



Focus on Personal Finance

An Active Approach
to Help You Achieve Financial Literacy

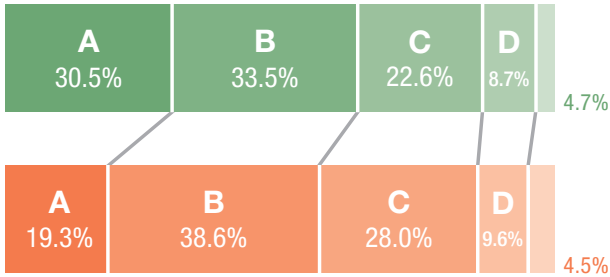
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Fifth Edition

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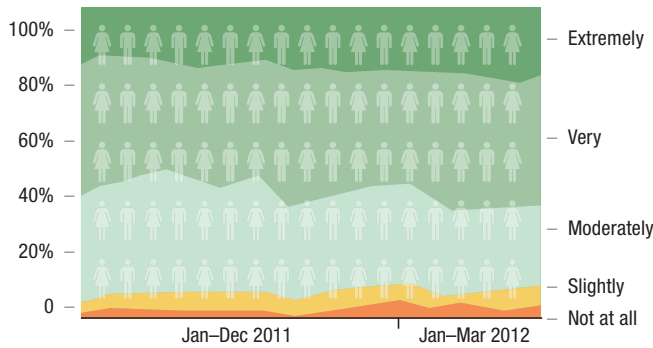
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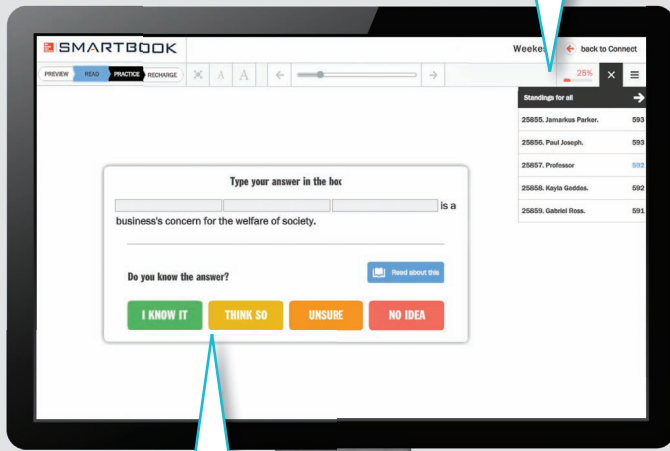
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Focus on Personal Finance

An Active Approach to Help You Achieve Financial Literacy

FIFTH EDITION

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Stephen A. Ross,

Franco Modigliani Professor of Finance and Economics, Sloan School of Management,
Massachusetts Institute of Technology, Consulting Editor

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Financial Literacy**

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COLLEGE OF DUPAGE

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Robert J. Hughes

DALLAS COUNTY COMMUNITY COLLEGES

Melissa M. Hart

NORTH CAROLINA STATE UNIVERSITY



FOCUS ON PERSONAL FINANCE: AN ACTIVE APPROACH TO HELP YOU ACHIEVE FINANCIAL LITERACY, FIFTH EDITION

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This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 0 RMN/RMN 1 0 9 8 7 6 5 4

ISBN 978-0-07-786174-2

MHID 0-07-786174-4

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Compositor: *SPi Global*

Printer: *R. R. Donnelley*

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Library of Congress Cataloging-in-Publication Data

Kapoor, Jack R., 1937–

Focus on personal finance : an active approach to help you achieve financial literacy/Jack R. Kapoor, Les R. Dlabay, Robert J. Hughes, Melissa M. Hart.—Fifth edition.
pages cm

ISBN 978-0-07-786174-2 (alk. paper)

1. Finance, Personal. 2. Investments. I. Dlabay, Les R. II. Hughes, Robert James, 1946– III. Hart, Melissa M. IV. Title.

HG179.K368 2016

332.024—dc23

2014041672

The Internet addresses listed in the text were accurate at the time of publication. The inclusion of a website does not indicate an endorsement by the authors or McGraw-Hill Education, and McGraw-Hill Education does not guarantee the accuracy of the information presented at these sites.

Dedication

To my wife, Theresa, and my children, Karen, Kathryn, and Dave; and in the memory of my parents, Ram and Sheela Kapoor

To my wife, Linda, and my children, Carissa and Kyle; and the memory of my parents, Les and Mary Dlabay

To my mother, Barbara Y. Hughes; and my wife, Peggy

To my husband, David Hart; and my children, Alex and Madelyn

Focus on . . . the Authors

Jack R. Kapoor, EdD, College of DuPage

Jack Kapoor is a professor of business and economics in the Business and Technology Division of the College of DuPage, Glen Ellyn, Illinois, where he has taught business and economics since 1969. He received his BA and MS from San Francisco State College and his EdD from Northern Illinois University. He previously taught at Illinois Institute of Technology's Stuart School of Management, San Francisco State University's School of World Business, and other colleges. Professor Kapoor was awarded the Business and Technology Division's Outstanding Professor Award for 1999–2000. He served as an assistant national bank examiner for the U.S. Treasury Department and has been an international trade consultant to Bolting Manufacturing Co., Ltd., Mumbai, India.

Dr. Kapoor is known internationally as a co-author of several textbooks, including *Business: A Practical Approach* (Rand McNally), *Business* (Cengage Learning), *Business and Personal Finance* (Glencoe), and *Personal Finance* (McGraw-Hill). He served as a content consultant for the popular national television series *The Business File: An Introduction to Business* and developed two full-length audio courses in Business and Personal Finance. He has been quoted in many national newspapers and magazines, including *USA Today*, *U.S. News & World Report*, the *Chicago Sun-Times*, *Crain's Small Business*, the *Chicago Tribune*, and other publications.

Dr. Kapoor has traveled around the world and has studied business practices in capitalist, socialist, and communist countries.

Les R. Dlabay, EdD, Lake Forest College

Teaching about the “Forgotten Majority” (the three billion people living on \$2 or less a day) is a priority of Les Dlabay, professor of business at Lake Forest College, Lake Forest, Illinois. He believes our society can improve global business development through volunteer time, knowledge sharing, and financial donations. In addition to writing several textbooks, Dr. Dlabay teaches accounting and various international business courses. His “hobbies” include a collection of cereal packages from over 100 countries and banknotes from 200 countries, which are used to teach about economic, cultural, and political aspects of international business environments.

His research involves informal and alternative financial services, microfinance, and value chain facilitation in base-of-the-pyramid (BoP) market settings. Dlabay has presented more than 300 workshops and seminars for teachers and community organizations. He serves on the boards of Bright Hope International (www.brighthope.org), which emphasizes microenterprise development through microfinance programs, and Andean Aid (www.andeanaid.org), which provides tutoring assistance to school-age children in Colombia and Venezuela. Professor Dlabay has a BS (Accounting) from the University of Illinois, Chicago; an MBA from DePaul University; and an EdD in Business and Economic Education from Northern Illinois University. He has twice received the “Great Teacher” award at Lake Forest College.

Robert J. Hughes, EdD, *Dallas County Community Colleges*

Financial literacy! Only two words, but Bob Hughes, professor of business at Dallas County Community Colleges, believes that these two words can change your life. Whether you want to be rich or just manage the money you have, the ability to analyze financial decisions and gather financial information are skills that can always be improved. Dr. Hughes has taught personal finance, introduction to business, business math, small business management, small business finance, and accounting for over 35 years. In addition to *Focus on Personal Finance* and *Personal Finance*, published by McGraw-Hill/Irwin, he has authored college textbooks for Introduction to Business, Business Mathematics, and Small Business Management. He also served as a content consultant for two popular national television series, *Dollars & Sense: Personal Finance for the 21st Century* and *It's Strictly Business*, and he is the lead author for a business math project utilizing computer-assisted instruction funded by the ALEKS Corporation. He received his BBA from Southern Nazarene University and his MBA and EdD from the University of North Texas. His hobbies include writing, investing, collecting French antiques, art, and travel.

Melissa M. Hart, CPA *North Carolina State University*

Melissa Hart is a permanent lecturer in the Poole College of Management at North Carolina State University. She was inducted into the Academy of Outstanding Teachers in 2012. She teaches courses in personal finance and corporate finance. She has developed multiple ways to use technology to introduce real-life situations into the classroom and the distance education environment. Spreading the word about financial literacy has always been a passion of hers. It doesn't stop at the classroom. Each year she shares her common-sense approach of "No plan is a plan" to various student groups, clubs, high schools, and outside organizations. She is a member of the North Carolina Association of Certified Public Accountants (NCACPA) where she serves on the Accounting Education Committee. She received her BBA from the University of Maryland and an MBA from North Carolina State University. Prior to obtaining an MBA, she worked eight years in public accounting in auditing, tax compliance, and consulting. Her hobbies include keeping up with her family's many extracurricular activities as well as working on various crafts. She travels extensively with her family to enjoy the many cultures and beauty of the state, the country, and the world.

Dear Personal Finance Students and Professors

Question: How important are the financial decisions you make?



Answer: Because financial decisions can change your life, they are very important. Just for a moment think about the decisions you make every day. For example:

- What happens if you run out of money before your next payday?
- Should you pay cash or use a credit card?
- How much insurance do you need?
- Is this a good investment?
- How much should you save for retirement?

For most people, the answers to questions like these affect not only their financial security, but also their quality of life. And while the answers to these questions are based on your unique personal situation, this book and accompanying digital study tools are designed to help you discover the answers to these questions, and many more.

Text (or eBook)

While the new, fifth edition of *Focus on Personal Finance* does not guarantee that you will become a millionaire, it does provide the information you need to develop a plan to achieve financial security. New to this edition is the “3 Steps to Financial Literacy” feature. Each of the three steps is designed to give you a starting point to help master the material in each chapter and includes websites and apps to help you start your personal financial journey. Current content, examples, exhibits, and box features within each chapter also illustrate how to apply important concepts to your life. And at the end of each chapter, a chapter summary, discussion questions, financial problems, and cases help you reinforce important concepts and review for exams. This edition also includes a new continuing case that illustrates the financial challenges a young couple experiences as they journey through the ups and downs of life. Finally “Your Personal Financial Plan” sheets at the end of each chapter help you build a plan that will enable you to achieve your personal and financial goals both now and in the future.

Digital Package

As authors, we recognize the importance of providing quality digital products to enhance learning. We're especially proud of our digital study tools that accompany this edition. For example, both the McGraw-Hill Connect™ and LearnSmart websites contain student learning activities—all designed to help you experience success. For more information about these digital products, visit the McGraw-Hill website at www.mheducation.com.

Thank You

We sincerely thank you for your current and past support of *Focus on Personal Finance*. We invite you to take a look at this new edition to see how *Focus on Personal Finance* can help you create the “right” financial plan to help you achieve your personal and financial goals. Finally, we encourage you to email us if you have comments or suggestions about the text or our digital study tools.

Welcome to the new *Focus on Personal Finance*!

