Introduction

Most people will find that their investment objectives change throughout their lives. Capital appreciation may be more important for the young investor, but once she enters her golden years, that same investor may place a greater emphasis on gaining income. Whatever your objective, knowing what investment options are out there is key.

Furthermore, as most successful investors will tell you, diversification is king. A
diversified portfolio not only reduces unwanted risk, but also contributes to a winning portfolio. And having a well-diversified portfolio doesn't necessarily mean just buying more than one stock; branching out into other areas of investment could be a viable alternative. Read on and learn about 20 investments that Investopedia feels every investor should know.

**American Depository Receipt (ADR)**

**What Is It?**
Introduced to the financial markets in 1927, an American Depository Receipt (ADR) is a stock that trades in the United States but represents a specified number of shares in a foreign corporation. ADRs are bought and sold on U.S. stock markets just like regular stocks and are issued/sponsored in the U.S. by a bank or brokerage.

ADRs were introduced in response to the difficulty of buying shares from other countries which trade at different prices and currency values. U.S. banks simply purchase a large lot of shares from a foreign company, bundle the shares into groups and reissue them on either the NYSE, AMEX or Nasdaq. The depository bank sets the ratio of U.S. ADRs per home country share. This ratio can be anything less than or greater than 1. For example, a ratio of 4:1 means that one ADR share represents four shares in the foreign company.

The majority of ADRs range in price from $10 to $100 per share. If the shares are worth considerably less in the home country, then each ADR will represent several real shares. Foreign entities generally like ADRs because it gives them U.S. exposure, which allows them to tap into the rich North American equity markets. In return, the foreign company must provide detailed financial information to the sponsor bank.

**Objectives and Risks**
The main objective of ADRs is to save individual investors money by reducing administration costs and avoiding duty on each transaction. For individuals, ADRs are an excellent way to buy shares in a foreign company and capitalize on growth potential outside North America. ADRs offer a good opportunity for capital appreciation as well as income if the company pays dividends.

Analyzing foreign companies involves more than just looking at the fundamentals. There are some different risks to consider such as the following:

**Political Risk** - Is the government in the home country of the ADR stable?

**Exchange Rate Risk** - Is the currency of the home country stable? ADRs track the shares in the home country; therefore, if its currency is devalued, it trickles down to your ADR and can result in a loss.
**Inflationary Risk** - This is an extension of the exchange rate risk. Inflation is a big blow to business, and the currency of a country with high inflation becomes less and less valuable each day.

**How to Buy or Sell It**
ADRs are bought in exactly the same way as common stock. Whether you use a full service or discount brokerage doesn't matter. There is no minimum investment for most ADRs; however, as with any investment, many brokerages require clients to have at least $500 to open an account.

**Strengths**
- ADRs allow you to invest in companies outside North America with greater ease.
- By investing in different countries, you have the potential to capitalize on emerging economies.

**Weaknesses**
- ADRs come with more risks, involving political factors, exchange rates and so on.
- Language barriers and a lack of standards regarding financial disclosure can make it difficult to research foreign companies

**Three Main Uses**
- Capital Appreciation
- Income
- Diversification

**Annuity**

**What Is It?**
You can think of an annuity as another way of saying "annual payments". An annuity is a series of fixed-amount payments paid at regular intervals over the specified period of the annuity. Most annuities are purchased through an insurance company.

A "deferred" annuity means that the series of annual payments will not begin until a later date. This is popular with retirees because they can defer taxes until annual payments are received. An "immediate" annuity means that the income payments start right away. Some annuity contracts are good for life, so if you live long, then the insurance company must continue to pay you. The insurance companies are basically betting that you will die before the full value of the
annuity is paid out.

There are two distinct types of annuities:

**Fixed Annuity** - This means the insurance company makes fixed dollar payments to the annuity holder for the term of the contract. This is usually until the annuitant dies. The insurance company guarantees both earnings and principal. This is a fairly good financial instrument for those looking to receive a fixed investment income.

**Variable Annuity** - This means that at the end of the accumulation phase the insurance company guarantees a minimum payment, and the remaining income payments can vary depending on the performance of your annuity investment portfolio. Annuities allow you to invest in a managed portfolio of stocks, bonds, money market funds, or any combination thereof. The performance of this portfolio determines the annual payment you will receive.

**Objectives and Risks**
Annuities are often forgotten by individual investors, partly because people are unaware of their benefits. Annuities are advantageous for those looking for a relatively low-risk investment with a decent rate of capital appreciation. Deferred annuities allow you to enjoy the benefits of compounding without worrying about the tax implications.

The risks involved with annuities are fairly small compared to those of other investments because your investment is heavily regulated by the government. It is a good idea to ask the company from which you purchase an annuity if the company is insured - not all of them are. One precaution: annuities allow you to withdraw your principal, but you may be subject to stiff penalties.

**How to Buy or Sell It**
Annuities are offered by most insurance companies, banks and brokers. The minimum investment for an annuity is typically $1,000 plus purchase fees. These fees can range from a load to an annual management fee that can be a maximum of 1.5% of your total investment.

**Strengths**
- Deferred annuities allow all interest, dividends and capital gains to appreciate tax-free until you decide to annuitize (start receiving payments).
- The risk of losing your principal is very low - annuities are considered very safe.

**Weaknesses**
Fixed annuities are susceptible to inflation risk because there is no adjustment for runaway inflation. Variable annuities that invest in stocks or bonds provide some inflation protection.

If you die early, then you will not get back the full value of your investment.

**Three Main Uses**
- Capital Appreciation
- Tax-Deferred Benefits
- Safe Investment

**Closed-End Investment Fund**

**What Is It?**
A closed-end fund is an investment fund that issues a fixed number of shares in an *actively managed* portfolio of securities. The shares are traded in the market just like stocks, but because closed-end funds represent a portfolio of securities they are very similar to a mutual fund. Unlike a mutual fund, the market price of the shares is determined by supply and demand and not by net asset value.

