paid, there are still management fees of 1 to 2%.

Three Quality Fidelity Mutual Funds

What investors discovered after much study was that most fund managers can not beat the average of the overall stock market. That is when Mutual Index Funds began being sold that tracked stock market indexes. These were not truly managed funds so the fee was less. Vanguard Investments is known for its low-priced index funds.

Someone came up with the idea of making a type of investment that was not a mutual fund, but just an index. These became known as ETFs (Exchange Traded Funds), and they have almost no fee involved. Normally 2% and most under 1%. So if you buy an ETF like VTI (Vanguard Total Index ETF), you are tracking ALL the stocks in the whole stock market. A great simple way to save money and get consistent returns.

Many say that the average return on the full stock market over the last 50 years is 12% or higher. Be aware that there are many times that the stock market has lost money for 3 consecutive years. But on average, stocks and ETFs are a good way to invest when tied to the index of the whole stock market or dividend-paying stocks.

ETFs are one of the most popular investment vehicles in investment circles.   You can sell them anytime the market is open. The ETF price reflects the whole market segment they represent.   You must realize that there is an ETF to track almost any type of investment nowadays   So what we are talking about being safer is FULL MARKET indexed ETFs like VTI, ITOT, and SCHB.   SPY is another good one for the S&P 500 only stocks.

Simple Path to Invest using ETFs.

It is amazing how much you must talk about to make basic investing simple. It simply cannot be done in one article.   I think we need to continue on this next week and explain a bit about capital gains and how to shelter your retirement from income taxes.

You will not fully understand all of the options in the stock market without studying for several years.   All of the articles on our Investment Page can help identify various methods to invest.

List of All Investment Articles

Thank you for your patience.   It truly takes an investment professional to help you fully understand what is involved and the tax concerns of investing.   Your lawyer or investment broker can shed more light on the complexities. You must study and grow to be effective in investing.   We began last year with many basic articles if you go to the bottom of our Investment Articles list and work your way up.

List of All Investment Articles

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