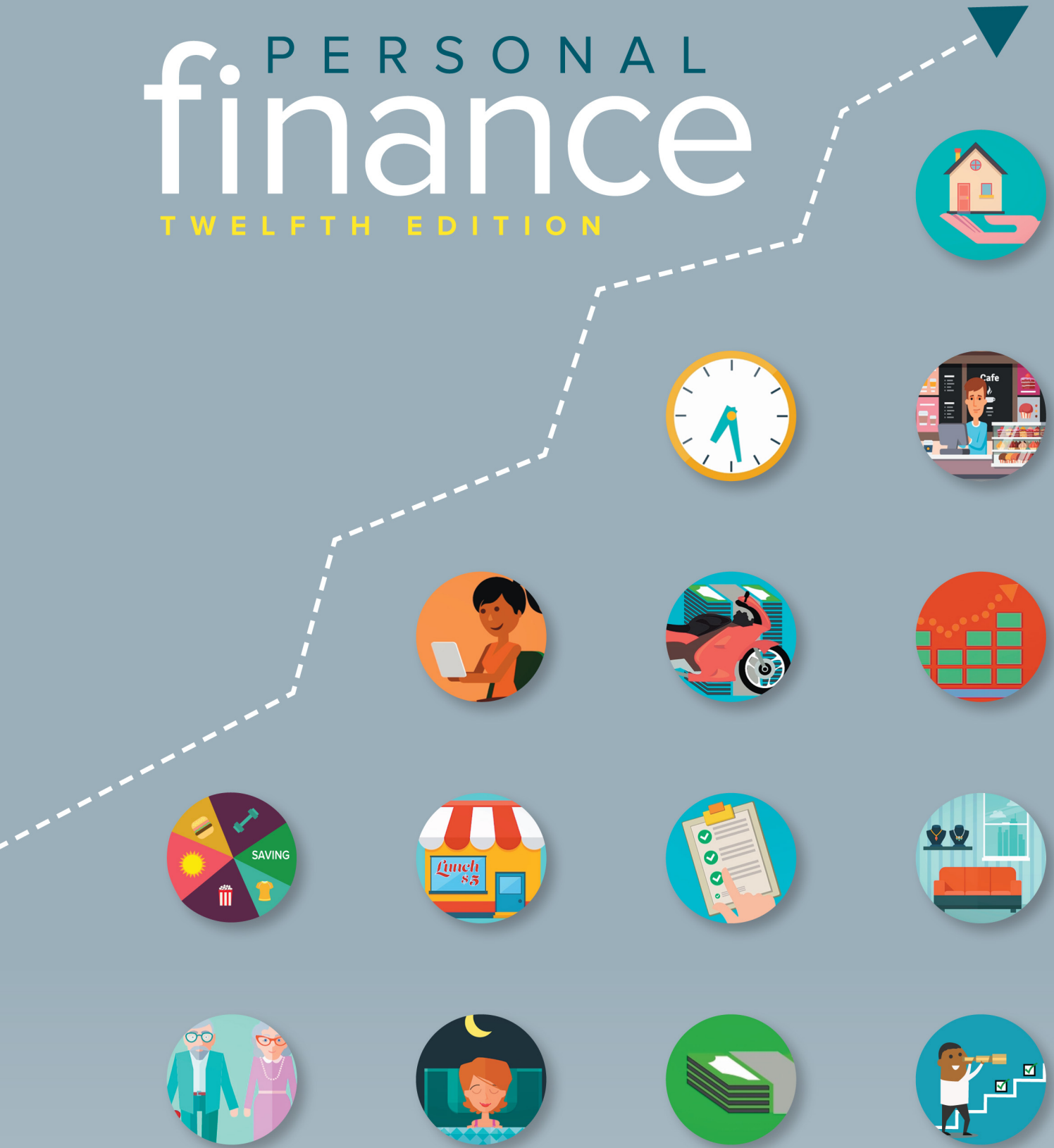


PERSONAL finance

TWELFTH EDITION



Kapoor • Dlabay • Hughes • Hart

PERSONAL FINANCE

TWELFTH EDITION

The McGraw-Hill/Irwin Series in Finance, Insurance, and Real Estate

Stephen A. Ross, Consulting Editor

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Personal Finance
Twelfth Edition

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PERSONAL FINANCE

TWELFTH EDITION

JACK R. KAPOOR

College of DuPage

LES R. DLABAY

Lake Forest College

ROBERT J. HUGHES

Dallas County Community Colleges

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PERSONAL FINANCE, TWELFTH EDITION

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

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

To my wife, Robin and to the memory of my mother, Barbara Y. Hughes

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

About 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 coauthor of several textbooks, including *Business: A Practical Approach* (Rand McNally), *Business* (Houghton Mifflin), *Business and Personal Finance* (Glencoe), and *Focus on 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 more than 3 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 paper currency 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 literally change people's lives. 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. In addition to writing several textbooks, Dr. Hughes has taught personal finance, introduction to business, business math, small business management, small business finance, and accounting since 1972. He also served as a content consultant for two popular national television series, *It's Strictly Business* and *Dollars & Sense: Personal Finance for the 21st Century*, and 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 and nominated for the Gertrude Cox Award for Innovative Excellence in Teaching and Learning with Technology. She teaches courses in personal finance and corporate finance and has developed multiple ways to use technology to introduce real-life situations into the classroom and online environment. Spreading the word about financial literacy has always been a passion of

hers. Each year she shares her common sense approach of “No plan is a plan” with 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 multiple committees. 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 and traveling. She travels extensively with her family to enjoy the many cultures and beauty of the state, the country, and the world.

Preface

Dear Personal Finance Professors and Personal Finance Students,

Just for a moment consider how the following questions affect you and your students.

- Will consumer prices begin to escalate?*
- Does Brexit deteriorate the world economic outlook?*
- How might an economic slowdown in other countries affect you?*
- Is this a good time to purchase a home?*
- Will the Dow Jones Industrial Average rise to record levels or crash again?*
- Are you saving enough for your retirement?*
- Will Social Security be around when you retire?*

For most people, the answers to the above questions affect not only their financial security, but also their quality of life. In fact, for many individuals the financial crisis of 2007–2009 was a wake-up call that forced them to examine how they managed their personal finances. These same economic problems had far reaching consequences, in terms of employment, housing, investing, and retirement planning. The possibility of another economic crisis in the future underscores the importance of managing your personal finances and your investment program.

As authors and teachers, we believe it is important to help people develop a plan to achieve financial security.

While the 12th edition of *Personal Finance* does not guarantee that each student will be able to get the ideal job or become a millionaire, it does provide the information needed to take advantage of opportunities and to help manage personal finances. As in previous editions, we address the changing financial needs and challenges that students face on a daily basis. The 12th edition of *Personal Finance* provides extensive coverage of career planning; money management; taxes; consumer credit, including college loans; housing; legal protection; insurance; investments; retirement planning; and estate planning. By teaching students how to make informed choices, we believe you can encourage them to build a foundation of financial security.

For 12 editions, we have listened carefully to both students and professors. With each revision, we have asked professors for suggestions that will help them teach better and help students learn more efficiently. And with each edition, we have incorporated these suggestions and ideas to create what has become a best-selling personal finance textbook. We are also proud to say that we have included extensive student feedback in our text and instructional package. We do sincerely **thank you** for your suggestions, ideas, and support.

A text and instructional package should always be evaluated by the people who use it. We encourage you to e-mail us if you have comments, suggestions, or would like more information about the new edition. Finally, we invite you to examine the visual guide that follows to see how the new edition of *Personal Finance* and instructional package can help your students obtain financial security and success.

Welcome to the new 12th edition of *Personal Finance*.

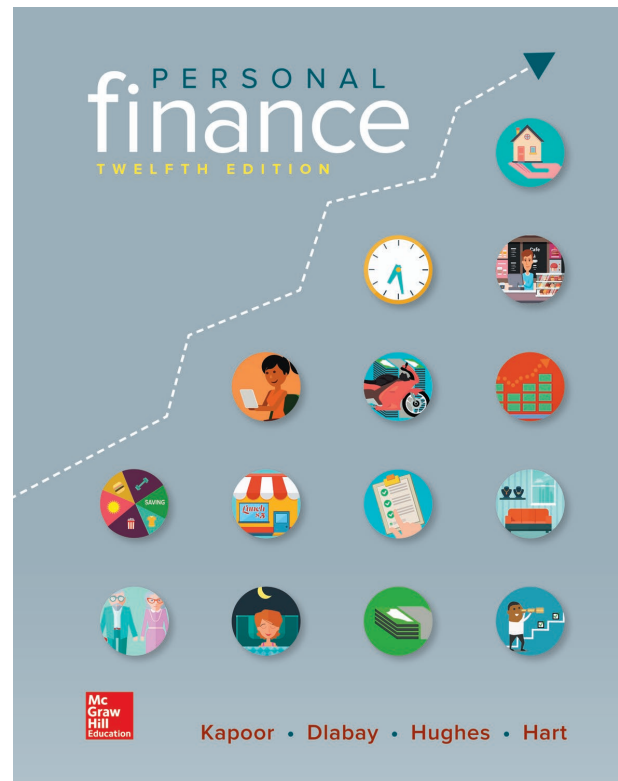
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Personal Finance Offers You Everything You Have Always Expected . . . and More!