Closed-end funds are usually specialized in their investment focus. For example, one might concentrate its focus on a particular geographic region. They invest in stocks, bonds and other securities to gain a bit of diversification, but because they focus on one region or industry they are not diversified to the overall market. There are several hundred different closed-end funds actively traded on North American stock markets.

There are also "dual purpose" closed-end funds, which simply means that they have two classes of shareholders: preferred shareholders who receive mainly dividends as income, and common shareholders who profit from the capital appreciation of the fund's share price.

**Objectives and Risks**
Objectives can vary from fund to fund, so it is important to read the prospectus before investing. Some closed-end funds have capital appreciation as their primary concern, while others are more interested in income.

**How to Buy or Sell It**
Closed-end funds can be bought on various stock markets with the assistance of a full service or discount broker. There is no minimum number of shares to buy, and selling the funds is very easy and quick. When purchasing a closed-end fund, you are typically charged the usual brokerage commission as well as an annual management fee, usually under 1%.
Strengths
- These funds are easy to buy and sell on financial markets. Furthermore, they are regulated by the Securities and Exchange Commission.
- The funds usually invest in hundreds of companies, so they offer good diversification in certain areas.

Weaknesses
- Fixed interest payments are taxed at the same rate as income.
- The price of the closed-end fund is not exclusively linked to the performance of the securities held by the fund. The fund's share price depends on supply and demand in the open market.

Three Main Uses
- Capital Appreciation
- Income
- Safe Tax Deferred Investment

Collectibles

What Is It?
Generally speaking, a collectible is any physical asset that appreciates in value over time because it is rare or it is desired by many. Many people think of collectibles as things like stamps, coins, fine art or sports cards, but there really are no strict rules as to what is or is not a collectible.

Objectives and Risks
The objectives behind investing in collectibles vary depending on the person and the collectible. Collectibles can take very long to increase in value, and they offer no assurances as to their value in the future. Furthermore, unlike other investments, collectibles offer no income. The one advantage is that most collectibles increase in value along with inflation.

How to Buy or Sell It
Collectibles can be bought just about anywhere. More popular places are flea markets, antique stores, collectible retailers, auctions, garage sales, and more recently, online exchanges such as eBay. The value of the collectible can vary widely, but is dependent for the most part on supply and demand for the asset.

The maturity for a collectible can also widely vary. For fads such as Beanie Babies or Pokémon cards, the price of the collectible can reach its peak very
quickly. Other items such as antiques can take several decades before appreciating in value.

**Strengths**
- Many collectibles offer reasonable protection from inflation.

**Weaknesses**
- Not very liquid, they can often be hard to sell at a desirable price.
- They do not provide any tax protection.
- Collectibles do not offer any income to the investor.
- The true value can often be difficult to determine.
- Because there are so many uncertainties don't count on any collectible for your retirement.

**Three Main Uses**
- Capital Appreciation
- Inflation Protection
- Self Fulfillment

**Common Stock**

**What Is It?**
Stock is sometimes referred to as shares, securities or equity. Simply put, common stock is ownership in part of a company. For every stock you own in a company, you own a small piece of the office furniture, company cars, and even that lunch the boss paid for with the company credit card. More importantly, you are entitled to a portion of the company's profits and any voting rights attached to the stock. With some companies, the profits are typically paid out in dividends. The more shares you own, the larger the portion of the company (and profits) you own.

Common stock is just that, "common". The majority of stocks trading today are in this form. Common stock represents ownership in a company and a portion of profits (dividends). Investors also have voting rights (one vote per share) to elect the board members who oversee the major decisions made by management. In the long term, common stock, by means of capital growth, yield higher rewards than other forms of investment securities. This higher return comes at a cost, as common stock entails the most risk. Should a company go bankrupt and liquidate, the common shareholders will not receive money until the creditors, bondholders and preferred shareholders are paid. (To learn more about stocks, see our [Stock Basics Tutorial](http://www.investopedia.com/university/20_investments/).)

**Objectives and Risks**
Over the long term, no investment provides better returns at a reasonable risk
than common stock. History dictates that common stocks average 11-12% per year and outperform just about every other type of security including bonds and preferred shares. Stocks provide potential for capital appreciation and income and offer protection against moderate inflation.

The risks associated with stocks can vary widely, and they usually depend on the company. Purchasing stock in a well-established and profitable company means there is much less risk you'll lose your investment, whereas purchasing a penny stock increases your risks substantially. If you use margin, you can also dramatically increase your leverage in a stock, but this is only recommended for experienced investors.

**How to Buy or Sell It**
The most common method for buying stocks is to use a brokerage, either full service or discount. There is no minimum investment for most stocks (other than the price per share), but many brokerages require clients to have at least $500 to open an account. Dividend reinvestment plans (DRIPs) and direct investment plans (DIPs) are two ways individual companies allow shareholders to purchase stock directly from them for a minimal cost. DRIPs are also a great way to invest money at regular intervals.

**Strengths**
- Common stock is very easy to buy and sell.
- Thanks in large part to the growth of the Internet, it is very easy to find reliable information on public companies, making analysis possible.
- There are over 11,000 public companies in North America to choose from.

**Weaknesses**
- Your original investment is not guaranteed. There is always the risk that the stock you invest in will decline in value, and you may lose your entire principal.
- Your stock is only as good as the company in which you invest - a poor company means poor stock performance.

