

Personal Finance

Investing



Financial Plan Assignment

Lifetime Projections of:

- **Career choice**
- **Expected income throughout career**
- **Family plans**
 - ✓ Married or single
 - ✓ Number of children
 - ✓ College enrollment
 - ✓ Retirement age
- **Amount of planned savings**
- **Projected living expenses**

Personal Income Statement

For The Year Ended ___/___/___

Income:

| | |
|---------------------|-------------------|
| Summer Job | \$4,500.00 |
| Help From Parents | <u>2,400.00</u> |
| Total Income | \$6,900.00 |

Expenses:

| | |
|-----------------------|------------------------|
| Giving | 450.00 |
| Saving | 450.00 |
| Automobile | 1,500.00 |
| Food | 1,000.00 |
| School Expenses | <u>1,000.00</u> |
| Total Expenses | <u>4,400.00</u> |

Net Income: **\$2,500.00**

Beginning Income Statement

- **Complete a projected income statement for the current calendar year.**
- **List assumptions that are made:**
 - After tax income
 - Ignore inflation
 - Still in school

Investing

- **Becomes relevant only if saving occurs**
- **When a Younger person learns to save – greater the potential benefit**
- **Reason - time value of money**

One Out of Every 125 Americans Is Now a Millionaire



Homeowners vs Renters

- **Average renter in 2001 had net worth of \$4,800**
- **Average homeowner had net worth of \$171,700**



Suggested Allocation Of Disposable Income

- **10 percent to give**
- **10 percent to save**
- **70 percent to live on**
- **10 percent for discretionary spending**

Application Of Economics

- **Allocation of scarce resources among unlimited wants**
- **No person ever has enough money to afford everything that can be bought**
- **Choices must be made**

Factors Affecting Time Value Of Money (Growth of Savings)

- **Size of deposits**
- **Rate of return**
- **Length of time**

Effect of: Deposit Size

(25 year old - 8 percent account)

| <u>Deposit Size</u> | <u>Total Deposit</u> | <u>Balance Age 65</u> |
|---------------------|----------------------|-----------------------|
| \$100 | \$ 48,000 | \$ 349,100 |
| 200 | 96,000 | 698,200 |
| 300 | 144,000 | 1,047,300 |
| 400 | 192,000 | 1,396,400 |
| 500 | 240,000 | 1,745,500 |

Effect of: Rate Of Return

(25 year old - \$150 monthly deposits)

| <u>Rate of Return</u> | <u>Total Deposit</u> | <u>Balance at 65</u> |
|-----------------------|----------------------|----------------------|
| 5.0% | \$72,000 | \$ 228,903 |
| 7.5 | 72,000 | 453,573 |
| 10.0 | 72,000 | 948,612 |
| 12.5 | 72,000 | 2,068,186 |

Effect of: Time

(\$150 monthly deposit – 8% rate of return)

| <u>Beginning Age</u> | <u>Total Deposit</u> | <u>Balance at 65</u> |
|----------------------|----------------------|----------------------|
| 55 | \$18,000 | \$ 27,441.90 |
| 45 | 36,000 | 88,353.06 |
| 35 | 54,000 | 223,553.91 |
| 25 | 72,000 | 523,651.17 |

Time Value of Money Illustration

- **Person One**

- ✓ **Starts saving age 25**
- ✓ **Deposits \$1,000 per year**
- ✓ **10 years and stop**
- ✓ **Total deposit \$10,000**
- ✓ **Leave deposit until 65**
- ✓ **8 percent**
- ✓ **Balance @ 65 \$145,772.45**

- **Person Two**

- ✓ **Saves nothing until age 35**
- ✓ **Deposits \$1,000 per year**
- ✓ **30 years**
- ✓ **Total deposits \$30,000**
- ✓ **Leave deposit until 65**
- ✓ **8 percent**
- ✓ **Balance @ 65 \$113,283.21**
- ✓ **Never catches up with person one**

Factors Affecting Time Value of Money

- **Size of Deposits**
- **Rate of Return**
- **Length of Time**

**Never Invest In Anything
You Do Not Understand**

Portfolio – Group or listing of investments

Risk – Possibility that something other than intended outcome will occur

Diversification

- **Investing in variety of things**
- **Not likely adversely affected by same factors**
- **Best method of risk reduction**

Random Walk Theory

- **Short term securities prices move randomly**
- **Impossible to predict**
- **Active trading does not pay**

Best Way To Make A Small Fortune Investing

- **Start With A Big Fortune**
- **Trade A Lot**

Dollar Cost Averaging

- **Invest equal amounts of money at regular time intervals**
- **Usually pay lower average price than those buying at “right time”**
- **Choose investments for long-term potential**

Types Of Securities

- **Debt**
- **Equity**

Debt Securities

- **Securities arising from a loan**
- **Examples: Bonds & Bank CDs**
- **Earnings - Interest**
- **Low level of risk if held to maturity**
- **Predictable results**
- **Moderate rate of return**

Equity Securities

- **Securities arising from ownership**
- **Example: Common stock**
- **Two ways to make money**
 - ✓ Increase in value
 - ✓ Distribution of earnings - Dividends
- **Higher level of risk**
- **Less predictable results**
- **Average higher long term rate of return**