Brokerage Accounts

by Sophia

WHAT'S COVERED

In this lesson, you will learn about brokerage accounts and the different types of brokerage firms. You will explore how your productivity skill can be a real benefit in this process. Specifically, this lesson will cover:

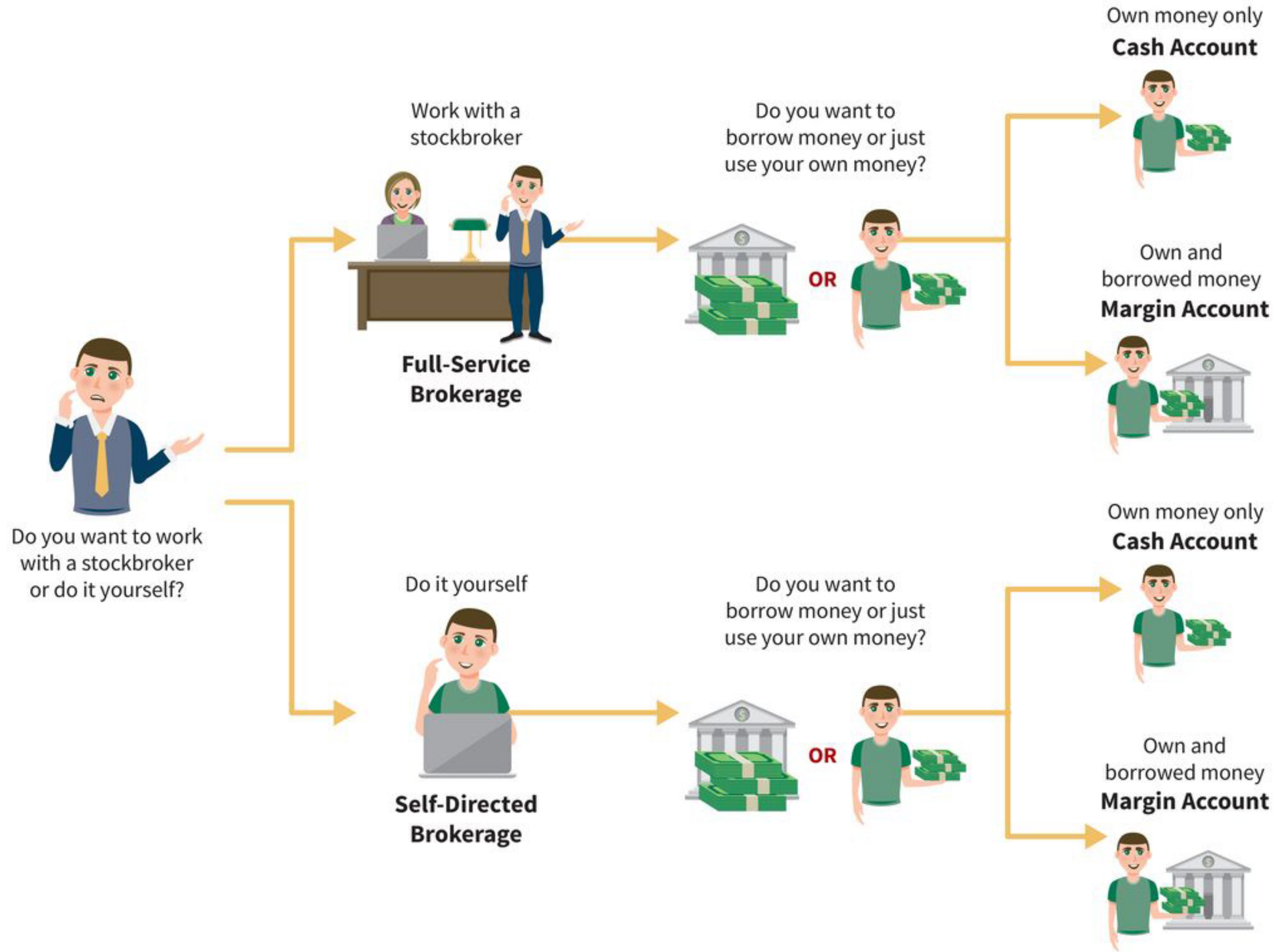
1. Overview of Brokerage Accounts

1a. Choosing a Brokerage Account

A **brokerage account** is a prefunded arrangement between you and a broker-dealer firm that allows you to buy and sell investment assets. The following flow chart shows the primary choices that you need to make in the account selection process.

