NebGuide
University of Nebraska–Lincoln Extension, Institute of Agriculture and Natural Resources
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Before You Invest

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Learn the difference between saving and investing and what financial requirements you should meet before investing. Also, learn how to choose a qualified investment advisor.

There is a difference between saving and investing. *Saving* provides money for use in the near future while *investing* sets money aside for future gain.

Your Financial Base — Four Things to Check Before You Invest

While keeping these definitions in mind, let's look at some financial requirements you should meet before you start to invest.

1. Emergency Fund

Financial experts recommend setting aside the equivalent of three to six months of living expenses for emergencies. The exact amount you need will depend on your situation. For example, you need less money in an emergency fund if you have adequate insurance coverage. This money should not be used for long-term investing.

Why do you need an emergency fund before you start to invest? You need an emergency fund so you do not have to cash in investments to cover a financial emergency. Should such an emergency occur, it may not be the best time to cash in those investments, or you may have to pay a penalty to get your money.

Emergency funds should be kept liquid. Liquidity means the funds are available as cash or can be easily converted to cash. Examples of such forms include savings accounts, short-term certificates of deposit, or money market accounts.

2. Adequate Insurance

Having adequate insurance for your situation is a second prerequisite to investing. You'll need

- *health insurance* with good major medical and catastrophic coverage,
- *disability income insurance* for all breadwinners,
- *life insurance* as income protection for dependents,
- *property and vehicle insurance* for your possessions, and
- *liability coverage*.

Exactly what type of insurance and how much is needed is determined by your situation.

3. Retirement Plan

Another prerequisite to investing is that you make regular contributions for retirement with an Individual Retirement Account (especially a Roth I.R.A.), Keogh or similar type of plan for the self-employed, or a 401(k), 403(b), or similar employer-provided retirement plan.

4. Equity in a Home

This requirement depends on one's values and goals. If home ownership is important, some equity in a home is needed before starting to invest. If home ownership is not important or accumulating a down payment for a home is the reason for investing, meeting this requirement is not necessary before starting to invest.

Investment Tips

- Know your investment goals and their priority.
- Diversify to spread risk.
- Establish a solid financial base before starting to invest.
- Gear investments to your situation, both financial and personal.
- Match investments with your risk tolerance level.
- Adopt an investment strategy.
- Stay flexible and adapt to change in your situation and in the economy.

Investment Considerations

Investment Goals

Why do you want to invest? What do you hope to achieve with your investments? Most investment goals fall into these four groups:

- **Present Income.** You need to receive current income from your investments. People who are retired or who have children in college are examples of those with present income as an investment goal.
- **Capital Growth.** You want to increase the value of what money you do invest, usually over a long time. If retirement is several years away or a child is young and many years from post-secondary education, capital growth will be a major investment goal.
- **Capital Preservation.** You want to be sure what you invest keeps its value in the future. Retirement or periods of double-digit inflation are both situations where capital preservation would be an investment goal.
- **Tax Considerations.** You want to shelter present income from taxes. This is a valid consideration no matter your income level.

You need to know your investment goals because the investment alternatives you choose depend on your goals. If you work with an investment adviser, that person will want to know your investment goals before they advise you.

Another important consideration when discussing investment goals is priority. Most people have goals that fit into two or more of the above categories. Depending on the situation, one of the goals will have priority.

Time

Different investments take different amounts of time to manage. Even a certificate of deposit takes management time. Are you willing to devote a great deal of time to managing your investments, or do you want an investment that requires a minimal amount of your time?

Knowledge of Investment Alternatives

How much do you know, or are you willing to learn, about the different investment alternatives? How much research are you willing to do to keep up with your investments? Investment advisers recommend investing in what you know about or are willing to learn about. Even if you work with an investment advisor, you will need a certain amount of knowledge so you can ask questions.

Amount to Invest

Realistically, how much money do you have to invest? Is this a one-time occurrence such as $5,000 from an inheritance, or do you expect to regularly put money in your investments, such as $150 each month?

Amount to Lose

What amount, if any, can you afford to lose? If that figure is zero, you will choose different investments from someone who can afford a loss.