**Three Main Uses**
- Capital Appreciation
- Income
- Liquidity

**Convertible Security**

This tutorial can be found at: [http://www.investopedia.com/university/20_investments/](http://www.investopedia.com/university/20_investments/)
What Is It?
A convertible, sometimes called a CV, is either a convertible bond or a preferred stock convertible. A convertible bond is a bond that can be converted into the company's common stock. You can exercise the convertible bond and exchange the bond into a predetermined amount of shares in the company. The conversion ratio can vary from bond to bond. You can find the terms of the convertible, such as the exact number of shares or the method of determining how many shares the bond is converted into, in the indenture. For example, a conversion ratio of 40:1 means that every bond (with a $1,000 par value) you hold can be exchanged for 40 shares of stock. Occasionally, the indenture might have a provision that states the conversion ratio will change through the years, but this is rare.

Convertibles typically offer a lower yield than regular bonds because there is the option to convert the shares into stock and collect the capital gain. However, should the company go bankrupt, convertibles are ranked the same as regular bonds, so you have a better chance of getting some of your money back than those people holding common stock. (To learn more, see Convertible Bonds: An Introduction.)

Objectives and Risks
Convertibles are an excellent choice for investors looking for capital appreciation, while still protecting their original investment in a bond. While CVs do provide some income, it's not very high. Investors give up higher returns on the bond in exchange for the option to convert into shares at a later date.

One risk associated with convertibles is that most are callable. In other words, the company can force convertible bondholders to convert the bonds to common stock by calling the bonds. This is called "forced conversion". When investing in convertibles, remember that the CV is only as good as the underlying stock, and if the CV is offering a high premium, be very wary.

How to Buy or Sell It
The most common method for buying stocks is to use a brokerage, either full service or discount. The minimum investment for a convertible is typically $1,000 - the price of one bond. Convertible preferred stock trades on the stock market like regular shares, so the prices usually range from $5 to around $100.

Strengths
- Your original investment cannot go lower than the market value of the bond; it doesn't matter what the stock price does until you convert into stock.
- Convertibles can be purchased through tax-deferred retirement accounts.
• CVs gain popularity in times of uncertainty, when interest rates are high and stock prices are low. This is the best time to buy a convertible.

**Weaknesses**
• The return on the bond or preferred stock is usually quite low.
• "Forced conversion" means the company can make you convert your bond into stock at virtually any time. Pay very close attention to the price at which the bonds are callable.

**Three Main Uses**
• Capital Appreciation
• Safe Investment
• Tax-Deferred Investment

**Corporate Bond**

**What Is It?**
Similar to a mortgage with a bank, bonds are an issue by a borrower to a lender. When you buy a corporate bond, you are loaning your money to a corporation for a predetermined period of time (known as the **maturity**). In most cases, the bond’s **par value** is $1,000. This is the face value of the bond and the amount the lender will be repaid once the bond matures.

Of course, you’re not going to loan your money for free. The borrower must also pay you a premium, known as a **coupon**, at a predetermined interest rate in exchange for using your money. These interest payments are usually made every six months until maturity is reached.

There are three important factors you need to consider before buying a bond. The first is the person issuing the bond. The second is the interest (or coupon) you will receive. The third is the **maturity date**, the day when the borrower must pay back the principal to the lender.

**Objectives and Risks**
Corporate bonds offer a slightly higher yield because they carry a higher **default risk** than government bonds. Corporate bonds are not the greatest for capital appreciation, but they do offer an excellent source of income, especially for retirees. Corporate bonds are also highly useful for tax-deferred retirement savings accounts, which allow you to avoid taxes on the semiannual interest payments.

The risks associated with corporate bonds depend entirely on the issuing company. Purchasing bonds from well-established and profitable companies is
much less risky than purchasing bonds from firms in financial trouble. Bonds from extremely unstable companies are called junk bonds and are very risky because they have a high risk of default.

How to Buy or Sell It
Corporate bonds can be bought through a full service or discount broker, a commercial bank or other financial intermediaries. The best time to buy a corporate bond is when interest rates are relatively high. (To learn more, see the Bond Basics Tutorial.)

Strengths
- Many corporate bonds offer a higher rate of return than government bonds, for only slightly more risk.
- The risk of losing your principal is very low if you only buy bonds in well-established companies with a good track record. This may take a bit of research.

Weaknesses
- Fixed interest payments are taxed at the same rate as income.
- Corporate bonds offer little protection against inflation because the interest payments are usually a fixed amount until maturity.

Three Main Uses
- Capital Appreciation
- Income
- Safe Investment

Futures Contract

What Is It?
As the name implies, futures are contracts on commodities, currencies, and stock market indexes that attempt to predict the value of these securities at some date in the future.

The popular perception of futures is that they are a form of very high risk speculation. This is true. But futures are also widely used as financial tools for reducing risk. Futures speculators invest in commodity futures in the same way others invest in stocks and bonds, and mutual fund managers also use futures to hedge against risk. The primary purpose of futures markets is to provide an efficient and effective mechanism for the management of price risks. Futures traders accept price risks from producers and users with the idea of making substantial profits.
A **futures contract** on a commodity is a commitment to deliver or receive a specific quantity and quality of a commodity during a designated month at a price determined by the futures market. For example, someone buying an April Canola contract at $5 a pound is obligated to accept delivery of 100 pounds of canola during the month of April at $5 per pound. Selling a futures contract means you are obligated to deliver these goods. The same concept applies to buying a futures contract on any other asset. It is important to know that a very high portion of futures contracts trades never lead to delivery of the **underlying** asset; most contracts are "closed out" before the **delivery date**. (For an in-depth look at the futures market, read our *Futures Fundamentals* tutorial.)

