Personal Finance

In order to achieve financial goals and success, you must understand your own personal finance. Just as it is important to understand your income, you must also learn how to manage it. Money management is achieved by understanding topics such as financial tools, budgeting, and money habits. By gaining knowledge from these topics, you will be able to practice personal finance and become financially responsible.

The only one responsible for your financial status is you.

Financial Tools

A 'Financial Tool' is a metaphor that can help you achieve your financial goals. Just like any other tool, it is important to learn how to use it. The following are the most common financial tools available through banks or credit unions (Chase, Wells Fargo, etc.), Brokerages (Vanguard, Fidelity, etc.), and other sources.

Basics:

- **Checking account**. A transactional deposit account held at a financial institution that allows for withdrawals and deposits. Money held in a checking account is liquid and can be withdrawn using checks, ATMs, debit cards, and other methods. This is your 'everyday use account' that is linked to your Debit account.

- **Savings account**. A deposit account held at a bank or other financial institution that provides principal security and a modest interest rate. It typically pays out better interest than a checking account. Most people set aside funds in these accounts as an emergency fund and for short-term goals like saving for holiday leave, summer leave, your class ring, or buying a car.

- **High Yield Savings Accounts.** A savings account with a higher interest than other savings accounts, typically because they are offered by online only banks.

- **Money Market account**. An account that typically pays a higher interest than a savings account. Similar to the interest earned on checking and savings accounts, the interest earned on a money market account is taxable. ***Individuals typically use money market accounts for short-term savings and emergency funds. Less reliable than HYS.***

- **Certificates of Deposit (CD)**. CDs are funds borrowed by the bank from their customers. A CD entitles the customer to receive interest over a set term that generally ranges from one month to 5 years. The longer the terms of the CD are, the better the interest paid out will be. CDs generally pay better interest than savings accounts and money market accounts but incur penalties for early withdrawals. CDs are primarily used for short-term financial goals ranging up to 5 years.

- **Bonds**. A debt investment in which an individual loans money to an entity (corporate or government) that borrows the funds for a defined period of time at a fixed interest rate. Bonds are used by corporations and governments to finance projects or to purchase assets. They are generally purchased by individuals looking to achieve better returns than those offered by bank-related services. Some bonds also have a tax-free yield.

Investing:

- **Mutual Funds**. An investment vehicle that is made up of a pool of funds contributed by many investors for the purpose of investing in securities such as stocks, bonds, money market instruments, and similar assets. Mutual funds are created by brokerages and financial institutions and are operated by their fund managers. The fund managers oversee the fund's capital and attempt to produce gains and income for the investors. When investors contribute to mutual funds, they are in essence purchasing shares of a portfolio composed of different securities. Mutual Funds are a great way to create a diversified portfolio of investments as it is considered less of a risk.

- **Exchange Traded Funds (ETFs)**. A security that tracks a specific market sector, a commodity, or a basket of assets. ETFs are exactly like Mutual Funds but are not actively managed by the fund managers. ETFs can be purchased through the stock exchanges (i.e. New York Stock Exchange) as they trade like regular stocks. In order for investors to purchase investments through exchanges, they must open a brokerage account via a financial institution.

- **Stocks**. A type of security that signifies ownership in a corporation. There are two main types of stock: common and preferred. Common stock usually entitles the owner to vote at shareholders' meetings and to receive dividends. Preferred stock generally does not have voting rights but has a higher claim on assets and earnings than the common shares. Shares of stock can also be purchased through brokerage accounts.

- **Individual Retirement Accounts (IRA)**. IRAs are an investing tool used by individuals to save specifically for retirement. There are two types of IRAs: Traditional and Roth. Contributions to the Traditional IRA may be tax deducted each year, which lowers your taxable income, but withdrawals are taxed. Roth IRAs do not provide a tax deduction immediately, but withdrawals are tax free. ***At your age of most new grads, Roth IRAs typically return significantly more money!*** Most IRAs can be obtained through financial institutions and/or banks to begin your retirement planning.