Present Asset Situation

What is your present asset situation? What do you own? How do your assets match your investment goals? Are your assets diversified enough to spread your investment risk?

Temperament

How comfortable are you with risk? We all have different temperaments and different tolerance levels when it comes to risk. All investments involve risk and the potential for losing part or all of your investment. Historically, the stock market has provided a 10% return on long-term investments, but it may take a long time to get that average return. If an investment causes you to lose sleep or not eat, your investment has a higher risk level than your personal comfort zone allows.

Another element involved with temperament is the emotional attachment you feel for a particular investment. Experts caution not to become too emotionally involved with investments. Keep them on a business basis. Emotional attachment prevents you from being objective. For this reason your home is not a true investment.

Choosing an Investment Advisor

Know Your Goals

Before you start to look for an investment advisor, know what your investment goals are. The clearer your goals are to you, the easier you will be able to explain them to someone else.

Ask for References

If you do not have an investment advisor, ask friends, relatives, and business associates for recommendations. Also check with financial advisors for their suggestions. Then schedule an initial interview with at least three of the individuals recommended to you. This initial interview should be free.

Interview Prospective Advisors

During the initial interview, explain your investment goals in general, describe your present asset situation, and provide your annual approximate income. Then ask what general recommendations the person you are interviewing would make for someone in your situation.

In addition, ask the prospective advisor:

- What is your personal philosophy of investing? (You are trying to find an investment advisor whose personal investment philosophy matches yours.)
- How often are clients contacted?
- How easy are you to contact when we need to talk?

- How have you handled past mistakes?
- What has your performance record been?
- What is the firm's performance record for the past 10 years?
- What is the fee schedule?
- How are you paid? Is it an hourly rate, a flat fee, a commission, or a combination of these methods?
- Do you receive a bonus from your firm for selling a particular product?
- Does your firm offer any special services, such as check writing?
- What provisions are there if I need to get part or all of what I've invested in case of an emergency?

Ask for references from past clients and talk with them. While advisors are likely to only provide references that reflect favorably on them, checking with their references can give you additional insight into how the advisor operates.

Review Responses

After the interview, carefully consider their responses and whether they meet your goals and expectations. Ask yourself:

- How comfortable am I with this person?
- Can I ask questions and have confidence in the answers?

Immediately cross off any one or any firm who pushes you to "sign up now." You have the right to take your time to decide about who you want for an investment advisor.

Check Credentials

Check to be sure that the individual advisor and the firm are licensed or registered. Federal or state securities laws require brokers, investment advisors, and their firms to be licensed or registered, and to make important information public. It's up to you to find that information to protect yourself and your investment dollars.

The Central Registration Depository (CRD) is a computerized database that contains information about most brokers, their representatives, and the firms they work for. For instance, you can find out if brokers are properly licensed in your state and if they have had problems with regulators or if investors have made serious complaints about them. You'll also find information about the educational background of brokers and where they worked before their current jobs.

Ask either the state securities regulator or the Financial Industry Regulatory Authority (FINRA) to provide you with information from the CRD. The state securities regulator may provide more CRD information than FINRA, especially when it comes to investment companies, so check with them first. Contact information for state securities regulators is available on the North America Securities Administration Association Web site. FINRA's online tool, BrokerCheck®, is available at *www.finra.org/Investors/ToolsCalculators/BrokerCheck.* The service is also available by calling FINRA's toll-free BrokerCheck hotline at (800) 289-9999.

If you do business with an unregistered securities broker or firm that later goes out of business, there may be no way for you to recover any losses, even if a court or arbitrator rules in your favor.

Working With an Investment Advisor

Don't expect an advisor to be right all of the time. They are human and will make mistakes. What is more important than always being right is that your advisor is honest and straightforward, provides good service, understands and respects your investment goals, and works for and with you.

Resources

Protect Your Money: Check Out Brokers and Investment Advisers at *www.sec.gov/index.htm.* U.S. Securities and Exchange Commission.

Consumer Action Web site at *www.consumeraction.gov*. U.S. General Services Administration, Federal Citizen Information Center, Washington, D.C.

This publication has been peer reviewed.

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