



FOURTEENTH EDITION

# Personal Finance



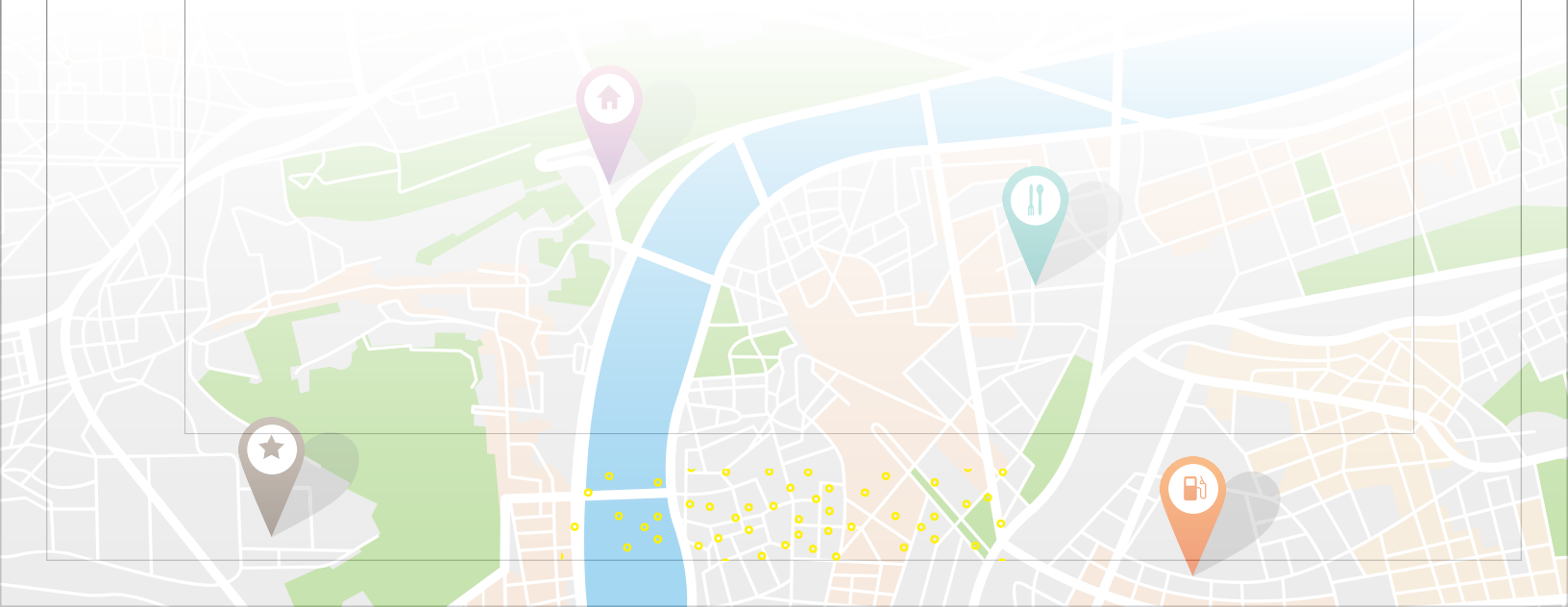
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# Personal Finance

**FOURTEENTH EDITION**

**JACK R. KAPOOR**

College of DuPage

**LES R. DLABAY**

Lake Forest College

**ROBERT J. HUGHES**

Richland Campus of Dallas College

**MELISSA M. HART**

North Carolina State University



**Mc  
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**PERSONAL FINANCE, FOURTEENTH EDITION**

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**Personal Financial Planner**



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

To my wife, Linda Dlabay; my children, Carissa and Kyle;  
their spouses, Doug Erickson and Anne Jaspers; and my  
grandchildren, Lucy Dlabay and Caleb Erickson

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 has been 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 University and his EdD in Business and Economic Education 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 two popular national television series, *The Business File: An Introduction to Business* and *Dollars & Sense: Personal Finance for the 21st Century*. He has also 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

“Learning for a life worth living” is the teaching vision of Les Dlabay, professor of business emeritus, who taught at Lake Forest College, Lake Forest, Illinois, for 35 years. In an effort to prepare students for diverse economic and cultural settings, he makes extensive use of field research projects and interactive learning related to food, water,

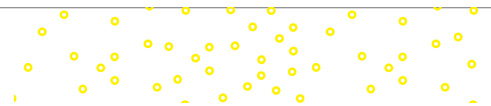
health care, and education. He believes our society can assist global business development through volunteering, knowledge sharing, and financial support. Dr. Dlabay has authored or has adaptations of more than 40 textbooks in the United States, Canada, India, and Singapore. He has taught more than 30 different courses during his career and has presented over 300 workshops and seminars to academic, business, and community organizations. Professor Dlabay has a collection of cereal packages from more than 100 countries and banknotes from 200 countries, which are used to teach about the economic, cultural, and political aspects of international business environments.

His research emphasis involves informal and alternative financial services in cross-cultural and global settings. Dr. Dlabay serves on the board of Andean Aid ([www.andeanaid.org](http://www.andeanaid.org)), which provides tutoring assistance and spiritual guidance to school-age children in Colombia and Venezuela, and teaches community-based money management and workforce readiness classes for Love INC of Lake County (Illinois), which mobilizes local churches to transform lives and communities. 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 received The Great Teacher award at Lake Forest College three times.

## Robert J. Hughes, EdD

Dallas County Community Colleges

Financial literacy! Only two words, but Bob Hughes, professor of business at Richland Campus of Dallas College, believes that these two words can 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 college 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 he is the lead author for a business math project utilizing computer-assisted instruction funded by the ALEKS Corporation. He has served as a consultant and investment adviser



to individuals, businesses, and charitable organizations. Dr. Hughes is the recipient of three different Teaching in Excellence Awards at Richland College—one of seven colleges in the Dallas system. 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 senior lecturer in the Poole College of Management at North Carolina State University. She is a member of the Academy of Outstanding Teachers. She has been nominated for the Gertrude Cox Award for Innovative Excellence in Teaching and Learning with

Technology as well as the Alumni Distinguished Undergraduate Professor Award. 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 commonsense 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) and the American Institute of Certified Public Accountants (AICPA). 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.

# Preface

## Dear Personal Finance Students and Professors,

Everyone has a story about how the COVID-19 pandemic affected their life. Take a moment and think about how the events since the spring of 2020 changed your life. For example, did you lose your job because of nonessential business closures? Did you worry about how to pay your rent, car payment, home mortgage, or credit card bills? Did you change your educational or career plans? All good questions that describe how a pandemic can impact your health, education, and financial security. In reality, the pandemic was a wake-up call for many Americans that they needed money for unexpected events and a personal financial plan.

## WHAT'S NEXT?

While there are no guarantees there won't be hardships ahead, the material in the 14th edition of *Personal Finance* can provide you with the information needed to weather another pandemic, an unexpected job loss, or the next crisis. As authors, we wrote this text with one purpose: To provide the information you need to make informed decisions that can literally change your life. Just for a moment consider the following questions:

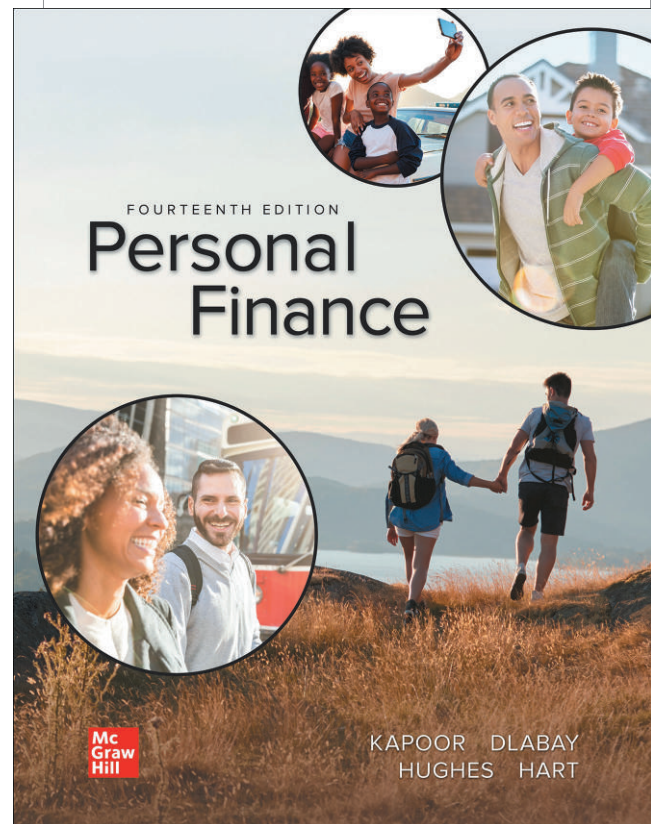
- How much money should you have in an emergency fund?
- What happens if you can't pay your bills?
- How can you balance current needs with investing for the future?
- Can you afford to buy an automobile or a home?
- How will your need for health and life insurance, employer-sponsored health care and a retirement plan, and Social Security affect your financial future?
- How can you attain your career and personal goals to create the life you really want?

Keep in mind, your answers to these questions affect not only the quality of life you have now, but also your future financial security. If you make wise financial decisions, life can become a more joyous experience. On the other hand, if you make bad decisions, life may not turn out so well. While *Personal Finance* does not guarantee that you will get the ideal job or become a millionaire, it does provide the information you need for your financial well-being.

## TEXT AND DIGITAL PACKAGE

This edition of *Personal Finance* is packed with new and updated information and examples that will not only help you get a better grade in this course, but also help you plan for the future and achieve financial security. For example, we have revised important topics like taxes, banking services, college loans, health care, investments, and retirement planning to provide the most current information available. In addition, our new features *Personal FinTech* and *Digital Financial Literacy* are both designed to help you use technology to improve financial decision making.

Because more Personal Finance courses are now taught online, we worked hard to develop digital materials that help students learn and help professors teach. For students, our digital package includes an interactive e-book, practice quizzes, and short videos along with assignable auto-graded questions. We're especially proud of our new Application Based Activities. These auto-graded activities allow students to test their knowledge and skills in simulated scenarios. For professors, our digital resources include a comprehensive instructor manual, computerized test bank, and



PowerPoint presentations for each chapter. When these components are combined, it's easy for professors to build their own online course or use a prebuilt course that enables students to learn anytime, anywhere.

## OUR FOCUS ON STUDENTS AND PROFESSORS

For 14 editions, we have listened carefully to both students and professors. With each revision, we have incorporated these suggestions and ideas to create what has become a best-selling personal finance textbook. *For your suggestions, ideas, and support, we thank you.*

We invite you to examine the visual guide that follows to see how the new edition of ***Personal Finance***, the McGraw Hill Connect learning software, and our SmartBook technology can help you achieve financial security and success.

Welcome to the new 14th edition of ***Personal Finance***!

Sincerely,

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## ACKNOWLEDGMENTS

The extensive feedback and thoughtful comments provided by instructors in the field have greatly contributed to the quality of the 14th edition of *Personal Finance*.

Many talented professionals at McGraw Hill Higher Education have also contributed to the development of *Personal Finance*, 14th edition. We are especially grateful to Michele Janicek, Chuck Synovec, Allison McCabe-Carroll, Trina Maurer, Amy Gehl, and Emily Windelborn.

In addition, Jack Kapoor expresses special appreciation to Theresa and Dave Kapoor, Kathryn Thumme, and Karen and Joshua Tucker for their typing, proofreading, and research assistance. Les Dlabay expresses his thanks to Fred Bell, Joe Chmura, Kyle Dlabay, Linda Dlabay, Anne Jaspers, Jennifer Lazarus, Melissa Panganiban, George Seyk, Jasmine Taylor-Newton, and Ben Rohde for their help reviewing the manuscript. Finally, we thank our spouses and families for their patience, understanding, encouragement, and love throughout the years.

