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FAMILY INVESTMENTS

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You may not think of yourself as a capitalist, but it is a fact that in the last few years a great many average-income families have become shareholders in the big businesses of our country. At the end of 1951 there were just under 6½ million individual share owners of corporate stocks in the United States, and almost a fifth of these stockholders were members of family groups who had annual incomes of less than $4,000. Somewhat less than half were members of a family group with an income between $5,000 and $10,000. In other words, teachers, farmers, factory workers, your barber, your next door neighbor – as well as big investors – have a stake in "big business."

It really matters to you and me and our neighbors how such-and-such a company is doing, because we count on our dividends to help out with some extras this year, to build up a college fund for Junior, or to help us finance a trip next year.

MANY CHANNELS FOR SAVINGS

But there are other ways, too, that most of us can, and do, invest capital – the money reserves we can set aside beyond what we must spend for day-to-day expenses.

In general, these are the channels we use for disposal of savings, the ways of providing for family security that are open to us:

1. Savings accounts.
2. Government bonds.
3. Life insurance.
4. Annuities, pension plans.
5. Social security.
6. Investment in a home.
7. Investment on own business or farm.
8. Investment in other real estate.
9. Investment in corporate securities (stocks and bonds).

These are the building materials, but there isn't any one model plan for building the structure of family security. For a young farmer with some experience and a reasonable amount of livestock and equipment, investment in a farm might be sound. On the other hand, investment in the same farm might turn out very badly for a middle-aged man who knows nothing about farming.

A young man might choose to invest in a new company putting out a new kind of can opener, while a man of 60 years would choose to put his savings into government bonds or "gilt-edged" securities. The 60-year-old would prefer safety of principal and certainty of income to the risk that goes along with the chance to make – or lose – a million in a new company putting out a new product. Or the young man might choose to put all of his savings into a grocery business. However, if he has a wife and children, he might not feel justified in taking the risk involved in either the grocery store or an untried concern until he has provided protection for his family through life insurance, some savings and possibly ownership of a home.

PRINCIPLES UNDERLYING FAMILY INVESTMENT

In short, you have to draw your own plans in relation to your own goals, resources and capabilities. There are, however, a few general principles which can serve as guides.

1. Liquidity

You need to have part of your capital where you can "get at" it – turn it quickly into cash – in case you need it for an emergency. Opinions vary as to desirable size of the emergency fund. From 1 to 3 months' salary is a fair guide.

A savings account in the bank is, of course, one of the most convenient places in which to put your emergency fund. Some banks reserve the right to defer repayment for 30 days, 90 days or some stipulated period, but ordinarily there is no delay.

"Series E" bonds are a good investment for the small saver. They may be cashed at any time after they have been held for 2 months, and interest rates in the early years have been improved by the 1959 changes in savings bonds. The average annual rate builds up to 3¾ percent, if held to maturity – which is 7 years and 9 months.

2. Safety of Principal

As an investor you're interested in getting a good return from your investment, but the average investor cannot afford to risk loss of capital in order to earn a high rate of return. Government bonds are, of course, a safe investment. Interest rates range from 3 to 5 percent — in contrast to common stocks which may yield many times as great a return, but on which you also run much greater risk. State and local bonds, the bonds of railroads, and public utilities and of certain other large corporations have records of providing income that is sure and regular.

Life insurance, too, provides a safe investment, as long as you buy insurance from a company that is licensed to operate within the state. (Exception – term insurance, though it serves a definite purpose in particular family plans, is pure protection and carries no investment values.) Along with your emergency saving fund, an insurance plan to provide protection for dependents should form the basis of your family's financial planning.

3. Rate of Return

High income and a high degree of safety do not come with one investment. The stock which pays a 10 percent dividend this year may pay nothing at all in poor years, whereas a Series H government bond at 3¾ percent interest can be depended upon to pay this amount if held to maturity. (Moreover, you can always feel sure that you will be able to get your original investment back from the government if you hold H bonds to maturity.) Similarly, you might receive a much higher rate of return from investment in a farm or a business than from government savings bonds, but you also run the risk of low income — or loss — some years.

This doesn't mean, though, that we will all think it wise to buy only savings bonds. Making financial progress depends upon taking some risks, but the successful small investor puts his money where it will bring the greatest return with the least risk to him.

