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Personal Finance

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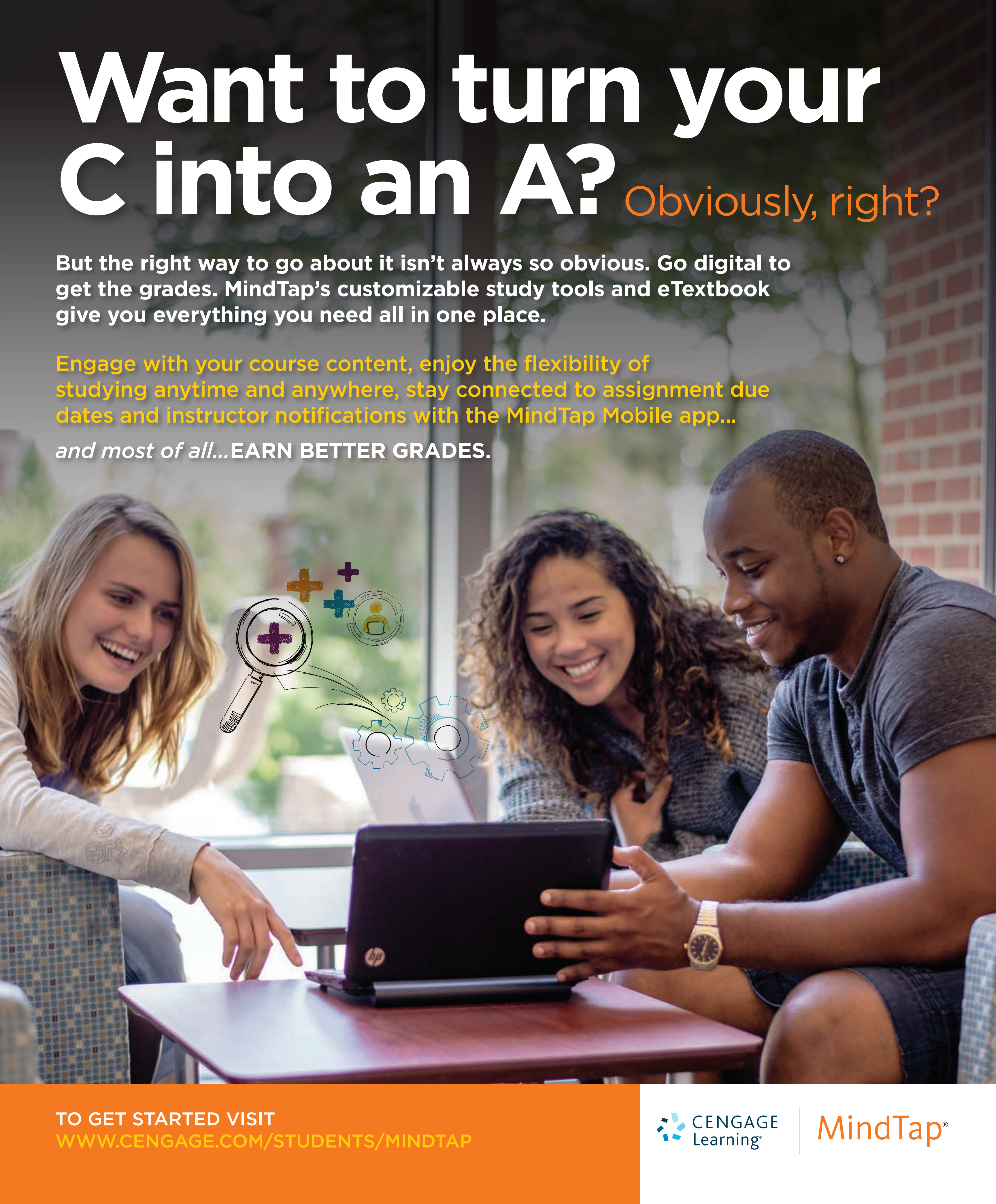

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Brief Contents

Contents

PART 3 INCOME AND ASSET PROTECTION 297

CHAPTER 10

Managing Property and Liability Risk 298

Preface

TO THE INSTRUCTOR

This 13th edition of ***Personal Finance*** has been happily revised, and it sets a high standard in the field. When revising, we once again surprised ourselves: We improved the book a lot! We absolutely loved revising because it is fun and we know how valuable the book is for students. This edition is a winner.

More Pizzazz We got "fired up" when revising because we know instructors want students to actually ***read*** the book before coming to class. A book must have some pizzazz to keep students reading, so we tried to make the style of writing a bit breezier as we updated the topical coverage. We think this edition has much more zip!

Involves the Student The text genuinely involves the student in learning the subject, particularly through information presented in more than 180 new boxes, enhanced end-of-chapter activities, and innovative "do-it soon" prescriptions from the authors. We are the "Doctors of Personal Finance"—with over 80 combined years of teaching experience, 70 years of writing 40 college textbooks, and authors of 200 refereed research articles.

Learn How to Learn By drawing on our years of experience, we have made the 13th edition more than just a compilation of what to know. In addition to providing the most up-to-date knowledge base in personal finance, we recognize that the role of the instructor has changed from teaching facts to teaching students how to learn. Thus, the book's many tools show students how to discover and where to find accurate facts and other essentials in personal finance that they need to know. Students need to learn how to replace the old personal finance knowledge they currently possess with the latest knowledge that is new, accurate, and reliable.

The Right Things to Do in Personal Finance ***Personal Finance*** emphasizes the "right things" to do in personal finance, and why, and then how to do them. Why such an emphasis? Because today's students—despite their many abilities—need more guidance than those of yesteryear. Personal finance has become much more complicated. Plus, advertising and marketing are nothing less than relentless in their aim to persuade one to buy, buy, and buy stuff as well as to confuse people about who is telling them the "truth."

Gets Students to Think This book's many features offer normative, value-laden suggestions on getting ahead in one's personal finances. It requires the reader to reflect on the facts and opinions presented, the advice they are given, the available choices in their communities and on the Internet, and finally to apply their personal values in their decision-making. In short, ***Personal Finance*** gets students to contemplate, deliberate, and think!

NOTES TO THE STUDENT

"Personal finance knowledge is obsolete." It's over. It's done for. It's history. This is great news! But, read on because this quote does not mean to skip reading this book.

Obsolete knowledge is that which we believe may have been valid at one time, if it ever was true in the first place. When we are confident about erroneous knowledge we are not motivated to look for new information. As the Jedi master Yoda told Luke Skywalker, "You must unlearn what you have learned." If you believe the world is changing and recognize that some of your knowledge is obsolete, you can begin to move past your outdated knowledge.

But how? Your response will be your true challenge in learning personal finance *and* applying it to your money matters in the many years of your life. Both are goals of this book.

Making good personal financial decisions for you and your loved ones requires making informed choices. To do this, you must learn the vocabulary of personal finance, consider reasonable prescriptions for success, and then apply your newly acquired beliefs in your everyday decision making. If you do these tasks soon—by reading this book from cover to cover—you absolutely, positively will reap big financial benefits in the future.

