The Top 10 Terms Every New Investor Should Know

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Investing isn't simple – it requires lots of decisions, from where to put your hard-earned money to how long you want to keep it tied up in any one investment. Even talking about investing can seem challenging, since financial experts use a language all their own to communicate their ideas.

Still, "It's empowering to know how to take care of your money," says Paula Hogan, a financial advisor in Milwaukee, Wis. "People who are smart about money matters have more options in life. It's part of being an independent, competent adult."

Becoming a savvy investor starts with looking, listening and building on what you already know. "What do you observe about how the people you know handle money? Whom do you want to emulate? Read the personal finance columns in your local newspapers and online. Understand the power of saving early, and develop a habit of saving a specific portion of every dollar you earn or receive as a gift, no matter what."

To help with some basics, Knowledge@Wharton High School has come up with a Top 10 list of terms that every new investor should know. Learn these and you'll be well on your way to navigating the investment landscape.

1. **Return on Investment**. Return on Investment, or ROI, refers to how much you'll earn (or expect to earn) as a percentage of your investment. So if you're investing $100, and you get back $110 (a $10 profit), your ROI is 10%. Generally, you hope to get a higher ROI on a riskier investment.
2. **Cash**. Everyone knows that cash refers to bills, coins and other kinds of currency. When financial advisors talk about moving some of your portfolio, or investments, into cash, they don't mean you should hang on to a bunch of dollar bills or other type of currency. Instead, they are usually referring to liquid investments, or investment vehicles that are easily swapped for cash, like certificates of deposit (CDs), Treasury bills or money market accounts.
3. **Portfolio**. A portfolio is a collection of investments owned by the same person or company. An individual typically builds his or her portfolio with different kinds of company stocks or different types of investments, such as stocks, bonds and mutual funds. You will often hear the phrase "diversified portfolio" to refer to a portfolio that has spread its risk over different types of industries and/or investments.
4. **Asset Allocation**. This refers to your plan, or strategy for your investments. You could put all of your money in a single investment, like buying stock in one company — but you could lose out big-time if it doesn't do well. Instead, you could try to balance your risk by investing among several companies. That way, if one goes down, another may still go up. Some financial advisors go even further by suggesting that you put your money in different classes, or types of investments, like cash, bonds or stocks. Check out the related stories in the toolbar to learn about the various types of investments.
5. **Bonds and Stocks**. Bonds are where you loan money to an entity – usually a company or a government body – in exchange for a promise that they will pay you interest on your money. Bonds are a little riskier than cash investments (what if the company goes bankrupt?), but will usually pay more interest than a bank savings account. Stocks are basically an ownership interest in a company. So, if a company does well, the price of the stock will probably rise, and the company may even pay dividends to stockholders. However, nothing is guaranteed, and you can lose part or all of your initial investment if a company doesn't perform well.
6. **Risk Tolerance**. It's important to remember as a new investor that all investments involve some degree of risk. The reward for taking on a riskier investment may be a higher return — or not, depending on the performance of that investment over time. As you invest, you need to understand your own tolerance for risk. Are you OK with the idea of potentially losing money to get better results? Then you have a high risk tolerance. If you would

rather take a safer investing path, then your risk tolerance is lower. Sometimes, it depends on where you are in the investment lifecycle. Typically, the younger you are when you start investing, the higher your risk tolerance and your potential for greater long-term results since you have more time to realize that investment.

7. **Mutual Fund**. This is when a group of investors gets together to buy assets like stocks and bonds. But rather than calling your friends and family and getting them to pool their money – which would probably take you until the next century to pull off – a mutual fund does all the legwork of bringing investors together and diversifying assets. A mutual fund may hold hundreds or more of stocks or other financial instruments, reducing the possibility of loss from any one investment. Professional money managers typically make the investment and selling decisions.
8. **Securities and Equities**. They are two different things! Securities refer to different types of investments, such as stocks, bonds and mutual funds. Equities refer specifically to stocks, or shares in a company.
9. **Price-to-earnings Ratio**. The P/E ratio, as it's often called, refers to a company's stock price as a percentage of its per-share earnings. A low P/E is usually 0 to 10 (a company that earns $1 a share and has a $10 per share stock price has a P/E ratio of 10), and might be a signal that the company isn't doing too well. A high P/E ratio, above 25, could mean that investors expect the company to do really well in the future. It's important to note that a low P/E could also mean that investors haven't realized the company's potential for growth, while a high P/E could mean that people are over-valuing the company because they think it's worth more than it actually is. In times like that, a stock price might be in danger of plummeting, and thus causing investors to lose money. Considering the P/E ratio might be a good starting point as you go about picking stocks for your portfolio, but financial advisors suggest that you still need to research a firm more deeply before investing in it. What's behind those numbers?
10. **Prospectus**. When it comes to investing, research is really important. Want to find out about a company or fund before you invest in it? Get the company prospectus, a legal document, filed with the Securities and Exchange Commission (SEC), which provides details about the expenses, finances and other important company info. But remember, a prospectus is a description and should be considered one tool in stock picking — it is not a guarantee of results, even if the prospectus has been approved by the SEC.

That's it for our Top 10. Financial advisor Hogan also recommends that new investors familiarize themselves with the following terms:

- A fiduciary is someone who has a legal obligation to act in your best interest.
- A sales person has a legal obligation to offer suitable investments to you.
- An employer matching contribution is the amount of money your employer will add to your 401(k) [retirement] account for every dollar that you contribute of your own funds.
- Capital gains tax is the tax the government levies – and you must pay — when you cash in on an investment gain.
- Compound interest is the interest added to the principal of a deposit or loan so that the added interest also earns interest from then on. One example is a bank account, which may have its interest compounded every year. For instance, an account with $1,000 initial principal and 20% interest per year would have a balance of $1,200 at the end of the first year, $1,440 at the end of the second year, and so on.

Learning the language of money and the stock market will put you that much closer to becoming a wise – and successful – investor.