The primary purpose of this book is to help you apply the personal finance practices you learn from the book and from your instructor to your own life. The following *new* features of the 12th edition expand on this principle. You can use them to assess your current personal financial literacy, identify your personal finance goals, and develop and apply a personal finance strategy to help you achieve those goals. (*For a complete list of all of the features in Personal Finance, 12th edition, refer to the Guided Tour on pages xviii–xxiii.*)

FINANCIAL LITERACY IN MY LIFE

This edition has moved with a laser-like focus toward the concept of financial literacy. In our many years of teaching and evaluating what knowledge and skills are most important to the lifelong success of our students, financial literacy—the ability to understand and interpret knowledge relating to the financial decisions we make—looms largest. We hope that students will remember all of the details we have put so much time and care into writing, and that you put into teaching. If nothing else, though, we feel we have been successful if students come out of this course with the skills required to interpret financial information and to make wise decisions about their own money, and the confidence that comes with knowing they are able to solve the problems they encounter.

Throughout the text, we spend more time talking about financial literacy. The new chapter opening vignettes ask questions about “Financial Literacy in My Life.” The Financial Planning features have been tweaked to emphasize “my life”—the life and decisions that you, the student, will make.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
Chapter 1	<i>Revised exhibit:</i> Changing economic conditions and financial decisions	Provides updated coverage of economic indicators, showing how they might influence financial planning decisions.
	<i>New Financial Planning for My Life feature</i>	Provides students with a way to assess their financial health as they get started in building their financial plan.
	<i>Revised Dashboard feature</i>	Provides an overview of emergency savings funds.
	<i>New Continuing Case:</i> Personal Finance Basics and the Time Value of Money	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 2	<i>New How to . . . Feature</i>	Emphasizes the career planning actions that students can take to target employment in a particular field.
	<i>New Continuing Case:</i> Financial Aspects of Career Planning	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
	<i>New Smart Money Minute feature</i>	Discusses the proliferation of new resume templates.
	<i>New content:</i> Cover letter tips	Covers ways to stand out in a cover letter.
	<i>New example:</i> The Q Letter	Provides a sample of a Q letter, an alternative to the traditional cover letter.
Chapter 3	<i>New content:</i> Differing outlooks and attitudes toward money	Provides information about the different ways that a student's relationship to money may shape a budget.
	<i>New content:</i> The phases of the budgeting process	Organizes the steps that students should take to create and implement a budget.
	<i>New Smart Money Minute feature</i>	Covers statistics on savings behavior.
	<i>New Continuing Case:</i> Money Management Strategy	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 4	<i>Updated Smart Money Minute feature</i>	Updates statistics on most and least "tax-friendly" states in the U.S.
	<i>Revised content:</i> Tax rates	Demonstrates how to calculate total tax due using a tax bracket schedule, with most current information.
	<i>Expanded content:</i> Health care and taxes	Updates students on key changes related to the Affordable Care Act.
	<i>Expanded content:</i> Tax credits	Covers new tax credits for 2016.
	<i>New Smart Money Minute feature</i>	Provides information about the benefits of early filing.
	<i>Revised content:</i> Contacting the IRS	Provides an updated listing of ways to contact the IRS, including through apps.
	<i>New Smart Money Minute feature</i>	Discusses the IRS's increased oversight of tax preparers.
	<i>Revised content:</i> Tax scams	Describes the latest and most popular tax scams.
	<i>Updated Exhibit:</i> How to avoid common filing errors	Provides an updated, detailed list of steps one might take to reduce the likelihood of a filing error.
	<i>New Continuing Case:</i> Planning Your Tax Strategy	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
Chapter 5	<i>New Smart Money Minute feature</i>	Covers access to ATMs without a traditional debit card.
	<i>Updated content: Credit unions</i>	Details the changes happening in credit union membership and services.
	<i>Expanded content: The “Unbanked” and High-Cost Financial Services</i>	Updates coverage of pawnshops, check-cashing outlets, payday loans, rent-to-own centers, and car title loans.
	<i>New exhibit: Financial services comparison</i>	Offers a concise summary of the differences among different types of financial institutions.
	<i>Updated content: Financial services in other cultures</i>	Presents updated information on financial alternatives around the world.
	<i>New Smart Money Minute feature</i>	Warns of potential dangers of "phishing."
	<i>New Continuing Case: Financial Services</i>	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 6	<i>Updated content: Changes in perception about credit.</i>	Provides information why many people use credit to live beyond their means, and why past generations used it sparingly.
	<i>Updated content: Advantages of credit</i>	Describes how most major cards provide benefits, such as accidental death insurance, collision damage waiver, roadside services, gift cards, etc., at no extra cost.
	<i>New content: Smart cards</i>	Includes information that some credit cards include increased security measures, and discussion of how those features work.
	<i>New content: Use of home equity loans as credit</i>	Expands discussion on the pros, cons, and appropriate uses of home equity loans.
	<i>New Smart Money Minute feature</i>	Covers how to establish a strong record of credit.
	<i>New Smart Money Minute feature</i>	Provides information on how to protect your security with mobile payments.
	<i>Updated Exhibit 6-9: Federal government agencies that enforce consumer credit laws</i>	Shows official consumer complaint form.
	<i>Updated Exhibit 6-11: Consumer credit laws</i>	Provides updated information about federal government agencies that enforce consumer credit laws.
	<i>New Continuing Case: Introduction to Consumer Credit</i>	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 7	<i>Updated content: Chapter 13 bankruptcy</i>	Updates statistics and fee information on Chapter 13 bankruptcy in the U.S. in recent years.
	<i>New Continuing Case: Choosing a Source of Credit</i>	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 8	<i>New content: Factors that influence buying</i>	Acknowledgement and discussion that psychological factors affect buying strategies.
	<i>New Smart Money Minute feature</i>	Offers tips for living in a frugal and environmentally friendly way.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
Chapter 8 (Cont.)	<i>New Smart Money Minute feature</i>	Discusses new safety features appearing in vehicles.
	<i>New Smart Money Minute feature</i>	Offers an explanation of bartering as an alternative way to exchange goods and services.
	<i>New Smart Money Minute feature</i>	Provides a breakdown of <i>Consumer Reports'</i> automobile testing process.
	<i>Updated content: Common frauds</i>	Presents an up-to-date discussion of popular cons, including new information on crowdfunding and online dating scams.
	<i>Updated content: Prepaid legal services</i>	Discusses the questions that need to be asked before hiring legal assistance.
	<i>New Continuing Case: Consumer Purchasing Strategies and Legal Protection</i>	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 9	<i>Updated Smart Money Minute feature</i>	Offers updated information on the most valuable home upgrades.
	<i>New Smart Money Minute feature</i>	Describes the ins and outs of online mortgage companies.
	<i>Expanded content: Mortgage applications</i>	Offers information on loan estimates.
	<i>Updated Smart Money Minute feature</i>	Suggests common apps and websites to use in researching the homebuying process.
	<i>New Continuing Case: The Housing Decision</i>	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 10	<i>New content: Strange but true tales of insurance</i>	Discusses the strange new world of insurance for any and everything.
	<i>New feature: Flood coverage</i>	Lists crucial facts on flooding and flood insurance in the U.S.
	<i>New content: When home insurance coverages collide</i>	Presents the very real dangers of not understanding anti-concurrent causation clauses in your home insurance coverage.
	<i>New example: Increase a deductible to reduce the premium</i>	Provides a mathematical example to show how paying a higher deductible affects your premium.
	<i>New feature: Pay as you go insurance</i>	Outlines how new "pay as you go" insurance plans work.
	<i>New Continuing Case: Property and Motor Vehicle Insurance</i>	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 11	<i>Revised coverage: High medical costs</i>	Provides revised and updated information on runaway health care costs.
	<i>Revised coverage: High administrative costs</i>	Discusses the ethics of high administrative costs in health care.
	<i>New Smart Money Minute feature: Medical insurance costs</i>	Covers the costs of private insurance.
	<i>New Exhibit 11-4</i>	Demonstrates costs of long-term care nationwide.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
Chapter 11 (Cont.)	<i>New Exhibit 11-5</i>	Provides resources that can be used to get information about long-term care.
	<i>New example:</i> Reimbursement versus indemnity	Explains the trade-off between reimbursement and indemnity using a real-life scenario.
	<i>Updated coverage:</i> Employer self-funded health plans	Provides new information about self-funded health plans.
	<i>New Exhibit 11-7</i>	Compares HSAs, FSAs, and HRAs.
	<i>New coverage:</i> Private insurance companies	Describes that as of September 23, 2012, all health insurance companies and group health plans are required to provide a summary of health plan's benefits and coverage.
	<i>New feature:</i> Health care law and taxes	Explains the relationship between the Affordable Care Act and personal taxes.
	<i>New coverage:</i> The Affordable Care Act and the Individual Shared Responsibility Provision	Describes the Affordable Care Act and its provisions and exemptions in detail.
	<i>Updated content:</i> Sources of health care information	Provides an updated roster of reliable sources of health care information.
Chapter 12	<i>Updated content:</i> Life insurance	Provides updated information on life insurance policies and their face value as of 2016.
	<i>Revised Exhibit 12-1</i>	Illustrates expectations of life and expected deaths based on sex and age in 2016.
	<i>New content:</i> Multiple of income method	Presents an additional method for determining the amount of insurance.
	<i>Updated Smart Money Minute feature</i>	Provides information on the amount of hours and equivalent wage of a stay-at-home mom.
	<i>Revised Exhibit 12-3:</i> Family need method worksheet	Provides an updated rubric to use when determining the amount of life insurance you need.
	<i>New Smart Money Minute feature:</i> Financial jeopardy	Describes the importance of life insurance in establishing financial stability.
	<i>Revised coverage:</i> Limited payment policy	Updates the statistics on premiums paid by those in excellent health.
	<i>Revised feature:</i> Preferred rates	Provides updated guidelines for achieving the lowest rates.
	<i>Updated Smart Money Minute feature:</i> Face amount of life insurance policies	Provides updated statistics about the average face amount of life insurance policies.
	<i>Updated Exhibit 12-7</i>	Shows updated data for the growth of different classes of life insurance.
<i>New Continuing Case:</i> Life Insurance	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.	

