Personal Finance

Comm 2730

Learning Outcomes

Comments and suggestions to prepare for the mid-term and final assessments:

- Assessments will be available via Canvas for completion from the location of your choice.
- You will not need a financial calculator or any tables to calculate future or present values.
- Use the learning outcome statements provided below to focus your studies.
- Read and study the financial planning cases in the book to apply your knowledge.
- Use and apply your personal finance knowledge as well as your critical-reading and critical-thinking skills when completing the assessment.

Part I

By the mid-point of the course, students should be able to identify, define, explain, and/or apply, compare and contrast and/or determine or calculate:

- The financial planning process (determine current financial situation; develop financial goals; identify alternative courses of action; evaluate alternatives; create and implement your financial action plan; review periodically and, if needed, revise the plan)
- Types of risk:
  - Inflation
  - Interest-rate
  - Income
  - Personal
  - Liquidity
- Human capital and financial capital (from attached graphic)
- Total economic wealth (from attached graphic)
- Opportunity cost: what you give up when making a choice/selection
- Time value of money: increases in an amount of money as a result of interest earned
- Inflation: a rise in the general level of prices
- Consumer Price Index: CPI is published by the Bureau of Labor Statistics and measures the average change in the prices urban consumers pay for a fixed “basket” of goods.
- Rule of 72
- Short-term, intermediate-term, and long-term financial goals
- Fixed expenses and variable expenses
- Commercial banks, credit unions, high-cost financial services (payday loans, auto-title loans, pawnshops, etc.)
- Checking accounts, savings accounts, money market accounts, money market funds
- Federal deposit insurance
- Cost of living differences

TAXES

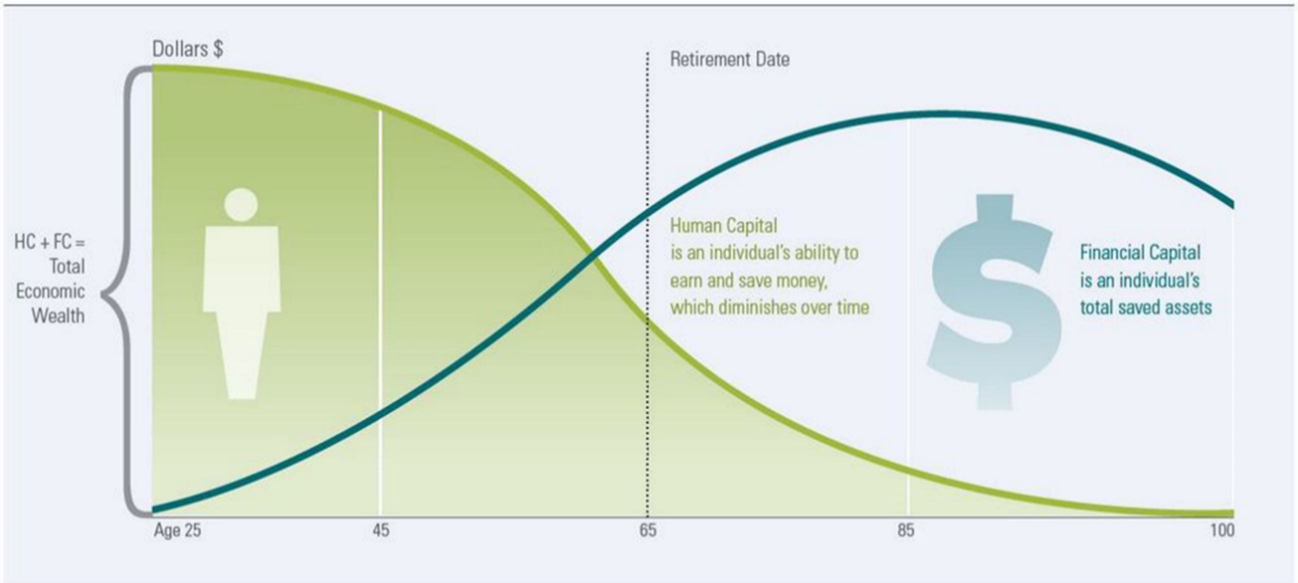
- Taxable Income
  - earned income
  - investment income
  - passive income
    - tax-deferred income
    - tax-exempt income
- Property, sales, excise, income, estate, inheritance, value-added tax (VAT), etc.
- Taxes: regressive versus progressive
- Income Taxes
  - Federal
  - State
  - Social Security also known as FICA, OASDI, or payroll taxes
- Marginal tax rate
- Effective (federal) tax rate
- Standard deduction for 2023 (The personal exemption has been eliminated as of 2017)
  - $13,850 for single taxpayers
  - $27,700 for married filing jointly
  - $20,800 for head of household
- Common tax deductions
  - mortgage interest for mortgages <$750K
  - state and local taxes (SALT: limited to $10,000 per return under 2017 tax law; these include state and local income and property taxes)
  - charitable contributions
- Tax credits
- Tax-advantaged accounts: tax-deferred retirement accounts and ROTH retirement accounts, 529 accounts, health savings accounts, etc.
- Gross salary and net after-tax take-home pay
- Taxes on investments
  - Interest: taxed as ordinary income
  - Qualified Dividends taxed same as long-term capital gains
  - Capital gains tax
    - Short-term capital gains: <12months; taxed as ordinary income
    - Long-term capital gains: ≥12 months, 0, 10%, and 20% (before Medicare surplus tax)
- Current U.S. and historical tax rates and revenues
- Current and historical U.S. spending, deficits, and debt levels
- U.S. tax policy and rates relative to the policies and rates of other OECD countries
- The relationship between tax policy and government revenues, spending, investment, deficits, and debt
- Some changes made by 2017 tax law are set to expire ("sunset") December 31, 2025.