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New to This Edition

The fifth edition of *Focus on Personal Finance* contains new and updated boxed features, exhibits and tables, articles, and end-of-chapter material. The following grid highlights some of the more significant content revisions made to *Focus*, 5e.

Global Changes for all chapters

- New chapter opener.
- Action items for each learning objective.
- A revised *Your Personal Finance Dashboard* feature at the end of each chapter.
- A new *Continuing Case* feature at the end of each chapter.
- Revised and updated problems.
- Updated websites and apps on all “Your Personal Financial Plan” sheets.

<p>CHAPTER 1 Personal Financial Planning in Action</p>	<ul style="list-style-type: none"> • Revised Exhibit 1–1 with expanded financial activities for various life situations. • New coverage of the role of the financial system for personal financial decisions. • New Exhibit 1–2 with an overview of the financial intermediaries and markets that facilitate personal financial decisions. • Revised <i>Figure It Out!</i> feature on using time value of money for achieving financial goals comparing formula, table, spreadsheet, and financial calculator methods.
<p>CHAPTER 2 Money Management Skills</p>	<ul style="list-style-type: none"> • Revised Exhibit 2–1 with suggestions for storing and organizing financial documents in various formats. • New content on storing financial documents “in the cloud.” • New in-text example for calculating net worth. • Updated content on selecting a savings technique. • New <i>From the Pages of Kiplinger’s Personal Finance</i> with suggestions for budgeting and tracking your finances. • New end-of-chapter case to evaluate and recommend actions for a household budget.
<p>CHAPTER 3 Taxes in Your Financial Plan</p>	<ul style="list-style-type: none"> • New <i>Caution!</i> feature on IRS scams. • Updated tax rate schedules (for 2014). • Updated section: Calculating your Tax. • Revised <i>Figure It Out!</i> feature: Short-Term and Long-Term Capital Gains. • Revised <i>Personal Finance in Practice</i>: New tax form exhibits. • Revised Exhibits 3–3 and 3–4 give updated tax forms. • Revised Exhibit 3–5, showing tax tables and tax rate schedules. • Updated electronic filing instructions. • New coverage: 529 plan tax implications. • New <i>From the Pages of Kiplinger’s Personal Finance</i> feature on taxes to consider when traveling. • Revised content on tax strategies. • Revised <i>Figure It Out!</i> feature: Tax Credits vs. Tax Deductions.

<p>CHAPTER 4 Financial Services: Savings Plans and Payment Accounts</p>	<ul style="list-style-type: none"> • Updated and expanded coverage of online and mobile banking. • New coverage of the expanded use of and many fees associated with prepaid debit cards. • New Exhibit 4–2 provides an overview of mobile banking services. • Updated coverage of “problematic” financial services such as pawnshops, payday loan companies, and rent-to-own centers. • New <i>From the Pages of Kiplinger’s Personal Finance</i> covering techniques for enhanced saving. • Updated coverage of various types of certificates of deposit. • New coverage of peer-to-peer payments, which allows the transfer of money to another person by e-mail or with a secured website. • New <i>Digi-Know?</i> with coverage of chip-embedded credit and debit cards to enhance security and reduce fraud.
<p>CHAPTER 5 Consumer Credit Advantages, Disadvantages Sources, and Costs</p>	<ul style="list-style-type: none"> • New content in Advantages of Credit section highlighting the benefits that major credit card issuers provide to their customers. • New summary of advantages and disadvantages of credit. • Updated Exhibit 5–2: Volume of Consumer Credit. • Updated <i>Did You Know?</i> feature in the Credit Card section. • Updated statistics for stored value cards for 2014. • Updated <i>Did You Know?</i> feature in the Applying for Credit section. • New material on credit scores: What is a credit score and what factors are used to calculate it? • New <i>Did You Know?</i> feature: What’s in Your FICO Score? • New material on FICO and VantageScore: the consequences of not maintaining a sound credit score can be very costly. • New What Can You Do to Improve Your Credit Score? section and information on how you can avoid credit-repair scams. • New <i>From the Pages of Kiplinger’s Personal Finance</i> feature on how to combat data theft. • New material in Cosigning a Loan section: Private lenders are placing borrowers into default and making balance due all at once when the cosigner dies or files for bankruptcy. • New material on the Consumer Financial Protection Bureau’s activities in 2014. • Updated material in the Chapter 7 Bankruptcy section on filing and administrative fees. • Updated Exhibit 5–10: U.S. Consumer Bankruptcy Filings, 1980–2014.
<p>CHAPTER 6 Consumer Purchasing Strategies and Wise Buying of Motor Vehicles</p>	<ul style="list-style-type: none"> • New <i>Did You Know?</i> feature that provides money-saving tips and actions to avoid overspending. • New <i>Caution!</i> feature warning shoppers about buying fake and counterfeit products that can waste money and be dangerous. • New <i>From the Pages of Kiplinger’s Personal Finance</i> comparing various sources of previously-driven vehicles. • New “Upside Down” example warning consumers to avoid a situation in which the loan amount owed may exceed the current value of the vehicle. • Revised text coverage of the consumer complaint process.

<p>CHAPTER 6 (Cont.)</p>	<ul style="list-style-type: none"> • New Exhibit 6–6 with detailed information for each step of the consumer complaint process. • New <i>Did You Know?</i> feature with suggested websites to assist with basic legal documents.
<p>CHAPTER 7 Selecting and Financing Housing</p>	<ul style="list-style-type: none"> • Revised coverage of standard lease forms when renting. • New <i>From the Pages of Kiplinger’s Personal Finance</i> covering current advice on renting or buying your housing. • Updated information on the process for financing a home purchase. • Revised content on types of mortgages. • Updated information on common closing costs (Exhibit 7–9). • Expanded information on actions to take when attempting to lower your property taxes.
<p>CHAPTER 8 Home and Automobile Insurance</p>	<ul style="list-style-type: none"> • Added new material on Superstorm Sandy in the Potential Property Losses section. • Updated <i>Personal Finance in Practice</i> feature on flood facts. • New <i>From the Pages of Kiplinger’s Personal Finance</i> feature: “If my home is damaged by a summer storm, will my insurance cover repairs?” • New <i>Personal Finance in Practice</i> feature: Are You Covered?
<p>CHAPTER 9 Health and Disability Income insurance</p>	<ul style="list-style-type: none"> • New <i>From the Pages of Kiplinger’s Personal Finance</i> feature on long-term care. • Updated material in the <i>Personal Finance in Practice</i> box; HSAs: How They Work in 2014. • New and revised material in the Health Insurance and the Patient Protection and Affordable Care Act of 2010 section. • New section on the Affordable Care Act and the Individual Shared Responsibility provision. • New <i>Personal Finance in Practice</i> feature on the Affordable Care Act: Checklist for You and Your Family. • Updated and revised the section on high medical costs. • Updated Exhibit 9–6: U.S. National Health Expenditures, 1960–2022. • New <i>Did You Know?</i> feature: The average cost of a 3-day hospital stay. • New <i>Did You Know?</i> feature: Victims of medical identity theft.
<p>CHAPTER 10 Financial Planning with Life Insurance</p>	<ul style="list-style-type: none"> • Updated the How Long Will You Live? section. • Updated Exhibit 10–1: Life Expectancy Tables, All Races, 2009. • Revised the Types of Life Insurance Companies and Policies section. • New <i>Did You Know?</i> feature: 75 million American families depend on life insurance products. • Added new material in the Term Life Insurance section. • New <i>Did You Know?</i> feature: 146 million individual life insurance policies in force in 2013. • Expanded the discussion on group life insurance. • New <i>Did You Know?</i> feature: What to do if you lose your life insurance policy. • New <i>Did You Know?</i> feature: Insurance industry payouts.

<p>CHAPTER 10 (Cont.)</p>	<ul style="list-style-type: none"> Expanded discussion on annuities. New discussion on index annuities. New <i>Caution!</i> feature emphasizes that an annuity is a long-term financial contract.
<p>CHAPTER 11 Investing Basics and Evaluating Bonds</p>	<ul style="list-style-type: none"> A new <i>From the Pages of Kiplinger's Personal Finance</i> feature provides tips for saving money and tactics to improve money management. A new <i>Did You Know?</i> feature provides information about the Motley Fool and Kiplinger websites. Updated material and new examples are used in the section How the Time Value of Money Affects Your Investments. New material about the risks of lost income and decrease in value is provided in the section Safety and Risk section. A new Exhibit 11–3 helps students determine their investment risk profile. In the Factors That Reduce Investment Risk section, updated statistics for the long-term performance of stocks and bonds are provided. A new <i>Digi-Know?</i> feature provides information about the Treasury Direct website at www.treasurydirect.gov. A new convertible bond example for Wesco Corporation is included in the Types of Bonds section. New information about the speculative nature of high-yield (junk) bonds is provided in the Types of Bonds section. A new example describes how Union Pacific Corporation used a sinking fund to make sure funds were available to repay a corporate bond issue. An updated <i>Did You Know?</i> feature provides information about the yields for 10-year U.S. treasury notes and high-grade corporate bonds. A new interest calculation for a 4 percent IBM bond is provided in the Interest Income section. A new example for calculating approximate market value is included in the Dollar Appreciation of Bond Value section. An updated Exhibit 11–7 provides current information found on the Yahoo! bond website for an AT&T bond. An updated <i>Case in Point</i> provides revised or new investment options that students must evaluate.
<p>CHAPTER 12 Investing in Stocks</p>	<ul style="list-style-type: none"> Updated statistics for the long-term performance of stocks and bonds is provided in the Common and Preferred Stock section. A new Exhibit 12–1 provides information on the record date and ex-dividend date for a Microsoft quarterly dividend. A new <i>Did You Know?</i> feature provides information about how fraudsters use a practice called “pump and dump” to increase the price of a stock before selling the stock at a profit. The Dollar Appreciation of Value section and a new Exhibit 12–2 illustrate how investors made money by buying and then selling Johnson & Johnson stock at the end of a three-year period. In the Possibility of Increased Value from Stock Splits section, the effect of a two-for-one stock split by Under Armour is explained.

