

# Money 2000 News



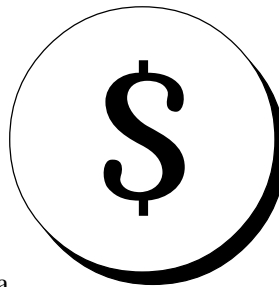
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## Dear Friend of Money 2000:

Many Americans want to get rich. How else could you explain the large numbers of people flocking to “Powerball” states recently to participate in a lottery with odds of 80 million or so to one? It seems like there should be a better way to become wealthy.

The good news is that there is. Two professors at Washington University in St. Louis, Richard McKensie and Dwight Lee, wrote a paper earlier this year called “Getting Rich in America: A Few Easy Rules to Follow.” Their rules are based on historical investment data, government income statistics, and data about millionaires from the Stanley and Danko book, *The Millionaire Next Door: The Surprising Secrets of America’s Wealthy*. Below are ten suggestions:



**1. Have a reasonable income base.** Then spend less than you earn and save a

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## Children and Investing: It’s Never Too Soon to Start

It is not uncommon these days to find baby boomer parents interested in educating their children about the stock market and personal finance issues. There are summer investing camps for kids. *Value Line* is packed right along with the bug spray. There are books written *by kids for kids*, as well as adult-authored books for both parents and/or children. There’s a stock market game that schools use to teach children about the market, where the children actually compete against other schools in picking a stock portfolio. There are even mutual funds (e.g., Stein Roe Young Investor’s Fund) that are marketed to kids (and parents) that invest in kid-friendly companies.

Introducing children to investing at a young age is an excellent idea. The earlier they understand the importance of saving and investing, the more likely they are to accumulate serious money. It has been shown that, if a child from age

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## Control Spending Now to Enjoy a Rosy Future

How a person spends money really does make a bigger difference than how they invest it. You’ll have an easier time reaching your retirement goal by choosing how to live rather than how to invest for retirement. Being in control of your money instead of it controlling you is what gives an individual peace of mind.

An example offered by Michael Leonetti, CFP, in the July 1998 *AII Journal*, dramatically shows how saving even a small amount today can have a major impact on future savings. At first glance, it appears to most people the difference in price of a full-sized

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### Topics Covered

- Children and Investing: It’s Never Too Soon to Start
- Control Spending to Enjoy a Rosy Future
- Dollar-Cost Advertising: A Strategy to Consider
- Index Funds: Pros and Cons
- Helpful Web Sites Can Assist With Consumer Decisions
- Retirement Summit Stresses Savings and Employer Involvement
- Credit Card Interest Rate Data Available

# Dollar-Cost Averaging: A Strategy to Consider

Dollar-cost averaging is a frequently used investment strategy. Very simply, it involves making a regular investment (e.g., \$200) at a regular interval (e.g., monthly). While no guarantee against loss, dollar-cost averaging lowers the average cost paid for an investment over time.

Table 1 is an example of dollar-cost averaging over a period of two years with eight quarterly \$400 deposits. After the second year, \$3,200 would be spent to buy 405 shares at an average cost per share of \$7.90 (\$3,200 divided by 405).

Notice that with dollar-cost averaging, an investor buys more shares when prices are low and fewer shares when prices are high. Thus, when financial markets are in a slump, more

shares can be purchased at a lower price per share. Dollar-cost averaging also takes the emotion out of investing. If an investor “stays the course,” they will make regular deposits no matter what is happening in the financial markets.

Dollar-cost averaging is also advantageous for another reason: most people can only invest small dollar amounts as they get paid. Dollar-cost averaging can easily be set up through automated mutual fund deposits. Simply list your bank and account number on a fund application and the fund will automatically withdraw the amount of the monthly deposit. Once an account is established, many funds only require \$100 or \$250 for subsequent deposits.

