

InvestWrite Essay

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Question: Imagine your parent(s) just inherited \$100,000 from a long lost aunt. Explain to them why it's important to invest their money so that it grows over time for retirement. Also, explain why it's important to diversify their investments among stocks, bonds and mutual funds, which are called asset classes. Choose two investments from among the stock, bond, and mutual fund asset classes that you would recommend for the long-term. Explain why you would choose each one. Also, explain why you think your choices would be good investments for their retirement.

R.I.P. Auntie

The power of investing often times is lost in the excitement of inheriting a large sum of money. I would explain to my parents that smart investing can grow money for retirement and allow them to live more comfortably during retirement. Since my parents are around age 50, the plan I present would have to be more of a short term investing plan. However, since my parents have already invested money for retirement, and have already established a strong financial base, I can suggest some positions which might include a higher level of risk. Regardless of any plan, the key to success will come through diversification and spreading risk.

With the current market conditions, many people speculate whether diversification really matters. Even well diversified portfolios have suffered through this economic hardship in recent times, but a closer look reveals that the diversified portfolios have outperformed those that are less diversified. While bonds have also lost a lot of ground along with stocks, those who held not only stocks but stocks and bonds lost significantly less. For example, a portfolio invested 100% in the Vanguard 500 index fell 37% in 2008. However, a portfolio invested 80% in the Vanguard 500 Index and 20% in the Vanguard Total Bond Market Index would have lost only 29%. Increasing the amount to 40% in the bond fund would reduce that loss to 20%. While many look and still see a loss, they have to understand that almost all portfolios are down, and diversification is a way to avoid and decrease big losses.

My parent's solid financial base gives them room to take on higher risk investments for a chance of higher return. Of the three given assets classes, the first recommendation would be to invest in stocks. Although stocks involve the most risk, they can yield the highest return and the risk can be properly managed with smart investing. Investing in stocks takes more time and research, which involves more involvement from the investor. Knowing my father (who watches at least an hour of CNBC daily), he will put in the appropriate time and find stocks that will continue to grow over time. They should invest in stocks with a commitment to pay strong dividends. The dividends will help pay out a solid percentage of the investment, even when stock prices remain steady. The overall reason for choosing to invest in stocks would be the consistent growth of the market over time. Although the market will go through

occasional slumps, over time the market has proven to be a solid long term investment to grow over time.

My second piece of advice would be investing in bonds. As shown with the example, a good mix of stocks and bonds is a great way to spread out risk. Although returns from bonds have been historically lower than those of stocks, they take on far less risk. An investor has more insight to the future, and knows that on the date of maturity they will have that set value. This defined term gives the investor less to worry about and although the money is never guaranteed, almost always pays the full amount promised. By avoiding junk bonds and high risk bonds, they can avoid riskier bonds. My parents should focus on bonds with a strong reputation. These less risky moves may lessen the return on parts of their investment; however it greatly lessens their chance for big swings that could happen when investing solely in stocks.

Investing in stocks and bonds provides a good balance of risk, and gives my parents a chance to take some chances on higher risk stocks because they already have a strong financial base. However, the key to their diversification continues beyond diversifying by asset class. Within each asset class they should look to diversify. For example, in stocks, they should invest in a broad amount of stocks in varying sectors. This also spreads risk and they can avoid big swings in different sectors. Overall, my parents still have many years before their retirement, and have time to let their money grow. By investing, their \$100,000 should have grown substantially by the time they retire.