Types of Investments

Estimated time: 3 minutes / Difficulty: Basic

Until now we've been talking about investing in general and and getting into more specifics with stocks. It's certainly a good starting-point, but in reality there is a wide variety of investments available, grouped together into what are often called asset classes. Admittedly, many of these will not be immediately available through ninety nine, but we think it's important to your education.

Investments come in all shapes and sizes.

Equities

Equities, or **stocks**, as you should know by now, are shares of ownership in a company. The kind of stock you are most likely to encounter on large exchanges will be common stock in a publicly traded entity.

Fixed Income

Fixed income investments are, surprise surprise, investments that provide you with income on a regular basis at more or less predictable levels. Unlike shares, fixed income investments are actually loans. You do not have ownership, but in return for lending a company or government money, you receive interest. The most common types of fixed income investments are **bonds** and **treasuries.** Whereas bonds, or corporate bonds, are loans to corporations, treasuries are loans to governments. The more stable a company or government is, the lower your interest rate, and vice versa.

Because you are actually a *creditor*, or *lender*, you typically have priority over shareholders for any repayments if the company defaults or goes into bankruptcy. This oftentimes makes fixed income investments less risky than traditional equity, or stock, investing, although you receive less return as a result. This makes them good for risk averse investors and people nearing retirement.

Cash and Equivalents

Cash and equivalents are fairly self-explanatory. These are investments into cash or similar instruments, such as **treasury bills**, which are essentially short term **treasury bonds** that only pay you at the end. The corporate equivalent to these **treasury tills** (or T-bills) is **commercial paper,** or short-term loans to corporations.

Another type of cash investment is the **money market**. These are commonly available through Money Market Accounts at banks, and behave similar to a checking account. However, they restrict your withdrawals and pay higher interest rates by investing in other cash equivalents such as Treasuries, Commercial Paper, or Certificates of Deposit.

Related to Cash, of course, are **currencies**. Because the exchange rate between different currencies, such as the Dollar and the Euro are almost constantly moving, some investors move between different currencies, looking for both return and safety. If you live in a country with high inflation, you can protect your investment by moving your excess cash into a more stable currency.

More recently, **cryptocurrencies** such as Bitcoin or Ethereum have begun to be considered an asset class. While the name is similar to traditional currencies, their behavior and underlying structure is very different, mainly in the fact that currencies are backed by governments, whereas cryptocurrency have no relationship to a government or central authority.

Others

Commodities are investments into raw materials such as gold, copper, oil, wheat, sugar, and many other items used in the production and manufacture of goods. Whereas industries do oftentimes use these goods, investors, who oftentimes never see or touch the commodity, speculate on the future supply and demand of these goods. In addition to the commodities one would expect, certain markets trade investments in goods such as salmon, frozen orange juice concentrate, and pork bellies.

Precious metals like gold and silver also sometimes serve as a safe alternative to currencies or other investments given their long history of being considered valuable.

Derivatives are contracts between two parties that *derive* their value from an underlying asset. As a category, derivatives includes a wide variety of assets, although two of the most common are **futures** and **options.**

In both scenarios, one investor, or *party,* agrees to a contract with another investero, or *counterparty*. Each side of the contract is betting that the underlying asset will change price, although they disagree on whether it will go up or down and when. An example could be a **futures contract** on the price of Apple stock. If an investor believes Apple stock will go down from its current price, to protect themselves they can enter into a contract with a counterparty who agrees to buy it at today's price, no matter where it is at that point in time. Obviously this person is betting that the price will actually increase by then, allowing them to purchase the shares for cheaper at that point in time.

Options are similar to futures, with the main difference being that the purchase of the asset in the future is *optional.* Other significant derivatives include **mortgage backed securities** and **credit default swaps**, although we won't go into detail here. Suffice to say that they played an important role in the most recent financial crisis and the average investor can't and shouldn't be involved in them.

As we mentioned in our first lesson, there are many forms of investments that you may already be making, and for many people that includes **real estate** and **property**.

Funds

If you've watched a lot of TV or regularly read the newspaper, you've probably heard a lot about **funds.** They come in all shapes, sizes, and forms, but the most relevant include Exchange Traded Funds, Mutual Funds, Hedge Funds, Private Equity Funds, and Venture Captial Funds.

Mutual funds can be thought of as a pool of money collected from a variety of individual investors to be invested in a variety of asset classes and individual securities, including equities and fixed income. If you own a *share* in the mutual fund, it will go up and down depending on how those assets, perform, and the benefit is that you are more *diversified*. What the fund invests in is determined by the **fund manager,** so when one invests in a fund, they are basically betting on the investment ability of the manager.

Exchange traded funds, or **ETFs**, are similar to mutual funds but with several key differences. Whereas mutual funds can only be traded at the end of the day, ETFs can be traded any time the market is open, as you would with any stock. Additionally, most mutual funds have a minimum investment level, whereas you can buy as little as a single share in an ETF.

Hedge funds pursue a variety of investment strategies across the asset classes, but they are only available to *accredited investors*, or people who have earned more than $200K for the past few years or have a net worth of over $1MM. In other words, they're not available to most people.

Private equity funds are similarly inaccessible to most people as they typically pool money from large investment groups or wealthy individuals. However they differ from hedge funds in that they invest in private companies or takeover public companies, thereby making them private. They also tend to invest for longer periods of time. **Venture capital funds** are a specific type of private equity funds that specialize in investing in startups and small businesses with possibilities for growth.

Finally **real estate investment trusts**, or **REITs,** operate similar to mutual funds, but invest primarily in real estate. Many REITs are actually publicly traded, either as part of mutual funds, or as **REIT ETFs.**

We could go on. As we mentioned in the first lesson, there are almost limitless forms of investments, which means there are nearly as many *asset classes*. Fortunately for all of us, this overview should give you more than enough information to feel familiar with most of the investments you'll encounter.