personal finance

BUILDING YOUR FUTURE

SECOND EDITION

Robert B. Walker | Kristy P. Walker

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Building Your Future

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COVER IMAGE: **© Monika Hallnowska/Getty Images**
TYPEFACE: **10/12 STIX Mathjax**
COMPOSITOR: **APTARA, INC.**
PRINTER: **R. R. DONNELLEY**

PERSONAL FINANCE: BUILDING YOUR FUTURE

Published by McGraw-Hill/Irwin, a business unit of The McGraw-Hill Companies, Inc., 1221 Avenue of the Americas, New York, NY, 10121.

This book is printed on acid-free paper.

1 2 3 4 5 6 7 8 9 RMN 21 20 19 18 17 16

ISBN 978-0-07-786172-8

MHID 0-07-786172-8

Design Elements

Dripping faucet: © Mipan/iStock/Getty Images RF; Pool balls: © Jan Pietruszka/iStock/Getty Images RF; Smartphone: © Alexsi/E+/Getty Images RF; Arrow: © Deliormanli/E+/Getty Images RF; piggy bank with coins: © Akirastock/iStock/Getty Images RF; three stacked piggy banks: © Henrik5000/iStock/Getty Images RF; four stacked piggy banks: © Lisa Thornberg/E+/Getty Images RF.

Library of Congress Cataloging-in-Publication Data

Names: Walker, Robert B., author. | Walker, Kristy P., author.
Title: Personal finance / Robert B. Walker, Mount Mercy University, Kristy P. Walker, University of Iowa.
Description: Second Edition. | New York : McGraw-Hill Education, 2016. |
Revised edition of the authors' Personal finance, 2013.
Identifiers: LCCN 2016006946| ISBN 9780077861728 (paperback : alk. paper) |
ISBN 0077861728
Subjects: LCSH: Finance, Personal. | BISAC: BUSINESS & ECONOMICS / Personal Finance / General.
Classification: LCC HG179 .W3124 2016 | DDC 332.024—dc23 LC record available at http://lccn.loc.gov/2016006946

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dedication

We dedicate this textbook to our children, Nate, Erin, and Clay, who always make us proud.

about the authors

Robert B. Walker Bob works at the University of Iowa, Tippie College of Business in the John Pappajohn Entrepreneurial Center, where he teaches students to pursue their passions and turn those passions into profit. He received his bachelor's degree in philosophy from Miami University, an MBA from the University of Iowa, and a PhD from Iowa State University. He spent 18 years working in community banks before starting his own consulting practice. During this time, he was the Executive Director of the East Central Iowa Chapter of the American Institute of Banking, a division of the American Bankers Association. He taught for nine years at Kirkwood Community College as Banking and Finance Coordinator and for five years at Mount Mercy University as Department Chair before returning to the University of Iowa, his Alma mater. Dr. Walker served on the Associates Degree Board of Commissioners for the Accreditation Council for Business Schools & Programs (ACBSP) and was actively involved in Kirkwood Community College's initial ACBSP accreditation. He was a Sam M. Walton fellow at Kirkwood Community College, starting the school's Students in Free Enterprise (SIFE) team and is currently lead Sam M. Walton Fellow for the University of Iowa's Enactus team. He is also faculty adviser at the University of Iowa for the Sigma Nu Tau entrepreneurial honors society and I-Envision, the University of Iowa's student entrepreneurial organization.

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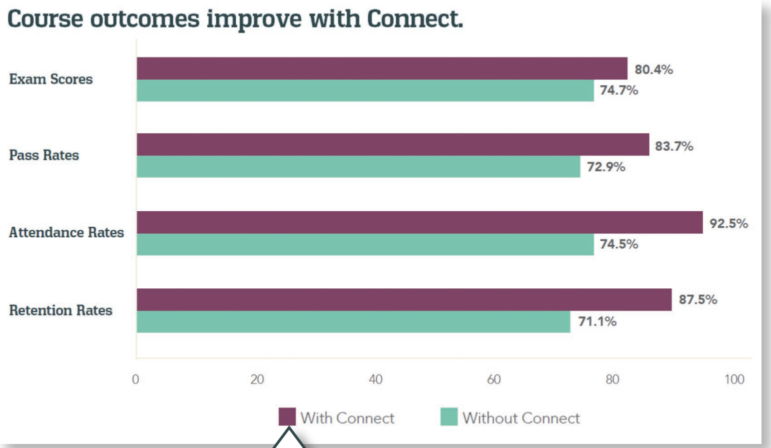

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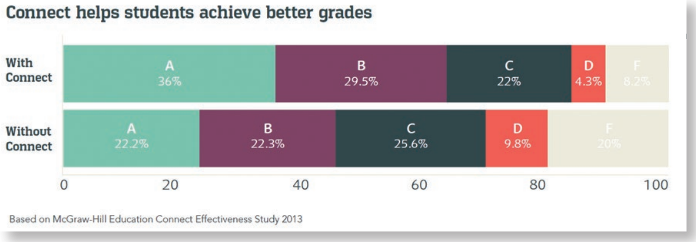

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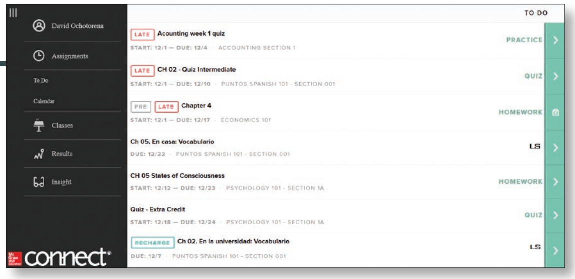

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preface

This book offers students a comprehensive and engaging treatment of personal finance, while incorporating unique themes, an application-driven pedagogy, and a definitive action plan. Unlike other texts on the market, it offers a frank and timely discussion of living within one's means and incorporating personal values and priorities into a personal financial plan. The intent is to help readers set priorities that guide their financial decisions, rather than the other way around. This book establishes a path toward financial freedom that is less about accumulating wealth and more about building a future tailored to individual goals which can increase happiness and reduce stress.

As we move into our second edition, we have put much time, effort, and love into making this edition easy for students and instructors to use. We reorganized the order of our chapters, moving up our discussion of planning and budgeting (now Chapter 2) and postponing the more challenging and math-heavy time value of money coverage until later, in Chapter 4. We condensed five units into three more tightly cohesive units, to give students a better sense of related topics and their overall importance in financial planning. Much of the book has been rewritten, and all of the examples and features are up-to-the-minute accurate, reflecting the constant changes we see in personal finance topics. We hope that you will find this updated version of the text to be just the reference you need as you start out on your financial journey.

GOALS AND THEMES

As we began to write, and throughout the development of the book, we focused on three main goals and themes: responsible financial decision making, alignment of personal and financial goals, and the importance of maintaining a personal financial plan.

Responsible Financial Decision-Making

Almost every personal finance instructor has the same central goal: to help students become financially literate so they can take and keep control of their finances. Before they can develop their own financial plan, however, it is crucial that students understand the key terms, concepts, and principles of financial planning. To address that need, the text offers a comprehensive table of contents and pedagogical features, providing students with the foundation they need to make responsible financial decisions. Extensive assessment tools built right into the book keep students on the right track toward mastering the material. The central goal is to make this material relevant and easy to master so that students can take control of their finances and be responsible decision makers.