4. Diversification

It's the old story – Don't "put all your eggs in one basket." First you want to provide a margin of safety in savings and life insurance protection for your family. For the young family, this may be the only provision for the future which can be managed along with day-to-day living costs. Many families would place investment in a home or a farm as next in importance. Others would place investment in a business of their own ahead of home ownership. Of course, with a farm purchase you ordinarily combine investment in home and business.

Whatever your decision as to the basics for family protection, after you have provided them, it is wise to divide investment funds between those that can be depended upon for a steady income year in and year out, and those which will yield higher income when business is good. This combination gives you certainty of steady income. At the same time it may be expected to provide more dollars when prices go up.

The man who owns his home, some life insurance, a savings account, his own grocery store or his own farm and several government bonds has diversified his investments. So has the salaried man who owns, in addition to life insurance and a savings account, an annuity policy and some common stock. But the prosperous farmer who buys more farms is "putting all his eggs in one basket." If the income from one farm is low, it's likely to be the same for the others.

Of the several savings and investment possibilities listed at the start of this booklet, we have chosen to discuss here only two – home ownership and corporate securities. We chose these two, not because they are necessarily the most important ones, but because they are subjects about which Michigan women have expressed a special interest recently.

INVESTMENT IN A HOME

We shall assume that you and your family have taken counsel together and have considered well all the pro's and con's of home ownership. For the family which has decided to buy a home, the next questions are: How much can we afford to spend for a home? How large a down payment must we have? Where can we get credit? Can we get terms that we will be able to carry out? How much will it cost to own our home?

1. Preliminary Planning

A rule of thumb which has been pretty generally accepted in the past says that the purchase price of your home should be no more than "2½ times your annual income." The difficulty with this formula is that building costs have zoomed higher than any other living cost, until now it is almost impossible to buy or build an adequate house at 2½ times the average income of the American family. On the other hand, with today's high income-tax rates, a family with an income of $5000 or more might well hesitate to invest more than twice that annual income in a house.

There is a difference, too, in what different families can do with the same income. A family with one child could invest more than a family with six children. Health needs and other special circumstances make great variations in day-to-day living costs for different families. If you will consider your own situation and that of other families you know who have about the same income, you'll recognize examples of such differences in family situations. Those differences make a hard-and-fast formula impractical, even though some of us would like to have such a formula to use as a guide.

Other more-or-less accepted guides have to do with the amount paid down and the carrying costs of financing a home. We have heard it said that a buyer should have as down payment "at least a quarter" of the purchase price. Some home-financing authorities say "one-third." It has been said, too, that the total monthly cost of principal payments, interest, insurance, taxes and upkeep should not be "more than one-quarter" of the monthly income.

These so-called "rules" have to be taken for what they are worth — as guides rather than ironclad principles. A safer way to decide what you can carry is to study your own financial situation. How much do your liquid assets total — your savings, as well as investments that can be turned into ready cash? How much do you need to keep in reserve for emergencies? What obligations do you have already? What are your regular living expenses — food, clothing, recreation, education costs and all the rest? How large a monthly payment can you fit into this budget?

When you have figured out these costs with your own family, you have a better guide than any of the formulas can provide for you.

Owning a home has special meaning for most of us, but it would be unfortunate to overlook investment values in the enthusiasm of acquiring a dream house. There are many things to consider in relation to the neighborhood. Is it a developing area where real estate is likely to increase in value? Or is it a neighborhood where houses are beginning to run down, or where business establishments are beginning to crowd in? Zoning regulations and restrictions will affect the kind of house you can build and its future value. If you are planning to build, will the kind of house you want fit in with those that surround it? What are the tax rates, and are there special assessments? Are the available utilities satisfactory? Convenience as to transportation and nearness to school, church and shopping center will be important, too.

Such considerations will mean much to you in satisfaction. They will affect the value of your property as security for a loan, and they will certainly affect the resale value of your home.

If you are buying, it is worth some expenditure to have a builder check an old house as to foundation, walls, roof, plumbing, wiring, heating equipment and insulation. An old house in good condition may offer more in space and living comfort than a new one which can be bought at the same price — but you'll want to have assurance that it *is* in good condition. A house which has been in use for a few years may be a safer bet than one that has just been built. There hasn't been time for defects to show up in the new house.

