

Personal Finance: The Stuff They Didn't Teach You in College

In This Chapter

- ◆ The meaning of personal finance
- ◆ Finding out how much (or little) you know about personal finance
- ◆ Money attitudes
- ◆ Starting to save and plan now
- ◆ Navigating the misleading: the confusing world of personal finance information

If the phrase *personal finance* makes you think of long and serious (and often-times boring) discussions about stocks, bonds, annuities, and interest rates, well, your impression is partially correct—all those subjects do have their place in the vast world of money and finance. In most ways, however, the emphasis in personal finance is on the first word, *personal*, which means it's all about what *you* do with *your* money. And what could be more interesting than that?

Exactly What Is Personal Finance?

Simply put, *personal finance* is every aspect of your life that deals with money—everything from buying a ticket to the movies, to finding an affordable apartment, to leasing that new Camry or Explorer you’ve had your eye on, to putting money into a retirement plan. Your personal finances affect your relationships, your lifestyle, and, very possibly, your perception of yourself.

Let’s face it, money is extremely important in our society. We place a lot of emphasis on owning big homes in the right neighborhoods, high-status cars, labels on our clothing, and vacations to the right places. Even kids as young as six and seven are affected. Look at a group of kids sometime and see how many are wearing hats or shirts bearing trademark logos.

After the September 11, 2001, terrorist attacks on the Pentagon and World Trade Center, a lot of people talked about reprioritizing American values, but it doesn’t appear that many of us are ready to give up our gas-guzzling SUVs or designer labels just yet.

The tragedies caused many of us to assess what’s really important in our lives, and spurred us to open up our pocketbooks along with our hearts and contribute record amounts of



Show Me the Money

Personal finance

includes every aspect of your life that deals with money. The emphasis of the phrase is definitely on the word “personal.”

money to the Red Cross and other charities. The majority of Americans, however, have not significantly changed their lifestyles, which, as you know, are some of the most affluent in the world.

Our country’s fascination with money is anything but new. Way back in 1835, Alexis de Tocqueville observed in his work *Democracy in America*, “I know of no country, indeed where the love of money has taken stronger hold on the affections of men.”



Show Me the Money

Generation Xers (also

called Gen Xers) and **baby boomers** are mentioned frequently in this book. Generation X refers to the 46 million Americans in their late 20s and early 30s. Baby boomers are defined as those 78 million Americans who are in the mid 40s to late 50s range.

No doubt about it, money is a big motivator in America. People work for money, gamble for money, marry for money, fight for money, and even kill for money. We look up to people who have a lot of money, pretty much regardless of where or how they got it. Money commands respect, even when the person who has the money doesn’t.

However, it’s important to keep money in perspective, and polls show that people in their 20s and 30s are tending to do so more than their baby boomer counterparts have. Studies show that family, spirituality, and personal satisfaction were important to many *Generation Xers*,

even before the events of September 11. Sociologists explain these priorities as a generation's backlash to the high divorce rate, obvious consumption, and get-ahead mentality of their *baby boomer* parents. Who knows? But if money is of any importance to you, then personal finance must be important to you, too. You can't separate the two things.

Personal finance is planning and implementing financial goals. It's putting away some money each week for that Jeep you've been looking at. It's whether you shop at Sam's Club or the gourmet specialty shop, and it's whether your vacation is one week or two. How well you accomplish your personal financial goals determines whether you buy a house or keep renting the condo, and eventually it will influence where your kids will go to school and the quality of your retirement.

Why Don't I Already Know This Stuff?

In many ways, we live in a strange society. At an early age, we learn the capitals of every state and can recite the nightly television schedule without consulting *TV Guide*. We debate the merits of upgrading Windows 98 to Windows 2000 and spout Red Sox batting averages from 1996. When it comes to our personal finances, however, many of us are lost. We've never learned the basics of managing our money.

On the surface, personal finance sounds complicated. It sounds scary. It sounds like something we'd rather not have to deal with. So, we let our hard-earned money lie in a bank account, making little or no interest, while we go about tackling the finer aspects of parasailing.

It's not that we *can't* learn about personal finance and managing our money. We *don't* learn about it because ...

- ◆ No one tells us how important it is.
- ◆ We think personal finance is only for people who have a lot of money.
- ◆ It seems like a lot of work to maybe save a little bit of money.
- ◆ It seems overly complicated and intimidating.
- ◆ We think that the money will take care of itself.

If these reasons sound familiar, it's time to rethink your attitudes about personal finance and managing money. These topics are extremely important, because your future depends on how you handle them. Left unattended, you might financially survive, but you surely won't prosper.



