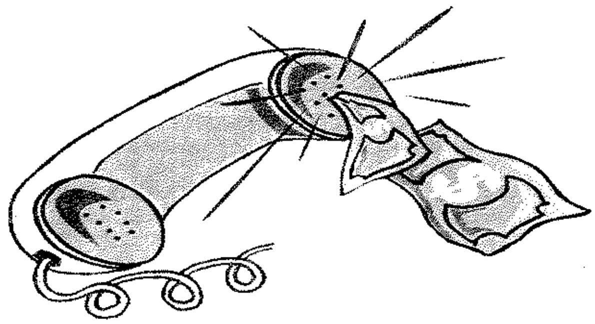
Supersize Your Money

Need to Save and Invest

Objective A



Money Talks

Money makes the world go 'round. That sounds so cliché, but it's really true, isn't it? What would you do without money? You wouldn't be able to buy CDs or new jeans. You wouldn't be able to go out to eat or to the movies with your friends. Even more important, without money you wouldn't have a place to live, food to eat, clothes to wear, or medical care for when you get sick—you know, life's essentials.

You've probably learned by now that there's a big difference between needs and wants. You may really *want* to play soccer this afternoon, but you *need* to finish your European history paper that's due tomorrow. You may *want* to drink that 20-ounce Pepsi, but you know you *need* to drink water instead. Needs and wants apply to how people use their money, too.

Objectives:

A **Discuss the nature of financial needs and goals.**

B **Describe the benefits of saving and investing.**

Needs and Wants

When it comes to spending money, what do you think is absolutely necessary to buy? Food, clothing, and shelter certainly come to mind, but your idea of "necessary" might still be very different from someone else's. Needs are the basics that are essential for survival. You need food, but it doesn't have to be steak. You need clothes, but they don't have to be designer. And you need a place to live, but it doesn't have to be a beachfront condo. When you're out on your own and your parents or guardians are no longer providing for you, how will you meet your basic financial needs?

You'll start with the income you earn from your job—you'll need to earn enough to cover the cost of living. But, of course, you'll want to do more than just survive. You'll want to have money tucked away for an emergency or for that dream vacation. And, you can't forget about owning a home, sending your kids to college, and retiring. If you want to meet your needs and wants, both now and in the future, a plan for saving and investing is essential.

Inflation

One of the main reasons saving and investing is so important is inflation. **Inflation** is an increase in the cost of goods and services. What your dollar buys today won't be the same as what it buys next year. Have you ever heard your parents or grandparents talk about when movie tickets were only a quarter or when stamps were only 10 cents? Over the years, the value of money declines. The current yearly inflation rate is about 3.5 percent. That means the $10 in your wallet right now will be worth only about $9.65 next year.

Objective B

Saving and Investing

Saving

What do you do with the money you earn from your job or your allowance? Do you immediately head to the mall, or do you set some aside for later? Hopefully, by now you understand the importance of saving. **Saving** is taking a portion of your current income and putting it away to use in the future. You may already have a savings account of your own, or your parents might be putting money away for you. There are many different places to save money, but the important thing is to be saving!

Why Save?

Saving money is important for reaching your short-term financial goals. Let's say you really want to go on the ski trip with your class next semester, and you also really want to buy a car before you begin college. Unless someone just hands you the money for those things (which *might* happen now, but certainly won't later in life), you're going to have to find a way to pay for them. That means you'll need to save.

When you're out on your own, you'll want to save for similar short-term financial goals, as well as for a "rainy day." You never know when the car might need $500 in repairs or when your spouse might require an emergency root canal not covered by insurance. Having savings set aside for such incidents is smart financial planning.

How Much?

How much you need to save is a question that only you can answer. Many guidelines suggest saving 10 percent of your income, but you might decide on more or less depending on your financial needs and goals. If you only have a year or so to save for a car, you may want to consider saving as much as you possibly can, especially while your parents are meeting your basic financial needs. With savings, the key is to make sure you have enough spending money to enjoy life now—you shouldn't feel that you can *never* buy a new CD or pair of jeans—but also make sure that you're setting aside a reasonable amount for the future.

