Passive income refers to money earned from assets, investments, or systems that continue producing revenue without requiring continuous daily labor. The defining characteristic is that the income does not depend on trading time directly for wages. Instead, something that already exists—such as property, investments, intellectual property, or a business system—generates the income. In economic terms, passive income is usually produced by capital, meaning assets that generate value over time. This is different from earned income, which comes from wages or salaries paid in exchange for labor. Many forms of passive income require substantial effort, knowledge, or money at the beginning. That initial effort is often called the setup phase, during which the system or asset is created. Afterward, the income may continue with minimal direct involvement. Common sources include rental properties, dividends from stocks, interest from bonds, royalties from books or music, or automated businesses. For example, a person might purchase a rental property and hire a professional property management company to handle tenant relations, maintenance coordination, and rent collection. Even though the owner is not actively working at the property each day, rent payments continue to arrive as long as the property remains occupied. Passive income is also influenced by inflation, which is the general rise in prices over time that reduces the purchasing power of money. If passive income remains fixed while inflation rises, the real value of that income gradually declines. This means that successful passive income strategies often involve assets that either increase in value or increase their payments over time, allowing income to keep pace with rising costs of living.

Cash on cash return is a measurement used primarily in real estate investing to evaluate the amount of annual cash income generated compared to the amount of cash the investor originally invested. It focuses strictly on cash flow, meaning the money remaining after operating expenses and loan payments are paid. This measurement does not include increases in property value, reductions in loan balances, or tax advantages. Because it measures actual cash income relative to invested capital, it is often used by investors who depend on regular income from properties rather than long-term appreciation alone. The calculation divides the annual pre-tax cash flow by the total cash invested. If an investor contributes $50,000 to purchase a property and the property produces $6,000 per year in cash flow after all expenses, the cash on cash return equals 12 percent. This measure helps investors understand how effectively their invested cash is producing income. However, it is strongly influenced by operating costs such as repairs, property taxes, insurance, vacancy periods, and management fees. If maintenance costs rise significantly or the property remains vacant for long periods, the annual cash flow declines, which directly reduces the cash on cash return. Some investors may still accept a lower cash on cash return if they expect strong property appreciation, meaning the value of the real estate increases substantially over time, or if the location offers long-term economic growth.

Return on investment, commonly abbreviated as ROI, is one of the simplest and most widely used ways to evaluate the profitability of an investment. ROI measures the relationship between the profit earned and the original cost of the investment. It expresses that relationship as a percentage, allowing investors to compare different opportunities using a common measurement. The formula subtracts the initial cost from the final value of the investment and then divides the profit by the original investment amount. For example, if an investor purchases $1,000 worth of stock and later sells it for $1,300, the profit is $300. Dividing $300 by the original $1,000 investment produces an ROI of 30 percent. While this calculation is straightforward, it does not always capture the full complexity of investments. ROI does not account for the amount of time required to achieve the return, meaning a 30 percent gain over one year is very different from the same gain over ten years. In addition, transaction costs such as brokerage fees, taxes, or closing costs reduce the actual profit received. Because of these limitations, ROI is often used as an initial comparison tool rather than a complete evaluation of investment performance.

Return on equity, abbreviated as ROE, is a financial ratio used primarily to evaluate the profitability of companies. It measures how effectively a company uses the capital invested by its shareholders to generate profits. Equity represents the portion of a company’s assets that belongs to shareholders after all debts have been subtracted. In other words, equity reflects the owners’ financial stake in the business. ROE is calculated by dividing the company’s net income, which is the profit remaining after all expenses and taxes, by total shareholder equity. For example, if a company has $1 million in shareholder equity and produces $200,000 in net profit during a year, its ROE is 20 percent. This indicates that the company generated twenty cents of profit for every dollar of equity invested by shareholders. Investors often analyze ROE to determine how efficiently management is using investor capital to grow the business. However, the ratio must be interpreted carefully. A company can increase ROE by taking on large amounts of debt, because borrowing reduces the amount of equity required to finance operations. While this may increase the ratio mathematically, excessive borrowing increases financial risk and may threaten long-term stability.

