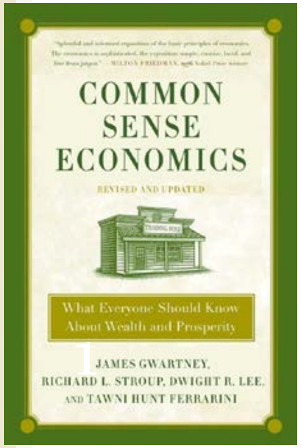
Module K: Smart Choices for Saving and Investing



Common Sense Economics ~ What Everyone Should Know About Wealth and Prosperity

http://CommonSenseEconomics.com/

Turn on the learning light!

Saving and Why It Is Important

- Read: Why Save? by John Morton
- Watch: Delbert McClinton- Too much stuff

Saving and Why It Is Important

Why save?

1. To cover emergencies such as car repairs, medical expenses, and job loss.
2. To buy expensive goods and services in the future such as a car, a home, and education without borrowing and paying interest.
3. To open the door more easily when opportunity knocks.
4. To fund a comfortable retirement.

Saving and Why It Is Important

Too many Americans will be unable to afford a comfortable retirement.

- A majority of Americans in the private sector do not have pension coverage.
- Over 60% of retired Americans rely on Social Security benefits for all or most of their retirement income.
- The average Social Security benefit is $1,230 a month—not enough for a comfortable retirement.
- 30% of workers reported they had less than $1,000 in savings and investments.

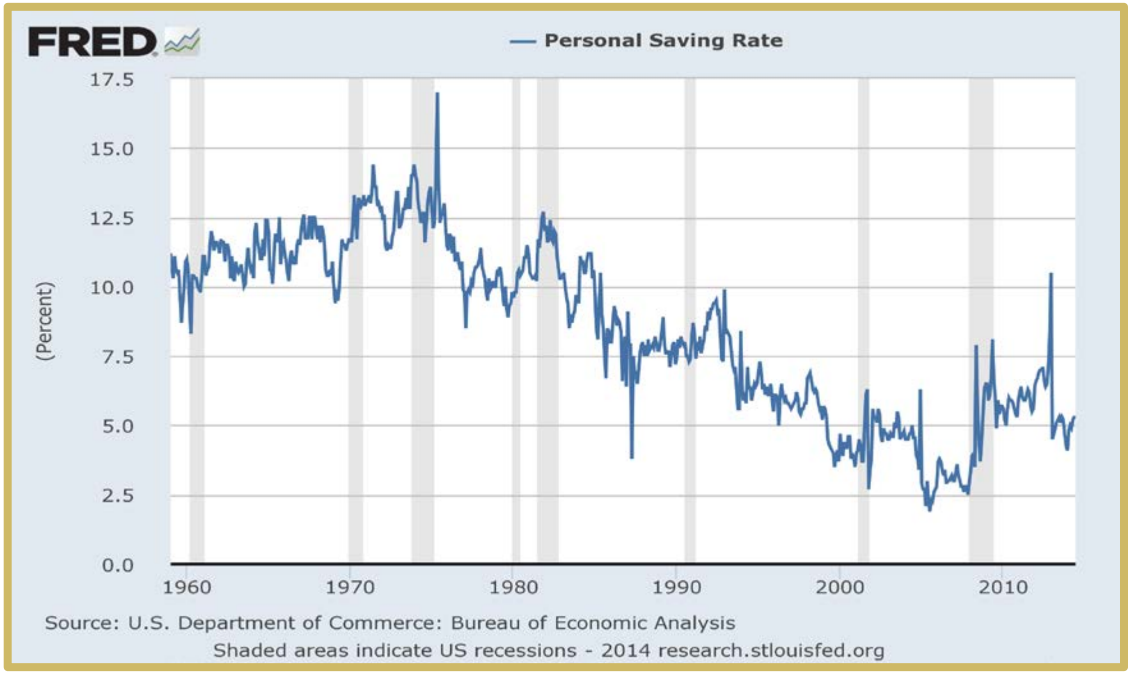
Saving and Why It Is Important

Do you plan to work forever?

You may think so, but one-half of current retirees say they left the workforce unexpectedly because of health problems, disability, or layoff.

Saving and Why It Is Important

Personal Savings as a Share of Income



- What is the personal saving rate today?
- Is this higher or lower than in the past?
- Is the trend for Americans to spend more or less?

http://commonsenseeconomics.com/

Saving and Why It Is Important

On average Americans save only about 5% of their income. Why?

- The costs of saving are immediate, painful, and certain.
- The benefits of saving are in the future and less certain.

Saving and Why It Is Important

But this does not have to be you

Start today to buy less stuff that loses value and more stuff that gains value.