Ignore these suggestions at your peril, however, because a lack of financial literacy will guarantee your financial failure. No kidding. That warning is for real. It is not easy to succeed financially, but sometimes it can be challenging. We'll show you how to do it correctly.

Our goal as authors is to provide the knowledge, tools, skills, and attitudes you need to become financially savvy and successful. Along with the textbook, we have developed a full, rich MindTap student resource and a companion website that you can use to learn as much as possible about personal finance as well as develop your own financial plans.

The 13th edition of ***Personal Finance*** offers confidence to readers about how to succeed financially. Yes, this book provides you with facts—the most up-to-date and best available—and much of the information is evolving and as such it will need to be replaced. *In today's world you need to learn how and where to accurately find the facts you need to know.* Without understanding the basics of personal finance, how could you even know what questions to ask?

This book is very good at giving you the tools to strengthen your knowledge. First, the authors provide you with fundamental knowledge in personal finance, lots of it. You need an excellent base of know-how in personal finance to work with, otherwise you will remain ignorant about some money matters and occasionally you will make small and sometimes big mistakes. Second, we provide a number of tools to guide you through the process of searching the Internet and resources in your community to find the best answers to your personal finance questions. Thus, you need to learn how to learn, and this book aims to help you accomplish that goal.

The 13th edition of ***Personal Finance*** is the language of today and tomorrow! Successfully handling your money today is important. All the tools—and we mean ALL—are here for you to learn to use to your advantage so you will do well financially throughout life.

You need the best knowledge, tools, and skills to successfully manage your financial resources because so much of the responsibility of financial accomplishment today rests solely upon your shoulders.

While personal finance is not rocket science, it sometimes feels like it. In fact, personal finance actually is not very complicated. But there are a lot of topics in personal finance, so please try to stay focused!

You are lucky because you are holding in your hands the 13th edition of ***Personal Finance***. This book carefully lays out your financial "marching orders" for challenging economic times. The mantra of this book is *"What to do, why do it, when to do it, and how to do it."* We give you "prescriptions" to follow that will guide you to success in your personal finances. If you pay attention, learn, and apply the knowledge contained herein you will enjoy a taste of the good life while still in college, plus you will have enough resources left over to start building an extremely successful financial future.

This 13th edition balances all the pieces of wise financial planning. In addition to updating and enhancing the quality of the content, this edition stimulates student interest in several new ways.

Each chapter of ***Personal Finance*** starts with a brief case with some questions that ask ***"What Do You Recommend?"*** And the student usually does not know much at that early point, and that is okay. At the end of the chapter, the question is repeated with ***"What Do You Recommend NOW?"*** Now the student should know a lot more after having read the chapter and the learning gained from class discussion. Then they can answer the questions more knowledgeably. Every chapter also contains dozens of Internet website addresses of high-quality sources of information to help replace some of your obsolete knowledge.

Throughout every chapter are prescriptions to achieve personal financial success in the form of box inserts. One such box is titled ***"To-Do Soon List."*** These boxes suggest five tasks to accomplish in the next few months or years. Then there is a new box called ***"Your Grandparents Say"*** that offers tips from those who have lived long and succeeded in their personal finances. There also is a new box titled ***"There Is an App for That!"*** that lists some good ones and almost all can be used on both Apple and Android devices. This is complemented by updated boxes on the best quality ***"Money Websites."*** Another new box series is ***"Numbers on"*** that highlight important numbers relevant to the subject of each chapter. Finally there are new ***"Common Sense"*** thoughts for readers to contemplate. Collectively, these boxes are full of prescriptions and insights to help students achieve financial success.

Every chapter also includes lots of interesting ***"Did You Know?"*** boxes that offer surprises in current understanding. There also is a robust list of concrete suggestions on how to ***"Turn Bad Habits INTO Good Ones."*** All chapters have one or more boxes revealing ***"Advice From a Seasoned Pro."*** The latter chapters also have boxes on ***"The Tax Consequences of (name of chapter)"*** to help the reader always think of the impact of income taxes when making financial decisions. The ***"Bias Toward"*** boxes give the reader a reality check on the behavioral economics biases that plague us into making bad financial decisions, and they also explain how to overcome them. Finally the reader may recall that we told you earlier there are a few things to not do wrong. So, we inserted new ***"Never Ever!"*** boxes in every chapter that headline what one should absolutely, positively not do in personal finance.

The revised end-of-chapter questions are extremely well organized and are designed to walk you to and through the most important topics in each chapter. The authors want you to learn how to find the best and most reliable sources of new information throughout your life and use it to your advantage.

The end-of-chapter activities begin with a thorough ***"Summary of Learning Objectives Recapped."*** Next are several ***"Let's Talk About It"*** questions designed to help you and your instructor create some lively class discussions. This is followed by ***"Do the Math"*** activities that require the student to practice the key mathematical applications in the chapter. Even more down to earth are the five or six ***"Financial Planning Cases"*** because they make the student think realistically about the information. The continuing case of ***"Harry and Belinda"*** has been updated and the couple eventually age into their mid-forties. So, too, has the ***"Victor and Maria"*** case, which now follows them almost into retirement. The other continuing case is that of ***"Julia Price,"*** whose successful financial life evolves through challenging economic times. Her cases always end with a question to challenge the student: *"Offer your opinions about her thinking."*

The end-of-chapter questions continue with ***"Be Your Own Personal Financial Planner"*** that focuses on personalizing the concepts and lessons to your life. The forms and questions are contained in the student workbook, ***My Personal Financial Planner***, which can be found on the book's MindTap**.** These activities are not busy-work. They are questions and tasks that require applying the knowledge provided in each chapter at a personal level—in your life. All of the ***"On the 'Net"*** activities have been designed to carefully direct students to reliable online materials that are truly useful and appropriate to use in your financial life. The end-of-chapter questions close with ***"Action Involvement Projects"*** that get the reader into their local community or on the Internet to expert sources to help you apply chapter concepts.

This edition connects all the dots in personal finance in a comprehensive manner, shows students the relevancy of the topics, and requires students to carefully think about their own financial lives. As a result, you will achieve genuine success in your personal finances!