Plenty of time to plan is an asset, if you are going to build. Aside from the pleasure of anticipation — which is not to be overlooked — you are likely to get a more livable house with a well considered plan. Think not only of the peculiar preferences of your family, but what will have resale value. For the builder, a margin of cash is necessary, because the costs of building almost always exceed estimates. Do not overlook the value of an architect's services and remember that, once you have decided on a plan, hiring the job done by a contractor may save you money in the long run.

2. Financing the Purchase

Most of us take it for granted that the biggest part of the purchase price of a home must be borrowed. If fact, few of us would hope to be able to buy or build homes when we need them most — while there is a young and expanding family — if it were not for the credit that is available through a number of sources. Just as there are several sources of credit, there are variations in the cost of it. And just as you may save money by shopping around for a coat, so you may effect a saving by shopping around for credit.

In judging "a good buy" in credit, consider: (a) the rate of interest charged, (b) the amount of down payment required, and (c) the terms that are offered.

A difference of one-half of 1 percent in interest rate is worth shopping for. It may surprise you when you figure the amount of difference this small percentage will make, say, on an \$8,000 loan which is to run 20 years. With interest payable on the unpaid balance of the loan, the monthly payment on an \$8,000 debt at 4 percent interest is \$48.48; at 4½ percent, \$50.64 – a difference of \$2.16 per month or \$25.92 per year. In 20 years this amounts to \$518.40.

The principal sources of credit for buying a home are: commercial and savings banks, savings and loan associations, individual lenders, life insurance companies. The rate of interest may vary from 4½ to 6 percent or higher. Individual lenders will not be subject to such restrictions as banks and other organizations are on the amount to be loaned and terms of the loan. Individuals are likely to be conservative, however, in the amount they are willing to loan and in the time allowed for repayment.

Requirements as to the amount that can be loaned (and consequently the required down payment) will vary among the lending agencies mentioned. A real estate loan is covered by a MORTGAGE against the real estate, as security for the loan. If you, as a prospective home owner, feel that you can qualify for a mortgage guaranteed by either the Federal Housing Administration or the Veterans Administration, it will be well worth your while to check into the possibilities with the various lending agencies. If you do qualify, it may mean more lenient terms as to down payment required and the length of time allowed for repayment.

In general, the determination of mortgage terms is affected by (a) certain nationwide regulations on credit, as revised from time to time by the Federal Reserve Board; (b) state laws, which may set up limitations even stricter than current Federal Reserve Board regulations; and (c) the discretion of the particular lending agency concerned. A veteran may also be allowed a longer period for repayment in hardship cases; but such cases are considered as specific exceptions, not as the rule.

Present-day loan agreements usually call for fixed monthly payments covering interest and principal. As payments are made, the principal outstanding decreases and a smaller proportion of each payment is required for interest. Consequently, the proportion of payment applied to the principal increases each month.

To protect his security, the lender may pay the taxes and fire insurance, adding these items to the monthly payments. Be sure that all extra costs such as these – as well as appraisal costs, legal fees, recording costs, title insurance premium, commissions – are listed in your agreement. Be sure, too, that you understand the property insurance provisions. Are *you* covered in case of loss, or does the insurance protect the lender only? You'll need to consult your lawyer before you sign the mortgage agreement. Ordinarily, the fees for drawing up this kind of contract are not great, but the risk of making mistakes in legal details may prove very costly to you.

What does your contract say about "pre-payments"? Suppose that you should receive an inheritance or extra income, will you be able to make payments in advance in order to cut down the amount of your debt? Or suppose you decide to sell the house and pay off the mortgage in a lump sum; can you do that? There is considerable variation among mortgage agreements in this respect.

When a SALES CONTRACT is used to finance a home instead of a mortgage loan, the buyer agrees to make certain monthly payments – and does not receive a deed to the property until he has fulfilled his agreement. He is in a much weaker position than when he holds title to the place himself, as he does in the case of a mortgage agreement.

Some experts quote figures to show that it is cheaper to buy than to rent a home. Other experts can show just as conclusively that it is cheaper to rent. Actually you can hardly make a comparison unless you consider the house *you* are renting, compared wtih the one that *you* plan to buy. In order to make a comparison, you'll need to find out the total monthly cost of the following items: Interest and repayment of principal; taxes; repairs and upkeep; insurance.