<p>CHAPTER 12 (Cont.)</p>	<ul style="list-style-type: none"> • Exhibit 12–3 now provides revised definitions for blue-chip, micro cap, and penny stocks. • The information available on the Yahoo! Finance website for Facebook is discussed in the updated The Internet section and a new Exhibit 12–4. • A discussion of the information available from Value Line for the Disney Corporation is provided in the Stock Advisory Services section and a new Exhibit 12–5. • A new <i>From the Pages of Kiplinger’s Personal Finance</i> feature presents information about how investors can use the information in a firm’s annual report to become better investors. • An updated <i>Did You Know?</i> feature provides information on the Dow Jones Industrial Average. • New and updated examples are included in the Numerical Measures That Influence Investment Decisions section. • A new example includes information about projected earnings for Starbucks in the Projected Earnings section. • New information on beta and an example of a beta calculation for Google is provided in the Other Factors That Influence the Price of a Stock section. • A new example describes how Papa Murphy’s used an initial public offering (IPO) to obtain financing. • A new <i>Did You Know?</i> feature describes investor options for holding securities (physical certificates, street name, or direct registration) until they are sold. • A new Exhibit 12–6 illustrates typical commissions charged for online, telephone, and broker-assisted stock transactions. • In the Sample Stock Transactions section, a new example provides information about a limit order for eBay. • In the Sample Stock Transactions section, a new example provides information about a stop-loss order for General Motors. • A new <i>Personal Finance in Practice</i> feature describes the techniques investors can use to pick a winning stock. • Exhibit 12–7 illustrates the dollar cost averaging concept for an investment in Johnson & Johnson over a seven-year period using current stock values. • In the Selling Short section, a new example describes how an investor could profit using the selling short technique for a General Motors stock transaction. • A new <i>Case in Point</i> asks students to evaluate the Disney Corporation using the information in the Value Line report in Exhibit 12–5.
<p>CHAPTER 13 Investing in Mutual Funds</p>	<ul style="list-style-type: none"> • To illustrate how important funds are for investors, updated statistics are provided in the Why Investors Choose Mutual Funds section. • An updated <i>Did You Know?</i> feature provides information about who owns mutual funds. • A new Exhibit 13–1 provides information about the type of securities contained in the Invesco Dividend Income Fund. • New statistics about the number of closed-end, exchange-traded, and open-end funds are included in the Characteristics of Funds section. • The fee table in Exhibit 13–2 has been updated to illustrate current fees for the Davis Opportunity Fund. • The investment objective for the Vanguard Mid-Cap Fund is now included in the Classification of Mutual Funds section.

<p>CHAPTER 13 (Cont.)</p>	<ul style="list-style-type: none"> • A new <i>Did You Know?</i> feature illustrates the type of funds investors use to obtain their financial goals. • The number of socially responsible funds has been updated in the <i>Did You Know?</i> feature. • A new <i>From the Pages of Kiplinger's Personal Finance</i> feature describes how employees can lower the fees associated with their retirement accounts. • A new Exhibit 13–4 describes the information about the T. Rowe Price Value Fund available from the Morningstar website. • A detailed Morningstar research report for the Oakmark Global Select I Fund is illustrated in Exhibit 13–5. • A new Exhibit 13–6 describes a portion of the funds included in the “Kiplinger 25” list of funds. • In the Return on Investment section, the example for the Fidelity Stock Selector All-Cap Fund has been updated with current price information. • A new <i>Did You Know?</i> feature provides both new and updated information about the characteristics of mutual fund owners. • A new <i>Case in Point</i> asks students to evaluate the Oakmark Global Select I Fund using the information in the Morningstar report illustrated in Exhibit 13–5.
<p>CHAPTER 14 Starting Early: Retirement and Estate Planning</p>	<ul style="list-style-type: none"> • New Saving Smart for Retirement section. • Updated Exhibit 14–2: How an Average Older (65+) Household Spends Its Money. • New <i>Caution!</i> box on safeguarding your Social Security card. • Revised <i>Did You Know?</i> feature: Estimated average monthly Social Security benefits in 2014. • Revised and updated the section on Individual Retirement Accounts. • New <i>Did You Know?</i> feature: Roth IRAs versus traditional IRAs. • New <i>From the Pages of Kiplinger's Personal Finance</i> feature: Roth 401(k)s. • New <i>Did You Know?</i> feature: IRA assets in 2013. • Updated stated amount will. • Updated credit shelter trust. • Updated estate taxes and gift taxes.
<p>APPENDIX A Education Financing, Loans, and Scholarships</p>	<ul style="list-style-type: none"> • New Exhibit A–1: Education compared to earnings and unemployment. • Revised information for the 2014–15 academic year for loans and federal grants. • New Exhibit A–3: Student loan default statistics.
<p>APPENDIX B Developing a Career Search Strategy</p>	<ul style="list-style-type: none"> • New highlighted example on social media résumés through LinkedIn, Twitter, and other online networks. • Revised coverage for a professional presentation of your résumé. • Additional suggestions for a résumé makeover (Exhibit B–1). • Revised Exhibit B–2 with a sample cover letter. • Updated coverage on techniques for submitting a résumé. • New Exhibit B–4 with suggestions for updating career planning activities.

Focus on . . . Learning

GET INSIDE THE BOOK

Three Steps to Financial Literacy

Getting your finances in order is simpler than you think, and we're here to show you how. These new chapter opening features break down key action items you need to take to address the most important personal finance issues from the chapter, as part of this edition's emphasis on taking action. These steps tie in to the "Your Personal Finance Dashboard" feature at the end of each chapter.



Financial Decisions

the money available. However, the amount, along with needs and vary from person to person. In this book, you will have the opportunity to learn about varied financial paths, and move forward with security.


to handle their finances so that they get full satisfaction from each financial goal may include buying a new car or a larger home, further training, contributing to charity, traveling extensively, and ensuring working and retirement years. To achieve these and other goals, and set priorities. Financial and personal satisfaction are the result of a plan that is commonly referred to as *personal money management* or *financial planning*.

Financial Planning and Financial Planning

Financial planning is the process of managing your money to achieve personal goals. This planning process allows you to control your financial situation, and your household has a unique situation; therefore, financial decisions are made to meet specific needs and goals.

A financial plan can enhance the quality of your life and increase your confidence about your future needs and resources. A **financial plan** is a report that summarizes your current financial situation, analyzes your

LO1.1
Identify social and economic influences on personal financial goals and decisions.



ACTION ITEM
Do you have an emergency fund for unexpected expenses?
 Yes No

personal financial planning The process of managing your money to achieve personal economic satisfaction.

financial plan A formalized report that summarizes your current financial situation.

Learning Objective References

Citations in the margins next to the relevant text refer to corresponding chapter objectives listed at the beginning of each chapter.

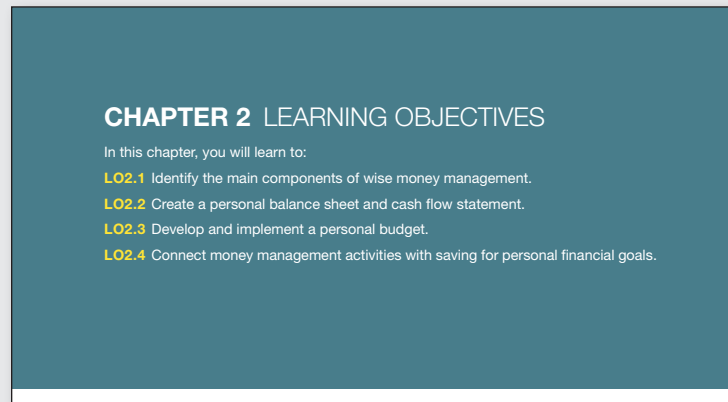
Action Items

As part of this edition's emphasis on taking action to gain financial skills, *new* Action Items are posted at the start of each main section of a chapter. These are designed to get you thinking about what daily actions you can be taking to achieve financial literacy and independence.

An interactive and engaging chapter opener gets students organized and demonstrates the relevance of the material to their own lives.

Learning Objectives

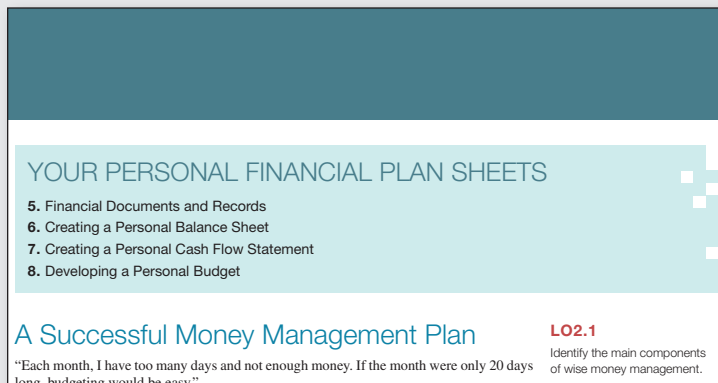
Learning objectives highlight the goals of each chapter for easy reference. Throughout the book, in the end-of-chapter material, and even in the supplement materials, these objectives provide a valuable foundation for assessment.



CHAPTER 2 LEARNING OBJECTIVES

In this chapter, you will learn to:

- LO2.1** Identify the main components of wise money management.
- LO2.2** Create a personal balance sheet and cash flow statement.
- LO2.3** Develop and implement a personal budget.
- LO2.4** Connect money management activities with saving for personal financial goals.



YOUR PERSONAL FINANCIAL PLAN SHEETS

- 5. Financial Documents and Records
- 6. Creating a Personal Balance Sheet
- 7. Creating a Personal Cash Flow Statement
- 8. Developing a Personal Budget

A Successful Money Management Plan

“Each month, I have too many days and not enough money. If the month were only 20 days long, budgeting would be easy.”

LO2.1
Identify the main components of wise money management.

Your Personal Financial Plan Sheets

A list of the “Your Personal Financial Plan” worksheets for each chapter is presented at the start of each chapter for easy reference.

Examples

Worked-out examples featuring key concepts and calculations appear throughout the text, a valuable feature for students to see how personal finance works in practice.

have not yet repaid. The more often you make payments, the lower the interest you'll pay. Most credit unions use this method.

EXAMPLE: Using the Simple Interest Formula on the Declining Balance

Using simple interest on the declining balance to compute interest charges, the interest on a 5 percent, \$1,000 loan repaid in two payments, one at the end of the first half-year and another at the end of the second half-year, would be \$37.50, as follows:

First payment:

$$\begin{aligned} I &= P \times r \times T \\ &= \$1,000 \times 0.05 \times 1/2 \\ &= \$25 \text{ interest plus } \$500, \text{ or } \$525 \end{aligned}$$

Second payment:

$$\begin{aligned} I &= P \times r \times T \\ &= \$500 \times 0.05 \times 1/2 \\ &= \$12.50 \text{ interest plus the remaining balance of } \$500, \text{ or } \$512.50 \end{aligned}$$

Total payment on the loan:

$$\$525 + \$512.50 = \$1,037.50$$

Using the APR formula,

$$\text{APR} = \frac{2 \times n \times I}{P(N + 1)} = \frac{2 \times 2 \times \$37.50}{\$1,000(2 + 1)} = \frac{\$150}{\$3,000} = 0.05, \text{ or } 5 \text{ percent}$$

ADD-ON INTEREST With the add-on interest method, interest is calculated on the full amount of the original principal, no matter how frequently you make payments. When

stores, charging a meal at a restaurant, and using overdraft -end credit. As you will soon see, you do not apply for open-phase, as you do with closed-end credit. Rather, you can use chases you wish if you do not exceed your **line of credit**, the fit the lender has made available to you. You may have to pay the use of credit, or other finance charges. Usually you have within 30 days without interest charges or to make set monthly int balance plus interest. Some creditors allow you a grace bill in full before you incur any interest charges.

g check credit. Also called a *bank line of credit*, this is a ed amount that you can use by writing a special check. ents over a set period. The finance charges are based on the e month and on the outstanding balance.

line of credit The dollar amount, which may or may not be borrowed, that a lender makes available to a borrower.

interest A periodic charge for the use of credit.

revolving check credit A prearranged loan from a bank for a specified amount; also called a *bank line of credit*.

ular. The average cardholder has more than nine credit d gasoline cards. Cardholders who pay off their balances in vn as *convenience* users. Cardholders who do not pay off known as *borrowers*.

offer a grace period, a time period during which no finance ccount. A **finance charge** is the total dollar amount you pay

finance charge The total dollar amount paid to use credit.