Changes in This Edition

The 13th edition contains lots of up-to-the minute original material, and the major changes include the following:

- **Personal financial planning spread over three chapters.** We did not jam the whole boring and esoteric "financial planning process" down the readers' throats in Chapter 1. If we put the all the steps in there, probably only a handful of students would read the details and fewer would understand it completely. Instead, the key concepts and examples in the financial planning process are explained and illustrated over the first three chapters. This is a personal finance textbook so we try to attract and keep student interest in the first chapter as well as throughout the remaining chapters of the book.
- **Exchange traded funds.** The growing popularity of ETFs as an investment is explored fully in chapter 15, now retitled as "Mutual and Exchange Traded Funds." The chapter also includes a new table of ETFs that allows one to compare which ones in which to invest.
- **Five new types of box inserts.** Every chapter has five new types of boxes: "To-Do Soon List," "Numbers on," "There is an App for That!," "Your Grandparents Say," and "Never Ever."
- **New material.** Newness prevails as we have added some 90 new headings, 180 new boxed inserts, 10 new tables and figures, 70 new terms, and 40 new boxed inserts on "Advice from a Seasoned Pro" (formerly called "Advice From a Professional"). We also retitled and expanded "Your Next Five Years" into the new "To-Do Soon List" that opens each chapter.
- **Continuing cases updated.** Both continuing cases—Harry and Belinda, and Victor and Maria—have been edited and they had all their numbers updated, thus income, ages, expenses, assets, liabilities, and everything else has been rationalized.
- **Definitions.** Hundreds of definitions that in the past were long considered quite clearly written have been tightened up for even more clarity. And we have added new terms with well-structured definitions.
- **Deletions.** Several headings and subheadings have been deleted as well as five tables and figures. To incorporate the latest thinking in personal finance and to save space, we also deleted the series of boxes on "Sean's Success Stories" and "Financial Power Point."
- **Stronger emphasis on budgeting, emergency fund saving, and investing for retirement.** From the first chapter onward, we are major cheerleaders for focusing on budgeting, emergency fund savings and investing for retirement. We encourage readers to think about the critical importance of saving, why they should save, how to do it when they believe they cannot, and then how to wisely invest for retirement. It all starts with creating a simple budget.
- **Breezier writing for more reading by students.** We know instructors want students to actually ***read*** the book before coming to class, so we paid careful attention to adding more pizzazz. To keep students reading, we livened up the style of writing and added more examples as we updated the topical coverage.

TOPICAL COVERAGE OF THE 13TH EDITION

We have carefully constructed the 13th edition to address instructors' concerns about getting through all the necessary material for this course. The table of contents outlines 17 chapters divided into four parts: Financial Planning, Money Management, Income and Asset Protection, and Investments. We also include a comprehensive chapter on "Career Planning" that provides students with innovative 21st century suggestions necessary to obtain and succeed in their careers.

FEATURES TO STRENGTHEN LEARNING OPPORTUNITIES

We have carefully designed pedagogical features to strengthen learning opportunities for students. Each feature is designed to communicate vital information meaningfully and to maintain student interest. The following features support student understanding and retention.

You Must Be Kidding, Right? If you typically skip the opening case, now is the time to change your ways. This feature opens every chapter with a short narrative about a financial topic and a question with four possible answers. The often surprising (and sometimes funny) answers provide an excellent opportunity to quickly engage students in a concept that is critically important to understanding the chapter.

YOU MUST BE KIDDING, RIGHT?

The world of personal finances is getting more complicated and challenging each year. Recent economic times have been tough with some negative impacts on people's personal finances. Which one of the following statements is false?

A. Half of Americans have less than one month's income saved for a rainy day.

B. Half of adults say they do not budget.

C. Sixty percent of Americans say they live paycheck-to-paycheck.

D. Forty percent of Americans say they find it difficult to meet monthly expenses

The answer is "none of the above" is false because all the statements are true. Clearly, many Americans are experiencing trouble with their personal finances. You can get smart about personal finances so these statements do not apply to you!

Learning Objectives Concise behavioral objectives that can be measured against the content of each chapter, its activities, and then tested.

What Do You Recommend? These concise, realistic cases are actually "pretests" at the beginning of each chapter followed by leading questions asking about the most important fundamental concepts in the chapter. The case acts as a pretest because a student who has not read the chapter will be able to offer only simplistic, experience-based opinions and suggestions to respond to the questions. This will communicate to them how much they have to learn from an instructor-led classroom discussion of the chapter. A corresponding posttest, ***"What Do You Recommend NOW?"*** appears as part of the end-of-chapter pedagogy. At that point, after reading and classroom discussion, student responses should be very different: informed, practical, and action oriented.

Boxed Inserts on Key Topics Many of the authors' prescriptions for success in personal finance and other important topics are explained in boxes, and these include:

To-Do Soon List These boxes list the most important tasks students need to take to get off to a great start financially. Every chapter includes five specific prescriptions for the student to accomplish in the next few months or years in life.

TO-DO SOON

Do the following to begin to achieve financial success:

1. *Get up to date on future economic conditions by going to www.conference-board.org to read their expectations for economic growth.*
2. *Do some time value of money calculations until you are comfortable using them.*
3. *Harness the power of compounding by starting early to save a consistent amount each month for a long-term goal.*
4. *When employed take advantage of tax sheltering through your employer's benefits program.*
5. *Use marginal and opportunity costs when making an important financial decision.*

Did You Know? These boxes have interesting, catchy titles that encourage students to actually read the information. These offer some surprises in current understanding that rejects obsolete knowledge.

Numbers On These highlight important numbers relevant to the subject of each chapter.

Never Ever! The reader may recall that we wrote that there are a few things to not do wrong. Accordingly, we have two new boxes that feature what one should absolutely, positively in no way ever do in personal finance.

Your Grandparents Say These offer tips from those who have lived long and succeeded in their personal finances.

There Is an App for That! Many good apps are listed and almost all can be used on both Apple and Android devices.

Money Websites These are updated lists of top quality websites that can be truly useful for readers to update their knowledge.

Turn Bad Habits Into Good Ones A robust list of concrete suggestions is offered.

Advice from a Seasoned Pro These boxes are written by some of the nation's best personal finance experts. They offer authoritative, real-world advice on topics such as getting out of credit card debt, buying a safe car, and paying for retirement on the layaway plan.

The Tax Consequences of These boxes focus on the income tax aspects in key chapters, so the reader is pushed to always think of the impact of income taxes when making important financial decisions.

Bias Toward These give the reader a reality check on the behavioral economics biases that plague us into making bad financial decisions. They also explain how to overcome them.

Common Sense Here we offer thoughts for readers to contemplate. These boxes are basic prescriptions to achieve financial success.

Concept Checks At the end of each major segment of each chapter, we provide a box of concept check questions tied to the major topics in that part. They may aid classroom discussion, serve as student assignments, or simply provide students with a self-check for a fuller understanding of the material.

Run the Numbers These boxes guide students to their best personal finance decisions that require mathematics, and they illustrate commonly confronted choices following a step-by-step process.

Do It in Class This feature highlights with icons the topics in the chapter that are most suitable for students to "turn the class upside down" by choosing perhaps to do in-class learning activities for 20–25 minutes.

End-of-Chapter Pedagogy The end of chapter pedagogy—much of which has been revised—carefully directs student learning of the concepts and principles that are key to success in personal finance.

What Do You Recommend NOW? This end-of-chapter section asks the same leading questions pertaining to the case at the beginning of the chapter. At this point, however, instructors can anticipate higher-quality responses and a deeper level of understanding because students have read the chapter and likely listened to instructor-led class discussion.

Summary of Learning Objectives Recapped Three to six sentences review the most important content cited in each of the chapter's learning objectives.

Let's Talk about It Students are given an opportunity to discuss their personal experiences related to the chapter by addressing these questions.

