Viewpoints

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Investing Basics: What Is Investing?

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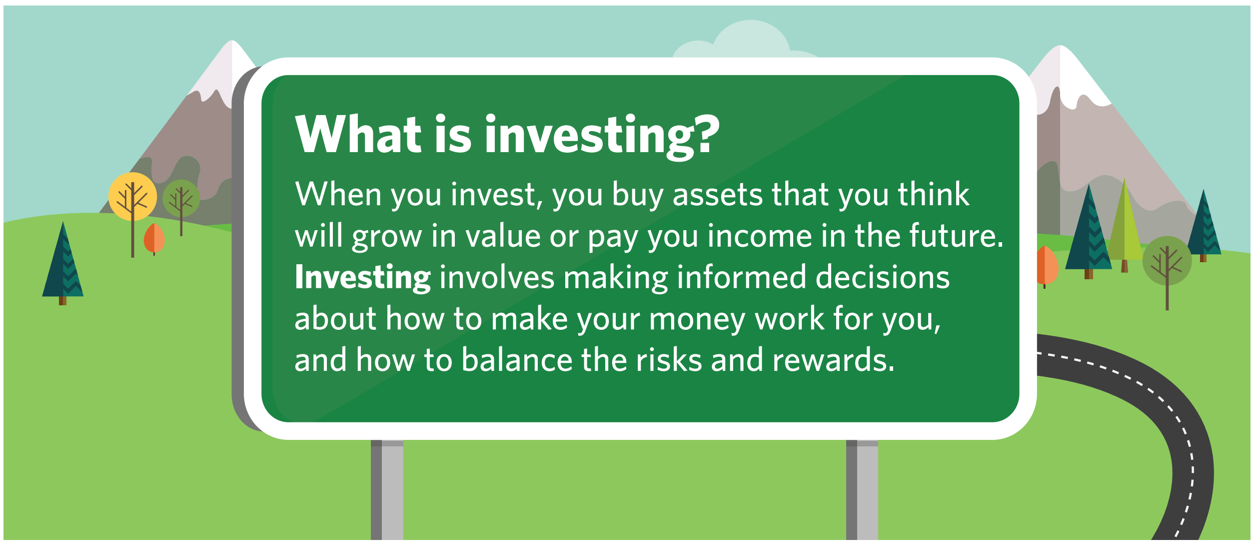
This month, the ICI Education Foundation celebrates 30 years of developing, delivering, and promoting investor education. As part of our yearlong celebration, we will be sharing an ICI Viewpoints post each month that explains a basic concept of investing, drawn from the ICI Education Foundation's Investing Road Trip.



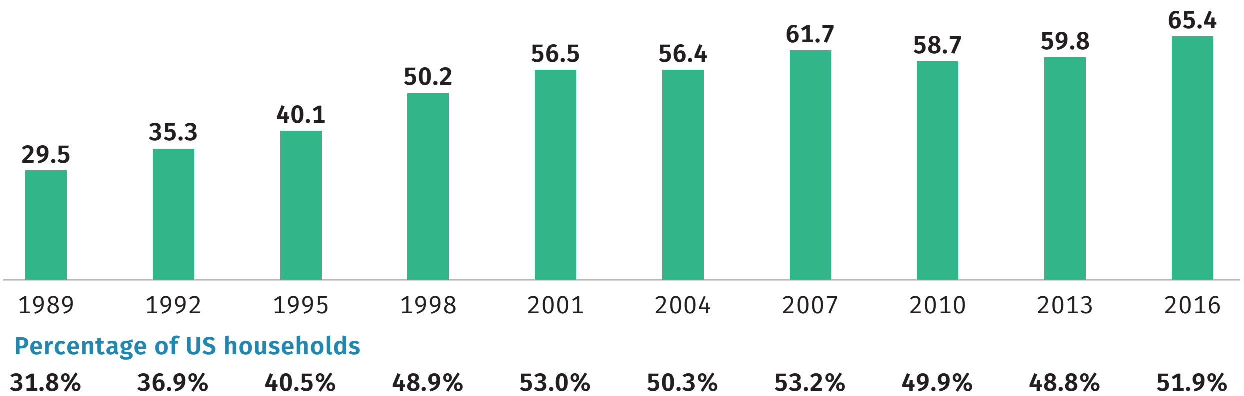
What Is Investing?