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
Chapter 13	<i>New Smart Money Minute feature:</i> Choosing a credit card	Provides information on choosing a credit card.
	<i>Updated coverage:</i> Managing a financial crisis	Includes new information on the government's efforts to maintain a sound economy and the effects of the business cycle on the economy.
	<i>Updated coverage:</i> Risk-return tradeoff	Uses Netflix stock as an updated example.
	<i>Updated Smart Money Minute feature:</i> U.S. income levels	Gives updated information for different income levels in the United States.
	<i>Updated Exhibit 13-6</i>	Provides an up-to-date roster of internet resources to be used in personal financial planning.
	<i>New examples:</i> Real-world examples	Uses real-world companies including Netflix, J.M. Smucker, Chesapeake Energy, Coca-Cola, Kraft Foods Group, Shutterfly, Biogen, AT&T, and General Mills to illustrate key topics in the chapter.
	<i>New Continuing Case:</i> Investing Fundamentals	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 14	<i>Updated content:</i> The psychology of stock investing	Explains the psychological reasons why people choose stocks for a long-term investment program.
	<i>Updated Smart Money Minute feature:</i> Stock ownership	Shows updated statistics about what groups own stock.
	<i>Updated information:</i> Income from dividends	Explains the importance of the record date for a quarterly dividend distribution for Chevron.
	<i>Updated Exhibit 14-2</i> Sample stock transaction	Illustrates how investors can make money with a stock investment in General Electric.
	<i>Updated Exhibit 14-5:</i> Stock information from the Internet	Describes the type of information provided by the Yahoo! Finance website for the Gap Corporation.
	<i>Updated Smart Money Minute feature:</i> DJIA	Provides new information about historical values for the Dow Jones Industrial Average for the period December 2009 through December 2015.
	<i>New Exhibit 14-7:</i> Value Line research information	Illustrates the type of detailed research information for Dollar Tree, Inc. available from the Value Line professional advisory service
	<i>Updated coverage:</i> Numerical measures	Provides updated examples for all examples in the section Dividend and Total Return Calculations.
	<i>Updated coverage:</i> Buying and selling stocks	Includes new information on the secondary market.
	<i>Updated Exhibit 14-8:</i> Typical commission charges	Shows current commission charges for some popular online brokerage firms.
	<i>Revised Exhibit 14-9:</i> Dollar-cost averaging	Includes seven years of investments instead of four years for the dollar-cost averaging example.
	<i>Updated example:</i> Margin transactions	Provides an example of how investors can increase their profits by using margin.
	<i>Updated example:</i> Selling short	Provides an updated example on the selling short process.
	<i>New Continuing Case:</i> Investing in Stocks	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
Chapter 15	<i>New Exhibit 15-1:</i> Differences between bonds and stocks	Includes information about the most important differences between bonds and stocks.
	<i>Updated Smart Money Minute feature:</i> Bond yields	Provides updated information for the yields on high-quality corporate bonds.
	<i>Updated coverage:</i> Convertible bonds	Updates coverage on convertible bonds with an updated example from Wesco International.
	<i>Revised example:</i> Interest calculation	Shows students how to calculate the interest for a \$1,000 Coca-Cola bond that pays 3.20 percent annual interest.
	<i>New coverage:</i> Dollar appreciation of bond value	Provides additional discussion around the effects of broader economic policies on bond value.
	<i>Updated example:</i> Approximate market value	Shows how a bond's value can change because of changes in overall interest rates in the economy.
	<i>Updated coverage:</i> A typical bond transaction	Describes how you might buy or sell a Bank of America bond.
	<i>Revised content:</i> Government securities	Addresses the quality of securities issued by the U.S. government.
	<i>Updated Smart Money Minute feature:</i> Treasury yields	Provides information about yields for 10-year treasury notes from 1990 to March 2015.
	<i>Revised Exhibit 15-6:</i> Bond information	Gives information from the Yahoo! Finance website about a Dell Corporation bond.
	<i>Revised examples:</i> Yields	Includes current dollar values for all the examples in the section.
	<i>Revised feature:</i> Financial Planning Calculations	Gives current financial information for Home Depot that can be used to calculate the times interest earned ratio.
<i>Updated coverage:</i> Other sources of information	Provides up-to-date sources to turn to for information on bonds.	
<i>New Continuing Case:</i> Investing in Bonds	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.	
Chapter 16	<i>Updated Smart Money Minute feature:</i> Mutual fund ownership	Includes current information about the age of investors who own mutual funds.
	<i>Updated Exhibit 16-1:</i> Fund diversification	Shows the type of stocks and securities included in the Invesco Growth and Income fund.
	<i>Updated Exhibit 16-2:</i> Fund fee table	Illustrates the fee table for the Davis New York Venture fund.
	<i>Updated Smart Money Minute feature:</i> Investing in mutual funds	Illustrates the reasons why people invest in funds.
	<i>Updated Exhibit 16-4:</i> Large funds	Updates information about three large funds: The Vanguard Group, Fidelity Investments, and American Funds.
	<i>New Exhibit 16-6:</i> Information from <i>Money</i> magazine	Shows a portion of the "Money 50: The World's Best Mutual Funds and ETFs" article from <i>Money</i> magazine.
	<i>New Continuing Case:</i> Investing in Mutual Funds	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
Chapter 17	<i>Updated Smart Money Minute feature:</i> Home ownership rates	Shows the trends in home ownership in the U.S. over the last 50 years, by region.
	<i>Expanded content:</i> Your home as an investment	Presents the questions you might want to ask to see if you're ready to buy a home.
	<i>New Smart Money Minute feature:</i> Housing share of net worth	Illustrates that home ownership, as a percentage of net worth, is on the rise.
	<i>Updated Exhibit 17-2:</i> U.S. home sales	Shows that recent economic indicators suggest that the worst of the housing crisis is over.
	<i>Revised and updated coverage:</i> Gold bullion	Provides the latest information on bullion production by the U.S. government.
	<i>Updated Exhibit 17-4:</i> Gold prices	Illustrates how the price of gold has fluctuated from 1976 to 2016.
	<i>Revised Smart Money Minute feature:</i> Biggest gold producers	Shows the biggest producers of gold in the world as of 2014.
	<i>New Continuing Case:</i> Investing in Real Estate	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.
Chapter 18	<i>Revised coverage:</i> Why retirement planning?	Provides updated statistics about Americans' attitudes toward retirement and recommend means to boost contributions.
	<i>Expanded coverage:</i> Starting early	Presents advice on saving for retirement.
	<i>Expanded coverage:</i> Housing	Details considerations that should be taken before obtaining a reverse mortgage.
	<i>Updated Exhibit 18-4:</i> Older household expenditures	Illustrates how an "average" older household spends its money (2013).
	<i>Updated Smart Money Minute feature:</i> Who gets Social Security?	Shows what groups are collecting Social Security, as of 2015.
	<i>Updated Smart Money Minute feature:</i> Monthly benefits	Presents average monthly Social Security benefits for different groups.
	<i>Updated Exhibit 18-8:</i> The future of Social Security	Shows that the number of workers per beneficiary has plummeted since 1945.
	<i>Updated coverage:</i> Internet access	Describes how to create a mySocial Security account.
	<i>Updated Exhibit 18-8:</i> Workers per beneficiary	Cautions that the number of workers per Social Security beneficiary is dropping in the U.S.
	<i>New feature:</i> Conflicts of interest	Provides an expanded discussion of what conflicts of interest in retirement advice cost.
<i>New Continuing Case:</i> Starting Early	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.	

