

Money 2000 News

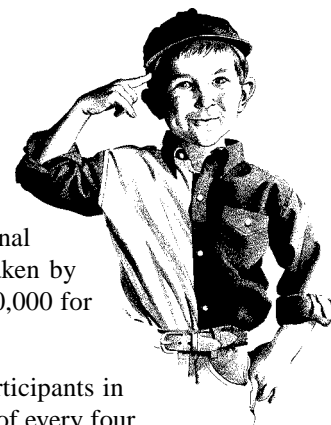


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Dear Friend of Money 2000™:

Why do some individuals and families achieve their financial goals while others, who earn the same income or more, fail to make progress? There are probably dozens of answers to this question including a person's age, income, employment, marital status, and access to employer savings plans (e.g., 401(k)s and credit unions). Another explanation for financial goal achievement is personal qualities, such as attitude, desire, self-control, determination, knowledge, and specific actions taken by people (e.g., investing \$2,000 annually in an IRA) to reach a financial goal (e.g., accumulate \$100,000 for retirement).



In the fall of 1998, Rutgers Cooperative Extension sent a research survey to MONEY 2000™ participants in New Jersey and New York. A total of 520 persons responded, about 23% of those enrolled. Three of every four respondents (74.3%) increased their savings since enrolling and 76.2% reduced their debt. The median (midpoint) amounts of savings and debt reduction were \$1,500 and \$2,000, respectively.

Respondents were asked "What helps you make progress toward your financial goals?" The most frequently mentioned resource, noted by over a third (36.5%) of the sample, was some type of personal quality (e.g., discipline) or action (e.g., "keeping a budget and net worth statement"). Some sample responses included: "Became more educated," "Will power and determination," "Thinking about the future and knowing that small change can really add up," "Keeping focused," and "My desire to eliminate debt."

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Investing Basics: Mutual Funds vs. Individual Securities

Even though 48.2% of Americans own stocks, either in mutual funds or individually, an Investment Company Institute (the mutual fund industry's trade group) survey shows that most investors do not understand what investments they own or how they work.

Almost everyone has a need to learn the basics of mutual funds. Some people might need to know how to choose investments for a 401(k) or other retirement plan. Others might want to invest money received from an insurance or divorce settlement. Many people just want to know how to get started as an investor. Still others own a hodge-podge of funds bought at

various times without much thought as to how they complement each other. Getting a year-end bonus, a tax refund, or just reading that a popular fund is about to close prompts many would-be investors to buy a fund.

An individual's investment portfolio should be more than just a collection of mutual funds. Before you select funds to invest in, you will want to determine your investment goals, the time-frame for needing the money, and the amount of risk you are willing to take.

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- Energy Deregulation Brings Choice and Possible Savings
- Videoconference Presents Financial and Investing Tips
- "Shoestring" Investment Strategies Described
- Secrets to Millionaires' Success Revealed

Strategies for Reducing Debt Described in New Book

In a new book called *Slash Your Debt*, personal finance authors Geri Detweiler, Marc Eisenson, and Nancy Castleman describe a variety of methods available for households to reduce the cost of outstanding debt. After each strategy is discussed, a summary table indicates how much could be saved on \$5,000, \$10,000, and \$15,000 credit card balances charging 17% interest. The tables were generated using Eisenson's *Banker's Secret* loan calculation software.

For example, if consumers transfer a \$5,000 balance on a 17% credit card to a card with a 5.9% "teaser rate," they'd save \$10,518 (note: this would involve periodically "surfing" for new low-rate cards). If the balance were transferred instead to a 14% personal loan and re-



paid in five years, \$9,324 would be saved. Transfer a \$15,000 balance from a 17% credit card to a five-year 14% loan and the savings approach \$30,000.

