Unit 1

Planning Personal Finances

WebQuest **Internet Project**

One Life to Plan

Financial planners help people plan for paying for college or retirement, and then show them how to save to reach those goals. Life planners assist clients to pinpoint what they want out of life, and then use financial planning to help people achieve it. In this project, you will weigh the pros and cons of each career and decide which one might best suit you.

Log on to **finance07.glencoe.com**. Begin your WebQuest by reading Task 1. Then continue working on your WebQuest as you study Unit 1.

Section	1.2	2.2	3.2	4.1
Page	25	52	71	96

BusinessWeek

FINANCE FILE

Which Adviser Knows the Way?

Almost anyone can claim to be a financial planner or investment adviser. If you're looking for an adviser for the first time—you need to figure out how much and what kind of advice you need. If all you want are some suggestions for your IRA or your investment portfolio, you could get that through Charles Schwab or Fidelity Brokerage Services for a fee of about $250.

But there's more to your financial well-being than stocks and bonds. Do you have a debt-management problem? Do you have enough insurance, and is your estate in order?

And what about credentials? Certified Financial Planner (CFP) is the most recognized designation. CFPs have comprehensive education and must pass a ten-hour certification exam and have at least three years' experience before qualifying.

The irony is that most people seek advisers to relieve the burden of managing their finances themselves. But it's a burden in itself to make sure you've got the right adviser.

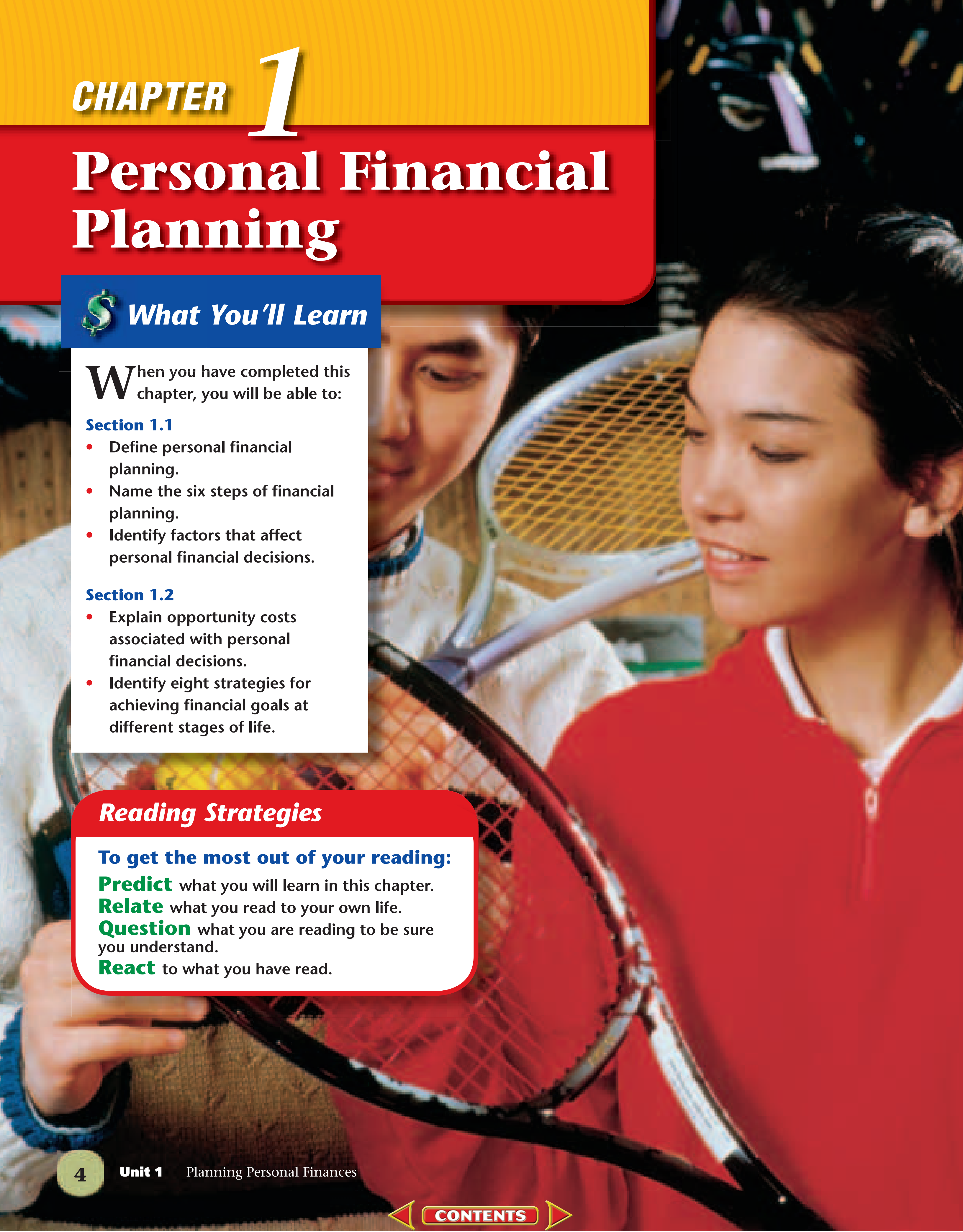
— By Lewis Braham with Amy Borrus

Write About It Why should you know how to plan your personal finances even if you can hire a financial planner?

Log On To read the complete *BusinessWeek* article and do the *BusinessWeek* Extension activity to help you learn more about financial and life planning, go to **finance07.glencoe.com**.

CHAPTER 1

Personal Financial Planning



What You'll Learn

When you have completed this chapter, you will be able to:

Section 1.1

- Define personal financial planning.
- Name the six steps of financial planning.
- Identify factors that affect personal financial decisions.

Section 1.2

- Explain opportunity costs associated with personal financial decisions.
- Identify eight strategies for achieving financial goals at different stages of life.

Reading Strategies

To get the most out of your reading:

Predict what you will learn in this chapter.
Relate what you read to your own life.
Question what you are reading to be sure you understand.
React to what you have read.

In the Real World . . .

Laurel Marquez is a high school senior who works part-time at a sporting goods store. She hopes to make enough money to attend junior college without having to get a student loan. Her brother Rick is a junior who works at a bicycle shop. He is trying to save enough money to go on a long-distance cycling trip during the summer.