Investing has never been easier, cheaper, or more prevalent, with more than half of US households reporting that they own stock, either directly or through mutual funds or retirement savings accounts, such as a 401(k) or individual retirement account (IRA).

FIGURE 1

Reach of Stock Ownership Has Dramatically Expanded in the United States

Stock ownership, millions of US households



Note: Stock ownership includes directly held shares as well as stocks held indirectly through mutual funds, ETFs, closed-end funds, and other managed accounts; inside and outside of retirement accounts.

Sources: Investment Company Institute tabulations of the Federal Reserve Board Survey of Consumer Finances

You may often hear the concepts of saving and investing used almost synonymously—"I'm saving for retirement through a mutual fund." While investing can be a way to save for an important financial goal, they're not the same.

It's Different Than Plain-Vanilla Saving

Merriam-Webster defines to *save* as "to put aside as a store or reserve." To *invest* is "to commit money in order to earn a financial return." Investing means putting your money to work for you by buying assets that you think will increase in value over time. The money you gain from investing is called your *return*.

Here's another way to think about investing. When you earn money through a job, your ability to earn income is limited by the hours that you can work. Assets that you've invested don't need to sleep or eat or watch Netflix—they can work for you around the clock.

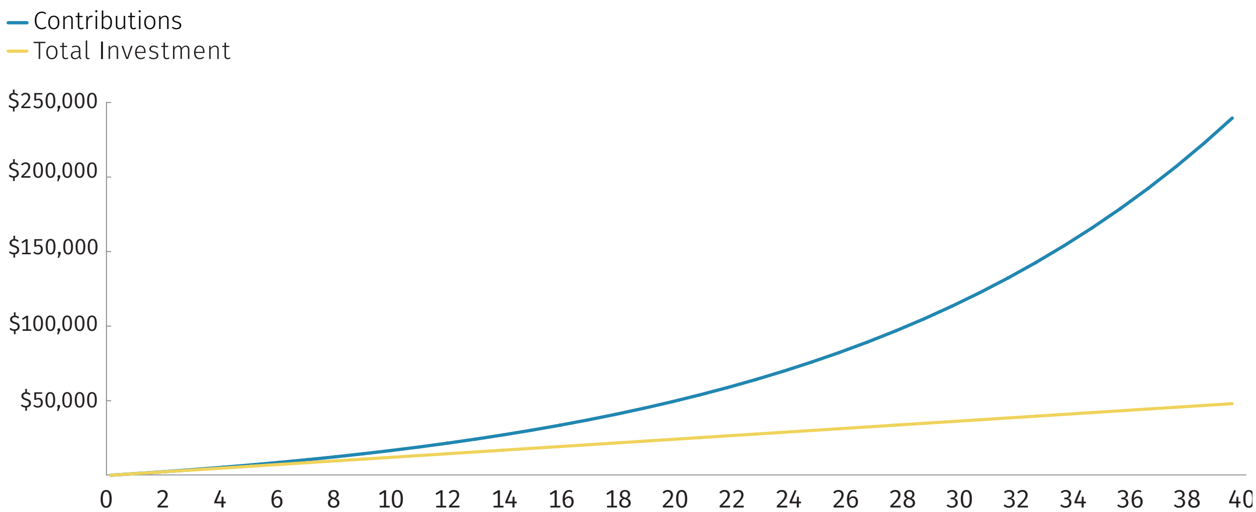
Your Money Works for You

Now imagine that you work, but you also invest some of the money that you earn—say, $100 each month. If you earn a return of 7 percent per year on your investment and reinvest your returns, your investment would grow as illustrated by the darker blue line below.

FIGURE 2

Growth of Investment with Compound Returns

$100 contribution per month with return of 7 percent per year



The gains are modest at first—for the first few years, returns add little to the total value of the investment. But as returns continue to compound over 40 years of investing, the total value of the investment reaches $240,000, and returns make up 80 percent of that.

In this example, setting money aside regularly—the saving—adds up to $48,000. But the impressive increase over time? That's the benefit of investing.

Investing involves making informed decisions about how to make your money work for you, and how to balance the risks and rewards that come from these decisions. As you can see from the dark blue line in the graph above, the rewards can be great!

Next in this series, we'll look at the potential downside of investing—risk—and some of the different types of risks investors face.

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