If we assume that you plan to buy a \$10,000 home, can make a down payment of \$2,000 and can borrow \$8,000 at 5 percent interest, the monthly cost may be \$75 to \$85 per month. In addition, consider that if the \$2,000 were not invested in a home, you might invest it in some other way and have the interest to pay on rent. At 4 percent, this would add \$80 a year (or \$6.67 a month) to the cost of buying. Again, if you now happen to rent an apartment where heat and water are furnished, you would have to add these expenses to the cost of buying — perhaps another \$200 or \$300 a year.

The results of your figuring may, or may not, show a favorable comparison for home ownership. Even though the comparison is unfavorable, you may find that you can fit the extra cost into your budget and that home ownership is worth some extra cost to you. There will be other considerations – such as the stability and sense of security which comes from owning your own home, income-tax advantage in home ownership, and incentive to save on non-essentials. Home ownership serves as protection against inflation, because as prices rise, so does the value of your property. Its value falls, too, with falling prices. Consequently, there is a financial hazard in buying when prices are high and running the risk of being forced to sell when values are down.

INVESTING IN SECURITIES

When you think of securities, the chances are that you think of BONDS as safe investments and STOCKS as risky ones. To a degree that is true—because a bond represents a loan to a corporation (or to a public body), whereas a share of stock represents a share in the company. As a *stockholder*, you are really a "part owner," and you share the risks with the other stockholders.

As a *bond owner*, you are a "creditor," and you have first claim to the profits of the company for the interest payments specified by your bond. At the stated maturity date of your bond you may expect repayment of your principal in full; and if the company should fail, you (along with other bond owners) would have first claim on its assets.

As a stockholder, on the other hand, you share in whatever profits there are *after* the creditors' claims are paid. You may receive very good income in years when business is good for your company — perhaps several times what you would receive from the same investment in bonds. But in poor years, you may receive a very poor income or none at all — and if the business should fail there would be a chance of losing the capital you invested.

Of course, no one would say on this basis that all bonds are safe investments and all stocks risky. You would look at the record of the issuing corporations. What does the balance sheet show as to property owned and debts owed? What have been the trends as to profit and loss? Bonds of some companies might be poorer risks than stocks of others, if the latter can show sound organization and a good record over the years as to profit and loss.

Government bonds are of course as safe as any kind of security you can buy. In addition to the familiar "Series E" and "Series H" savings bonds, there are a number of other kinds of government bonds. Standard "United States Treasury Bonds" and several other kinds are bought and sold on the market, just as other securities are. Their value may rise and fall with general business conditions in this country and abroad. Treasury bonds are purchased principally by banks, insurance companies and other corporations. Their low yield makes them unattractive to individuals, except for those with very large sums to invest. Treasury bills and notes are the types of government securities most commonly purchased by small investors.

1. Corporate Securities

There are different kinds of corporate securities, both in bonds and stocks.

Corporate bonds may be secured by a mortgage against property of the corporation. Such bonds are called MORTGAGE BONDS. In contrast, DEBENTURE BONDS are secured only by the general credit of the corporation. The safety and security of either would depend primarily upon the earning capacity of the issuing corporation.

"Registered bonds" are registered in the owner's name, the interest payments being sent to him on specified dates. In the case of "coupon bonds," when interest is due, the owner clips a coupon from a sheet attached to the bond and deposits it at his bank. The coupon is comparable to a check and is handled like other checks he may deposit.

We have noted that interest on bonds has first claim to corporation income, and that the amount of dividends paid on stock depends upon the balance of income left over after creditors' (bond owners') claims have been met. PREFERRED STOCK has preference over common stock as to dividend payments up to a specified amount, and may or may not carry some preference as to voting rights. COMMON STOCK carries more risk, but may produce higher yields in years of high profit.

No one kind of security is the "best" investment. Experts speak of a "balanced portfolio" of investments which assumes a sizable amount of capital to invest. INVESTMENT TRUST COMPANIES seem in part to provide the answer to this problem for the small investor, who may purchase what amounts to a ready-made package of investments. The investment trust corporation employs a staff of experts to buy in the market and supervise a portfolio of different kinds of securities; shares in the corporation itself are sold to individual investors.

For the person who has little experience or interest in selecting and supervising his investments, this is a good answer. There are good and not-so-good investment trust companies, however. But it may be easier to check up on one company than to study the records of many individual corporations.