The moral of the story is that dollar-cost averaging is simple to do and assures that investment deposits will

consistently be made according to schedule. Another form of dollar-cost averaging is to reinvest cash distributions (e.g., dividends) into additional shares. By doing so, you’ll enjoy the power of compound interest and purchase shares at whatever time interval that distributions are made. \$

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**Table 1.**

Quarterly Deposit (\$)	Share Price (\$)	Shares Purchased
400	5	80
400	8	50
400	8	50
400	10	40
400	10	40
400	16	25
400	10	40
400	5	80
<b>Total: \$3,200</b>		<b>405 shares</b>

## Money 2000 News

is a quarterly newsletter sent to persons enrolled in the Money 2000 program sponsored by Rutgers Cooperative Extension. Money 2000 and all Rutgers Cooperative Extension educational programs are offered without regard to race, sex, age, handicap or disability, color, or national origin.

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## Index Funds: Pros and Cons

An investment index tracks the prices of a certain number of stocks or bonds. Examples include the widely quoted Dow Jones Industrial Average (DJIA) and the Standard and Poors 500 (S&P 500) index, both of which measure the performance of large American company stocks. Indices also exist to track the performance of bonds and small company stocks and international securities.

Index funds are mutual funds that buy the same companies (or a representative sample) that comprise a market index. Thus, their performance is similar to the index they’re tracking: good in bull markets and poor in bear markets. Not surprisingly, in the bull market of the last three years (1995–1997), index funds have outperformed a majority of actively-managed mutual funds with similar objectives (e.g., growth, growth and income).

Many financial experts believe there is a compelling case to purchase index funds for at least part of your portfolio. Here are some advantages cited by Judith

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# Helpful Web Sites Can Assist With Consumer Decisions

Many people have started to “surf” the Internet for personal finance information. If you’re looking for some helpful information, consider the following Web sites:

## **www.ssa.gov**

Visit the Social Security Administration’s Web site to learn about Social Security benefits and request a personal earnings and benefits estimate statement.

## **www.pueblo.gsa.gov**

The Consumer Information Catalog (CIC) Web site contains text versions of hundreds of federal consumer publications. The “Money” section has brochures on financial planning topics.

## **www.aarp.org/programs/retire/reaarp.html**

The American Association of Retired Persons (AARP) Web site’s “Retirement” section provides advice on a host of retirement planning issues.

## **www.asec.org/bpk-comp.htm**

Visit the American Savings Education Council (ASEC) Web site to use

its Ballpark Estimate worksheet to determine how much you will need to save for retirement.

## **www.ebri.org**

The Employee Benefit Research Institute (EBRI) Web site contains research on Social Security reform, investment education, pension design, and investment trends. It also includes the annual Retirement Confidence Survey.

## **www.investoreducation.org**

The Alliance for Investor Education (AIE) Web site provides investment education to investors of all ages. Visit the “Older Investors” section for information on retirement planning.

## **www.cfp-board.org**

Visit the Certified Financial Planner Board of Standards (CFP Board) Web site for information on financial planning, as well as free brochures: *What You Should Know About Financial Planning* and *10 Questions To Ask When Choosing A Financial Planner*.

## **www.publicdebt.treas.gov/**

## **sav/savinvst.htm**

The Department of the Treasury’s Web site answers questions about interest rates, buying and cashing in bonds, and taxes.

## **www.moneyinsider.msn.com**

The Microsoft Money Insider Web site provides timely summaries about financial topics, current loan rates, and financial case studies.

## **www-invest-faq.com**

The Investment Frequently Asked Questions (FAQ) Web site contains a wealth of information about investment-related topics. Simply find a topic of interest and click on it for a detailed discussion.