To help students learn how to make responsible choices with their finances, the textbook includes:

- **Learning objectives** that shape the organization and goals of each chapter. These objectives link to individual sections of the book and are referenced in the review and assessment materials, allowing instructors to assign the most important concepts in personal finance in a deliberate and complete fashion and test students' mastery of that content.
- **Concept checks** in the Making $ense boxes at the end of each section that test students' retention of key content.
- Quality end-of-chapter **concept questions** and **quantitative practice problems,** along with a **running case** for concept application, that allow additional opportunities for assessment and review.

LEARNING OBJECTIVES *After reading this chapter, you should be able to:*

LO 1-1
Evaluate your spending and saving habits and define what financial success means to you.

LO 1-2
Develop a plan for achieving fiscally responsible, goal-based spending and saving.

LO 1-3
Align your financial plan with your personal goals.

LO 1-4
Explore the different career choices that fit your personal mission statement and established goals.

Making $ense

1.1 What determines your money personality?

1.2 How do you take control over spending?

1.3 When is enough *enough*?

Alignment of Personal and Financial Goals

Financial success means different things to individuals with different priorities. *Personal Finance* recognizes this fact and sets itself apart from the field by helping students direct their finances according to *their* individual values and goals. Many personal finance books presuppose maximized wealth accumulation as the students' outright goal. While maximizing wealth may well be in the long-term interests of many, not everyone is going to be wealthy—nor is everyone motivated by the pursuit of wealth. By recognizing that students need, want, and are fulfilled by different things, this book encourages students to take a closer look at their own lives and priorities as they set their financial plans and to consider the opportunity costs of their decisions in terms of both their financial *and* their personal goals.

continuing case

Throughout the text, the continuing case scenario at the end of each chapter will involve situations encountered by the housemates of 906 East College Street. All of the residents are either current students or recent graduates. Leigh, Blake, and Nicole are siblings. Their parents bought the home, which is close to campus, as an investment when Leigh started at the university her freshman year. The following profiles describe each of the housemates and their intermediate goals.

1. For each housemate, identify a SMART short-term goal that supports his or her success in achieving an intermediate goal.

906 E. College Street
Source: © Kristy and Bob Walker

> Budget: A mathematical confirmation of your suspicions.
>
> —A. A. LATIMER

> “Any intelligent fool can make things bigger, more complex, and more violent. It takes a touch of genius—and a lot of courage—to move in the opposite direction.”
>
> —E. F. SCHUMACHER

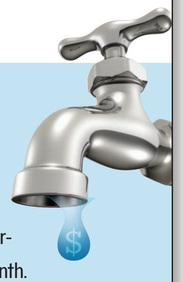
Similarly, the text examines the value of *mindful spending*. “Going green” may originally have been meant only as a reference to preserving the environment, but it has come to encompass the growing tendency in all aspects of our lives to reuse materials, reduce waste, and increase long-term sustainability. This text applies these same principles to personal finance, emphasizing the importance of *living within one’s means* by living simply, reducing consumption, and budgeting for a long-term, sustainable financial plan.

To help students understand the running theme of aligning financial and personal goals, the textbook includes:

- **Financial Fitness** boxes that give creative and, in some cases, eye-opening tips about how cutting down on small, unnecessary spending can lead to big savings.
- An online **Every Penny Counts spending journal** and instructions for using it effectively.

financialfitness:

STOPPING LITTLE LEAKS



Simple Savings While You Sleep

There are lots of little things you can do to save almost unconsciously (literally!). For example, investing in a programmable thermostat that turns off your air conditioning or furnace while you are gone during the day or while you sleep can save you $15 per month. You can automatically deposit that $15 into a savings account.

Every Penny Counts Diary: Month 3

Days of the Month

Daily Expenses	DAY 1	DAY 2	DAY 3	DAY 4	DAY 5	DAY 6	DAY 7
Breakfast	$3.54	$4.00					
Snacks	$3.75						
Gasoline/Oil	$30.00						
Laundry/Dry Cleaning							
Parking	$2.25	$2.25					
Newspaper/Magazine							
Lunch	$7.07	$5.00					
Snacks/Pop							
Beauty/Barber		$18.00					
Books							
Cigarettes/Alcohol							
Clothing/Shoes							
Gifts	$10.00						
Household (cleaning supplies, etc.)							
Groceries	$27.00						
Gym							
Dates							
Movie/Theater	$16.00						
Nightclub/Bar							
iTunes		$4.00					
Entertainment							
Other 1							
Other 2							
Other 3							
Grand Total for the Day	$99.61	$33.25	$0.00	$0.00	$0.00	$0.00	$0.00

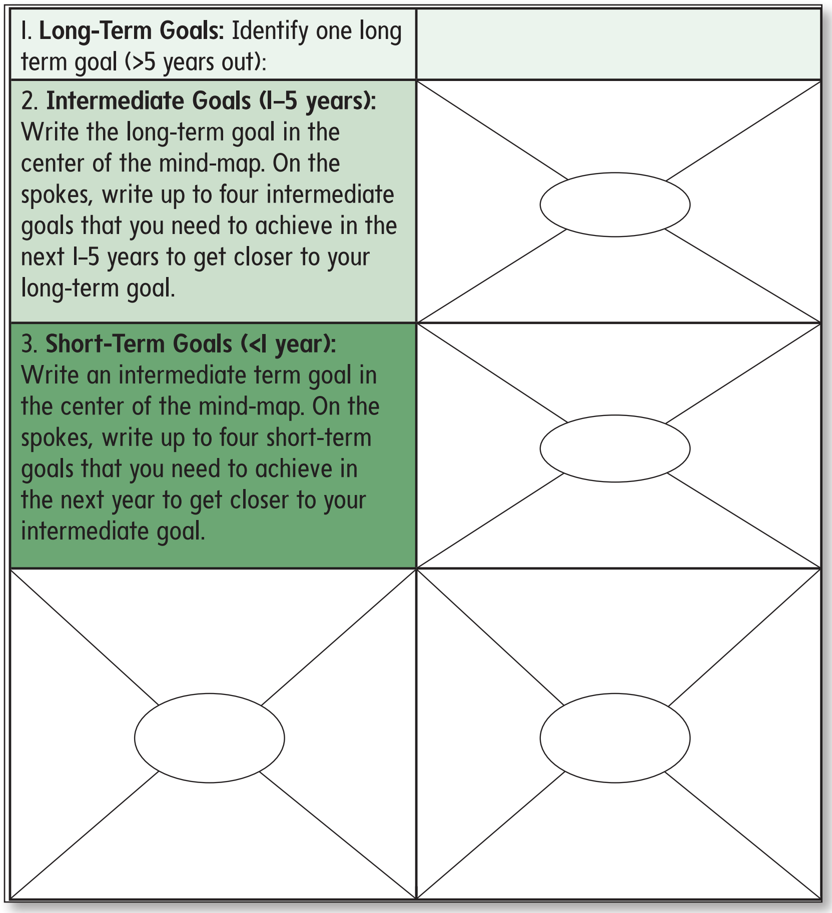
Maintaining a Personal Financial Plan

We encourage readers throughout the book to actively assess their relationship with money by including in every section examples relevant to students’ lives and plans. Through ample opportunities to actively apply the concepts to their own financial decisions, by the end of the course, students will have laid the foundation for their own successful personal financial plan. In this way, the text teaches students to make and review financial plans as a lifelong habit.