Rick and Laurel enjoy going to restaurants and seeing movies and concerts. However, to reach their goals, they will have to watch their spending. Although they are still in high school, the financial habits they develop now will pay off in the long run. Setting financial goals will help them avoid debt and achieve financial security in the future.

As You Read *Consider how personal values affect Rick and Laurel's financial goals.*

ASK STANDARD & POOR'S

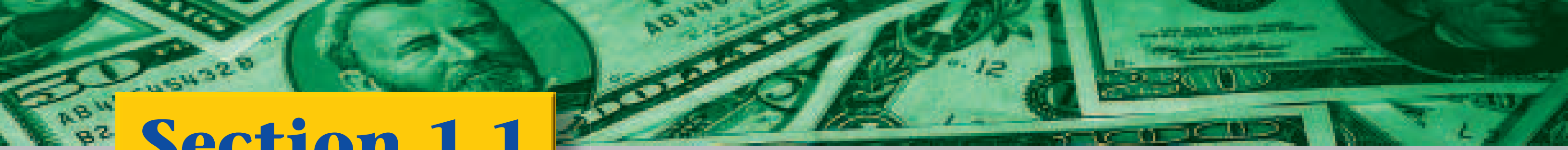
The Money Plan

Q: I am a high school student. I do not have money for investments or buying property. So what difference does it make how I spend my money now?

A: You will not always be a student. Learning to save and use money wisely now will help you know how to achieve financial security in the future. While you are in high school, financial planning can help you decide how to spend, save, and invest your money for special purchases or activities that matter to you. You may even be able to buy stock!

Ask Yourself What item do you think you could buy if you saved some money for several months? Explain why this would be financial planning.

Go to **finance07.glencoe.com** to complete the Standard & Poor's Financial Focus activity.



Section 1.1

Focus on Reading

Read to Learn

- How to define personal financial planning.
- How to name the six steps of financial planning.
- How to identify factors that affect personal financial decisions.

Main Idea

The financial planning process can help you reach your financial goals.

Key Terms

- personal financial planning
- goals
- values
- opportunity cost
- liquidity
- service
- good
- economics
- economy
- supply
- demand
- Federal Reserve System
- inflation
- consumer
- interest

Before You Read

PREDICT

List three of your financial goals.

Financial Decisions and Goals

Personal Financial Decisions

What are the benefits of financial planning?

What is personal finance? It is everything in your life that involves money. **Personal financial planning** is arranging to spend, save, and invest money to live comfortably, have financial security, and achieve goals. Everyone has different financial goals. **Goals** are the things you want to accomplish. For example, getting a college education, buying a car, and starting a business are goals. Planning your personal finances is important because it will help you to reach your goals, no matter what they are. It is up to you to make and follow a financial plan.

Some of the benefits of planning are:

- You have more money and financial security.
- You know how to use money to achieve your goals.
- You have less chance of going into debt you cannot handle.
- You can help your partner and support your children, if you have a family.

Whether you are spending, saving, or investing money, planning can help you to make big or small financial decisions. The financial planning process has six steps to help you reach your goals.

STEP 1: Determine Your Current Financial Situation

To figure out your current financial situation, make a list of items that relate to your finances:

- Savings
- Monthly income (job earnings, allowance, gifts, and interest on bank accounts)
- Monthly expenses (money you spend)
- Debts (money you owe to others)

A good way to estimate your expenses is to keep a careful record of everything you buy for one month. You can use a small notebook to track your expenses. When you have determined your financial situation, you will be able to start planning.

STEP 2: Develop Your Financial Goals

To develop clear financial goals, think about your attitude toward money and ask yourself some questions: Is it more important to spend your money now or to save for the future? Would you rather get a job right after high school or continue your education? Do your personal values affect your financial decisions? **Values** are the beliefs and principles you consider important, correct, and desirable. Different people value different things.

Needs and Wants Another important aspect of developing financial goals is knowing the difference between your needs and your wants. A *need* is something you must have to survive, such as food, shelter, and clothing. A *want* is something you desire or would like to have or do. For example, if you live in an area where the winter is cold, you need a coat. So you may want a leather jacket, but other less expensive coats would also keep you warm.

Only you can decide what specific goals to pursue. For example, you might want to save money. So, you could save $50 every month or 15 percent of every paycheck.

TechByte

Using Software There are many software products on the market today designed to help you keep track of your personal finances. One of the first and most popular is Quicken®. Features allow you to track and pay bills and see if you have enough money to cover upcoming bills. You can also schedule bill payments and deposits.

@ Describe the information given on the Quicken monthly view screen by reading information through **finance07.glencoe.com**.

STEP 3: Identify Your Options

It is impossible to make a good decision unless you know all your options. Generally, you have several possible courses of action. Suppose that you are saving $50 a month. You might have these options:

- **Expand the current situation.** You may decide to increase the amount of money you save every month to $60.
- **Change the current situation.** You could invest in stocks instead of putting your money into a savings account.
- **Start something new.** You could use the $50 to pay off your debts.
- **Continue the same course of action.** You may choose not to change anything.

However, in each case, be aware that the costs of your decision may outweigh the benefits.

▶ **MONEY MATTERS** Your values affect your spending habits. *Why might people shop at vintage clothing stores or swap meets?*

STEP 4: Evaluate Your Alternatives

In this step, you evaluate your alternatives as part of the financial planning process. Use the many sources of financial information that are available. (See **Figure 1.1.**) Look at your situation in life, your present financial situation, and your personal values. Consider the consequences and risks of each decision you make.

Sources of Financial Information It is important to keep up-to-date with social and economic conditions because they can affect your financial situation. For example, a company that manufactures the latest technology or designs the trendiest clothes may be a good investment. On the other hand, if you learn that the company is being sued, would you invest in it?

