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Investing Basics: Types of Investments

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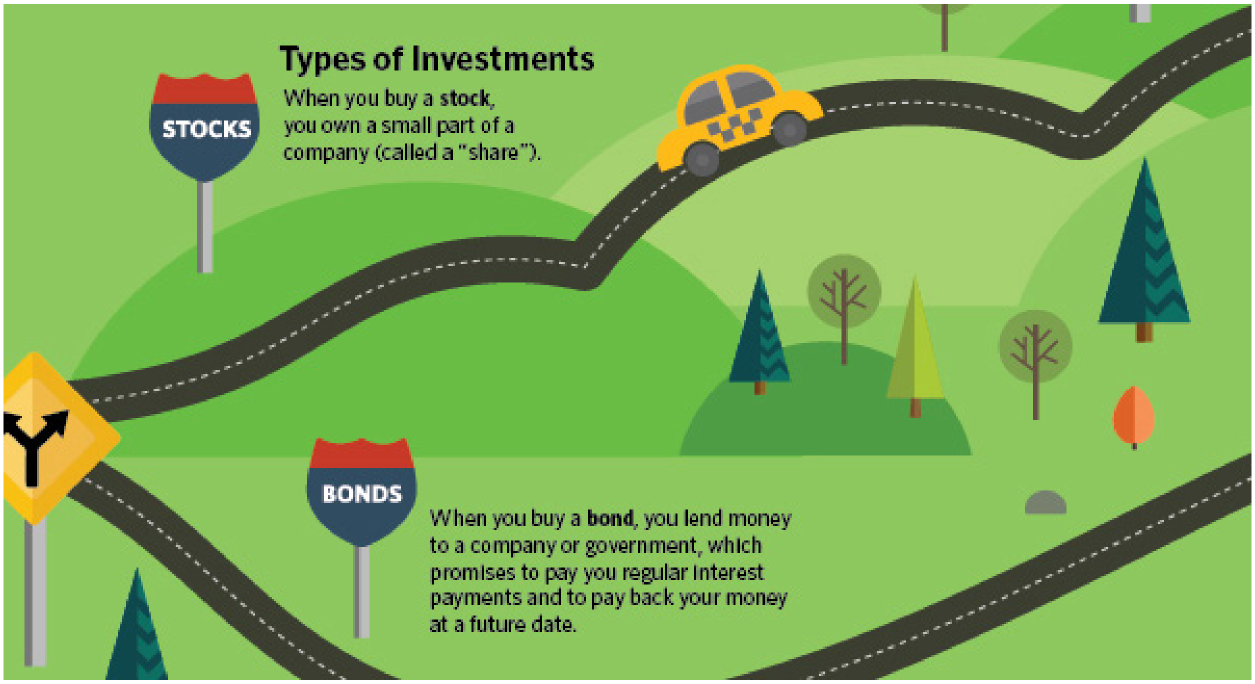
As part of the ICI Education Foundation's ***30th anniversary celebration****, we will be sharing a series of* ICI Viewpoints *explaining basic concepts of investing, drawn from the ICI Education Foundation's Investing Road Trip.*

Two of the most common investments are stocks and bonds. Chances are if you own a portfolio of investments, those two types of assets make up a significant part—or perhaps all—of it. For those who want to start investing, it's essential to understand these common portfolio building blocks. Both stocks and bonds are types of securities, which means they are financial assets that can be bought and sold. And like all investments, they carry opportunities for earning returns, **as well as risks**.



Of Good Stock

A stock is an ownership share in a company—usually a tiny share. (If you currently own one share of Apple stock, that would be about 0.00000002 percent of the company's outstanding shares!) Owning even a tiny part of a company entitles a shareholder to a corresponding share of the profits that a company pays out (called a dividend) and to a proportional vote in shareholder meetings. If the company's value rises, so does the price of its stock and the value of an investor's holdings.

Stocks are liquid—they can be easily bought and sold while the market is open and are priced continuously throughout the trading day. Stock investing can be volatile, with prices moving sharply up or down, depending on any number of factors, including the company's financial health, a change in interest rates, economic and political events, and even a natural disaster that may affect the company's operations. Despite these risks, stocks attract investors because they present an opportunity for shareholders to participate in the growth of a company over time. (Amazon stock, for example, has increased an eye-popping 495 percent in the last five years!) Of course, money invested in stocks is not guaranteed, and if a company struggles or goes bankrupt, its shares could lose some or all of their value.

A Strong Bond

A bond is a loan. A borrower (typically a company, government, or municipality) sells bonds through the market to investors. The bond issuer promises to pay bondholders back at a future date, along with regular interest payments while the debt is outstanding. Bonds can be particularly attractive for those interested in receiving a regular stream of income from an investment, such as retirees.

Bonds are typically less volatile than stocks, although they too can lose some or all of their value. The price of bonds can be affected by changes in interest rates. If interest rates rise, bond prices go down; if interest rates decrease, bond prices rise. Other factors that can affect the price of bonds are an issuer's creditworthiness (known as credit risk) and the possibility that an issuer may pay off the debt sooner than promised, causing the bondholder to miss out on future interest payments (prepayment risk). And bond investors should also consider inflation risk, which is a factor when the overall cost of goods rise faster than an investment's growth. If a bond issuer does go bankrupt, bondholders are typically paid first (stockholders are typically paid last, if at all).

Sky's the Limit…

Stocks and bonds are a good place to start learning about the types of investments available, but they are by no means the end. Investors arguably have more options for where to put their money than ever before—today, you can invest in pretty much anything, from Bitcoin to bullion to Beanie Babies.

…But Just Because You Can Doesn't Mean You Should

While some might be tempted to chase wild investing fads and others might want to stick all their money under the mattress, neither approach is wise—a more measured approach is probably the best bet. Of course, what that means will depend on the individual investor.

Most investors buy a mix of assets—stocks, bonds, real estate, and commodities. That reduces their risks in two ways: they're not vulnerable to problems that might befall a single company or bond issuer, and they can count on different asset classes to behave differently as markets change. For example, stocks historically have gone up in value when bond prices fall, and vice versa.

One way to spread those risks is by investing in regulated funds. In the United States, many investors—more than 100 million, in fact—own regulated funds, such as mutual funds and exchange-traded funds (ETFs).

Mutual funds and ETFs hold a diversified pool of investments, such as stocks, bonds, or other financial assets, and offer a simple option for investors. By buying shares in a mutual fund or ETF, investors gain access to all the stocks or bonds that the fund holds in its portfolio. Mutual funds continue to be popular investments because they offer professional money management and a diversified portfolio at a reasonable price.

We'll look more closely at the concept of diversification and the benefits of mutual funds and ETFs in future posts.

Putting It All Together

Choosing the right mix of investments is highly specific to the individual. A portfolio's risk profile and investment objectives should fit with the investor's personal risk tolerance, investing goals, and other investments. When those things align, it's a match.

Other Posts in This Series

» **Investing Basics: What Is Investing?**
» **Investing Basics: What Is Risk?**
» **Investing Basics: Types of Investments**

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