

How Can I Teach My Child About Investing?

Christopher and Angelica Nicholson, both 43, want their 12-year-old son, Jim, to learn about investing. First, they explain that when done carefully, investing can be a way to build savings.

Next, to help him understand the rewards and risks involved, the Nicholsons open a UGMA (Uniform Gifts to Minors Act) account, which allows adults to invest on a child's behalf. They deposit half of Jim's weekly allowance in this account.

Choosing stocks

The Nicholsons then talk to Jim about companies he likes, such as gaming and computer retailers, and suggest that he could own a little piece of each company if he bought its stock. Jim chooses three companies to watch on a daily basis. With the help of his parents, he starts a log and tracks the ups and downs of these stocks' prices by checking a financial news website.

Explaining diversification

The log teaches Jim that stock prices tend to fluctuate. Christopher and Angelica explain that it's smart to hold several different investments, so if one loses value others could potentially keep your money growing. A mutual fund could hold many stocks. For this reason they invest his UGMA money in a mutual fund.

Compounding in action

Finally, the Nicholsons show Jim that his fund makes regular payments, called dividends, to his account. Together they arrange for his dividends to be reinvested to buy more shares, pointing out that investment gains can produce their own gains—a process called compounding.

Jim has learned valuable lessons that will help him make smart financial decisions in the years to come.

Diversification strategies do not assure a profit and do not protect against losses in declining markets.

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