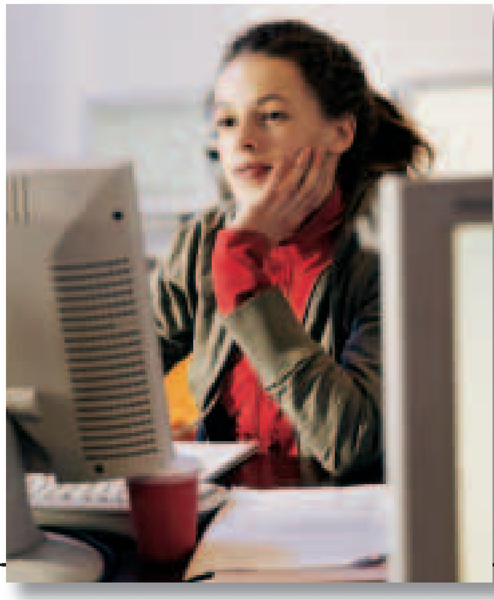
Consequences of Choices When you choose one option, you eliminate other possibilities. You cannot choose all options. Suppose that you want to become a full-time college student. You also want the income you would earn at a full-time job. In choosing to pursue your education, you give up the opportunity to work full time, at least for the moment. An **opportunity cost**, or a trade-off, is what is given up when making one choice instead of another. The opportunity cost of going to college would be the benefit of having a full-time job.

Figure 1.1 Get the Facts

Information on financial planning can come from many sources:

1 **Financial Specialists:** accountants, bankers, financial planners, insurance agents, tax attorneys, and tax preparers

2 **Technology:** computer software and the Internet



However, choosing involves more than knowing what you might give up. It also involves knowing what you would gain. For example, by going to college, you could gain a higher-paying job.

Understanding Risks If you decide to ride your bicycle on a very busy city street, you are taking a risk of having an accident. When you make a financial decision, you also accept certain financial risks. Some types of financial risks include:

- **Inflation Risk**—If you wait to buy a car until next year, you accept the possibility that the price may increase.
- **Interest Rate Risk**—Interest rates go up or down, which may affect the cost of borrowing or the profits you earn when you save or invest.
- **Income Risk**—You may lose your job due to unexpected health problems, family problems, an accident, or changes in your field of work.
- **Personal Risk**—Driving for eight hours on icy mountain roads may be hazardous. The risk may not be worth the money you would save on airfare.
- **Liquidity Risk**—**Liquidity** is the ability to easily convert financial assets into cash without loss in value. Some long-term investments, such as a house, can be difficult to convert quickly.

As You Read
RELATE

What are your financial goals? Which goals are needs and which goals are wants?

3 **The Media:** books, magazines, newsletters, newspapers, radio, and television

4 **Financial Institutions:** banks, credit unions, insurance and investment companies, and savings and loan associations

5 **Education:** high school and college courses and seminars

STEP 5: Create and Use Your Financial Plan of Action

A plan of action is a list of ways to achieve your financial goals. If your goal is to increase your savings, a plan of action could be to cut back on spending. If you want to increase your income, you might get a part-time job or work more hours at your present job. You could use the extra money you earn to pay off debts, save money, purchase stocks, or make other investments.

STEP 6: Review and Revise Your Plan

Financial planning continues as you follow your plan. As you get older, your finances and needs will change. That means that your financial plan will have to change too. You should reevaluate and revise it every year.

Developing Personal Financial Goals

What should you consider to set financial goals for yourself?

Why do so many people have money problems? The main reason is that they do not plan how they will use their money. You can avoid money problems by planning with some clear financial goals in mind.

Types of Financial Goals

Two factors will influence your planning for financial goals. The first factor is the time frame in which you would like to achieve your goals. The second factor is the type of financial need that inspires your goals.

Time Frame of Goals Goals can be defined by the time it takes to achieve them:

- **Short-term goals** take one year or less to achieve (such as saving to buy a computer).
- **Intermediate goals** take two to five years to achieve (such as saving for a down payment on a house).
- **Long-term goals** take more than five years to achieve (such as planning for retirement).

Start with short-term goals that may lead to long-term ones. Some goals, such as having money for the holidays or other special occasions, occur every year. Other goals, such as buying a car, may come up only occasionally. What are some of your short-term, intermediate, and long-term financial goals?

Common CENTS

Pay Yourself First
When you receive your paycheck, pay yourself first. This means that before you pay bills or buy anything, you should put something into your savings account—even a small amount. Think of it as paying yourself. Try saving a percentage of your take-home pay or allowance—1 percent the first month, 2 percent the second month, and so forth. Then sit back and watch your money grow. *If your take-home pay is $860 a month and you save the percentages listed above for 12 months, how much would you have?*

Careers in Finance

PERSONAL BANKER **Jason Lee**
National Bank

Working as a personal banker for National Bank, Jason develops, manages, and expands customer relationships. His challenge is to recognize the needs of the customers and match them to the services offered by his branch. His clients range from high school students, who are opening their first savings and checking accounts, to businesspeople, who are seeking very precise financial products and services. Jason enjoys working with a wide variety of customers and gains satisfaction from helping them reach their financial goals.

SKILLS: Communication, customer-service, computer, interpersonal, math, sales, cross-selling, and second language skills

PERSONAL TRAITS: Good judgment, likes working with people, tactful, detail oriented, ability to adapt to a flexible schedule in a high-volume environment

EDUCATION: Associate degree or bachelor's degree with a major in business administration or economics

ANALYZE Banking services are increasingly offered via ATMs, the telephone, or online. Explain why personal bankers are still in demand.

To learn more about career paths for personal bankers, visit **finance07.glencoe.com**.

Goals for Different Needs The need to have your hair cut at a salon is different from the need to buy a new car. A haircut is a **service**, or a task that a person or a machine performs for you. A new car is a **good**, or a physical item that is produced and can be weighed or measured. You might buy a soda every day. You might buy a new car every five or six years. How you establish and reach your financial goals will depend on whether a goal involves the need for consumable goods (such as a soda), durable goods (such as a car), or intangible items (such as an education):

- **Consumable goods** are purchases that you make often and use up quickly. Food and products, such as shampoo and conditioner, are in this category. Although the cost of such items may not equal the cost of a car, the costs of consumable goods add up.
- **Durable goods** are expensive items that you do not purchase often. Most durable goods, such as cars and large appliances, will last three years or more when used on a regular basis.
- **Intangible items** cannot be touched but are often important to your well-being and happiness. Examples of intangibles include your personal relationships, health, education, and free time. Intangibles are often overlooked but can be expensive.

As You Read
QUESTION

Think about consumable goods, durable goods, and intangibles. Over the long term (ten years or more), which category do you think has the highest cost?

Document Detective

Learn to identify and understand the standard financial documents you will use in the real world.

Investigate: A Monthly Budget Worksheet

A monthly budget worksheet contains the following information:

- Income
- Payroll deductions
- Take-home pay
- Other income
- Expenses
- Income less expenses

Your Motive: A monthly budget worksheet helps you analyze and compare your monthly expenses to the income you receive each month. This analysis helps you plan your spending.

