PERSONAL FINANCE

SPENDING, SAVING, & INVESTING

I. RATIONAL DECISIONS & FINANCIAL PLANNING

- A. Marginal Benefits vs. Marginal Costs
- B. Needs & Wants
- C. Delayed vs. Instant Gratification
- D. Financial Institutions For Savings - Lower Interest Rates & Low Risk; insured by the Federal Deposit Insurance Company (FDIC) up to $250,000.
  - 1. Banks - a corporation that stores deposits & makes loans in order to earn a profit.
  - 2. Certificates of Deposits (CD) - a promise to leave money in the bank for a certain amount of time (time deposit) in exchange for a higher interest rate
  - 3. Savings & Loan Associations - savings from consumers & loans to homebuyers

- E. Financial Institutions For Investments - Higher Interest Rates & High Risk
  - 1. When you “invest” money either with a business or government, you do so for a specified amount of time in return for interest, a share of the profits (profit-sharing), and/or part ownership in the company (shares or stocks)
  - 2. The greater the risk you take, the higher the potential rewards.
  - 3. The three most important types of investment are: bonds, stocks, & mutual funds.

- a. Bonds - you are lending money to a corporation (corporate bond) or government (government bond); in return you periodically are paid interest until the bond “matures.” Bonds earn a higher interest rate than savings accounts & CD’s
  - (1) governments issue bonds to pay debts or pay for public projects
  - (2) corporations issue bonds to raise capital (money) funds for investment & expansion

- b. Stocks - highest potential reward on investment…but the riskiest
  - (1) Stocks are shares of a corporation, you are paid dividends (preferred stock) every quarter based on the profits the corporation earns.
  - (2) Stocks earn you money if you “buy low; sell high.” This happens when there is a “bull market.” You can also earn mown from “short-selling” stock by purchasing at a higher price and selling at a lower price (I know, sounds weird, but it works); this can occur during a “bear market.”
  - (3) The profit you earn from stocks is called capital gains
  - (4) If a company goes out of business or loses money, so do you.

- c. Mutual Funds - pools money from many investors and uses it to buy a variety of stocks & bonds (diversification) called a portfolio.
    - (1) a comprise between low & high-risk investments

USING CREDIT

I. LOANS & CREDIT CARDS

- A. The U.S. economy runs on credit. Credit is the ability to buy goods now, and pay for them later.
  - 1. Bank loans - major purchases such as a car, house, & college.
    - a. Fixed-rate loans
    - b. Adjustable-rate loans (ARMS)
  - 2. Credit cards - minor purchases such as food, clothing, & gas.
    - a. Installment plan
    - b. Revolving balance
    - c. Grace period
    - d. Annual percentage rate (APR)
    - e. Annual fee
  - Pros & Cons

II. CREDITWORTHY

- A. Before you receive a loan you apply for, banks decide whether you are “creditworthy.”
  - 1. Are you able to pay back the money?
  - 2. Are you likely to pay it back or “default” on the loan?
  - 3. Do you have collateral?
    - a. Collateral is something the bank can take if you default on the loan.
- B. To decide creditworthiness, banks look at your employment history, and your credit history.
  - 1. Credit bureaus - Equifax, Experian, & Tranunion
  - 2. FICO score

III. CREDIT DECISIONS

- A. Based on budget, how expensive credit is.
- B. Fixed vs. Variable expenses.
- C. Design a budget

IV. INTEREST RATES

THE COST OF BORROWING MONEY

- A. Interest is the COST of using credit.
  - a. The lender earns interest; the borrower pays the interest
- B. To compare the cost of credit you need to know the following:
  - 1. Is the interest rate annual? IOW, are you charged per year or per month?
  - 2. Is it fixed or variable?
  - 3. Is the interest calculated as simple or compound?
    - a. Simple interest means you are charged only on the original amount you borrowed called the principal (ex: bank loan for a house)
    - b. Compound interest means you are charged interest on the balance each month which includes interest charges from previous months (ex. credit cards)

TYPES OF INSURANCE

I. HOW INSURANCE WORKS

- A. When you buy insurance you receive an insurance policy. This is an agreement between you & the insurance company. It explains:
  - 1. the losses the IC will cover (claims)
  - 2. how much they will pay out on those losses
  - 3. how much you must pay for this protection (deductible & premiums)
    - a. The deductible is the amount you must pay BEFORE your insurance kicks in.
    - b. The premium is what you pay monthly, quarterly, or yearly in order to guarantee your coverage. Premiums can differ based on many factors such as: type of insurance, amount of coverage, amount of deductible, your age, marital status, where you live, how old you are, your health, and your credit history.

II. TYPES OF INSURANCE

- A. Car insurance - all states require drivers to carry minimum coverage in case of an accident. This is called liability insurance. If you want your car covered for damages, this is called collusion.
- B. Health insurance - pays your medical bills
- C. Disability insurance - covers your monthly income if you cannot work due to an injury or illness
- D. Life insurance - beneficiary is who gets the money when you die
  - 1. Term - cheaper; pays a higher benefit; only covers a limited amount of time; premiums increase as you age; has no cash value
  - 2. Whole - more expensive; pays a lower benefit; covers your whole life; premiums never increase; has cash value