This goal of building a personal financial plan is emphasized by the *My Financial Action Plan* section at the end of each chapter. Each one helps students understand how they can apply the chapter's topics and concepts in their own lives. Students *learn* the concepts of personal finance by reading the text and studying the material. Each *My Financial Action Plan* first offers a *Sum It Up* section that outlines the chapter's learning objectives in a way that applies directly to the student's financial well-being. The students can then use the *Get To Work* section to execute their plan and use critical thinking skills to assess whether their plan is working and what adjustments need to be made. Finally, they are asked to *Think It Through* and see how their plan fits in with their financial and personal goals. In this way, personal finance comes to life for the students, making it accessible and easily applicable to their own lives.

To help students engage in building their personal financial plan, the textbook includes:

- Chapter-by-chapter updates to *My Financial Action Plan*.
  - SUM IT UP - bulleted summaries of the topics students have studied and the objectives achieved.
  - GET TO WORK - a checklist of action items for students to do while setting up their financial plan.
  - THINK IT THROUGH - questions that help students analyze the effectiveness of their plan.
- An online **Goal Tracker** at the end of each chapter. This feature helps students create their own financial plan and align their personal goals with their finances.



> "The only reason a great many American families don't own an elephant is that they have never been offered an elephant for a dollar down and easy weekly payments."
>
> —MAD MAGAZINE

- A **Worksheets** section at the end of each chapter. These worksheets, available in full within *Connect*, show students step by step how to get financial aspects of their lives under control. For example, in Chapter 3, on financial institutions, Worksheet 3.1 (shown below) asks students to think through how they can use different financial instruments to meet different goals.

connect — Find the worksheets online in Connect for Walker/Walker 2e. — **worksheets**

3.1 TIMELINES, GOALS, AND FINANCIAL INSTRUMENTS

1. Using Worksheet 3.1, record your goals, the dates by which you hope to achieve those goals, and the financial instruments you will use to achieve them. Keep Worksheet 3.1 on file and use it as a roadmap for selecting the appropriate financial instruments to reach your goals. *(LO 3-2)*

Goals/Financial Life Stages Itinerary

Dependant Life Stage	Institution	Goal	Date
Savings Accounts			
Certificates of Deposit			

Independant Life Stage	Institution	Goal	Date
Savings Accounts			
Certificates of Deposit			
Electronic Banking/Bill Payment Services			
Student Loans			
Auto Loans			
Individual Retirement Accounts			
Credit Cards			

Early Family Life Stage	Institution	Goal	Date
Savings Accounts			
Certificates of Deposit			
Electronic Banking/Bill Payment Services			
Student Loans			
Auto Loans			
Individual Retirement Accounts			
Credit Cards			
529 Plan			
401(k) Plan			
Mortgage Loans			
Home Equity Line of Credit			
Investments			

"I am having an out of money experience."

—AUTHOR UNKNOWN

COURSE CHALLENGES

Our market research, conversations with colleagues, and personal experiences in the classroom converged on two persistent course challenges: (1) how to engage students in the material, and (2) how to reach students who lack the computational skills needed to solve financial problems. We designed the book to address both of those challenges.

Engaging Students

One of the biggest challenges instructors say they face when teaching personal finance is keeping students engaged and interested in the material. Students may be interested in areas of personal finance that affect them *right now,* such as credit card debt, financing an education, or buying a car. Unfortunately, their enthusiasm often wanes as the conversation turns to topics that may seem irrelevant to their current lives, such as investing or estate planning.

To help students become and stay engaged with the variety of personal finance topics in the course, the textbook includes:

- **Chapter-opening scenarios** that make the topics real and relatable to student readers. Personal finance is *personal*. The chapter-opening scenarios lay the groundwork for the importance of the chapter topic by sharing the stories of real people. These stories illuminate how financial planning (or the lack of) affects people differently, depending on their age and life situation.

Source: © DanielBendjy/Getty Images RF

Each year since birth, Clay received $1,000 from his grandparents for his birthday. "I decided to keep my birthday money in savings instead of using it for college expenses. The $17,000 that my grandparents have given me over the years now totals more than $30,000. If at all possible, I am going to keep the money to invest. I have a goal of becoming a millionaire before my older brother."

Clay plans to keep all of the money in his money market account and continue to add just the $1,000 gift each year from his grandparents. "If I've done my math correctly and the market conditions match my predictions, this will help me reach my goal to become a millionaire when I'm in my 50s."

"He that is of the opinion money will do everything may well be suspected of doing everything for money."
—BENJAMIN FRANKLIN *(1706–1790)*

- **Examples of real-life situations** to reinforce concepts and lessons. These examples are taken from current events, hypothetical situations, and actual experiences.
- **Interesting quotes** about finance, such as those you see here in the preface. Our students have enjoyed the quotes over the years and have demonstrated their enthusiasm by sharing new ones with us.

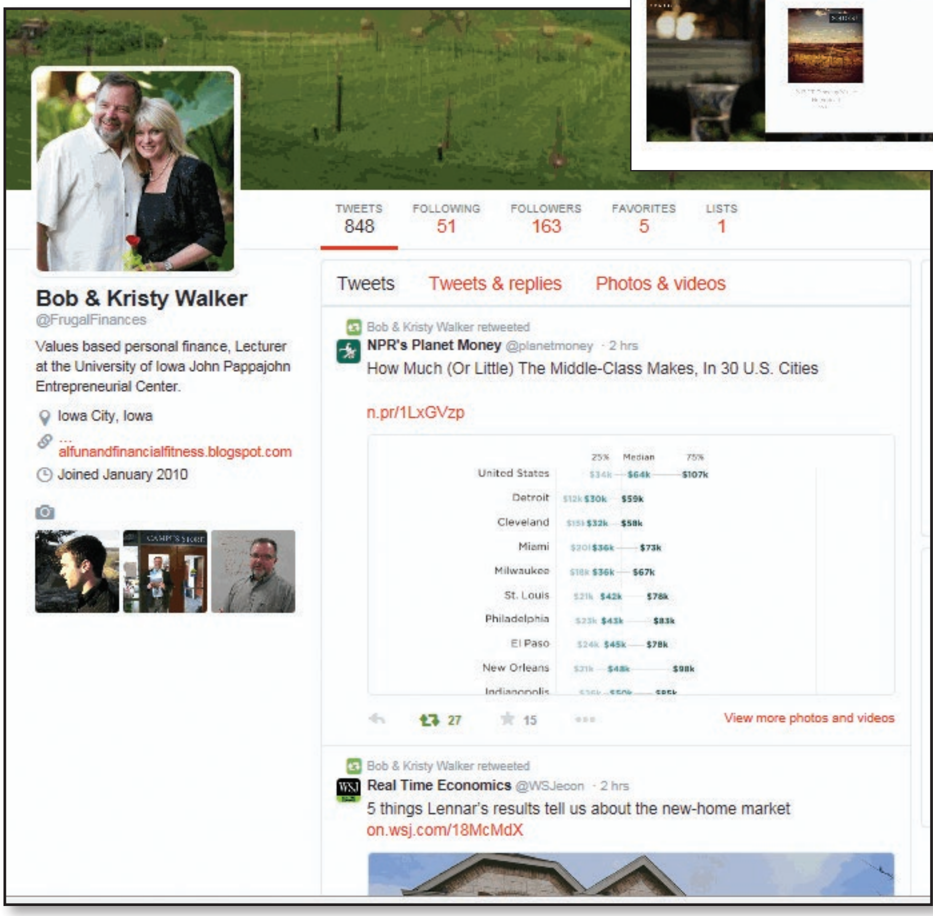
"Annual income twenty pounds, annual expenditure nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pound ought and six, result misery."
—CHARLES DICKENS (in *David Copperfield*)