## ASSURANCE OF LEARNING

Most educational institutions have a focus on assurance of learning, an important element of accreditation standards. *Personal Finance*, 14th edition, is designed specifically to support your assurance of learning initiatives with a simple, yet powerful, solution.

Each test bank question for *Personal Finance*, 14th 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.

## STOCKTRAK'S PERSONAL FINANCE PRODUCT: U.S. INVESTING SIMULATION AND PERSONAL BUDGETING GAME

Students can now receive a 50% discount on access to StockTrak's market-leading simulations.

### INVESTING SIMULATION

This real-time investing simulation challenges students to build a portfolio of U.S. stocks, ETFs, mutual funds, and bonds and manage it over the course of a semester. StockTrak is packed with research tools, reports, and tutorials to help students get started and real-time rankings to keep them engaged.

### PERSONAL BUDGETING GAME

This budgeting simulations puts students in the role of a college graduate who just started their first job. Each participant works through a simulated year balancing their work/life balance, striving to reach savings goals, build up their credit score, maintaining a high quality of life, and deal with life's many unexpected events that will challenge students' money management skills.

For more information visit: [www.StockTrak.com/Kapoor](http://www.StockTrak.com/Kapoor) and reference access code: KAP-621 or ask your McGraw Hill representative how you can get more information.



## **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 14th 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, 14th edition, refer to the Guided Tour on pages xxvii–xxxiii.)*

### **FINANCIAL LITERACY IN MY LIFE**

This edition continues to focus on financial literacy and financial well-being. In our many years of teaching and evaluating what knowledge and skills are most important, financial literacy—the ability to understand and interpret knowledge relating to the financial decisions we make—is of highest priority. We hope students will remember and use 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 can solve the problems they encounter.

Throughout the text, strong emphasis is placed on financial literacy. The chapter opening questions about “Financial Literacy in My Life,” and the Financial Planning features are focused to emphasize “my life”—the life and decisions that you, the student, will make. Features on financial calculations and decision making have also been altered to focus on students achieving financial literacy.



Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 1</b> <b>Personal Finance Basics and the Time Value of Money</b>	New content: Financial difficulties	Addresses financial difficulties caused by the pandemic and the importance of an emergency fund.
	New content: Opportunity fund	Discusses <i>opportunity fund</i> , money set aside to expand your income and net worth, or to invest in yourself with an advanced degree.
	New content: Financial literacy definition	Offers an explanation of the knowledge and skills for achieving personal, family, and community financial goals.
	New Smart Money Minute feature	Provides a warning to avoid overspending or taking on more debt when receiving a salary increase.
	New Personal FinTech feature	Presents an introduction to FinTech (financial technology), which involves apps, websites, and mobile devices for banking and personal finance activities.
	New exhibit: Goals and Actions for Personal Financial Literacy (Exhibit 1-6)	Connects attitudes and abilities with financial literacy development skills for planning short-term and long-term goals.
	Revised Financial Literacy for My Life feature	Expands the feature to create and implement SMART financial goals.
	Updated apps and websites	Presents additional online and mobile sources to consult for expanded information and assistance.
<b>Chapter 2</b> <b>Financial Aspects of Career Planning</b>	New Digital Financial Literacy activity	Encourages students to make use of personal finance blogs to enhance their knowledge.
	Revised Your Personal Financial Plan activity	Creates a foundation for identifying and implementing short-term and long-term financial planning activities.
	Revised exhibit: Education and income (Exhibit 2-1)	Updates median weekly earnings for various levels of education, based on Bureau of Labor Statistics data.
	New content: Leadership	Provides a brief discussion of leadership qualities vital for career success.
	Revised Financial Literacy for My Life feature	Guides students through a personal SWOT analysis to develop a career action plan.
	New content: Negotiating salary	Suggests actions for negotiating salary in difficult economic times.
	Updated content: Industry trends	Lists job opportunities with the greatest potential in various industries.
	Expanded Financial Literacy for My Life feature	Suggests personal finance actions for people who own their own business.
	Revised Financial Literacy for My Life feature	Provides an overview of innovative benefits offered by various companies.
	New Personal FinTech feature	Discusses artificial intelligence (AI) and other technology used for identifying and hiring employees.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 2</b> (Cont.)	New Digital Financial Literacy activity	Makes students aware of résumé word tracking with an applicant tracking system (ATS).
	Revised Your Personal Financial Plan activity	Guides students with short-term and long-term activities for career planning.
	New Smart Money Minute feature	Offers information on human-centered design (HCD), a valuable career skill for creative problem solving.
	Revised example: Your career brand	Suggests actions guidelines for planning and using a personal brand.
	Expanded example: Preparing for an online interview	Presents reminders for a successful online interview.
	Updated example: Interview checklist	Suggests reminders for interview success.
	Revised Smart Money Minute feature	Reminds students to include required job position words in a résumé since an applicant tracking system (ATS) may screen the document.
	Revised example: Social media résumé	Suggests methods for the use of social media to communicate career competencies to hiring managers.
	Revised exhibit: Interview questions you should expect (Exhibit 2-D)	Presents additional commonly encountered interview questions.
<b>Chapter 3</b> <b>Money Management Strategy: Financial Statements and Budgeting</b>	Revised example: A checklist for interview success	Provides a list of factors to consider for enhanced interview success.
	Revised Smart Money Minute feature	Includes discussion of simulations, job auditions, and informal settings that may be encountered in the interview process.
	Revised exhibit: Money management activities (Exhibit 3-1)	Emphasizes the relationship among financial documents, personal financial statements, and budgeting.
	New Smart Money Minute feature	Presents the CLARK framework for successful money management and budgeting.
	New Smart Money Minute feature	Discusses <i>kakeibo</i> , a system used in Japan for managing personal finances.
	New Smart Money Minute feature	Suggests actions to make budgeting and money management fun.
	Revised Personal FinTech feature	Lists innovative apps and websites available to assist with money management activities.
	New example: Tracking budget success	Presents key numbers for tracking budget success for a reliable picture of financial health.
	New Smart Money Minute feature	Suggests activities for developing financial literacy among children.
	Updated Smart Money Minute feature	Presents innovative apps and websites related to savings, borrowing, and other financial activities.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 3</b> (Cont.)	Revised content: Budgeting systems	Expands discussion of digital budgeting systems, including a spreadsheet, software, a website, or an app.
	New Smart Money Minute feature	Suggests unusual saving methods for achieving financial goals.
	New Digital Financial Literacy activity	Provides guidelines to evaluate budgeting apps.
	Revised Your Personal Financial Plan activity	Suggests short-term and long-term activities for personal financial statements, budgeting, and saving for goals.
<b>Chapter 4</b> <b>Planning Your Tax Strategy</b>	New coverage of Tax Cuts and Jobs Act (TCJA)	Includes information throughout about new tax laws.
	Revised tax rates	Includes updated tax rates.
	New coverage of Qualified Business Income deduction.	Explains use and demonstrates calculation of taxable income with deduction.
	Updated removal of Individual Mandate Penalty	Includes coverage of individual mandate for health insurance and its removal for federal taxes.
	New Exhibit 4-4	Updated 1040 Federal Tax Forms.
	New Personal FinTech feature	Provides information to check on federal refund status.
	New Exhibit 4-5	Updated 1040 Federal Tax Forms.
	New Exhibit 4-6	Updated Tax Tables and Tax Rate Schedules.
	Updated directions for filing taxes online	Describes new amounts and filing process for filing taxes online.
	Updated Financial Literacy For My Life	Includes New Tax Scams relating to phishing and ransomware.
<b>Chapter 5</b> <b>Financial Services: Saving Plans and Payment Accounts</b>	New content: Contactless payments	Emphasizes the expanded use of tap and go payments with health and safety benefits.
	New content: Video teller machines (VTMs)	Presents an overview of the services and benefits of video teller machines (VTMs).
	New content: Digital wallets	Discusses the increased use and expanded services available with digital wallets, also called mobile wallets.
	New Personal FinTech feature	Discusses FinTech products, such as paperless checking, automatic savings, “buy now, pay later” (BNPL) services with interest-free payments, and apps to guide financial health.
	Revised exhibit: Mobile banking services (Exhibit 5-2)	Presents an updated summary of financial services offered through mobile, online, and other technology.
	Revised exhibit: Selecting a financial service provider (Exhibit 5-5)	Offers an updated and expanded framework for assessing and selecting a financial services organization.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 5</b> (Cont.)	Updated data: Understanding interest rates	Provides data for various interest rates that affect spending, saving, borrowing, and investing decisions
	New Personal FinTech feature	Discusses <i>neobanks</i> , FinTech start-ups offering financial services through digital channels and apps.
	New content: High-yield savings accounts	Presents an introduction to high-yield savings accounts.
	New Financial Literacy for My Life feature	Suggests an array of savings accounts to effectively manage finances.
	Expanded content: Checking accounts	Provides an overview of traditional, special feature, and checkless checking accounts.
	Expanded Personal FinTech feature	Presents information on the benefits and concerns associated with Bitcoin and other cryptocurrencies.
	Updated How To: Avoid Identity Theft	Expands suggestions to prevent identity theft with an update of sources for assistance.
	New Digital Financial Literacy activity	Provides a framework for analyzing person-to-person (P2P) payment apps.
<b>Chapter 6</b> <b>Introduction to Consumer Credit</b>	Revised Your Personal Financial Plan activity	Suggests short-term and long-term activities for planning and implementing the use of banking services.
	New introductory paragraph on consumer credit	Describes consumer credit and why it is important to understand and protect it.
	Revised section on credit	Points out how society today has popularized credit and its use.
	Updated exhibit: Volume of consumer credit (Exhibit 6-1)	Illustrates that the volume of credit has been increasing steadily, reaching \$4.18 trillion in 2020.
	New example: Revised credit card section.	Explains how credit card rewards remain popular and have continued to increase in number over the last few years.
	New Smart Money Minute: Credit Card Facts	Provides the latest statistics on credit cards.
	New Smart Money Minute feature	Distinguishes between a home equity loan and a home equity line of credit.
	New Personal FinTech feature	Points out that consumers are entitled to order a free copy of their credit report every year from each of the major credit reporting agencies.
	New Smart Money Minute feature	Explains how consumers can get six credit reports every 12 months from Equifax through December 2026.
	New Personal FinTech feature	Suggests how to protect privacy and security when making mobile payments.
	Revised all Self-Test Problems	Provides updated examples.
	New Digital Financial Literacy feature	Asks students to determine what it takes to protect consumers from credit card scammers.
	New Your Personal Financial Plan feature	Asks students to complete short-term and long-term financial planning activities in establishing and maintaining a credit record.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 7</b> <b>Choosing a Source of Credit: The Cost of Credit Alternatives</b>	Revised medium-priced loans section	Updates the number of Americans who belong to credit unions, the number of credit unions, and the assets held by credit unions in the United States.
	New material in Exhibit 7-1	Adds payday loan companies and online lenders as possible sources of credit.
	New Smart Money Minute feature	Explains loan origination fees and how these fees increase the total cost of a loan.
	New Smart Money Minute feature	Reports how credit card companies provide assistance to consumers during the COVID-19 pandemic.
	New section in debt collection practices	Describes what debt collectors can or cannot do by federal law to collect debts.
	New Exhibit 7-3	Provides sample letter to inform debt collectors when and how to contact you.
	New Financial Literacy for My Life feature	Describes different ways to respond appropriately to debt collectors.
	Revised Exhibit 7-5	Updates total U.S. Chapter 7 and Chapter 13 bankruptcy filings (1980–2020).
	New Smart Money Minute feature	Explains that despite continued high unemployment due to COVID-19 pandemic, personal bankruptcies fell sharply.
	Revised Chapter 7 bankruptcy discussion	Updates information about bankruptcy fees required in 2021.
	New Personal FinTech feature	Explains that personal bankruptcy can be filed without an attorney, which is called filing pro se.
<b>Chapter 8</b> <b>Consumer Purchasing Strategies and Legal Protection</b>	New Digital Financial Literacy feature	Asks students to conduct a cost/benefit analysis before making any major purchase.
	New Your Personal Financial Plan feature	Asks students to research short-term or long-term financial planning activities in comparing credit services and costs, using Personal Financial Planning sheets 30 or 31.
	New Personal FinTech feature	Presents retail technology trends enhancing the shopping experience.
	New Smart Money Minute feature	Presents information on current retailing technology trends designed to enhance the shopping experience.
	New Smart Money Minute feature	Discusses the increasing popularity of electric vehicles (EVs) along with the benefits, concerns, and types of EVs.
	Updated Financial Literacy for My Life feature	Provides updated coverage of pandemic cons, payment scams, and other fraudulent activities.
	New Smart Money Minute feature	Explains how to avoid scams of online used-car sellers.
	New Smart Money Minute feature	Points out that people who drive older vehicles save more for retirement.
	New Smart Money Minute feature	Discusses buying habits of minimalists and frugal people.



Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 8</b> (Cont.)	New Digital Financial Literacy activity	Provides an opportunity to better understand consumer product testing procedures.
	Revised Your Personal Financial Plan activity	Suggests short-term and long-term activities for wise buying.
<b>Chapter 9</b> <b>The Housing Decision: Factors and Finances</b>	New Smart Money Minute feature	Compares ready-to-assemble home kits of the early 20th century with 3D printing of today for creating houses.
	New Personal FinTech feature	Discusses technology to plan, build, buy, sell, and manage real estate; and information on the interconnectivity of devices for smart home features.
	Revised Financial Literacy for My Life feature	Expands actions when deciding whether to pay off a mortgage early along with potential risks of an early mortgage payoff.
	New content: ATR/QM rule	Offers an explanation of the Ability-to-Repay (ATR) /Qualified Mortgage (QM) rule that requires lenders to carefully consider a borrower's financial situation.
	Updated Exhibit: Common closing costs (Exhibit 9-11)	Lists potential closing costs, the fees and charges paid when a real estate transaction is completed.
	Revised Smart Money Minute feature	Suggests upgrades that add value to a home and that have the highest payoffs when selling.
	New Personal FinTech feature	Discusses tech-oriented companies called iBuyers that will buy your home.
	New Digital Financial Literacy activity	Guides students in using online sources for comparing housing alternatives and analyzing housing costs.
<b>Chapter 10</b> <b>Property and Motor Vehicle Insurance</b>	Revised Your Personal Financial Plan activity	Suggests short-term and long-term activities for housing.
	New Financial Literacy for My Life feature	Cautions readers that standard home insurance policies don't cover flood damage.
	Updated Smart Money Minute feature	Explains that for about \$100 a year, homeowners can obtain \$10,000 of coverage for sewage and drain backup damage.
	New examples of actual cash value and replacement value coverage	Illustrates the differences between actual value and replacement value coverage.
	Updated statistics for motor vehicle crashes	Reports that motor vehicle crashes cost over \$250 billion in lost wages and medical costs.
	New Smart Money Minute feature	Cautions readers to think twice before lending their car to friends.
	New example of a deductible	Explains that a deductible may be a specific dollar amount or a percentage.
	Added two Self-Test Problems	Asks students to solve problems related to motor vehicle and homeowners insurance.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 10</b> (Cont.)	New Digital Financial Literacy feature	Asks students to gather information about careers in the insurance industry.
	New Personal Financial Plan feature	Asks students to create an insurance plan to cover financial difficulties.
<b>Chapter 11</b> <b>Health, Disability, and Long-Term Care Insurance</b>	Revised content: High medical costs	Provides revised and updated information on runaway health care costs.
	Revised content: Rapid increase in medical expenditures	Updates data on medical expenditures.
	Revised Exhibit 11-1	Illustrates current and projected health care costs to year 2028.
	New Personal FinTech feature	Provides information on electronic health records.
	New Financial Literacy for My Life feature	Offers seven steps to keep medical costs and debt under control.
	New Smart Money Minute feature	Explains various government and private sources to get health insurance coverage.
	Revised Example: Deductibles and Coinsurance	Updates the deductible and coinsurance example with revised dollar amounts.
	Revised content in long-term care insurance	Updates nursing home costs in the United States.
	New Exhibit 11-7	Summarizes main features of HMO, EPO, PPO, and POS plans.
	New Smart Money Minute feature	Cautions readers not to contribute to HSAs once Medicare coverage begins.
	Revised Financial Literacy for My Life feature	Updates how HSAs work in 2021.
	New Smart Money Minute feature	Informs readers that the CARES Act of 2020 permits HSA, FSA, and HRA account holders to pay for over-the-counter medication.
	New Personal FinTech feature	Assures readers that Medicare covers the COVID-19 lab tests and vaccines.
	Revised material on Affordable Care Act	Updates Health Insurance and Patient Protection and Affordable Care Act of 2010.
	New Smart Money Minute feature	Explains that many young adults and children were uninsured in 2019.
	Revised Self-Test problems	Updates Self-Test problems.
	New Digital Financial Literacy feature	Explains why readers should care about health care costs.
	New Your Financial Plan feature	Asks students to compare health insurance plans.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 12</b> <b>Life Insurance</b>	Updated statistics for policy coverage and total coverage.	Reports current statistics for total life insurance policies and total coverage.
	Updated statistics for life insurance coverage	Reports current statistics for life insurance coverage for adult consumers.
	New Exhibit 12-1	New exhibit for top reasons that people do not have life insurance.
	Updated statistics for life expectancy	Reports current statistics for life expectancy for males and females based upon current age.
	New Exhibit 12-3	New exhibit for average face amount of policies purchased.
	Updated Smart Money Minute	Includes current information about stay-at-home moms' equivalent wage.
	Updated Smart Money Minute	Provides a possible reason why people don't purchase life insurance policies.
	New Personal FinTech feature	Asks students to calculate the amount and cost of a life insurance policy.
	New Personal Financial Plan feature	Asks students to create an insurance plan to cover financial difficulties.
	Updated Exhibit 12-8	Reports current information for credit, group, and individual policies.
<b>Chapter 13</b> <b>Investing Fundamentals</b>	New Digital Financial Literacy feature	Asks students to research life insurance coverage and premiums post-pandemic.
	New Your Personal Finance feature	Describes short-term and long-term financial planning activities.
	New information on goals	Includes planning for emergencies and retirement.
	New information for budgeting apps	Provides information for four popular apps that can help budget and manage your money.
	Updated statistics for credit cards	Reports current statistics for credit cards and time required to repay credit card debt.
	Revised Smart Money feature	Provides current customer ranking for overall customer satisfaction for credit cards.
	New material in the business cycle section	Describes the effect of the COVID-19 pandemic on the business cycle.
	New example of the time value of money	Describes how \$1,800 invested at 8 percent can grow to \$466,302 in 40 years.
	New Exhibit 13-1	Illustrates the growth of investments that earn 2 percent or 8 percent over different time periods.
	New example of risk-return trade-off	Shows the effect of dividends and a recent price increase on the total return for an investment in Procter & Gamble stock.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 13</b> (Cont.)	New example of the effect of changing interest rates in the economy	Illustrates how bond prices for an Amazon corporate bond increase or decrease because of changes in the overall interest rates in the economy.
	New example of business failure risk	Explains what happened to investors who owned JC Penney stock or bonds when the company filed for bankruptcy.
	New statistics for investment returns	Illustrates different investment returns for stock investors over different time periods.
	New information on the largest one-day loss for the stock market	Provides information about the decline in stock values that occurred on March 16, 2020.
	Revised Smart Money Minute	Includes new statistics for income for American families.
	New example of asset allocation for older investor	Explains how many investors become more conservative as they get older.
	New example of interest calculation for a Clorox bond	Describes the options for an investor who chooses a Clorox bond that pays 3.90 percent and matures in 2028.
	New How To ... feature	Provides information about how to open a brokerage account.
	New Personal FinTech feature	Points out how some investors are using robo advisors.
	Revised Exhibit 13-7 and Exhibit 13-8	Includes more websites and sources that investors can use to stay current with financial news.
	New Digital Financial Literacy feature	Asks students to determine what it takes to become a certified financial planner.
	New Your Personal Financial Plan feature	Asks students to complete short-term and long-term financial planning activities.
<b>Chapter 14</b> <b>Investing in Stocks</b>	New information on corporate dividends	Explains why some companies don't pay dividends and some companies have a long history of paying dividends.
	Revised information on a McDonald's investment	Illustrates how an investor made money by investing in McDonald's stock over a long period of time.
	New information about stock market returns	Shows average returns for the stock market over different time periods.
	Updated Smart Money Minute	Provides new information on the percentage of people that own stock in different age groups.
	Updated Exhibit 14-1	Illustrates the record date and payable date for a recent Starbucks dividend.
	New Exhibit 14-2	Describes the total return for an investment in Clorox stock over a 12-month period.
	New information for stock splits	Describes the effect of a 4 for 1 stock split for Apple.
	New Exhibit 14-5	Illustrates the type of information available from the Yahoo! Finance website for Coca-Cola.
	New Exhibit 14-7	Illustrates a Value Line report for Walmart.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 14</b> (Cont.)	Updated Smart Money Minute	Shows values for the Dow Jones Industrial Average for the period 2015 to February 2021.
	New examples in the section Numerical Measures that Influence Investment Decisions	Uses current financial information for calculations that can be used to evaluate an investment.
	New example for an IPO	Describes how DoorDash raised \$3.3 billion in its IPO.
	New Exhibit 14-8	Shows the amount required to open an account, the commission charge for stock trades, and specific advantages for popular online brokerage firms.
	New Personal FinTech feature	Explains how investors can practice their investment skills by using a virtual stock game.
	New examples for a limit and stop-loss order	Describes how investors can use a limit order to buy or sell Walt Disney stock and a stop-loss order for American Airlines.
	Revised Exhibit 14-9	Explains how dollar cost averaging can be used to buy Johnson & Johnson stock for the period 2015 to 2021.
	New example for day trading	Describes the volatility that investors experienced when they bought and sold GameStop in 2021.
	New Digital Financial Literacy feature	Illustrates how investors can use Yahoo! Finance to track the historical value of dividends, stock prices, and stock splits.
	New Financial Planning Case	Asks students to evaluate Walmart based on the Value Line report in Exhibit 14-7, and then make a decision to buy the stock or not.
	New Your Personal Financial Plan feature	Asks students to research different brokerage firms and also evaluate a specific company that would be a good long-term investment.
<b>Chapter 15</b> <b>Investing in Bonds</b>	New example in the chapter introduction	Describes how one person chose to invest in bonds to avoid investment losses during the COVID-19 pandemic.
	Revised Smart Money Minute	Provides average interest rates for high-quality corporate bonds for the period 2000 to 2020.
	New example for convertible bonds	Explains why Southwest Airlines issued convertible bonds.
	New example for bond interest calculation	Shows the interest calculation for a Microsoft bond that pays 3.3 percent and matures in 2027.
	New example explains why bond prices fluctuate	Illustrates how the price of a bond issued by Apple can increase or decrease because of changes in the overall interest rates in the economy.
	New example to approximate the value of a bond	Uses an internet link for a bond price calculator to approximate the current value of a bond.
	New Exhibit 15-3	Explains how bond investors can make money if they purchase a Clorox bond.
	Revised Smart Money Minute	Provides average interest rates for 10-year Treasury notes for the period 2000 to 2020.



Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 15</b> (Cont.)	New example for tax-equivalent yield	Shows the calculation to determine the tax-equivalent yields for a taxpayer in the 24 percent tax bracket who purchases a tax-free bond that pays 3 percent.
	New Exhibit 15-5	Illustrates the tax-equivalent yields based on different tax-free returns and current individual tax rates.
	New websites for bond investors	Provides additional websites that bond investors can use to get current information.
	New Exhibit 15-6	Describes the type of bond information available on the FINRA website.
	New example for bond pricing	Calculates the current price for a bond based on a bond quotation.
	New Personal FinTech feature	Describes brokerage firm apps that can be used to help screen possible bond investments.
	Revised Exhibit 15-7	Provides current ratings information available from Moody's Investor Services and Standard & Poor's.
	Enhanced explanation of bond ratings	Provides more detailed information about what bond ratings mean.
	New example for current yield	Calculates the current yield for a Boeing bond.
	New example for yield-to-maturity	Calculates the yield-to-maturity for a Boeing bond.
	Updated Financial Literacy Calculations feature	Uses current financial information to calculate the times interest earned ratio for Home Depot.
	New Digital Financial Literacy feature	Asks students to explore the Treasury Direct website.
	New Financial Planning Case	Updates the information needed by an investor who is trying to choose between different bond investments and a conservative stock investment.
<b>Chapter 16</b> <b>Investing in Mutual Funds</b>	New Your Personal Financial Plan feature	Asks students to explain the difference between stocks and bonds and also use the FINRA website to research a specific corporate bond.
	Updated example in the chapter introduction	Revised average return is now 16 percent for the T. Rowe Price Dividend Growth mutual fund.
	New statistics for mutual funds	Lists statistics from the Investment Company Institute about mutual fund investments.
	New Exhibit 16-1	Provides information about the number and type of securities contained in the Fidelity Blue Chip Growth Fund.
	Updated Smart Money Minute feature	Shows the percentage of fund investors for different generations.
	New statistics for different types of funds	Includes the number of closed-end, exchange-traded, and open-end funds.
	New example for net asset value	Explains how to calculate the NAV for the New American Frontiers fund.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 16</b> (Cont.)	Revised information on fees for a load fund	Explains that the average sales charge for a load fund is now 2 to 5 percent.
	Revised Exhibit 16-3	Updates the load charges, management fees, 12b-1 fees, and expense ratio for the Davis New York Venture fund.
	Increased coverage of different types of funds	Discusses why young investors often pick more growth-oriented funds and investors closer to retirement choose more conservative funds.
	New fund objective	Includes the fund objective for the Vanguard U.S. Growth fund.
	Updated Smart Money Minute feature	Shows the four top reasons why people invest in funds.
	New material on the difference between a managed fund and an index fund	Supplies additional material on the reasons why index funds often outperform managed funds.
	New Exhibit 16-4	Provides information about the three largest U.S. mutual fund families—Blackrock, Vanguard, and Fidelity.
	New Exhibit 16-5	Discusses a Morningstar research report for the Calvert Balanced A Fund.
	Updated Exhibit 16-6	Provides fund information from Kiplinger's 25 Favorite No-Load Mutual Funds.
	New example on how to make money with fund investments	Shows how an investor can make money with an investment in the T. Rowe Price Communications and Technology fund.
	Revised Financial Literacy Calculations feature	Provides information to illustrate how to compute total return and percentage of return for a fund investment.
	New Personal FinTech feature	Describes investment apps for mutual fund investors.
	New Digital Financial Literacy feature	Asks students to read a Forbes article and use the internet to research different investment apps.
<b>Chapter 17</b> <b>Investing in Real Estate and Other Investment Alternatives</b>	New Financial Planning Case	Asks students to determine if they would invest in a specific fund based on information from the internet and their answers to the questions on Personal Financial Planner sheet 62.
	New Your Personal Financial Plan feature	Asks students to evaluate sources of mutual fund information and also evaluate a specific mutual fund.
	New material in Your Home as an Investment section	Explains that even though the global pandemic shattered the United States economy in 2020, the housing market remained strong.
	Revised Exhibit 17-2	Updates data of annual home ownership rates by age groups.
	New material in Your Vacation Home section	Explains that during the COVID-19 pandemic, the demand for vacation homes remained strong.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 17</b> (Cont.)	New material in Commercial Property section	Reveals that COVID-19 pandemic had stalled the commercial real estate market, but the market continued to recover gradually.
	Revised Financial Literacy for My Life feature	Describes that over five decades, Freddie Mac has provided more than \$11 trillion to more than 69 million homeowners.
	New material in Gold Bullion Coins section	Cautions readers to ask the seller for the coin melt value when purchasing gold bullion coins.
	Revised content: Prices of precious metals	Includes the latest prices of silver, platinum, and rhodium.
	New content in Silver, Platinum, Palladium, and Rhodium section	Advises readers not to take cash from their retirement accounts and invest it in precious metals.
	New Personal FinTech feature	Cautions buyers of jewelry, precious stones, and collectibles to compare quality, price, and service from several different sellers before making the purchase.
	New Financial Literacy for My Life feature	Provides tips for buyers of Bitcoin and other cryptocurrencies.
	New Digital Financial Literacy for My Life feature	Explains that the value of bullion coins is determined mostly by their precious metals content rather than by their rarity and condition.
	New Your Personal Financial Plan feature	Cautions that speculative ventures must be considered carefully in relation to personal financial situations.
<b>Chapter 18</b> <b>Starting Early: Retirement Planning</b>	Revised contents: Centenarians	Updates the number of centenarians in the United States.
	Revised content: Inflation rate	Updates annual inflation rate for 2021.
	Updated statistics for Social Security	Reports current statistics for Social Security recipients as of 2021.
	Revised Smart Money Minute feature	Provides current statistics on who receives Social Security benefits.
	Revised Smart Money Minute feature	Shows what groups are collecting Social Security benefits as of 2021.
	New Smart Money Minute feature	Explains how to protect yourself from Social Security phone scams.
	Revised content on the future of Social Security	Provides updated statistics about the future of Social Security.
	Revised Exhibit 18-8	Illustrates how the number of workers per beneficiary has plummeted over the decades.
	New content in Other Public Pension Plans	Explains how PensionHelp America assists people if they have questions about retirement plans.
	New Smart Money Minute feature	Describes how despite increasing wealth, most Americans have only modest savings relative to their retirement income needs.
	Revised content: 401(k) plans	Updates the contribution limits for 2021.

Chapter	Selected Topics	Benefits for the Teaching-Learning Environment
<b>Chapter 18</b> (Cont.)	New Personal FinTech feature	Illustrates that when you change jobs, generally you have four choices about what to do with your 401(k) plan savings.
	Revised content: Pension Benefits Guaranty Corporation (PBGC)	Explains that since 1974, the PBGC has protected the pension benefits of over 34 million workers, retirees, and their families.
	Revised content: IRAs	Updates the contribution limits for 2021.
	Revised content: Rollover IRAs	Updates the contribution limits for 2021.
	Revised content: SEP-IRAs	Updates the contribution limits for 2021.
	New content: Keogh Plans	Explains that you may contribute 25 percent of your income, up to a maximum of \$58,000 as of 2021.
	New Digital Financial Literacy feature	Assists readers in creating their own My Social Security account.
	New Your Personal Financial Plan feature	Helps readers to plan for retirement using Personal Financial Planning sheets 64 and 65.
<b>Chapter 19</b> <b>Estate Planning</b>	Revised content: New lifestyles	Points out that the law allows \$11.7 million exemption for estate taxes.
	New Personal FinTech feature	Provides rules to remember when writing a will.
	Revised content: Cost of a Will	Updates the cost of a standard will.
	Revised content: Stated dollar amount will	Updates the amount (\$11.7 million) for 2021.
	Revised content: Credit-shelter trust	Provides updated new exemption amounts for 2021.
	Updated Exhibit 19-6	Includes the new exemption amounts for 2019, 2020, and 2021.
	Revised content: Estate taxes	Points out that the surviving spouse's estate in excess of \$23.4 million (in 2021) faces estate tax of 40 percent.
	Revised content: Estate taxes	Explains that only 12 states and the District of Columbia impose an estate tax. Maryland imposes both estate and inheritance tax.
	Revised content: Self-test problems	Updates examples for 2021.
	Revised content: Financial Planning Problems	Updates problems for 2021 amounts.
	New Digital Financial Literacy feature	Includes student activities for making a will.
	New Your Personal Financial Plan feature	Asks students to perform short-term and long-term financial planning activities in developing an estate plan.

# GUIDED TOUR

## Learning Objectives

Learning objectives are presented at the start of each chapter. These goals are then 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, as well as materials in the *Instructor's Manual* and *Test Bank*. Problems in *Connect* can also be organized using the objectives.

## Personal Finance Basics and the Time Value of Money

# 1



### 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.
- The Chapter 1 Appendix provides expanded discussion of time value of money calculations and applications.



## Financial Literacy IN YOUR LIFE

► **What if you . . .** needed funds for major auto repairs? Or encountered unexpected medical bills? Financial difficulties of the recent pandemic emphasized the importance of an emergency fund 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. Tracking your spending will help you set aside 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? Do you have a system for tracking your spending? You will be able to monitor your progress using the Your Personal Finance Roadmap and Dashboard feature at the end of the chapter.

**my life** HOW DO I START?

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

Each of these financial situations involves planning and 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 concerns. How will you best plan to use your finances? For each of the following statements, select "yes," "no," or "uncertain" to indicate your responses to 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 expensive possessions or having a high income. People may associate being rich with not having to worry about finances by being able to pay bills. For others, being rich means donating to organizations that make a difference in our society.

People obtain financial wealth in varied ways. Starting a business or pursuing a high-paying career are common paths. Frugal living and wise investing can also result in long-term financial security. You might consider an *opportunity fund*, money set aside to expand your income and net worth, or to invest in yourself with an advanced degree.

## Financial Literacy in Your Life

This introductory feature covers the why and how of key chapter topics, with suggested action alternatives that a person might consider when encountering related decisions.

## My Life

The *My Life* concept begins with the chapter opener. Students are presented with an engaging scenario relating what they're about to learn to their own lives. The follow-up questions are designed to get students thinking about current personal finance activities and to motivate them to try new beneficial practices. The *My Life* boxes throughout the chapters and the Learning Objectives in the chapter summary expand on this concept.



Boxed features in each chapter build student interest and highlight important topics. Three different types of boxed features are available.

## How To . . .

The *How To . . .* boxes emphasize application-driven personal finance themes. Each box highlights an issue and walks students through how to navigate the situation.



### HOW TO . . .

#### Choose a Credit Counselor

Credit counseling organizations provide valuable assistance to financially distressed consumers. However, some firms may be misleading you about who they are, what they do, or how much they charge. Experts advise that you ask the following questions to find the best credit counselor.

