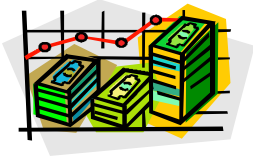


## **Part IV: Twelve Key Elements of Practical Personal Finance**



### **Element 1: Discover Your Comparative Advantage.**

1. Explain how the concept of comparative advantage applies to personal finance as well as to international trade.
2. What are the major factors that determine whether you have a comparative advantage in a specific area?
3. Is it important to specialize in an area that you find interesting and fulfilling? Why or why not?
4. Is it important to specialize in providing goods and services that others value? Why or why not?

### **Element 2: Be Entrepreneurial. In a Market Economy, People Get Ahead by Helping Others and Discovering Better Ways of Doing Things.**

5. What are the four factors mentioned by the authors for the success of self-employed entrepreneurs?
6. If you want to make a lot of money, why should you figure out how you can help others a great deal?
7. “Successful entrepreneurs must be good at discovering and acting upon opportunities that are often overlooked by others.” Is this statement true?
8. Should employees “think like entrepreneurs?” If employees figure out how to make their services more valuable to employers, how may their earnings be affected?
9. Explain how recognizing strategic opportunities, enjoying independent work, learning from failures and accepting challenges will help you get ahead in all aspects of life.
10. In which of these ways can improve your human capital?
  - a. learning
  - b. practicing new skills
  - c. receiving advanced training
  - d. purchasing tools and machinery

**Element 3: Spend Less Than You Earn. Begin a Regular Savings Program Now.**

11. Why should you save regularly? If you save are you necessarily giving up consumption? Explain.
12. What are the benefits of savings? What are the costs? When do the benefits of savings occur? When do the costs of savings occur?
13. Why should all individuals start saving at a young age? If you saved 10 percent of your income, how much would this amount to over a 20 year period? How much would it amount to over a 35 year period?
14. What are “before-tax dollars”? Under current legislation, Americans are permitted to save with before-tax dollars. How does this affect your incentive to save? Explain.

**Element 4: Don't Finance Anything for Longer than its Useful Life.**

15. When does it make sense to buy things on credit? Provide examples of a savvy consumer purchasing items on credit.
16. If you finance an asset such as a car or a machine, why is it important to pay off the debt before the asset is worn out?
17. If you pay for items that are consumed immediately or wear out quickly by placing them on your credit card, what is happening to your wealth?

**Element 5: Two Ways to Get More Out of Your Money: Avoid Credit Debt and Consider Purchasing Used Items.**

18. Why should you avoid using credit card debt as a method to purchase normal consumer goods and services?
19. If you have several outstanding debts, which ones should you pay off first? Why?
20. Can you think of some items that are “bargains” when purchased used? What are the characteristics of used items that can be purchased at attractive prices?
21. Why is it expensive to purchase a new car every year? Do you think most millionaires purchase new cars every year?

**Element 6: Begin Paying Into a “Real world” Savings Account Every Month.**

22. What is a “real world” savings account? Can it help you purchase some “peace of mind”?
23. List some expenses that you can expect to incur at various times in the future even though you may not know precisely when you will incur them.
24. How much should you set aside monthly in order to have sufficient funding for surprise expenditures?
25. How can you determine if your “real world” savings are adequate?

**Element 7: Put the Power of Compound Interest to Work For You.**

26. Describe the “miracle of compound interest”. Why is the analogy to a snowball so useful?
27. If a pack of cigarettes costs \$4 and a person starts smoking one pack per day at age 16, how much retirement wealth would they be giving up if they smoked until age 66? Assume they could earn a real return of 7 percent if they allocated the funds into an investment account.
28. Switch hats. Now, consider yourself a borrower. Define the relationship between compound interest and incentive to borrow, not save. How does this relationship influence your views on financing current expenditures with credit card debt? Elaborate.

**Element 8: Diversify – Don’t Put All Your Eggs in One Basket.**

29. What is “diversification” and how does it “put the law of large numbers to work for you”?
30. What is volatility? What are the two ways that diversification can help to reduce volatility?
31. When the authors state that the stock market has yielded an average real rate of return of approximately 7 percent over the last 150 years, what does this mean?
32. Why do the authors recommend selling off your employer’s stock (as part of a company investment plan) as soon as you are permitted to do so? How does the term “double jeopardy” influence your answer to this question?
33. What is a stock mutual fund? Explain how it can help even small investors maintain diversity in their holdings of stock.

**Element 9: Indexed Equity Funds Will Help the Ordinary Investor Beat the Experts Without Taking Excessive Risk.**

34. What is an indexed equity mutual fund? What is a managed equity mutual fund? How will the administrative costs of the two differ?
35. What is the random walk theory of stock prices? What does it indicate about the ability of “experts” to forecast accurately the future direction of stock prices?
36. When considered over lengthy time periods such as a decade, how has the rate of return of actively managed funds compared with the return derived from indexed funds? Is this surprising?
37. If a mutual fund has earned a high rate of return during the last five years, is this solid evidence that it can also be expected to earn an attractive return during the next five years?
38. During the last two centuries, what has been the best method for a long-term investor to earn an attractive return and build funds for their retirement years?

**Element 10: Invest In Stocks for Long-Run Objectives; as the Need For Money Approaches, Increase the Proportion of Bonds.**

39. As a person approaches retirement or anticipates that they will want access to their funds some time during the next few years, why does it make sense for them to switch out of stocks and into bonds?
40. Over a relatively short time period such as five years, are stocks likely to have more variability in rate of return than bonds? Why?
41. What is the major risk of investing in long-term bonds? How do changing interest rates affect bond values?
42. If the inflation rate increases sharply in the near future, what will happen to the market value of any ordinary bond you are currently holding?
43. What is a Treasury Inflation-Protected Security (TIPS)? How do TIPS differ from ordinary bonds? Which investors will find TIPS most attractive?

**Element 11: Beware of Investment Schemes Promising High Returns with Little or No Risk.**

44. What is the principal-agent problem? Is this problem often present when an agent is trying to get you to invest in stocks, insurance, or a business proposition? Why should this cause you to be cautious?

45. Will it be attractive for entrepreneurs to contact and raise funds from a large number of relatively small investors? Under what circumstances are they likely to do so?
46. How can you avoid making investment decisions that, even though they sound good, may well result in the loss of all or most of your funds? What are some of the things that should cause you to be highly cautious?

**Element 12: Teach Others How to Earn Money, Spend Wisely and Save and Invest Strategically.**

47. Teach others the golden rules for building wealth. They include which of the following?
- a. Start saving and investing only after you get your first big job.
  - b. Buy stocks and sell them as soon as possible.
  - c. Diversify.
48. What can parents and adult volunteers do to help children learn how to make wise financial decisions?
49. People tend to appreciate things they earn more than things that they are given. Do you think this is true? Should this affect how you deal with others?