DCC

DELRAY CREDIT COUNSELING

Debt Consolidation and Credit Counseling

Investing Basics

Investment Types

Here's a quick guide to some of the investment options available to you:

Savings Accounts. Such accounts are a good place to store your emergency funds. They are generally insured by the FDIC up to $100,000 for all deposits at one institution and provide easy access to your money. The chief drawback is that interest rates tend to be low.

Money Market Deposit Accounts. These accounts usually earn slightly higher interest than a savings account but still allow easy access to your money. Some banks and financial institutions require an initial deposit of $1,000 or more and limit the number of withdrawals or transfers you can make during a given period of time.

CDs (Certificates of Deposit). CDs usually earn more interest than a savings account and are a very low-risk financial vehicle. They are generally insured up to $100,000 by the FDIC for all deposits at one institution. You agree to keep your money on deposit for a fixed period of time. Usually, the longer the term, the higher the interest rate. There may be penalties for early withdrawal.

401(k) Plans. If your employer offers a 401(k) plan, it may be one of the best retirement vehicles available to you. A 401(k) is a retirement savings plan to which you can contribute a certain percentage of your gross income. However, contributions to a 401(k) and certain other qualified deferred compensation arrangements cannot exceed $10,500 in 2001, and are scheduled to gradually increase to $15,000 in 2006. Typically with a 401(k) plan you have several investment options from which to choose, including stocks, bonds, mutual funds or CDs.

Your employer may contribute matching funds to your 401(k) plan. For example, your employer may match 50% of your contribution for any amount up to 5% of your compensation. That means an additional 50% contribution on the first 5% you contribute to your plan. That’s also why 401(k)s are so highly recommended by financial advisors.

Contributions made to a 401(k) should reduce your current income taxes as well. You do defer paying income tax on the contributions you make. Likewise, the earnings in your 401(k) grow tax-deferred until the money is withdrawn. Income tax is due when the money is withdrawn. If you withdraw money before you turn 591/2, however, you may also be subject to a 10% IRS penalty. While withdrawals are generally not permitted, certain 401(k) plans may permit withdrawals for "hardship" reasons, such as medical emergencies or college tuition. You do pay income tax on the amount withdrawn, and a 20% mandatory withholding generally is required from the distribution. Moreover, the hardship distribution may also be subject to the 10% IRS penalty.

Individual Retirement Arrangements (IRAs). IRAs were established to encourage people to save for retirement. Subject to certain limitations, an individual generally may be able to contribute the lesser of the amounts shown below or 100% of your compensation to an IRA, and the earnings grow tax deferred until you begin withdrawals. Additionally if you are age 50 and over, you are permitted to make catch-up contributions to your IRA for years that you did not fully invest. You may contribute an extra $500 per year through 2005 and an extra $1,000 per year in 2006 and beyond. Your annual contribution may also be fully or partially deductible, depending on your income level and whether you are covered by another retirement plan. As with 401(k) and 403(b) plans, you may be subject to a 10% IRS penalty for premature withdrawals (generally before the age of 591/2), in addition to the income tax. You may have a choice of investment options for your IRA, including stocks, bonds, mutual funds or CDs. Keep in mind that your money must be in an IRA-approved account and that it must be designated as an IRA.

Keogh Plans. Keoghs are retirement plans for people who are self-employed. Usually a maximum of 25% of your net income (or a maximum of $40,000) can be contributed to these plans on a tax-deferred basis. Keoghs are more complicated than an IRA, 401(k) or 403(b), so get tax advice before setting up a plan.

Stocks. When you buy stocks, you acquire shares of a company's assets. If the company does well, you may receive periodic dividends and/or be able to sell your stock at a profit. If the company does poorly, the stock price may fall and you could lose some or all of the money you invested.

Bonds. When you purchase a bond, you are essentially loaning money to a corporation, the U.S. government or a local government for a certain period of time, called a term. The bond certificate promises that the issuing entity will repay you on a specified date with a fixed rate of interest. Bond terms can range from a few months to 30 years.

Bonds are generally considered a safer investment than stocks because bondholders are paid before stockholders if a company becomes insolvent. Independent bond-rating agencies such as Standard & Poor's and Moody's rate the likelihood that any given bond will default. You can find bond ratings in each agency's publications at your local library.

Although there are no penalties for selling a bond before the end of its term, the value of the bond is subject to interest rate fluctuations. If interest rates have risen since you bought your bond, you may have to sell it at less than face value. It is also possible that the bond's yield will turn out to be less than the rate of inflation.
Some of the bonds available include:

- **Savings bonds, Treasury bills** (commonly called T-bills) and other securities issued by the U.S. Government.
- **Zero coupon bonds**, which are similar to savings bonds. No periodic payments of interest are made. The bonds are bought at a discount and are worth their face value upon maturity.
- **Municipal bonds (munis),** which are sold by states, cities and other local governments. They are often tax-exempt, which means you will pay no taxes on the interest earned.
- **Insured bonds,** which are less risky but generally pay lower interest rates because of the protection.
- **Convertible bonds,** which can be converted into stock.
- **High-yield bonds** commonly referred to as junk bonds, which are issued by corporations or governments with low ratings. They are very risky.