Janet Lopez's Monthly Budget Worksheet

Monthly Income	Amount
Wages (before taxes)	$3,500
Allowance	0
Other income	35
Payroll Deductions	
Federal tax	$ 700
Social Security tax	268
State tax	175
Local tax	35
Other	0
Total Take-Home Income	$ 2,357
Fixed Monthly Expenses	
Savings	$ 100
Rent/Mortgage	750
Car loan	425
Vehicle and apartment or house insurance	125
Life and health insurance	55
Cable TV/Internet access	45

Variable Monthly Expenses	Amount
Utilities (gas, electric)	$75
Telephone/Cell phone	65
Groceries	135
Clothing	75
Credit card	150
Donations	25
Gasoline	85
Personal items	45
Discretionary Monthly Expenses	
Movies	$ 15
Hobbies	35
Restaurants	55
Other	155
Total Expenses	$ 2,465
Income Less Expenses	- $ 108

Key Points: You create a budget by determining your take-home income. Take-home income is the difference between your wages and deductions. Taxes, union dues, and health insurance are wage deductions. Expenses are also listed. Some expenses are fixed. They do not change. Variable expenses change each month. Discretionary expenses do not include expenses for basic needs.

Find the Solutions

1. Explain the difference between fixed expenses and variable expenses.
2. List other possible expenses that are not listed on this worksheet.
3. Decide if Janet has enough monthly income for monthly expenses.
4. Explain why utilities are a variable expense.
5. Suggest ways this budget can be balanced.

Guidelines for Setting Goals

How can you make good financial decisions? You must identify your goals. Then identify the time frame for achieving each goal and the type of need. However, these factors will change as you go through life. The financial goals you set as a student will be different from the goals you may have if you marry or have children. **Figure 1.2** shows examples of financial goals and activities related to various life situations.

When setting your financial goals, follow these guidelines:

1. Your financial goals should be realistic.
2. Your financial goals should be specific.
3. Your financial goals should have a clear time frame.
4. Your financial goals should help you decide what type of action to take.

Academic Connection

LANGUAGE ARTS

Look at Figure 1.2 and consider setting some financial goals for yourself. *Think of three goals. Write them down, explaining how each meets the four guidelines.*

Figure 1.2 **Financial Goals and Activities for Various Life Situations**

Life Situation	Financial Goals and Activities
Young single adult	• Obtain career training. • Become financially independent. • Obtain health insurance. • Develop a savings plan. • Carefully manage your use of credit.
Young couple with no children	• Create an effective financial record-keeping system. • Obtain adequate health and life insurance. • Implement a budget. • Carefully manage your use of credit. • Develop a savings and investment program.
Couple with young children	• Purchase a home. • Obtain adequate health and life insurance. • Start a college fund. • Make a will and name a guardian for your children.
Single parent with young children	• Obtain adequate health, life, and disability insurance. • Make a will and name a guardian for your children. • Establish an emergency fund.
Middle-aged, single adult	• Contribute to a tax-deferred retirement plan. • Evaluate and select appropriate investments. • Accumulate an adequate emergency fund. • Review will and estate plans.
Older couple with no children at home	• Plan retirement housing, living expenses, and activities. • Obtain health insurance for retirement. • Review will and estate plans.

Economic Conditions Your financial needs and goals change at different stages of life.

What are some goals you will have ten years from now that you do not have today?

$avvy Saver

Good Financial Habits

1. Save money every time you get paid.
2. Spend less than you make.
3. Work out a budget and stick to it.
4. Pay your bills and taxes on time.
5. Balance your checkbook every month.

Influences on Personal Financial Planning

What factors can influence your personal financial planning?

Many factors will influence your day-to-day decisions about finances. The three most important factors are:

- Life situations
- Personal values
- Economic factors

Life Situations and Personal Values

As you enter adulthood, you will experience many changes. You may go to college, start a new career, get married, have children, or move to a new city. These new life situations will affect your financial planning. Your personal values also influence your financial decisions.

For example, Angela just graduated from high school and will be going to college in the fall. She will move out of her parents' house and live in the college dorm. Angela is beginning a new and exciting stage in her life. She values independence, and so she plans to move to an apartment with a roommate in her sophomore year. She will experience more personal freedom, but with her independence will also come more financial responsibility.

Economic Factors

Economic factors across the country and around the world can affect personal finances. They play a role in day-to-day financial planning and decision making for most people. **Economics** is the study of the decisions that go into making, distributing, and using goods and services. The **economy** consists of the ways in which people make, distribute, and use their goods and services. To understand economics and the economy, you need to be aware of the market forces, financial institutions, global influences, and economic conditions that affect global as well as personal decisions.

Market Forces The forces of supply and demand determine the prices of products, or goods and services, you purchase. **Supply** is the amount of goods and services available for sale. **Demand** is the amount of goods and services people are willing to buy. When there is a high demand for an item, such as a popular toy, or when a company cannot manufacture enough of a certain product to keep up with the demand, the price of the product rises. When there is little demand for a product, or when a company produces more than it can sell, the price of the product drops.

Financial Institutions Most people do business with financial institutions, which include banks, credit unions, savings and loan associations, insurance companies, and investment companies. Financial institutions provide services that increase financial activity in the economy. For example, they handle savings and checking accounts, provide loans, sell insurance, and make investments for their clients.

STANDARD &POOR'S

Global Financial Landscape

Standard and Poor's publishes the globally recognized S&P 500® financial index. It also gathers financial statistics, information, and news, and analyzes this data for international businesses, governments, and individuals to help them guide their financial decisions.

INDIA

Most travelers to India expect to see a country carved out of 5,000-year-old traditions, but they also find modern-day landmarks that look like home. Driven by a booming economy and growing incomes in large cities, Indians have become avid consumers of Western culture. Fast-food chains and sprawling malls dot the ancient landscape. Teenagers wear the latest fashions. In fact, India also boasts a growing fashion design industry. Imported cosmetics are popular, and beauty pageants are national events. On a one-mile stretch of a typical city of India, construction takes place to accommodate more than 40,000 multinational technology and service workers.

A decade ago, when India opened its doors to the world, critics labeled this kind of expansion as corruptive. But as foreign businesses pour billions into the country, some say the modernization is too slow. One young Indian laments, "Night life is nonexistent."

