Money 2000 News



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Dear Friend of Money 2000™:

Step Down to Improved Finances in 2000 and Beyond

Have you heard the television advertisement for a product that helps people gradually quit smoking? It uses the words "step down" over and over to indicate that a person's exposure to nicotine is reduced, in pre-determined stages, while using this product. According to the manufacturer, "stepping down," by gradually reducing the amount of nicotine consumed, makes it easier to quit smoking than going "cold turkey" and trying to change from "smoker" one day to "non-smoker" the next. In other words, the odds of successful behavioral change are greater when a person makes small, gradual changes than by making one large change all at once.

"Stepping down" can also be used as a method to generate ideas to reduce household spending. Just like the smoking cessation product described above, the principle is that people will be more successful, and feel less deprived, if their spending is reduced in gradual stages as opposed to eliminating spending on an item completely.

To visualize the "step-down principle," imagine a staircase with four steps. On the top step is the most expensive way to purchase an item and on the floor below the bottom step is the least expensive purchasing method. Again, note that you're not completely eliminating the item.

You're just trying to purchase it at a lower cost to free up money to save or reduce debt.

To illustrate the "step-down principle," think about buying four pancakes for breakfast. The most expensive method (top step of the staircase) would be going to a "sit-down" restaurant like IHOP, Denny's, or Friendly's and paying about \$3.49, plus a tip. The next step down would be to buy the pancakes at a fast food outlet for around \$1.99. Go down another two steps on the staircase and you might pay 77¢ for frozen pancakes purchased at a supermarket and 25¢ for four pancakes prepared with a dry mix. At the "floor" of the staircase would be the cheapest method still: about 16¢ for a serving of pancakes prepared "from scratch" (i.e., dry ingredients).

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How to Find the Right Mutual Fund

Finding the right mutual fund to either begin an investment program or add to an existing portfolio can sometimes seem an overwhelming task. Assuming you are familiar with the various types of mutual funds, below are some specific steps for picking them:

STEP 1: Identify the type of funds you need (e.g., growth) to reach your goals. Getting started will be easier if you first focus your search on a specific type of mutual fund with a specific investing objective. Eventually, your goal should be to build a portfolio that includes both stock and bond funds with various investment objectives and investment

styles for maximum diversity. This portfolio allocation process

involves assigning appropriate percentages of your total investment portfolio, no matter its size, to interest-earning (income) and stock (growth) investments (e.g., 50% stocks, 30% bonds, 20% cash).

STEP 2: Do more reading. Visit the library or buy some specialized books on mutual fund investing. Some useful ones are: Mutual Funds For Dummies by Eric Tyson, (IDG Books, 1995) Sheldon

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Money "Baggage" and Personalities Affect Spending and Saving Decisions

Inancial decisions, such as spending and saving, are not just the result of having a certain amount of income. On the contrary, they are largely driven by people's feelings about money and childhood experiences and influences. "Emotional" factors, such as a person's "money personality," can have as much of an influence, or more, than "financial" factors such as an amount or type of assets and income.

Susan Zimmerman, author of *The Money Rascals*, likens a person's financial belief system to an iceberg. Just as the crew of the *Titanic* could see only the tip of the iceberg with which it collided, only part of the root causes of people's "money behavior" is usually "visible." In other words, you may need to "dig deep" to find out what really motivates people to spend or save money.

Money 2000 News

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Children develop beliefs about money through their family of origin, and from the U.S. culture at large (e.g., advertisements). They may tithe the same amount to their church, for example, or keep records in the same manner their parents did. Even if a child's money behavior is the exact opposite of their parents (e.g., disorganized parents and organized child), the parents still had an influence.

To understand some of the influences on your money beliefs, answer the following questions:

- How did the people who raised you handle money?
- Do you have any specific childhood memories about money that stand out?
- How were family conflicts about money resolved?
- In what ways is your money management style the same or different than family members?
- What commercials or advertisements do you recall as being most influential?

Zimmerman classifies people into eight distinct belief systems ranging from "super spenders" to "super savers." People often have "pieces" of several money personalities but usually one dominant style that drives their financial behavior. The eight money styles are as follows:

- People who make flashy purchases to impress others (i.e., "image" spenders)
- People who make rash and impulsive financial decisions and hate planning and budgets
- People with conflicting money beliefs who procrastinate so as not to have to make decisions
- People who are "too busy" and avoid all types of financial activities (e.g., balancing checkbook)
- People who live a very modest



lifestyle and display their virtue by rejecting luxuries

- People who feel helpless, fearful, or insecure about money and worry a lot about their finances
- People who are security conscious and save steadily in slow-growth cash assets
- People who invest steadily and assume risks to potentially achieve a high rate of return.