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
Chapter 19	<i>Revised content:</i> Wills	Covers the hazards of not having a will.
	<i>Updated content:</i> Credit-shelter trust	Points out that a married couple will not pay any estate tax if their estate is less than \$10.9 million in 2016.
	<i>Revised content:</i> Federal and state estate taxes	Provides the latest available information about gift taxes (2016).
	<i>New Continuing Case:</i> Estate Planning	Allows students an opportunity to assess various financial situations and recommend courses of action, based on the knowledge gained in mastering the chapter material.

ASSURANCE OF LEARNING

Many educational institutions today are focused on the notion of assurance of learning, an important element of some accreditation standards. *Personal Finance*, 12th edition, is designed specifically to support your assurance of learning initiatives with a simple, yet powerful, solution.

Each test bank question for *Personal Finance*, 12th edition, maps to a specific chapter learning outcome/objective listed in the text. You can use the test bank software to easily query for learning outcomes/objectives that directly relate to the learning objectives for your course. You can then use the reporting features of the software to aggregate student results in similar fashion, making the collection and presentation of assurance of learning data simple and easy.

Guided Tour

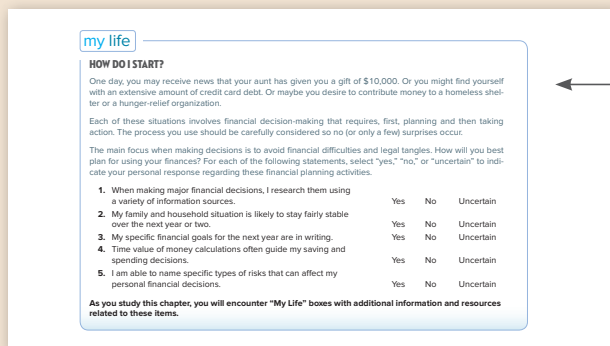
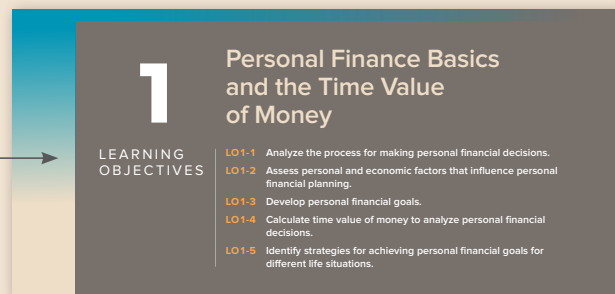
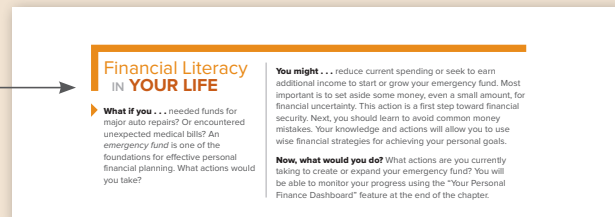
Chapter Opener: The chapter opener contains new features that serve as the chapter road map at a glance!

Financial Literacy in Your Life

Covers why and how the issues presented in the chapter are important, and presents some alternatives that one might consider when facing related decisions. There is a strong emphasis here on action.

Learning Objectives

A summary of learning objectives is presented at the start of each chapter. These objectives are highlighted at the start of each major section in the chapter and appear again in the end-of-chapter summary. The learning objectives are also used to organize the end-of-chapter problems and activities, as well as materials in the *Instructor's Manual* and *Test Bank*. Problems in *Connect* can also be organized using the objectives.



My Life

The *My Life* concept begins with the chapter opener. It presents students with an engaging scenario that relates what they're about to learn to their own lives. The follow-up questions are designed to get students thinking about how involved they currently are in their personal finances and to motivate them to try new beneficial practices in their own personal finance life. The *My Life* boxes throughout the chapters and the Learning Objectives in the chapter summary expand on this concept.

Key Terms

Key terms appear in bold type and in the margin definition boxes. The terms and their page references are also listed at the end of each chapter.

My Life Boxes

My Life boxes appear next to material that relates back to the opening *My Life* scenario and the Learning Objectives. These boxes offer useful tips and possible solutions to help students better manage their finances.

Smart Money Minute

Each chapter contains several *Smart Money Minute* features with fun facts, information, and financial planning assistance.

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PART 1 PLANNING YOUR PERSONAL FINANCES

For example, \$500 on deposit at 6 percent for six months would earn \$15 ($\$500 \times 0.06 \times 6/12$, or 1/2 year).

The increased value of money from interest earned involves two types of time value of money calculations, future value and present value. The amount that will be available at a later date is called the *future value*. In contrast, the current value of an amount desired in the future is the *present value*. Five methods are available for calculating time value of money:

1. **Formula Calculation.** With this conventional method, math notations are used for computing future value and present value.
2. **Time Value of Money Tables.** Traditionally, before calculators and computers, future value and present value tables were used to provide for easier computations.
3. **Financial Calculator.** A variety of calculators are programmed with financial functions. Both future value and present value calculations are performed using appropriate keystrokes.
4. **Spreadsheet Software.** Excel and other spreadsheet programs have built-in formulas for financial computations, including future value and present value.
5. **Websites and Apps.** Many time-value-of-money calculators are available online and through mobile devices. These programs may be used to calculate the future value of savings as well as loan payment amounts.

future value The amount to which current savings will increase based on a certain interest rate and a certain time period; also referred to as compounding.

my life 4
Time value of money calculations often guide my saving and spending decisions. To assist you with using future value and present value computations for achieving personal financial goals, several websites are available: for example, www.dinkytown.net, www.moneychimp.com/calculator, and cgi.money.cnn.com/tools.

FUTURE VALUE OF A SINGLE AMOUNT Deposited money earns interest that will increase over time. **Future value** is the amount to which current savings will grow based on a certain interest rate and a certain time period. For example, \$100 deposited in a 6 percent account for one year will grow to \$106. This amount is computed as follows:
Future value = $\$100 + (\$100 \times 0.06 \times 1 \text{ year}) = \106

The same process could be continued for a second, third, and fourth year, but the computations would be time-consuming. The previously mentioned calculation methods make the process easier. An example of the future value of a single amount might involve an investment of \$650 earning 8 percent for 10 years. This situation would be calculated as follows:

Formula	Time Value of Money Table	Financial Calculator	Spreadsheet Software
$FV = PV(1 + i)^n$	Using Exhibit 14.A, Chapter Appendix, multiply the amount deposited by the factor for the interest rate and time period.	$650 \times 1.99 = \$1,403.55$	= FV(rate, periods, amount per period, single amount) = FV(0.08, 10, -650) = \$1,403.50

(Different financial calculators will require different keystrokes.)

8

PART 1 PLANNING YOUR P

smart money minute

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, and objectivity to prevent a conflict of interest, and has a commitment to continuing education.

computations are often referred to as *compounding*, since interest is continuously earned interest. Compounding allows the future value of a deposit

PFP Sheet 1
Personal data

PFP Sheet 2
Financial institutions and advisers

PRACTICE QUIZ 1-1

1. What are the main elements of every decision we make?
2. What are some risks associated with financial decisions?
3. What are some common sources of financial planning information?
4. Why should you reevaluate your actions after making a personal financial decision?

Practice Quiz

The *Practice Quiz* at the end of each major section provides questions to help students assess their knowledge of the main ideas covered in that section. As shown here, many of these quizzes include references to related *Personal Financial Planning* sheets, offered both in Excel and in hard copy at the back of the book.

A variety of end-of-chapter features are offered to support the concepts presented throughout each chapter.

Personal Finance Dashboard and My Life Stages

There are increasing numbers of nontraditional students taking personal finance. The Dashboard feature provides students of all ages with a high-level snapshot outlining how to evaluate progress in achieving mastery of the chapter concepts in real life. The *My Life Stages* box at the end of each chapter provides personal finance action items for students of all ages.

my life stages for financial planning

YOUR PERSONAL FINANCE DASHBOARD

The creation of an emergency fund is often overlooked. Financial advisers suggest saving three to six months of living expenses for unexpected situations. A larger amount may be needed if you are self-employed or a full-time student.

Your emergency fund can be measured with a dashboard, a tool used by organizations to monitor key performance indicators such as delivery time, product defects, or customer complaints. As an individual, you can use a *personal finance dashboard* to assess your financial situation. As with driving, a personal finance dashboard allows you to keep track of your progress to a destination.

