**PFL Academy**

Chapter 13.1: Introduction to Investment Types

Student Activity Packet

## THE CHALLENGE

*Priya, 24, landed her first full-time job earning $45,000 annually. Feeling overwhelmed by investment choices, she researched simple strategies. She decided to invest 15% of her gross income ($563/month) split between two low-cost index ETFs: 80% in a total stock market ETF and 20% in a total bond market ETF. Both charged expense ratios under 0.05%. Rather than trying to pick winning stocks or time the market, Priya committed to automated monthly contributions regardless of market conditions. By age 30, her disciplined approach and low fees had built a portfolio worth over $52,000 despite market volatility—all from a simple two-fund strategy.*

**How can understanding different investment types help you build wealth aligned with your financial goals and risk tolerance?**

### Learning Objectives

- Analyze the characteristics and functions of major investment types including stocks, bonds, mutual funds, and ETFs.
- Compare the risk-return profiles of different investment vehicles.
- Evaluate how different investment types align with various financial goals and time horizons.
- Calculate potential returns and assess risks associated with different investments.
- Make informed investment decisions based on personal financial situation and objectives.

## CORE CONCEPTS

| Term | Definition |
|---|---|
| Stock (Equity) | Ownership shares in a company that entitle you to a portion of the company's assets and earnings; can increase in value and may pay dividends. |
| Bond (Fixed Income) | A loan you make to a government or corporation that pays regular interest for a specified period and returns your principal at maturity. |
| Mutual Fund | An investment vehicle that pools money from many investors to purchase a diversified portfolio of stocks, bonds, or other securities. |
| ETF | Exchange-Traded Fund—similar to a mutual fund but trades on exchanges like stocks; typically has lower fees and often tracks a market index. |

| | |
|---|---|
| Diversification | Spreading investments across different asset types, industries, and securities to reduce risk; "don't put all your eggs in one basket." |

**Background:** Building wealth through investing is one of the most powerful financial strategies available. The choice between stocks, bonds, or funds depends on your financial goals, time horizon, and tolerance for risk. Historically, the S&P 500 has averaged approximately 10% annual returns, but with substantial year-to-year volatility. Understanding these basic investment types empowers you to make choices aligned with your personal financial journey.

## APPLY IT

### PART A: INVESTMENT TYPE COMPARISON

Compare the characteristics of four major investment types:

| Characteristic | Stocks | Bonds | Mutual Funds | ETFs |
|---|---|---|---|---|
| **Potential Return** | High (10% avg) | Moderate (3-5%) | Varies by type | Varies by type |
| **Risk Level** | High volatility | Lower volatility | Diversified risk | Diversified risk |
| **Typical Fees** | Trade commission | Trade commission | 0.5-1.5% | 0.03-0.25% |
| **Minimum Investment** | Price of 1 share | $1,000+ | Often $1,000+ | Price of 1 share |
| **Best For** | Long-term growth | Stability/income | Diversification | Low-cost diversity |

**1.** A 25-year-old saving for retirement 40 years away should emphasize which investment type? Explain your reasoning.

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**2.** Someone saving for a house down payment in 3 years might prefer which investment type? Why?

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### PART B: FEE IMPACT ANALYSIS

Compare the long-term impact of investment fees on $500 invested monthly for 30 years at 8% return:

| Fee Type | Expense Ratio | Annual Fee on $100,000 | Value After 30 Years |
|---|---|---|---|
| **Low-cost Index ETF** | 0.03% | $30 | $733,904 |
| **Average Mutual Fund** | 0.75% | $750 | $654,165 |

| | | | |
|---|---|---|---|
| **High-cost Active Fund** | 1.25% | $1,250 | $600,430 |
| **Difference (Low vs High)** | | | |

**3.** Calculate the difference in final wealth between the low-cost ETF and the high-cost fund. How many years of $500 monthly contributions does this difference represent?

Show your calculations:

**Fee difference impact: $___________ equals ____ years of contributions**

> **Insight:** *A 1% fee difference over 30 years costs you over $130,000 on the same contributions. Always check expense ratios before investing!*

### PART C: PORTFOLIO ALLOCATION SCENARIOS

Match these investors to the most appropriate portfolio allocation:

**4.** Alex, 22, starting first job, building retirement savings, 40+ year horizon:

- ☐ A. 90% stocks / 10% bonds (aggressive growth)
- ☐ B. 60% stocks / 40% bonds (balanced)
- ☐ C. 30% stocks / 70% bonds (conservative)

**5.** Morgan, 58, retiring in 7 years, wants to protect accumulated wealth:

- ☐ A. 90% stocks / 10% bonds (aggressive growth)
- ☐ B. 60% stocks / 40% bonds (balanced)
- ☐ C. 40% stocks / 60% bonds (conservative)

## CHECK YOUR UNDERSTANDING

**1.** Which investment type typically offers the highest long-term returns but with greater volatility?

- ☐ A. Government bonds
- ☐ B. Stocks
- ☐ C. Money market funds
- ☐ D. Certificates of deposit

**2.** What is the primary advantage of ETFs over traditional mutual funds?

- ☐ A. ETFs always have higher returns
- ☐ B. ETFs typically have lower fees and can be traded throughout the day
- ☐ C. ETFs are guaranteed by the government
- ☐ D. ETFs don't have any investment risk

**3.** Explain why diversification is often described as "the only free lunch in investing." How does spreading investments across asset types reduce risk?

**4.** Why do financial advisors typically recommend younger investors hold more stocks and older investors hold more bonds?

**5. Reflection:** Based on your current financial situation, time horizon, and risk tolerance, what investment allocation would you choose? What specific steps would you need to take to start investing?