- *What services do you offer?* Look for an organization that offers budget counseling and money management classes as well as a debt-management plan.
- *Do you offer free information?* Avoid organizations that charge for information or demand details about your problem first.
- *What are your fees?* Are there setup and/or monthly fees? A typical setup fee is \$10. If you're paying a lot more, you may be the one who's being set up.
- *How will the debt-management plan work?* What debts can be included in the plan, and will you get regular reports on your accounts?
- *Can you get my creditors to lower or eliminate my interest and fees?* If the answer is yes, contact your creditors to verify this.
- *What if I can't afford to pay you?* If an organization won't help you because you can't afford to pay, go somewhere else for help.
- *Will you help me avoid future problems?* Getting a plan for avoiding future debt is as important as solving the immediate debt problem.
- *Will we have a contract?* All verbal promises should be in writing before you pay any money.
- *Are your counselors accredited or certified?* Legitimate credit counseling firms are affiliated with the National Foundation for Credit Counseling or the Association of Independent Consumer Credit Counseling Agencies.

Check with your local consumer protection agency and the Better Business Bureau to see if any complaints have been filed about the company.

## Financial Literacy for My Life

### IS IT TAXABLE INCOME? IS IT DEDUCTIBLE?

Certain financial benefits individuals receive are not subject to federal income tax. Indicate whether each of the following items would or would not be included in taxable income when you compute your federal income tax.

Is it taxable income?	Yes	No
1. Lottery/Jackpot winnings	_____	_____
2. Child support received	_____	_____
3. Worker's compensation benefits	_____	_____
4. Life insurance death benefits	_____	_____
5. Cash rebate for laptop	_____	_____
6. Unemployment income	_____	_____

Note: These taxable income items and deductions are based on the 2018 tax year and may change due to changes in the tax code.

Indicate whether each of the following items would or would not be deductible when you compute your federal income tax.

Is it deductible?	Yes	No
7. Life insurance premiums	_____	_____
8. Baggage fees for self-employed	_____	_____
9. Fees for traffic violations	_____	_____
10. Mileage for driving to volunteer work	_____	_____
11. An attorney's fee for preparing a will	_____	_____
12. Income tax preparation fee	_____	_____

ANSWERS: 1, 6, 8, 10—yes; 2, 3, 4, 5, 7, 9, 11, 12—no.

## Financial Literacy for My Life

This feature offers information to assist students when faced with special situations and unique financial planning decisions. Many emphasize the use of online sources.

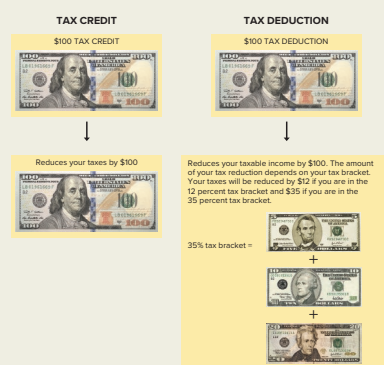
## Financial Literacy Calculations

### TAX CREDITS VERSUS TAX DEDUCTIONS

Many people confuse *tax credits* with *tax deductions*. Is one better than the other? A *tax credit*, such as eligible child care or dependent care expenses, results in a dollar-for-dollar reduction in the amount of taxes owed. A *tax deduction*, such as an itemized deduction in the form of medical expenses, mortgage interest, or charitable contributions, reduces the taxable income on which your taxes are based.

Shown at right is how a \$100 tax credit compares with a \$100 tax deduction:

As you might expect, tax credits are less readily available than tax deductions. To qualify for a \$100 child care tax credit, you may have to spend \$500 in child care expenses. In some situations, depending on deductible items may be more beneficial than qualifying for a tax credit. A knowledge of tax law and careful financial planning will help you use both tax credits and tax deductions to maximum advantage.



(100 dollar bill) andreykrasov/123RF; (5, 10, 20 dollar bill) Ruslan Nasayrov/Getty Stock Photo

## Financial Literacy Calculations

This feature presents over 90 mathematical applications for various personal financial activities and decisions.

Margin notes provide connections to supplementary information. The Smart Money Minute feature provides interesting statistics and tips in personal financial planning. The Concept Check feature provides an ongoing assessment tool.

## 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 margin notes 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.

### personal fintech

Innovative apps and websites are available to assist with money management activities.

- **Albert** ([www.meetalbert.com](http://www.meetalbert.com)) is an app to guide your financial decisions.
- **EARN** ([www.earn.org](http://www.earn.org)) helps you to create a habit of saving.
- **Scratch** ([www.scratch.fi](http://www.scratch.fi)) helps borrowers understand, manage, and repay loans.
- **SaverLife** ([about.saverlife.org](http://about.saverlife.org)) helps you to create a habit of saving.
- **Axos Invest** ([axosinvest.com](http://axosinvest.com)) suggests and manages investments for financial goals.
- **Greenlight** ([greenlightcard.com](http://greenlightcard.com)) teaches financial responsibility to children.
- **gohenry** ([gohenry.com](http://gohenry.com)) helps kids build money management skills.

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PART 1 PLANNING YOUR PERSONAL FINANCES



Daily purchasing decisions influence cash outflows and long-term financial goals. [georgenyd/123RF](#)

**discretionary income**  
Money left over after paying for housing, food, and other necessities.

### my life 2

I know the details of my cash flow statement.

In what ways might the Daily Spending Diary (at the end of Chapter 1) be of value when preparing a personal cash flow statement?

### smart money minute

Many people make the **mistake** of not having an accurate record of spending, which results in high debt levels and low saving amounts. An **action** is to use an app or a written spending record, or to track spending with sticky notes, a whiteboard, a monthly calendar, or by collecting receipts as a visual reminder. This can result in **success**—having funds for financial goals and emergencies. To reduce financial stress, potential actions include: (1) Have a low debt-to-income ratio. (2) Delay, reduce, or eliminate unnecessary expenses. (3) Build up emergency savings. (4) Seek additional income by selling unneeded items, working extra hours at your job, securing part-time work, starting a home-based or online business, turning a hobby into a business, or selling your expertise as a consultant. Search online for other ideas for increased income.

Her take-home pay is \$3,100; this amount, plus earnings from savings and investments, gives her an available income of \$3,196 for use during the current month.

Take-home pay may also be referred to as **disposable income**, the amount a person or household has available to spend. **Discretionary income** is money left over after paying for housing, food, and other necessities. The amount available for discretionary income will vary by age, income level, and economic conditions. During the recent pandemic many people had very limited discretionary income.

**STEP 2: RECORD CASH OUTFLOWS** Cash payments for living expenses and other items are the second component of a cash flow statement. Lin Ye divides her cash outflows into two major categories: **fixed expenses** and **variable expenses**. While every individual and household has different cash outflows, these main categories, along with the subcategories Lin uses, can be adapted to most situations.

1. **Fixed expenses** are payments that do not vary from month to month. Rent, mortgage payments, loan payments, wifi service fees, and a monthly train ticket for work are examples of constant or fixed cash outflows. For Lin, another type of fixed expense is the amount set aside each month for payments due once or twice a year. For example, Lin pays \$384 every March for life insurance. Each month, she records a fixed outflow of \$32 for deposit in a savings account so the money will be available when her insurance payment is due.

2. **Variable expenses** are flexible payments that change from month to month. Examples of variable cash outflows are food, clothing, utilities (electricity, cell phone, gas), recreation, medical expenses, gifts, and donations. The use of an app or other system is necessary for an accurate total of cash outflows.

**STEP 3: DETERMINE NET CASH FLOW** The difference between income and outflows can be either a positive (**surplus**) or a negative (**deficit**) cash flow. A deficit exists if more cash goes out than comes in during a month. This amount must be made up by taking money from savings or by borrowing.

When you have a cash surplus, as Lin did (Exhibit 3-4), this amount is available for saving, investing, or paying off debts. Each month, Lin sets aside money for her **emergency fund** in a savings account that she could use for unexpected expenses or to pay living costs if she did not receive her salary. She deposits the additional surplus in savings and investment plans with two purposes: (1) short-term and intermediate financial goals, such as a new car, a vacation, or returning to school; (2) long-term financial security—her retirement.

A cash flow statement is the foundation for a spending, saving, and investment plan. The cash flow statement reports the **actual** spending of a household. In contrast, a budget, with a similar format, is used to **project** income and spending.

The *Financial Literacy Calculations* feature offers tools that may be used to determine how to improve your balance sheet and cash flow statement.

## Personal FinTech

The *Personal FinTech* feature, new to this edition, presents ways in which apps, websites, mobile devices, and other technology are influencing how people earn, save, spend, and invest.

Examples of key concepts and calculations reinforce student learning. The Practice Quizzes provide an ongoing assessment tool.

## Highlighted Examples

Worked-out examples featuring key concepts and calculations appear throughout the text for students to see practical applications of personal finance. Many examples include a **How About You?** question to guide personal applications of the topic.

### EXAMPLE: Net Worth

If a household has \$193,000 of assets and liabilities of \$88,000, the net worth would be \$105,000 (\$193,000 minus \$88,000).

**How about you?** What is an estimate of your current net worth? What actions might you take to increase your net worth?

## Practice Quiz

The *Practice Quiz* at the end of each major section provides questions to help students assess their knowledge of the main ideas 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.



PFP Sheet 17  
Cash budget  
PFP Sheet 18  
Annual budget  
summary



### PRACTICE QUIZ 3-3

1. What are the main purposes of a budget?
2. How does a person's life situation affect goal setting and amounts allocated for various budget categories?
3. What are the main steps in creating a budget?
4. What are commonly recommended qualities of a successful budget?
5. What actions might you take when evaluating your budgeting program?

A variety of end-of-chapter features support the concepts presented in the chapter.

#### Your Personal Finance Roadmap and Dashboard:

##### Money Management



A monthly cash flow analysis will help you achieve various financial goals.

By comparing your cash inflows (income) and cash outflows (spending), you will determine if you have a surplus or a deficit. A surplus allows you to save more or pay off debts. A deficit reduces your savings or increases the amount you owe.

##### Your Situation

Do you maintain a record of cash inflows and outflows? Does your cash flow situation reflect a deficit with unnecessary spending? How can you reduce spending to improve your cash flow situation? Other money management actions you might consider during various stages of your life include:

##### First Steps

- Maintain a spending diary to monitor daily finances.
- Create a system for financial records and documents.
- Develop a budget with a regular amount for savings.
- Create a personal balance sheet and cash flow statement.
- Maintain an appropriate emergency fund.

##### Next Steps

- Update personal financial statements.
- Begin an investment program for funding children's education and other long-term goals.
- Adapt your budget to changing household needs.

##### Later Steps

- Determine potential changes in daily spending needs during retirement.
- Consider increased savings and contributions to retirement plans.

**YOUR next step...** select one or more of the items above and create an action plan to implement those financial planning activities.

## Personal Finance Roadmap and Dashboard

An increasing number of nontraditional students take personal finance. The Dashboard feature provides students of all ages with a high-level snapshot outlining how to evaluate progress for key financial planning activities. The Roadmap at the end of each chapter provides personal finance action items for students of all ages.

## Financial Planning Problems

With added and revised items, these problems allow students to apply their quantitative analysis to personal financial decisions.