Money Pit

Nearly 1.25 million American households filed for personal bankruptcy protection in 2000, according to the American Bankruptcy Institute, and the rate has increased by 400 percent in the past 20 years.

Once you decide to start learning about personal finance and how it affects you, you're halfway there. Personal finance and money management are not all that complicated once you understand the basics.

Whatever Happened to Personal Finance 101?

When you're in school, learning the state capitals, the multiplication tables, and the periodic table is important business. I can still see my third-grade teacher with those flash cards, running through the six tables. You just had to know those tables, remember? Had you not learned them and all that other must-have information, you probably would have ended up repeating a grade.

Things weren't too much different in college, either. You couldn't move to the next college history level until you were able to speak with authority about the political situation of early twentieth-century Russia or advance in the English program without being able to analyze at least three Shakespearean sonnets. But I bet money, personal finance, and *financial planning* weren't even part of the curriculum.



Show Me the Money

Financial planning is the process of evaluating your present financial situation, identifying financial goals, preparing a plan (often written) to achieve those goals, and carrying out the plan.

A recent survey of high school seniors showed that (no surprise here) the majority has many misconceptions about investing and saving money, using credit cards, and preparing for retirement. Many did not know how a checking account works and had little knowledge about interest, bank fees, and other issues.

This lack of knowledge, experts say, should not be a surprise. Kids can't know what they've never been taught. If no one tells you that personal finance is important, how are you supposed to know it? Granted, the subject of money will arise if you happen to take an economics class, but it's more likely to be in relation to China or the Great Depression than to your bank account or retirement fund. The theories of simple and compound interest are taught in some schools, but they are rarely applied to the students' savings accounts. These concepts are taught in the abstract, so kids have little incentive to remember them once the class ends.

But America's schools can't bear the blame for financial ignorance all by themselves. Experts say that kids aren't learning responsible personal finance from their parents either. Kids often pick up bad money habits at home and continue in those habits when they're on their own.



Money Pit

There's no shortage of companies willing to take advantage of a person's lack of personal finance knowledge. Bank card companies and retail stores make it very easy for young, financially uneducated people to start racking up debt at an early age. Often, the first real financial lesson occurs when somebody realizes he or she has got too much credit card debt and little or no means to pay it off.

Before you get too depressed about the sad state of financial education, though, it looks as though things might be starting to change. Although it will take some time to know for sure, there is encouraging news concerning attitudes toward teaching and learning about finance.

The Jump Start Coalition for Personal Financial Literacy, a group advocating that financial education be taught in schools, was founded in 1997. Based in Washington, D.C., the organization has 115 partners, including federal agencies, corporations, nonprofit groups, and universities. Its goal is to fight financial illiteracy, which it calls one of our country's worst enemies, and to ensure that students have the skills to adequately handle their finances by the time they graduate from high school.

Still, too many people just don't understand that personal finance is important. They have no idea that their financial future is at risk. Those who do realize the importance of financial planning, like you (after all, you bought this book), are to be congratulated. By taking time to learn how to make the most of your money, you're giving yourself a huge advantage over those who aren't paying attention.

But I Don't Think I'll Be Able to Understand It

The subject of personal finance can seem intimidating. It includes topics such as taxes, insurance, investments, and interest. But when you begin learning about each of these topics, you'll find that personal finance is not all that complicated. A lot of personal finance and money management is just good common sense. Sure, mastering all the nuances of Wall Street would be a major challenge, but you don't need to do that to manage your own finances and ensure your future financial health.

As you move through different stages and situations in your life, you'll need to know different things concerning personal finances. Say, for instance, that you're in your early 20s and just out of college. You've just landed your first job, and the salary isn't as much as you had hoped. In fact, you're trying to figure out how you'll get enough money together for a security deposit on that apartment you've been looking at.

At this point of your life, you don't need to learn about dividend reinvestment plans or dollar-cost averaging. You do, however, need to worry about budgeting your income to meet all your expenses, finding some transportation to and from work, and paying off college debt. Those things don't sound quite as complicated as dividend reinvestment or dollar-cost averaging, but they're

Pocket Change

Dividend reinvestment plans, by the way, are plans that allow shareholders to reinvest the dividends they receive as stock earnings into more shares of stock, without paying any brokerage commissions. Dollar-cost averaging is a method of investing money by dividing the total into equal chunks and investing it at regular intervals.

extremely important to you at this moment. As you get older, stock earnings and dollar-cost averaging might become relevant and important. But right now you've got more pressing matters to think about.

Somebody's Got to Mind the Store

You can take shortcuts when it comes to your personal finances or pretty much just ignore them altogether, and things will be okay, for a while. After you've rounded up the security deposit, you probably can get by with your personal finances just by paying what you owe and stashing any leftovers in a savings account.