CREDIT

- Types of credit (closed-end and open-end or non-revolving and revolving)
- The factors that contribute to your credit score (5 Cs)
- Credit reports versus credit scores
- How credit scores are used
- The effects of a high or low credit score
- Advantages/disadvantages of credit cards and/or debt
- Co-signing a loan (advantages/disadvantages and/or risk/rewards)
- Managing your credit
    - Strategies for building credit
    - Actions that can affect your credit (positive or negative)
    - Safeguarding your credit: credit locks and credit freezes

HOUSING & TRANSPORTATION

- Cost to purchase/acquire a vehicle/home versus cost to own/operate
- Depreciation and appreciation
- The pros and cons of a leasing an automobile
- The pros and cons of owning an automobile
- When leasing (or owning) a vehicle (or home) could be the smarter financial choice for an individual
- Fixed-rate versus adjustable-rate mortgages (ARMs)
    - Discount and origination points
    - Index, margin, and fully-indexed rates
    - Annual and life-time caps on ARMs
- Tax advantages of owning a home (deductibility of mortgage interest and real estate taxes paid)
- Advantages and disadvantages of owning or renting a home
- Criteria for home purchases
- Role of real estate broker
- Fixed-rate, adjustable-rate, and balloon-payment mortgages
- Closing costs including loan application fee, loan origination fee, points, appraisal fee, home inspection, title search, private-mortgage insurance
- Home equity loans versus home equity lines of credit



Source: Ibbotson Associates.

GENERAL
Students should be able to calculate and/or determine:

- Cost of living differences—i.e. the income or financial resources needed to maintain your current standard of living in a different location.
- The adjusted (actual) balance held in a checking account (reconcile a checking account)
- An expected future value or average return of an investment using the rule of 72
- Net after-tax take-home pay
- The tax equivalent value of a *nontaxable* employee benefit.
  - $ Value of benefit/ (1-marginal tax rate)
  - Example: $100/ (1-.25) = $100/.75 = $133.33
- The dollar value of an employer matching contribution to a retirement plan
- Tax savings from contributing pre-tax contributions to a tax-deferred retirement plan
- The difference between a tax deduction and a tax credit
- Taxable income based on gross income, filing status, and deductible expenses
- Federal tax owed given current tax rates, gross income, filing status, and deductible expenses
- Effective (or average) federal tax rate: the average rate at which an individual's earned income is taxed. Calculated by dividing total taxes paid by taxable income.
- Marginal tax rate: the rate used to calculate the tax on the last (and next) dollar of taxable income. In which bracket will the dollar under consideration be taxed?
- Tax savings from contributing pre-tax salary to a tax-deferred retirement plan
- The value of a tax deduction as well as a tax credit
- Debt-to-equity ratio (total liabilities/net worth)
- Loan-to-value (LTV) ratio

Students should be able to develop and calculate/determine:

- A personal budget
- An income statement

- A balance sheet or statement of net worth

Part II

Learning personal finance, like learning languages and mathematics, is cumulative. You must retain the knowledge you learned in the first half of the semester for application in the second half of the semester. In addition to the previously listed LOS, for the final assessment students should be able to identify, define, explain, and apply (and when appropriate compare and contrast and/or determine or calculate):