Rutgers Cooperative Extension of Sussex County has a free handout, *Using the Internet to Make Consumer Decisions*, that describes over a hundred helpful Web sites. The list can be downloaded from the Rutgers Cooperative Extension Money 2000 Web site: **www.rce.rutgers.edu/programs/money2000**. \$

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# Retirement Summit Stresses Savings and Employer Involvement

On June 4 and 5, a National Summit on Retirement Savings was held in Washington, D.C. The purpose of the summit was to help federal lawmakers understand the retirement savings needs of individuals and businesses and to recommend future legislation to address this issue. Rutgers Cooperative Extension taped the conference via satellite and is pleased to present the following highlights:

- Several speakers, including President Clinton, noted that “the time is now” to act on the issue of inadequate retirement savings. With the economy doing well and unemployment low, people have the “emotional space” to think about their future finances.

- Other reasons to promote retirement savings include: the aging of baby boomers, the fact that half of all Americans lack a pension and a third of those eligible for 401(k)s don’t participate, and that fully 20 percent of workers have nothing saved for retirement.
- Three groups of particular concern to summit delegates were: women (who are traditionally concentrated in jobs without pensions), minorities (who have the lowest participation rates in pension plans), and small businesses (of the 50 million Americans who lack pensions, 33 million work in small businesses).

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# Credit Card Interest Rate Data Available

Looking to save money on credit card interest? According to the Federal Reserve Board, there are three key factors that affect the amount of interest paid by credit card users: the annual fee, the annual percentage rate (finance charge), and the grace period. The last is a period of time, usually about 20 or 25 days, during which new purchases can be added without paying a finance charge. Under almost all credit card plans, the grace period applies only if you pay your balance in full each month.

Another important variable is the method used to determine the balance on which interest is assessed. The higher the balance on which finance charges are assessed, the greater the amount of interest paid. Card issuers use different balance calculation methods such as the average daily balance method (the most common), the previous balance method, and the adjusted balance method.

With the average daily balance method, a credit card issuer calculates the balance on which interest is paid by taking the amount of debt owed on an account each day during the period covered by a billing statement and averaging it. Thus, the sooner a payment is made during the statement period, the lower the average daily balance. For this reason, it is wise to pay a credit card bill as soon as it arrives (if you carry a balance) rather than let it sit for several weeks until it is due. One of the smartest moves a credit card user can make is to switch to a credit card with a lower interest rate. For example, a consumer with a \$2,500 balance would pay \$450 in interest on an 18 percent card and only \$350 on a 14 percent card, a savings of \$100 a year.

Every six months the Federal Reserve System publishes a report on the terms of credit card plans offered by financial institutions. This report includes information supplied by the largest card issuers in the country, as well as any other financial institutions that indicate to the Federal Reserve System

that they would like to participate in the report and submit information about their credit card plans.

To obtain a copy of this list on the Internet, visit the Federal Reserve web site at [www.bog.frb.fed.us/pubs/shop](http://www.bog.frb.fed.us/pubs/shop). The report includes the type of interest rate (fixed or variable), grace period, extent of availability (national or in selected states), and other card features (e.g., product rebates and travel accident insurance). \$

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## Retirement Summit

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- A big problem in tax-deferred retirement plans is “leakage.” This is where people take a lump sum distribution and spend it instead of rolling the funds over into another tax-deferred plan.
- Results of the 1998 Retirement Confidence Survey indicated that a third of Americans are worried about their retirement prospects and 44 percent were “somewhat confident.” Unfortunately some of the assumptions behind confidence levels are false, such as the assumption that you can work as long as you wish.
- Secretary of Labor Alexis Herman, noted that, “there may be a lot of people who want to simply hit the snooze button on this issue but, if you snooze, you lose.” Herman and other speakers noted that making even modest changes in savings now can have a huge impact later, due to the power of compound interest.
- The “meat” of the summit was the small-group deliberations by some 200 delegates, who discussed barriers to retirement savings and suggested strategies to increase American savings rates. Some ideas suggested for improvement were: increased educational programs about investing and retirement, encouraging savings early with personal finance programs in schools, decreasing vesting periods for pensions, tax withholding for IRAs, automatic enrollment in employer plans like 401(k)s unless workers “opt out,” simplification of rules for employer pensions, giving part-time workers access to employer plans, “catch-up” provisions for people who get a late start saving, and higher annual contribution limits for tax-deferred plans.
- One of the speakers noted that there are some “fundamental steps” that people can take to improve their financial security: become financially literate, calculate the amount of savings needed to maintain your lifestyle, take advantage of savings opportunities provided by an employer, preserve (read: don’t spend) lump sum distributions, and contribute to an IRA. \$