Internal rate of return, known as IRR, is a financial metric used to estimate the annualized rate of return that an investment is expected to generate over time. Unlike ROI, IRR accounts for the timing of cash flows, meaning when money enters or leaves the investment. This makes it especially useful for long-term investments such as real estate developments, infrastructure projects, or private equity investments where returns occur over multiple years. IRR calculates the discount rate that makes the net present value of all future cash flows equal to zero. Net present value refers to the idea that money received in the future is worth less than money received today because money available today can be invested and grow over time. For example, if an investor purchases an apartment building, receives rental income each year, and eventually sells the property for a higher price, IRR estimates the annual growth rate of the entire investment considering all income and the final sale. Two investments may have the same IRR but still differ significantly in risk because the stability and reliability of their cash flows may vary. Additionally, the timing of payments affects the IRR calculation. Investments that produce earlier cash flows generally produce higher IRR values because those funds can be reinvested sooner.

A capital gain occurs when an asset is sold for a higher price than the amount originally paid for it. The difference between the purchase price and the sale price represents the profit. Assets that can produce capital gains include stocks, bonds, real estate, collectibles, artwork, and other investment property. Capital gains are generally categorized into short-term and long-term gains based on the length of time the asset was held before being sold. In many tax systems, short-term gains—profits from assets held for less than one year—are taxed at higher rates because they are treated similarly to ordinary income. Long-term gains, generated from assets held longer than a year, often receive more favorable tax rates. For example, if someone buys shares of stock for $2,000 and later sells them for $2,800, the $800 difference represents the capital gain. Investors sometimes delay selling assets to manage when taxes are triggered, since taxes typically become due only when the asset is sold and the gain is realized.

Yield refers to the income generated by an investment relative to its value or cost. In financial terms, yield measures how much cash income an investor receives compared to the amount invested. This income may come from interest payments, dividends, or other periodic returns. Yield is typically expressed as a percentage so that different investments can be compared easily. For example, if an investor buys a bond for $1,000 and receives $50 in interest each year, the yield is 5 percent. Yield can change even when the payment amount stays the same because it is calculated relative to the price of the investment. If the price of the bond falls while the interest payment remains fixed, the yield increases because the same income is now earned from a smaller investment amount. Higher yields often attract investors seeking income, but unusually high yields can sometimes signal elevated risk, such as financial distress within the company or issuer responsible for making the payments.

Dividend yield is a specific form of yield that applies to stocks that distribute part of their profits to shareholders. A dividend is a payment made by a corporation to its shareholders, typically funded from company profits. Dividend yield compares the annual dividend payment per share to the current price of the stock. If a company’s stock trades at $40 per share and it pays $2 per share in dividends each year, the dividend yield is 5 percent. This measure helps investors evaluate how much income they receive from owning the stock relative to its price. Dividend yield can increase if the stock price declines while the dividend remains unchanged. This situation sometimes occurs when investors lose confidence in a company’s future earnings. For that reason, extremely high dividend yields may signal potential financial instability if investors believe the company may eventually reduce or eliminate the dividend.

A portfolio is the complete collection of financial assets owned by an individual or institution. These assets may include stocks, bonds, real estate, cash, mutual funds, exchange-traded funds, commodities, and other investments. The structure of a portfolio determines its risk profile, meaning the level of uncertainty and potential loss associated with the investments. One of the most important principles in portfolio management is diversification, which means spreading investments across different asset types, industries, and geographic regions. Diversification reduces the impact of losses from any single investment because different asset classes often respond differently to economic conditions. For example, a diversified portfolio might include stock index funds representing large companies, government bonds providing stable interest income, and real estate assets generating rental revenue. The composition of a portfolio often changes over time as investors adjust their goals, risk tolerance, and financial circumstances.