Key Terms

Key terms appear in bold type within the text and are defined in the margins. A list of key terms and page references is located at the end of each chapter.

Your Personal Financial Plan Sheet References

The integrated use of the “Your Personal Financial Plan” sheets is highlighted with an icon. This visual helps integrate this study resource into the learning process and continue to track personal financial habits.

Methods can help you select the best course of action for funding needs, educational expenses, and retirement needs of dependents.

Sheet 1 Personal Financial Data

operation of the financial system and personal financial decisions?
 person would tend to “suffer” or tend to “benefit” from inflation.

suffer	benefit
suffer	benefit
suffer	benefit
suffer	benefit

the recent inflation rate that reflects the change in price for

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PRACTICE QUIZ 1-1

1. How do personal and economic factors affect the operation of the financial system?
2. For each of the following situations, indicate if the person would tend to suffer or benefit from inflation. (Circle your answer)

A person with money in a savings account.	suffer	benefit
A person who is borrowing money.	suffer	benefit
A person who is lending money.	suffer	benefit
A person receiving a fixed income amount.	suffer	benefit

Apply Yourself!

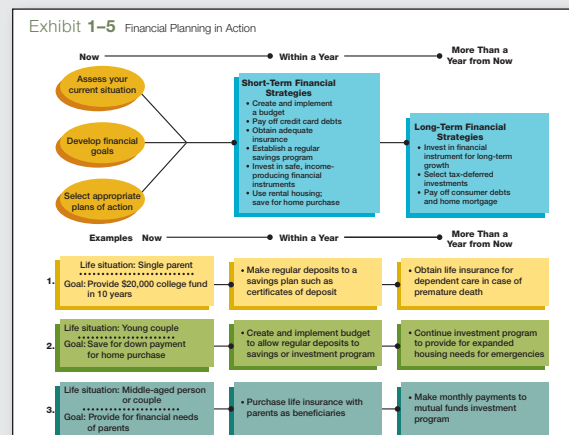
Using online research and discussion with others, calculate the recent inflation rate for items frequently bought by you and your family.

Practice Quizzes

Practice Quizzes at the end of each major section provide questions to help assess knowledge of the main ideas covered in that section. These will determine whether concepts have been mastered or if a need exists to do additional study on certain topics.

Exhibits and Tables

Throughout the text, exhibits and tables visually illustrate important personal finance concepts and processes.



Focus on . . . Personal Finance in Real Life

Did You Know?

Each chapter contains several *Did You Know?* boxes. The **yellow** notes contain fun facts, information, and financial planning assistance for wise personal financial actions.

Green *Did You Know?* boxes recommend socially conscious financial activities for students interested in giving back to others.

Blue *Digi-Know?* boxes share tips and topics on using technology to help manage your finances.

did you know?



According to the National Endowment for Financial Education, 70 percent of major lottery winners end up with financial difficulties. These winners often squander the funds awarded them, while others overspend and many end up declaring bankruptcy. Having more money does not automatically mean making better financial planning choices.

STEP 2: Develop Your Financial Goal

You should periodically analyze your financial values and goals. The purpose of this analysis is to differentiate your needs from your wants. Specific financial goals are vital to financial planning. Others can suggest financial goals for you; however, you must decide which goals to pursue. Your financial goals can range from spending all of your current income to developing extensive savings and investment program for your future financial security.

did you know?



Nearly one billion people around the world live on \$1 or less a day. Various organizations provide these people with basic need items and future opportunities. Bright Hope International assists the extreme poor by providing food, clothing, shelter, health care, education, orphan support, microloans, job training, and spiritual guidance. You can help to provide assistance to the extreme poor at www.brighthope.org.

CONSEQUENCES OF CHOICES Every decision closes off alternatives. For example, a decision to invest in stock means you cannot take a vacation. A decision to go to school full time may mean you cannot work full-time. Opportunity cost is what you give up by making a choice. These trade-offs can always be measured in dollars. However, the resources you give up (money or time) have a value that is lost.

EVALUATING RISK Uncertainty is also a part of every decision. Selecting a college major and choosing a career field involve risk. What if you don't like working in this field or cannot obtain employment in it? Other decisions involve a very low degree of risk, such as putting money in an insured savings account or purchasing items that cost only a few dollars. Your chances of losing something of great value are low in the situations.

In many financial decisions, identifying and evaluating risks are difficult. Common risks to consider include:

digi-know?




The use of mobile apps for personal financial activities continues to expand with instant access to bank accounts, budget amounts, investment information, and time value of money calculations. Some of the most popular are Mint, Unsplurge, Easy Money, and Pocket Money, with costs ranging from free to a few dollars.

for six years, starting at the end of the first year, you will have \$357.65 at the end of that time ($\$50 \times 7.153$). The near "Figure It Out!" box presents examples of using future value to achieve financial goals.

PRESENT VALUE OF A SINGLE AMOUNT Another aspect of the time value of money involves determining the current value of an amount desired in the future. **Present value** is the current value of a future amount based on a particular interest rate for a certain period of time. Present value computation also called *discounting*, allow you to determine how much deposit now to obtain a desired total in the future. For example using the present value table (Exhibit 1-3C), if you want \$1,000 five years from now and you earn 5 percent on your savings, you need to deposit \$784 ($\$1,000 \times 0.784$).

Which Route Is Best for You?

	CPO	NON-CPO	PRIVATE PARTY
	Certified pre-owned vehicles are as close to a new-car-buying experience as you can get. You'll pay an extra \$1,500 to \$2,500 compared with non-CPO vehicles.	Dealers sell vehicles they acquire at auction or through trade-ins that aren't scooped up by the CPO programs. You'll likely pay at least 10% more to a dealer than to a private party.	The cheapest way to buy a used car. Private sellers can sell a used car for a higher price to you than they could to a dealer, but they can't inflate the price as much.
Condition	Excellent—models are five years old or newer with fewer than 60,000 miles. Because many CPOs are off-lease, they have had only one owner.	Mostly cosmetic reconditioning. Don't expect repairs to be made. Most dealers offer a vehicle history report from AutoCheck.com or Carfax.com.	It varies. Ask for maintenance records and get a vehicle history report on AutoCheck.com or Carfax.com.
Inspection	A 100- to 200-point inspection. Vehicles are repaired and reconditioned. Worn parts are replaced, saving money on future maintenance.	A dealer's service department inspects the car, but get your own mechanic to go over the car before you buy.	You're on your own. If the seller won't agree to let you take it to a mechanic, move on to the next prospect.
Warranty	Usually a year or two extension of new-car comprehensive and power-train warranty, backed by the manufacturer, not the dealer.	You get what's left of the new-car warranty . Resist the hard sell on an extended warranty. Some states have laws to protect used-car buyers.	As with a dealer sale, you get what's left of the new-car warranty . If you get stuck with a lemon, you have little or no recourse.
Financing	Carmakers' finance companies offer lower rates than you'd pay on non-CPO loans. You may save hundreds of dollars in interest.	The F&I department will arrange financing, but dealers may get a commission. Get prequalified at your bank or credit union and compare offers.	You'll have to pay cash. If you need a loan, consider drawing on a home-equity line, or get a used-car loan at a bank or credit union.

Jessica L. Anderson

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1. From your perspective, what are the benefits and drawbacks of each of the three alternatives for buying a motor vehicle?
2. What factors should a person consider before buying an extended warranty?
3. What actions would you suggest when using any of the three alternatives presented in the article?

From the Pages of . . . Kiplinger's Personal Finance

This one-page chapter feature presents a recent article from the well-known *Kiplinger's Personal Finance* magazine related to a chapter topic. Each article covers a personal finance issue to consider, using the questions that accompany the article. This is an excellent tool to develop critical thinking and writing skills!

Personal Finance in Practice

These boxes offer information that can assist you when faced with special situations and unique financial planning decisions. They challenge you to apply the concepts you have learned to your life and record personal responses. Many of these boxes have been updated to include exercises and topics on ethics in personal finance.

Personal Finance in Practice

A Money Management SWOT Analysis

SWOT (strengths, weaknesses, opportunities, threats) is a planning tool used by companies and other organizations. This technique can also be used for your money management and budgeting activities. Listed below are examples of possible items for each SWOT category. Now, in the area provided, assess your strengths, weaknesses, opportunities, and threats related to budgeting and money management. Do online research and talk with others to get ideas for your personal SWOT items.

Internal (personal) Factors	External (economic, social) Influences
<p style="text-align: center;">Strengths</p> <ul style="list-style-type: none"> • saving 5–10 percent of income • informed on personal finance topics • no credit card debt • flexible job skills <p>Your strengths: _____</p>	<p style="text-align: center;">Opportunities</p> <ul style="list-style-type: none"> • phone apps for monitoring finances • part-time work to supplement income • availability of no-fee bank account • low-interest-rate education loan <p>Potential opportunities: _____</p>
<p style="text-align: center;">Weaknesses</p> <ul style="list-style-type: none"> • high level of credit card debt • no emergency fund • automobile in need of repairs • low current cash inflow <p>Your weaknesses: _____</p>	<p style="text-align: center;">Threats</p> <ul style="list-style-type: none"> • lower market value of retirement fund • possible reduced hours at part-time job • reduced home market value • increased living costs (inflation) <p>Potential threats: _____</p>

Creating a money management SWOT analysis is only a start. Next you need to select actions to build on your strengths, minimize your weaknesses, take advantage of opportunities, and avoid being a victim of threats. Through research and innovation, weaknesses and threats can become strengths and opportunities.

Figure It Out!

After-Tax Savings Rate of Return

The taxability of interest on your savings reduces your real rate of return. In other words, you lose some portion of your interest to taxes. This calculation consists of the following steps:

1. Determine your top tax bracket for federal income taxes.
2. Subtract this rate, expressed as a decimal, from 1.0.
3. Multiply the result by the yield on your savings account.
4. This number, expressed as a percentage, is your after-tax rate of return.

For example,

1. You are in the 28 percent tax bracket.
2. $1.0 - 0.28 = 0.72$.

ANSWERS 1. 3.4 percent $- 0.04 \times (1 - 0.15) = 0.04 \times 0.85 = 0.034$; 2. \$69 $= \$100 \times (1 - 0.31)$

Figure It Out!

This boxed feature presents important mathematical applications relevant to personal finance situations and concepts.

Focus on . . . Practice and Assessment


Personal Finance Dashboard

Having read the chapter, you now consider your financial progress. The dashboard feature is designed to help you monitor key performance indicators in your personal financial situation. The next step will be to review your habits and take action for better results.