Building Wealth

- Read: Building Wealth Over Time by John Morton and Scott Niederjohn
- Watch: Seinfeld-Compound Interest
- Watch: 2 Minute Finance–Types of Retirement Accounts

Building Wealth

What is the difference between saving and investing?

- Saving is putting aside money on a regular basis in a safe place or product so you can withdraw your money quickly and without penalty when you need it.

- An investment is an asset designed to grow your money over time.

Building Wealth

Economics, Scarcity, and Choice

- Resources are limited.
- People's desire for goods and services is unlimited.
- Therefore, we must make choices among alternatives.
- Every choice means sacrificing the opportunity to do something else. This is called opportunity cost.

Building Wealth

Budgeting is a tool to help you make wise financial choices.

- Just as a GPS system helps a driver reach a destination, a budget helps you reach your financial destination.
- Budgeting does not need to be complicated, but it does take time and practice.
- A budget is always a work in progress.

Building Wealth

Steps to Reaching a Financial Destination

1. Decide on your spending goals.
   - Your goals determine your budget. Each of us will have unique goals.
   - A budget is for those goals that can be achieved with money.
   - Some goals are short-term (under 1 year) such as buying food, clothes, rent, and entertainment.
   - Some goals are long-term (more than 3 years) such as buying a car and home and funding retirement.

Building Wealth

Steps to Reaching a Financial Destination

2. Estimate your income.
   - Use disposable (after tax) or net income rather than gross income.
   - Deductions from gross pay include state, local, and federal taxes, Social Security tax (FICA), and insurance coverage.

Little Treasures Child Care, Inc.
P.O. Box 1327 New Albany, IN 47151

Empl. Name:	ALEXANDRIA C. JOHNSON
Empl. Number:	S418
CHECK #:	476
Issue Date:	01/16/2014
Pay Period Start:	01/02/2014
Pay Period End:	01/16/2014
Gross Pay:	$1445.20
Net Pay:	$1147.64
Taxable Y-T-D:	$1445.20
Gross Y-T-D:	$1445.20

EARNINGS	DEDUCTIONS

Building Wealth

Steps to Reaching a Financial Destination

3. Estimate your expenses.
   - Fixed expenses are payments that are the same each month. Shop carefully before signing a lease, financing an automobile, or buying an entertainment package or gym membership. These expenses are longer-term commitments and harder to cut.
   - Variable expenses change from month to month. Expenditures for food, clothing, and entertainment can be cut quickly.
   - Keep track of every expense for a month. Which ones are most important? Which ones can be cut? Then adjust your spending.

Building Wealth

Steps to Reaching a Financial Destination

4. Plan your savings.
   - Everyone needs an emergency fund, or “real world” savings account.
   - Savings are also needed to achieve short-term and intermediate goals.
   - Savings give you flexibility in making future choices.

Building Wealth

Steps to Reaching a Financial Destination\

5. Evaluate and adjust your budget.
   - As your goals change, your budget must also change.
   - Expenses should always be on the chopping block.
   - Think about getting ahead by adding. Add income by taking a better job or a second job. Plan your career path and learn skills that will make you more desirable to hire.

Building Wealth

Steps to Reaching a Financial Destination

6. Stick to your budget.
   - This might be the hardest step of all.
   - Discipline pays dividends.

Building Wealth

Rules for Building Wealth

1. Save and invest early and often.
2. Invest for the long haul.
3. Don't leave money on the table.
4. Diversify your investments.

http://commonsenseeconomics.com/

Building Wealth

Save and Invest Early and Often

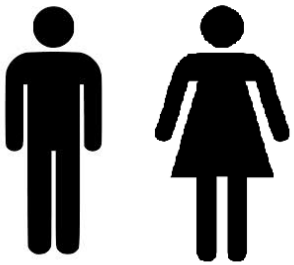
- Because of compound interest, your money grows more the longer it is invested.
- Waiting to invest is costly because you will have less interest earned available to earn more interest later.
- Over time, earning interest on your interest greatly increases your savings.

Building Wealth

Save and Invest Early and Often

Who will have a more comfortable retirement?

- Gina, who starts saving at age 21, saves for 10 years—and then stops
- Mike, who starts saving at age 30 and saves the same annual amount as Gina but saves that amount for 40 years



The surprising answer: Gina

Why? The returns from saving and investing themselves generate future gains.

Building Wealth

Invest for the Long Haul

How much you save for retirement?