Investing is the process of allocating money to assets with the expectation that the value of those assets will increase or that they will generate income over time. Unlike saving, which typically involves storing money in low-risk accounts with minimal growth, investing involves accepting a certain level of risk in exchange for the possibility of higher returns. Investors place money into various assets such as stocks, bonds, real estate, private businesses, or investment funds. Each asset class behaves differently depending on economic conditions, interest rates, technological developments, and market demand. Successful investing often requires a long-term perspective because many investments fluctuate in value over short periods. The concept of time horizon—the length of time an investor expects to hold an investment—is important when selecting appropriate assets. Investors with long time horizons may accept greater volatility because they have more time for markets to recover from downturns. Those with shorter time horizons often prefer more stable investments to reduce the risk of losses shortly before funds are needed.

Venture capital is a form of financing provided to young companies that are in the early stages of development but are believed to have the potential for extremely rapid growth. The funding usually comes from specialized investment firms called venture capital firms, which raise money from wealthy individuals, pension funds, university endowments, and institutional investors. These firms invest that pooled capital into startup companies in exchange for equity, which is ownership in the business. Because startups often have little revenue, unproven products, and uncertain markets, traditional lenders such as banks are usually unwilling to provide loans. Venture capital fills this gap by accepting very high risk in exchange for the possibility of extremely large returns if the company becomes successful. Venture capitalists typically look for businesses capable of scaling quickly, meaning they can grow revenue rapidly without proportionally increasing costs. This type of growth is common in industries such as technology, biotechnology, and software. When a venture-backed company grows successfully, investors eventually recover their profits through an exit event, which occurs when the company is sold to another corporation or becomes publicly traded through an initial public offering, commonly called an IPO. Because venture capital involves ownership, founders often give up a portion of control over the company, since investors may receive voting rights, board seats, and influence over major strategic decisions.

Over-the-counter trading, commonly abbreviated as OTC, refers to the buying and selling of financial securities directly between two parties rather than through a centralized stock exchange. In traditional stock exchanges such as the New York Stock Exchange (NYSE) or NASDAQ, buyers and sellers meet through an organized marketplace with standardized rules, listing requirements, and regulatory oversight. In OTC markets, transactions occur through a network of dealers and brokers who negotiate prices directly with one another. Many securities traded over the counter belong to smaller companies that do not meet the financial or regulatory requirements necessary to list on a major exchange. OTC markets also include certain types of bonds, foreign company shares, and complex financial instruments called derivatives, which are contracts whose value depends on the price of another asset. Because OTC markets are less regulated and involve companies with less public financial information, they often carry greater investment risk. Prices can be more volatile, liquidity—meaning the ease of buying or selling an asset—may be lower, and reliable financial reporting may be limited.

Stock represents partial ownership in a company. When a company issues stock, it divides ownership of the business into units called shares. Each share represents a fractional claim on the company's assets, earnings, and future growth. Individuals who purchase shares become shareholders, meaning they are owners of a portion of the company. Shareholders may benefit from the company's success in two primary ways: increases in the stock's market price and distributions of company profits through dividends. Stocks are typically traded on organized exchanges where investors buy and sell shares through brokerage firms. The price of a stock is determined by the forces of supply and demand, meaning how many investors want to buy shares compared with how many want to sell them. If investors believe a company's future earnings will grow, demand for its shares increases, causing the price to rise. If confidence declines or profits fall, the price may decrease. Over long periods, stock ownership has historically been one of the primary ways individuals build wealth because successful companies can grow substantially in value over time.

A call option and a put option are financial contracts known as options, which give the holder the right—but not the obligation—to buy or sell a specific asset at a predetermined price within a defined period of time. The asset underlying the option is typically a stock. A call option gives the holder the right to buy shares at a fixed price known as the strike price before the option expires. Investors purchase call options when they expect the underlying stock price to rise above the strike price. A put option gives the holder the right to sell shares at a predetermined strike price before expiration. Investors purchase put options when they expect the stock price to decline. Options are often used for speculation, meaning attempting to profit from predicted price movements, but they are also widely used for hedging, which means reducing potential losses from existing investments. For example, an investor who owns stock may purchase a put option to protect against a decline in the stock's price, functioning similarly to an insurance policy on the investment.