Ways to Save

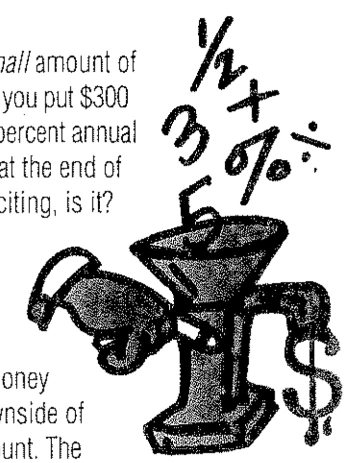
You might be groaning at the thought of having to set aside money when you feel that you barely have enough as it is! You might think that you can't afford to save, but the truth is, you can't afford *not* to. If you don't get in the habit of saving now, it will be impossible to meet your financial needs and wants later in life. Here are a few guidelines for saving:

- Take the money off the top. Decide how much you're going to save, and set that money aside before you spend. Let's say you've decided on 10 percent. When you get your paycheck for $200, you immediately take $20 out and put it in your savings. Now, you can go out and spend the $180 you have left without feeling guilty about it!

- Plan with your family. Many companies have programs in which they add, for instance, 25 cents to every dollar that employees set aside for retirement. Consider proposing a similar deal to your parents or grandparents. You might find that they're willing to add more than most companies would—they might even match your savings dollar for dollar! Wouldn't saving seem easier if you knew you were doubling your money?

- Save money by spending less of it. Sounds simple enough, but the truth is that we often spend more money than we realize. Analyze your spending habits by keeping a log for several weeks, recording everything you spend money on and how much you spent. Then, determine what you bought that you really needed and what you bought just because you wanted it. You might be surprised how much money you spent on items that really weren't necessary. This knowledge might help you make wiser decisions in the future.

Interest on Savings



Most savings accounts earn you a *small* amount of interest on your money. For example, if you put $300 into a savings account that earns one percent annual interest (and that's being generous!), at the end of the year, you'll have $303. Not too exciting, is it? While saving is essential, you'll learn quickly that it isn't the best way to make money or create wealth. As a matter of fact, in an inflationary environment of 3.5 percent a year, your money will actually *lose* value. That's the downside of keeping your money in a savings account. The upside is that the interest on a savings account is guaranteed. While you can't make nearly as much money by saving as you can on the stock market, you don't have to face the risks you do with investing.

Investing

While saving is a necessity for a sound financial plan, it will only take you so far. You can save consistently your whole life, but you probably still won't have enough to retire. That's where investing comes in. **Investing** is using money to make money. By investing, you can make more money to put toward your financial needs and wants than you ever can with just income and savings.

Why Invest?

Investing is important for you to reach your long-term financial goals. Most people are interested in sending their children to college, as well as retiring at an early enough age to truly enjoy it. Both of these financial goals require a lot of money. Investing makes earning that amount of money possible.

Risks of Investing

It's true that there are more risks involved with investing than there are with saving. The stock market is never a sure thing. However, investing isn't a short-term deal. If you leave your money in the stock market for the long haul, you'll be able to come up with an average annual return (or interest) rate of 10 or 11 percent, possibly even more.

Compounding

The magic of **compounding** is earning interest upon interest. Compounding takes place anytime you earn interest, but its effects are most dramatic when you're investing. Sound confusing? Let's break it down. There are three key factors involved in compounding growth:

1. The amount of money you invest
2. How long your money is invested
3. How much your investment grows each year

Now, go back to that $300 you put in your savings account. Let's say you had invested it in the stock market instead. With the stock market's average yearly gain of 10 percent, after one year, your $300 would be $330 (or about $319, if you consider the effect of inflation). Now, that's already better than the $3 you made in the savings account, right? With the same 10 percent return the next year, your $330 would turn into $363. And the year after that, you'd have $399. In 50 years, that mere $300 would become over $35,000! That's a lot of money to make for doing nothing but investing a few hundred bucks and then watching it grow.[1]

'Okay,' you're thinking, 'so I see that the rate of return for investing is greater than the interest from a savings account. But 50 years is a long time to wait for $35,000. I mean, it'll take a lot more money than that to retire!' Now, imagine how much money you could make if you invested *more* than just that initial $300. What if you invested another $300 each year, or even more than that?

If you invested $300 a year (the amount of money you invest—compounding key #1), for 50 years (how long your money is invested—compounding key #2), at an average annual return rate of 10 percent (how much your investment grows each year—compounding key #3), you'll wind up with $419,307. And that's *just* $300! If you decided on $500 a year, you'd have $698,845 after 50 years. And $1,000 a year will get you $1,397,690 in the same amount of time! Amazing! Adding $1,000 per year to a savings account with three percent interest would yield only $120,564 after 50 years. That's a difference of over $1.2 million!