STANDARD &POOR'S

DATABYTES

Capital	New Delhi
Population	1,086,572,000
Language	Hindi, English, and 14 other official languages
Currency	Indian rupee
Gross Domestic Product (GDP)	$3.02 trillion (2003 est.)
GDP per capita	$2,900

Industry: Textiles, chemicals, food processing, steel, transportation equipment, cement, and mining

Agriculture: Rice, wheat, oilseed, cotton, cattle, and fish

Exports: Textile goods, gems and jewelry, engineering goods, chemicals, and leather

Natural Resources: Coal, iron ore, manganese, mica, and bauxite

Think Globally

Working Indian teens spend money to keep up with the times. Many of them like the same things American teens like. Create a budget for a typical Indian teen.

Among the various government agencies that regulate the financial activities of financial institutions, the Federal Reserve System has a significant responsibility in the U.S. economy. The **Federal Reserve System**, or the Fed, is the central banking organization of the United States. Its primary role in the U.S. economy is the regulation of the money supply. The Fed controls the money supply by determining interest rates and by buying or selling government securities. Its decisions affect the interest rate you earn on your savings, the interest rate you pay when you borrow money, and to some extent the prices of the products you buy.

Global Influences You and the money you spend are part of the global marketplace, which is another economic factor that can affect financial planning. Look at the items in your home or classroom and you will discover that many of the products were made in other countries.

The economy of every nation is affected by competition with other nations. Each country wants consumers in other countries to buy their products. When other countries sell more goods to the United States than U.S. companies can sell in those markets, more money leaves the United States than enters it. Then less money is available for spending and investing, and interest rates may rise. These global influences also affect financial decisions.

Economic Conditions Current economic conditions also affect your personal financial decisions. **Figure 1.3** shows how economic conditions can influence financial planning. There are three important economic conditions:

1. Consumer prices
2. Consumer spending
3. Interest rates

- **Consumer Prices** Over time the prices of most products go up. This rise in the level of prices for goods and services is called **inflation**. During times of rapid inflation, it takes more money to buy the same amount of goods and services. For example, if the rate of inflation is 5 percent, then a computer that cost $1,000 a year ago would now cost $1,050 if the computer price increased at the inflationary rate.

  The main cause of inflation is an increase in demand without an 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, then prices will rise.

  Inflation can be especially hard on certain groups, such as retired people whose income may not increase. The inflation rate affects consumer prices and varies from year to year. In the early 1960s, the annual inflation rate was between 1 and 3 percent. In the late 1970s and early 1980s, the inflation rate climbed to 10–12 percent each year. More recently it slowed to 2–4 percent each year.

- **Consumer Spending** A **consumer** is a person who purchases and uses goods or services. You are a consumer whenever you buy anything—a CD, books, clothes, lunch, or even a haircut. Consumer spending affects the economy by helping to create and maintain jobs. When people buy more goods or services, companies have to hire extra employees to meet the demand. This situation leads to a higher rate of employment, making more jobs available. More people work, and they have more money to spend. However, when consumers buy fewer goods and services, companies have to produce less and lay off workers. Then unemployment rises, making jobs harder to find.

Figure 1.3 **Economic Conditions and Financial Planning**

Economic Condition	What It Measures	How It Influences Financial Planning
Consumer prices	The value of a dollar; changes in inflation	If consumer prices increase faster than wages, the value of the dollar decreases—a dollar buys less than it did before. Consumers tend to buy fewer goods and services. Lenders charge higher interest rates.
Consumer spending	Demand for goods and services by individuals and households	Increased consumer spending usually creates more jobs and higher wages. Reduced consumer spending causes unemployment to increase.
Interest rates	Cost of money, cost of credit when you borrow, and the return on your money when you save or invest	Higher interest rates make borrowing money more expensive and make saving more attractive. When interest rates increase, consumer prices tend to increase.
Money supply	The dollars available for spending in our economy	The Federal Reserve System (Fed) sometimes adjusts interest rates in order to increase or decrease the amount of money circulating in the economy. If the Fed lowers interest rates, the money supply increases. If the Fed raises interest rates, the money supply decreases.
Unemployment	The number of people without jobs who are willing and able to work	Low unemployment increases consumer spending. High unemployment reduces consumer spending.
Gross domestic product (GDP)	Total dollar value of all the goods and services produced in a country in one year	The GDP provides an indication of how well people are living in a country.

Economic Conditions Economic conditions you cannot control will affect your financial planning.

Choose an economic condition listed above, and explain how it affects your life today.

- **Interest Rates** Like everything else, money has a price, and this price is called interest. **Interest** is the price that is paid for the use of another's money. Interest rates also affect the economy. When you deposit your paycheck in a savings account, the interest you receive is money the bank or another financial institution pays you for the use of your money. The bank, in turn, uses your money to make loans to people who want to purchase items such as houses, automobiles, and new businesses. Borrowers who receive the loans must pay a fee, or interest to the bank or lending institution.

Interest rates represent the cost of money. When consumers increase their savings and investments, the supply of money that is available for others to borrow grows, and interest rates go down. When consumers borrow more money, the demand for money increases, and interest rates go up.

Interest rates on loans also rise during times of inflation. Interest rates will affect your financial planning, whether you save, invest, or obtain loans. The amount of earnings you receive from your savings account or the interest you pay on a loan depend on the current interest rates. Interest rates are just one facet of the economic factors that influence your personal financial planning.

Section 1.1 Assessment

QUICK CHECK

1. What are the six steps used to create a financial plan?
2. What is the relationship between the timing of your goals and the type of good or service that you want?
3. What are two economic factors that affect financial decisions? How might these factors influence your financial planning?

THINK CRITICALLY

4. Why is it important to distinguish between your needs and your wants?

USE COMMUNICATION SKILLS

5. **Left to Chance?** You are talking to a friend who says that she never sets any financial goals and that her financial success or failure happens by luck.

Role-Play With a partner, role-play a response to your friend's philosophy. Explain how planning, more than luck, determines financial success or failure.

SOLVE MONEY PROBLEMS

6. **Financial Planning Process** Rosa and her best friend, Linda, live in Chicago and want to drive cross-country next year. Both work part-time and earn $97 a week after taxes. They need to save at least $500 each to pay for the trip. They plan to visit Rosa's aunt, who lives in Albuquerque, and Linda's brother in Los Angeles.

Write About It Help Rosa and Linda apply the six steps of the financial planning process to reach their goal. Write a six-step plan for them.