Other:

- **Credit Cards**. A card issued by a financial institution giving the holder an option to borrow funds, usually at the point of sale. Credit cards charge monthly interest and are primarily used for short-term financing. Credit cards are a great tool for building your credit rating (discussed below) and earn points or rewards. Since credit cards can be useful financial tools, it is important to learn how not to 'abuse' them by piling debt. The best way to manage your credit cards is to charge what you can afford to pay off that month, and pay the balance in full each month. The average college student carries a $500 balance; do not be average!

- **Charge Card**. A credit card for use with an account that must be paid when a statement is issued. An example is the American Express Platinum card.

Interest

Interest is expressed as *the charge for the privilege of borrowing or lending money, typically expressed as an Annual Percentage Rate (APR).* If you are borrowing from a credit card, you need to understand how much interest you are paying. Likewise, if you are lending or opening an interest-paying account, understand how much interest you are making. ***The higher the interest, the more money you pay or make.*** **There are two types of Interests**:

- **Compound Interest**. Compound interest is charged on the amount borrowed or lent plus the interest it has accrued. Therefore, compound interest can be thought of as 'interest on interest/amount', and will make your debt or investment grow at a faster rate than simple interest would. For example, Annual Percentage Yield (APY)

- **Simple Interest**. Simple interest does not compound. It is only charged on the amount borrowed or lent. For example, Annual Percentage Rate (APR)

When you obtain debt through credit card use or loans, most financial institutions use compound interest in order to make more money off you. However, there are financial predators such as 'Payday Loans.' Avoid them at all costs due to their outrageous terms/conditions and high interest rates of up to 400%. It is best to stay away from Payday loans at all times!

Money Habits

The definition of a habit is *an acquired behavior pattern regularly followed until it has become almost involuntary.* Therefore, when it comes to finances, you can develop either Good Money Habits or Bad Money Habits. Carrying debt on a credit card, for example, is a Bad Money Habit where you are 'abusing' the financial tool by not paying it back. As a student, it is much easier to steer towards the Bad Money Habits. You may get complacent when you do not have a significant money worries like paying a mortgage or having dependents (spouse, children, etc.). In addition, by having a limited income, if you do not track your money habits carefully, it is easy to waste money. Below you will find some of the most common money habits you should work to acquire or avoid:

- **Good Money Habits (Acquire)**
    - **Pay yourself first.** A good 'Rule of Thumb' is to save at least ***10% of your monthly income***. Setting up a monthly automatic transfer on the first of every month to your savings account can be the easiest way to "set it and forget it." Following this concept, you will not be spending money first and saving what is

left over or nothing at all. This also means determining what your priorities are. Not everyone wants the same things; once you stop letting others tell you what to spend on, you can spend on what you actually care about. This means asking yourself what you really want to put money into versus what you can buy the generic brand for. For example, buying generic soap so you can buy high quality conditioners in the same month, or saving for a ski trip instead of hitting the bars for the fourth time this month. Write down what you really want and then pursue it within your means.

- **Budgeting**. A budget is an estimation of the revenue and expenses over a specified future period. It allows you to analyze your spending and identify where you are overspending on one or multiple expenses (cell phone, shopping, food, entertainment, etc.). Remember, overspending on unnecessary personal expenses will prevent you from saving money. One of the easiest ways to budget as a student is to do so on a weekly basis. For example, if you have $200 to spend each month and choose to save $20 each month, you can break up the $180 of spending money into $45 per week. If you happen to spend less than $45 in a week, you can carry the difference over to the next week or, better yet, save it!
- **Live below your means**. Do not spend more than you make. Ensure that your spending does not exceed your budget to avoid borrowing money. This habit will help you avoid a pile of debt that may take years to pay back.
- **Pay with cash**. Paying with cash provides a physical connection between the exchange of money and goods/services. The habit is especially effective when you are trying to avoid debt. In addition, paying with cash helps you budget better as you can physically see your money disappear from your wallet, as opposed to swiping your debit/credit cards.
- **Save for retirement now**. One of the best financial decisions you can make at a young age is to save for your retirement. For example, Sally starts saving $50 per month at age 18, while Joe starts $50 per month at age 28. Both folks invested in the same Mutual Fund with an annual return of 7%. If both withdrawal their funds at age 60, Sally would have a total of $142,765 while Joe would only have $68,227. In order for Joe to have the same amount as Sally at age 60, his/her starting contribution would have to be $104 per month instead of $50. Remember, the sooner, the better as you want compounding interest to do the work for you. (One of our ITM faculty members did this with $150 per month for just 17 years, starting at age 21, and nearing retirement that investment is now worth over $750,000.)