#### FINANCIAL PLANNING PROBLEMS

- LO3-2 1. Determining Liquid Assets and Current Liabilities.** Based on these items, what is the total of the (a) liquid assets and (b) current liabilities?
- |                                      |   |
|--------------------------------------|---|
| Checking account balance, \$860      | Savings account balance, \$2,675        |
| Retirement account balance, \$57,000 | Current student loan payment due, \$220 |
| Credit card balance, \$117           | Investment account balance, \$8,000     |
| Rare jewelry, \$450                  | Mortgage, \$178,000                     |
- LO3-2 2. Calculating Balance Sheet Amounts.** Based on the following data, compute the total assets, total liabilities, and net worth.
- |                              |                                 |
|------------------------------|---------------------------------|
| Liquid assets, \$4,670       | Household assets, \$93,780      |
| Investment assets, \$26,910  | Long-term liabilities, \$76,230 |
| Current liabilities, \$2,670 |                                 |
- LO3-2 3. Preparing a Personal Balance Sheet.** Use the following items to prepare a balance sheet and a cash flow statement. Determine the total assets, total liabilities, net worth, total cash inflows, and total cash outflows.
- |                                      |                                    |
|--------------------------------------|------------------------------------|
| Rent for the month, \$650            | Auto insurance, \$230              |
| Monthly take-home salary, \$1,950    | Household possession, \$3,400      |
| Cash in checking account, \$450      | Home entertainment system, \$2,350 |
| Savings account balance, \$1,890     | Payment for electricity, \$90      |
| Spending for food, \$345             | Lunches/parking at work, \$180     |
| Balance of educational loan, \$2,140 | Donations, \$70                    |
| Current value of automobile, \$7,800 | Computers, \$1,500                 |



#### DIGITAL FINANCIAL LITERACY: BUDGETING APPS

While a written budget provides a tangible experience, many people use apps to guide their spending. In recent years, the most popular budget apps included YNAB, Mint, Personal Capital, EveryDollar, and Zeta. Some apps emphasize investing, while others help couples coordinate money management activities.

In addition to planning and monitoring spending, other features offered in budgeting apps include:

- Coordination of financial activities, such as account balances, bill tracking, and net worth.
- Financial advice and a visual summary of progress toward suggested financial goals.
- Detailed information on spending; accounting for every dollar (zero-based budgeting).
- Spending reminders with an option to adjust amounts among categories.

- Avoiding paycheck-to-paycheck living by only spending "aged" money (at least 30 days old).
- The ability to split transactions when out to eat, and to enter cash payment transactions.

An evaluation of budgeting apps will likely include the cost (some are free). This assessment might also consider the presence of ads for financial products appropriate to your personal situation, privacy controls, and security measures.

##### Action items:

1. (a) Locate online reviews for budget apps. (b) Talk to several people about their experiences with budget apps. What benefits and concerns are associated with these apps?
2. Prepare a summary response for a budget app review that might be posted online to guide others when using a budgeting app.

## Digital Financial Literacy

The *Digital Financial Literacy* feature provides students with an opportunity to enhance their skills to identify, research, and implement money decisions as both consumers and producers of digital content.

## Financial Planning Case

Students are given a hypothetical personal finance dilemma and data to work through to practice concepts learned in the chapter. Questions help students use analytic and critical thinking skills while reinforcing their mastery of chapter topics.



#### FINANCIAL PLANNING CASE

##### Adjusting the Budget

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

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

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

plan allows for all their needs and also includes regularly saving and investing for the children's education and for retirement.

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

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

"Not really," was Jason's response.

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

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

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

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



## YOUR PERSONAL FINANCIAL PLAN

### PERSONAL FINANCIAL STATEMENTS AND A SPENDING PLAN

Money management activities are the foundation for other financial planning actions. Creation of a financial document filing system, a personal balance sheet, a cash flow statement, and a budget provide you with tools for setting, implementing, and achieving financial goals.

#### Your Short-Term Financial Planning Activity

**Task** Create a system for financial documents and develop personal financial statements.

#### Research

- 1) Based on PFP Sheet 14, propose a filing system to organize your financial records and documents.
- 2) Using PFP Sheet 15 and 16 or a similar format, create a personal balance sheet and a personal cash flow statement for your current situation.
- 3) Considering your current situation, use PFP Sheets 17 and 18 to develop a budget and monitor your spending plan.

**Outcome** Add these documents and files to your portfolio or to your Personal Financial Plan online folder.

#### Your Long-Term Financial Planning Activity

**Task** Plan long-term savings activities.

#### Research

- 1) As needed, use PFP Sheet 19 to plan long-term financial goals related to education.
- 2) Assess your current emergency fund. Develop a plan, such as automatic withdrawals, to increase your emergency fund and to achieve long-term financial goals.

**Outcome** Prepare an audio or written summary of your proposed actions for increased savings. What factors are creating any limitations for savings to achieve your financial goals?

Note: All *Personal Financial Planner* sheets are available at the end of the book and in an Excel spreadsheet format in *Connect Finance*.

## Your Personal Financial Plan

This feature provides long- and short-term financial planning activities based on the chapter topics, and referenced to relevant *Personal Financial Planner* sheets, located at the end of the book and on Connect.

## Continuing Case

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



## CONTINUING CASE

### Money Management Strategy: Financial Statements and Budgeting

Jamie Lee Jackson, age 25, a busy full-time student and part-time bakery clerk, has been trying to organize her priorities, including her budget. She has been wondering if she is allocating enough of her income toward savings to accumulate the \$9,000 down payment she needs to achieve her dream of opening a cupcake café.

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

#### Current Financial Situation

##### Assets:

Checking account: \$1,250  
Emergency fund savings account: \$3,100

Car: \$4,000

##### Liabilities:

Student loan: \$5,400

Credit card balance: \$400

##### Income:

Gross monthly salary: \$2,125

Net monthly salary: \$1,560

##### Monthly Expenses:

Rent obligation: \$275

Utilities obligation: \$125

Food: \$120

Gas/maintenance: \$100

Credit card payment: \$50

##### Savings:

Regular savings: \$150

Rainy day savings: \$25

##### Entertainment:

Cake decorating class: \$35

Movies with friends: \$50

#### Questions

1. According to the text, a *personal balance sheet* is a statement of your net worth. It reports what you own and what you owe. Using the information provided, prepare a personal balance sheet for Jamie Lee.
2. Using the table found in Ratios for Evaluating Financial Progress, what is Jamie Lee's debt ratio? When comparing Jamie Lee's liabilities and her net worth, is the relationship a favorable one?



## DAILY SPENDING DIARY

"I am amazed how little things can add up. However, since I started keeping track of all my spending, I realized that I need to cut down on some items so I can put some money into savings."

#### Directions

Continue or start using the *Daily Spending Diary* sheets, or create your own format, to record every cent of your spending in the categories provided. This experience will help you better understand your spending patterns and help you achieve financial goals.

#### Analysis Questions

1. What information from your *Daily Spending Diary* might encourage you to reconsider various money management actions?
2. How can your *Daily Spending Diary* assist you when planning and implementing a budget?

A *Daily Spending Diary* sheet is located at the end of Chapter 1 and on the library resource site within Connect.

## Daily Spending Diary


Do you buy a latte or a soft drink every day? 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 spending activities might go unnoticed, yet they have a significant effect on your overall financial health. The *Daily Spending Diary* sheet (following Chapter 1 and online) and end-of-chapter activities offer students a place to track their spending in various categories. Careful monitoring and assessing of spending habits can lead to better financial control and expanded personal financial understanding.

*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 located at the end of the text and in an Excel format on *Connect*. Each worksheet asks students to work through the application and record their personal financial plan answers. These sheets apply concepts learned to personal situations and serve as a roadmap for your personal financial future. Students can fill them out, submit them for homework, and keep them filed 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 plan future decisions. The authors also recommend apps to guide help students with this task. 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 material in the preceding section.

20  **Income Tax Estimate**

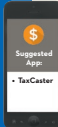
Name: \_\_\_\_\_ Date: \_\_\_\_\_

**Purpose:** To estimate your current federal income tax liability.  
**Instructions:** Based on last year's tax return, estimates for the current year, and current tax regulations and rates, estimate your current tax liability. This sheet is also available in an Excel spreadsheet on the library resource site in *Connect*.  
**Suggested websites:** [www.irs.gov](http://www.irs.gov), [turbotax.intuit.com/tax-tools/calculators/taxcaster/](http://turbotax.intuit.com/tax-tools/calculators/taxcaster/)  
**Suggested app:** TaxCaster

<b>Gross income</b> (wages, salary, investment income, and other ordinary income)	\$
<b>Less</b> Adjustments to income (see current tax regulations)	– \$
<b>Equals</b> Adjusted gross income	= \$
<b>Less</b> Standard deduction <b>or</b> Itemized deduction	
medical expenses (exceeding 7.5% of AGI)	\$
state/local income & property taxes	\$
mortgage, home equity loan interest	\$
contributions	\$
casualty and theft losses	\$
other itemized deductions (see current tax regulations)	\$
<b>Amount – \$</b>	<b>Total</b> – \$
<b>Equals</b> Taxable income	= \$
<b>Estimated tax</b> (based on current tax tables or tax schedules)	\$
<b>Less</b> Tax credits	– \$
<b>Plus</b> Other taxes	+ \$
<b>Equals</b> Total tax liability	= \$
<b>Less</b> Estimated withholding and payments	– \$
<b>Equals</b> Tax due (or refund)	= \$

**What's Next for Your Personal Financial Plan?**

- Develop a system for filing and storing various tax records related to income, deductible expenses, and current tax forms.
- Using [www.irs.gov](http://www.irs.gov) and other online sources, identify recent changes in tax laws that may affect your financial planning decisions.

 **Suggested App:** TaxCaster

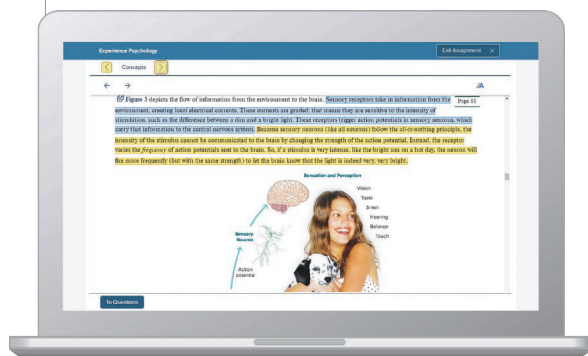


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- Jordan Cunningham,  
Eastern Washington University