- **You're the Expert cases,** which are extended problems that put students in hypothetical situations and then ask them to lay out a financial plan and solve problems.
- **Financial Fitness boxes,** which provide additional interesting and useful tips and information about different aspects of financial planning.
- **Live and interactive media** through the authors' blog (www.frugalfunandfinancialfitness.blogspot.com) and Twitter account (@frugalfinances). Through these resources, students can access additional articles, tips, and thoughts about finance directly from the authors.

Solving Financial Problems

A second challenge of this course, especially for the increasing number of personal finance students who are not finance majors, is learning how to apply mathematical equations in order to solve financial problems. To address this challenge, the text incorporates strategies and tools to help students master the math in personal finance:

- A detailed explanation of **time value of money** early in the book (Chapter 4). This allows students time to learn the concept and then move on to applying it throughout the course, in different areas of personal finance.



- **Doing the Math** boxes throughout each chapter provide example problems that require the use of financial calculations to solve.

doing the MATH

2.2 Your Opportunity Cost

Calculate the opportunity cost of one extra year of college:

Tuition, room, board, books, fees, spending money	______
Plus your estimated salary upon graduation	+ ______
Equals opportunity cost of one extra year of college	= ______

Is it worth it to you to work extra hours, take fewer credits, and graduate in five years, or would you be better off to not work a part-time job, take extra classes, and get an extra student loan to graduate sooner?

ORGANIZATION OF CHAPTERS

A nationwide survey of finance professors also helped determine the text's key topics, how much coverage each topic requires, and where each topic fits best in a typical course. The book's organization, described below, provides a comprehensive and logically sequenced approach to personal finance that aligns with the goals of varying types of personal finance programs. Where coverage strays from most other books on the market, we explain our reasoning below.

Section One: Money $ Money $ Money $

This section emphasizes that personal financial success is more easily achieved when the student's spending and saving plans are aligned with overall values and goals. Values, vision, mission, and goals established in Chapter 1 serve as a guide when evaluating options in subsequent chapters. The student's record of every penny spent in Chapter 2 teaches the student to: (1) get control of spending, (2) set a realistic budget based on wanting and spending needs, and (3) determine whether his or her spending reflects personal values and priorities. Chapter 3 introduces financial instruments and institutions. In Chapter 4, we discuss the time value of money so students have a solid understanding of savings, investing, and opportunity cost.

Section Two: Credit Management and Limiting Liability

The Great Recession of 2008 had a major impact on credit availability and has placed new emphasis on credit management. We decided it was a good idea to spend time discussing not only the importance of avoiding debt, but also the steps involved in debt management. During the recession, many Americans were faced with the task of lowering their personal debt load, which is still relevant today. We provide specific strategies for how to dig out of debt, while also emphasizing that debt is created over time and that it may take time, discipline, and sacrifice to get one's finances back in order. We also examine bankruptcy and the foreclosure process so there is an understanding of the debtor's rights and responsibilities during the process. We also cover the topics of taxes and insurance. Insurance is important in safeguarding our investments, assets, and cash flows. This unit encourages saving money by being a wise consumer of insurance and taking advantage of tax deductions and incentive plans that minimize tax liability.

Section Three: Wealth Accumulation

This section first covers investment basics and then moves into mutual funds and stocks and bonds. We cover mutual funds first for a couple of reasons: (1) More people invest in mutual funds than in individual stocks and bonds; and (2) finance majors will have specific classes to cover the details of stocks, bonds, derivatives, options, and other financial instruments. Other majors probably do not need such detailed information, and it may be more confusing than helpful for them. We also spend time covering real estate investments in this unit. Many people during the early 2000s thought real estate investment was a way to amass a quick fortune. We discuss how the real estate bust in 2008–2009 cost many people their life savings and forced them into bankruptcy. We are now seeing an increase in house flipping as the real estate market recovers. The final chapters examine retirement, estate planning, and charitable giving, tying back to the book's theme of values-based personal finance and purposeful living. We conclude by talking about a sustainable lifestyle and by coaching students to continually reevaluate where they are in their financial plans and whether they are still on track to meet their goals.

SUPPLEMENTS

Personal Finance comes with an innovative, engaging, and complete set of instructional resources to improve the classroom experience of both students and teachers.

Instructor Resources

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

The **Instructor Resources** holds all supplementary material, including the following resources:

- The *Instructor's Manual* includes discussion starters, teaching tips, projects, supplementary links and resources, and insights into the prepared lecture material that comes with the book. It also supplies lecture outlines, supplementary activities, answers to concept checks, and end-of-chapter questions, cases, and problems.

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- *Chapter PowerPoint® Presentations* offer clear, concise, and interactive ways of presenting material to students. These may be edited and customized for best use in the classroom.
- *Worksheets* give students practice in tracking spending, setting budgets, shopping for insurance, and the like.
- *GoalTracker* helps students think through and record their goals and helps them realize those goals as they learn the concepts of personal financial planning.
- *Current Events Blog*, updated regularly by the authors, engages students in understanding the importance of personal finance and applying the concepts of planning in a real-life context (http://frugalfunandfinancialfitness.blogspot.com).

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ACKNOWLEDGMENTS

We would like to thank the following reviewers for their time and feedback. Their help has sincerely made the text stronger and provided balance. For this, we are extremely grateful.

Angel Alexander
Brenda Anthony
Michael Araujo
Sean Basford
Pam Bennett
Ross Blankenship
Karin Bonding
Walter Boyle
Craig Bythewood
Ron Camp
Peter Chen
Margaret (Meg) Clark
Fernando Conde
Barbara Connolly
Nirmalendu Debnath
Beth Deinert
Susan Feinberg
Chuck Finnell
Elizabeth Fletcher
Roy Fletcher
Paula Freston
David Fricke
Wayne Gawlik
Terri Gonzales
Judith Griffin
Jana Hosmer
Sandra Huston
Seonah Kendall
Jim Keys
Lee Kitchen
Juannae Landry
Jeff Livingston
Thomas Lynch
Bala Maniam
John Marcis
Mario Mastrandrea
Diane Masuo
Robert McCalla
Jamshid Mehran
Jim Meir
Tammi Metz
Dianne Morrison
Pattabiraman Neelakantan
Thomas O'Keefe
Dan Oglevee
Diana Parker
Martina Peng
Lori Radulovich
Andreas Rauterkus
Greg Richey
Andrew Salcido
Lawrence Schuffman
Patricia Shaw-Crabb
Michael Slates
Martin Spechler
Edith Strickland
Sven Thommesen
Steve Tolbert
Lilian Nnenna Ukadike
Shafi Ullah
Randall Valentine
Dick Verrone
Rubina Vohra
Andy Whitman
Walt Woerheide
Bruce Xiao

NOTE TO STUDENTS

Have you ever considered what life would be like without keeping up with the Joneses, buying on credit, paying for it over time, and getting into perma-debt? Throughout Bob's 18+ years of experience in the banking industry, and his teaching of personal finance, he observed how habits of overspending and under-saving eventually catch up to people. He often wondered how much growth and prosperity in the 1990s and 2000s was financed by credit.