Opportunity Costs

Opportunity cost refers to the trade-off that occurs when you choose one alternative over another. For example, you have a choice this weekend of going to the homecoming dance or to a baseball game with your dad. If you choose the dance, you'll have a great time, but you'll miss getting to see your favorite team. If you choose the game, you'll also have a great time, but you'll miss making memories with your friends.

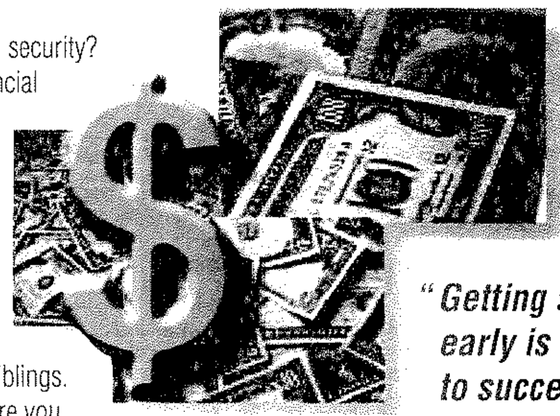
Opportunity costs apply to how you choose to save, spend, and invest your money as well. Let's say that you want to buy a new sweater for $50. You don't really need a new sweater, but you like it, and it's only $50, right? Now, think about what that $50 might mean to you 50 years from now. If you invest it at a 10 percent average annual return rate for that amount of time, your $50 becomes $5,869. Is that sweater you don't really need worth almost $6,000? Only you can decide.

[1] Calculate compound interest on your own at http://www.moneychimp.com/calculator/compound_interest_calculator.htm

Objective 3

The Importance of Saving and Investing–NOW

Do you see now how income alone won't cut it in terms of lifelong financial security? Saving and investing are absolute musts if you want to meet both your financial needs and wants. And if you want to invest $1,000 or more a year that can help you become a millionaire by the time you retire, you'll have to save up that $1,000 before you can invest it. That's the power of saving and investing working hand in hand.

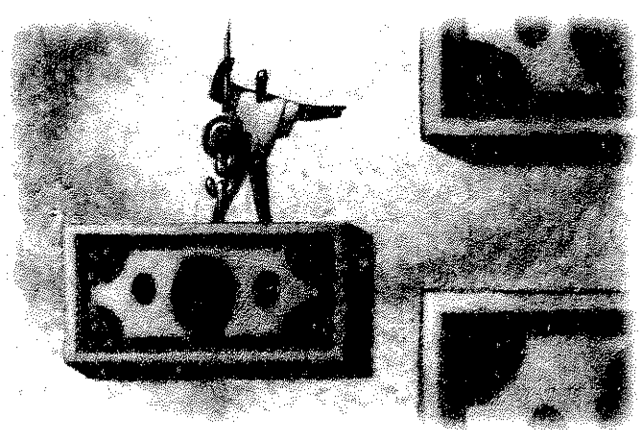


The sooner you begin to take advantage of the compounding growth of the stock market, the better. Compounding is your best friend, because right now, time is on your side. As a teenager, you have more years ahead of you to invest than your grandparents, your parents, and even your older siblings. Maybe you're 17 now, and you think you have plenty of time to spare before you begin saving and investing. Take a look at the table below to see what the price of waiting may be.

"Getting started early is the key to successful investing."

Age You Start Investing ($300 a year)	*Your Return at Age 67 (Average Annual rate of 10%)*
17	419,307.07
27	159,633.32
37	59,517.85
47	20,919.00

As you can see, waiting even just 10 years from now to begin investing can cost you over $250,000 in retirement. And that's just with $300 a year! Any ideas for what you could do with that cool quarter-million? *Getting started early is the key to successful investing.*



The Rule of 72

This neat trick can help you figure out just how long it will take to double your money by saving or investing. First, pick an average annual growth (interest) rate. For a traditional savings account, it might be one percent; on the stock market, it's around 10 percent. Then divide 72 by that number. For your savings account, you come up with 72; for your investments, 7.2. That means the same amount of money will take 72 years to double in your savings account, but only a little over 7 years to double on the stock market. Hopefully, the importance of investing is becoming clearer to you by the minute.

The more you learn about saving and investing, the more you'll hear about the "time value of money." The value of your money changes over time due to many factors—inflation, interest rates, compounding, and even tax rates. That's why it's so important to save and invest wisely. Don't get left behind!