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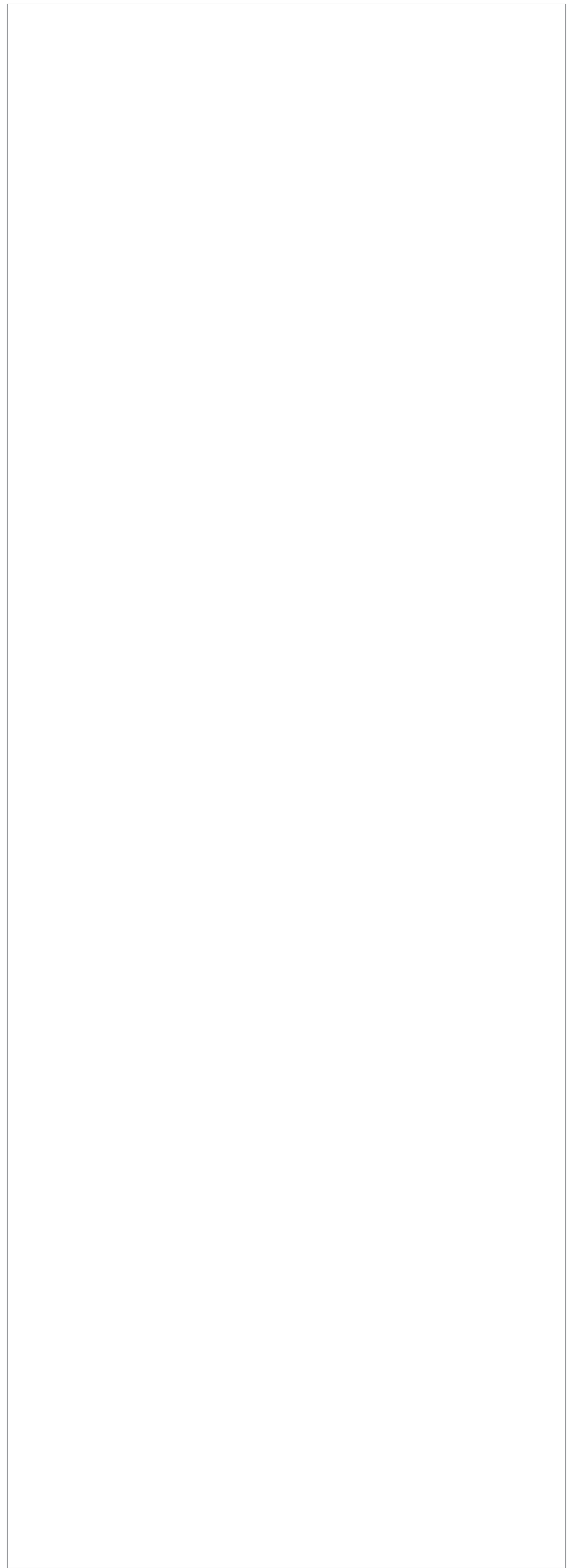
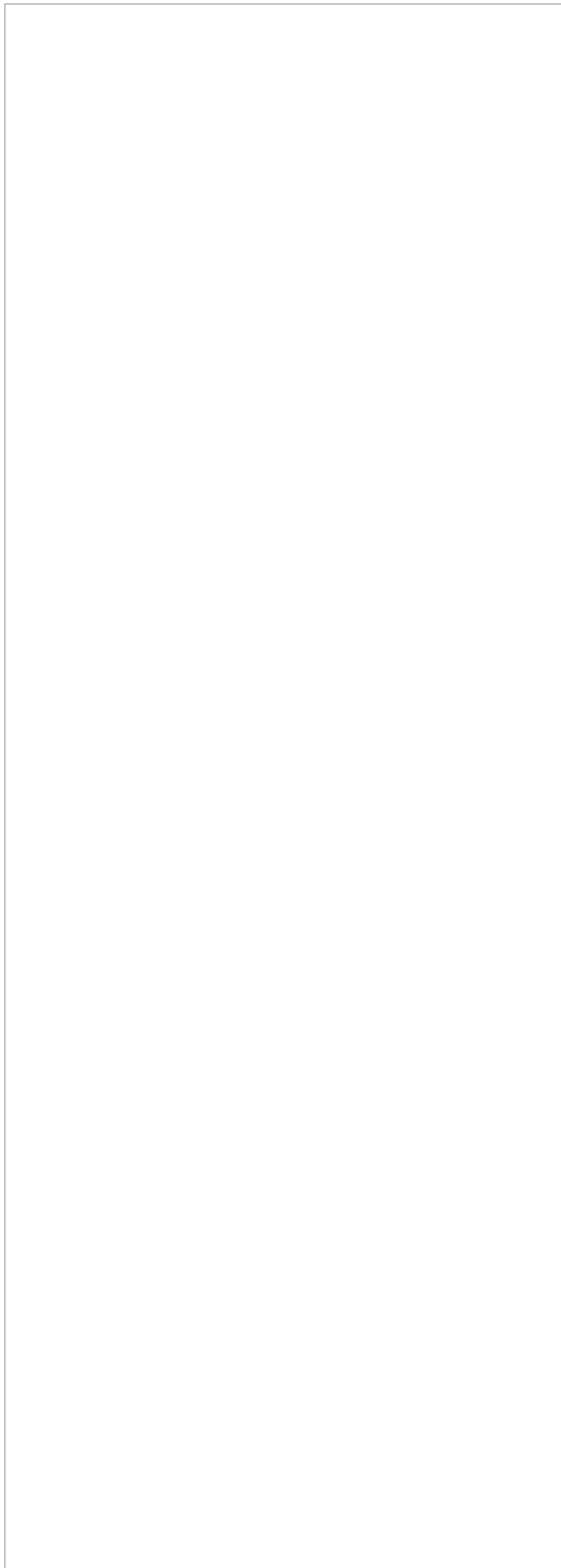
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**Personal Financial Planner**



# Personal Finance Basics and the Time Value of Money

# 1

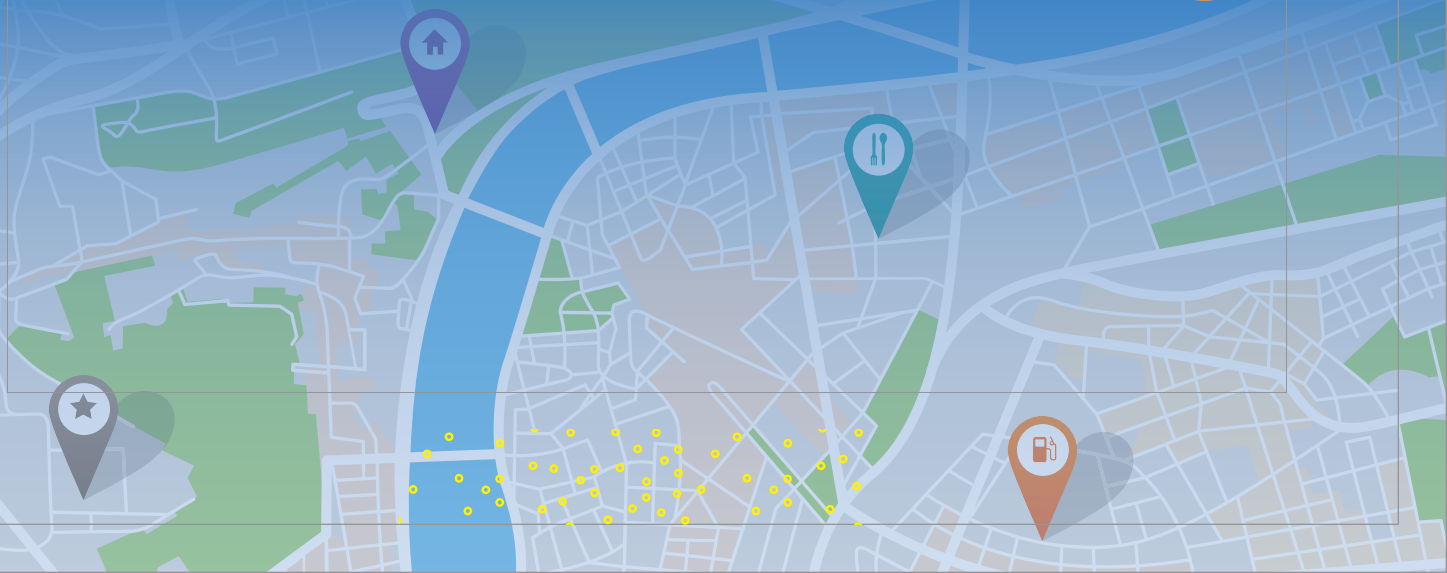


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## LEARNING OBJECTIVES

- 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.

The Chapter 1 Appendix provides expanded discussion of time value of money calculations and applications.



# Financial Literacy

## IN YOUR LIFE

What if you . . . needed funds for major auto repairs? Or encountered unexpected medical bills? Financial difficulties of the recent pandemic emphasized the importance of an *emergency fund* 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. Tracking your spending will help you set aside 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? Do you have a system for tracking your spending? You will be able to monitor your progress using the Your Personal Finance Roadmap and Dashboard feature at the end of the chapter.

my life

### HOW DO I START?

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

Each of these financial situations involves planning and 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 concerns. How will you best plan to use your finances? For each of the following statements, select “yes,” “no,” or “uncertain” to indicate your responses to 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 expensive possessions or having a high income. People may associate being rich with not having to worry about finances by being able to pay bills. For others, being rich means donating to organizations that make a difference in our society.

People obtain financial wealth in varied ways. Starting a business or pursuing a high-paying career are common paths. Frugal living and wise investing can also result in long-term financial security. You might consider an *opportunity fund*, money set aside to expand your income and net worth, or to invest in yourself with an advanced degree.

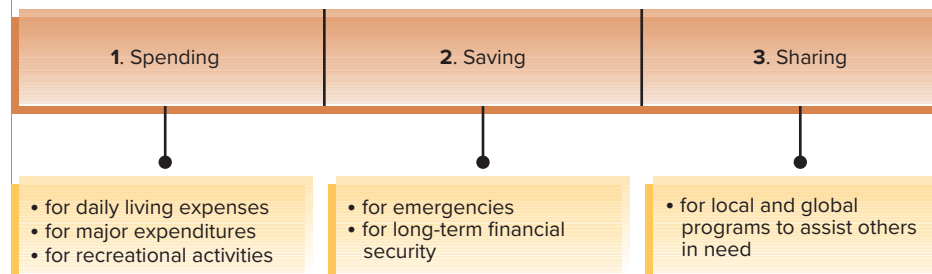
Many believe that the quality of life should be measured by something other than money. An emphasis on family, friends, and serving others is a priority. Both financial and personal satisfaction result from an organized process that is commonly referred to as *personal money management* or *personal financial planning*.

**Personal financial planning** is the process of managing your money to achieve personal economic satisfaction. These actions help you control your financial situation. Since every person, family, or household has a unique financial position, every financial activity should be carefully planned to meet specific needs and goals.

*Financial literacy* is the use of knowledge and skills for earning, saving, spending, and investing money to achieve personal, family, and community goals. The process includes developing attitudes, behaviors, and competencies to meet current and future financial obligations. Financial literacy leads to financial well-being and a lifetime of financial security, allowing you to adapt to changing personal and economic circumstances. The advantages of being financially literate include:

- Increased effectiveness in obtaining, using, and protecting financial resources.
- Expanded control of financial activities to avoid excessive debt, bankruptcy, and dependence on others.
- Improved personal relationships with well-planned and effectively communicated financial decisions.
- Enhanced freedom from financial worries achieved by looking to the future, anticipating expenses, and achieving personal economic goals.

You make hundreds of decisions each day. Most choices are quite simple, with minimum consequences. Others are complex and have long-term effects. 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 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. Maintaining a record of your daily spending and preparing a list of asset and debt balances are the foundation for financial decisions. The Daily Spending Diary at the end of the chapter and the personal financial statements discussed in Chapter 3 provide the information needed to match your goals with your current and future monetary resources.

### 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 values and goals. This 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 a desire for security? How will the economy affect your goals and priorities? The purpose of this analysis is to differentiate between your needs and wants. Specific financial goals are vital to financial planning. Others can suggest financial goals for you; however, *you* must decide which goals to pursue.

**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 short-term or long-term goals that might be appropriate for you.



### STEP 3: IDENTIFY ALTERNATIVE COURSES OF ACTION

Identifying alternatives is crucial for making decisions. Although many factors can influence your alternatives, common courses of action include:

- *Continue the same course of action.* For example, you may determine that the amount you are saving 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 alternatives 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 alternatives under the category “Take a new course of action.”

Creative decision-making is vital for effective choices. By considering many alternatives, you will likely make more effective decisions. For instance, most people believe they must own a car. However, other alternatives may include public transportation, carpooling, renting a car, shared car ownership, or use of a ride-sharing program.

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 alternatives for achieving the financial goals you identified in the previous step.

### STEP 4: EVALUATE YOUR ALTERNATIVES

Next, evaluate possible courses of action, and consider 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 might changes in interest rates affect your financial situation?

**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 a *trade-off*, is not always measured in dollars. It may refer to the money you forgo by attending school rather than working, but it may also be the time you spend comparison shopping for a major purchase. Remember, the resources you give up (money or time) have a value that is lost. Since decision-making will be an ongoing part of your life, always consider the lost opportunities of a decision.

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

### smart money minute



Some people become victims of *lifestyle inflation*. When receiving a salary increase, they overspend and take on more debt. Choose to maintain your existing spending at a frugal level. Instead of buying a bigger house or a new car, pay off debts and save for future needs. Keep living expenses and housing costs low; upgrade, maintain, and improve your current home. Increase your automatic savings amounts. Avoid the temptation to increase your spending just because you have more money.