**Objectives and Risks**

There are two reasons to use commodity futures contracts: to hedge a price risk or to speculate. What do we mean by hedging? Let's say you are a farmer and you have 1,000 pounds of wheat to sell. You could either wait until harvest and sell your wheat at the current market price, or you could use a futures contract to "lock-in" the price today. If you are satisfied with the price of wheat today, then you will sell (or **short**) the appropriate wheat futures contract. By shorting the contract, you are guaranteeing that you will get today's price at harvest time. How does that work? The gain (or loss) on the futures contract will equal the gain (or loss) on the market price at harvest time - this is called a perfect hedge. A mutual fund manager would use this same strategy, but with **index futures**. He or she would short futures contracts on a stock index, therefore reducing any **downside risk** for a certain period of time.

The risks associated with futures contracts apply mainly to speculators. Speculators take positions on their expectations of future price movement, often with no intention of either making or taking delivery of the commodity. They buy when they anticipate rising prices and sell when they anticipate declining prices. The reason futures are so risky is because they are usually bought on **margin**, and each futures contract represents a large amount of the underlying asset. For example, a bond futures contract might cost $10,000 but represent $100,000 in bonds. Futures rules state that you only need to deposit 5-10% down and the rest of the contract can be purchased through the use of margin. (To learn more about the advantages and risks of margin trading, read our *Margin Trading* tutorial.)

The bottom line is that you should only invest in futures if you are very experienced and you have a lot of money.

**How To Buy or Sell It**

Futures can be purchased through most **full-service** and some **discount brokers**. There are also brokers that specialize in futures trading.
Strengths
- Futures are extremely useful in reducing unwanted risk.
- Futures markets are very active, so liquidating your contracts is usually easy.

Weaknesses
- Futures are considered one of the riskiest investments in the financial markets - they are for professionals only.
- In volatile markets, it's very easy to lose your original investment.
- The very high amount of leverage can create enormous capital gains and losses, you must be fully aware of any tax consequences.

Three Main Uses
- Capital Appreciation
- Leverage
- Hedge Against Risk

Life Insurance

What Is It?
Life insurance is income protection in the event of your death. The person you name as your beneficiary will receive proceeds from an insurance company to offset the income lost as a result of your death. You can think of life insurance as a morbid form of gambling: if you lived longer than the insurance company expected you to, then you would "lose" the bet. But if you died early, then you would "win" because the insurance company would have to pay out your beneficiary.

Insurers (or underwriters) look carefully at decades worth of data to try to predict exactly how long you will live. Insurance underwriters classify individuals based on their height, weight, lifestyle (i.e. whether or not they smoke) and medical history (i.e. if they have had any serious health complications). All these variables will determine what rate class category a person fits into. This doesn't mean that smokers and people who've had serious health problems can't be insured, it just means they'll pay different premiums.

There are two very common kinds of life insurance: term life and permanent life. Term life insurance is usually for a relatively short period of time, whereas a permanent life policy is one that you pay into throughout your entire life. These payments are usually fixed from the time you purchase your policy. Basically, the younger you are when you sign-up for this type of insurance, the cheaper your monthly payments will be. (For an in-depth discussion of these two types of
insurance, see Buying Life Insurance: Term versus Permanent.

Objectives and Risks
No matter who you are, one benefit of life insurance is the peace of mind it gives you. If anything happens to you, your beneficiary will receive a check in a matter of days. Life insurance can also be used to cover any debts or liabilities you leave behind. The bank doesn't just write off your mortgage once you pass away - these payments must be made, or your house may be liquidated. Life insurance can also create an inheritance for your heirs, or it can be used to leave a legacy if it's put toward donations to charitable organizations.

Most life insurance policies carry relatively little risk because insurance companies are usually stable and heavily regulated by the government. In "cash value" policies you are allowed to invest your policy in stock, bond or money market funds. In these types of policies, the value of your insurance depends on the performance of those funds.

How To Buy or Sell It
There are thousands of insurance brokers and banks across North America. Keep in mind that you will usually have to pay a commission for the salesperson.

Strengths
• Life insurance provides excellent peace of mind - it eases concerns about what will happen to your loved ones if you die suddenly.
• A life insurance policy is a relatively low risk investment.

Weaknesses
• If you live a long life, your family likely won't get the full value out of your policy.
• Cash value funds can fluctuate depending on the financial markets.

Three Main Uses
• Income Protection
• Capital Appreciation
• Tax-Deferred Savings

The Money Market

What Is It?
The money market deals in fixed-income securities, not unlike the bond market. The major difference is that the money market deals in short-term debt and monetary instruments. In other words, money market instruments are forms of debt that mature in less than one year and are very liquid.
That sounds simple enough, so why don't more brokers offer you the ability to buy money market securities? The reason is that money market securities trade in very high denominations, giving the average investor limited access to them. The easiest way for retail investors to gain access is through money market mutual funds or a money market bank account. These accounts and funds pool together the assets of thousands of investors to buy money market securities.

Some investors also purchase treasury bills and other money market instruments directly from Federal Reserve Banks or through other large financial institutions with direct access to these markets. There are several different instruments in the money market: certificates of deposit, T-bills, commercial paper, banker's acceptances and more.

Objectives and Risks
Institutional investors have used the money market as a safe haven for quite some time. The emergence of money market mutual funds has allowed individual investors to take part in the money market's rates of return, which are higher than those of a savings account or other low-risk investments. The performance of a money market fund depends heavily on the interest rate situation; the best time to put your money in money market funds is when interest rates are peaking.

Money market funds are low-risk investments because they invest in short-term government treasuries such as T-bills and in highly regarded corporations. The one downside of money market funds is that they are not covered by the same federal securities insurance that covers bank accounts, although some funds pursue insurance through private companies.