YOUR SITUATION Have you started your emergency fund? Do you make progress each month? Where is the needle on your Personal Finance Dashboard for an emergency fund? Other personal financial planning actions you might consider during various stages of your life include:

In College	In My 20s	In My 30s and 40s	In My 50s and Beyond
<ul style="list-style-type: none"> Develop wise budgeting habits Create a regular savings program Establish a plan for wise use of banking services and credit 	<ul style="list-style-type: none"> Pay off any college loans Increase amounts saved and invested Continue proper spending and credit habits 	<ul style="list-style-type: none"> Assess progress toward long-term financial goals Evaluate needed insurance as a result of changes in household or financial situation 	<ul style="list-style-type: none"> Assess need for long-term health care coverage Review your will and estate plan Consider various activities, locations for retirement

Financial Planning Problems

With more added to this edition, these problems allow students to apply their quantitative analysis of personal financial decisions.

FINANCIAL PLANNING PROBLEMS

(Note: Some of these problems require the use of the time value of money tables in the Chapter Appendix.)

1. **Calculating the Future Value of Property.** Ben Collins plans to buy a house for \$220,000. If that real estate is expected to increase in value by 3 percent each year, what will its approximate value be seven years from now? LO1-2
2. **Using the Rule of 72.** Using the rule of 72, approximate the following amounts. LO1-2
 - 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?
3. **Determining the Inflation Rate.** In 2006, selected automobiles had an average cost of \$16,000. The average cost of those same automobiles is now \$28,000. What was the rate of increase for these automobiles between the two time periods? LO1-2
4. **Computing Future Living Expenses.** A family spends \$48,000 a year for living expenses. If prices increase by 2 percent a year for the next three years, what amount will the family need for their living expenses after three years? LO1-2
5. **Calculating Earnings on Savings.** What would be the yearly earnings for a person with \$8,000 in savings at an annual interest rate of 2.5 percent? LO1-4

Financial Planning Activities

The *Financial Planning Activities* provide methods of researching and applying financial planning topics.

FINANCIAL PLANNING ACTIVITIES

- LO1-1 1. **Determining Personal Risks.** Talk to friends, relatives, and others about their personal financial activities. Ask about potential risks involved with making financial decisions. What actions might be taken to investigate and reduce these risks?
- LO1-1, 1-2 2. **Using Financial Planning Experts.** Prepare a list and contact information for financial planning specialists in your community, such as investment advisers, credit counselors, insurance agents, real estate brokers, and tax preparers, who could assist people with personal financial planning.
- LO1-2 3. **Analyzing Changing Life Situations.** Ask friends, relatives, and others how their spending, saving, and borrowing activities changed when they decided to continue their education, change careers, or have children.
- LO1-2 4. **Researching Economic Conditions.** Locate online sources or apps to determine recent trends in interest rates, inflation, and other economic indicators. Information about the consumer price index (measuring changes in the cost of living) may be obtained at www.bls.gov. Report how this economic information might affect your financial planning decisions.
- LO1-3 5. **Setting Financial Goals.** Ask friends, relatives, and others about their short-term and long-term financial goals. What are some of the common goals for various personal situations? Using Sheet 3 in the *Personal Financial Planner*, create one short-term and one long-term goal for people in these life situations: (a) a young single person, (b) a single parent with a child age 8, (c) a married person with no children, and (d) a retired person.
- LO1-4 6. **Comparing Alternative Financial Actions.** What actions would be necessary to compare a financial planner who advertises "One Low Fee Is Charged to Develop Your Personal Financial Plan" and one that advertises "You Are Not Charged a Fee, My Services Are Covered by the Investment Company for Which I Work"?

FINANCIAL PLANNING CASE

You Be the Financial Planner

At some point in your life you may use the services of a financial planner. However, your personal knowledge should be the foundation for most financial decisions. For each of these situations, determine actions you might recommend:

Situation 1: Fran and Ed Blake, ages 43 and 47, have a daughter who is completing her first year of college and a son three years younger. Currently they have \$42,000 in savings and investment funds set aside for their children's education. With increasing education costs, they are concerned whether this amount is adequate. In recent months, Fran's mother has required extensive medical attention and personal care assistance. Unable to live alone, she is now a resident of a long-term care facility. The cost of this service is \$4,750 a month, with annual increases of about 5 percent. While a major portion of the cost is covered by Social Security and her pension, Fran's mother is unable to cover the entire cost. In addition, Fran and Ed are concerned about saving for their own retirement. While they have consistently made annual deposits to a retirement fund, current financial demands may force them to access some of that money.

Situation 2: "While I knew it might happen someday, I didn't expect it right now." This was the reaction of Patrick Hamilton when his company merged with another organization and moved its offices to another state, resulting in him losing his job. Patrick does have some flexibility in his short-term finances since he has three months of living expenses in a saving account. However, "three months can go by very quickly," as Patrick noted.

Situation 3: Nina Resendiz, age 23, recently received a \$12,000 gift from her aunt. Nina is considering various uses for these unexpected funds including paying off credit card bills from her last vacation or setting aside money for a down payment on a house. Or she might invest the money in a tax-deferred retirement account. Another possibility is using the money for technology certification courses to enhance her earning power. Nina also wants to contribute some of the funds to a homeless shelter and a world hunger organization. She is overwhelmed by the choices and comments to herself, "I want to avoid the temptation of wasting the money on impulse items. I want to make sure I use the money on things with lasting value."

Questions

1. For each situation, identify the main financial planning issues that need to be addressed.
2. What additional information would you like to have before recommending actions in each situation?
3. Based on the information provided and your assessment of the situation, what actions would you recommend for the Blakes, Patrick, and Nina?

Financial Planning Case

Students are given a hypothetical personal finance dilemma and data to work through to practice concepts they have learned from the chapter. A series of questions helps students to use analytic and critical thinking skills while reinforcing chapter topics.

Personal Financial Planner in Action

This feature provides long- and short-term financial planning activities per the concepts learned within the chapter, and links each to relevant *Personal Financial Planner* sheets (located at the end of the book) and websites for further personal financial planning.

PERSONAL FINANCIAL PLANNER IN ACTION

Starting Your Financial Plan
 Planning is the foundation for success in every aspect of life. Assessing your current financial situation, along with setting goals is the key to successful financial planning.

Your Short-Term Financial Planning Activities	Resources
1. Prepare a list of personal and financial information for yourself and family members. Also create a list of financial service organizations that you use.	PPF Sheets 1, 2 http://time.com/money/ www.kiplinger.com
2. Set financial goals related to various current and future needs.	PPF Sheet 4 http://financialplan.about.com
3. Monitor current economic conditions (inflation, interest rates) to determine possible actions to take related to your personal finances.	PPF Sheet 3 www.federalreserve.gov www.bizgov.com
Your Long-Term Financial Planning Activities	Resources
1. Based on various financial goals, calculate the savings deposits necessary to achieve those goals.	PPF Sheet 5 www.dinkytown.net
2. Identify various financial planning actions for you and other household members for the next two to five years.	Exhibit 1-6 www.brightspcakfinancial.com



CONTINUING CASE

Personal Finance Basics and the Time Value of Money

Jamie Lee Jackson, age 24, has recently decided to switch from attending college part-time to full-time in order to pursue her business degree and aims to graduate within the next three years. She has 55 credit hours remaining in order to earn her bachelor's degree, and knows that it will be a challenge to complete her course of study while still working part-time in the bakery department of a local grocery store, where she earns \$390 a week. Jamie Lee wants to keep her part-time job at the grocery store, as she loves baking and creates very decorative cakes. She dreams of opening her own cupcake café within the next five years. She also realizes that by returning to school full-time, she will forgo any free time that she enjoys now socializing with friends.

Jamie Lee currently shares a small apartment with a friend, and they split all of the associated living expenses, such as rent and utilities. She would really like to eventually have a place of her own. Her car is still going strong, even though it is seven years old, and she has no plans to buy a new one any time soon. She is carrying a balance on her credit card and is making regular monthly payments of \$50 with hopes of paying it off within a year. Jamie has also recently taken out a student loan to cover her educational costs and expenses. Jamie Lee also began depositing \$1,800 a year in a savings account that earns 2 percent interest, in hopes of having the \$9,000 down payment needed to start the cupcake café two years after graduation.

Current Financial Situation:

Checking account: \$1,250
 Emergency Fund savings account: \$3,100
 Car: \$8,000
 Student loan: \$5,400
 Credit card balance: \$400
 Gross annual salary: \$2,125
 Net monthly salary: \$1,560

Questions

- Using *Personal Financial Planner* Sheet 3, Personal Financial Goals, as a guide, what are Jamie Lee's short-term financial goals? How do they compare to her intermediate financial goals?
- Browse Jamie Lee's current financial situation. Using the *SMART* approach, what recommendations would you make for her to achieve her long-term goals?
- Name two opportunity costs that would be considered in Jamie Lee's situation.
- Jamie Lee needs to save a total of \$9,000 in order to get started in her cupcake café venture. She is presently depositing \$1,800 a year in a regular savings account earning 2% interest.

