AURORA UNIVERSITY

Forming Financial Security

Saving, Investing, Credit, Risk Management, and Retirement

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Discussion Overview

1. Your Personal Relationship with Money & Budgeting
2. Build Savings Into your Budget
3. The Three Dimensions of Saving
4. You Must Begin Saving Right Away!
5. The Lesson of John and Jane
6. Credit – Definitely Dangerous but Potentially Helpful
7. Retirement Planning
8. Risk Management – The Why of Insurance?
9. A Model for How to Save
10. Wrap Up
11. Procrastination

Your Personal Relationship with Money and Budgeting

You Can Achieve Your Reasonable Objectives!

- You Must Set Out to Accomplish Two Objectives:
  - Build a Healthy Relationship with Your Money
  - Keep Five Things Top of Mind:
    - Budget for savings
    - Save/Invest Early and Often
    - Understand and Prepare for Retirement
    - Take Charge of Your Knowledge About and Use of Credit
    - Manage Your Risk

#1 Relationship with Money? Yes!

- What do you value?
  - Family?
  - Big Bank Account?
  - Job Satisfaction?
  - Possessions?
  - Security?
  - If More Than One, How Do You Rank Them?

- You Probably Can’t Achieve All of Your Preferred Values. You Will Have to Make Choices!

- Your Values Will Inform Your Choices.

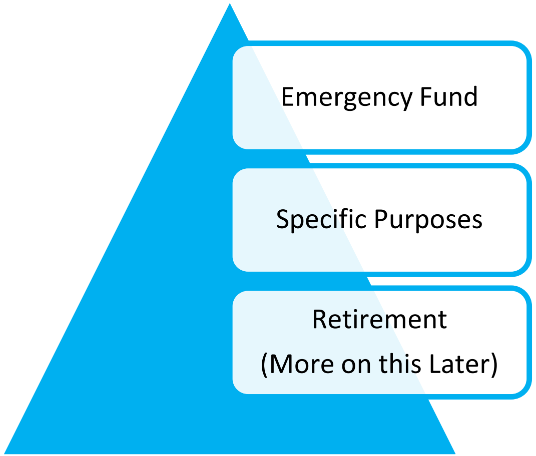
- **How Much Money is Enough?**

#2 Be Sure You Build Saving Into Your Budget- You Have to Plan Personal Financial Independence

- Budget to Spend Less than You Make. Spending Less than Your Income is the Key to Financial Independence.
- Don’t Become a Victim of Lifestyle Creep.
- Pay Yourself First.
- Learn to Discern if an Expenditure is a “Want” or “Need”
- Don’t be Disappointed if You Sometimes <u>Have</u> to Spend Funds Budgeted for Savings. Just Get Back on Track Next Month.
- Persistently Cut Costs and Save

#3 What Should You Do With the Money You Budget to Save?

- There are Three Dimensions to Saving:



- Regular Savings and the Returns Earned on Your Savings Will Make You Independent. But…You Must Try Not to Spend your Savings.

#4 You Have To Start Saving Right Away

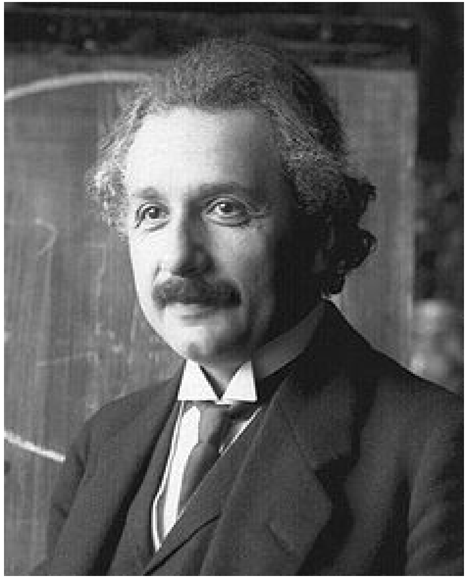
Why?

- The sooner you start to save the more math can work in your favor to maximize your wealth!

LET'S ASK AN EXPERT…

Just Ask Einstein…

"…Compound Interest [or Investment Return] is the Most Powerful Force in the Universe…"



What is Interest (or Return)? How is it earned?

- Money paid to a depositor by a bank, government or corporation in exchange for the deposit

- Two forms:
  - Simple interest is paid to the depositor and not reinvested
  - Compound interest is paid to the depositor and reinvested so that the depositor can earn interest on the original investment AND the interest previously earned.