Do the Math These questions apply the relevant quantitative mathematical calculations used in personal finance decision making. The companion website includes Excel calculators for these exercises.

Financial Planning Cases Students must apply key concepts when analyzing typical personal financial problems, dilemmas, and challenges that face individuals and couples. Because some cases are designed to be both continuous and independent of the other chapters' cases, each case can be analyzed by itself. One continuing case is that of "Julia Price," whose sometimes complicated financial life evolves through challenging economic times, and each of her cases ends with a question for the student: *"Offer your opinions about her thinking."* Two other continuing cases are "Harry and Belinda Johnson," starting out married life as a young couple, and "Victor and Maria Hernandez," a family starting in their thirties. This edition also features five or six cases in each chapter. The series of case questions requires data analysis and critical thinking, and this effort reinforces mastery of chapter concepts.

MY PERSONAL FINANCIAL PLANNER

Be Your Own Personal Financial Planner This end-of-chapter section provides concrete, personalized activities that engage students in developing aspects of their own financial plans. Most are keyed to the "My Personal Financial Planner" worksheets—available in MindTap—complete with interactive spreadsheets.

On the 'Net All of these exercises have been updated to carefully focus the student to online materials that are genuinely useful and appropriate for this time in their personal financial lives. Each chapter includes several Internet-based exercises, activities, and focused questions that expand the student's learning in a guided manner, allowing the student to research and apply chapter concepts while finding the best and most accurate answers available.

Action Involvement Projects Each out-of-class project points the student toward taking specific steps in their communities or on the Internet that require communicating with experts to apply the knowledge provided in each chapter at a personal level, particularly aiming to have an impact on their thoughts about personal finance.

"Flip the Classroom" icons tell instructors and students about "Do It in Class" Exercises for Instructors to Flip the Classroom The traditional pattern of teaching and learning has been for instructors to assign students to read a textbook and have them work on problems, cases, and exercises outside of school. Then the students come to class to listen to lectures, participate in discussions, and take tests.

Flip teaching or a **flipped classroom** is a pedagogical model in which the typical lecture and homework elements of a course are reversed. It is a form of learning where students learn new content by what used to be class work (the "lecture") that is usually done online at home by students who watch video lessons and what used to be "homework" (assigned problems and cases) is now done in class with instructors who offer more personalized guidance and interaction with students.

In a flipped classroom, the instructor has decided that students will study the chapter before coming to class, often using videos, podcasts or screencasts prepared by the instructor or a third party. Sometimes these can be found online from YouTube, the Khan Academy, MIT's OpenCourseWare, Coursera, or other similar sources. As a result the students may watch, rewind, and fast-forward as needed. Then the students the come to class to apply their knowledge by working on problems, cases, and various exercises, including short discussions, for part or all of what used to be the usual class time.

In the flipped class the instructor tutors the students when they become stuck working on problems, rather than imparting the initial lesson by lecturing in person. The flipped classroom frees up class time for hands-on work. Students learn by doing and asking questions. Students can also help each other, a process that benefits both the advanced and less advanced learners.

A breakthrough approach for instructors is offered with this ***Personal Finance*** textbook. You do not have to, but you may try out a flipped classroom. If instructors provide students some at-home video lessons or if they simply want to take a crack at flipping the classroom, they may review the end-of-chapter "Do It in Class" icons and decide which questions might be most suitable for their students. They might plan for perhaps 20 to 25 minutes of class time for students to solve appropriate problems.

DO IT IN CLASS

To assist with this endeavor we have placed several "Do It in Class" icons within each chapter that are suitable for students to "turn the class upside down" should they choose to do the related in-class learning activities marked with icons at the end of the chapter. The in-chapter icons have no meaning upon first reading the chapter. However, their importance becomes apparent when the student sees the selected end-of-chapter questions that are marked with the same icons. Each of these questions also has page numbers that direct the student to the appropriate section of the chapter (marked with the same icon) where the content exists for them to review and learn so they may perform the tasks requested. The instructor needs only to assign some end-of-chapter "Do It in Class" activities and supervise the student learning.

Glossary A comprehensive end-of-text glossary includes precise definitions of all key terms and concepts. More than 80 terms new have been added and hundreds of others have been rewritten for more clarity.

COMPLETE INSTRUCTOR SUPPORT

- **Instructor Website.** The instructor website that accompanies ***Personal Finance*** provides a wealth of supplemental materials to enhance learning and aid in course management. Features of the site include PowerPoint slides, downloadable Instructor Manual and Solution Manual files, and test bank content.
- **Instructor's Manual.** Written by coauthor author, Ray Forgue, this ancillary includes a variety of useful components: suggested course syllabi to emphasize a general, insurance, or investments approach to personal finance; learning objectives; a summary overview for use as a lecture outline; and teaching suggestions including student application exercises and tips for bringing the Web into the classroom. This item is found on the instructor companion website.
- **Solutions Manual.** Answers and solutions to all end-of-chapter questions and problems are included. This item is found on the instructor companion website.
- **PowerPoint Slides.** The PowerPoint slides contain chapter outlines, figures, and tables from the main text, which were written by coauthor Ray Forgue. Lecture material is available within the PowerPoint slides.
- **Test Bank.** Each chapter boasts a Test Bank of multiple choice and true/false questions varying in difficulty level and covering the key concepts. The Test Bank for each chapter will be available through ***Cognero***, an online, fully customizable version of the Test Bank, which provides instructors with all the tools they need to create, author/edit, and deliver multiple types of tests. Instructors can import questions directly from the *Test Bank,* create their own questions, or edit existing questions.

COMPLETE STUDENT SUPPORT

- **My Personal Financial Planner** is a fantastic tool for students to use in planning and organizing their personal finances. This online product contains over 60 useful worksheets, schedules, and planners for personal finance. They are not busywork for students. Some of the worksheets mimic the calculations and planning exercises covered in the book; others help students develop their own personal financial plans and details for future actions. A student's use of this tool virtually guarantees positive changes in their personal financial behaviors and quick success in money matters. "My Personal Financial Planner" is available in the MindTap student resource for *Personal Finance.*
- **Student Companion Website** is accessible *without* an access code. Among other assets, students can find a short interactive quiz for each chapter.
- **Quizlet.** We know that in a lot of courses, terminology is an important part of how you study. We also know that you may love to use Quizlet on your phone or tablet to help you create flashcards as a study tool. To make it easier for you to use Quizlet with this book, we have created flashcard templates for you. You'll find instructions and the templates on this book's companion site.