Once a person understands the origins of his or her money beliefs and dominant personality trait, it is often easier to change future behavior (e.g., increase savings). Another driving force that is important to understand is a person's "money baggage," which are feelings and beliefs, however false or irrational, which affect financial behavior. One example of "financial baggage" is that some people believe that their bank account or "name brand" possessions determine their self worth.

In summary, emotional aspects of spending and saving money are often extremely complicated. They are also very essential to getting your financial house in order. What is your dominant money personality, childhood money influences, and "financial baggage"? Insights into these emotional aspects of money can be a very important resource for taking charge of your financial future.

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Financial Calculators Show Benefits of Saving

Several cardboard "slide-rule" type calculators are available that, despite their apparent simplicity, provide a large amount of detailed information about the growth of savings over time. The principle behind them is that, even small amounts of money, especially if placed in tax-deferred savings vehicles (e.g., 401(k)s and IRAs), will grow to significant sums over time.

The large New York pension firm TIAA-CREF (800-842-2733) developed a slide-rule, called "*Tax Savings Calculator*." The calculator shows the monthly tax savings available for various amounts contributed monthly to tax-deferred plans (e.g., 401(k)s). The tax savings is calculated by multiplying the amount saved by a person's marginal tax bracket, as follows:

Tax Bracket	Monthly Contribution to Tax-Deferred Plan				
	\$50	\$100	\$200	\$300	
15%	\$ 8	\$ 15	\$ 30	\$ 60	
28%	\$14	\$ 28	\$ 56	\$112	
31%	\$16	\$ 31	\$ 62	\$124	

On the flip side of the TIAA-CREF slide-rule is another set of tables called "Compound Interest Calculator." This calculator shows how much an investor can accumulate by making various monthly contributions that earn various rates of interest over specified periods of time. Obviously, the longer one saves, and the more they earn on their money, the more they'll accumulate, as the following table, for \$200 of monthly savings, indicates:

Rate of Return	Length of Contribution to Tax-Deferred Savings Plan					
	5 Years	10 Years	20 Years	30 Years		
3%	\$12,948	\$27,958	\$ 65,532	\$116,028		
6%	\$13,965	\$32,653	\$ 91,129	\$195,851		
8%	\$14,683	\$36,257	\$114,532	\$283,523		
10%	\$15,434	\$40,292	\$144,797	\$415,859		

Another helpful slide-rule is the "401(k) Booster Calculator" from Advantage Publications (800-323-6809). This calculator shows what investing just one percent more of your pay will grow to in a tax-deferred savings plan. For example, one percent of a \$30,000 salary is \$300. For a 40-year old, an extra \$300 contributed each year to a 401(k) plan would grow to \$33,835. The table below provides additional illustrations of investment growth, assuming an eight percent average annual return and four percent average annual pay increases:

A	ge of Worker			
30	40	50	60	
\$ 59,579	\$ 22,557	\$ 7,267	\$ 1,318	
\$ 89,369	\$ 33,835	\$10,901	\$ 1,977	
\$119,158	\$ 45,113	\$14,535	\$ 2,637	
\$148,948	\$ 56,391	\$18,168	\$ 3,296	
	\$ 59,579 \$ 89,369 \$119,158	\$ 59,579 \$ 22,557 \$ 89,369 \$ 33,835 \$119,158 \$ 45,113	30 40 50 \$ 59,579 \$ 22,557 \$ 7,267 \$ 89,369 \$ 33,835 \$10,901 \$119,158 \$ 45,113 \$14,535	30 40 50 60 \$ 59,579 \$ 22,557 \$ 7,267 \$ 1,318 \$ 89,369 \$ 33,835 \$10,901 \$ 1,977 \$119,158 \$ 45,113 \$14,535 \$ 2,637

As the chart indicates, younger workers (people with more time) and those earning higher salaries (people saving one percent of a higher income) stand to accumulate the most. If the one- percent contribution also triggers an additional one percent match by an employer, the figures can be doubled.

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Interested in investing? Get a copy of our 158 page *Investing For Your Future* home study course at your local Rutgers Cooperative Extension office, at a cost of only \$15.

Take Charge of Your Finances With a Spending Plan

"People don't plan to fail, they fail to plan."

ow often have you heard that phrase? Nowhere is it more true than personal finance. Unfortunately, instead of taking charge of their money, people let their money manage them. They approach their finances much like unprepared travelers who fail to consult maps or travel guides. In other words, they don't have a clue where they're going or how much it will cost to get there.

A much better way to "travel" financially is with a spending plan. A spending plan is a plan for spending and saving money. To put it another way, it is a realistic side-by-side comparison of what you earn (income) and where the money goes (savings and household expenses). A spending plan provides direction for future spending and assures that there is sufficient income with which to pay expenses.