We observed the results of overspending in the fall of 2008 with the fall of Lehman Brothers and the beginning of the financial crisis. During this time, when conventional wisdom was being upended, he kept looking for a textbook he could teach from that emphasized value-based spending, savings, and investing, and which successfully debunked the myth that money and the accumulation of material things bring happiness.

As a couple living with our own financial challenges and watching our children grow, we thought we could offer a new perspective on personal finance: one that emphasizes spending, saving, and investing in accordance with your own personal values. Our fundamental philosophy is that money does not provide happiness. Spending, saving, and investing in accordance with your individual values and goals, and using money wisely as a resource (and not an end in itself) can reduce stress and lead to happiness. You *can* do well and do good at the same time. There is nothing more rewarding than watching students grow, achieve their goals, and succeed in life—and that has served as a powerful motivator for us to write this book, our blog, and disperse our views through our Twitter account.

This book is not only about personal finance, but also about personal happiness and pursuing your passions. It has lessons that can be followed for a lifetime to help you achieve personal financial success.

Thank you for purchasing this book. We wish you the best of luck as you use it to better understand your finances and goals. We invite you to follow us on Twitter (@FrugalFinances) and on our blog (http://frugalfunandfinancialfitness.blogspot.com) to keep current with the changing financial landscape as it relates to the principles of this text and also to continue the conversation. We are here to help, and we hope that, in our own small way, we can help you find as much happiness and fulfillment as we have found by living simply and in line with what is most important to us.

Happy Finances!
Bob and Kristy

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chapter one

MONEY MATTERS: Values, Vision, Mission, and You

LEARNING OBJECTIVES *After reading this chapter, you should be able to:*

LO 1-1
Evaluate your spending and saving habits and define what financial success means to you.

LO 1-2
Develop a plan for achieving fiscally responsible, goal-based spending and saving.

LO 1-3
Align your financial plan with your personal goals.

LO 1-4
Explore the different career choices that fit your personal mission statement and established goals.

"What's money? A man is a success if he gets up in the morning and gets to bed at night, and in between he does what he wants to."

—BOB DYLAN, *Singer songwriter (1941–)*

Ashley, a sophomore at a mid-sized public college, recently developed her mission, vision, and value statements and used them to set her short-term, intermediate, and long-term goals. "I thought I was living my life according to my values, but until I used the tools that I learned about in my personal finance class, I really had no idea how far off I was. It was hard to create my mission statement so that it said what I wanted about me, my priorities, and my goals. The whole

Source: © Peathegee Inc LLC RF

financial plan goal-based activity related to future income, spending, investment, protection, and giving

process helped clarify what I want to do and where I want to go. Setting my short-term, intermediate, and long-term financial goals helped me decide how I'm going to spend and save my money. I feel like I have my money working for me now, not the other way around."

1.1 YOUR PERSONAL RELATIONSHIP WITH MONEY

LO 1-1 Evaluate your spending and saving habits and define what financial success means to you.

The first step to understanding why we spend money is to examine our relationship with money. If you received an unexpected cash gift of $600, would you hit the mall to buy a large luxury item with your newfound money as a down payment? Would you pay off bills? Perhaps you would treat yourself to a small purchase and then bank the majority of the windfall.

Think about your current financial situation and your spending habits. Do they reflect your desired lifestyle and goals? To increase happiness, sometimes less may be more. This chapter will help you lay the foundation for a financial plan that is guided by your values and personal mission statement and incorporates your goals. Using the worksheets that accompany the text, you will outline your values, vision, and mission statements to help you create a financial plan that is completely in line with how you want to live your life.

A **financial plan** is a goal-based activity that incorporates your future income plan *(career goals)*, budget plan *(spending goals)*, investment plan *(gaining assets goals)*, insurance plan *(protection goals)*, and estate plan *(giving goals)*. In the process of developing a personal financial plan, you may very well discover your passion and a sense of purpose. By aligning your actions with your values, you establish priorities in your life and gain control over your time and money. Money is simply a resource, a commodity. To truly be in control of money is to be in a position where you are in balance with your priorities. The following sections lay out the steps to creating a foundation for your financial plan.

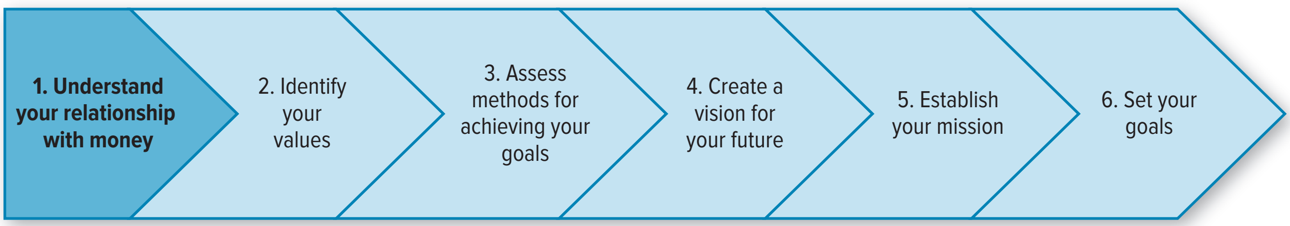
> "He that is of the opinion money will do everything may well be suspected of doing everything for money."
>
> —BEN FRANKLIN *(1706–1790)*

Step 1: Understanding Your Relationship with Money

Money can influence your attitudes and behavior. Not having enough money is stressful. Having a lot of money can cause different kinds of stress. If you had a lot more money than your friends, would they expect you to always pay? Would you feel like they were taking advantage of your wealth? How does having more money impact your level of happiness? As shown in Figure 1.1, the first step in your financial journey is to assess your current relationship with money. To begin, take the Money Relationship Quiz in Figure 1.2.

FIGURE 1.1

Setting the foundation of your financial plan, step I



Your Money Personality Count up the number of times you circled A, B, C, D, and E statements. If you mostly circled:

A: You value money for the security it provides.

B: You want a lot of material items, and you want them now.

C: Money helps you feel important.

D: Money is a resource to get the things you need or want.

E: You are not concerned with money; there is no reason to worry about it.

money personality
the style and habits of money management

Are you surprised by this quick assessment? Knowing how you feel about money is the key to understanding your spending, savings, and investment habits. Aligning your spending and saving habits with your overall priorities and life goals allows you to maintain a sense of control, direction, and purpose in your financial life.

To understand how you manage your money, you need to uncover your **money personality**, the style and habits of money management you are most comfortable with (online Worksheet 1.1). Similar to other personality traits, our money personalities are part nurture and part nature. They come from a combination of values, how we were raised, and our parents' traits. Your money personality plays a big part in how you deal with money and finances.