- **Bad Money Habits (Avoid)**:
  - **Living paycheck to paycheck**. This term refers to an individual who devotes their entire month's pay to expenses without saving any of it. Most individuals who live 'paycheck to paycheck' typically do not have any savings or budget and tend to live above their means.
  - **Maxed out Credit Cards**. Refers to when a credit card balance amount has reached the line of credit available. To avoid reaching the limit, you must budget the amount each month that can be charged and not exceed it. Pay off the full credit card balance every month. This way, you avoid paying interest each month and carrying outstanding debt. Carrying debt from month to month, specifically ***30% or more of your credit card limit***, counts against you on your Credit Report/Score.
  - **Paying the minimum payment on Credit Cards.** Credit cards will often allow you to pay a "minimum payment" on credit balances. This often gives credit card holders a false sense of security. Credit cards typically have very high interest rates, sometimes upwards of 20%. If you only pay the minimum each month, interest will add up over time and can snowball into an unmanageable level of debt. If you have an outstanding balance, create a reasonable payoff plan and include it in your monthly budget.
  - **Not reviewing your Credit Report/Scores**. You need to be aware of your Credit Report/Score at all times. If a predator steals your identity and takes out a loan on your behalf, you may never know unless you check your Credit Reports. Make it a habit to check this information at least three times per year.

Credit Reports

Your Credit Report is a detailed report of your credit history prepared by a credit bureau and used by a lender to determine your creditworthiness. Your Credit Report is composed of credit history such as credit cards, loans, previous or current home addresses, number of late payments, bankruptcy, accounts in default, etc. Here are important facts you need to understand about Credit Reports:

- **How to obtain it**. You can either pay for the Credit Report through well-trusted websites like www.myfico.com or receive a free Credit Report through www.annualcreditreport.com (this includes the report but does not show you a score).
- **Three different Credit Agencies**. The three different credit agencies are Experian, Equifax, and Transunion. They should all correlate with each other in terms of information/history on your Credit Report. However, it is your job to ensure they all have the same information, as **you are your only auditor** when it comes to your Credit Report.
- **Credit Score**. A three-digit number (ranges from 300-850) that tells creditors how likely you are to pay back the money you want to borrow. Here is a breakdown of how creditors view you based on your Credit Score range:
  - ***<630: Bad credit***
  - ***630-689: Fair credit***
  - ***690-719: Good credit***
  - ***720-850: Excellent credit***
  - ***The lower your credit score, the riskier you appear to lenders.*** Hence, a lower credit score will qualify you for a higher interest (meaning you will be charged more to borrow money) or possibly disqualify you entirely.
  - Credit scores are also used more and more by potential employers, landlords, utility companies, and others. ***If you are employed by a U.S. government agency—including the NSA—they may use your Credit Score and Report to determine the type of Security Clearance you may obtain.***

  Remember, if your credit score looks bad, you look bad.
- **Fraud on your Credit Report.** If you notice suspicious information that does not pertain to you, contact one of the credit reporting agencies immediately:
  - Equifax: www.equifax.com, 1-888-766-0008
  - Experian: www.experian.com, 1-888-397-3742
  - TransUnion: www.transunion.com, 1-800-680-7289

  Once you contact them, explain with details the situation and ask that a **"fraud alert"** be placed in your file. If after the investigation they determine that you were a victim of fraud, the information will be disputed on your Credit Report.