2. The Place of Securities in Family Investments

There is a place for corporate securities in family investment plans — but not for *every* family. Remember that there are other kinds of investments; choose what fits your own needs and pocketbook. Remember, too, that it takes a great deal of knowledge and skill to manage security investments. In order to make a profit, it is necessary to watch market developments constantly and to be able to judge the best time to buy and to sell. It is most important, too, to have enough reserve so as to be able to leave some kinds of investments untouched through periods when dividends fall — or perhaps stop altogether.

3. Getting The Facts About Securities

The beginner will surely want to do some real "boning up" before he (or she) goes into the market for securities. The financial section of a good city newspaper is a good place to start. At first it looks complicated and dull, but pick several securities and watch their progress in the stock market reports. Read the news items to see what's happening in the world of business and how it affects you. You may be surprised at how much glamour and excitement you will find in the financial section.

Your banker is a good person to give you advice about investments. Investment services are published which give records of major corporations for many years back: *Standard and Poor's* and *Moody's* are two of the best known. (Though these publications are expensive, they are often available in public libraries. They may be difficult, however, for the beginner to interpret.) Usually the corporation whose securities you may be considering will send you a financial statement, if you request it. Your investment broker is another source of information. Some brokerage houses employ a research staff and have a great deal of information available.

Those would be the principal sources of information and advice for most of us. But remember – It's your money. Whatever kind of advice you depend upon, you will want to be well enough informed to make wise decisions. The person inexperienced in business, who may suddenly be faced with managing large holdings, should employ a reputable and well established investment counselor – although this kind of service is too expensive for the average investor.

THE STOCK MARKETS

Securities are bought and sold either through an EXCHANGE, which is an organized market, or "OVER-THE-COUNTER." If you wish to buy or sell a certain security which is handled on an exchange, you can go to a broker who will be able to complete your order by wire in a matter of minutes. A brokerage house is located in most cities of any size. It will have a direct wire to the New York Stock Exchange and you can see the transaction recorded on ticker tape, just as it is on the Exchange.

The New York Stock Exchange is the largest and best known market. It handles quality investments. The American Stock Exchange* is a smaller market and handles securities of greater risk, the so-called "cats and dogs." There are other smaller stock exchanges in metropolitan cities, including one at Detroit and the "Midwest" at Chicago. Securities of local business are usually handled through markets like these.

"Over the Counter"

If you buy over-the-counter you do business with a dealer instead of a broker. The DEALER buys securities and sells them to you, expecting to make a profit by selling at a higher price than he pays. The BROKER simply acts as your agent and carries out your orders in making transactions. The broker's earnings are from commissions which he charges on both the purchase and sale of a security. Stocks are sold in lots of 100 shares, although an individual may buy in any quantity that he wishes. Less than 100 is called an *odd lot* and the broker charges an additional "⅛ point" on both the purchase and sale of odd lots.

Certain securities may be sold either on an exchange or over-the-counter. United States Treasury notes and bills, state and municipal bonds, bank and insurance company stocks, and many railroad and public utility issues are bought and sold only over-the-counter. United States Treasury bonds, Federal Farm Mortgage Corporation and Home Owners Loan securities are traded on both markets – but the volume over-the-counter is greater, especially for the Treasury bonds.

The prices of stocks are quoted in *dollars* and *1/8's of a dollar* (12½ cents). A stock quoted at "75 3/8" is priced at $75.37½ per share. Bond price quotations are in *percents* and *1/8's of a percent of* par value. A $1,000 par-value bond quoted at "101 1/4" would cost the buyer $1,012.50. Government bonds are quoted in *percents* and *1/32's of a percent.* A quotation of "101.16" on a government bond means "101 16/32 percent," or a price of $1,015.00 for a thousand-dollar bond.

Although we have given most attention to home ownership and investment in securities, these might not be the most important items in your family's financial planning. They are only two of the blocks you could use to build family financial security. For all families there is a schedule of priorities for using whatever resources are available — and only you and your family can decide what comes first on your schedule.

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*Formerly called the New York Curb Exchange – an odd name, carried over from British financial tradition. Originally, the term was applied to those traders who conducted business in the street outside of the London Exchange – either because it was after closing hours, or because the investments offered carried such high risk they were refused regular listing – literally "on the curbstones." The London "curb" soon developed into an organized market in its own right; the New York institution, specializing in such securities, took the name to indicate its special purpose.

FOR FURTHER READING

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