Using *Personal Financial Planner* Sheet 5, Time Value of Money, as a guide, how much will she have accumulated five years from now in this regular savings account, assuming she will be leaving her Emergency Fund savings account balance untouched and for a rainy day?

Continuing Case

The new continuing case gives students the opportunity to apply course concepts in a life situation. This feature encourages students to evaluate the changes that affect a family and then respond to the resulting shift in needs, resources, and priorities through the questions at the end of each case.



DAILY 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."

Directions

Nearly everyone who has taken the effort to keeping a Daily Spending Diary has found it beneficial. While at first the process may seem tedious, after awhile, recording this information becomes easier and faster.

Using the "Daily Spending Diary" sheets, 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.

Analysis Questions

- What did your Daily Spending Diary reveal about your spending habits? What areas of spending might you consider changing?
- How might your Daily Spending Diary assist you when identifying and achieving financial goals?

The Daily Spending Diary sheets are located in Appendix D at the end of the book and on the library resource site within *Connect*.

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 try to donate to your favorite local charity every 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 (in Appendix D and online) and end-of-chapter activities 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 students' personal finances.

Personal Finance continues to provide instructors and students with features and materials to create a learning environment that can be adapted to any educational setting.

Personal Financial Planner Sheets

The PFP sheets that correlate with sections of the text are conveniently located at the end of the text. Each worksheet asks students to work through the application and record their own personal financial plan answers. These sheets apply concepts learned to students' personal situation and serve as a road map to their personal financial future. Students can fill them out, submit them for homework, and keep them filed in a safe spot for future reference!

Key websites 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. The authors also recommend favorite apps to help students master the relevant contents.

Look for one or more PFP icons next to many Practice Quizzes. The icons direct students to the *Personal Financial Planner* sheet that corresponds with the preceding section.

PERSONAL FINANCIAL PLANNER

22

Name: _____ Date: _____

Tax Planning Activities

Purpose: To consider actions that can prevent tax penalties and may result in tax savings.
Instructions: Consider which of the following actions are appropriate to your tax situation. This sheet is also available in an Excel spreadsheet on the library resource site in Connect.
Suggested websites: www.irs.gov turbotax.intuit.com/tax-tools/

	Action to be taken (if applicable)	Completed		
Filing Status/Withholding <ul style="list-style-type: none"> • Change filing status or exemptions because of changes in life situation. • Change amount of withholding because of changes in tax situation. • Plan to make estimated tax payments (due the 15th of April, June, September, and January). 				
Tax Records/Documents <ul style="list-style-type: none"> • Organize home files for ease of maintaining and retrieving data. • Send current mailing address and correct Social Security number to IRS, place of employment, and other sources of income. 				
Annual Tax Activities <ul style="list-style-type: none"> • Be certain all needed data and current tax forms are available well before deadline. • Research tax code changes and uncertain tax areas. 				
Tax Savings Actions <ul style="list-style-type: none"> • Consider tax-exempt and tax-deferred investments. • If you expect to have the same or lower tax rate next year, accelerate deductions into the current year. • If you expect to have the same or lower tax rate next year, delay the receipt of income until next year. • If you expect to have a higher tax rate next year, delay deductions because they will have a greater benefit. • If you expect to have a higher tax rate next year, accelerate the receipt of income to have it taxed at the current lower rate. • Start or increase use of tax-deferred retirement plans. • Other. 				
What's Next for Your Personal Financial Plan? <ul style="list-style-type: none"> • Identify saving and investing decisions that would minimize future income taxes. • Develop a plan for actions to take related to your current and future tax situation. 				

Suggested Apps:

- IRSgo
- IDeddit



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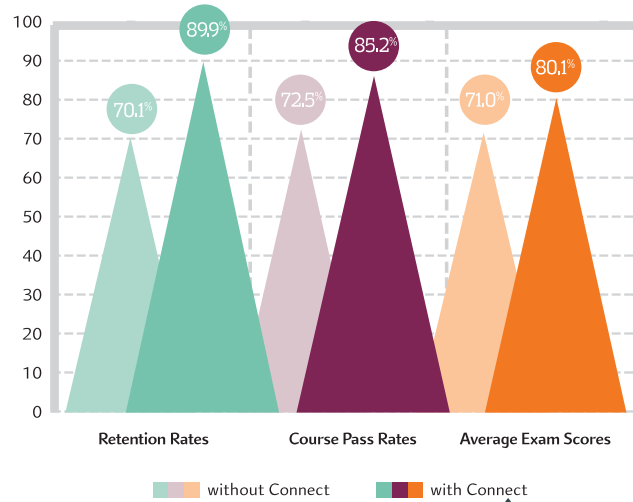
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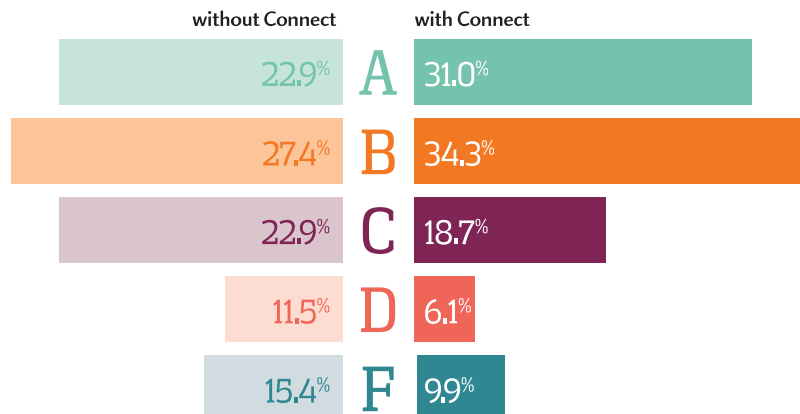
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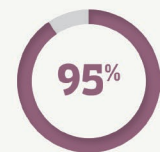
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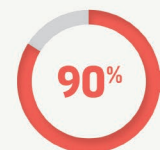
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For Instructors

The *Instructor Resources* for this edition can be found in *Connect*, and include all supplementary material, including the *Instructor’s Manual*, *Test Bank*, computerized Test Gen testing software, PowerPoint, and related Web links:

- The *Instructor’s Manual* 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 problems, and cases.
- The *Test Bank*, revised by Michelle Grant, *Bossier Parish Community College*, and reviewed by Montgomery Hill, *Northern Virginia Community College*, consists of almost 2,000 true–false, multiple-choice, and essay questions. Each test item is tagged with a corresponding learning objective, topic, level of difficulty, page number, and Blooms category. Use these tags to easily and effectively customize your test bank.
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Many helpful study tools for students now reside in *Connect*. These include Narrated PowerPoint slides, crossword puzzles, the Excel-based *Personal Financial Planning* sheets, and video case media.

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If you teach personal finance as a telecourse, this text is a perfect fit! A telecourse program is available from Coastline Community College titled *Dollar\$ & Sense: Personal Finance for the 21st Century* that is based on the Kapoor, Dlabay, Hughes, and Hart text. The program includes 26 thirty-minute videotapes, which you purchase directly from Coast by contacting Lynn Dahnke, Marketing Director, Coast Learning Systems, 11460 Warner Ave., Fountain Valley, CA 92708, (800) 547-4748 or www.CoastLearning.org. The course also has a *Telecourse Study Guide* available that connects the videos to the text.

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Personal Financial Planner



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1

Personal Finance Basics and the Time Value of Money

LEARNING OBJECTIVES

- LO1-1** Analyze the process for making personal financial decisions.
- LO1-2** Assess personal and economic factors that influence personal financial planning.
- LO1-3** Develop personal financial goals.
- LO1-4** Calculate time value of money to analyze personal financial decisions.
- LO1-5** Identify strategies for achieving personal financial goals for different life situations.

Financial Literacy IN YOUR LIFE

▶ **What if you . . .** needed funds for major auto repairs? Or encountered unexpected medical bills? An *emergency fund* is one of the foundations for effective personal financial planning. What actions would you take?

You might . . . reduce current spending or seek to earn additional income to start or grow your emergency fund. Most important is to set aside some money, even a small amount, for financial uncertainty. This action is a first step toward financial security. Next, you should learn to avoid common money mistakes. Your knowledge and actions will allow you to use wise financial strategies for achieving your personal goals.

Now, what would you do? What actions are you currently taking to create or expand your emergency fund? You will be able to monitor your progress using the “Your Personal Finance Dashboard” feature at the end of the chapter.

my life

HOW DO I START?

One day, you may receive news that your aunt has given you a gift of \$10,000. Or you might find yourself with an extensive amount of credit card debt. Or maybe you desire to contribute money to a homeless shelter or a hunger-relief organization.

Each of these situations involves financial decision-making that requires, first, planning and then taking action. The process you use should be carefully considered so no (or only a few) surprises occur.

The main focus when making decisions is to avoid financial difficulties and legal tangles. How will you best plan for using your finances? For each of the following statements, select “yes,” “no,” or “uncertain” to indicate your personal response regarding these financial planning activities.