FIGURE 1.2

Money relationship quiz

In order to assess your relationship with money, circle the statements that best describe you:

A. It's a good feeling to have money in my wallet.

B. No one can ever really have enough money.

C. Clothing should look expensive.

B. You cannot live without credit.

D. There are a lot of things more important than money.

E. Keeping track of every dollar would drive me crazy.

A. It is important to record every dollar you spend.

C. Money and prestige go hand in hand.

E. A person can get along without a savings account.

D. It is easy to have fun with simple things that do not cost much money.

A. Money should only be spent for necessities.

C. I want nothing but the very best.

E. If I just wait, my money problems will take care of themselves.

D. Money does not buy happiness.

B. It would be easy to spend $5,000 in just a couple of days.

A. I shop around to find the best price.

E. If I need money, it will come from somewhere.

A. I will not buy anything unless I have enough money for it.

C. If I am going to buy something, I am going to buy the best option of it.

B. I will never buy something used, always brand new.

D. A lot of money would be nice, but I do not really need it.

E. I never make plans about money.

Source: Money Relationship Quiz extracted from "Money Talks," ANR Publication 8272. © 2007 by the Regents of the University of California Division of Agriculture and Natural Resources.

personal values the qualities and beliefs that are most important to you and to which you must be true to lead a happy and fulfilling life

voluntary simplicity a simplified lifestyle, reducing unvalued consumption to focus on other priorities

frugal avoiding waste; to be resourceful when fulfilling one's need for goods and services

enough point at which increased spending has a diminishing rate of fulfillment

Some people enjoy knowing where every penny is spent and are very aware of their financial condition. Other people don't pay much attention; they never balance their checkbooks, review their charge history, or question their account balance if something seems off. These people are more likely than those in the first group to have overdraft fees on their checking account and over-limit fees on their credit cards, and they are also more likely to spend money on transaction fees and other charges. For some people, image or "keeping up with the Joneses" is important. Others are oblivious to material trends. These are just a few of the many ways people interact with money and their personal finances.

Step 2: Identifying Your Values

Personal values are unique to you and influence your actions and decision making. Personal values develop early in life and are influenced by family, religion, social groups, and culture. If how you are living your life does not coincide with your personal values, you will be in conflict. As shown in Figure 1.3, identifying your values is the second step in setting the foundation of your financial plan. If you understand what you value, you can make better decisions and choices to reduce inner conflict. Knowing your values can help you create a financial plan that fits you. If you can do this, your increased investment and ownership in your plan will help you to be more successful in adhering to it.

Value-Driven Financial Planning Taking time to think about what you value will help guide you in creating an overall financial plan. Online Worksheet 1.2, "Clarifying Values," will help you to make your personal values explicit. By identifying your priorities and building a financial plan focused on supporting those priorities, you will increase the likelihood of successfully sticking to that plan exponentially. Your perspective will change from one of negativity ("I'm making a sacrifice") to one of positive gratification ("I'm investing in things I care about"). Let's look at some of the methods we can use to achieve our goals.

Scaling Back **Voluntary simplicity** is selecting a simplified lifestyle and reducing meaningless or idle consumption in order to focus energy on other priorities. People choose this lifestyle for many reasons, including to live in a more environmentally friendly fashion, increase quality time with friends and family, reduce stress, improve health, or increase spirituality.

To be **frugal** is to be resourceful when fulfilling needs for goods and services, perhaps using previously owned items or doing things yourself. It is to be penny-wise and practice restraint in how you consume goods and services. It is the epitome of Benjamin Franklin's adage, "Waste not, want not."

Enough Between frugal and excessive is the balance point of **enough**. Joe Dominguez and Vicki Robin in *Your Money or Your Life* (1992) describe the relationship between consumer purchasing and consumer fulfillment as one of diminishing returns after reaching the point of "enough." As illustrated in Figure 1.4, you receive fulfillment on money spent to survive. After that, fulfillment increases, but at a decreasing rate. Once enough is reached, fulfillment decreases with increased spending.

FIGURE 1.3

Setting the foundation of your financial plan, step 2

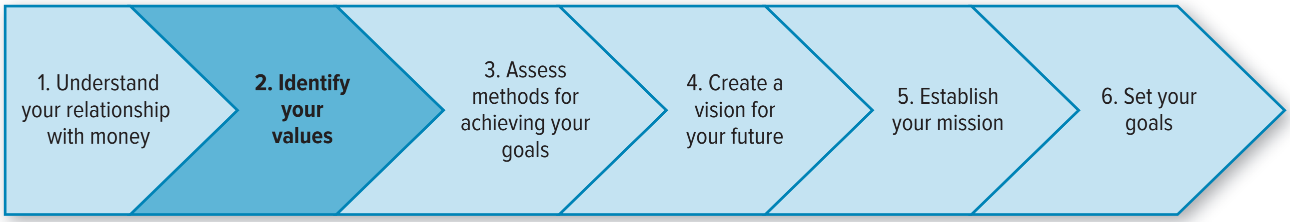
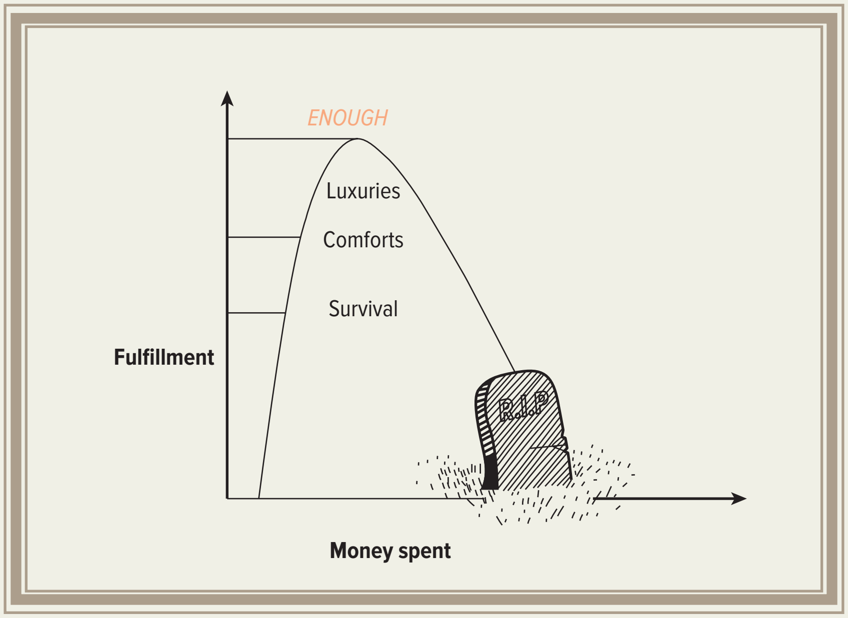


FIGURE 1.4

Defining enough



Source: Adapted from J. Dominguez and V. Robin, *Your Money or Your Life,* Rev. Ed. (New York, NY: Penguin Books, 1999).