How To Buy or Sell It
Today, money market funds can be purchased through just about any bank or broker. If you are looking to invest directly in the money market, then you may need to get a full-service brokerage, although you can sometimes buy directly from the government. Minimum investment in a money market fund is usually around $500-$1,000, while investing directly in the money market can cost you anywhere from $1,000-$10,000 to start. (For an in-depth look at the money market, see our Money Market Tutorial.)

Strengths
- Gains on money market funds are usually tax exempt because they invest mainly in government securities. However, any dividends are taxable.
- Because they are a good low-risk investment, money market funds are widely used defensive investments when the stock markets are declining.
Weaknesses

• Although returns on a money market fund are higher than those on a savings account, they are still much lower than returns on equities or bonds.
• Some money market securities are very costly (easily in the $100,000 range), which makes it difficult for individual investors to purchase them.

Three Main Uses

• Income Protection
• Capital Appreciation
• Tax-Exempt Savings

Mortgage-Backed Securities

What Is it?
A mortgage-backed security (MBS), also known as a "mortgage pass-through" or a "pass-through certificate", is an investment instrument that represents ownership of an undivided interest in a group of mortgages. Principal and interest from the individual mortgages are used to pay principal and interest on the MBS.

When you invest in a mortgage-backed security, you are lending money to a homebuyer or a business. MBSs are a way for small regional banks to give mortgages to their customers without having to worry if they have the assets to cover the loan. Instead, the bank acts as an intermediary between the homebuyer and the investment markets.

Who pools these mortgages together? The majority of MBSs are issued and backed by government-sponsored corporations such as the Government National Mortgage Association (Ginnie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae). Each entity offers a slightly different variation in the securities it issues. Ginnie Mae MBSs are typically the most popular and widely held because they are backed by the U.S. government, whereas Fannie Mae is government sponsored but also trades as a public company.

Objectives and Risks
Mortgage-backed securities are an undiscovered gem. While these securities are primarily used to provide safe income, there is also the opportunity to get some capital appreciation as interest rates fall. Another advantage to MBSs is that they are very suitable for most tax-deferred savings accounts.

Generally, MBSs are traded actively, much like bonds are, so there is very little liquidity risk. Furthermore, they are considered an extremely safe investment, often said to have the same credit worthiness as treasuries but with a return that is 1-2% greater. Monthly income from MBSs can vary as interest
rates change because mortgages can be prepaid, and when interest rates are falling, prepayments tend to rise. Prepayments only shorten the life of the MBS and are passed directly to the investors.

**How To Buy or Sell It**

Mortgage-backed securities can be purchased at almost any full-service broker. More and more discount brokers are offering MBSs as well. These securities don't come cheap - most are sold in chunks of $25,000. But there are some variations of MBS (called collateralized mortgage obligations, or CMOs) that can sell for under $5,000.

**Strengths**
- Very low-risk investment that offers a return that's 1-2% higher than comparable low-risk securities.
- Most MBSs are either fully backed or sponsored by the U.S. government.

**Weaknesses**
- Minimum investment can be fairly high, upwards of $25,000.
- Outside of a retirement account, there are virtually no tax advantages to owning an MBS. The income from an MBS is taxed as regular income.

**Three Main Uses**
- Provide Income
- Capital Appreciation
- Tax-Deferred Savings

**Municipal Bonds**

**What Is It?**

Municipal bonds, or "munis" for short, are debt securities issued by a state, municipality or county to finance its capital expenditures. Such expenditures might include the construction of highways, bridges or schools. Munis are bought for their favorable tax implications and are popular with people in high income tax brackets.

The major advantage to municipal bonds is that many of them are exempt from federal taxes and most are exempt from state and local taxes too, especially if you live in the state that issues the municipal bond. For example, Washington residents can get triple tax savings by buying WA municipal bonds because they
pay no federal, state or local income tax on them. For this reason, munis are very popular with wealthy investors because they avoid having to claim the income for tax purposes. (To learn more about munis, see The Basics of Municipal Bonds and Weighing the Tax Benefits of Municipal Securities.)

There are two types of municipal debt: 
**Public Purpose** - these are bonds used for government projects and are always tax exempt.

**Private Purpose** - slightly different in the sense that they are only tax exempt if it clearly says so, otherwise you are subject to the provisions placed on the bond. (This can vary widely from bond to bond.) These types of munis are called private purpose because they usually fund a project that will benefit both government and a private entity.

**Objectives and Risks**
For the most part, investors should buy munis for income. While capital appreciation is possible in a falling interest rate environment, this isn't considered a primary objective of munis. When looking at muni quotes, remember that their yield is usually quite low because the tax benefits are usually priced into the bond already.

There are no substantial risks associated with buying a muni - just make sure to research the municipality from which you are purchasing it. For example, a New York muni would probably be a little more creditworthy than one from Puddle Jump, Wyoming.

**How To Buy or Sell It**
Municipal bonds can be purchased from almost any full-service broker and most discount brokers. Some municipalities also allow you to purchase the bonds directly through them. Minimum investment in a muni can start in the thousands of dollars.

A popular new way to invest in munis is through municipal bond funds, which pool together munis from various states and cities, allowing you to have a well-diversified portfolio while getting all the benefits that you would get purchasing the muni yourself. (For a general introduction to the world of bonds, see our Bond Basics Tutorial.)

**Strengths**
- Income from municipal bonds is tax exempt, but capital gains are not.
- Munis are considered to be very low-risk investments.
Weaknesses
- Municipal bonds in smaller municipalities can sometimes be difficult to sell quickly.

Three Main Uses
- Tax-Exempt Savings
- Provides Income
- Protects Principal

Mutual Funds

What Is It?
Are you someone who wants to invest (or already does), but doesn't want to bother deciphering a company's numbers and deciding whether or not the stock is a good buy? Or are you someone who finds the risk and volatility of the stock market stomach-turning?