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## Children and Investing

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14 to 18 contributes \$2,000 in a IRA (total \$10,000) and it grows at 10% a year, he or she will be a millionaire by age 65.

However, in order to get started, a child will need to open an account at either a mutual fund, a brokerage firm or perhaps, a company's dividend reinvestment plan. When establishing an account for a child, take into consideration these factors:

A common account registration for a child is called a Uniform Gift to Minor's Account, a.k.a. UGMA. In this case, the account is registered in the name of the child, and a custodian (usually a parent or grandparent) is assigned to the account. The advantage of an UGMA is that taxes on the account are paid at the child's rate (15%) which is likely to be lower than the parent's rate. However, beware of the "kiddie tax" that comes into play if the child is under age 14 and earns over \$1,400 in interest. Over that amount, earnings are taxed at the parent's rate.

The downside to a UGMA is that control reverts to the child when he or she reaches the age of majority—18 in many states, 21 in New Jersey. If junior decides a shiny new sports car is "cooler" than college, he or she can empty the account and spend the money anyway they please. Another potential disadvantage to a UGMA is that a family may have difficulty in securing financial aid for the child if there is substantial money in the child's name. In making financial decisions, colleges look closely at how much children can contribute to their education and would look at assets held in an UGMA as dollars earmarked for college.

Another way to invest for a child is merely to open an account in the parent's or grandparent's name and earmark the funds for the child. The plus is that the parent maintains control of the account as long as desired. The minus is that the adult (parent or grandparent) is responsible for the taxes.

A third way to establish a child's account is to establish an Education IRA. Anyone can contribute to this account including parents and grandparents, friends and relatives, or the child for whom the account is established (the beneficiary). There can be multiple contributions to a child's Education IRA and even multiple Education IRAs for each child. Regardless of the source, however, the combined contribution to any child's Education IRA may not exceed \$500 per year. Unlike the traditional IRA or Roth IRA, there is no requirement to have earned income in order to contribute to an Education IRA. These accounts are available at various mutual fund companies, banks, and brokerage firms. \$

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## Control Spending

*Continued from front page*

car, fully loaded, and a compact car is about \$10,000. In reality, it's a million dollars plus if you look at it in this light: Borrowing \$25,000 over four years will total \$634 a month. If you borrow just the \$15,000, the payment will be only \$381 per month. If the car buyer saved the difference between the two—\$253 a month for 35 years, earning eight percent annually on the money, it would grow to \$580,352. Drawing out monthly payments of \$4,479 from that amount from age 65 to 90, the total received would be \$1.3 million.

This example clearly demonstrates the magic of compound interest. Unfortunately, it is not retroactive. In order to enjoy the benefits of compound interest later, one must start saving now. It's never too early, and waiting never makes financial sense. In the above example, if you had started saving 10 years later, the difference in retirement income would have been \$2,622. It also shows that a simple choice between cars can impact ultimate retirement income. Think about the possibilities if you applied the same principle to other lifestyle choices such as size of home, furnishings, wardrobes, vacations, etc.

Spending money can be made more exciting by careful planning ahead of time. Following are some tips to help you take control of spending:

- Choose direct deposit for your paycheck into an account, setting aside 10% for savings and investments.
- Prepare a written spending plan and follow it.
- Pay all credit card bills in full at the end of the month.
- Review your statement of estimated benefits available from Social Security and retirement plan statements from your employer.
- Account for all cash spent every day.
- Review insurance policies for duplication. Choose higher deductibles if possible.
- Become a comparison shopper for most purchases, checking for quality, price, and value.
- Limit the number of meals eaten out to one or two per week.
- Take advantage of garage and estate sales.
- Separate shopping trips from spending trips (making comparisons vs. actually buying).