Below is some additional information from this helpful book:

- The lower the minimum payment on a credit card, the higher the cost to borrow over the long run. For example, a \$5,000, 17% interest rate credit card balance with a minimum payment of 3% of the outstanding balance would cost \$4,296 in interest and take 18 years to repay. Lower the minimum to 2% and the interest cost jumps to \$11,304, with 40 years needed to erase the debt.
- A low-rate credit card with a low monthly minimum payment can actually cost more than a higher-interest rate card with a higher minimum payment. For example, a \$5,000 balance on a 19.8% card with a 3% minimum payment would cost \$5,858 and take 21 years to repay, compared to \$9,159 and 35 years for a 15.9% card with a 2% monthly minimum.
- Like home mortgages, debt that takes decades to repay will cost 2 to 3 times (or more) the amount borrowed. An example is given of a \$10,000 balance on a 17% rate credit card with a 2% minimum payment. If this balance is

not switched to a lower-rate loan, the amount repaid, after 50 years, will be \$33,447, more than three times the amount borrowed.

- Even small amounts added to minimum payments produce awesome results. For example, send \$25 a month more on a 17%, \$10,000 credit card balance and you'll save \$11,662 in interest and 397 monthly payments (that's 33 years!). Even what the authors call "pee-wee pre-payments" make a difference. For example 25 cents a day toward that \$10,000, 17% balance will save \$5,970 and 20 years of payments.
- Consumers should beware of so-called "125% Equity Loans" that allow loans greater than the value of a home, minus its outstanding first mortgage. First, if you had to sell quickly, you'd be unlikely to get back the total amount owed. Second, the IRS does not allow deductions for loans that exceed a home's fair market value. Third, these loans tend to charge more than conventional home equity loans, resulting in higher borrowing costs.
- A 30-year mortgage may be a better alternative to a shorter (e.g., 15-year) loan. The principal can then be prepaid to pay it back faster. However, if a borrower experiences financial difficulty, longer-term loans with smaller payments provide "breathing room."
- Individual retirement account (IRA) funds can be borrowed for up to 60 days. After that, it's considered a taxable withdrawal, complete with a 10% penalty. Borrowing from an IRA should be done only if you're sure to have money to pay back their account on time.

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Money 2000 News

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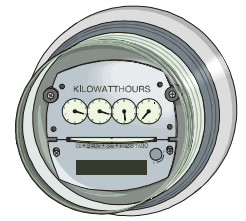
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Energy Deregulation Brings Choice and Possible Savings



You've been hearing about it for months. Energy deregulation has come to New Jersey. According to an article in the October 1999 issue of *Consumer Reports*, there are now 24 states in various stages of deregulation. New Jersey's law, The Electric Discount and Energy Competition Act, was passed in February 1999 and the New Jersey Energy Choice program has already taken effect.

Energy deregulation is a national trend, driven by increased competition and technological advances (e.g., the ability to enroll and pay bills via the Internet). The purpose of the new law is to give consumers more control over their energy purchases. The legislature also expects that, over time, competition will deliver energy services to consumers in greater variety and at a lower cost.

The New Jersey energy deregulation law has two parts. First, it mandates across the board reductions on electricity costs beginning at 5% in August 1999 and reaching at least 15% in 2002. These reductions will happen automatically and benefit all consumers. The second feature of the law is that it allows consumers (if they want) to choose what company supplies their electricity and gas.

Before deciding whether or not to choose a new energy supplier, it's important to understand how energy gets to your home or business. There are three steps in the energy delivery process: generation, transmission, and distribution. Generation can be likened to a factory. It is where electricity is manufactured (e.g., in nuclear or coal-fired plants). A good analogy for transmission is an interstate highway. It is how electricity is moved over long distances. Distribution is like a local road that feeds off a highway and takes electricity directly into your home.

In the past, your local utility provided all three services (generation, transmission, and distribution) and charged a single price per kilowatt-hour. With deregulation, however, you can now shop for the generation piece (i.e., which company generates the power that you buy). Regardless of who generates your power, however, it will still flow through the local utility's (e.g., GPU Energy) transmission and distribution system. Thus, if you experience a power outage, the local utility continues to be responsible for maintaining and repairing the local distribution system, regardless of who you buy your energy from.