RISK MITIGATION/INSURANCE

- Insurance:
  - Premium: the amount paid or to be paid by the policyholder for coverage under the contract, usually in periodic installments
  - Deductible: the amount required to be paid by the insured before insurance coverage will begin and insurer will pay a claim.
  - Coverage: What and how much is covered by insurance
- Auto insurance: collision insurance, comprehensive insurance, liability insurance, deductible, salvage value, rental reimbursement, roadside assistance.
- Discounts offered to lower auto insurance costs (Good Student, Student Away at School, Driver Training, Mature Driver, Multi-Vehicle, Restricted Mileage)
- Renter's and homeowners insurance, coverage, and limitations
- Flood and earthquake insurance
- Liability insurance
- Umbrella liability insurance
- Health insurance:
  - Premium
  - Deductible
  - co-payment (co-pay): amount required from insured for a visit, service, or drug at time of delivery of service or product before insurance company makes payment.
  - coinsurance: percentage not covered by insurance and required from insured for healthcare services.
  - Exclusions: healthcare services and products not covered by the insurance policy
  - Maximum out-of-pocket
- Types of health insurance plans and their advantages/disadvantages
  - fee-for-service plan
  - high-deductible health plan (HDHP)
  - managed care plan
- Methods for managing health insurance and healthcare costs (e.g. HDHP, generic drugs; 90-day prescriptions through mail-order pharmacy; avoid unhealthy habits/maintain healthy lifestyle)
- Health Savings Account:
  - a tax-advantaged account in which an individual with an HDHP (and/or his/her employer) can contribute up to $3500 pre-tax annually.

    - Contributions may be invested in mutual funds (and sometimes other investments), and the account grows tax free in the individual's name.
    - Employer contributions are fully vested immediately.
    - The individual may make tax-free withdrawals from the account to reimburse themselves or pay for qualified out-of-pocket medical expenses for themselves and their dependents.
    - Qualified expenses may be reimbursed at any time; thus some individuals use the HSA as a tax-advantaged savings vehicle, delaying withdrawals as long as possible—ideally for retirement when medical expenses are generally higher.
    - Account owner may designate beneficiary
    - Proceeds left to spouse become an HSA for the spouse.
    - Proceeds left to a non-spouse must be distributed within the year and are taxable as income; proceeds left to qualified charity are not taxed.
    - 2023 max contribution for individual/family coverage = $3850/$7750
    - Individuals >55 may contribute additional $1000 to their individual HSA.
    - Considered a "super-Roth" because of tax savings on contribution, earnings, and qualified withdrawals
- Disability insurance
- Long-term care insurance
- Life insurance: life stages/events/factors to consider when determining life insurance needs
- Advantages/Disadvantages of:
    - Term life insurance
    - "Permanent" or cash-value life insurance
        - Whole life insurance
        - Universal life insurance
- Ways to lower cost of life insurance

INVESTMENT FUNDAMENTALS

- Before investing, you should:
    1. Balance your budget
    2. Manage credit card debt
    3. Establish an emergency fund
    4. Have access to other sources of cash/assets for emergency needs.
- Actions to manage a financial crisis:
    1. Establish a larger than usual emergency fund
    2. Know what you owe
    3. Reduce spending
    4. Pay off credit cards
    5. Apply for a line of credit
    6. Notify credit card companies and lenders if you are unable to make payments.
    7. Monitor the value of your investment and retirement accounts
    8. Consider converting investments to cash to preserve value. (The book notes "For this strategy to work, you must be able to sell when the economy is beginning a downturn and then repurchase quality investments before the economy begins to rebound"—this is extremely difficult to do.)
- Risk-return trade-off

- Risk tolerance: willingness and ability to withstand or bear risk.
- Factors that affect risk tolerance: time horizon, liquidity needs, financial capacity (income, expenses, cash flow, assets, job/employment security), financial knowledge, and personality.
- Components of investment risk—inflation, interest-rate risk, business failure, company risk, credit-downgrade risk, industry risk, market risk, global investment risk.
- Liquidity and risks associated with inadequate liquidity
- Asset allocation and its role in investment decisions/returns
- Factors to consider when making asset allocation decisions (example: time horizon, risk tolerance, investment goal, etc.)
- Asset classes, risks, and rewards:
    - Cash and cash equivalents
    - Stocks or equity securities (large-cap, mid-cap, small-cap, international, etc.)
    - Bonds or fixed-income securities (Government or corporate, long- or intermediate-term)
    - Alternative assets (pros and cons, risks/rewards, costs/benefits)
        - Real estate (commercial and/or residential)
        - Commodities
        - Options and derivatives
        - Collectibles such as coins, stamps, antiques, etc.