- Save at least 8 times your ending salary to increase the odds you won't outlive your savings.
- Example: Someone with ending salary of $60,000 would shoot for

  $60,000 x 8 = $480,000
- Can you stay on track?
  - By age 35, 1x current salary
  - By age 45, 3x current salary
  - By age 55, 5x current salary

Building Wealth

Invest for the Long Haul

- Tax Advantaged Retirement Accounts
  - *401(k)s* allow employees to save a percentage of their pretax paycheck dollars in an employer-sponsored account. Some employers match the contribution up to a certain amount.
  - *403(b)s* are similar to 401(k)s and are for employees of public schools and nonprofits.
  - In a *Traditional IRA* you do not pay taxes on your contributions; you pay taxes on the future withdrawals.
  - In a *Roth IRA* you pay taxes on your contributions but do not pay taxes on the principal or earnings on the withdrawals.

Building Wealth

Invest for the Long Haul

	401(k)	Roth IRA	Traditional IRA
Tax Treatment	Retirement income taxed, but contributions during working life have tax advantages	Qualified retirement income tax-free, but no tax advantages from contributions	Retirement income taxed, but contributions during working life have tax advantages
Employer of Individual	Employer sets this plan up	Individual sets this plan up	Individual sets this plan up
Contribution Limits	Employee contribution limit of $17.5k/yr for under 50 in 2013; $23k/yr for age 50 or above; limits are a total of pre-tax Traditional 401(k) and Roth 401(k) contributions.	$5.5k/yr for age 49 or below; $6.5k/yr for age 50 or above in 2013; limits are total for traditional IRA and Roth IRA contributions combined. Cannot contribute more than annual earned income.	$5.5k/yr for age 49 or below; $6.5k/yr for age 50 or above in 2013; limits are total for traditional IRA and Roth IRA contributions combined. Cannot contribute more than annual earned income.

http://commonsenseeconomics.com/

Building Wealth

Invest for the Long Haul

The role of Social Security:

- Cannot by itself provide comfortable retirement.
- Can begin collecting as early as age 62.
- But substantial benefits from waiting until full retirement age, or even to age 70.
- It *looks* like an investment account – pay in during working life, collect in retirement.
- But government does not invest the money.
- Depends on future tax revenues.
- Program almost certain to survive, though benefit formulas expected to change.

Building Wealth

Don't Leave Money on the Table

- Don't borrow from your 401(k) or 403(b).
- Don't withdraw money early from tax-deferred accounts. If you do, you will pay taxes and penalties.
- Money withdrawn is money not compounding, that is, money not working for you.
- Search for low-cost high return i

http://commonsenseeconomics.com/

Building Wealth

Don't Leave Money on the Table

- Retirement may seem remote now, but even small savings can grow a lot. "When it comes to starting, the best rule is: 'Just do it.'"
- *Common Sense Economics* illustration (p. 160)
  - Save $2 a day for two years when you turn 22.
  - Next, $3 a day until you are 26.
  - Next, $4 a day until you are 30.
- At 30 you have saved $9,490 plus interest.
- If invested wisely, that early start adds $153,305 to your retirement wealth at age 67!

Building Wealth

Diverse Your Investments

- *Risk* is the chance that an investment will earn less than anticipated or will even lose money.
- You can reduce risk by spreading money among different investments.
- The farther out the *time horizon* of the investment, the more risk you can take.
- Consider your *tolerance for risk* before investing. Do not make riskier investments if you panic when an investment loses value.
- Investments with higher returns generally involve more risk.

Building Wealth

Risky Business: Types of Investment Risk

- *Market price risk* is the chance that the price of an investment will decline.
- *Business risk* is the chance that a business will fail, be less profitable than expected, or that a government will not pay interest on the money it borrowed.
- *Inflation risk* is the possibility that the purchasing power of the return on investment will be less than expected because of inflation.
- *Political risk* is the risk that government action will hurt your investment.
- *Interest rate risk* is the risk that changes in interest rates will hurt your investment, particularly bonds.
- *Fraud risk* is the chance you invested with a person who lied about the risks or return of the investment.

Instruments for Saving and Investment

- Watch: Mutual Funds Simply Put
- Watch: Mutual Funds Explained: Buy Index Funds

Instruments for Saving and Investment

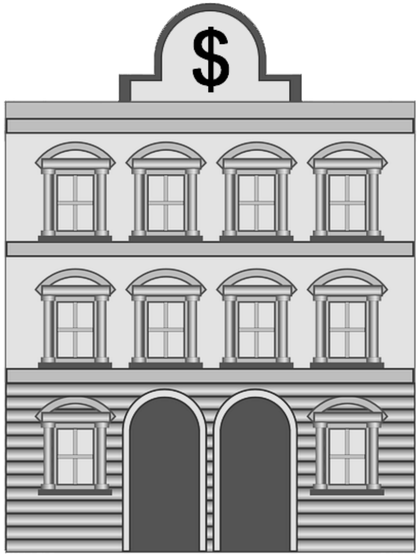
Low-Risk Saving Options

- These choices have lower risk and lower returns.
- They are most appropriate for savings you may need in the short term.
- They allow you to access your money quickly and without penalty.