Adding some discipline to your spending habits is the key to accumulating savings quickly and routinely so that it can be invested for your rosy retirement years. \$

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## Dear Friend

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portion of earned income. For most Americans of modest means or above, a substantial net worth is possible through periodic savings and the power of compound interest.

**2. Take the power of compound interest seriously and do so early.** The sooner a person saves, the greater the opportunity for compound interest to work its magic. Also, the higher the return on an investment, the greater its growth over time.

**3. Save as much as possible, consistently, from an early age.** Many Americans are unwilling to forego “the good life” in order to save. Habits like smoking are also a culprit. McKensie and Lee note that a two-pack a day smoker (at age 22) would have \$150,000 at age 70 by not smoking, assuming a 6 percent return, and \$3.4 million with a 15 percent return (possible with quality growth mutual funds).

**4. Avoid frivolous temptations.** It is a fact that most rich Americans buy cars only slightly more expensive than those who earn less. A key to wealth, at all incomes, is living below your means.

**5. Stay in school or, if out of school, re-enroll.** On average, a college education almost doubles the income possible with a high school diploma and a professional degree results in an average annual income of about twice that of college graduates.

**6. Pick your field of study (and career) carefully.** Right or wrong, people who major in areas that are in demand, like engineering, earn more (and therefore need to save less) than others (e.g., teachers).

**7. Marry someone with equal or higher education and stay married.** About 95 percent of millionaires are married and the median value of married couples’ assets is two-thirds higher than median assets of all households. Being married makes it harder to fall into poverty.

**8. Work with some diligence and save for a long time.** Lottery winners aside, most people get rich over time. That’s why most people are in their 50s or 60s before they accumulate significant sums. It takes years of earnings and compound interest.

**9. Do (or make) something of value for a large number of people.** Sam Walton, the late founder of Wal-Mart, and Microsoft CEO Bill Gates are examples of people who amassed great wealth by providing customers with value for their dollar and products in demand.

**10. Take risks. Not many people get rich by playing it safe.** Yes, the stock market is risky but, over time, the risk of volatility (i.e., ups and downs of prices) is reduced.

So there you have it. Ten suggestions to get rich, based on research, not fantasy. Try one and get started...today. As they say in the ad for the New York lottery, “you never know.” \$

*Barbara M. O’Neill, Ph.D., CFP, AFC  
Editor*

## Index Funds

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Urich, an Arkansas Cooperative Extension specialist:

- **You never lag the market an index is tracking.** Index funds either hold the same or similar stocks or bonds as a particular index. You will get the same gains (or losses) as the index, minus the expenses of running the fund.
- **Low costs.** Index funds change portfolios only when the index changes. Thus, trading expenses are low. As a result, annual index funds expenses are in the 0.20% to 0.69% range compared with 1.25% and higher for actively managed stock funds.
- **Low taxes.** Index funds with fewer trades mean fewer capital gains to pass on to investors once a year.
- **Control of your asset allocation.** Index funds will not change their investment focus, therefore, the asset mix changes little or not at all. Stock funds frequently change their cash and bond holdings as the market changes.

Index funds are not a “perfect” investment, despite three years of outstanding performance. Below are two disadvantages:

- **The share price in an index fund will fall** when prices of the investments inside the index drop. The downward trend will continue until such time as market prices start to rebound.
- **Some funds will out-perform a particular index.** If you are willing to do your homework, with luck and savvy you may be successful in beating a market index. Some experts suggest you build the base of your portfolio with index funds and round out a portfolio with a non-index funds, individual stocks, or bonds. \$

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