If this sounds like "budgeting," you're right. "Spending plan" is a fancy word for "budget." Still, there are subtle differences between the two. First, "spending plan" is more positive because it includes the word "spending." Most people like to spend money. The word "plan" also emphasizes control of your money, rather than the other way around. The word "budget," on the other hand, is often perceived negatively (e.g., deprivation) and discourages people from taking financial control.

Spending plans provide a number of advantages. They force people to make

spending choices and prioritize needs and wants. They can also help you live within your income. In addition, savings can be included for "big ticket" financial goals such as a new car or retirement. Many people also report that spending plans reduce worrying, out-of-control feelings, and family fights about money.

While not nearly as "sexy" a topic as some "hot" new investment, spending plans are the foundation of financial planning. Why? Unless money is left after covering household expenses, there's little that can be done in other areas such as investments or retirement planning.

To prepare a spending plan, it is first necessary to know what you earn and spend. Household earnings include net (aftertax) income, benefit payments (e.g., Social Security, unemployment, disability), child support or alimony, public assistance, self employment income, and other income sources. Add all income from all family members together to obtain a total of monthly household net income.

Once you total your monthly income, do the same for expenses by tracking spending for an entire month. Using your spending records as a guide, make a list of fixed expenses such as housing, car loan payments, and insurance premiums. Next, make a list of flexible expenses such as food, transportation, and gifts. Finally, make a list of periodic expenses and divide the annual by cost by 12 to arrive at a monthly cost. For example, \$4,000 of annual property taxes would cost \$333 monthly. Forms to develop a



spending plan are available from Rutgers Cooperative Extension.

Be sure to set aside money for financial goals (e.g., \$100 deposited monthly into a mutual fund) as a monthly "expense." If you lack an emergency fund of three months' expenses, include a "line item" in your spending plan to gradually build up your reserves. If you have access to "automated" savings plans, such as a 401(k), sign up today. Even small amount of savings (e.g., \$15 per paycheck) will grow substantially over time.

Spending plans should balance the "bottom line." In other words income should equal expenses, including savings. It may take several attempts to get the numbers to balance. This is perfectly normal. As you make expense adjustments, make small cuts in several categories rather than large cuts in only one or two areas. Psychologically, this is more appealing (less deprivation).

One study found that three of five U.S. households lack a spending plan. This is unfortunate. A spending plan is a tool for improved financial planning, not a financial "straightjacket." If you don't currently have a spending plan in place, start today.

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U.S. Savings Bonds: An Attractive Option for Small Investors

any people are somewhat familiar with U.S. Savings Bonds. Perhaps they received some bonds for a wedding gift or their children have received bonds as gifts. At many places of employment, workers can also participate in a U.S. Savings Bond purchase plan and gradually purchase bonds via payroll deduction.



Even when people own U.S. Savings Bonds, however, misperceptions persist. For example, some people mistakenly believe that savings bonds provide low interest rates. Others think that bond values are difficult to keep track of and that it's almost impossible to calculate their current value. All of these beliefs are wrong. In fact, the U.S. Treasury Department has made a number of improvements to U.S. Savings Bonds in recent years to make them more attractive to investors. Below is a summary of some important bond features:

- EE bonds earn a competitive market-based rate: 90 percent of the average yield on 5-year Treasury notes. Thus, they compare quite favorably with other cash assets such as bank CDs and money market mutual funds. The rate of return on EE bonds is adjusted each May and November and is currently 5.73% (until November 1). Earnings are exempt from state and local income taxes and may also qualify for a federal tax exemption if used for qualified education expenses.
- EE bonds are purchased for half of their full face value (e.g., \$25 for a \$50 bond). Interest can be earned for up to 30 years. The time that it will take for EE bonds to double to full face value depends upon prevailing

interest rates during the time an investor holds them. For an rough estimate, use the "Rule of 72." Divide the interest rate earned (the average of rates during each six month holding period) into 72 to determine how long it takes the principal to double (e.g., 72 divided by 5.7% equals 12.6 years).

- The Treasury Department introduced the inflation-adjusted I bond in September 1998, with a base rate updated every May and November. The base rate is currently 3.6% and is good for the life of I bonds bought between May 1, 2000 and October 31, 2000. The total return on I bonds, however is 7.49%. This is a combination of the base rate and an inflation adjustment for the previous six months.
- I bonds are bought at full face value with a minimum denomination of \$50. In other words, you pay \$50 for a \$50 I bond and it increases in value by earning interest. Like EE bonds, I bonds pay interest for up to 30 years. Bondholders can redeem both EE and I bonds anytime between 6 months to 30 years after purchase, depending on their personal financial goals and income needs. If savings bonds are redeemed within 5 years, however, there is a penalty equal to 3 months interest.
- The Treasury Department offers a number of support services to help Americans purchase U.S. Savings Bonds and track their value. One helpful feature is the "Savings Bond Wizard" that allows users to create an inventory of their bonds and automatically calculate their current value. The "wizard" is available for free on the Web site www.savingsbonds.gov. and can also be purchased for \$23 on a disk by calling 800-487-2663. The program maintains an inventory of bonds and updates their value monthly. It will also warn users if their savings bonds have stopped earning interest.
- Another helpful program is EasySaver™. Introduced in 1998, it provides the benefits of automatic payroll savings to anyone with an account at a financial institution. To obtain an enrollment form, use the Web site or phone number listed above. Simply list your name and address, when and how much money you want set aside (e.g., \$50 on the third of every month), and which series and denomination of savings bond you want (e.g., \$50 I bond). That's all there is to it. Investors then receive their bonds automatically by mail on a regular basis.

