Risks and Rewards of Investing Your Money

There are three rules for building wealth: 1) start early because money needs time to grow; 2) buy and hold (in other words, keep your money invested) and 3) diversify your investments- don't put all your eggs in one basket.

It may seem unreasonable to think about building wealth when you are young. However, wealth can begin to accumulate if you use your money wisely and control how much you spend. There are rewards to investing money, but there are also risks.

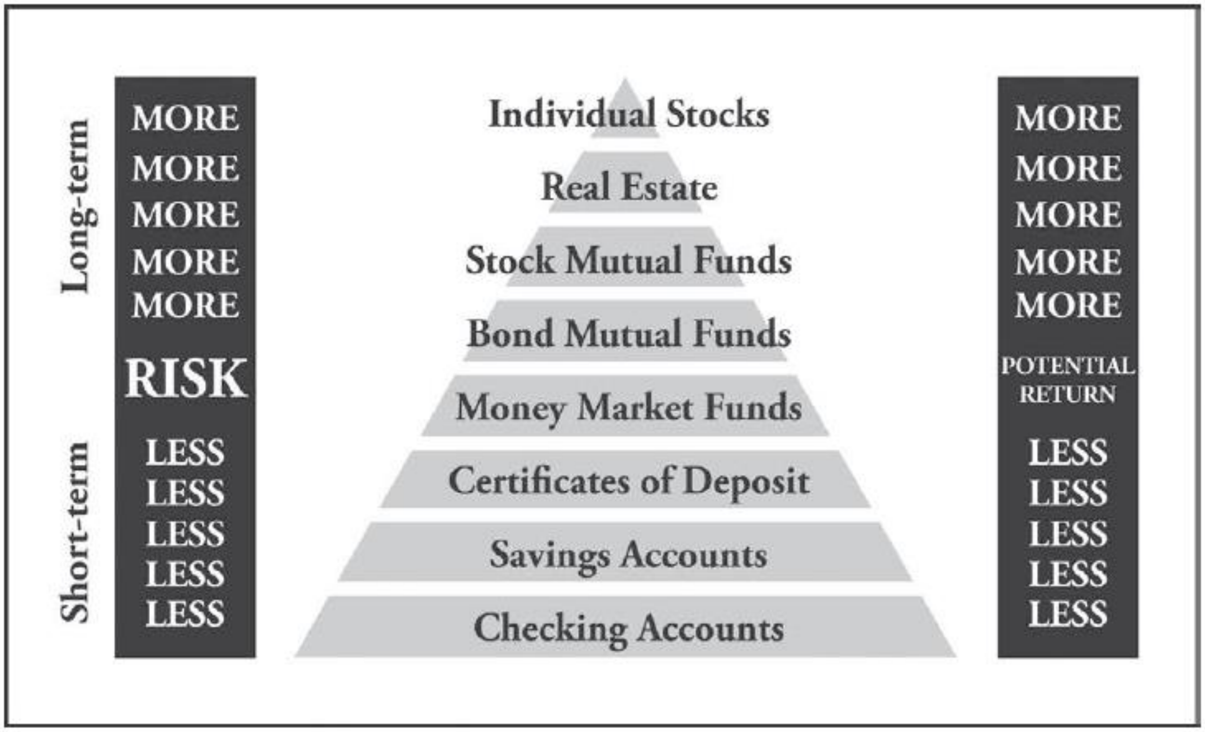
What exactly is risk? In a nutshell, it is uncertainty about a situation. A situation can have several possible outcomes and it is difficult to predict what the outcome may be. Some of the outcomes are positive while others are negative. When a risk involves investments, the greater the risk the greater the potential reward (or increased value) of the investment. Younger individuals can typically afford greater risks because they have a longer period of time to regain any losses suffered along the way. For that same reason, an older person typically takes less risks because they don't have as much time to recover any financial setbacks while they are still earning money.

Individuals have different comfort levels associated with risk. Some are willing to take a risk whereas other are more cautious. It's important to determine what your investment goals are. Are you saving for a new phone? Or perhaps a college education? Your goals will determine whether you invest for the short or long term.

Below is a Risk-Return Pyramid that shows the various categories of investments. There is less risk involved with checking and savings accounts in comparison to individual stocks. Every person has a level of tolerance for risk. Some people ignore the ups and downs of financial markets and concentrate on their long-term objectives. Other people get nervous every time they see any changes As you can see, the bottom portion of the pyramid includes shorter-term investments that give you easier access to your money, but also have less of a return. In other words, you will not be able to make a lot of money off of those investments. The higher you go on the pyramid, the longer your money is tied-up, but you also have a higher potential of making money on your investment.

Source: National Center for Economic Education: Learning, Earning, and Investing

The Risk-Return Pyramid



Remember, everyone has a certain comfort level with risk – especially when it comes to money! You want to be cautious and diversify your risk. That means that you want to split up your investments into several different areas, so your risk is spread across different types of investments. As a result, you will be less vulnerable if an investment loses money.

Source: National Center for Economic Education: Learning, Earning, and Investing