

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
- **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.

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:

## Risks

When you buy stock, you're basically betting (hopefully based on your research) that the business will do well. But, if the company runs into problems, the value of your stock may go down. You could even lose your entire investment if the company goes out of business.

All stock ownership involves risk. But the amount of risk can vary widely depending on the individual company you are investing in. Smaller companies tend to have a higher level of risk and may experience wider swings in price. Larger, more established companies tend to have less risk and more stable share prices.

## Rewards

Stock will likely have ups and downs over a few months or a few years. However, stock investing historically has resulted in higher returns over the long-term than other investments. If you want to invest in individual companies, take a long-term view, buying shares after studying the company's business, leadership, and prospects for continued success.

## How Not to Succeed

Shortsighted investors buy and sell stocks often, based on frequent price changes. Some get into "day trading," which is buying and selling stocks throughout the day as the prices go up and down. Still others

invest in "penny stocks"—those that are around \$5 or less. They hope they're getting in on the ground floor of the next big thing, but more often than not penny stock investors lose a lot more than pennies. None of these activities is recommended—especially when you're investing to save for or pay now for your retirement.

## Stock Funds

A good way to reduce the risk of investing in stocks is to buy shares of stock **mutual funds**. A mutual fund is a pool of money from many investors. A financial professional manages the money, investing it in a large number of companies. The advantages are:

- **Diversification.** The risk of losing money is spread broadly, rather than tied to a single company.
- **Ease.** Someone else manages the investments, so you don't have to constantly make decisions about whether to buy or sell your shares.

Before choosing a mutual fund, check on the costs. You may have to pay commissions to buy or sell funds, but some funds do not charge commissions. There will always be an administrative fee, known as the "expense ratio." This cost is subtracted from your account, which cuts into your return. For more information on these fees, see AARP's Tip Sheet on Mutual Funds.

### 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/online/pubs/invest/invrisks.htm](http://www.ftc.gov/bcp/online/pubs/invest/invrisks.htm).
- Use AARP's online Retirement Planning Calculator** at [www.aarp.org/finance](http://www.aarp.org/finance) to figure out what investment returns you'll need to meet your retirement savings goal.
- Read "Invest Wisely,"** [www.sec.gov/investor/pubs/inwsmf.htm](http://www.sec.gov/investor/pubs/inwsmf.htm), a guide to mutual funds published by the Securities and Exchange Commission (SEC).
- Learn more about mutual funds** at [www.aarp.org/finance](http://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 [sec.gov](http://sec.gov).
- Compare fees charged by different brokers** on the Internet 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](http://www.sec.gov/investor/brokers.htm).

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