KEY CONCEPT

The process of opening a brokerage account is relatively easy and similar to establishing an online bank account, with a few additional considerations.



First, you need to decide if you want to work with a broker or manage the assets in the account on your own.

- Full-service brokerage firms, sometimes referred to as broker-dealers, match you with a broker – a financial professional who will provide guidance and support throughout the investing process. **Stockbrokers** are also known as investment representatives, registered representatives, or account managers. Firms such as UBS, Merrill Lynch Advisors, Raymond James, and Morgan Stanley dominate the full-service marketplace.
- A self-directed brokerage account allows you to make your own investment decisions. Firms like Charles Schwab, Fidelity, TD Ameritrade, and E*Trade provide this option.

Second, you must also decide if your broker-dealer will allow you to purchase securities with borrowed money.

- A **cash account** is the most common and requires you to pay, in advance, for all securities purchased.
- A **margin account** allows you to buy stocks, bonds, and other assets with borrowed money. Most often, margin accounts, because they involve borrowing, are reserved for wealthy clients who have both a high credit rating and a high risk tolerance.

TERMS TO KNOW

Brokerage Account

A prefunded arrangement between you and a broker-dealer firm that allows you to buy and sell investment assets.

Stockbroker

Registered representatives, or account managers. Also known as *investment representatives*.

Cash Account

The most common and requires you to pay, in advance, for all securities purchased.

Margin Account

A type of brokerage account that allows an investor to purchase investments with borrowed money.

1b. Self-Directed Compared to Full-Service Accounts

As a brokerage-firm client, you must pay for the advice and guidance provided.

- By law, brokers are required to get to know you. This just means that brokers must learn as much about your goals, attitudes, financial situation, and risk tolerance as possible.
- Brokers are required to use this information to help guide their recommendations.
- Because of this, the fees and commissions charged in full-service brokerage accounts will be higher than those charged in self-directed accounts.

BIG IDEA

If you have a self-directed brokerage account, you are totally responsible for making your own investment decisions. The investment choices you make are yours and yours alone.

The table below compares estimated minimum account values, fees, and commissions charged in self-directed and full-service brokerage accounts. Generally, given the lower fees and commissions, self-directed accounts are the better option for individuals just getting started with investing. If you decide later during your lifetime financial journey that you need help managing your assets, a full-service brokerage account might be appropriate.

Account Information*	Self-Directed Account	Full-Service Account
Minimum initial deposit	$1,000	$25,000
Minimum initial deposit for individual retirement account	$500	$5,000
Minimum initial deposit for 529 savings plan	$100	$1,000
Minimum initial deposit for educational savings account	$250	$1,000
Flat rate online commission per trade	$8.95	$25 plus commissions of 1% up to 5% of the sale
Fee for certificates of deposit	$0.00	$0.00

Annual account maintenance fee	$0.00 unless account value drops below initial minimum investment, then $100	$0.00 unless account value drops below initial minimum investment, then $100

* This is an example. Actual minimum requirements and fee rate schedules vary.

If you plan to go it alone through a self-directed account, you'll need to bring along your productivity skills . Review the quick tips in this toolbox. Keeping these tips handy will give you the confidence you need to make the best investment decisions.

HINT

You can also download the toolbox below.

1c. Opening a Self-Directed Account

You might be thinking, "This all seems too complicated and uncomfortable." This is a common reaction but one that is easily remedied. Let's walk through the process of opening a self-directed account.