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Naheel Jeries, *Iowa State University*
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Hyungsoo Kim, *University of Kentucky*
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Virginia S. Zuiker, *University of Minnesota*

This 13th edition also has benefited from the contributions of some of the best personal finance experts in the United States, who have shared some specialized expertise by contributing to a series of boxes titled "Advice From a Seasoned Pro":

Dennis R Ackley, *Ackley & Associates*
Katie Barrow, *Louisiana Tech University*
Linda A. Bradley, *California State University*
Morgan Bridge, *Colorado Mesa University*
Bryan Brullon, *Polk State College*
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Jamey Darnell, *College of Central Florida*
Howard Davidoff, *Brooklyn College*
William Dean, *Southern University*
Lucy Delgadillo, *Utah State University*
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Jenn J. Dorwart, *Chardron State College*
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Gerson M. Goldberg, *Northeastern University*
Mark Guild, *Southern Adventist University*
Sherman Hanna, *The Ohio State University*
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Erica Tobe, *Michigan State University*
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Jon Wentworth, *Southern Adventist University*
David Windle, *Baker College*
Brianne Wilson, *Huntingdon College*
Stephanie R. Yates, *University of Alabama at Birmingham*
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We definitely wish to thank the many students who had the opportunity to read, critique, and provide input for various components of the ***Personal Finance*** project. Please keep sending us your e-mails.

This edition of ***Personal Finance*** benefited enormously from the editorial efforts of Conor Allen. In addition to being a fine manager and editor, he brought much insight, creativity, intelligence, and wisdom to the project. His staff also was kind enough to provide some excellent insights. Conor is a master of his art, and it has been a privilege to work with him on this as well as others of our books. Many thanks go to Conor's successors for their strong efforts to manage the many complex decisions as they completed the book on schedule: Tara Slagle and Julie Dierig. Finally, and this is a first in our 13 editions, sincere appreciation is given to the firm that composed the book—implementing hundreds of critical decisions as well as making the content perfectly fit the pages—Lumina Datamatics, and the team led by Joseph Malcolm, Senior Project Manager.

A project of this dimension could never have been completed without the patience, support, understanding, and sacrifices of our friends and families during the book's development, revision, and production. Tom Garman, professor emeritus and fellow at Virginia Tech University, retired to life in The Villages, Florida, and stays in contact with his children and their spouses and significant others: Scott and his husband Dave, Dana and her husband Tom with Julia, Alieu and his wife Isatou with Kumba, Alimatou, and Ousman. Thanks are owed to all. Tom also credits the mentors in his life—Ron West, Bill Boast, Bill McDivitt, and John Binnion—for guiding him along the way, particularly through their noble examples of compassion, commitment, and excellence. Most helpful of all, most encouraging and inspiring, and most deserving of my wholehearted gratitude, is my wife, Gerry. I thank her for being the love of my life. Her laughter, love, and support guarantees that the fourth quarter of my life is and will continue to be blessed with tremendous happiness.

Ray Forgue, retired from University of Kentucky, lives in Easley, South Carolina, with his wife Snooky. They take great pleasure in traveling to visit their children. Ray's son, Matthew, and his wife, Kat, live in Oregon. His daughter, Amy, her husband, Mack, and their two daughters live in Colorado. Snooky's children, Stuart and Dru, live in South Carolina. Her son, Seth, his wife, Alexandra, and their two boys live in New York. Ray wishes to thank his mother, Mary, and brothers Bob, Gary, Joe, and Dave for their patience over the years as he spent time during vacation and holiday visits working on this book. Special thanks to Snooky, whose assistance on the first edition of ***Personal Finance*** continues to shine through to this current edition.

Finally, we wish to say "thank you" to the hundreds of personal finance instructors around the country, who have generously shared their views, in person, via telephone, mail, fax, text, Facebook, and e-mail on what should be included in a high-quality textbook and ancillary materials. Some of you thankfully have communicated multiple times, especially Professors Sherman Hanna of The Ohio State University, Jonathan Fox of Iowa State University, and Jean Lown of Utah State University. Their views have always been astute and insightful, and they are among the nation's best college personal finance professors.

Instructors around the country demand the best for their students, and we have listened. ***Personal Finance*** is your book! The two of us and the quality team of professionals at Cengage have tried very hard to meet your needs in every possible way. We hope we have exceeded your expectations. Why? Because we share the belief that students need to study personal finance principles thoroughly and learn them well so that they will be genuinely financially successful throughout their lives.

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P.S. Dear students: If you are going to save any of your college textbooks, be certain to keep this one because the basic principles of personal finance are everlasting. Also, you might want to present the book as a gift to a significant other, spouse, sibling, or parent.

PART 1

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1

Understanding Personal Finance

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YOU MUST BE KIDDING, RIGHT?

Lauren Crawford, age 23, earns $50,000 a year and she invests 6 percent of her salary, $3,000 annually, through her employer-sponsored 401(k) retirement account. Because her employer also contributions 50 cents for every dollar she contributes, Lauren is saving $4,500 each year ($3,000 + $1,500). Even if she never increases her 401(k) contributions, about how much money will she have in the account after 40 years if she earns an 8 percent return?

A. Less than one-quarter of a million dollars

B. More than one-quarter million dollars but less than one-half million

C. Close to $1 million

D. Over $1 million

The answer is D; approximately $1,165,750. This is even though her total contributions will only be $180,000 ($4,500 x 40). Lauren will make the big money from "the annual compounding of money," not just on the amounts she puts into her retirement plan each month (the $180,000). Growing wealth is all about the magic of compound interest over time!

Learning Objectives

After reading this chapter, you should be able to:

1. Recognize the keys to achieving financial success.
2. Understand how the economy affects your personal financial success.
3. Think like an economist when making financial decisions.
4. Perform time value of money calculations in personal financial decision making.
5. Make smart decisions about your employee benefits.
6. Identify the professional certifications of providers of financial advice.

WHAT DO YOU RECOMMEND?

Jing Wáng, age 23, recently graduated with her bachelor's degree in accounting. She is about to take her first professional position as an accountant with a large firm in an expanding area in California. While in school, Jing worked part time for that firm during the summers, earning about $15,000 per year. For the past two years, she has managed to put $1,000 each year into an individual retirement account (IRA). Jing owes $35,000 in student loans on which she will soon start to make payments. Her new job will pay $80,000. Jing may begin participating in her employer's 401(k) retirement plan immediately, and she can contribute up to 8 percent of her salary to the plan. Her employer will contribute 1/2 of 1 percent for every 1 percent that Jing contributes.

qingqing/Shutterstock.com

What do you recommend to Jing on the importance of personal finance regarding:

1. **Participating in her employer's 401(k) retirement plan?**
2. **Understanding the effects of her marginal tax rate on her financial decisions?**
3. **Considering the current state of the economy in her personal financial planning?**
4. **Using time value of money considerations to project what her IRA might be worth at age 63?**
5. **Using time value of money considerations to project what her 401(k) plan might be worth when she is age 63 if she were to participate fully?**

TO-DO SOON

Do the following to begin to achieve financial success:

1. *Get up to date on future economic conditions by going to www.conference-board.org to read their expectations for economic growth.*
2. *Do some time value of money calculations until you are comfortable using them.*
3. *Harness the power of compounding by starting early to save a consistent amount each month for a long-term goal.*
4. *When employed take advantage of tax sheltering through your employer's benefits program.*
5. *Use marginal and opportunity costs when making an important financial decision.*

Can you successfully manage your personal finances in today's economy? Yes you can! Most people realize that the key to long-term financial stability and success is to live below your means, have an emergency fund to handle financial surprises, pay off credit cards and student loans, and save and invest for your future. But it is tough to accomplish today with all the demands on your money.