YOUR PERSONAL FINANCE DASHBOARD

A key indicator of your potential financial success is the percentage of income saved each month. Various financial institutions and savings instruments can be used to implement this element of your financial plan.

While most people in our society save nothing or very little, financial experts recommend a savings rate of between 5 and 10 percent. These funds might be used for emergencies, unexpected expenses, or short-term financial goals as well as long-term financial security.



YOUR SITUATION: Are you able to set aside an amount for savings each month? Are there expenses you can reduce, or sources of increased income that could add to the amount you save each month? An improving savings rate is the foundation for progress toward financial independence.

POSSIBLE ACTIONS TO TAKE

- ✓ Reconsider your responses to the "Action Items" (in the text margin) to determine actions you might take for improved actions for the wise use of financial services.
- ✓ Conduct a web search of online banks to obtain information on their services. Consider how changing interest rates might affect your decision to use various types of financial services.
- ✓ Consider various sources of financial services, such as credit unions, which often offer low-cost alternatives for financial services. For additional information about credit unions, go to www.cuna.org and www.creditunion.coop.
- ✓ Obtain current interest rates for CDs and other savings plans at www.bankrate.com. For the latest rates and information on U.S. savings bonds, go to www.savingsbonds.gov.


LO4.1 Financial products such as savings plans, checking accounts, loans, trust services, and electronic banking are used for managing daily financial activities.

LO4.2 Commercial banks, savings and loan associations, mutual savings banks, credit unions, life insurance companies, investment companies, finance companies, mortgage companies, pawnshops, and check-cashing outlets may be compared on the basis of services offered, rates and fees, safety, convenience, and special programs

LO4.3 Commonly used savings plans include regular savings accounts, certificates of deposit, interest-earning checking accounts, money market accounts, money market funds, and U.S. savings bonds. Savings plans may be evaluated on the basis of rate of return, inflation, tax considerations, liquidity, safety, restrictions, and fees.

LO4.4 Debit cards, online payment systems, and stored-value cards are increasing in use for payment activities. Regular checking accounts, activity accounts, and

Chapter Summary



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Chapter Summary

Organized by learning objective, this concise content summary is a great study and self-assessment tool, located conveniently at the end of chapters.

Page	Topic	Formula
50	Net worth	Net worth = Total assets - Total liabilities <i>Example:</i> = \$125,000 - \$53,000 = \$72,000
51	Debt ratio	Debt ratio = Liabilities/Net worth <i>Example:</i> = \$7,000/\$21,000 = 0.33
51	Current ratio	Current ratio = Liquid assets/Current liabilities <i>Example:</i> = \$8,500/\$4,500 = 1.88
51	Liquidity ratio	Liquidity ratio = Liquid assets/Monthly expenses <i>Example:</i> = \$8,500/\$3,500 = 2.4
51	Debt-payments ratio	Debt-payments ratio = Monthly credit payments/Take-home pay <i>Example:</i> = \$760/\$3,800 = 0.20
51	Savings ratio	Savings ratio = Amount saved per month/Gross monthly income <i>Example:</i> = \$460/\$3,800 = 0.12
57	Cash surplus (or deficit)	Cash surplus (or deficit) = Total inflows - Total outflows <i>Example:</i> = \$5,600 - \$4,970


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Key Formulas

A list of *Key Formulas* and page references appears at the end of select chapters, grouped for easy reference.

Discussion Questions

- Describe how advertisements, news articles, online sources, and personal observations might be used to make wiser buying decisions. (LO6.1)
- When using the research-based approach for purchasing described in this chapter, which actions do you believe are overlooked by most shoppers? (LO6.2)
- What are potential concerns associated with obtaining furniture, appliances, and other items from a rent-to-own business? (LO6.3)
- What is a "certified pre-owned" vehicle? What are the benefits and drawbacks of this type of purchase? (LO6.2)
- While fraud usually involves deceptions against consumers, what are some "frauds" that consumers commit against businesses? (LO6.3)




Discussion Questions

These questions test qualitative analysis of personal finance content.

Self-Test Problems

Self-Test Problems are worked out using step-by-step solutions so that students can see how they were solved. This user-friendly feature increases students' comprehension of the material and gives confidence to solve the end-of-chapter problems.

Self-Test Problems




1. The Rule of 72 provides a guideline for determining how long it takes your money to double. This rule can also be used to determine your earning rate. If your money is expected to double in 12 years, what is your rate of return?
2. If you desire to have \$10,000 in savings eight years from now, what amount would you need to deposit in an account that earns 5 percent?

Self-Test Solutions

1. Using the Rule of 72, if your money is expected to double in 12 years, you are earning approximately 6 percent ($72 \div 12 \text{ years} = 6 \text{ percent}$).
2. To calculate the present value of \$10,000 for eight years at 5 percent, use Exhibit 1-3C (or Exhibit 1-C in the appendix to Chapter 1): $\$10,000 \times 0.677 = \$6,770$

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Problems




(Note: Some of these problems require the use of the time value of money tables in the appendix directly following this chapter, a financial calculator, or spreadsheet software.)

1. Using the Rule of 72, approximate the following amounts: (LO1.1)
 - a. If the value of land in an area is increasing 6 percent a year, how long will it take for property values to double?
 - b. If you earn 10 percent on your investments, how long will it take for your money to double?
 - c. At an annual interest rate of 5 percent, how long will it take for your savings to double?
2. In 2011, selected automobiles had an average cost of \$16,000. The average cost of those same automobiles is now \$20,000. What was the rate of increase for these automobiles between the two time periods? (LO1.1)
3. A family spends \$46,000 a year for living expenses. If prices increase 3 percent a year for the next three years, what amount will the family need for their living expenses after three years? (LO1.1)
4. Ben Collins plans to buy a house for \$320,000. If the real estate in his area is expected to increase in value 2 percent each year, what will its approximate value be seven years from now? (LO1.2)
5. What would be the yearly earnings for a person with \$6,000 in savings at an annual interest rate of 2.5 percent? (LO1.3)
6. Using time value of money tables (Exhibit 1-3 or chapter appendix tables), calculate the following: (LO1.3)
 - a. The future value of \$550 six years from now at 7 percent.
 - b. The future value of \$700 saved each year for 10 years at 8 percent.

Problems

A variety of problems allow students to put their quantitative analysis of personal financial decisions to work. Each problem is tagged with a corresponding learning objective for easy assessment.

Case in Point



ADJUSTING THE BUDGET

In a recent month, the Constantine family had a budget deficit, which is something they want to avoid so they do not have future financial difficulties. Jason and Karen Constantine and their children (ages 10 and 12) plan to discuss the situation after dinner this evening.

While at work, Jason was talking with his friend Ken Lopez. Ken had been a regular saver since he was very young, starting with a small savings account. Those funds were then invested in various stocks and mutual funds. While in college, Ken was able to pay for his education while continuing to save between \$50 and \$100 a month. He closely monitored his spending. Ken realized that the few dollars here and there for snacks and other minor purchases quickly add up.

Today, Ken works as a customer service manager for the online division of a retailing company. He lives with his wife and their two young children. The family's spending plan allows for all their needs and

also includes regularly saving and investing for the children's education and for retirement.

Jason asked Ken, "How come you never seem to have financial stress in your household?"

Ken replied, "Do you know where your money is going each month?"

"Not really," was Jason's response.

"You'd be surprised by how much is spent on little things you might do without," Ken responded.

"I guess so. I just don't want to have to go around with a notebook writing down every amount I spend," Jason said in a troubled voice.

"Well, you have to take some action if you want your financial situation to change," Ken countered.

That evening, the Constantine family met to discuss their budget situation.

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Case in Point

Students can work through a hypothetical personal finance dilemma in order to apply concepts from the chapter. A series of questions reinforces your successful mastery and application of these chapter topics.

Continuing Case

This feature allows students to apply course concepts in a life situation. It encourages students to evaluate the finances that affect a household and then respond to the resulting shift in needs, resources, and priorities through the questions at the end of each case.

Continuing Case



MANAGING A BUDGET

Jamie Lee Jackson, age 24, now a busy full-time college student and part-time bakery clerk, has been trying to organize all of her priorities, including her budget. She has been wondering if she is allocating enough of her income toward savings, which includes accumulating enough money toward the \$9,000 down payment she needs to open her dream cupcake café.

Jamie Lee has been making regular deposits to both her regular and her emergency savings accounts. She would really like to sit down and get a clearer picture of how much she is spending on various expenses, including rent, utilities, and entertainment, and how her debt compares to her savings and assets. She realizes that she must stay on track and keep a detailed budget if she is to realize her dream of being self-employed after college graduation.

Current Financial Situation

Assets:	Income:
Checking account: \$1,250	Gross monthly salary: \$2,125
Emergency fund savings account: \$3,100	Net monthly salary: \$1,560
Car: \$4,000	
Liabilities:	Monthly Expenses:
Student loan: \$5,400	Rent obligation: \$275
Credit card balance: \$400	Utilities obligation: \$125
	Food: \$120
	Gas/Maintenance: \$100
	Credit card payment: \$50

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Daily Spending Diary

Do you buy a latte or a soda every day before class? Do you and your friends meet for a movie once a week? How much do you spend on gas for your car each month? Do you like to donate to your favorite local charity a couple of times a year?

These everyday spending activities might go largely unnoticed, yet they have a significant effect on the overall health of an individual's finances. The Daily Spending Diary sheets offer students a place to keep track of *every cent they spend* in any category. Careful monitoring and assessing of these daily spending habits can lead to better control and understanding of your personal finances.

Spending Diary

"I FIRST THOUGHT THIS PROCESS WOULD BE A WASTE OF TIME, BUT THE INFORMATION HAS HELPED ME BECOME MUCH MORE CAREFUL OF HOW I SPEND MY MONEY."

Nearly everyone who has made the effort to keep a daily spending diary has found it beneficial. While at first the process may seem tedious, after a while recording this information becomes easier and faster.

Directions Using the Daily Spending Diary sheets provided at the end of the book, record *every cent* of your spending each day in the categories provided. Or you may create your own format to monitor your spending. You can indicate the use of a credit card with (CR). This experience will help you better understand your spending patterns and identify desired changes you might want to make in your spending habits. The Daily Spending Diary sheets are located in Appendix D at the end of the book and in Connect Finance.

Questions

1. What did your daily spending diary reveal about your spending habits? What areas of

Daily Spending Diary

Directions: Record every cent of your spending each day in the categories provided, or create your own format to monitor your spending. You can indicate the use of a credit card with (CR). Comments should reflect what you have learned about your spending patterns and desired changes you might want to make in your spending habits. (Note: As income is received, record in Date column.)

