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Investments

Goal: In this unit, you will learn about investment options through formal and informal measures. Clients who have the financial ability to invest can build some security in their financial future and plan for long-range expenses like their children's college education. While investments may not be an option for all clients, a basic understanding of investments is part of the skill set for economically literate professionals in the human services.

Assisting clients in making wise and informed financial decisions is an impo-rtant part of protecting the well-being of vulnerable populations. Asset-building for low-income clients often is different from asset-building for middle-income clients.

While investments in the stock market or other money markets generally appreciate over time, and thus, build the wealth of many Americans, the poor typically have not participated. People with few resources generally do not have much money to save, much less to invest. The investment plan for clients needs to be individualized based on needs and resources. People with limited assets might be better off placing money into a secured account at the bank so their money is more liquid and they have faster access to it.

Clients who have the ability to invest can build some security in their financial future and plan for long-range expenses like their children's college education. Understanding what investment options exist, and knowing how to connect clients with available information and resources, is important. When workers in the human services are familiar with investing, they are better equipped to help clients to gain financial power and build a more secure future.

Learning about investment options offered through financial institutions can be a complex and scary process fraught with fear and mistrust. Many people are reluctant to invest in financial institutions. During the economic collapse of 2008, many financial services failed and the valuation of many stocks plummeted. However, while there are risks, particularly in some types of investments, understanding the investment process is important.

A. Investments

Investments represent money placed with financial institutions for the purpose of gaining a future return on the amount invested (principal). Investments can include stocks, bonds, mutual funds, and other vehicles. Investing in stocks and bonds carries risk of devaluation, meaning that the price of the stock or bond might decrease below what you paid for it. This means that if you sold the stock or bond at this reduced price you'd suffer a "negative profit" or loss. A downturn in the economy can be a huge source of devaluation. The impact of an economic downturn on an investment is especially problematic if the individual or family cannot hold on to the investment until the economy picks up which would allow the investment to regain its value. If the family needs to sell a stock or bond to cover daily expenses, the family loses out if the fall in market prices has reduced the value of the investment.

Never offer investment advice to clients

There are many investment options. Deciding which ones to use is a complicated process. Considering the complexity and risks involved from participation in the financial markets, human service practitioners should refrain from providing any sort of investment advice whatsoever to a client. To do so puts the social worker in danger of engaging in a dual relationship with a client, and thereby violating the NASW Code of Ethics. Should the client lose money based on that advice, it would be understandable if the client blamed the social worker for overstepping his/her professional role and expertise.

An angry client could possibly jeopardize the social worker's reputation and career and also jeopardize the agency s/he works for in the case that the client initiates a lawsuit. It is best to refer clients to expert sources for information and to learn to defer questions having to do with specific investment advice. However, an economically literate worker is better equipped to understand client concerns, explore the reasoning behind the client's investment choices, and recognize that different options are associated with different risks.

RESOURCE:

"10 Investment Blunders to Avoid"
http://www.plannersearch.org/Pages/Home.aspx
from the Financial Planners Association

1. **Certificates of Deposit (CD)**. If a person has enough extra money to invest funds for six months or longer, then investing in a secured bank vehicle such as a certificate of deposit (CD) may provide a moderate rate of return. CDs are considered reasonably safe investments because they are guaranteed to provide a specified return on investment as well as being insured by the Federal Deposit Insurance Corporation (FDIC). Funds invested in a CD cannot be withdrawn before the period of time specified in the agreement. Generally, the longer the time period that the investor agrees to leave the money in the CD, the higher the promised return. These investments pose little risk to the investor compared to other investments.

2. **Mutual Funds.** A mutual fund is a professionally managed investment that pools money from many investors and places the money in stocks,[1] bonds,[2] short-term money market accounts[3] and/or commodities[4] such as precious metals.[5] Mutual funds have benefits and risks: They share the same risks associated with any investment in the private market: If the fund invests primarily in stocks, it is subject to the same ups and downs as the stock market.[6] While the risks are increased, the potential return on investment rate are also increased.

3. **Treasury Bills or T-Bills** are securities issued by the U.S. government for one year or longer. The minimum purchase is $100 (but to increase the value, the security can be bought in increments of $100. The consumer can hold a bill until it matures or sell it before it matures. While invested the T-bill earns interest which is equal to the face value minus the purchase price. The T-bill may be issued as a discount from its face value.[7]

4. **Stocks** are typically issued by public companies and can be thought of as owning a small share of the ownership of that company. There are generally two classes of stock: 'Preferred' stock guarantees a certain cash dividend to the shareholders while 'common' stock does not. The rise and fall of the common stock will rest on the company's profits or losses and is far riskier than the preferred. As such, it is a good idea for investors, on a regular basis, to check stock prices and understand the company's financial situation. To minimize losses, investors will want to sell the stock before it becomes worthless. Stocks are easily traded from one person to the next through financial institutions. There should be a differentiation between preferred stock and common stock.

5. Bonds are contractual agreements between buyers and sellers for specified amounts of money and set periods of time. There are two types of bonds — government and corporate — with different types of tax implications, the former are generally, tax free depending on the governmental unit which issues the bonds. Government bonds are generally tax free, but have lower yield and corporate bonds are taxable but have higher yields. Not everyone has sufficient savings or wishes to purchase stocks and bonds in the hope that the deposited money will grow. In difficult economic times, when the market is faring badly, investing in stocks and bonds becomes riskier than usual. As in the latest downturn of the economy, placing savings in stocks and bonds can mean substantial losses. The same is true for using one's savings to purchase real estate or art. If the markets in these areas fall, the housing and art are no longer assets but represent losses.