Section 1.2

Opportunity Costs and Strategies

Personal and Financial Opportunity Costs

What are personal and financial opportunity costs?

As discussed in Section 1.1, whenever you make a choice, you have to give up, or trade off, some of your other options. When making your financial decisions and plans, consider both the personal and financial opportunity costs carefully.

Personal Opportunity Costs

Like financial resources, your personal resources—your health, knowledge, skills, and time—require management. Do you eat a lot of junk food and avoid exercise? Do you get enough sleep each night? The decisions you make about your health now can have consequences as you get older.

In much the same way, the financial decisions you make today will affect your financial health in the future. For example, suppose that you and your friends have tickets to a sold-out concert this Thursday night. On Thursday afternoon your algebra teacher announces an important test for Friday. You must decide whether you will go to the concert, study for the test, or somehow do both. The opportunity cost of going to the concert might be getting a good grade on the test. You have to decide how to use your time to meet your needs, to achieve your goals, and to satisfy your values.

Financial Opportunity Costs

You also must make choices about how you spend money. For example, would you buy the $129 pair of sneakers you saw at the mall or save that money? You cannot do both, because most people have a limited amount of money. To help make choices, consider the **time value of money**, which is the increase of an amount of money due to earned interest or dividends. If you decide to save or invest the $129 instead of buying the sneakers, that money could be worth more later because you would earn interest or dividends on it.

Focus on Reading

Read to Learn

- How to explain opportunity costs associated with personal financial decisions.
- How to identify eight strategies for achieving financial goals at different stages of life.

Main Idea

By recognizing the trade-offs of financial decisions and learning to use your money wisely now, you will be able to live according to your values and meet your financial needs and goals throughout your life.

Key Terms

- time value of money
- principal
- future value
- annuity
- present value

Before You Read

PREDICT

Why do you think you may have to make trade-offs to meet your financial goals?

▲ **TIMING YOUR FUN** Managing your time by making trade-offs is as important as managing your money. *How can you use your time more efficiently when studying so you will also have time to do things you enjoy?*

On the other hand, perhaps your sneakers are worn out. In that case, your current needs would determine that trading off interest earnings is worthwhile.

Every time you spend, save, or invest money, think about the time value of that money as an opportunity cost. For example, if you start early in life to save money for retirement, you will probably be able to live comfortably in the future.

Calculating Interest You can calculate the time value of your savings by figuring out how much interest you will earn. To do this, you need to know the principal, the annual interest rate, and the length of time your money will be in an account.

For a savings account, the **principal** is the original amount of money on deposit. (For a loan, the principal is the amount that you borrow.) When you open a savings account, the bank or financial institution identifies the interest rate for your account. This is usually given as an annual percentage so that you know how much you will earn each year. By comparing interest rates at several financial institutions, you can figure out which one will make your money grow the fastest.

You can figure out how much interest your money will earn in the first year by multiplying the principal by the annual interest rate.

As You Read
RELATE

Is it important to start planning your financial future and monitoring your costs at your age now? Why or why not?

GO FIGURE FINANCIAL MATH

ANNUAL INTEREST

Synopsis: Interest is extra money earned from money in an account.

Example: You just deposited $1,000 in a savings account. The bank will pay you 3 percent annual interest. How much interest will you earn if you keep your money in the bank for one year?

Formula: Principal × Annual Interest Rate = Interest Earned for One Year

Solution: $1,000 × .03 = $30

You will earn $30 in interest.

YOU FIGURE

What if your sister deposited $50 for one year at the same interest? How much would she have?

Future Value of a Single Deposit **Future value** is the amount your original deposit will be worth in the future based on earning a specific interest rate over a specific period of time. Figure out how much your savings will earn and grow by multiplying the principal by the annual interest rate and then adding that interest amount to the principal.

You can determine the future value for two years, three years, and so on. Each year, interest is earned on your principal and on previously earned interest.

To calculate the interest earned for the second year, add interest earned in the first year to the principal. Then take that amount and multiply it by the annual interest rate.

Future value computations are also called *compounding*. With compounding, your money increases faster over time. If you make deposits now, your money will have more time to increase.

GO FIGURE FINANCIAL MATH

THE FUTURE VALUE OF A SINGLE DEPOSIT

Synopsis: When you earn interest from money you deposit in the bank, your balance increases over time.

Example: You just deposited $1,000 in a savings account that will pay you 3 percent (.03) annual interest. You earned $30 in interest after the first year. How much will you earn after two years?

Formula: (Principal + Previously Earned Interest) × Annual Interest Rate = Interest Earned for the Second Year

Solution: ($1,000 + $30) × .03 = $30.90

You will earn $30.90 in interest. Add this earned interest to your previous amount ($1,030 + $30.90 = $1,060.90). The future value of your original $1,000 deposit will be $1,060.90 after two years.

YOU FIGURE

What if you decided to deposit more money, say, $1,500? With 3 percent annual interest, how much would you have after three years?

As You Read
QUESTION

Why should you know the future value of a deposit when making financial plans?

Future value tables simplify the process of figuring out the effect of compounding. Many online future value calculators are available. The table in Part A of **Figure 1.4** shows the future value of a single deposit of $1. To use the table, find the annual interest rate that your money is earning. Then see what the future value is at Year 5, Year 6, and so on. Multiply the future value figure by the amount of your deposit. For example, if you deposit $1 in a 7 percent account, at the end of Year 7, you would have $1.61:

$$\$1 \times 1.606 = \$1.606$$

Future Value of a Series of Deposits Some savers and investors like to make regular deposits into their savings. A series of equal regular deposits is sometimes called an **annuity**. Use Part B of the chart in Figure 1.4 (future value of a series of equal yearly deposits) to find out the future value of $1,000 a year at 5 percent annual interest for six years. At the end of the six years, you would have $6,802:

$$\$1{,}000 \times 6.802 = \$6{,}802$$

Present Value of a Single Deposit You can also calculate the **present value**, which is the amount of money you would need to deposit now in order to have a desired amount in the future. For example, if you want to have $1,000 in five years for a down payment on a car, and your savings account pays 5 percent annual interest, how much money will you need to deposit now to accumulate $1,000? Part C of Figure 1.4 will help you find the answer. Find Year 5 in the left column, and look across to the 5 percent interest-rate column. The value given is 0.784. Multiply this value by the amount of money you want to have in five years:

$$\$1{,}000 \times 0.784 = \$784$$

You need to deposit $784 now to have $1,000 in five years.