90-10 rule saving 10% of income and living on 90%

80-10-10 rule living on 80% of income, saving 10%, and giving away 10%

A simple example would be buying a pair of shoes. The first pair is purchased out of necessity. Other shoes may serve different purposes (e.g., working out, matching outfits, going to the beach, shoveling snow), but if one continues to acquire more shoes, each new pair brings less fulfillment. At a certain point, a person may not have room for any more shoes, may not find the ones they want because there are so many, or may not find satisfaction in an additional pair. In fact, one more pair of shoes can bring about *more* problems than satisfaction. With decisions based on your values, mission, and goals, you decide when enough is *your* enough.

Allocations What you do with your money is a reflection of your priorities. Financial experts recommend saving at least 10% of your income each pay period, setting that money aside for retirement and for rainy day emergencies. Saving 10% and living on 90% is referred to as the **90-10 rule** and shows a commitment to financial security.

A cousin of the 90-10 rule is the **80-10-10 rule**. It is living on 80% of your income, saving 10%, and giving away 10%. Adhering to this rule reflects valuing community and social responsibility in addition to financial security and independence. Whether giving to the Arbor Society to plant more trees or to a local food bank to help those in need, the goal of this rule is to start the habit of saving and giving.

It may be intimidating to imagine going from 100-0 to 90-10 or to 80-10-10, but the road to this kind of personal financial security can begin with incremental increases and gradual adjustments. If you want to aim for an 80-10-10

financialfitness:

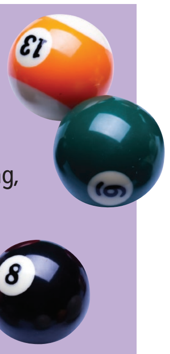
STOPPING LITTLE LEAKS

Stress Management

To escape the stress of everyday life, you may be tempted to go shopping. Items purchased during these "escape" moments are not necessarily items you highly value or include on your priority list. Counter any urge to indulge in "retail therapy", or shopping to improve one's mood. Next time you are feeling down, go for a run, a bike ride, or a brisk walk. You will get an exercise-induced endorphin boost and the feeling will cost you nothing.

financialfitness:
NUMBERS GAME

Trade-Offs



Consider your values and the costs involved when one or both adults of a household work outside the home or one adult works long hours. Costs can include childcare, clothing, commuting, eating out, entertainment, and decompressing. A second person in the household working brings in extra income, but it may also increase expenses and stress. It is important to think this through, and to strike a thoughtful balance.

financial plan, start off by living on 98% of your income, saving 1%, and giving 1%. The following year, increase savings and giving by 1% each. Keep this pattern up, and over a 10-year adjustment period, you can achieve your goal of living by the 80-10-10 rule without a drastic, scary change.

To be successful at saving, you need to pay yourself (in the form of your savings account) first. To make this habit as painless as possible, establish automatic transfers or withdrawals from a paycheck or checking account into a savings or investment account. Many investment companies will establish an investment account by setting up an automatic transfer of $50 each month. Transfers from checking to savings can be set up for any amount and scheduled to occur on the same day of each month. Many charities, nonprofit foundations, and religious organizations are able to help you set up automatic payments from your checking account. By establishing automatic transfers and withdrawals, you are paying yourself first, making your savings and giving goals as important as paying your bills. You are making a commitment to your values and priorities.

Making $ense

1.1 What determines your money personality?

1.2 How do you take control over spending?

1.3 When is enough *enough*?

Personal Financial Success What is your definition of **personal financial success**? Is it having millions of dollars in the bank? Is it being able to drive a new sports car or travel the world? Or is financial success just having enough money to cover your basic needs?

The wealthiest Americans include Bill Gates, Warren Buffett, and Mark Zuckerberg. Each is well known for his business and financial success. Likewise, each one has different personal priorities and has chosen different ways to use his wealth. Warren Buffet has lectured that money and material wealth do *not* bring happiness. For all but the very few, there will always be someone with more money, more toys, more material goods, a bigger house, and a bigger boat. You have to determine your own definition of financial success.

1.2 FINANCIAL INDEPENDENCE, LITERACY, AND PLANNING

LO 1-2 Develop a plan for achieving fiscally responsible, goal-based spending and saving.

personal financial success achieving financial goals and living life in accordance with your values, vision, and mission

financial independence passive income exceeds expenditures

Step 3: Assessing Methods for Achievement

As shown in Figure 1.5, the third step in setting the foundation of your financial plan involves assessing methods for achieving your goals. A popular financial goal is to achieve financial independence. For some people, this may be the definition of financial success. **Financial independence** is when passive income exceeds expenditures (see Figure 1.6). This is a simple concept that, when understood, can influence decision making on every purchase. Do you really want to spend all your money on the wants of today? Or do you want to invest some of it to reach financial independence sooner? Once you achieve financial independence, you do not have to work for income, but can choose whether or not to work and how to spend your time and energy.

Passive income is money received from investments and savings. The Internal Revenue Service (IRS) calls this **unearned income**. It is the income received from money and investments that are working for you. Passive income can be from stock dividends, interest from bank investments, money from rental property, or other investments. Many people do not have enough passive income to achieve financial independence as defined above until late in life, after years of putting money into savings or in retirement accounts and relying on Social Security as part of their passive income.

Figure 1.7 illustrates the relationship between passive income, expenses, and financial independence. To reach financial independence sooner: (1) reduce your expenses and live more frugally; (2) increase the amount of money going into savings and investments; or (3) do both.