Month: _____ Amount available for spending: \$ _____ Amount to be saved: \$ _____

Date (Income)	Total Spending	Auto, Transportation	Housing, Utilities	Food (H) Home (A) Away	Health, Personal Care	Education	Recreation, Leisure	Donations, Gifts	Other (note item, amount)	Comments
Example	\$83	\$20 (gas) (CR)		\$47 (H)		\$2 (pen)	\$4 (DVD rental)	\$10 (church)		This takes time but it helps me control my spending.
1										
2										
3										
4										
5										
6										

Your Personal Financial Plan

The "Your Personal Financial Plan" sheets that correlate with sections of the text are conveniently located at the end of each chapter. The perforated worksheets ask students to work through the applications and record their own personal financial plan responses. These sheets apply concepts learned to your unique situation and serve as a roadmap to your personal financial future. Students can fill them out, rip them out, submit them for homework, and keep them filed in a safe spot for future reference. Excel spreadsheets for each of the "Your Personal Financial Plan" sheets are available through Connect.

Key websites and apps are provided to help students research and devise their personal financial plan, and the "What's Next for Your Personal Financial Plan?" section at the end of each sheet challenges students to use their responses to plan the next level, as well as foreshadow upcoming concepts.

Look for one or more "Your Personal Financial Plan" icons next to most Practice Quizzes. This graphic directs students to the Personal Financial Plan sheet that corresponds with the preceding section.

Name: _____ Date: _____

Comparing Savings Plans

Purpose: To compare the costs and benefits associated with different savings plans.

Financial Planning Activities: Analyze advertisements and contact various financial institutions to obtain the information requested below. This sheet is also available in an Excel spreadsheet format in Connect Finance.

Suggested Websites: www.bankrate.com www.nerdwallet.com www.savingsaccounts.com

Type of savings plan (regular savings account, certificates of deposit, interest-earning checking accounts, money market accounts and funds, U.S. savings bonds)			
Financial institution			
Address/phone			
Website			
Annual interest rate			
Annual percentage yield (APY)			
Frequency of compounding			
Insured by FDIC, NCUA, other			
Maximum amount insured			
Minimum initial deposit			
Minimum time period savings that must be on deposit			
Penalties for early withdrawal			
Service charges/transaction fees, other costs, fees			
Additional services, other information			

What's Next for Your Personal Financial Plan?

- Based on this savings plan analysis, determine the best types for your current and future financial situation.
- When analyzing savings plans, what factors should you carefully investigate?

12
YOUR PERSONAL FINANCIAL PLAN

Suggested App: Savings Plan

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Online Support for Students and Instructors

Few textbooks provide such innovative and practical instructional resources for both students and teachers. The comprehensive teaching–learning package for *Focus on Personal Finance* includes the following:

For Instructors

The Instructor’s site, delivered through Connect, provides the instructor with one resource for all supplementary material, including:

- *Instructor’s Manual*: Created and revised by the authors, this supplement includes a “Course Planning Guide” with instructional strategies, course projects, and supplementary resource lists. The “Chapter Teaching Materials” section of the *Instructor’s Manual* provides a chapter overview, the chapter objectives with summaries, introductory activities, and detailed lecture outlines with teaching suggestions. This section also includes concluding activities, ready-to-duplicate quizzes, supplementary lecture materials and activities, and answers to concept checks, end-of-chapter questions, problems, and cases.
- *Test Bank*, revised by Michelle Grant, Bossier Parish Community College consists of true–false, multiple-choice, problem-solving, and essay questions. These test items are organized by the learning objectives for each chapter. This resource also includes answers and an indication of difficulty level.
- *Computerized Testing Software*, McGraw-Hill’s EZ Test is a flexible and easy-to-use electronic testing program. The program allows instructors to create tests from book-specific items. It accommodates a wide range of question types, and instructors may add their own questions. Multiple versions of the test can be created, and any test can be exported for use with course management systems such as WebCT or BlackBoard. EZ Test Online gives you a place to easily administer your EZ Test–created exams and quizzes online. The program is available for Windows and Macintosh environments.
- Chapter *PowerPoint Presentations* revised and enhanced by Janet Payne and Vance Lesseig, Texas State University offer more than 300 visual presentations that may be edited and manipulated to fit a particular course format. If you choose to customize the slides, an online digital image library allows you to pick and choose from all of the figures and tables in the book.

Assurance of Learning Ready

Assurance of learning is an important element of many accreditation standards. *Focus on Personal Finance, 5e* is designed specifically to support your assurance of learning initiatives. Each chapter in the book begins with a list of numbered learning objectives which appear throughout the chapter, as well as in the end-of-chapter problems and exercises. Every test bank question is also linked to one of these objectives, in addition to level of difficulty, topic area, Bloom’s Taxonomy level, and AACSB skill area. Connect, McGraw-Hill’s online homework solution, and EZ Test, McGraw-Hill’s easy-to-use test bank software, can search the test bank by these and other categories, providing an engine for targeted Assurance of Learning analysis and assessment.

AACSB Statement

McGraw-Hill Education is a proud corporate member of AACSB International. Understanding the importance and value of AACSB accreditation, *Focus on Personal Finance, 5e* has sought to recognize the curricula guidelines detailed in the AACSB standards for business accreditation by connecting selected questions in the test bank to the general knowledge and skill guidelines found in the AACSB standards.

The statements contained in *Focus on Personal Finance, 5e* are provided only as a guide for the users of this text. The AACSB leaves content coverage and assessment within the purview of individual schools, the mission of the school, and the faculty. While *Focus on Personal Finance, 5e* and the teaching package make no claim of any specific AACSB qualification or evaluation, we have, within the test bank, labeled selected questions according to the six general knowledge and skills areas.

For Students (available through Connect and through your class instructor)

Digital Broadcasts

View chapter-related videos to see how personal finance topics are applied in everyday life.

Narrated Student PowerPoint

Every student learns differently and the *Narrated PowerPoint* was created with that in mind! Revised and expanded by Lynn Kugele, University of Mississippi, they guide students through understanding key topics and principles by presenting real-life examples based on chapter content.

And More!

Looking for more ways to study? Self-grading crossword puzzles will help you learn the material. You can also access Excel templates for the “Your Personal Financial Plan” sheets and the Daily Spending Diary.

McGraw-Hill’s



Less Managing. More Teaching. Greater Learning.

McGraw-Hill Connect Finance is an online assignment and assessment solution that connects students with the tools and resources they’ll need to achieve success.

Connect helps prepare students for their future by enabling faster learning, more efficient studying, and higher retention of knowledge.

McGraw-Hill Connect Finance Features

Connect Finance offers a number of powerful tools and features to make managing assignments easier, so faculty can spend more time teaching. With Connect Finance, students can engage with their coursework anytime and anywhere, making the learning process more accessible and efficient. Connect Finance offers you the features described below.

Simple assignment management With Connect Finance, creating assignments is easier than ever, so you can spend more time teaching and less time managing. The assignment management function enables you to:

- Create and deliver assignments easily with selectable end-of-chapter questions and test bank items.
- Streamline lesson planning, student progress reporting, and assignment grading to make classroom management more efficient than ever.
- Go paperless with the eBook and online submission and grading of student assignments.

Smart grading When it comes to studying, time is precious. Connect Finance helps students learn more efficiently by providing feedback and practice material when they need it, where they need it. When it comes to

teaching, your time is also precious. The grading function enables you to:

- Have assignments scored automatically, giving students immediate feedback on their work and side-by-side comparisons with correct answers.
- Access and review each response; manually change grades or leave comments for students to review.
- Reinforce classroom concepts with practice tests and instant quizzes.

Instructor Library The Connect Finance Instructor Library is your repository for additional resources to improve student engagement in and out of class. You can select and use any asset that enhances your lecture.

Student Study Center The Connect Finance Student Study Center is the place for students to access additional resources. The Student Study Center:

- Offers students quick access to lectures, practice materials, eBooks, and more.
- Provides instant practice material and study questions, easily accessible on the go.



LearnSmart Students want to make the best use of their study time. The LearnSmart adaptive self-study technology within Connect Finance provides students with a seamless combination of practice, assessment, and remediation for every concept in the textbook. LearnSmart’s intelligent software adapts to every student response and automatically delivers concepts that advance the student’s understanding while reducing time devoted to the concepts already mastered. The result for every student is the fastest path to mastery of the chapter concepts. LearnSmart:

- Applies an intelligent concept engine to identify the relationships between concepts and to serve new concepts to each student only when he or she is ready.
- Adapts automatically to each student, so students spend less time on the topics they understand and practice more on those they have yet to master.
- Provides continual reinforcement and remediation, but gives only as much guidance as students need.
- Integrates diagnostics as part of the learning experience.
- Enables you to assess which concepts students have efficiently learned on their own, thus freeing class time for more applications and discussion.



SmartBook SmartBook is an extension of LearnSmart—an adaptive eBook that helps students focus their study time

more effectively. As students read, SmartBook assesses comprehension and dynamically highlights where they need to study more.

Student progress tracking Connect Finance keeps instructors informed about how each student, section, and class is performing, allowing for more productive use of lecture and office hours. The progress-tracking function enables you to:

- View scored work immediately and track individual or group performance with assignment and grade reports.
- Access an instant view of student or class performance relative to learning objectives.

Lecture Capture through Tegrity Campus—For an additional charge Lecture Capture offers new ways for students to focus on the in-class discussion, knowing they can revisit important topics later. This can be delivered through Connect or separately. See below for more details.

McGraw-Hill Connect Finance McGraw-Hill reinvents the textbook learning experience for the modern student with the new Connect Finance. The new Connect Finance provides all of the Connect Finance features plus the following:

- An integrated eBook, allowing for anytime, anywhere access to the textbook.
- Dynamic links between the problems or questions you assign to your students and the location in the eBook where that problem or question is covered.
- A powerful search function to pinpoint and connect key concepts in a snap.

In short, the new Connect Finance offers you and your students powerful tools and features that optimize your time and energies, enabling you to focus on course content, teaching, and student learning. Connect Finance also offers a wealth of content resources for both instructors and students. This state-of-the-art, thoroughly tested system supports you in preparing students for the world that awaits.

For more information about Connect, go to **connect.mheducation.com** or contact your local McGraw-Hill sales representative.



Tegrity Campus: Lectures 24/7

Tegrity Campus is a service that makes class time available 24/7 by automatically capturing every lecture in a searchable format for students to review when they study and complete assignments. With a simple one-click start-and-stop process, you capture all computer screens and corresponding audio. Students can replay any part of any class with easy-to-use browser-based viewing on a PC or Mac.

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Thank You!

We express our deepest appreciation for the efforts of the colleagues whose extensive feedback over the years has helped to shape and create this text.

Janice Akao, *Butler Community College*

Sophia Anong, *University of Georgia*

Anna Antus, *Normandale Community College*

Eddie Ary, *Ouachita Baptist University*

Chris A. Austin, *Normandale Community College*

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Sally Wells, *Columbia College*
Micheline West, *New Hampshire Tech*
Marilyn Whitney, *University of California—Davis*
Bob Willis, *Rogers State University*
Glen Wood, *Broome Community College*
Russell Woodbridge, *Southeastern College*

Many talented professionals at McGraw-Hill Education have contributed to the development of *Focus on Personal Finance*. We are especially grateful to Chuck Synovec, Jennifer Upton, Melissa Caughlin, Keri Johnson, Debra Kubiak, Debra Sylvester, and Kristin Bradley.