Instruments for Saving and Investment

Bank and Credit Union Savings Accounts

- Completely flexible
- Pay low interest rates
- Insured by the federal government and safe



Instruments for Saving and Investment

Certificates of deposit (CDs)

- Must be held until the maturity date or a penalty will be assessed
- Pay higher interest rates than savings accounts
- Insured by the federal government and safe
- Search online to find the most favorable interest rates

Instruments for Saving and Investment

Money Market Mutual Funds

- Investors' money is pooled and invested in U.S. Treasury bills and commercial paper.
- Quick access to your money—some funds even offer check-writing.
- Not insured by the federal government

Instruments for Saving and Investment

Longer-Term Investments

- These investments are designed to grow your money over the longer term.

http://commonsenseeconomics.com/

Instruments for Saving and Investment

Bonds

- Loans to governments, government agencies, or corporations
- Pay a fixed interest rate
- Have a maturity date, the date the principal will be returned to the investor
- Can be bought and sold before the maturity date
- Bond prices depend on interest rates and the financial strength of the issuer.
- Prices of existing bonds rise when interest rates decline.
- Prices of existing bonds fall when interest rates rise.

Instruments for Saving and Investment

Stocks

- A share of stock represents a share of ownership in a corporation
- When you buy the stock of a corporation, you become a part-owner of the business.
- Corporate profits can be distributed to shareholders in the form of *dividends*.
- Shareholders also benefit if the price of shares increases, and they sell the shares. This is called a *capital gain*.
- If the price of shares decreases and the shares are sold, the difference is called a *capital loss*.

Instruments for Saving and Investment

The Rewards and Risks of Owning Stocks

- Stocks have the highest long-term rate of return of any investment.
- Stocks are riskier than other investments.

Instruments for Saving and Investment

Mutual Funds

- A mutual fund pools investors' money and invests the money in financial assets such as stocks and bonds.
- Once a day an open-ended mutual fund determines the *net asset value (NAV)* of one share.
- Investors may buy shares from the mutual fund at the NAV and sell shares to the mutual fund at the NAV.

Instruments for Saving and Investment

The Galaxy of Mutual Funds

- There are over 18,000 mutual funds that would like to invest your money.
- Mutual funds have different objectives. There are growth funds, balanced funds, bond funds, value funds, small company funds, international funds, index funds, and energy funds. And that's just for starters!

http://commonsenseeconomics.com/

Instruments for Saving and Investment

Mutual Funds Have Differing Costs

- Check the cost of a mutual fund before investing.
  - Some mutual funds have loads or sales commissions. They are called load funds. Stock brokers often push load funds because of these sales incentives. Never buy them.
  - Some mutual funds do not charge loads. They are called no-load funds.
  - All mutual funds have expenses, which vary from fund to fund.
  - Some mutual funds sneak in a marketing fee called a 12b-1 fee.

Instruments for Saving and Investment

Actively Managed Mutual Funds

- Actively managed mutual funds try to earn a rate of return that is greater than the market average.
- Few funds have achieved this goal over the long run.
- This year's hot fund may be next year's dog.
- Because they are actively managed, costs are higher than for index funds.

Instruments for Saving and Investment

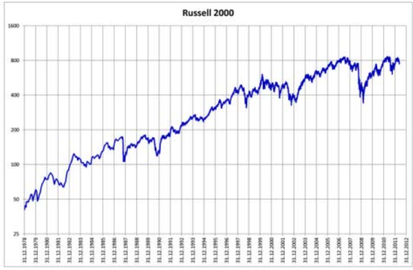
Index Funds

- Index funds try to replicate a market average such as the Standard and Poor's 500 stock index (S & P 500) or the total stock market average.
- For diversification, focus on a broad index such as the S & P 500 fund or a total market index fund.
- Avoid index funds that target only one sector of the economy such as value index funds or small-cap index funds. They do not offer enough diversification.

Instruments for Saving and Investment

Index Funds and Their Advantages

- Because the composition of the index is clear, it costs less to manage an index fund than an actively managed fund. Lower expenses mean more of your investment is working for you.
- Most index funds have outperformed actively managed funds over the long term.
- The expenses and performance of index funds vary. Do your research before inve



INVESTING MADE SIMPLE

1. Save as much as you can each month. Build your emergency fund in a federally insured savings account or money market mutual fund. Open an index mutual fund account for mid-term and long-term goals.
2. Make regular contributions to a 401(k), 403(b), Traditional IRA, or Roth IRA. Take full advantage of employer matches. Do not withdraw money until retirement unless you have a real emergency.
3. Invest for your retirement and other long-term goals with a broadly based, low-cost, equity index mutual fund.