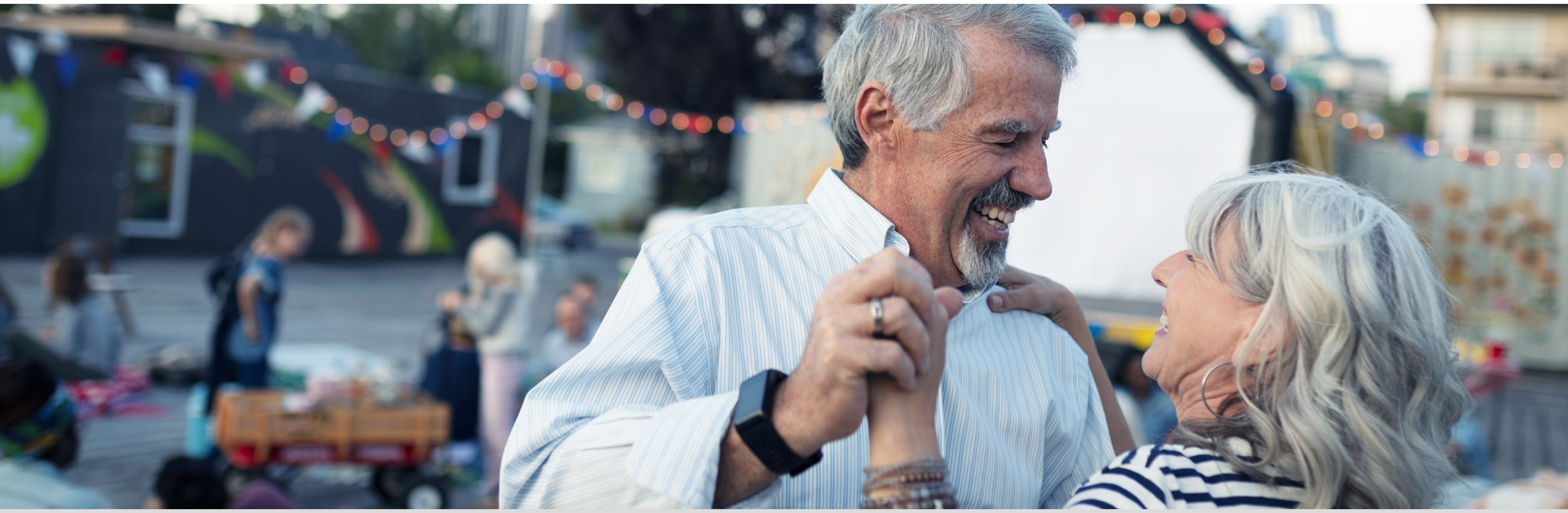

Understanding the basics of 401(k) investing

One way to build retirement savings over the long term is investing. With the right asset allocation and investment selections, you may benefit from years of compound interest and capital appreciation. But, most people lack the confidence to get started, and understandably so. The majority of investment terms are far from intuitive. Before you can set yourself up for investment success, it's important to understand the basics of 401(k) investing.

TYPES OF INVESTMENTS

Most 401(k) plans offer investment options in three primary asset classes – equity, fixed income and capital preservation, which consists of stable value or cash alternatives.

EQUITY/STOCKS

When a company is publicly traded, its stock trades on an exchange, such as the New York Stock Exchange, and is available for investors to purchase on the open market. When an investor owns a company's stock shares, they own a portion of that company. This is referred to as equity.

The return an investor earns usually depends on the company's performance – the better the company performs, the higher the usual return. Equity investors primarily make money in one of two ways:

401(K) FUNDAMENTALS

We'll cover the broad types of investments you're likely to encounter in your 401(k) plan lineup to help you feel more confident about investing for your future.

Dividends: Profitable companies may choose to distribute a portion of their earnings to investors in the form of a dividend. Investors have the choice of leaving the dividend as a cash distribution or reinvesting it to purchase additional shares of the company.

Capital Gains: A company's stock price is ultimately determined by

Dividends are not guaranteed and a company's future ability to pay dividends may be limited.

supply and demand. As demand for a company's stock increases, supply typically decreases and the stock price rises. Conversely, when investors no longer want to own a company's stock, they sell their shares on the open market. Supply increases, and the stock price decreases. When an investor sells shares for a higher price than they initially paid for them, the difference is called a capital gain. When an investor sells their shares for a lower price, a capital loss occurs.

FIXED INCOME/BONDS

When an investor owns a bond, they are effectively lending money to the issuer – typically a government, federal agency, corporation or other organization – for a set amount of time (the bond's term, or years to maturity). At the end of the term, the investor expects to receive their initial investment (principal) back with interest paid along the way (the bond's coupon). Bonds are often referred to as fixed income because the issuer is obligated to make payments of a fixed amount on a fixed schedule.

Bond investors mainly make money based on the interest rate paid by the issuer, which is generally paid out semiannually. The higher the interest rate, the higher the potential return to the investor. However, it's important to note that higher interest rates often indicate greater risks associated with owning the bond.

STABLE VALUE

Offered exclusively in employer-sponsored defined contribution plans, stable value funds are structured to generate steady, positive returns while aiming to preserve investor capital in all market environments. These funds primarily invest in a diversified portfolio of high-quality, short- and intermediate-term fixed income securities that are protected against fluctuations in interest rates by contracts from banks and insurance companies. The contracts – commonly referred to as wrappers – guarantee* a certain return, even if the underlying securities decline in value.

Although stable value funds are designed to preserve capital, historically they have lost money in extreme market conditions despite the insurance guarantee. Therefore, stable value funds are not a perfect substitute for cash.

CASH ALTERNATIVES

In retirement plans such as 401(k) plans, money market funds are typically the lowest risk – and therefore lowest return – option for holding excess cash. Money market funds are open-ended mutual funds that invest in short-term bonds and cash alternatives such as U.S. Treasury bills and commercial paper. Money market funds are considered safe because they generate a modest yield similar to that of a savings account while offering more protection for investor capital.

*Guarantees are based on the claims paying ability of the insurance company.

NEXT STEPS

- Consult your 401(k) lineup to see what equity, fixed income, stable value and cash alternative options are available.
- Check out Asset Allocation Basics, our corollary educational piece, to better understand how these asset classes work together in a portfolio.

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INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863