STEP BY STEP

1. Make sure you have some money saved that can be used for investment purposes.
2. Conduct an Internet search for "self-directed brokerage account." Compare the options among several of the companies listed and then select the firm that has a low minimum account balance, low (or no) trading commissions, and low (or no) account fees.
3. Check that the firm offers Securities Investor Protection Corporation (SIPC) insurance, which protects your account up to $500,000 per customer, per firm, with up to a $250,000 limit for cash. SIPC covers you in the event that the brokerage firm goes out of business or experiences theft. Keep in mind that SIPC does not insure against losses in the markets.
4. Open the account. You can begin buying and selling securities almost immediately.

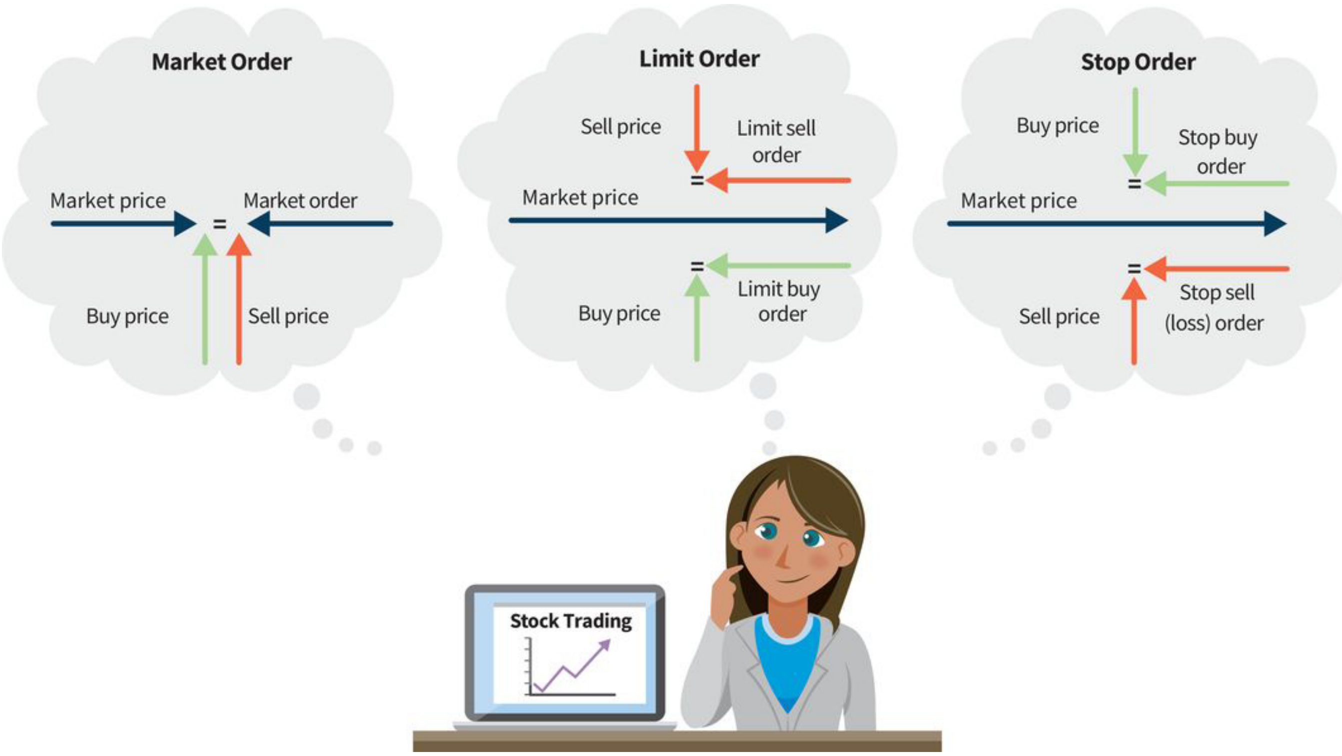
HINT

You will always want to make sure that you already have some savings set aside for emergencies and other short-term goals.

2. Placing Orders

2a. Types of Orders

When you make your first stock purchase, you will be asked how you want your purchase to be handled. You have three basic choices, as shown in the following illustration.