If this describes your personality, you are a prime candidate for mutual funds. A mutual fund is simply a large group of people who lump their money together and give it to a management company to invest it on their behalf. A mutual fund manager proceeds to buy a number of stocks from various markets and industries. Depending on the amount you invest, you own a part of the overall fund.

Objectives and Risks
For the most part, investors should buy mutual funds as a long-term investment. The nice thing about mutual funds is that the objectives change from fund to fund. Each mutual fund has a different strategy - it is your job to decide what your objectives are and which fund best suits those objectives. Mutual fund strategies include growth/aggressive, low risk, balanced, momentum, and many others.

Your risk tolerance will play a big role in determining which fund you purchase - it all comes down to the old risk/return tradeoff. For example, if your fund is meant for retirement, then perhaps a low-risk money market fund is best for you. Many funds justify their under-performance as a factor of risk. For example, a mutual fund might fall short of beating the S&P 500, but at the same time it offers a beta (risk) that is much less than that of the market. If you are willing to sacrifice some performance in return for a good night's sleep, then these "low-risk" funds are a good option.

How To Buy or Sell It
There are thousands of different mutual funds out there. Most of them can be...
purchased directly through the mutual fund company, a bank, a brokerage or a financial planner. The commissions on mutual funds can vary widely depending on the company and the style of the fund. A load mutual fund charges you for the shares bought, plus a sales fee. A no-load fund sells its shares without a commission or sales charge, but management fees can be higher. (For an in-depth look at mutual funds, see our Mutual Fund Basics Tutorial.)

Strengths
• No matter how much you invest, you get to own several companies. In other words, you get instant diversification.
• You can easily make monthly contributions.
• Your money is being managed by a professional manager. Because of his/her experience and knowledge, you should receive above average returns, at least in theory.

Weaknesses
• The majority of mutual fund companies don't come close to beating market averages like the S&P 500 and the DJIA. (Notice we said you will receive above average returns "in theory". This will be discussed in detail in future pages.)
• Fund managers take a slice of the profits for their work. This slice varies, but it can be quite high.
• You pay management fees whether the fund actually makes you money or not.

Three Main Uses
• Capital Appreciation
• Provides Income
• Tax-Deferred Savings

Options (Stock)

What Is It?
Options are a privilege sold by one party to another that offers the buyer the right to buy (call) or sell (put) a security at an agreed-upon price during a certain period of time or on a specific date.

There are two basic types of options: calls and puts.

A call gives the holder the right to buy an asset (usually stocks) at a certain price
within a specific period of time. Buyers of calls hope that the stock will increase substantially before the option expires, so they can then buy and quickly resell the amount of stock specified in the contract, or merely be paid the difference in the stock price when they go to exercise the option.

A put gives the holder the right to sell an asset (usually stocks) at a certain price within a specific period of time. Puts are very similar to having a short position on a stock. Buyers of puts are betting that the price of the stock will fall before the option expires, thus enabling them to sell it at a price higher than its current market value and reap an instant profit.

The exercise or strike price of the option is what the stock price must pass (for calls) or go below (for puts) before options can be exercised for a profit. All of this must occur before the maturity date, also known as the expiration date. It should be noted that an option gives the holder the right, not the obligation, to do something. The holder is not required to exercise if he/she does not want to or if the terms are not favorable.

Objectives and Risks
For most options strategies, you need to have a very high risk tolerance; it is not uncommon for a stock option to fluctuate 30-40% or more in a single trading day.

The objectives of options are up to the holder. There are two types of people who use options: speculators and hedgers. Speculators simply buy an option because they think the stock will go either up or down over the next little while. Hedgers use options strategies - for example, the covered call, which allows them to reduce their risk and essentially lock-in the current market price of a security. Options (and futures) are popular with institutional investors because they allow institutions to control the amount of risk they are exposed to.

How To Buy or Sell It
Options trade very similarly to stocks and can be purchased through just about any discount or full-service broker. To trade options, you need to be approved by the brokerage first. They will typically ask questions to determine if you have enough knowledge or experience before they will approve you. Options are usually bought through a margin account, or borrowed money. (For a more in-depth look at options, see our Options Basics Tutorial.)

Strengths
- Allow you to drastically increase your leverage in a stock if you are speculating.
- Options in 100 shares will cost much less than actually buying the 100 shares.
• If used properly, options can be a useful tool in hedging against an existing position.

Weaknesses
• Options are highly complex and highly leveraged. If you are using options to speculate, you need to keep a close watch on them and to have a high tolerance for risk.
• Options require more than just a basic knowledge of the stock market.
• You have the potential to lose a lot of money if you take various positions - for e.g. if you are the writer of an option.

Two Main Uses
• Capital Appreciation
• Increase Leverage

Preferred Stock

What Is It?
Preferred stock represents ownership in a company, but it usually does not give the holder voting rights (this may vary depending on the company). With preferred shares, investors are guaranteed a fixed (or sometimes variable) dividend forever, while common stocks have variable dividends. One of the main advantages to being a preferred stockholder is that, should the company experience financial trouble and have to liquidate, you would be paid off before the common stockholders (but still after debt holders).

Preferred stock may also be callable, meaning that the company has the option to purchase the shares from shareholders at any time - and usually for a premium.

While certainly not as popular as common stock, preferred shares are offered by a wide range of companies. It is important to remember that even though preferred shares are known as a type of stock, they are really more of a cross between a stock and a bond.

Objectives and Risks
The major objective of a preferred stock is to provide a much higher dividend than that provided by common stock. Preferred stock is also much less volatile than common stock and less risky if the company goes bankrupt - a preferred
shareholder is far more likely than a common shareholder to get at least some of his/her money back. As a company liquidates, bondholders are paid first, followed by preferred shareholders. Common shareholders are at the bottom of the ladder.