An Example of Simple Interest

- Invest $10,000 at 5% annual interest
- At the end of each year you receive $500 ($10,000 * .05) interest
- You spend the interest instead of reinvesting it.
- You never have more than $10,000

An Example of Compound Interest

- Let's say you invest $10,000 at 5% interest
- At the end of the first year you receive a $500 interest payment
- You combine your interest payment with the original investment and reinvest $10,500.
- At the end of year two you receive interest of $525 which is interest on both the original $10,000 investment AND the previously earned interest of $500

$25 Isn't a Big Deal
What Makes Compound Interest So Powerful?

- Time is what makes compound interest powerful
- If you leave that $10,000 invested for 30 years you would have $43,219
- In general, you can compute the future value of an investment as follows:
  - $FV = C\,(1+r)^t$ where C is the invested amount, r is the interest rate and t is the time of the investment
- In the example above $\$10{,}000\,(1.05)^{30} = \$43{,}219$

But, If It Takes 30 Years to Make $10,000 Turn Into $43,000 How Do I Get Rich?

- The key is systematic or regular investing
- Consider someone who works from age 22 to age 65, 43 years.
- Each year they save $6,000
- So, in 43 years they would have saved $258,000
- But, is that their savings balance?
- NO! With 5% compound interest, they would have saved $857,960.
- The key is systematic or regular investing

What Does it Take To Be a Millionaire?

- Invest regularly
  - $6,000 per year over a 43 year working life will yield $1,000,000 at an interest rate of 5.57%
- The good news: In the past 90+ years a market basket of diverse investments has returned about 8%
- At 8% return, that $6,000 per year will be worth **$1,977,498**

Formula For Future Value (FV) of an annuity:

$$FV = Pmt \times \{(1+r)^n - 1\}/r$$

Pmt = Annual Investment
r = rate of return
n = number of compounding periods

#5 The Lesson of John and Jane!

Jane		John
Jane Invests $6,000 Annually at 8% Return From Age 23 to Age 65		John Invests $12,000 Annually at 8% Return From Age 44 to Age 65
Jane Invests a Total of $252,000		John Invests a Total of $252,000
At Age 65 Jane Will Have $1,825,461		At Age 65 John Will Have $605,075
Jane Wins by Starting Early		To Catch Up to Jane, John Needs to Invest $36,203 per year
Procrastination is NOT an Option		

#6 Credit is Dangerous but Can be Helpful

- Try to Use Credit Only for Appreciating Assets
- Shop For the Lowest Available Interest Rate
- Always Pay Your Balances in Full if You Can
  - If You Can't, Pay Them Off ASAP
- Don't Let Yourself Be Lured Into Optional Credit Spending, It Will Make You Feel Badly

- "I'd Rather Earn Interest Than Pay Interest"

Two Credit Behaviors That Can Help You Succeed

- Pay Cash as Much as Possible
  - Keeps You Connected With Your Spending
  - Helps Make Budget Compliance and Saving Possible
- Avoid Credit Cards
  - They Encourage Optional Spending and Make Consequences Emotionally Remote
  - Credit Card Interest Rates are Very High – As Much As 30%
  - Credit Cards are Addictive

A Credit Card Example

- Emergency Dental Situation - $8,000
- Credit Card Interest – 12.99%
- Minimum Monthly Payment $150

- Takes nearly 7 Years to Pay Off
- Interest Cost: $3,995
- Assuming You Don’t Buy Anything Else

- If you have credit card debt your **first priority** is to pay it off. Credit card debt can wreck your financial life.

#7 Retirement

- The days of employer’s providing “defined” retirement benefits are largely gone
  - Local governments and public education are notable exceptions.
- You will likely qualify for modest Social Security benefits but will pay for them through your work life.
  - Assuming you were not a local government or public education employee.
  - Assuming Social Security is not changed by Congress.
- Bottom Line:
  - To assure a comfortable retirement you will have to plan and save for it.
- Let’s consider available plans

Two Common Self Funded Retirement Plans

- **Roth Individual Retirement Account:**
  - You can set it up at any financial institution
  - Contribute up to $6,500 per year of taxed income
- **Employer Sponsored 401(K) or 403(B) Plan:**
  - The employer sets up a plan with an independent Trustee
  - You can contribute up to $22,500 each year with the contribution being excluded from your taxable income
  - Generally, the employer will match a portion on the employee contributions. This is essentially free money so maximize your retirement by contributing at least enough to collect the employer contribution.