Present Value of a Series of Deposits You can also use present value calculations to determine how much you would need to deposit so you can take a specific amount of money out of your savings account for a certain number of years. If you want to take $400 out of your account each year for nine years, and your money is earning interest at 8 percent a year, how much money would you need to deposit now? Part D of Figure 1.4 will help you find the answer. Find Year 9 in the left column and look across to the 8 percent interest-rate column. The value given is 6.247. Multiply this value by the amount of money that you want to take out every year:

$$\$400 \times 6.247 = \$2{,}498.80$$

You need to deposit $2,498.80 now to be able to take out $400 each year for nine years. This calculation is used for retirement.

STANDARD & POOR'S

Put on Your Financial Planner's Cap

If you were planning an investment for yourself, would you choose an annuity? Why or why not?

CONTENTS

Figure 1.4 Future and Present Value Tables

A. Future Value of a Single Deposit of $1

	Annual Interest Rate				
Year	**5%**	**6%**	**7%**	**8%**	**9%**
5	1.276	1.338	1.403	1.469	1.539
6	1.340	1.419	1.501	1.587	1.677
7	1.407	1.504	1.606	1.714	1.828
8	1.477	1.594	1.718	1.851	1.993
9	1.551	1.689	1.838	1.999	2.172
10	1.629	1.791	1.967	2.159	2.367

B. Future Value of a Series of Equal Annual Deposits

Year	5%	6%	7%	8%	9%
5	5.526	5.637	5.751	5.867	5.985
6	6.802	6.975	7.153	7.336	7.523
7	8.142	8.394	8.654	8.923	9.200
8	9.549	9.897	10.260	10.637	11.028
9	11.027	11.491	11.978	12.488	13.021
10	12.578	13.181	13.816	14.487	15.193

C. Present Value of a Single Deposit

Year	5%	6%	7%	8%	9%
5	0.784	0.747	0.713	0.681	0.650
6	0.746	0.705	0.666	0.630	0.596
7	0.711	0.665	0.623	0.583	0.547
8	0.677	0.627	0.582	0.540	0.502
9	0.645	0.592	0.544	0.500	0.460
10	0.614	0.558	0.508	0.463	0.422

D. Present Value of a Series of Equal Annual Deposits

Year	5%	6%	7%	8%	9%
5	4.329	4.212	4.100	3.993	3.890
6	5.076	4.917	4.767	4.623	4.486
7	5.786	5.582	5.389	5.206	5.033
8	6.463	6.210	5.971	5.747	5.535
9	7.108	6.802	6.515	6.247	5.995
10	7.722	7.360	7.024	6.710	6.418

Time Is Money

Future value tables can save you time and reduce errors when you compute interest over a long period of time. Present value tables can help you figure out how much you need to deposit now in order to have a certain amount of money in the future.

How much money will you have if you save $2,000 a year for ten years at 9 percent interest?

After You Read

REACT

Do you think financial planning and the strategies provided in this book can help you to achieve your goals? If yes, in what ways? If no, why not?

Achieving Your Financial Goals

What strategies can you use to reach your financial goals?

Throughout your life you will have many different financial needs and goals. By learning to use your money wisely now, you will be able to achieve many of those goals.

Financial planning involves choosing a career, and then learning how to protect and manage the money you earn. By using eight strategies, you can avoid many common money mistakes:

1. **Obtain**—Obtain financial resources by working, making investments, or owning property. Obtaining money is the foundation of financial planning because you will use that money for all other financial activities.
2. **Plan**—The key to achieving your financial goals and financial security is to plan how you will spend your money.
3. **Spend Wisely**—Many people spend more than they can afford. Other people buy things they can afford but do not need. Spending less than you earn is the only way to achieve financial security.
4. **Save**—Long-term financial security starts with a savings plan. If you save on a regular basis, you will have money to pay your bills, make major purchases, and cope with emergencies.
5. **Borrow Wisely**—When you use a credit card or take out another type of a loan, you are borrowing money. Borrowing wisely—and only when necessary—will help you achieve your financial goals and avoid money problems.
6. **Invest**—People invest for two main reasons: to increase their current income and to achieve long-term growth. To increase current income, you can choose investments that pay regular dividends or interest. To achieve long-term growth, you might choose stocks, mutual funds, real estate, and other investments that have the potential to increase in value in the future.

◀ **RISKY BUSINESS** Accidents can happen when you least expect them. *What are some ways to manage the financial risks associated with sports accidents?*

7. **Manage Risk**—To protect your resources in case you are ever seriously injured, get sick, or die, you will need insurance coverage. Insurance will protect you and those who depend on you.
8. **Plan for Retirement**—When you start to plan for retirement, consider the age at which you would like to stop working full time. You should also think about where you will want to live and how you will want to spend your time: at a part-time job, doing volunteer work, or enjoying hobbies or sports.

Developing and Using a Financial Plan

A good personal financial plan includes assessing your present financial situation, making a list of your current needs, and deciding how to plan for future needs. You can design a plan on your own, hire a financial planner, or use a good money-management software program. Making your financial plan work takes time, effort, and patience, but you will develop habits that will give you a lifetime of satisfaction and security.

WebQuest

One Life to Plan
Learn about how financial counselors help people get out of debt and plan for the future—just one aspect of a financial planner's job.

To continue with Task 2 of your WebQuest project, visit **finance07.glencoe.com**.

Section 1.2 Assessment

QUICK CHECK

1. What are the opportunity costs associated with financial decisions?
2. What is the time value of money?
3. What are the eight strategies you can apply to achieve your financial goals?

THINK CRITICALLY

4. Using the concept of the time value of money, write an argument in favor of shopping for a good interest rate.

USE MATH SKILLS

5. **Saving Strategies** Tanya wants to open her own pet-grooming business after she graduates from high school. However, after doing research, she realizes that she needs to save $18,000 for the start-up capital for her business. Tanya plans to make a series of deposits of $3,000 every year for five years. She estimates that she will earn an annual interest rate of 5 percent on her savings.

Calculate Using the tables in Figure 1.4, calculate what amount Tanya will have available in five years to start her business. How much more money will she need to save?