1. **Market order**, which instructs the brokerage firm to buy (or sell) at the current ask or bid price. This is the fastest way to transact trades in an account. However, a market order does not guarantee the buy or sell price because sudden market swings can alter the price.
2. **Limit order**, which tells the brokerage firm to only buy (or sell) at a specific price or better. Let's say you want to buy shares in a company only if the price drops below $25 per share. The limit order will stay in effect until the price drops under $25. It is important to use limit orders when you are buying or selling stock that does not have many buyers and sellers, or if you are trading a stock with large daily price swings (see Hint below).
3. **Stop order** (sometimes known as a stop-loss order), which directs the brokerage firm to buy (or sell) only when the price falls below a set point, say, $24.50. If the stock price jumps down from $25 to $22, then the stock will sell at the next available price ($22) even though the order was set at $24.50. In some situations, a stop-loss order will require the stock price to trade at an exact amount for it to be sold.

HINT

By using limit orders, you are able to protect yourself against sudden price swings in the market price. Some investors also use a buy stop or sell stop order. A buy stop sets a limit on how much you are willing to pay, whereas a sell stop instructs the brokerage firm to sell shares if the price falls.

TERMS TO KNOW

Market Order

Instructs a brokerage firm to buy (or sell) at the current market value; the fastest way to transact trades in an account.

Limit Order

Tells the brokerage firm to only buy (or sell) at a specific price or better.

Stop Order

Directs the brokerage firm to buy (or sell) only when the price falls below a set point. Sometimes known as a *stop-loss order*.

2b. Online Orders

In today's highly technical world, most brokerage account activity is handled online.

- Years ago, you would have received a stock certificate, which is paper proof of ownership, whenever you purchased shares of stock.
- Although you can still receive a certificate, nearly all brokerage firms require that you hold shares of stock in street name. This refers to the brokerage firm being shown as the owner of record even though you, as the brokerage account client, actually own the shares.
- Street-name ownership allows for quicker and simpler transactions.

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3. Reading a Brokerage Statement

Once your account is set up, you will begin to receive account statements, like the one shown in the following illustration (see Hint). Looking at TJ's account in the illustration, you can see that she withdrew $1,000 from the account, earned $50 in interest, and paid a $30 account fee. TJ's investments also increased by $300 during the month.

HINT

Similar to your bank account, it is important to review your brokerage account statement monthly.

BROKERAGE ACCOUNT STATEMENT

ABC Brokerage Services
101 Dawson Street
Atlanta, GA 30001

The name and address of the brokerage firm

Account Number: 999-123456789

Statement Period: 05/01/2020 – 5/31/2020

TJ Client
850 Waverly Drive
Any city, Any state 89891

The name of the client

Beginning account value	$9,670.00
Cash withdrawals	–$1,000.00
Dividends/interest	$ 50.00
Fees	–$ 30.00
Change in account value	$ 300.00
ENDING ACCOUNT VALUE	$8,990.00

Opening account balance

Ending account balance

Summary of investments held in account

ASSET ALLOCATION	**Value Last Period**	**Value This Period**	**Change in Value**	**Percent Allocation**
Money market	$4,000.00	$3,020.00	$ 0.00	33.59%
Short-term bond fund	$1,000.00	$1,000.00	$ 0.00	11.12%
S&P 500 index fund	$4,670.00	$4,970.00	$300.00	55.28%

Allocation of investments in account

TRANSACTIONS

Description	*Date*	*Activity/Account*	*Amount*
Interest received	05/05/2020	Money market	$ 50.00
Check issued	05/20/2020	Money market	$1,000.00
Account fee	05/30/2020	Money market	$ 30.00

Summary of account activity

SUMMARY

In this lesson, you went through an **overview of brokerage accounts**. When you **choose a brokerage account**, you should **compare the features of self-directed and full-service accounts**. With a self-directed account, you'll make your own investment decisions. You will need to use your productivity skill to make sure you are on top of things. If you **open a self-directed account**, be sure the firm offers SIPC insurance. Conversely, full-service brokerage firms will match you with a broker who can help you interpret and **read your brokerage statements**.

When you're ready to place an order for stocks, you'll select from three **types of orders**: a market order, a limit order, or a stop order. With the advent of the Internet, most orders today are placed as **online orders**.

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