In addition, Jack Kapoor expresses special appreciation to Theresa and Dave Kapoor, Kathryn Thumme, and Karen and Joshua Tucker for their typing, proofreading, and research assistance. Les Dlabay would also like to thank Bryna Mollinger for her help reviewing the manuscript. Finally, we thank our spouses and families for their patience, understanding, encouragement, and love throughout this project.

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Focus on . . . the Cover

How do you feel when you look at this cover? We hope the image on the book conveys a feeling of relaxation and overall peace of mind—both achieved, in part, by developing a solid financial plan. From cover to cover, this text's goal is to help you gain the financial literacy and personal finance skills you need to make sound financial decisions for life. Use this book as a tool to help you plan for a successful financial future!



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Focus on Personal Finance

1

Personal Financial Planning in Action

3 Steps to Financial Literacy . . . Building an Emergency Fund

1 Determine the desired amount of your emergency fund based on monthly financial needs and income volatility. Most financial advisors recommend three to nine months. **Website:** money.com

2 Monitor your daily spending to locate possible areas of reduced spending and increased savings. **App:** BUDGT or Mint

3 Decide where to keep your emergency fund. Your choices include a bank, credit union, and other financial institutions. **Website:** www.findabetterbank.com

What are the financial benefits of an emergency fund?
You will be able to avoid or minimize a financial crisis due to job loss, unexpected expenses, or other unforeseen situation. At the end of the chapter, "Your Personal Finance Dashboard" will provide guidelines for measuring the progress of your emergency fund along with suggested actions to improve your personal financial activities.

CHAPTER 1 LEARNING OBJECTIVES

In this chapter, you will learn to:

- LO1.1** Identify social and economic influences on personal financial goals and decisions.
- LO1.2** Develop personal financial goals.
- LO1.3** Calculate time value of money situations associated with personal financial decisions.
- LO1.4** Implement a plan for making personal financial and career decisions.

YOUR PERSONAL FINANCIAL PLAN SHEETS

1. Personal Financial Data
2. Setting Personal Financial Goals
3. Achieving Financial Goals Using Time Value of Money
4. Planning Your Career

Making Financial Decisions

Every person has some money available. However, the amount, along with needs and financial choices, will vary from person to person. In this book, you will have the opportunity to assess your current situation, learn about varied financial paths, and move forward toward future financial security.

Most people want to handle their finances so that they get full satisfaction from each available dollar. Typical financial goals may include buying a new car or a larger home, pursuing advanced career training, contributing to charity, traveling extensively, and ensuring self-sufficiency during working and retirement years. To achieve these and other goals, people need to identify and set priorities. Financial and personal satisfaction are the result of an organized process that is commonly referred to as *personal money management* or *personal financial planning*.

Your Life Situation and Financial Planning

Personal financial planning is the process of managing your money to achieve personal economic satisfaction. This planning process allows you to control your financial situation. Every person, family, or household has a unique situation; therefore, financial decisions must be planned to meet specific needs and goals.

A comprehensive financial plan can enhance the quality of your life and increase your satisfaction by reducing uncertainty about your future needs and resources. A **financial plan** is a formalized report that summarizes your current financial situation, analyzes your financial needs, and recommends future financial activities. You can create this document on your own (by using the sheets at the end of each chapter) or you can seek assistance from a financial planner or use a money management software package.

LO1.1

Identify social and economic influences on personal financial goals and decisions.



ACTION ITEM

Do you have an emergency fund for unexpected expenses?

Yes No

personal financial planning

The process of managing your money to achieve personal economic satisfaction.

financial plan A formalized report that summarizes your current financial situation, analyzes your financial needs, and recommends future financial activities.

Advantages of effective personal financial planning include

- Increased effectiveness in obtaining, using, and protecting your financial resources throughout your life.
- Increased control of your financial affairs by avoiding excessive debt, bankruptcy, and dependence on others.
- Improved personal relationships resulting from well-planned and effectively communicated financial decisions.
- A sense of freedom from financial worries obtained by looking to the future, anticipating expenses, and achieving personal economic goals.

Many factors influence financial decisions. People in their 20s spend money differently from those in their 50s. Personal factors such as age, income, household size, and personal beliefs influence your spending and saving patterns. Your life situation or lifestyle is created by a combination of factors.

As our society changes, different types of financial needs evolve. Today people tend to get married at a later age, and more households have two incomes. Many households are headed by single parents. More than 2 million women provide care for both dependent children and parents. We are also living longer; over 80 percent of all Americans now living are expected to live past age 65.

As Exhibit 1–1 shows, the **adult life cycle**—the stages in the family situation and financial needs of an adult—is an important influence on your financial activities and decisions. Your life situation is also affected by events such as graduation, dependent children leaving home, changes in health, engagement and marriage, divorce, birth or adoption of a child, retirement, a career change or a move to a new area, or the death of a spouse, family member, or other dependent.

In addition to being defined by your family situation, you are defined by your **values**—the ideas and principles that you consider correct, desirable, and important. Values have a direct influence on such decisions as spending now versus saving for the future or continuing school versus getting a job.

adult life cycle The stages in the family situation and financial needs of an adult.

values Ideas and principles that a person considers correct, desirable, and important.

Financial Planning in Our Economy

Daily economic transactions facilitate financial planning activities. Exhibit 1–2 shows the monetary flows among providers and users of funds that occur in a financial system. These financial activities affect personal finance decisions. Investing in a bond, which is a *debt security*, involves borrowing by a company or government. In contrast, investing in stock, called an *equity security*, represents ownership in a corporation. Other financial market activities include buying and selling mutual funds, certificates of deposit (CDs), and commodity futures.



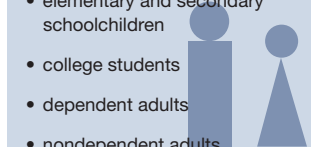

In most societies, the forces of supply and demand set prices for securities, goods, and services. **Economics** is the study of how wealth is created and distributed. The economic environment includes business, labor, and government working together to satisfy needs and wants. As shown in Exhibit 1–2, government agencies regulate financial activities. The Federal Reserve System, the central bank of the United States, has significant economic responsibility. The Fed, as it is often called, attempts to maintain an adequate money supply to encourage consumer spending, business growth, and job creation.

economics The study of how wealth is created and distributed.

GLOBAL INFLUENCES The global economy can influence financial activities. The U.S. economy is affected by both foreign investors and competition from foreign companies. American businesses compete against foreign companies for the spending dollars of American consumers. When the level of exports of U.S.-made goods is lower than the level of imported goods, more U.S. dollars leave the country than the dollar value of foreign currency coming into the United States. This reduces the funds available for

Exhibit 1-1 Financial Planning Influences, Goals, and Activities

Life Situation Factors Affect Financial Planning Activities

Age	Marital Status	Number and Age of Household Members	Employment Situation
<ul style="list-style-type: none"> • 18–24 • 25–34 • 35–44 • 45–54 • 55–64 • 65 and over 	<ul style="list-style-type: none"> • single • married • separated/divorced • widowed 	<ul style="list-style-type: none"> • no other household members • preschool children • elementary and secondary schoolchildren • college students • dependent adults • nondependent adults 	<ul style="list-style-type: none"> • full-time student • not employed • full-time employment or volunteer work • part-time employment or volunteer work 

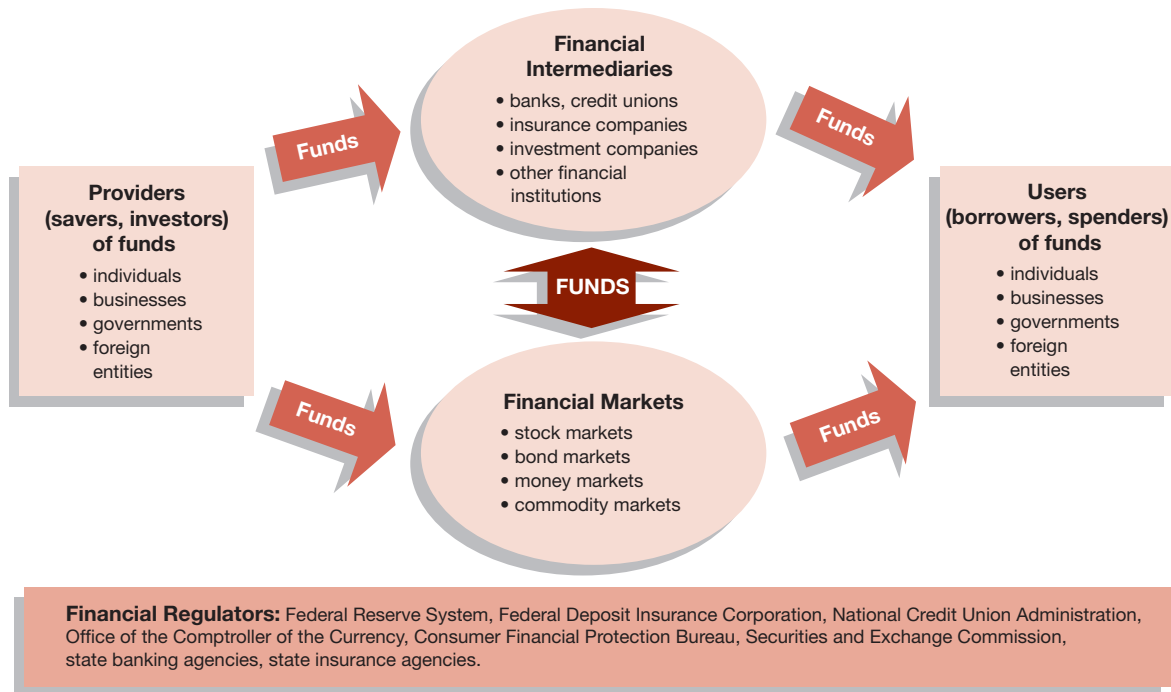
TIME TO TAKE ACTION . . . COMMON FINANCIAL GOALS AND ACTIVITIES

- | | | |
|---|---|---|
| <ul style="list-style-type: none"> • Obtain appropriate career training. • Create an effective financial recordkeeping system. • Develop a regular savings and investment program. | <ul style="list-style-type: none"> • Accumulate an appropriate emergency fund. • Purchase appropriate types and amounts of insurance coverage. • Create and implement a flexible budget. | <ul style="list-style-type: none"> • Evaluate and select appropriate investments. • Establish and implement a plan for retirement goals. • Make a will and develop an estate plan. |
|---|---|---|

SPECIALIZED FINANCIAL GOALS AND ACTIVITIES FOR VARIOUS LIFE SITUATIONS

Young, Single (18–35)	Young Couple with Children under 18	Single Parent with Children under 18	Young, Dual-Income Couple, No Children
<ul style="list-style-type: none"> • Establish financial independence. • Obtain disability insurance to replace income during prolonged illness. • Consider home purchase for tax benefit. 	<ul style="list-style-type: none"> • Carefully manage increased need for the use of credit. • Obtain an appropriate amount of life insurance for the care of dependents. • Use a will to name guardian for children. 	<ul style="list-style-type: none"> • Obtain appropriate health, life, and disability insurance. • Contribute to savings and investment fund for college. • Name a guardian for children and make other estate plans. 	<ul style="list-style-type: none"> • Coordinate insurance coverage and other benefits. • Develop investment program for changes in life situation (larger house, children). • Consider tax-deferred contributions to retirement fund.
Unmarried Couple, No Children	Older Couple (50+), No Dependent Children	Mixed-Generation Elderly Individuals and Children under 18	Older (50+) Single Person, No Dependent Children
<ul style="list-style-type: none"> • Plan joint and individual bank and credit accounts. • Communicate budgeting attitude differences. • Discuss and share joint and individual financial goals. • Consider a home purchase with a property agreement. 	<ul style="list-style-type: none"> • Review financial assets and estate plans. • Consider household budget changes several years prior to retirement. • Plan retirement housing, living expenses, recreational activities, and part-time work. 	<ul style="list-style-type: none"> • Obtain long-term care, life, and disability insurance coverage. • Use dependent care service. • Provide for handling finances of elderly if they become ill. • Consider splitting investment cost—elderly get income while alive, principal to survivors. 	<ul style="list-style-type: none"> • Make arrangement for long-term health care coverage. • Review will and estate plan. • Plan retirement living facilities, living expenses, and activities. • Monitor investments to consider current financial needs and market conditions.