- | | | | |
|---|-----|----|-----------|
| 1. When making major financial decisions, I research them using a variety of information sources. | Yes | No | Uncertain |
| 2. My family and household situation is likely to stay fairly stable over the next year or two. | Yes | No | Uncertain |
| 3. My specific financial goals for the next year are in writing. | Yes | No | Uncertain |
| 4. Time value of money calculations often guide my saving and spending decisions. | Yes | No | Uncertain |
| 5. I am able to name specific types of risks that can affect my personal financial decisions. | Yes | No | Uncertain |

As you study this chapter, you will encounter “My Life” boxes with additional information and resources related to these items.

The Financial Planning Process

LO1-1

Analyze the process for making personal financial decisions.

Being “rich” means different things to different people. Some define wealth as owning many expensive possessions and having a high income. People may associate being rich with not having to worry about finances or being able to pay bills. For others, being rich means they are able to donate to organizations that matter to them.

How people obtain financial wealth varies. Starting a successful business or pursuing a high-paying career are common paths to wealth. However, frugal living and wise investing can also result in long-term financial security. In recent years, many have discovered that the quality of their lives should be measured in terms of something other than money and material items. A renewed emphasis on family, friends, and serving others has surfaced.

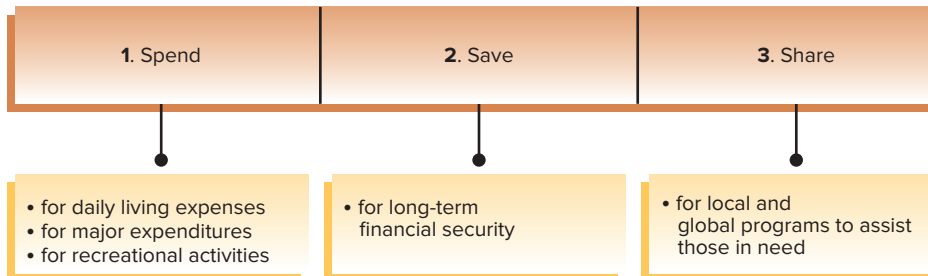
Most people want to handle their finances so that they get full satisfaction from each available dollar. To achieve this and other financial goals, people first need to identify and set priorities. Both financial and personal satisfaction are the result of an organized process that is commonly referred to as *personal money management* or *personal 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 financial position, and any financial activity therefore must also be carefully 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. The advantages of 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 for economic security.
- 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 your personal economic goals.

We all make hundreds of decisions each day. Most of these decisions are quite simple and have few consequences. Some are complex and have long-term effects on our personal and financial situations. Personal financial activities involve three main decision areas:



While everyone makes decisions, few people consider how to make better decisions. As Exhibit 1-1 shows, the financial planning process is a logical, six-step procedure that can be adapted to any life situation.

STEP 1: DETERMINE YOUR CURRENT FINANCIAL SITUATION

First, determine your current financial situation regarding income, savings, living expenses, and debts. Preparing a list of current asset and debt balances and amounts spent for various items gives you a foundation for your financial planning activities. The personal financial statements discussed in Chapter 3 will provide the information needed to match your goals with your current income and potential earning power.

EXAMPLE: Step 1 - Determine Current Situation

Within the next two months, Kent Mullins will complete his undergraduate studies with a major in global business development. He has worked part-time in various sales jobs. He has a small savings fund (\$1,700) and over \$8,500 in student loans. What additional information should Kent have available when planning his personal finances?

How about you? Depending on your current (or future) life situation, what actions might you take to determine your current financial situation?

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

EXHIBIT 1-1

The financial planning process

**STEP 2: DEVELOP FINANCIAL GOALS**

Several times a year, you should analyze your financial values and goals. This activity involves identifying how you feel about money and why you feel that way. Are your feelings about money based on factual knowledge or on the influence of others? Are your financial priorities based on social pressures, household needs, or desires for luxury items? How will economic conditions affect your goals and priorities? 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 an effective savings and investment program for your future financial security.

EXAMPLE: Step 2 - Develop Financial Goals

Kent Mullins has several goals, including paying off his student loans, obtaining an advanced degree in global business management, and working in Latin America for a multinational company. What other goals might be appropriate for Kent?

How about you? Depending on your current (or future) life situation, describe some short-term or long-term goals that might be appropriate for you.

STEP 3: IDENTIFY ALTERNATIVE COURSES OF ACTION

Developing alternatives is crucial when making decisions. Although many factors will influence the available alternatives, possible courses of action commonly fall into these categories:

- *Continue the same course of action.* For example, you may determine that the amount you have saved each month is still appropriate.
- *Expand the current situation.* You may choose to save a larger amount each month.
- *Change the current situation.* You may decide to use a money market account instead of a regular savings account.
- *Take a new course of action.* You may decide to use your monthly savings budget to pay off credit card debts.

Not all of these categories will apply to every decision; however, they do represent possible courses of action. For example, if you want to stop working full time to go to school, you must generate several alternatives under the category “Take a new course of action.”

Creativity in decision making is vital for effective choices. By considering many alternatives, you will likely make more effective and satisfying decisions. For instance, most people believe they must own a car to get to work or school. However, they should consider other alternatives such as public transportation, carpooling, renting a car, shared ownership of a car, or a company car.

Remember, when you decide not to take action, you elect to “do nothing,” which can be a dangerous alternative.



Financial choices require periodic evaluation.

© Tetra Images/Getty Images

EXAMPLE: Step 3 - Identify Alternatives

Kent Mullins has several options available for the near future. He could work full time and save for graduate school; he could go to graduate school full time by taking out an additional loan; or he could go to school part time and work part time. What additional alternatives might he consider?

How about you? Depending on your current (or future) life situation, list various alternatives for achieving the financial goals you identified in the previous step.

STEP 4: EVALUATE YOUR ALTERNATIVES

Next, evaluate possible courses of action, taking into consideration your life situation, personal values, and current economic conditions. How will the ages of dependents affect your saving goals? How do you like to spend leisure time? How will changes in interest rates affect your financial situation?

opportunity cost What a person gives up by making a choice.

CONSEQUENCES OF CHOICES Every decision closes off alternatives. For example, a decision to invest in stock may mean 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. This cost, commonly referred to as the trade-off of a decision, cannot always be measured in dollars. It may refer to the money you forgo by attending school rather than working, but it may also refer to the time you spend shopping around to compare brands for a major purchase. In either case, the resources you give up (money or time) have a value that is lost.

smart money minute

According to the National Endowment for Financial Education, an estimated 70 percent of major lottery winners end up with financial difficulties. These winners often squander their winnings, while others overspend. Many end up declaring bankruptcy. Having more money does not mean you will make better financial choices.

Decision making will be an ongoing part of your personal and financial situation. Thus, you will need to consider the lost opportunities that will result from your decisions. Since decisions vary based on each person's situation and values, opportunity costs will differ for each person.

EVALUATING RISK Uncertainty is 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 these situations.

In many financial decisions, identifying and evaluating risk are difficult (see Exhibit 1-2). The best way to consider risk is to gather information based on your experience and the experiences of others, and to use financial planning information sources.

FINANCIAL PLANNING INFORMATION SOURCES When you travel, you might use a GPS or a map. Traveling the path of financial planning requires a different kind of map. Relevant information is required at each stage of the decision-making process. This book provides the foundation you need to make appropriate personal financial planning decisions. Changing personal, social, and economic conditions will require that you continually supplement and update your knowledge. Exhibit 1-3 offers an overview of the resources available when making personal financial decisions.




EXAMPLE: Step 4 - Evaluate Alternatives

As Kent Mullins evaluates his alternative courses of action, he must consider his income needs for both the short term and the long term. He should also assess career opportunities with his current skills and his potential with advanced training. What risks and trade-offs should Kent consider?

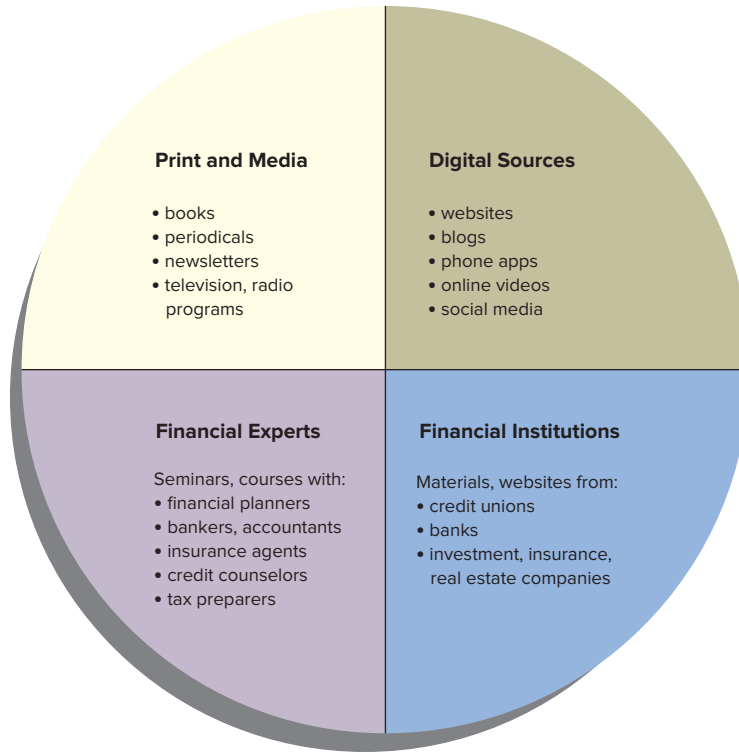
How about you? Depending on your current (or future) life situation, what types of risks might you encounter in your various personal financial activities?