EQUITIES

- Common stock
- Equity financing
- Dividends, record date, ex-dividend
- Stock split
- Preferred stock, cumulative preferred, convertible preferred stock
- Stock classifications: Blue chip, growth, defensive, income, large-cap, mid-cap, small-cap, micro-cap, penny stock
- Earnings per share (EPS)
- Price-to-earnings (PE) ratio
- Price/earnings-to-growth (PEG) ratio
- Dividend yield; dividend payout
- Beta
- Book value; market-to-book value
- Fundamental analysis versus technical analysis
- Efficient market hypothesis (EMH)
- Equity financing
    - Investment bank
    - Primary market
    - Initial public offering (IPO)
    - Why companies issue equity or use equity financing
    - Why investors invest in equities
- Secondary market, securities exchanges, Nasdaq and the over-the-counter market
- Full-service versus discount-brokerage firms
- Market order; limit order; stop order
- Buy-and-hold
- Dollar-cost averaging
- Direct investment plan

- Dividend reinvestment plan
- Day trader
- Margin; buying stock on margin; current limit is 50%; including risks
- Selling short; including risks
- Options (put options and call options); including risks

FIXED INCOME/BONDS

- Bonds
    - maturity date
    - face or par value
    - coupon
    - frequency of interest payments
    - current yield
    - yield-to-maturity
    - mortgage bonds
    - debenture bonds
    - subordinated debenture bonds
    - convertible bonds
    - high-yield bonds
    - municipal bonds
        - general obligation bonds
        - revenue bonds
        - tax-equivalent yield
    - call feature
    - premium
    - registered bonds
    - bearer bonds
    - zero-coupon bonds
    - why organizations issue bonds
    - why investors purchase bonds
    - bond ladder
    - bond ratings (high-grade, medium-grade, speculative, default)
- Treasury bills, notes, and bonds
- Treasury inflation-protected securities (TIPS)

PORTFOLIO MANAGEMENT/DIVERSIFICATION

- Mutual funds
    - Actively managed funds
    - Passively managed (index) funds
    - Target-date funds
- Exchange Traded Funds (ETFs)

TAX-EFFICIENT INVESTING

- Tax-advantaged accounts: tax deferrals versus tax exempted investments

- Retirement planning vehicles: traditional 401(k), Roth 401(k), traditional Individual Retirement Accounts (IRA), Roth IRA.
- 401(k) employer matching; vesting

LIFETIME FINANCIAL PLANNING

- Life stages of retirement planning: young adulthood; early family life; empty nest; retirement stage
- Estate planning
  - Why estate planning matters (for everyone)
  - Simple will
  - Executor
  - Probate
  - Power of attorney
  - Advance medical directive/living will
  - Estate tax
  - Inheritance tax
  - Revocable living trust
  - Irrevocable trust
  - Charitable remainder trust
  - Bypass trust
    - Trustee
    - Beneficiaries
- Annual gift tax exclusion for 2023 = $17,000 per beneficiary (married couple can give $17,000 each for total of $34,000)
- Federal estate tax
  - 2023 exclusion = $12.92 million/person (set to expire in 2025)
  - Unlimited marital deduction for citizen spouses
  - Step-up basis adjusts cost basis of assets to market value at death. (This is a topic of interest among policy makers.)
  - Percentage of U.S. estates that pay **zero** federal estate tax (>99%)
  - Common ways to reduce, avoid, and/or eliminate federal estate taxes
  - Pros & Cons of an estate tax versus a wealth tax from a policy as well as taxpayer perspective

GENERAL

You should be able to calculate and/or determine:

- Total return on an investment
- Annualized holding period yield
- Book value; market-to-book value
- Approximate market value of a bond: dollar amount of annual interest/comparable (market) interest rate
- Tax-equivalent yield of a municipal bond: tax-exempt yield/ (1 – marginal tax rate)
- Bond price calculation: face value x bond quote
- Current yield on a bond = annual income/current market value

You should be able to develop and calculate/determine:

- A personal budget
- An income statement
- A balance sheet or statement of net worth
- An appropriate portfolio allocation
- An appropriate financial plan

Updated: September 4, 2023