6. Real Estate. Unlike renting a home, owning a home tends to build and maintain one's wealth, assuming the house appreciates (increases) in value. The ability to borrow money to finance the purchase depends on the individual buyer's income and creditworthiness. However, in periods of economic downturns, the housing market may decline and homes may depreciate in value. During the crisis and housing market collapse of 2008-09, the combination of subprime loans requiring low or no down payments with the dramatic drop in housing values resulted in a significant amount of home-owners around the country being "underwater" - meaning that they owed more money on their home than it was actually worth.

RESOURCE:

"Wealth Gaps Rise to Record Highs Between Whites, Blacks and Hispanics (Homeownership Rates)"

http://www.pewsocialtrends.org/2011/07/26/wealth-gaps-rise-to-record-highs-between-whites-blacks-hispanics/5/#chapter-4-asset-ownership

from the Pew Research Center

7. Antiques, Jewelry, and other Collectibles. Luxury or rare items often hold their financial value but are less easily converted to cash than are other types of investments. In addition, they may be physically lost over time.

8. The Risk vs. Return Trade-Off. A concept that economists and financial experts discuss a lot is the risk vs. return trade-off. Some investment vehicles, such as stocks, are riskier than others, such as saving your money in a bank. The risk one faces when buying stock is that the price of the stock might decrease after you've purchased it so you'd suffer a loss if you sold it at this lower price. The risk of saving your money in a bank is that the bank could experience a "run". A run is when everyone (or many people) with bank accounts, demand their money from the bank all at the same time.

Since banks typically don't have enough money to pay back everyone if everyone asked for their money all at the same time, many people may not get their money back. But due to the Federal Deposit Insurance Act, as long is the money deposited is less than $250,000, you don't have to worry about losing it. The more relevant risk for most people who save their money in a bank is that inflation might eat away at the value of their money, as was discussed earlier. The idea of the risk vs. return trade-off is that the riskier an asset is, the higher the returns from that asset tend to be. Stocks tend to generate higher returns than bank accounts, but investing in stocks also means a greater risk of "losing your shirt".

Case Example: Investing in Mutual Funds

Kim H. is a young Vietnamese woman who works in a beauty salon and attends English classes three evenings a week. She is very excited about investment advice she received from a friend. She was told to put her money into a mutual fund that promised. a guaranteed return of 5%. Currently, her money is in a savings account, which has an interest rate of less than 1%.

Kim discusses this in her English class, and also relates it to a social worker on staff. The social worker knows that during the present economic recession, she is earning less than 1% from her bank account. She also knows that certificates of deposit, which are FDIC insured, do not generally pay more than 2% even if invested for 10 years. The social worker suspects that the investment sounds too good to be true, but she does not want to cross an ethical boundary and become a financial advisor.

For Discussion:

1. Should the social worker provide Kim H with financial information? Where do you think the line should be drawn between the role of social worker and financial counselor?

2. What kinds of financial institutions/professionals might you consider referring Kim H to?

3. Familiarize yourself with the basic components and pros and cons of mutual funds by reading the FAQs on mutual funds on the SEC website.[8] Can you think

of some client conditions under which a mutual bond might make sense for a client? Can you think of some conditions where a mutual bond might not work well for a client?

B. Alternative Asset–Building Strategies

1. Bartering. When no money is available to purchase items or services, individuals and families may resort to bartering – exchanging goods or services with others. Even when money is available, a barter system may be preferred. In the current economy and the world of the Internet, bartering is enjoying a renaissance and several sites exist to facilitate the exchange of goods and services, such as professional services, childcare, vehicles, homes, furniture, etc.

2. Time Banks. Similarly, there is a growth in Time Banks – a form of barter measured in units of time. One example of donating time is teaching your neighbor a language or shopping for a person with impaired mobility or volunteering to dog walk for an elderly or ill neighbor. This time of volunteer time is rewarded with a time credit or time dollar that may be 'cashed in' in the future when you need it. Perhaps another member of the Time Bank will repair your leaking faucet or provide childcare. Time Banking, which exists in 22 countries and on six continents, is credited with having profound effects, transforming neighborhoods and entire communities. Some regard it as a "social movement."[9]

> **RESOURCE:**
> "Time Banks NYC" is a network of New York neighborhoods with neighbors sharing skills and supporting each other.
> http://www.nyc.gov/html/timebanks/html/home/home.shtml

3. Peer Lending. Peer Lending is a practice where communities come together to make small grants or microloans. Historically, many immigrant groups formed mutual aid and loan associations to help others from their community access financial resources. The most well-known contemporary example is the Grameen Bank: The Bank for the Poor in Bangladesh. The Grameen Bank extends microcredit to poor families. Microcredit is the extension of small loans to those in poverty to help spur entrepreneurship and bring people out of poverty.

Grameen America has brought microcredit to New York City. Since 2008 it has used peer lending to extend grants to mostly first generation immigrations, starting at $1500. These loans are reported to credit reporting agencies to help the borrowers build credit. The lending circles meet on a schedule and to monitor loans and repayments. This form of credit can be a crucial asset-building tool for new immigrants and others excluded from traditional forms of credit.[10]

RESOURCE:

The Grameen America

http://www.grameenamerica.org

NOTES
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