A reverse stock split is a corporate action in which a company reduces the total number of its outstanding shares while increasing the price per share proportionally. The overall value of the company and the total value of an investor's holdings remain unchanged immediately after the split. For example, in a 1-for-5 reverse split, every five existing shares are combined into one new share. If an investor owned 100 shares priced at $2 each before the split, they would own 20 shares priced at $10 each afterward. Companies sometimes implement reverse splits when their stock price has fallen very low and they want to increase the price to meet the listing requirements of stock exchanges. Many exchanges require a minimum share price to remain listed. Reverse splits can also influence investor perception, since extremely low-priced stocks are sometimes associated with financial distress or speculative trading.

A prospectus is a detailed legal document provided to potential investors when a company offers securities for sale. The prospectus serves as a disclosure document explaining the essential facts about the investment opportunity so that investors can make informed decisions. It typically includes information about the company's business model, financial statements, management team, competitive environment, potential risks, and the intended use of funds raised through the offering. Prospectuses are especially important during initial public offerings, when companies first sell shares to the public. Securities regulators require these documents because transparency helps protect investors from fraud or misleading claims. The prospectus outlines the company's historical financial performance, including revenue, expenses, assets, and liabilities, which allows investors to evaluate the company's financial health. It also describes possible risks such as industry competition, regulatory challenges, or dependence on certain products or markets.

A blue chip stock refers to shares of large, established companies with long histories of stable earnings, strong financial performance, and widely recognized brand names. The term originates from the game of poker, where blue chips traditionally represent the highest-value betting tokens. In finance, blue chip companies are typically leaders in their industries and possess significant financial resources, global operations, and consistent profitability. These companies often generate steady revenue streams and may distribute regular dividends to shareholders. Because of their size, financial strength, and reputation, blue chip stocks are often considered relatively stable compared with smaller companies. However, they are not immune to economic cycles, changes in consumer demand, or shifts in industry conditions. Even large, well-established companies can experience declines in revenue or market value during recessions or technological disruptions.

A dividend is a distribution of a company's profits paid to shareholders. When a company generates earnings, its management must decide how those profits will be used. Some profits are reinvested into the business to fund expansion, research, or acquisitions. Another portion may be returned to shareholders as dividends. Dividends are commonly paid in cash, though companies may also issue additional shares in what is known as a stock dividend. Many dividend-paying companies distribute payments on a regular schedule, often quarterly. Dividends provide investors with a source of income separate from increases in the stock's price. Companies that pay dividends are often mature businesses with stable earnings rather than rapidly growing firms that prefer to reinvest all profits. Some investors choose to reinvest dividends, meaning the dividend payments are automatically used to purchase additional shares, allowing investment returns to compound over time.

A stock split is a corporate action in which a company increases the number of its outstanding shares while proportionally lowering the price per share. The total value of the company and the value of an investor’s holdings remain unchanged immediately after the split. For example, in a 2-for-1 stock split, every existing share becomes two shares, each priced at half the previous value. If an investor owned 100 shares priced at $80 each before the split, they would own 200 shares priced at $40 each afterward. Companies often perform stock splits when their share price becomes very high, which may discourage smaller investors from purchasing the stock. By lowering the price per share while increasing the number of shares available, the company may improve trading liquidity and make the stock appear more accessible to investors.

Preferred stock is a special class of ownership in a corporation that has characteristics of both stocks and bonds. Like common stock, preferred stock represents an ownership interest in the company. However, preferred shareholders typically receive fixed dividend payments that are paid before dividends to common shareholders. These dividend payments resemble interest payments on bonds because they are usually predetermined rather than variable. In addition, preferred shareholders generally have a higher claim on the company’s assets if the company is liquidated, meaning its assets are sold to repay creditors and investors. However, preferred shareholders usually do not have voting rights in corporate decisions, which are typically reserved for common shareholders. Because of their predictable dividend payments and higher priority in liquidation, preferred shares are often considered less volatile than common stock, although they still carry risk if the issuing company experiences financial difficulty.