In the years ahead many opportunities will arise for you to take smart actions to help assure your future financial success. Financial success may seem like a far-off prospect when you are in your twenties. But the personal finance patterns you put into practice while enrolled in your personal finance course and immediately after graduation will help you manage, as well as accumulate, money in the years ahead.

This book is your ticket for a financially successful life! You can have it all by becoming a wealth builder. You can become financially responsible and economically independent. And you will learn to handle any financial surprises along the way.

Personal finance is the study of personal and family resources considered important in achieving financial success. It involves how people spend, save, protect, and invest their financial resources. A good understanding of personal finance topics offers you a great chance of success in facing the financial challenges, responsibilities, and opportunities of life.

At the heart of it, personal finance is totally about money. On the question of "What makes the world go around, love or money?" The answer: "Love makes it very special. But without money you are in serious trouble. And the trouble is so bad that it is like being up the proverbial creek without a paddle." So, please, continue reading and get started on how to be very smart in your personal finances.

This book provides prudent guidance for every step of the way. Careful study will enhance your **financial literacy**, which is your knowledge of facts, concepts, principles, and technological tools that are fundamental to being smart about money. Financial literacy empowers you. It improves your ability to handle day-to-day financial matters, helps you avoid the consequences of poor financial decisions that could take years to overcome, helps you make informed and confident personal money decisions, and makes you more financially responsible.

Financial well-being, says the federal government, is a state of being wherein a person can fully meet current and ongoing financial obligations, can feel secure in their financial future, and is able to make choices that allow them to enjoy life. To achieve financial well-being, one must be **financially responsible**. This means that you are accountable for your future financial well-being and that you strive to make good decisions in personal finance. The best example of not being financially responsible is to live like you are rich *before* you are. Being financially responsible means you will control your personal financial destiny and be successful.

At the beginning of each chapter, we provide a short case vignette titled "What Do You Recommend?" Each story focuses on the financial challenges that can be experienced by someone who has not learned about the material in that chapter. You will be asked to think about what advice you might give the person as you study the chapter. At the end of each chapter, you will again be asked to provide more informed advice based on what you have learned. The question at that point is "What Do You Recommend NOW?" You will be much better informed then!

personal finance
The study of personal and family resources considered important in achieving financial success; it involves how people spend, save, protect, and invest their financial resources.

financial literacy
Knowledge of facts, concepts, principles, and technological tools that are fundamental to being smart about money.

financial well-being
A state of being wherein a person can fully meet current and ongoing financial obligations, can feel secure in their financial future, and make choices that allow them to enjoy life.

financially responsible
Means that you are accountable for your future financial well-being and that you strive to make wise personal financial decisions.

Learning Objective 1
Recognize the keys to achieving financial success.

1.1 ACHIEVING PERSONAL FINANCIAL SUCCESS

Today's marketplace provides a constant barrage of messages suggesting that you can spend and borrow your way to financial success, security, and wealth. Well, they are wrong because you can't. These messages are very enticing for those starting out in their financial lives. It is hard to resist the immediate gratification of spending. In truth, however, overspending and overuse of consumer credit seriously impedes financial success.

The fact is that "you" are the result of your financial decisions. If you regularly purchase things you cannot afford, that is who you are. There is a right and a wrong way, and that is the wrong way. If this sounds like you, then you must learn to make better financial decisions.

Many people think that being wealthy is a function of how much one earns or inherits. In reality, it is much more closely related to your ability to make good decisions that generate wealth for you. The most important point in this book is to realize that you must live within your means, save some of what you earn, and avoid the temptation of having to purchase every new thing your friends buy.

You must have the discipline to delay gratification and make the right decisions to succeed in your finances. You have to do only a *few* things right in personal finance during your lifetime, as long as you don't do too many things wrong. Personal finance is not rocket science. You can succeed very well in your personal finances by making appropriate plans and taking sensible actions to implement those plans.

1.1a The Five Fundamental Steps in the Financial Planning Process

There are five fundamental steps to the personal financial planning process, and these are examined in this chapter and the two that follow:

(1) Evaluate your financial condition relative to your education and career choice;
(2) Define your financial goals;
(3) Develop a plan of action to achieve your goals;
(4) Periodically develop and implement spending plans to monitor and control progress toward goals; and
(5) Review your financial progress and make changes as appropriate.

1.1b You Must Plan for Financial Success and Happiness

Financial success is the achievement of financial aspirations that are desired, planned, or attempted. Success is defined by the person who seeks it. Some define financial success as being able to actually live according to one's standard of living. Many seek **financial security**, which provides the comfortable feeling that your financial resources will be adequate to fulfill any needs you have as well as most of your wants. Others want to be **wealthy** and have an abundance of money, property, investments, and other resources.

Financial happiness encompasses a lot more than just making money. It is the experience you have when you are satisfied with your money matters. People who are happy about their finances are likely to be spending within a budget and taking steps to achieve their goals, and this happiness spills over in a positive way to feelings about their overall enjoyment of life. Financial happiness is in part a result of practicing good financial behaviors. Examples of such behaviors include paying bills on time, spending less than you earn, knowing where your money goes, and investing some money for the future. The more good financial behaviors you practice, the greater your financial happiness. In fact, simply setting financial goals contributes to financial happiness.

financial success
The achievement of financial aspirations that are desired, planned, or attempted, as defined by the person who seeks it.

financial security
The comfortable feeling that your financial resources will be adequate to fulfill any needs you have as well as most of your wants.

financial happiness
The experience you have when you are satisfied with your money matters, which is in part a result of practicing good financial behaviors.

1.1c You Must Spend Less So You Can Save and Invest More

Financial objectives are rarely achieved without forgoing or sacrificing current **consumption** (spending on goods and services). This restraint is accomplished by putting money into **savings** (income not spent on current consumption) for use in achieving future goals. Some savings are actually **investments** (assets purchased with the goal of providing additional future income from the asset itself). By saving and investing, people are much more likely to have funds available for future consumption. If you save for tomorrow, you will be happier today *and* tomorrow.

Effective financial management often separates the *haves* from the *have-nots*. The haves are those people who learn to live on less than they earn and are the savers and investors of society. The have-nots are the spenders who live paycheck-to-paycheck, usually with high consumer debt. They fail to manage money and as a result money manages them.

savings
Income not spent on current consumption.

investments
Assets purchased with the goal of providing additional future income from the asset itself.

standard of living
Material well-being and peace of mind that individuals or groups earnestly desire and seek to attain, to maintain if attained, to preserve if threatened, and to regain if lost.

level of living
Refers to the level of wealth, comfort, material goods and necessities one is currently living.

obsolete knowledge
That which we believe may have been valid at one time, if it ever was true in the first place.