SOLVE MONEY PROBLEMS

6. **Saving Versus Spending** Omar received $1,525 in gifts when he graduated from high school. His parents want him to save the money for college, but Omar wants to buy new clothes, a watch, some CDs, and a video game. He also needs new tires because the ones on his car are badly worn. Omar asks you for advice. How should he spend his graduation money?

Analyze Working in a small group, discuss what Omar should do with his money. Consider the various financial opportunity costs and the time value of money.

Chapter 1 Review & Activities

CHAPTER SUMMARY

- Personal financial planning means managing your money (spending, saving, and investing) so that you can achieve financial independence and security.
- The six steps of financial planning are: (1) Determine your current financial situation; (2) develop financial goals; (3) identify alternative courses of action; (4) evaluate alternatives; 5) create and use your financial plan of action; and (6) review and revise your plan.
- The most important factors that influence personal financial planning are your life situations, your personal values, and outside economic factors.
- For all your financial decisions, you must make choices and give up something. These opportunity costs, or trade-offs, can be personal or financial.
- The eight strategies for achieving your financial goals and avoiding money problems are: Obtain, plan, spend, save wisely, borrow wisely, invest, manage risk, and plan for retirement.

Communicating Key Terms

Find an article on unemployment, inflation, interest rates, or the value of the U.S. dollar. Use 8 to 12 of the terms below and write three paragraphs relating the information in the article to personal financial planning.

- personal financial planning
- goals
- values
- opportunity cost
- liquidity
- service
- good
- economics
- economy
- supply
- demand
- Federal Reserve System
- inflation
- consumer
- interest
- time value of money
- principal
- future value
- annuity
- present value

Reviewing Key Concepts

1. **Explain** personal financial planning and its importance.
2. **Describe** the six strategies of financial planning.
3. **Describe** the factors that affect personal financial decisions.
4. **Explain** opportunity costs and how they might affect your personal financial decisions.
5. **List** eight strategies for achieving financial goals.

ACADEMIC SKILLS

Language Arts The prices of new electronic gadgets usually come down over time.

Write About It Write a paragraph explaining why this might occur. Also explain how those prices might affect your financial planning if you want to buy certain items.

YOUR FINANCIAL FIGURES

Current Interest Rates Find out from a bank or other financial institution the current interest rate on a standard savings account. Find out what other savings plans are available and their interest rates.

1. **Calculate** by using the interest rate on regular savings accounts to find out the future value of your account after eight years if you deposit $1,600 in it every year.
2. **Compute** by using spreadsheet software to calculate and compare the future values of your series of deposits based on the different interest rates offered for other savings plans.

REAL-WORLD Application

Connect with Global Economics Your brother works for a company that makes components for DVD players. The company has started to outsource some of its component assembly work to a country where employees' wages are much lower than in the United States. As a result, the company can sell components at lower prices. However, your brother's employer has started to lay off employees at its U.S. plants. Your brother believes he will have a job for two more years, but after that, he is not sure.

1. **Research** Use the Internet or library to research the trend to outsource manufacturing of electronic products in countries such as China.
2. **Think Critically** Your brother comes to you and asks if you think he should look for another job now. What would you say to him?

Internet CONNECTION

Interest Rates and Inflation Inflation (how much your money will buy) and interest rates (how much your money will earn if saved) are connected—and both of these economic factors should be considered in your financial planning, particularly for long-term goals.

Log On Use an Internet search engine. Type "inflation and interest rates." Answer the following questions:

1. If inflation is low, how does that affect interest rates?
2. If inflation is high, how does that affect interest rates?

BusinessWeek ONLINE

Newsclip: Internet Planning If your knowledge about personal finance is limited, being Web and tech savvy will help you learn more. Finance is a frequent topic on the news and is easy to research.

Log On Go to **finance07.glencoe.com** and open Chapter 1. Learn more about financial decisions and strategies. Write a list of ways you can learn more about finance.

WHAT'S YOUR FINANCIAL ID?

YOUR SPENDING PROFILE

Being a saver or a spender is part of your personality. Here is a chance to test your financial personality.

If someone gave you $200, what would you do with it? Read the options below and choose three. Write the number of points for each of the three choices on a separate piece of paper. Then add up your points.

_____ Take my closest friends out to eat and to the movies (5 points)

_____ Spend $50 on fun items and save the rest (3 points)

_____ Put the money toward my next car payment (1 point)

_____ Buy new clothes for school (3 points)

_____ Hit the nearest record store and buy several CDs (5 points)

_____ Buy a CD player (3 points)

_____ Get a cell phone (5 points)

_____ Buy a savings bond (1 point)

_____ Put it in a savings account for future education (1 point)

_____ Buy the hottest new concert tickets (5 points)

What do your choices say about you?

Big saver: If you scored 3–5, you are willing to give up things today so you can buy something you want more tomorrow.

Middle of the roader: If you scored 7–11, you know how to use your money for current needs while keeping an eye on the future.

Big spender: If you scored 13–15, you like to spend money!

Your Financial Portfolio

Getting Your Own Wheels

Are you dreaming of buying your own car? Olivia Johnson is. So far she has saved \$3,000. Olivia has her eye on a used car that costs \$9,000. Olivia figures she can afford a monthly car payment of no more than \$200. Using the interest-rate table below, Olivia calculates the monthly payment needed to repay her car loan by multiplying the amount of the loan by the interest factor. She wants to pay off her loan in three years.

Olivia's Loan Story

Cost of car	\$9,000.00
Less the down payment	– 3,000.00
Amount of loan	\$6,000.00

Interest Rate of 8%

Months	**Interest Factor**
12 (one year)	0.08698
24 (two years)	0.04522
36 (three years)	**0.03133**
48 (four years)	0.02441

Multiply loan amount by interest factor (0.03133) for 36 months

\$6,000 X 0.03133 = \$187.98

Olivia will pay \$187.98 a month if she decides to borrow \$6,000 for three years.

Calculate

Now look in your local newspaper for a car you would like to buy. How much will it cost? Suppose you can afford 25 percent of the total price for a down payment. How much money will you need to borrow to pay the complete cost of the car you want? On a separate sheet of paper, calculate how much money you will need for your monthly car payment. Calculate what your monthly payment will be if you paid off your loan in 1, 2, 3, or 4 years. (1) What is the total amount you will pay for your car if you pay it off in 1, 2, 3, or 4 years? (2) How much interest will you pay on your loan? (3) Which payment plan would enable you to pay the least amount of money for your car? (4) Which payment plan would have the lowest payments?