Starting this fall, consumers started to see more detail on their electric bill, even if they didn't switch providers. Instead of a single price for all three steps of energy delivery, there are now separate line items for generation, transmission, and distribution. The amount charged for generation of energy is clearly identified so consumers can compare offers and calculate the savings, if any, available from switching. The amount charged for generation is called "the price to compare" or "shopping credit."

Many people are asking if the amount of savings is worth the time needed to shop around. It depends. Obviously, businesses with large buildings and consumers with large and/or total electric homes stand to benefit the most. In an example provided in the state brochure, if a family could save one half of one cent per kwh on the price charged for energy generation and used 750 kwh per month on average, their savings would be \$3.75 per month (750 x .005).

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Financial Planning Insights Shared at Conference

Rutgers Cooperative Extension hosted its fifth "Countdown to 2000" personal finance conference last October. The general session speakers were Joel Lerner, author of *Financial Planning For the Utterly Confused*, and Sandra Barlow from the New Jersey chapter of the National Association of Investors Corporation (NAIC). Below are some program highlights:

- Lerner began with a quote that emphasizes the need to plan ahead financially: "In two days, tomorrow will be yesterday." He also ended with another widely used phrase: "If it is to be, it is up to me."
- Bonds are a company or government IOU (debt). To determine the price of bonds in a newspaper bond table, it is important to know that bonds are quoted on the basis of a percentage of \$1,000. For example, a quote of "86" means that a bond is selling for \$860 (\$1,000 x .86). The par or face value of most bonds is \$1,000. If a bond sells at a premium, that means that investors pay more than face value (e.g., \$1,020). Investors

are willing to do this because bonds selling for a premium pay a return greater than available market rates.

- Zero-coupon bonds are named for the fact that they pay no (zero) current interest. Instead, the bonds are purchased at a steep discount from \$1,000 par value and grow steadily in value over time. For example, an investor would pay \$208 for a zero-coupon bond that would grow to \$1,000 of value in 20 years at 8% interest. The annual incremental increase in value is taxable income unless zero-coupon bonds are placed in a tax-deferred IRA.
- GO (general obligation) bonds are the least risky of government bonds because the issuer's full taxing ability backs them. Revenue bonds, on the other hand, are backed only by revenues (e.g., tolls) collected by the issuer (e.g., NJ Turnpike). Bonds are rated by bond rating firms according to the perceived ability of the issuer to repay its debt.

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Videoconference Presents Financial and Investing Tips

Rutgers Cooperative Extension recently hosted a downlink site for a videoconference called “Financial Strategies For A New Century.” Panelists in the program included *Money* magazine senior editor, Teresa Tritch, and 1990 Nobel Prize Winner, William Sharpe of Stanford University. Below is a summary of the information provided to conference participants:

- The stock market always reflects predictions for the future. Recently, investment performance has sagged during the fall months but that hasn’t always been the case. Investments have also done well in October and November in previous years.
- Current stock market volatility is not surprising compared to past market performance. Although large numerical drops in the Dow Jones Industrial Average (e.g., 400 points) make people very nervous, they are well within historical norms on a percentage basis.
- Investors should never make decisions solely on investment volatility. Instead, factors like personal goals, changes in job status, or family size, should dictate investment choices.
- Retirement planning by baby boomers is cause for concern. Early in the next century, 19% of the U.S. population will be age 65 or older, like Florida is today. An estimated 25 million boomers have less than \$1,000 of assets and need to begin serious saving efforts soon. Inflation protection of invested assets was advised throughout retirement by keeping a healthy percentage of your portfolio in individual company stocks or growth mutual funds.
- It is dangerous to invest in just one asset class (e.g., stock). Investors need diversification in other assets like bonds and cash equivalent assets. It is also important to avoid overlapping funds that invest in the same securities (e.g., large company stocks).
- A caller asked which gets priority: retirement, children’s college savings, or the financial needs of aging parents? The consensus of the panel was retirement savings, if “sandwich generation” baby boomers can only do one thing. Scholarships and loans exist for college students and government and other needs-based social programs exist for aging parents. Retirement security, on the other hand, is largely influenced by how individuals save and invest for themselves.
- Another question concerned fears that stock market prices may drop sharply when large numbers of baby boomers start withdrawing their assets. While this could happen in another 20 years or so, videoconference viewers were advised to invest based on current market conditions and not fears about the future.
- Another suggestion by panelists was to purchase index funds. By doing so, you “buy the stock market” and get the same performance of a stock market index, minus fund expenses. The Wilshire 5000 is an index that tracks a broad array of U.S. companies of varying sizes. Mutual funds tracking this index often have the words “total stock market” in their name.
- “Finding” money to invest is always a challenge. Possible sources of funds mentioned by panelists include investing tax refunds, reduced tax withholding, reduced household expenses, and automatic investment deposits taken directly from your checking account. Another great source of investment dollars is employer matching (e.g., to 401(k) plans), which is “free money” that should never be passed up. Many employers match 6% or more of employees’ pay if workers themselves contribute.

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Financial Planning Insights Shared at Conference

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- Lerner advised conference participants to check their series EE U.S. savings bonds. Bonds issued after December 1965 only pay interest for up to 30 years. Unfortunately, many people don’t realize this and are holding on to an investment that is paying them nothing. In addition, the IRS expects full payment of tax in the year of final maturity or penalties could result.
- It is important, when redeeming EE bonds, to time the transaction properly. Otherwise, you could forfeit up to six months of interest. To earn the most in-

terest until EE bonds are redeemed, Lerner advised that you count seven months from the month of issue (this date can be found on the front of the bond). For example, if an investor has bonds issued in January, they should redeem them in July and would get credited for interest from January through June. If the bonds were redeemed a month earlier, however, the investor would lose six months interest.

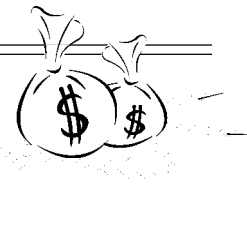
- According to Barlow, NAIC assists investment clubs with tools to make stock investing decisions. Investment club

members aim to earn a 15% average annual investment return, which doubles their money about every five years. To determine how long it takes for a sum of money to double, divide the interest rate earned into 72 (e.g. 72 divided by 9% = 8 years).

- Four investment principles are followed by NAIC-sponsored investment clubs: invest a specific sum of money regularly, reinvest dividends and capital gains (to maximize the effects of compound interest), buy growth stocks, and diversify your stock portfolio.

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"Shoestring" Investment Strategies Described



Contrary to popular belief, it is possible to invest "on a shoestring" with small dollar amounts (\$1,000 or less). Some investments can be purchased in increments of \$25 or \$50 or less (e.g., \$10 per paycheck invested in an employer retirement savings plan).

The best place to start investing is with a tax-deferred employer plan (e.g., 401(k), 403(b), etc.) because contributions are deductible on federal income tax returns (e.g., a worker with a \$35,000 salary who makes a \$3,000 contribution only pays federal tax on \$32,000). All of these plans provide tax-deferred growth of principal and investment earnings and the amount invested is deducted directly from a worker's paycheck, before it can be spent.

The minimum amount invested in employer retirement savings plans can be as low as \$10 or 1% of pay per paycheck. Another advantage is employer matching: available in about 85% of 401(k)s and 30% of 403(b)s. This is a tremendous gift that shouldn't be passed up.