EXHIBIT 1-2

Types of risk

	<ul style="list-style-type: none"> • Rising or falling (deflation) prices cause changes in buying power. • Decide whether to buy something now or later. If you buy later, you may have to pay more.
	<ul style="list-style-type: none"> • Changing interest rates affect your costs (when you borrow) and your benefits (when you save or invest). • Borrowing at a low interest rate when interest rates are rising can be to your advantage. Variable rate loans may increase, resulting in higher payments. If you save when interest rates are dropping, you will earn a lower return with a six-month savings certificate than with a certificate having a longer maturity.
	<ul style="list-style-type: none"> • The loss of a job may result from changes in consumer spending or expanded use of technology. • Individuals who face the risk of unemployment need to save while employed or acquire skills they can use to obtain a different type of work.
	<ul style="list-style-type: none"> • Many factors can create a less than desirable situation. Purchasing a certain brand or from a certain store may create the risk of having to obtain repairs at an inconvenient location. • Personal risk may also take the form of health risks, safety risks, or additional costs associated with various purchases or financial decisions.
	<ul style="list-style-type: none"> • Some savings and investments have potential for higher earnings. However, they may be more difficult to convert to cash or to sell without significant loss in value.

Source: Georgetown University, Center on Education and the Workforce.

EXHIBIT 1-3Financial planning
information sources**STEP 5: CREATE AND IMPLEMENT YOUR FINANCIAL ACTION PLAN**

The next step of the financial planning process involves developing an action plan to identify methods to achieve your goals. For example, you can increase your savings by reducing your spending or by increasing your income through extra hours at work. If you are concerned about year-end tax payments, you may increase the amount withheld from each paycheck, file quarterly tax payments, shelter current income in a tax-deferred retirement program, or invest in tax-exempt securities. As you achieve your short-term and immediate goals, the goals next in priority will come into focus.

To implement your financial action plan, you may need assistance from others. For example, you may use the services of an insurance agent to purchase property insurance or the services of an investment broker to purchase stocks, bonds, or mutual funds.

my life 1

When making major financial decisions, I research a situation using a variety of information sources.

Always consider information from several sources when making financial decisions. In addition to various websites, see Appendix B for other financial planning resources.

EXAMPLE: Step 5 - Implement Financial Action Plan

Kent Mullins has decided to work full time for a few years while he (1) pays off his student loans, (2) saves money for graduate school, and (3) takes a couple of courses in the evenings and on weekends. What are the benefits and drawbacks of this choice?

How about you? Depending on your current (or future) life situation, describe the benefits and drawbacks of a financial situation you have encountered during the past year.

smart money minute

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, and objectivity to prevent a conflict of interest, and has a commitment to continuing education.

STEP 6: REVIEW AND REVISE YOUR PLAN

Financial planning is a dynamic process that does not end when you take action. You need to regularly assess your financial decisions. You should do a complete review of your finances at least once a year. Changing personal, social, and economic factors may require more frequent assessments.

When life events affect your financial needs, this financial planning process will provide a vehicle for adapting to those changes. Regularly reviewing this decision-making process will help you make priority adjustments that will bring your financial goals and activities in line with your current life situation.

EXAMPLE: Step 6 - Review and Revise the Plan

Over the next 6 to 12 months, Kent Mullins should reassess his financial, career, and personal situations. What employment opportunities or family circumstances might affect his need or desire to take a different course of action?

How about you? Depending on your current (or future) life situation, what factors in your life might affect your personal financial situation and decisions in the future?



PFP Sheet 1
Personal data

PFP Sheet 2
Financial institutions and advisers



PRACTICE QUIZ 1-1

1. What are the main elements of every decision we make?
2. What are some risks associated with financial decisions?
3. What are some common sources of financial planning information?
4. Why should you reevaluate your actions after making a personal financial decision?

Influences on Personal Financial Planning

LO1-2

Assess personal and economic factors that influence personal financial planning.

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

Many factors influence daily financial decisions, ranging from age and household size to interest rates and inflation. Three main elements affect financial planning activities: life situation, personal values, and economic factors.

LIFE SITUATION AND PERSONAL VALUES

People in their 20s spend money differently than those in their 50s. Personal factors such as age, income, household size, and personal beliefs influence spending and saving patterns. 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. People are also living longer; over 80 percent of all Americans now living are expected to live past age 65.

The **adult life cycle**—the stages in the family and financial needs of an adult—is an important influence on your financial

my life 2

My family and household situation is likely to stay fairly stable over the next year or two.

Many personal, social, and economic factors can affect your life situation. Refer to Exhibit 1-6 for further information on financial goals and personal finance activities for various life situations.

activities and decisions. Your life situation is also affected by marital status, household size, and employment, as well as events such as

- Graduation (at various levels of education).
- Engagement and marriage.
- The birth or adoption of a child.
- A career change or a move to a new area.
- Dependent children leaving home.
- Changes in health.
- Divorce.
- Retirement.
- 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.

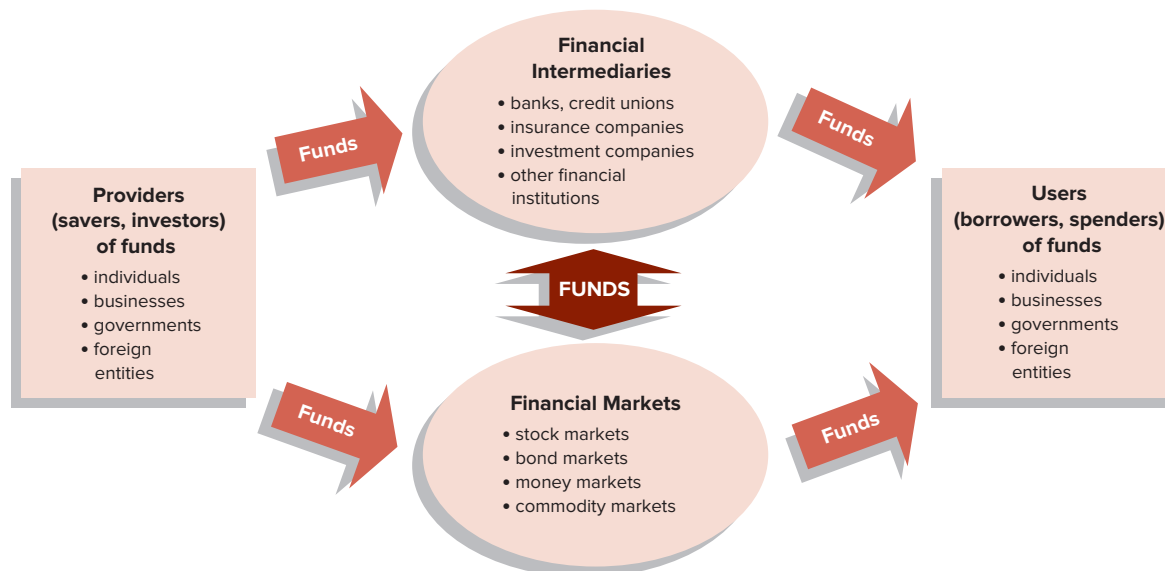
values Ideas and principles that a person considers correct, desirable, and important.

THE FINANCIAL SYSTEM AND ECONOMIC FACTORS

The financial system and daily economic activities influence personal financial decisions. As shown in Exhibit 1-4, money in an economy flows from providers of funds to users of funds through intermediaries and financial markets. The buying and selling of investments occur in these financial settings.

While some investments are physical items (houses, land, gold, rare coins), others represent borrowing or ownership. A *security* is a financial instrument that represents debt or equity. *Debt securities*, such as bonds, represent money borrowed by companies or governments. These debt securities are often bought as an investment. In contrast, *equity securities* (stock) represent ownership in a corporation. Shares of stock are also bought by investors. In addition to stocks and bonds, other examples of securities include mutual funds, certificates of deposit (CDs), and commodity futures.

EXHIBIT 1-4 The financial system



Financial Regulators: Federal Reserve System, Federal Deposit Insurance Corporation, National Credit Union Administration, Office of the Comptroller of the Currency, Consumer Financial Protection Bureau, Securities and Exchange Commission, state banking agencies, state insurance agencies.