In 20 years, though, you're likely to be sorry. Investing some time and effort (and money!) now will pay big dividends down the road and help you to avoid some potentially major pitfalls. Most bankruptcies aren't caused by any great misfortune or catastrophe within a family, just by a lack of attention and mismanagement of its finances.

You might not remember all those state capitals when you're 50 years old, but you'll know that you've made the most of your money and helped to ensure financial security for yourself and your family.

Money's Not a Dirty Word

Before the 1960s, sex wasn't an acceptable topic of conversation. Young women who "got into trouble" disappeared for six or seven months under the pretense of visiting long-lost relatives in Peoria. And many weddings were quickly planned and executed before the bride's dress got too tight across the middle.

Forty years later, sex talk is as commonplace as mosquitoes in a swamp. No longer a taboo topic, sex is everywhere. Supermodels parade down the runway, scantily clad in Victoria's Secret unmentionables on network TV. People still snicker about the Bill and Monica sex scandal, and sex scenes fill the screen on daytime soaps and prime-time series.

Although sex has become an acceptable conversation topic, talk about some aspects of money is still somewhat taboo. Studies have shown that parents are more likely to talk with their kids about sex than about money (and you know how reluctant most parents are to talk about sex).

Pocket Change

In a survey of married couples, more than half of them said that, sooner or later, money is the most important concern in a marriage. Yet most couples don't talk about it until it becomes an issue.

Couples fight more about money than any other issue, mostly because they don't talk about it unless it gets to be a problem in their marriage. Money problems are blamed for much of the marital strife that leads one out of every two married couples in this country down the road to divorce court.

To your credit, Gen Xers tend to be more open about financial matters than previous generations. While it's understandable that you don't want the guy living two doors down the hall to know the amount of your weekly paycheck or the balance of your savings account, there's surely nothing wrong with talking with friends about your 401(k), or whether it's better to buy or lease your next car.

When folks were making great gains in the stock market a year or so back, many loved to talk about what they were buying, selling, and earning. When the market went south in 2001, however, much of the stock conversation went away with the gains. It seems to be okay to discuss some aspects of our money, but not all aspects. Perhaps by 2010 or so, money talk will be as common as talk about sex.



Dollars and Sense

There are indications that 20- and 30-somethings are becoming increasingly interested in personal finance. One reason cited is the growing number of 401(k) plans, in which many Gen Xers participate. And there is a personal finance newsletter just for Gen Xers called *Green*, which uses the slogan "Personal Finance for the Unashamed." You can check it out at www.greenmagazine.com.

Personal Finance Is for My Parents

Who needs to think about personal finance? Anyone with any money at all should be concerned about where it's going and whether it's being managed to its best advantage. Sure, that includes your parents, but it also includes you. If your parents are nearing retirement age or perhaps still have a child in college, they're probably painfully aware of their personal finances. Hopefully they've been smart about managing their money and will have financial security in the future.

This book, however, is for 20- and 30-somethings who traditionally are notorious for not paying much attention to their personal finances. Polls do show that Generation Xers are saving more money than baby boomers did in their 20s and 30s, but that's not exactly great news. Baby boomers are notorious spenders, and many of them are still not saving any money. Still, there are many Gen Xers who aren't saving anything either. The decision to not save or the lack of a decision to save occurs for various reasons, including the following:

- ◆ You're too busy having a great time spending the first real money you've ever made to worry about saving any of it.
- ◆ You figure you'll have plenty of time to worry about saving later (like after you get married).
- ◆ You've got an apartment, a car, and plenty of spending money; what else could anyone want?

Pocket Change

Surveys reveal that in 2001, 26 percent of American workers reported they were not saving any money for retirement.

These *carpe diem* attitudes offer no security or comfort for later in your life. Time does fly, however, and the older you get, the faster it seems to pass.

Baby boomers listened to rock-and-roll while they spent their money, borrowed some more, and spent that, too. They talked of peace and love and spent some more money. Then they discovered (or created) the self-help movement, and spent some more money there. Twenty and thirty years later, many boomers are still wondering where the flowers and their money have gone, while they ponder whether they'll be able to retire before they're 70.

Keep the mistakes of your elders in mind as you cruise on through your 20s, spending just about every dollar you make from that job you landed. You're finally living on your own in a pretty nice apartment. You're eating out or ordering in most nights because, well, who wants to cook? You're dating, and you're buying those Abercrombie & Fitch shirts you always liked, but couldn't afford, in college. Your car is just so-so, but hey, you can dream about that little BMW you pass on your way to work every morning, right?