For persons already contributing to a tax-deferred employer retirement plan, contribute more (e.g., increase from 2% to 4% of

pay). The best time to "kick it up a notch" is when you receive a raise or a household expense (e.g., car loan, child care) ends. With compound interest, contributing just 1% more of pay (\$400 on a \$40,000 income) annually can provide tens of thousands of dollars more for retirement.

Below are some specific examples of investment growth from saving just one percent more of your salary:

◆ Worker Age 35 – \$40,000 annual income-saving 1% more of salary per year will grow to \$74,240 by age 65.

◆ Worker Age 45 – \$50,000 annual income-saving 1% more of salary per year will grow to \$33,003 by age 65.

Note that younger workers (more time) and those at higher salary levels (1% of a higher number) stand to accumulate the most by saving an extra 1% of their salary. These examples were taken from the *401(k) Booster Calculator* by Advantage Publications (800-323-6809) and assume an 8% average annual return on investments and 4% average annual pay increases.

Once a 401(k) is funded, at least to the maximum amount (e.g., 6% of pay)

matched by an employer (reason: you never pass up "free money"), consider an Individual Retirement Account (IRA) for additional savings. The maximum annual contribution is \$2,000 but you don't have to invest it all at once. You could make eight \$250 deposits.

Tax deductibility of traditional IRA contributions depends on access to a qualified employer retirement plan and household adjusted gross income (AGI). Limits will be increasing each year through 2007. Roth IRAs do not allow taxpayers to take a deduction for their contribution but earnings can be withdrawn tax-free if a person is 59 ½ and invests in a Roth IRA for at least five years. To determine which type of IRA is best for you, check the calculators on the Web site www.rothira.com.

Other recommended "shoestring investing" practices are: investing in a SEP or Keogh plan with self-employment income, investing windfalls (e.g., retroactive pay, holiday bonus checks), and automatic investment plans (e.g., \$50 per month deposited into a mutual fund). Compound interest is not retroactive so get started today!

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Investing Basics: Mutual Funds vs. Individual Securities

Continued from page 1.

For most people, mutual funds should be a major part of their investment portfolio – unless they have a lot of money and ample time to devote to investing in individual securities. While there are arguments for buying stocks and bonds directly, consider buying mutual funds first, or at least use them as a core holding, because there are drawbacks to individual stock and bond picking and trading. The **first** drawback to individual securities is that it takes a great deal of time and expertise to analyze a company – its prospects for earnings growth, how it compares to its competitors with regard to performance over the short and long term, the company's debt level and creditworthiness, what new products are in the pipeline, and technological changes loom-

ing that might harm or improve business. **Second**, purchasing individual securities involves higher transaction costs. Even when you use a discount broker, the commissions you pay to buy and sell are not cheap, although the cost of online trading is getting lower every year. **Third**, owning individual stocks means less probability of proper diversification. To properly diversify a stock portfolio, you need to own at least 10 to 20 different companies in different industries, which could cost thousands of dollars. For the same price you might pay for 100 shares of one security, you can buy shares in a fund that owns 100 securities. Diversification lowers your investment risk – if one or two stocks plunge, others may gain in value, offsetting the loss.

Nevertheless, there are several circumstances when you do not need mutual funds:

- You are adept at picking individual stocks.
- You have at least \$20,000-50,000 to buy at least 10 to 20 stocks (depending on stock prices), or
- you plan to invest in Treasury bills, notes, or bonds.

In the last case, you would probably do better purchasing treasury securities directly through the Federal Reserve's Treasury Direct program (www.publicdebt.treas.gov).

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Secrets to Millionaires' Success Revealed

Millionaires are certainly in the news today. Some indications are popular new television game shows such as *Greed* and *Who Wants to Be a Millionaire?* and the long time (over two years) that the book *The Millionaire Next Door* has spent on best seller lists.

According to the book *The Millionaire Next Door*, you can't necessarily tell if a person is wealthy by looking at them. Also, most millionaires work hard to achieve their wealth; they are not born with it. Self discipline (i.e., regular investing and living below one's means) is a key factor in accumulating wealth. The average age of millionaires is 57, indicating that, for most people, it takes three or four decades of hard work to accumulate wealth.