**How To Buy or Sell It**
Preferred stock trades the same way as common stock, usually through a brokerage, either full service or discount. Commissions to buy preferred stock are usually the same as common stock fees. There is no minimum investment for most preferred stocks, but many brokerages require clients to have at least $500 to open an account. (To learn more, see our [Stock Basics Tutorial](http://www.investopedia.com/university/stockbasics/).)

**Strengths**
- Dividends are higher than those of common stocks.
- If the company goes bankrupt, you have a better chance of getting some money back than common shareholders.

**Weaknesses**
- Dividends are taxed at the same rate as income, so higher dividends mean you will likely pay more taxes.
- Rates of return on preferred stock are very close to those for corporate bonds, and corporate bonds are considered less risky.

**Three Main Uses**
- Provides Income
- Capital Appreciation
- Lower Risk

**Real Estate & Property**

**What Is It?**
Usually, the first thing you look at when you purchase a home is the design and the layout. But if you look at the house as an investment, it could prove very lucrative years down the road. For the majority of us, buying a home will be the largest single investment we make in our lifetime. Real estate investing doesn't just mean purchasing a house - it can include vacation homes, commercial properties, land (both developed and undeveloped), condominiums and many other possibilities.

When buying property for the purpose of investing, the most important factor to consider is the location. Unlike other investments, real estate is dramatically
affected by the condition of the immediate area surrounding the property and other local factors.

Several factors need to be considered when assessing the value of real estate. This includes the age and condition of the home, improvements that have been made, recent sales in the neighborhood, changes to zoning regulations, etc. You have to look at the potential income a house can produce and how it compares to other houses in the area.

**Objectives and Risks**
Real estate investing allows the investor to target his or her objectives. For example, if your objective is **capital appreciation**, then buying a promising piece of property in a neighborhood with great potential will help you achieve this. On the other hand, if what you seek is income, then buying a rental property can help provide regular income.

There are significant risks involved in holding real estate. **Property taxes**, maintenance expenses and repair costs are just some of the costs of holding the asset. Furthermore, real estate is considered to be very illiquid - it can sometimes be hard to find a buyer if you need to sell the property quickly.

**How To Buy or Sell It**
Real estate is almost exclusively bought through real estate agents or brokers. Their compensation usually is a percentage of the purchase price of the property. Real estate can also be purchased directly from the owner, without the assistance of a third party. If you find buying property too expensive, then consider investing in **real estate investment trusts** (REITs), which are discussed in the next section.

**Strengths**
- Whether your objective is income or capital appreciation, real estate investing can help you achieve your goal.
- Mortgages allow you to borrow against the property up to three times the value. This can dramatically increase an investor’s leverage. Remember that you typically need a 5% down payment first.

**Weaknesses**
- Selling property quickly can be difficult.
- There are significant holding costs, especially if you are not residing in the property. Examples include property taxes, insurance, maintenance, etc.

**Three Main Uses**
Real Estate Investment Trust (REIT)

What Is It?
What if you want to invest in the real estate sector, but you either already have a house or don't have enough money to buy one right now? The answer is REITs. REITs sell like stocks on the major exchanges and invest in real estate directly through properties or mortgages. A major advantage to REITs is that they receive special tax considerations. Furthermore, they typically offer investors high yields as well as a highly liquid method of investing in real estate.

There is a wide variety of REITs, but you can break it down into three main categories:

Equity REITs - Equity REITs invest in and own properties (thus responsible for the equity or value of their real estate assets). Their revenues come principally from their properties' rents.

Mortgage REITs - Mortgage REITs deal in investment and ownership of property mortgages. These REITs loan money for mortgages to owners of real estate, or invest in (purchase) existing mortgages or mortgage-backed securities. Their revenues are generated primarily by the interest they earn on the mortgage loans.

Hybrid REITs - Hybrid REITs combine the investment strategies of equity REITs and mortgage REITs by investing in both properties and mortgages.

There are over 300 publicly traded REITs operating in the United States whose average daily trading volume has more than quadrupled during the last three years, reaching over $280 million dollars. The average dividend yield of an REIT is 9-12%.

Objectives and Risks
REITs can be used to meet a wide range of objectives within the real estate sector. They allow you to focus on different sectors of real estate, such as residential versus commercial. They allow you to target different geographical areas. And REITs have often been thought to closely follow the performance of small- to medium-cap stocks.

Still, no matter what the market does, the performance of a REIT is determined
by the value of its real estate assets. This is one major advantage to a REIT - its performance is not correlated to other financial assets such as stocks and bonds. As a result, REITs are usually less volatile and provide some degree of inflation protection.

**How To Buy or Sell It**
As we mentioned earlier, REITs sell like stocks on the major exchanges. Therefore, they can usually be bought through a brokerage, either full service or discount. Commissions to buy REITs are usually the same as common stock fees. There is no minimum investment for most REITs, although you may need to buy the shares in even blocks of 10 or 100. Also, many brokerages require clients to have at least $500 to open an account and trade stocks or REITs.

**Strengths**
- Dividends are higher than those of common stocks.
- The performance of an REIT follows the real estate market more closely than it follows the stock market.

**Weaknesses**
- Dividends are taxed at the same rate as income, so the higher dividends mean you will likely pay more taxes.
- Mortgage REIT’s tend to do poorly as interest rates rise.

**Three Main Uses**
- Provide Income
- Capital Appreciation
- Diversification

**Treasuries**

**What Is It?**
Also known as "government securities", treasuries are a debt obligation of a national government. Because they are backed by the credit and taxing power of a country, they are regarded as having little or no risk of default.

