Investing in Stocks

The goal for retirement should be to have enough money to live comfortably and carry out the plans you’ve made. Investing some of your savings in stocks can help you achieve this goal. But, it can also be risky.

One way to reduce the risk of losing money is to buy stock mutual funds instead of stocks in individual companies. But, before buying any type of stock, take the time to learn the basics of how stocks work.

How Stocks Work
When you own a stock, you own part of a company. Companies sell these pieces of ownership, known as shares, to raise money to finance their business. If the business does well, your stock generally does well. If the business does poorly, you can lose some or all of the money you paid for the shares.

There are two ways to earn money when you invest in stocks:
• **Price increase**—when the price of the stock rises.
• **Paying dividends**—when the company shares its profits with investors, anywhere from one to four times a year.

If your stock pays a dividend, you can usually choose between reinvesting dividends in the company by purchasing more shares, or taking the cash. When you’re saving for the future, if the stock is doing well, reinvest the money instead of spending it.

Types of Stock
• **Index fund**: To avoid high fees and get the benefits of ease and diversification, invest in index funds. These are mutual funds that hold all or a sample of the stocks or bonds that are included in a particular index. The S & P 500, which tracks primary large companies, is an example of an index. An index fund simply tracks a particular group of stocks or types of companies. To invest in large-cap stocks, simply buy a large-cap index fund and it will match the returns of large-cap companies. If you own one of these funds, when the index goes up, your investment makes money. When it goes down, your fund loses money. Index funds have performed well historically.

To buy individual stocks, you typically need to go through a broker, who receives a commission when you buy and sell. “Discount” brokerage houses, usually on the Internet, tend to charge lower fees than full-service brokerages where you may discuss your purchase with a broker and receive research on the company whose stock you’re considering buying.

If you want to buy individual stocks, you should diversify—invest in different types of companies—to reduce your risk of losing money. There are several ways to categorize stocks: **industry** (auto, biotechnology), **market sector** (utilities, health care), or **geography** (U.S. or foreign).

Another way of grouping stocks is by the total value of a company’s stock, known as market capitalization. Large-cap stocks are generally companies worth $5 billion or more; medium-cap, $1 to $5 billion; small-cap, $250 million to $1 billion; and micro-caps, less than $250 million.

Yet another way to group stocks is based on financial experts’ perception of a company’s basic financial health, its current price and its historical performance. These categories include:
• **Growth stocks**: These stocks have a high price, although earnings may be low or non-existent. Investors expect better returns in the future.
• **Value stocks**: These stocks have a lower price in relation to their earnings because investors may consider them a bargain.
• **Income stocks**: Companies that have a history of paying dividends. They tend to be large-caps and utility stocks, and are an especially appropriate investment for retirees or those near retirement.
Your To-Do List:

☐ To learn about investing in stocks, enroll in an adult education class.

☐ Read the Federal Trade Commission's list of questions to ask before you invest at www.ftc.gov/bcp/edu/pubs/consumer/invest/inv03.shtm.

☐ Use AARP's online Retirement Planning Calculator at www.aarp.org/finance to figure out what investment returns you'll need to meet your retirement savings goal.


☐ Learn more about mutual funds at www.aarp.org/finance.

☐ Before you buy a mutual fund, add up the fees using the SEC's mutual fund cost calculator, under Investor Calculators at www.sec.gov.

☐ Compare fees charged by different online brokers by searching “comparing brokerage.”

☐ To make sure you're choosing a reputable broker or investment advisor, check out the sources recommended by the SEC at www.sec.gov/investor/brokers.htm.

This and other tip sheets provide general financial information; it is not meant to substitute for, or to supersede, professional or legal advice.

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