**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? Some decisions involve a very low 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 is 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 map. Traveling the path of financial planning requires a different kind of guidance. Valid information is required at each stage of the decision-making process. This book provides the foundation. Changing personal, social, and economic conditions requires that you continually 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 based on current skills and potential situations once he obtains 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 personal financial activities?

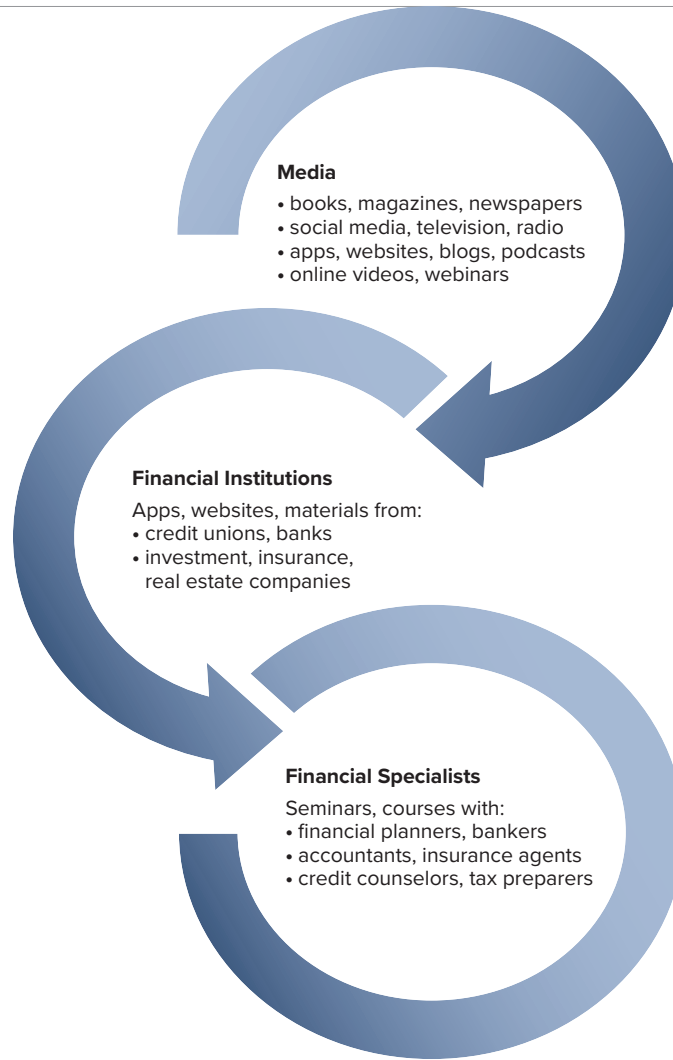
## EXHIBIT 1-2

Types of risk

	<ul style="list-style-type: none"> <li>• Rising or falling (deflation) prices cause changes in buying power.</li> <li>• Decide whether to buy something now or later. If you buy later, you may have to pay more.</li> </ul>
	<ul style="list-style-type: none"> <li>• Changing interest rates affect your costs (when you borrow) and your benefits (when you save or invest).</li> <li>• Borrowing at a low interest rate when interest rates are rising can be to your advantage. Variable-rates on 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.</li> </ul>
	<ul style="list-style-type: none"> <li>• The loss of a job may result from changes in consumer spending or expanded use of technology.</li> <li>• 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.</li> </ul>
	<ul style="list-style-type: none"> <li>• 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.</li> <li>• Personal risk may also take the form of health risks, safety risks, or additional costs associated with various purchases or financial decisions.</li> </ul>
	<ul style="list-style-type: none"> <li>• Some savings and investments have the potential for higher earnings. However, they may be more difficult to convert to cash or to sell without significant loss in value.</li> </ul>

**EXHIBIT 1-3**

Financial planning information sources



Note: For additional guidance when using financial planning information sources, see the Chapter 3 Appendix.

## STEP 5: CREATE AND IMPLEMENT YOUR FINANCIAL ACTION PLAN

The next step of the process involves developing an action plan to achieve your goals. For example, you can increase your savings by reducing spending or by working extra hours. If you are concerned about year-end tax payments, you may increase the amount withheld from your paycheck, file quarterly tax payments, use a tax-deferred retirement program, or invest in tax-exempt securities.

To implement your financial action plan, you may need assistance from others. For example, you may contact an insurance agent to purchase property insurance or use an online investment account 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 consult several information sources when making financial decisions. In addition to apps and online sources, talk to friends, relatives, and financial planning specialists for banking, insurance, tax, and investment guidance.



**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.

**personal fintech**

FinTech (financial technology) involves apps, websites, and mobile devices for banking and personal finance activities. Artificial intelligence, robotics, drones, blockchain, and other innovations will influence how you earn, save, spend, and invest. Robo-advisors, for example, offer personalized investment advice based on your income, assets, debt, financial goals, and risk tolerance. Other FinTech activities include crowdfunding, cryptocurrencies, budgeting and payment apps, and start-up insurance companies operating online.

**STEP 6: REVIEW AND REVISE YOUR PLAN**

Financial planning does not end when you take action. You need to regularly assess your financial decisions. Plan to do a review of your finances at least once a year. Changing personal, social, and economic factors may require more frequent reviews to adapt your financial plan. Regularly reviewing this decision-making process helps connect your financial goals and activities to 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 Advisors

**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 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.**

Many factors influence daily financial decisions, such as age, household size, interest rates, and inflation. An *ecosystem* is a network of activities and interconnections. Elements of the personal finance ecosystem include life situation, personal values, the financial system, and economic factors.

**LIFE SITUATION AND PERSONAL VALUES**

People in their 20s have different spending behaviors 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 a composite of several factors.

As society changes, different financial needs surface. In contrast to the past, people today tend to marry at a later age, and more households have two incomes. Many households are headed by single parents. Millions of women provide care for both dependent children and parents. People are also living longer; over 80 percent of Americans now living are expected to live past age 65.

The **adult life cycle**—the stages in the family situation and financial needs of an adult—influences financial activities and decisions. Your life situation is affected by marital status, household size, and employment. In addition, financial decisions will be influenced by events such as graduation (at different levels of education), the birth or adoption of a child, a career change, dependent children leaving home, changes in health, divorce, retirement, and the death of a spouse or family member.

In addition to 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 decisions such as whether to spend now or save for the future, or whether to continue school or get a job.

## my life 2

**My personal 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 you to consider.



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

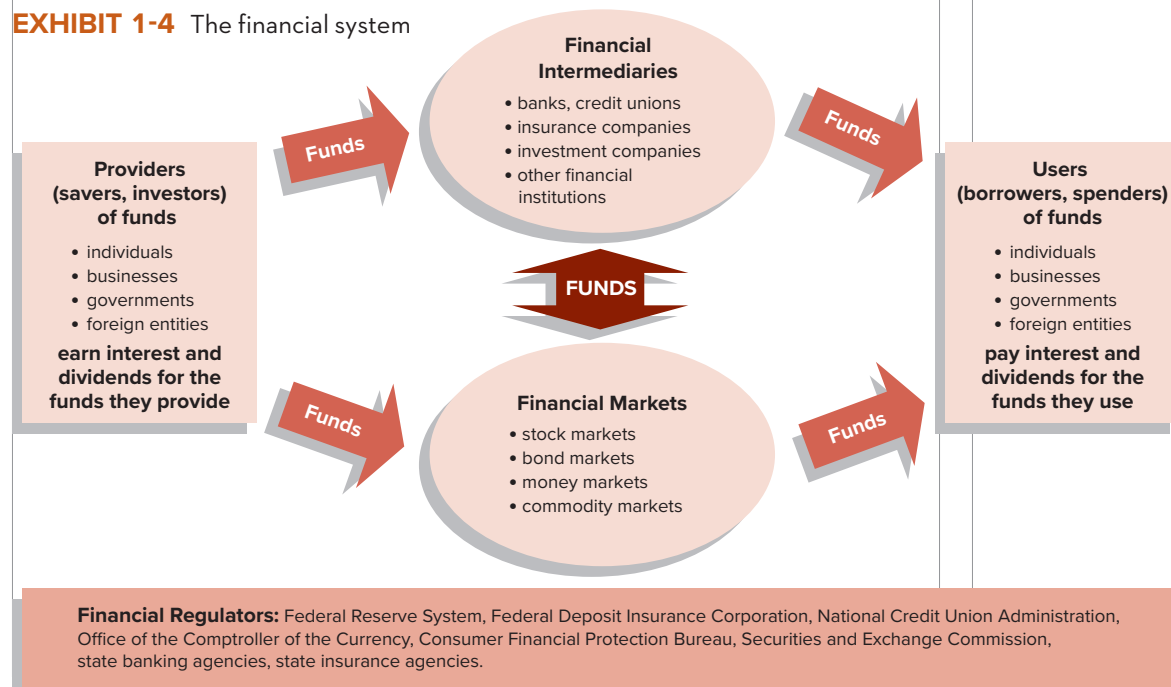
**values** Ideas and principles that a person considers correct, desirable, and important.

## 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 involve physical items (houses, land, gold, rare art), 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



**economics** The study of how wealth is created and distributed.

In most societies, the forces of supply and demand set prices for securities, goods, and services. **Economics** is the study of how wealth is created and distributed. The economic environment includes various institutions, such as businesses, labor, and government, that work together to satisfy needs and wants.

Several government agencies regulate financial activities (see Exhibit 1-4). The Federal Reserve System, the central bank of the United States, has significant economic responsibility. *The Fed* attempts to maintain an adequate money supply with efforts to influence borrowing, interest rates, and the buying and selling of government securities. An appropriate money supply is necessary for consumer spending and business expansion while keeping interest rates and consumer prices at an acceptable level.

**GLOBAL INFLUENCES** The global economy also influences personal finance. Our economy is affected by both the financial activities of foreign investors and competition from global companies. U.S. businesses compete against foreign companies for the spending dollars of consumers.

When the value of exports of U.S.-made goods is lower than the value of imported goods, more U.S. dollars leave the country than the dollar value of foreign currency coming into the United States. This reduces the funds available for domestic spending and investment. Also, if foreign companies decide not to invest in the United States, the domestic money supply is reduced. This reduced money supply can result in higher interest rates. A *trade deficit* also affects the value of a nation's money and the cost of items being purchased by consumers. While a country may impose a *tariff*, an import tax, to reduce its trade deficit, this action may not have the intended effect.

**ECONOMIC CONDITIONS** The economic conditions that most often influence personal finance are consumer prices, consumer spending, and interest rates. These and other economic factors are presented in Exhibit 1-5.

**inflation** A rise in the general level of prices.

**1. Consumer Prices Inflation** is a rise in the general level of prices. In times of inflation, the buying power of the dollar decreases. For example, if prices increased 5 percent during the last year, items that cost \$100 one year ago would now cost \$105. This means it now takes more money to buy the same amount of goods and services as a year ago.

The main cause of inflation is an increase in demand without a comparable increase in supply. For example, if people have more money to spend because of pay increases or borrowing but the same amounts of goods and services are available, the increased demand can bid up prices for goods and services.

Inflation is most harmful to people living on fixed incomes. Due to inflation, retired people and others with fixed incomes can afford fewer goods and services.

Inflation can also adversely affect lenders of money. Unless an adequate interest rate is charged, amounts repaid by borrowers in times of inflation have less buying power than the money borrowed. If you pay 4 percent interest on a loan and the inflation rate is 6 percent, the dollars you pay the lender have lost buying power. For this reason, interest rates rise in periods of higher inflation.

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

### EXAMPLE: Rule of 72

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