Exhibit 1-2 The Financial System



domestic spending and investment. Also, if foreign companies decide not to invest in the United States, the domestic money supply is reduced. This reduced money supply can cause higher interest rates.

inflation A rise in the general level of prices.

INFLATION Most people are concerned with the buying power of their money. **Inflation** is a rise in the general level of prices. In times of inflation, the buying power of the dollar decreases. For example, if prices increased 5 percent during the last year, items that previously cost \$100 would now cost \$105. This means more money is needed to buy the same amount of goods and services.

Inflation is most harmful to people with fixed incomes. Due to inflation, retired people and others whose incomes do not change are able to afford fewer goods and services. Inflation can also adversely affect lenders of money. Unless an adequate interest rate is charged, amounts repaid by borrowers in times of inflation have less buying power than the money they borrowed.

Inflation rates vary. During the late 1950s and early 1960s, the annual inflation rate was in the 1 to 3 percent range. During the late 1970s and early 1980s, the cost of living increased 10 to 12 percent annually. At a 12 percent annual inflation rate, prices double (and the value of the dollar is cut in half) in about six years. To find out how fast prices (or your savings) will double, use the *Rule of 72*: Just divide 72 by the annual inflation (or interest) rate.

EXAMPLE: Rule of 72

An annual inflation rate of 4 percent, for example, means prices will double in 18 years ($72 \div 4 = 18$). Regarding savings, if you earn 6 percent, your money will double in 12 years ($72 \div 6 = 12$).

More recently, the reported annual price increase for goods and services as measured by the consumer price index has been in the 2 to 4 percent range. The *consumer price index (CPI)*, computed and published by the Bureau of Labor Statistics, is a measure of the average change in the prices urban consumers pay for a fixed “basket” of goods and services.

Inflation rates can be deceptive since the index is based on items calculated in a predetermined manner. Many people face *hidden* inflation since the cost of necessities (food, gas, health care), on which they spend the greatest proportion of their money, may rise at a higher rate than nonessential items, which could be dropping in price. This results in a reported inflation rate much lower than the actual cost-of-living increase being experienced by consumers.

Deflation, a decline in prices, can also have damaging economic effects. As prices drop, consumers expect they will go even lower. As a result, consumers cut their spending, which causes damaging economic conditions. While widespread deflation is unlikely, certain items may be affected and their prices will drop.

INTEREST RATES In simple terms, interest rates represent the cost of money. Like everything else, money has a price. The forces of supply and demand influence interest rates. When consumer saving and investing increase the supply of money, interest rates tend to decrease. However, as borrowing by consumers, businesses, and government increases, interest rates are likely to rise.

Interest rates can have a major effect on financial planning. The earnings you receive as a saver or an investor reflect current interest rates as well as a *risk premium* based on such factors as the length of time your funds will be used by others, expected inflation, and the extent of uncertainty about getting your money back. Risk is also a factor in the interest rate you pay as a borrower. People with poor credit ratings pay a higher interest rate than people with good credit ratings. Interest rates influence many financial decisions.

Financial Planning Activities

To achieve a successful financial situation, you must coordinate various components through an organized plan and wise decision making.

OBTAINING (CHAPTER 1) You obtain financial resources from employment, investments, or ownership of a business. Obtaining financial resources is the foundation of financial planning, since these resources are used for all financial activities.

PLANNING (CHAPTERS 2, 3) Planned spending through budgeting is the key to achieving goals and future financial security. Efforts to anticipate expenses along with making certain financial decisions can reduce taxes, increase savings, and result in less financial stress.

SAVING (CHAPTERS 2, 4) Long-term financial security starts with a regular savings plan for emergencies, unexpected bills, replacement of major items, and the purchase of special goods and services, such as a college education, a boat, or a vacation home. Once you have established a basic savings plan, you may use additional money for investments that offer greater financial growth.

BORROWING (CHAPTER 5) Maintaining control over your credit-buying habits will contribute to your financial goals. The overuse and misuse of credit may cause a situation in which a person’s debts far exceed the resources available to pay those debts. **Bankruptcy** is a set of federal laws allowing you to either restructure your debts or remove

did you know?



U.S. consumer prices between 1970 and 1980 nearly doubled, while between 2000 and 2010 prices rose only about 27 percent. Some countries, such as Bolivia and Zimbabwe, have encountered *hyperinflation* in their history, with consumer prices increasing more than 50,000 percent.

bankruptcy A set of federal laws allowing you to either restructure your debts or remove certain debts.

certain debts. The people who declare bankruptcy each year may have avoided this trauma with wise spending and borrowing decisions. Chapter 5 discusses bankruptcy in detail.

SPENDING (CHAPTERS 6, 7) Financial planning is designed not to prevent your enjoyment of life but to help you obtain the items you want. Too often, however, people make purchases without considering the financial consequences. Some people shop compulsively, creating financial difficulties. You should detail your living expenses and your other financial obligations in a spending plan. Spending less than you earn is the only way to achieve long-term financial security.

MANAGING RISK (CHAPTERS 8, 9, 10) Adequate insurance coverage is another component of personal financial planning. Certain types of insurance are commonly overlooked in financial plans. For example, the number of people who suffer disabling injuries or diseases at age 50 is greater than the number who die at that age, so people may need disability insurance more than they need life insurance. Yet surveys reveal that most people have adequate life insurance but few have adequate disability insurance.

INVESTING (CHAPTERS 11, 12, 13) Although many types of investments are available, people invest for two primary reasons. Those interested in *current income* select investments that pay regular dividends or interest. In contrast, investors who desire *long-term growth* choose stocks, mutual funds, real estate, and other investments with potential for increased value in the future. You can achieve investment diversification by including a variety of assets in your *portfolio*—these may include stocks, bond mutual funds, real estate, and collectibles such as rare coins.

RETIREMENT AND ESTATE PLANNING (CHAPTER 14) Most people desire financial security upon completion of full-time employment. But retirement planning also involves thinking about your housing situation, your recreational activities, and possible part-time or volunteer work.

Transfers of money or property to others should be timed, if possible, to minimize the tax burden and maximize the benefits for those receiving the financial resources. Knowledge of property transfer methods can help you select the best course of action for funding current and future living costs, educational expenses, and retirement needs of dependents.

PRACTICE QUIZ 1-1



Sheet 1 Personal Financial Data

- How do personal and economic factors affect the operation of the financial system and personal financial decisions?
- For each of the following situations, indicate if the person would tend to “suffer” or tend to “benefit” from inflation. (Circle your answer)

A person with money in a savings account.	suffer	benefit
A person who is borrowing money.	suffer	benefit
A person who is lending money.	suffer	benefit
A person receiving a fixed income amount.	suffer	benefit

Apply Yourself!

Using online research and discussion with others, calculate the recent inflation rate that reflects the change in price for items frequently bought by you and your family.

Developing and Achieving Financial Goals

Why do so many Americans—living in one of the richest countries in the world—have money problems? The answer can be found in two main factors. The first is poor planning and weak money management habits in areas such as spending and the use of credit. The other factor is extensive advertising, selling efforts, and product availability that encourage overbuying. Achieving personal financial satisfaction starts with clear financial goals.

Types of Financial Goals

What would you like to do tomorrow? Believe it or not, that question involves goal setting, which may be viewed in three time frames:

- *Short-term goals* will be achieved within the next year or so, such as saving for a vacation or paying off small debts.
- *Intermediate goals* have a time frame of two to five years.
- *Long-term goals* involve financial plans that are more than five years off, such as retirement, money for children’s college education, or the purchase of a vacation home.

Long-term goals should be planned in coordination with short-term and intermediate goals. Setting and achieving short-term goals is commonly the basis for moving toward success of long-term goals. For example, saving for a down payment to buy a house is a short-term goal that can be a foundation for a long-term goal: owning your own home.

A goal of obtaining increased career training is different from a goal of saving money to pay a semiannual auto insurance premium. *Consumable-product goals* usually occur on a periodic basis and involve items that are used up relatively quickly, such as food, clothing, and entertainment. *Durable-product goals* usually involve infrequently purchased, expensive items such as appliances, cars, and sporting equipment; these consist of tangible items. In contrast, many people overlook *intangible-purchase goals*. These goals may relate to personal relationships, health, education, community service, and leisure.

Goal-Setting Guidelines

An old saying goes, “If you don’t know where you’re going, you might end up somewhere else and not even know it.” Goal setting is central to financial decision making. Your financial goals are the basis for planning, implementing, and measuring the progress of your spending, saving, and investing activities. Exhibit 1–1 offers typical goals and financial activities for various life situations.

Your financial goals should take a SMART approach, in that they are:

- **S**—*specific*, so you know exactly what your goals are and can create a plan designed to achieve those objectives.
- **M**—*measurable* by a specific amount. For example, “Accumulate \$5,000 in an investment fund within three years” is more measurable than “Put money into an investment fund.”
- **A**—*action-oriented*, providing the basis for the personal financial activities you will undertake. For example, “Reduce credit card debt” will usually mean actions to pay off amounts owed.
- **R**—*realistic*, involving goals based on your income and life situation. For example, it is probably not realistic to expect to buy a new car each year if you are a full-time student.
- **T**—*time-based*, indicating a time frame for achieving the goal, such as three years. This allows you to measure your progress toward your financial goals.

LO1.2

Develop personal financial goals.



ACTION ITEM

Do you have specific financial goals that you hope to achieve in the future?

Yes No



CAUTION!

Most financial planning professionals have a code of ethics, but not all abide by these principles. To avoid financial difficulties and potential fraud, make sure your financial planner strictly applies industry policies regarding confidentiality, integrity, objectivity to prevent a conflict of interest, and a commitment to continuing education.