passive income money received from investments and savings

unearned income defined by the IRS as income from investments and savings

FIGURE 1.5

Setting the foundation of your financial plan, step 3

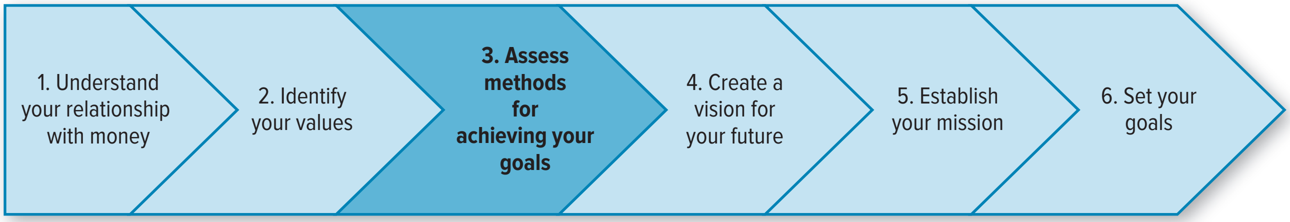


FIGURE 1.6

Financial independence

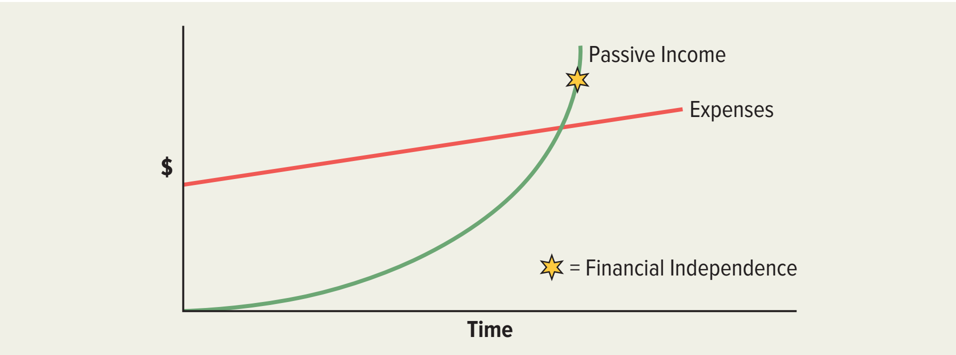
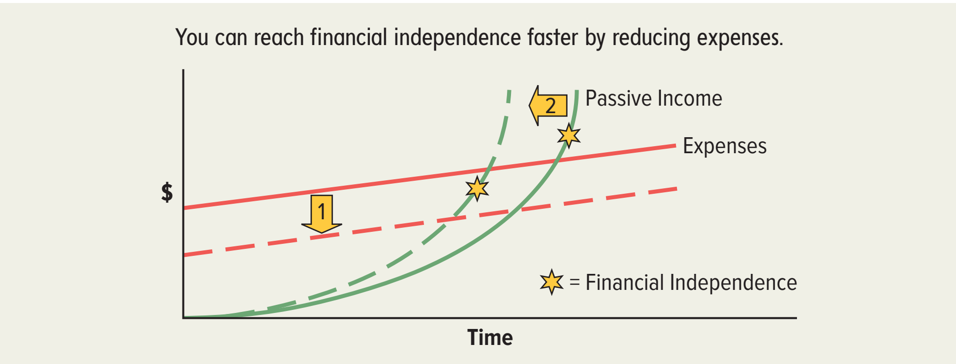


FIGURE 1.7

Controlling the timeline to financial independence



financial literacy ability to understand how money is earned, invested, and spent, and the risks and rewards of financial decisions

downshifting reducing expenditures by deliberately cutting back income or expenditures or both, in the pursuit of financial independence

You might also try to increase the returns on your investments, but doing so will increase your risks. For example, many baby boomers who wanted to decrease their time to financial independence invested their retirement savings in high-risk, high-return stocks. This plan played out well until the financial crisis of 2008 caused the stock market to decrease 54% in value, which dramatically reduced the amount of passive income available from these retirement investments. Those who were planning to retire that year faced tough decisions about when and how to retire. Many had to choose between postponing retirement or reducing expenses and living on less to gain their financial independence. A basic understanding of financial products and investment diversification can help reduce these types of risks. (This topic is covered in more detail in Chapter 11, "Investment Basics.")

Financial Literacy

Financial literacy is the ability to understand how money is earned, invested, and spent, and to understand the risks and potential rewards of the different investments and financial products and services available to help you achieve your goals. When you accept your first full-time job, you may need to make decisions regarding your 401(k) retirement plan. Making wise personal finance decisions is *your* responsibility. No one is going to be more concerned about your financial welfare than you, and that is why being financially literate is so crucial.

There are many thousands of different investment opportunities. How do you know you picked the right ones to meet your investment objectives? Even if you get assistance from a financial planner, who can you trust? You have to be financially literate; you have to know enough to protect your assets. On March 12, 2009, prominent investment manager Bernie Madoff pled guilty to an 11-count criminal charge, admitting to defrauding thousands of investors with total losses estimated to be over $64.8 billion. Mr. Madoff had the confidence of many wealthy and experienced investors, and of many nonprofit foundations who invested millions with him, trusting they were making sound investments. It is your responsibility to make certain you put yourself in the best possible position to understand the stakes, identify promises that are too good to be true, and to protect your investments. None of this is possible without basic financial literacy.

No one but you can control your spending and make on-the-spot financial decisions that reflect your values. This book will not make you a financial planner, but it will give you enough knowledge to understand the basics of personal finance and help you make wise decisions for yourself.

Paths to Financial Independence

Financial literacy is the key to achieving financial independence. There are a number of avenues to reach this goal sooner, rather than later.

financialfitness: JUST THE FACTS

Control

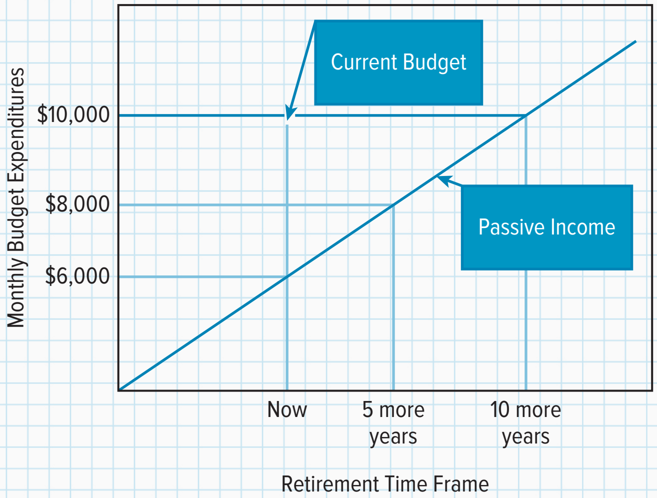
Money (or the lack thereof) is one of the most common causes of unhealthy stress in our society. Many people worry more about money than about their relationships or their health. Reduce money as a stress point by taking control of your finances through planning and budgeting.

Downshifting One way to financial independence is to reduce your expenditures via deliberately **downshifting**, or cutting back. It can involve spending less money, living frugally, or taking on a completely new lifestyle, requiring prioritization and a totally different mindset. People decide to downshift for a variety of reasons. Some want to escape job stress, while others downshift because of a life-changing experience, health problems, or a crisis in the family.

Augmenting Income Instead of lowering expenses, you might get a second job to increase income and live the lifestyle you desire. Perform an honest inventory of your skills and doing the **MATH**

1.1 Financial Independence

You are thinking about retiring someday. You currently live off of $10,000 per month. Your investment projections pay out according to this graph:



1. To retire now, you need to downsize by how much each month?
2. If you put off retirement for five years, what could you afford for a monthly budget?
3. If you plan to maintain your current lifestyle, how long will you need to keep working until your retirement income accommodates your current budget?

your ability to create value. Take a look at what you are currently doing and look for opportunities for you to offer your skills and expertise to others. For example, if you are knowledgeable in a trade or a craft, maybe you could teach a class at night. If socializing is up your alley, being a tour guide or driving for Uber once a week can provide both fun and cash.

Investing to Achieve Greater Passive Income One way to develop passive income is to start an automatic investment plan. **Dollar-cost averaging** is the practice of investing a fixed dollar amount at regular intervals of time, regardless of market conditions or your personal financial outlook. One way to accomplish this is to have a regular amount deducted from every paycheck and put into an **investment account**.

By depositing a set amount on a regular basis into an investment account, you do not have to worry about timing the market and buying low. You will end up investing some money at low prices and some at high prices, but what is important is that you will be consistently putting your savings goals first. In doing so, your savings will grow. The magic of compound interest (see Chapter 4) will ensure the invested money is working hard for you. You can trim expenses

dollar-cost averaging
investing a fixed dollar amount at regular intervals

investment account
account that enables you to invest in stocks, bonds, mutual funds, or other securities with the objective of making a profit

financialfitness:
STOPPING LITTLE LEAKS

Resources

Voluntary simplification, downshifting, and frugal living often call for a creative response to make do with what's on hand. The website www.choosingvoluntarysimplicity.com is a helpful resource for those interested in a more in-depth exploration of downshifting and frugal lifestyle ideas.