Being frugal is not about abstinence. It is about being smart in personal finance. Saving money does not make you cheap; it makes you smarter than those who just spend and spend. Spending less is about prioritizing your choices. You should think about making good choices in life when making every day spending decisions by asking yourself "What is most important to me?" This helps you get out of the habit of simply spending money and instead making choices that will enhance your life.

Saving for future consumption represents a good illustration of the human desire to achieve a certain **standard of living**. This standard is what an individual or group earnestly desires and seeks to attain, to maintain if attained, to preserve if threatened, and to regain if lost. Our standards include our wants and needs—as well as our comforts and luxuries too. In contrast, individuals actually experience their **level of living** at any particular time. In essence, your standard of living is where you would like to be, and your level of living is where you actually are.

1.1d What You Will Accomplish Studying Personal Finance

Learning about and succeeding in money matters means that by the time you finish this book you will:

1. Recognize how to manage the unexpected and unplanned financial events.
2. Pay as little as possible in income taxes to the Internal Revenue Service (IRS).
3. Understand how to effectively comparison shop for vehicles and homes.
4. Protect what you own.
5. Invest wisely.
6. Accumulate and protect wealth that you may choose to spend during your non-working years or donate it.

Figure 1-1 shows the building blocks to achieving financial success and how they fit together. Figure 1-2 shows how to get your financial house in order by age 30. Accomplish these steps and you will be well on your way to being truly financially successful.

1.1e Replace Your Obsolete Knowledge

Obsolete knowledge is that which we believe may have been valid at one time, if it ever was true in the first place. When we are sure of erroneous knowledge we are not

Figure 1-1 **Building Blocks to Achieving Financial Success**

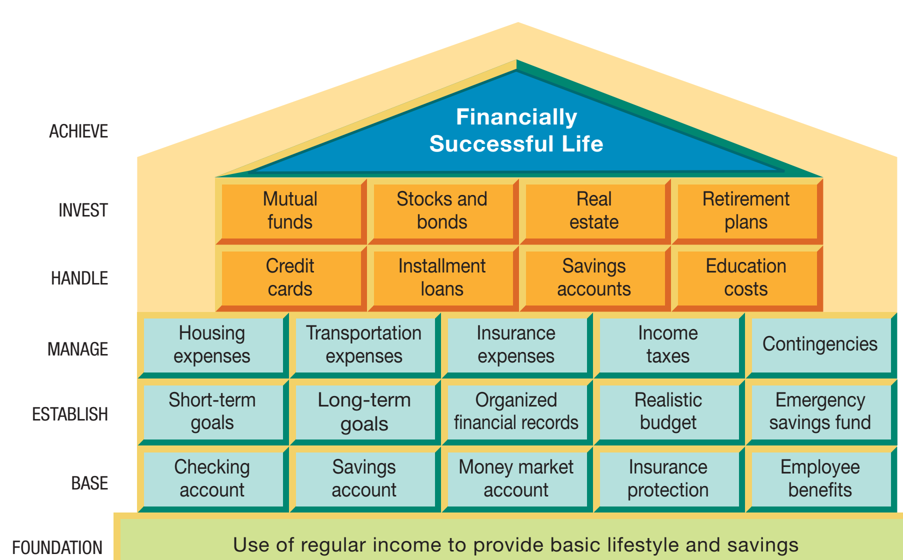
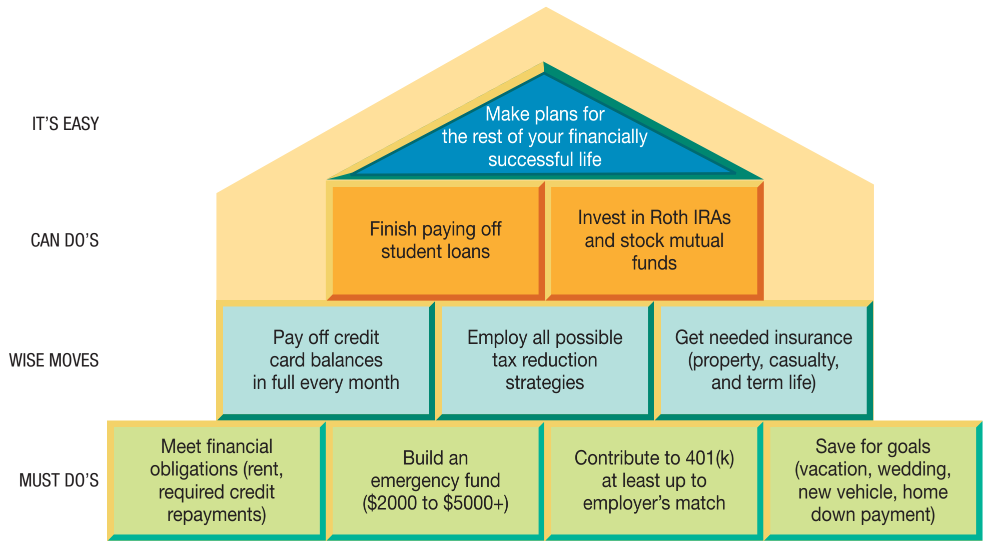


Figure 1-2 **Get Your Financial House in Order by Age 30**



motivated to look for new information. As the Jedi master Yoda told Luke Skywalker, "You must unlearn what you have learned." If you believe the world is changing and recognize that some of your knowledge is obsolete, you can begin to move past your outdated knowledge.

But how? Your response will be your true challenge in learning personal finance *and* applying it to your money matters in the many years of your life. This book provides you with the most up-to-date and best facts available, and much of the information is evolving and as such it will need to be replaced. In today's world you need to learn how and where to accurately find the facts you want to know. This book will show you.

CONCEPT CHECK 1.1

1. Explain the five fundamental steps in the financial planning process.
2. Distinguish among financial success, financial security, and financial happiness.
3. Summarize what you will accomplish studying personal finance.
4. What are the building blocks to achieving financial success?

1.2 THE ECONOMY AFFECTS YOUR PERSONAL FINANCIAL SUCCESS

Learning Objective 2
Understand how the economy affects your personal financial success.

Your success in personal finance depends in part on how well you understand the economic environment; the current stage of the business cycle; and the future direction of the economy, inflation, and interest rates.

1.2a How to Tell Where We Are in the Business Cycle

An economy is an economic and political system of managing the productive and employment resources of a country, state, or community. The U.S. economy is **capitalism**. Here a country's trade and industry are controlled by private owners who seek profit.

capitalism
Here a country's economy, its trade and industry, are controlled by private owners who see profit.

The U.S. federal government attempts to regulate the country's overall economy to maintain stable prices (low inflation) and stable levels of employment (low unemployment). In this way, the government seeks to achieve sustained **economic growth**, which is a condition of increasing production (business activity) and consumption (consumer spending) in the economy—and hence increasing national income. Specific government policies also affect the economy. For example, tax cuts keep money in consumers' pockets, money that they are then likely to spend. Tax increases, in contrast, depress consumer demand.

economic growth
A condition of increasing production (business spending) and consumption (consumer spending) in the economy and hence increasing national income.