Treasuries include short-term **treasury bills**, medium-term **treasury notes** and long-term **treasury bonds**. One major advantage of treasuries is that they are exempt from state and municipal taxes - this is especially important in states with high income tax rates.

- **Treasury Bills**: A U.S. government debt security with a **maturity** of less than
one year. T-bills do not pay a fixed interest rate. They are issued through a competitive bidding process at a discount from par.

- **Treasury Notes**: A marketable, fixed-interest rate U.S. government debt security with a maturity between one and 10 years.

- **Treasury Bonds**: A marketable, fixed-interest U.S. government debt security with a maturity of more than 10 years. Treasury bonds are usually issued with a minimum denomination of $1,000.

**Objectives and Risks**
Treasuries are mainly used as safe havens for investors, especially when the markets head south. The fact that these debt instruments offer very little risk of default means the interest rate investors receive is relatively low. The price of treasuries rises as interest rates fall, and the opposite is true when interest rates rise. Therefore, the best time to buy treasuries is when interest rates are relatively high.

**How To Buy or Sell It**
Treasuries can be bought through various discount and full service brokers. Bond brokers also allow you to buy and sell treasuries. Perhaps the best way for individuals to buy or sell treasuries is through the U.S. Treasury's "Treasury Direct" program, which provides transactions for little or no fees.

**Strengths**
- Treasuries are considered to be almost risk free.
- Their low risk makes it fairly easy to borrow against the bonds.
- The U.S. treasury market is among the most active in the world, thus lack of liquidity is not a concern.

**Weaknesses**
Compared to other debt instruments, rates of return for treasuries are not that great.

**Three Main Uses**
- Provides Income
- Liquidity
- Tax Exemption

**Unit Investment Trust (UIT)**
What Is It?
A **unit investment trust** (UIT) is a registered trust in which a fixed portfolio of income-producing securities is purchased and held to maturity. UITs usually hold a large amount of **municipal bonds**, but they may also consist of government bonds, corporate bonds, or even **common stocks**. Common stock is held in a "stock trust" that mainly relies on dividends and capital appreciation of stock prices to make money.

Two examples of variations on the stock trust are **diamonds** and **spiders** (SPDRs), which attempt to track the performance of the major market indexes. Investors receive interest (or dividends) on the bonds (or stocks) held within the UIT. This interest is proportionate to the amount they invested into the trust.

A UIT is sort of like a mutual fund, but once the UIT selects the securities it will hold them - the portfolio is not managed like mutual funds are. It is not until the bonds held in the UIT mature that the trust is dissolved.

Objectives and Risks
Their steady and predictable income stream makes bond UITs very popular with retirees looking for supplements to their income. One risk that comes with a UIT is that, because the interest on the UIT is fixed for the life of the security, it is more susceptible to **inflation**. For the most part, UITs are fairly low-risk investments, but stock UITs depend heavily on the performance of the stock market, and in a stock trust there is no certainty of return like there is in a bond trust.

How To Buy or Sell It
Most UITs usually cannot be purchased through traditional brokers. Instead, they can be bought through some insurance companies or financial advisors/planners. Each unit typically costs $1,000, is sold by brokers to investors, and can be resold in the secondary market. You will usually pay a sales fee when purchasing the UIT - therefore, UITs don't make good short-term investments.

Strengths
- UITs are very well diversified.
- If your goal is to provide income, you can buy a bond trust. If you want capital appreciation, then you can buy a stock trust.

Weaknesses
- Because the interest payments on a UIT are fixed, holding a UIT for a long time could undermine performance.
- Depending on the type, a UIT can sometimes be difficult to sell quickly.
Three Main Uses
- Provides Income
- Capital Appreciation
- Tax-Deferred Savings

Zero-Coupon Securities

What Is It?
A zero-coupon security, or "stripped bond", is basically a regular coupon-paying bond without the coupons. The process of "stripping" or "zeroing" a bond is usually done by a brokerage or a bank. The bank or broker stripping the bonds then registers and trades these zeros as individual securities.

Once the bonds are stripped, there are two parts: the principal and the coupons. The interest payments are known as "coupons", and the final payment at maturity is known as the "residual" since it is what is left over after the coupons are stripped off. Both coupons and residuals are bundled and referred to as zero-coupon bonds or "zeros".

You can think of a zero-coupon security just like a T-bill. Basically, you pay a certain amount right now in exchange for the par value of the security at a future date, usually $1,000. For example, you might pay $800 for a zero-coupon bond today and in five years you will receive the par value of $1,000. The longer the time to maturity, the cheaper you can buy the bond for. This predictability also makes zeros popular - when you buy the security, the yield is essentially locked in.

Objectives and Risks
The basic objective of a zero-coupon security is "buy low, sell high". You purchase the bond for a sum of money, and once it reaches maturity you will be paid an even larger sum of money. When interest rates are low, the price of the zero will be higher. The best time to buy a zero is when interest rates are high because the bond will be at a deeper discount.

The one major problem with zeros is that the annual accumulated return is actually considered to be income, and while you don't actually collect that interest until the bond reaches maturity, you still have to pay income tax on it. In other words, the gains on a zero are not treated as capital gains, instead they are considered to be interest.

How To Buy or Sell It
Zero-coupon securities can be bought through most full service or discount
brokers, commercial banks, and some other financial intermediaries.

**Strengths**
- Zeros can be bought at huge discounts.
- Once you buy a zero-coupon security, you essentially lock in the yield to maturity.

**Weaknesses**
- If the company issuing the zero goes bankrupt or defaults, then you have everything to lose. Whereas, with a regular coupon bond, you may have at least gotten some interest payments out of the investment.
- Interest earned on the zero-coupon bond is taxed as income (a higher rate) rather than capital gains.

**Three Main Uses**
- Capital Appreciation
- Tax-Deferred Savings
- Predictability