#8 Risk Management: The Why of Insurance

- After you save and invest to accumulate assets, you need to protect them from damage or loss
- You also need to protect your financial assets from claims made against you for negligence
- Therefore, you need quality insurance to protect:
    1. Your home and cars
    2. Claims made in connection with professional liability
    3. Your life, to provide for your family after your death
- Develop a trusted advisor relationship with an insurance professional to help you select appropriate coverage, limits, and providers.
- Remember to Include Your Insurance Costs in Your Budget

#9 How to Save:
Building an Investment Strategy

1. Establish an Emergency Fund
   A. Should be at a bank; insured deposits of cash
   B. 3 Months of Living Expenses

2. Save for Planned Expenses
   A. Such as Home, Car, Wedding, Education

3. Build a Personal Financial Cushion
   A. Retirement
   B. Personal Security
   C. Legacy
   D. Philanthropy

Places to Save / Invest

- **Bank Accounts, CD's, Money Markets**
  - Should be your first investments
  - Emergency Fund – Very Liquid
  - Very low risk; defined return
- **US government securities**
  - Low Risk
  - Longer Term
  - Defined return
- **Mutual Funds, Stocks, Bonds**
  - Best Returns, Greatest Risk
  - Attention to Diversification
  - Requires Professional Assistance
- **Real Estate**
  - Individual Properties
  - Real Estate Investment Trusts
- **Options, Futures, Commodities**
  - Don't do this; too risky

Advisors

- In the early stages, keep your saving limited to banks and US Government Securities. They can advise you on the optimal accounts.
  - Banks are relatively low risk
  - You won't need an outside advisor
- When you expand your investing to include mutual funds, stocks, bonds and other securities you should engage an advisor.
  - Be cautious of "captive" advisors
  - Engage an advisor with a good reputation
  - Advisors with credentials such as CFP® can be a plus

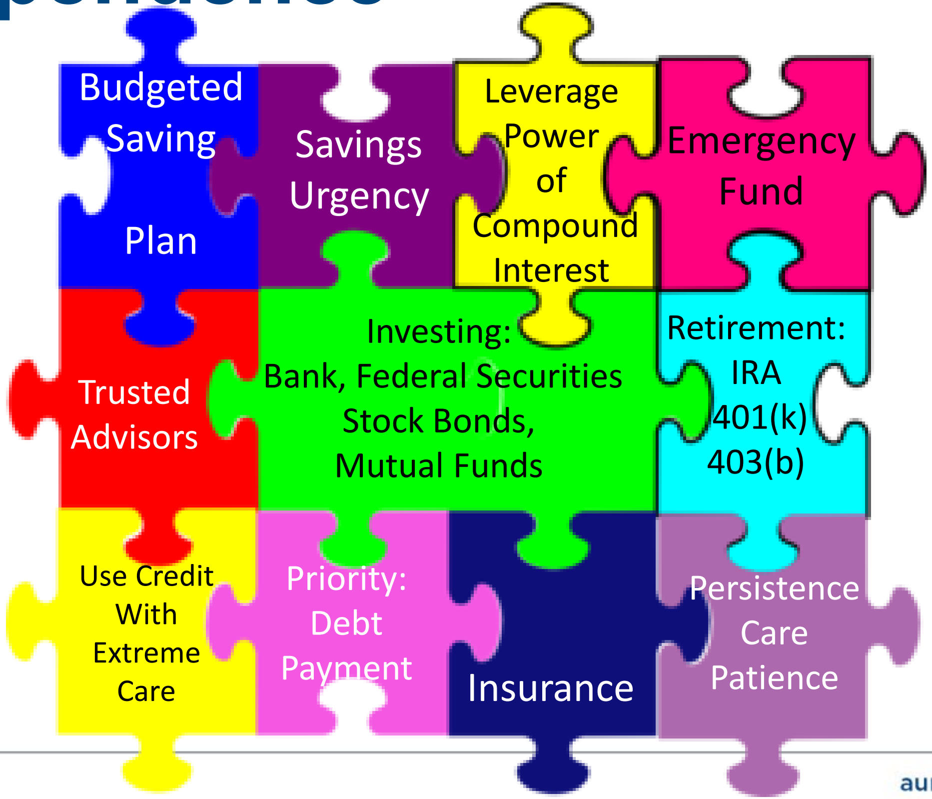
#10 You Won’t Become Financially Independent Overnight

- However:
  - Consistent Savings Over Time
  - Carefully Invested
  - Patiently Stewarded

- Yields:
  - Financial Independence
  - More Means Than You Will Require

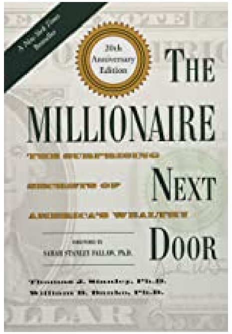
#11 Components of Financial Independence

Success!



A Book You Should Read

The Millionaire Next Door: The Surprising Secrets of America's Wealthy
by Thomas J. Stanley Ph.D., William D. Danko Ph.D, et al. | Oct 1, 2016



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