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Dear Friend of Money 2000™

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Two advantages of the "step-down principle" are that it increases awareness of personal spending habits and offers a variety of options to make a purchase. Obviously, other factors, like time availability, also need to be considered. One person might decide to prepare "from scratch" mixes on weekends when they have more time. Another might decide that stepping down from eating out at a restaurant to cooking from scratch (five whole steps) is not feasible. They might decide to buy frozen pancakes, a "step down" of two steps from a restaurant meal. They'd still pocket considerable savings (\$2.77 in the above example), although it won't save them the most money.

The "step-down principle" also works well with other "discretionary" household expenses. For example, clothing. Steps of spending, from top to bottom, might include a department store, a discount store, factory outlets, a consignment store, and thrift shops/flea markets/garage sales.

"Stepping down" can also refer to the frequency or amount of a purchase as well as where it is made. For example, you may decide to eat out six times a month instead of twelve. You're not completely eliminating what is obviously a pleasur-

able activity. You're simply taking steps to contain the cost. Or you might "step down" by eliminating an appetizer, drink, and/or dessert.

Many budgets fail because people feel resentful or deprived. Nobody likes to feel that they can't do something that they enjoy. If you're looking for ways to improve your finances without crimping your lifestyle, try "stepping down." You'll remain in control of your finances by choosing realistic steps. You'll also see quick results, which can serve as an incentive for additional changes.

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How to Find the Right Mutual Fund

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Jacob's Guide to Successful No-load Fund Investing (Irwin, 1995), and The Right Way to Invest in Mutual Funds by Walter Updegrave (Warner Books, 1996). More advanced books are John Bogle's Bogle on Mutual Funds (Irwin, 1994) and Common Sense on Mutual Funds (John Wiley and Sons, 1999).

STEP 3: Do some research on specific funds. There are excellent tools to help with the process of narrowing the list. Personal finance magazines publish their "best buy" lists generally twice a year in February and August (e.g., Money, Kiplinger's Personal Finance Magazine, Business Week and Forbes). Barron's and The Wall Street Journal publish a quarterly Mutual Fund Review that reports on a fund's category and objective, current and past performance, and fee structure. Also, the Investment Company Institute (www.ici.org) has excellent publications on mutual funds.

Once you spot several funds that have consistently performed well and are aligned with your goals, go to your library's reference section to complete your research. Bi-monthly rating services such as Morningstar Mutual Funds provide

current data on nearly 1,700 mutual funds with a one-page report on each. This makes it easy to review and compare funds you are considering. Look at 3, 5, and 10-year performance records.

STEP 4: Determine your selection criteria and eliminate funds. You can whittle down the 12,000+ fund universe to a manageable list in short order by using a few criteria to help with the elimination process. For example, suppose you are looking for a stock fund to invest in for retirement. Right there, you have cut the number to a little over 5,000 funds by eliminating all the bond and money market funds. Perhaps you will toss out all funds that have a sales commission, all stock funds with an expense ratio over 1.4%, funds that have an investment minimum over \$3,000, any fund where the manager's tenure is less than 5 years, and all funds that have not outperformed 60% of comparable funds over the last 3 and 5 five years, etc. Applying these criteria as you research your favorites, pay most attention to performance, cost to invest, and risk.

STEP 5: Call or write for a prospectus. A prospectus is the selling

document legally required to be distributed to mutual fund investors. It describes the fund's investment strategy as well as the risks and costs of an investment.

STEP 6: Make your purchase. For noload funds you can always do business by mail, and in some cases, at a local investment center. Most mutual fund groups also offer a toll-free 800 number for telephone assistance in completing an application. Of course, if you are buying a fund with a sales commission, the broker or financial planner executes your order.

STEP 7: Continually buy more shares. One of the best ways to grow your investments is to use a dollar-cost averaging strategy – investing a fixed number of dollars (e.g., \$50) in a mutual fund(s) at periodic intervals, usually monthly or quarterly. When the price of the fund is low, your dollars buy more shares. When the fund's price moves higher, you will buy fewer shares. Although dollar-cost averaging does not guarantee you a profit, in most cases your average cost per share will be less than the current price.

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