Research was conducted by the authors, Thomas Stanley, Ph.D., and William D. Danko, Ph.D., to determine characteristics that millionaires have in common. These characteristics include spending less than they earn and choosing well-paying occupations. Many millionaires also value financial independence and save/invest regularly.

Key findings from Stanley & Danko's research include the fact that most millionaires exhibit discipline and hard work. Many don't look the part. The Texas saying "Big Hat- No Cattle" means that many



people who look wealthy (big hat) really aren't (no cattle).

An especially helpful part of the book is a formula, described on page 13, to evaluate your own financial progress based on your age and household income. PAWS (prodigious accumulators of wealth) are doing better than average (top 25% of households) and UAWS (under accumulators of wealth) are in the bottom quartile. Average accumulators of wealth (AAWS) are in the middle 50%.

The formula works as follows: multiply your age by your pre-tax income from all sources except an inheritance. Then divide by ten. This gives you a dollar figure to compare with your personal net worth (assets minus debts). For example, a 35-year old with a \$40,000 annual income should have a net worth of at least \$140,000 ($35 \times 40 = \$1,400,000$ divided by 10).

According to the book, frugality, goal orientation, and planning are key factors in wealth accumulation. Housing costs that are lower than what millionaire households might otherwise qualify for are also a factor. Spouses (mostly wives) of mil-

lionaires are frugal and high-status items are not important.

Stanley and Danko also found that many millionaires run their finances "like a business." They invest early and often and take action to achieve specific financial goals. Planning is key to financial success. Many millionaires also avoid high-status items and they often buy used cars.

Of course, not everyone will become a millionaire. But everyone can learn from the habits that make millionaires successful:

- ♣ Live below your means by spending less than you earn.
- ♣ "Pay yourself first" through regular savings (e.g., contributions to a 401(k) plan).
- ♣ Invest in a diversified portfolio that includes stock to "grow" your money.
- ♣ Set clearly defined goals with a price and a date (e.g., "\$20,000 saved by 2007").

Motivation is a powerful incentive to save. You have within yourself the ability to take action to improve your finances (e.g., sign up for a 401(k) plan). Who knows. You could even become tomorrow's future millionaire, even if you're never on a game show.

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Dear Friend of Money 2000™

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It appears, therefore, that achieving financial goals is not just a matter of money. It's about an internal desire to improve your finances and "walking the walk" with specific practices (e.g., enrolling in a 401(k) plan) that move you forward. According to a popular theory, behavioral change occurs in defined stages, based on a person's readiness to change.

In the first stage, called "pre-contemplation," people are in denial or don't even realize they need to make a change. Then as they slowly begin to realize that a change would improve their life, they prepare to make the change (e.g., contact employer about 401(k) plan investments), and take action. The final stage of behavior change is "termination," where a new behavior is

so fully integrated into a person's lifestyle that they don't even have to think about it.

Much can be learned from the successful practices of MONEY 2000™ participants. Consider the following five tips to improve your finances during the year 2000 and beyond:

- Put your savings/investments on "automatic pilot" through payroll deduction and automatic investment programs for the purchase of stock or mutual fund shares. Sign up today!
- Set specific financial goals (e.g., "save \$3,000 a year for five years for a car"). Post a picture or description of your goal in plain view as a daily reminder of what you're saving for.

■ Develop a spending plan (a.k.a., budget) and stick to it. Forms to track household income and expenses are available through your local Rutgers Cooperative Extension office.

■ Increase your financial knowledge. Take a course, read a book, or subscribe to a personal finance publication such as *Money* magazine.

■ Believe in yourself and your ability to make changes that will improve your finances. Even small amounts of savings add up of time. When there's a will, there's a way. Like the popular Nike ad says, "just do it!"

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