1.2b The Business Cycle

Growth in the U.S. economy varies over time. The **business cycle** (also called the **economic cycle**) is a process by which the economy grows and contracts over time. It can be depicted as a wavelike pattern of rising and falling economic activity in which the same pattern occurs again and again over time. As illustrated in Figure 1-3, the phases of the business cycle are expansion (when the economy is increasing), peak (the end of an expansion and the beginning of a contraction), contraction (when the economy is falling), and trough (the end of a contraction and beginning of an expansion).

business cycle/economic cycle
Business cycles can be depicted as a wavelike pattern of rising and falling economic activity; the phases of the business cycle include expansion, peak, contraction (which may turn into recession), and trough.

The preferred stage of the economic cycle is the **expansion phase,** where production is at high capacity, unemployment is low, retail sales are high, and prices and interest rates are low or falling. Under these conditions, consumers find it easier to buy homes, cars, and expensive goods on credit, and businesses are encouraged to borrow to expand production to meet the increased consumer demand. The stock market also rises because investors expect higher profits in the future.

As the demand for credit increases, short-term interest rates rise because more borrowers want money. Consumers and businesses purchase more goods, exerting upward pressure on prices. Eventually, prices and interest rates climb high enough to stifle consumer and business borrowing, send stock prices down, and choke off the expansion. One effect of such economic turmoil is **deleveraging**, meaning that instead of normal economic times when credit usage grows, it shrinks because companies and individuals pay down their debts. When businesses and consumers use less debt, home and car sales decline as does employment. The result is a period of negligible economic growth or even a decline in economic activity.

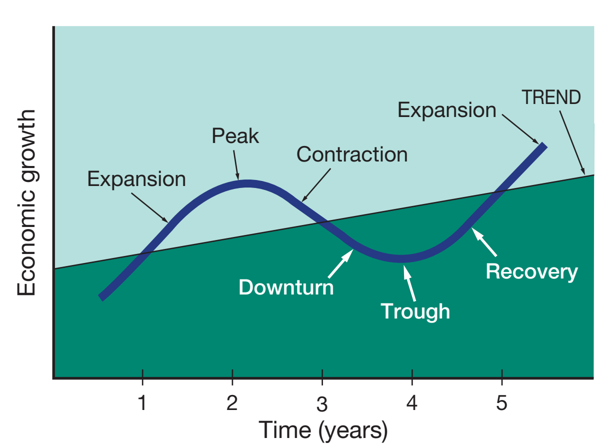
deleveraging
A time period when credit use shrinks in an economy instead of expanding as during normal economic times.

In such situations, the economy often contracts and moves toward a **recession**. During recessions, consumers become pessimistic about their future buying plans. The typical U.S. recession is marked by an average economic decline of 2 percent that lasts for ten months with an average unemployment rate exceeding 6 percent.

recession
A recurring period of decline in total output, income, employment, and trade, usually lasting from six months to a year and marked by widespread contractions in many sectors of the economy.

There have been five recessions since 1980. The federal government's Business Cycle Dating Committee of the National Bureau of Economic Research officially defines a recession as "a period of falling economic activity spread across the economy, lasting

Figure 1-3 **Business Cycle Phases**



more than a few months, normally visible in real gross domestic product, real income, employment, industrial production, and wholesale-retail sales."

The Great Recession The Great Recession began in 2007 and lasted 18 months, which makes it the longest of any recession since 1929–1941. The economy contracted 5.1 percent, which was of historic proportions. Nine million people had their jobs disappear as unemployment surpassed 10 percent. Half of all American workers suffered job losses, pay cuts, or reduced hours at work, or they were forced into part-time employment. The decline was almost a genuine depression.

The Great Recession reduced the asset values and wealth of individuals. Many people of your parents' ages saw the value of their homes shrink 25 to 65 percent while at the same time half of their retirement funds evaporated. In total, it destroyed 20 percent of Americans' wealth in both home values and investments. Surveys revealed that over 60 percent of those between ages 50 and 61 had to delay their retirements; the average age at retirement rose three years. Consumer confidence dropped to an all-time low.

Some people feared a **double dip recession**. This happens when the economy has a recession and then, soon after emerging from the recession with a short period of growth, falls back into recession. Fortunately, this did not occur although rebound growth was slow.

The Economic Future Will Be Expansion Despite the severity or length of any recession, eventually the economic contraction ends, and consumers and businesses become more optimistic. The economy then moves beyond the trough toward recovery and expansion, where levels of production, employment, and retail sales begin to improve, allowing the overall economy to experience some growth from its previously weakened state. The entire business cycle typically takes about six years.

Politicians and economic advisors struggle with which path to take to create economic growth. Most of the world has followed the Keynesian economic theory since the 1930s, which is to increase demand with stimulus spending even if it creates large temporary government deficits. The logic is that when consumers and businesses spend less, the economy will be further depressed unless the government spends more. Such spending creates additional economic growth that results in increased tax revenues, thus resulting in budget surpluses that can be used to pay down the debts.* Now, however, the deficits themselves are seen as the problem by some U.S. politicians and in other countries resulting in calls to slash public outlays. Others say such an austerity approach will lead to lower demand, lower growth, lower tax revenues, stock market declines, and an even higher national debt.

COMMON SENSE
Be Optimistic About Your Future

During poor economic times people face uncertain financial futures. However, this does not mean that they should stop saving and investing for their futures. Every generation has faced similar uncertainties. You should be positive about the long-term economic future. Make good decisions regarding spending, saving, investing, and donating by putting in practice what you learn in this book.

1.2c How to Tell the Future Direction of the Economy

To make sound financial decisions, you need to know where we are in the business cycle, how well the economy is doing, and where the economy might be headed. You can do this by paying attention to some economic statistics that are regularly reported in the news as well as on cable TV business shows. Your knowledge can help guide your long-term financial strategy. An **economic indicator** is any economic statistic, such as the unemployment rate, GDP, or the inflation rate (terms discussed in the next few paragraphs), that suggests how well the economy is doing and how well the economy might do in the future.

economic indicator
Any economic statistic, such as the unemployment rate, GDP, or the inflation rate, that suggests how well the economy is doing now and how well it might be doing in the future.

Look at Procyclic Indicators, like GDP and Jobs A **procyclic** (or **procyclical)** economic indicator is one that moves in the same direction as the economy. Thus, if the economy is doing well, this number typically is increasing. If we are in a recession, this indicator is decreasing. Examples of procyclic indicators are retail sales, industrial production, new orders for durable goods (like household appliances), number of employees on nonagricultural payrolls, and the gross domestic product. Consumer spending accounts for about 70 percent of the total U.S. economy.

The best understood example of a procyclic economic indicator is the **gross domestic product (GDP)**, which is the market value of all the goods and services produced in

gross domestic product (GDP)
The nation's broadest measure of economic health; it reports how much economic activity (all goods and services) has occurred within the U.S. borders during a given period.

*Every year since 1970, Congress has authorized more spending than projected revenue, except for the last two years of the William Jefferson Clinton presidency (1999 and 2000), which had budget surpluses.