Mutual Funds. A mutual fund is generally a professionally managed pool of money from a group of investors. A mutual fund manager invests your funds in securities, including stocks and bonds, money market instruments or some combination and decides the best time to buy and sell. By pooling your resources with other investors in a mutual fund, you can diversify even a small investment over a wide spectrum, which should reduce risk.

There are many types of mutual funds with varying degrees of risk. Most mutual funds charge fees, and you often pay income tax on your profits. Tax rules can be complicated, requiring professional advice.

Annuities. Annuities may be deferred or immediate. Both are financial contracts you make with an insurance company. However, a deferred annuity helps you accumulate money for retirement, while an immediate annuity provides you with a steady stream of retirement income in return for your money.

With a deferred annuity you put money in, and over time it accrues income and interest. The payout occurs at some later date, when you receive a steady stream of payments to supplement your other income. The contributions you make to a non-qualified annuity are not tax-deductible. Contributions to a qualified annuity that is funding an IRA, 401(k), 403(b) or other qualified plan may be before tax or tax deductible. However, taxes on the earnings in the annuity are deferred until you begin receiving payments. Because insurance companies generally administer annuities, they can be set up to include life insurance benefits, such as a death benefit to a surviving spouse.

Immediate annuities are usually purchased with one lump sum payment and then begin an immediate payout. You receive payment on a monthly or other regular basis, giving you needed income. You can generally choose to have the payouts guaranteed by the issuer for as long as you live or choose from a number of other payment options.

Both deferred and immediate annuities can be either fixed or variable. The issuer of a fixed annuity guarantees a fixed rate of interest (deferred) or a fixed payment (immediate). Although you are protected from any downturn in the market, you won't benefit from any upswings. A variable annuity can earn a flexible rate (deferred) or pay a variable payment (immediate) depending on the performance of the underlying investment options you choose. Variable annuities are designed to accumulate money or provide an income stream that hopefully will rise over time to keep pace with inflation. However, there is some risk involved if the market does poorly during the time your money is invested.

Annuities can be a complicated investment, so discuss them with a qualified financial advisor to make sure you understand all the options and make the smartest decisions for your financial needs.

Your Home. Your home may be the largest investment you will make during your lifetime. The market value of your home is determined by such things as its condition, the neighborhood, school districts, square footage of the house and house style.

Social Security. You've paid into it most of your life, so don't forget to include it in your financial planning. The income you receive when you reach the eligibility age (e.g., 65) is based on the average of your 35 highest salary years. You also can collect 80% of your benefit at age 62. If you die, your spouse may be entitled to your benefits. The age at which you can collect full benefits is currently scheduled to increase gradually to 67. You can check the record of your earnings and get a statement of your anticipated benefits by calling Social Security at 800/772-1213.

Life Insurance. Life insurance can help to financially protect your loved ones in the event of your death. It's important if you are married and even more important if you have dependent children. There are several types of life insurance:

Term life insurance pays a fixed amount of money to your beneficiary if you die during the term of the policy. The cost of premiums increases as you get older.

Whole life insurance is permanent insurance that provides a death benefit that is guaranteed for the insured's life as long as premiums are paid. Participating policies may pay dividends that can increase the policy's cash value, but they are not guaranteed.

Universal life insurance is considered a variation of whole life insurance with more flexibility. Within limits, the policy owner determines the amount and frequency of his or her premium payments and is permitted to adjust the policy face amount up or down to reflect changes in his or her needs. As premiums are paid and cash values accumulate, interest is credited to the policy's accumulation fund.

Variable Life Insurance is similar to universal life in that there is flexibility in connection with premium payments and death benefits. However, with variable life, premium payments are held in separate accounts, and the policy owner chooses how the cash value will be invested. Consequently, such a policy's cash value will fluctuate with the performance of the chosen investment portfolios.

Health Insurance. Health coverage protects you in case of sickness or injury. Without it you run the risk of being financially wiped out by just one serious illness or accident. Most people receive subsidized health benefits through their employer, but coverage can also be purchased as an individual.

Disability Insurance. This is probably one of the most overlooked forms of insurance for working-age people. Disability coverage replaces a portion of your income when you can't work because of illness or injury. Most policies replace 60% to 80% of your income. (You also may receive income from Social Security for certain disabilities, or from Workers Compensation if you are injured on the job.) If your employer provides a 60% disability policy, you might want to consider a supplemental policy covering 20% of your income.

Long Term Care Insurance. Long Term Care insurance is designed to help pay for nursing home care, assisted living care or home health care expenses. This fast growing type of insurance can protect you and your assets against the high cost of long-term care. Most policies pay benefits when long-term care is prescribed by a physician as medically necessary or when someone can no longer physically or mentally take care of basic needs.

Homeowners Insurance. Homeowners' coverage protects your financial investment in your home. It provides compensation for damages to your home and its contents, and it may protect you from financial liability if someone is injured on your property. The extent and amount of coverage needed depends on your situation, but if you can afford it, it is wise to insure your home for 100% of its replacement cost.

Compliments of
Delray Credit Counseling Corp.
5300 West Atlantic Ave. Suite 200
Delray Beach Florida 3348
(800) 982-8445