In the back of your mind, you probably know you should be saving some money, and many people your age are. But too often, saving just doesn't seem to happen. There's always something else to buy. But you're not too worried about it. You figure you'll probably be married in 5 or 10 years, and then you'll have to get serious about many things, money included.

Your 20s are a perfect time to check out all the things life has to offer. You're likely to have financial resources (income) without too many responsibilities. That combination adds

up to a great time. You're being shortsighted, however, if you don't save something from those years. What happens if you're waiting to start saving money until you're married, but Mr. or Ms. Right doesn't show up for another 8 or 10 years? You will have lost a lot of savings time and interest in those years.

Even if you can't save a lot, you should be saving something in your 20s and 30s. No one is saying you have to save half of each paycheck. Small savings don't add up as quickly as big savings, but they do add up. Remember, saving money is a big aspect (but not the only aspect) of personal finance.



Dollars and Sense

If you start saving \$2,000 a year in an IRA when you're 25, and you save that much for 10 consecutive years, earning about 9 percent interest per year, you'll have \$440,000 when you turn 65. That should be a pretty good incentive to put some money away!

How Hard Is This Gonna Be?

There's no denying that there's a lot to learn about personal finance. All you have to do is walk into your local Barnes & Noble and head for the money section. The vast number of titles on display should give you a good indication of the huge amounts of information out there dealing with money management.

With so much material available, it's very easy to get confused. And some of the material out there is more than confusing; it's unreliable. It might even be downright wrong. Even popular, respected financial magazines occasionally miss the boat.

One of those magazines published a piece in the 1980s that recommended buying oil and gas limited partnerships as an investment that would result in "safe, high yields." Limited partnerships, an investment option that typically carries high costs for the buyer and huge commissions for the salesperson, are long-term investments, generally considered unsuitable for all but a few investors. Still, many people followed the advice of the magazine, and many of them lost very large amounts of money.

Although some of the popular financial books available are comprehensive, many of them deal only with one area of personal finance, such as investing for retirement, or reducing your taxes, or paying for a college education. Learning about taxes or college funds is useful, but it's only one piece of the pie. Personal finance is a lot more than any one of those areas, and to understand the big picture, you've got to have information about all of it. You want the whole pie, not just a piece.

This book will give you a lot of information about nearly every aspect of your personal finances. It won't, however, be difficult to understand. We're not going to give you page after page of impossible-to-read charts and formulas, designed to drive you crazy and leave you more confused than you were before. We will provide you with basic forms and easy-to-use worksheets that you can fill out using your own numbers. We'll tell you exactly what those things that you might not understand mean, and we'll discuss various aspects of personal finances that will apply to different stages of your life.

Reading and understanding this book won't be difficult, but it will require your attention. Think about how the information you're reading applies to your particular situation and your personal finances.

Let's Get Started

There's no time like right now to start learning about and improving your personal financial situation. Managing your personal finances will become a natural part of your life, once you understand the basic ideas and concepts. After you've practiced managing your personal finances for a while, it becomes second nature, like brushing your teeth or checking the oil level in your car. If you've decided to save a certain amount a week, and you're diligent about it, you'll very quickly get used to saving that amount.

If you haven't got much money at this point of your life, you'll feel better knowing that you're using what you have to its greatest advantage. If you're comfortable financially, you'll learn how to use your money to assure that you'll remain comfortable, even if your circumstances change. If you're just starting in the workplace, but anticipating a bright

financial future, you'll learn how to stash away extra money as you start making it, while maintaining or improving your standard of living.

The fine points of personal finance will change as you move from your 20s to your 30s to your 40s, 50s, and beyond, but the general principles remain the same. Learning effective personal finance will help you throughout your life.

Personal finance is an exciting and interesting topic and is one you'll easily be able to understand and master. When you do, you'll thank whoever recommended this book to you for putting you on the road to good financial health.

Let's get started by taking a look at the real world. It will be decidedly different from the MTV version and, at times, much less attractive. But it's your world now, and you're going to do just fine in it. In Chapter 2, "You're Out Here—Now What Are You Gonna Do?" you'll take a Personal Finance Assessment Quiz (don't worry, it's just our version) to see how informed you already are on the topic of personal finance. After you've taken the test, you'll know what areas you're fairly well versed in, and the ones to which you'll have to pay close attention.

The Least You Need to Know

- ◆ Personal finance is every aspect of your life that deals with money.
- ◆ Personal finance is an often overlooked or ignored topic by people of all ages.
- ◆ Talking about money is sometimes still considered impolite or even taboo, but it shouldn't be.
- ◆ The younger you are when you learn about personal finance and managing money, the better off you'll be later in your life.
- ◆ There's a glut of information about personal finance, much of which is confusing and inaccurate.