

# REVIEW INFORMATION FOR PERSONAL FINANCIAL MANAGEMENT

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## GENERAL INSTRUCTIONS

The number of decimal places used in calculations and in the reporting of your answers is very important. Below are guidelines to use as you take this test. If a problem varies from these guidelines, it will be noted in the problem.

### Percentage Problems

Round to the nearest tenth when working with percentages.

Example: Use 2.3% NOT 2%

Example: An answer of .9638 should be written as 96.4%

### Interest

All interest rates are stated in one-year simple interest, unless otherwise noted.

Interest is to be calculated on 360 days (not 365 days). So 180 days is .5 of a year.

### Dollar Amounts

All dollar amounts must be rounded to the second place (nearest cent).

Example: \$35.9765 to \$35.98

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## INVESTMENTS

- The purpose of investing is to make your money grow.
- The three major stock markets in the U.S. are the NYSE (New York Stock Exchange, the oldest stock market; has mainly large, well-known companies), NASDAQ (mostly technology stocks), and AMEX (American Stock Exchange, mostly smaller, unknown companies).
- Diversification is when you spread your risk among several types of investments
- Only corporations can sell stock
- Liquidity means how quickly you can get your money back from an investment. Cash is the most liquid (obviously), then checking accounts, savings accounts, CDs, stocks and bonds, and real estate)
- Dow Jones Industrial Average (DJIA 30): 30 large stocks that represent the economy as a whole.
- S&P 500: considered a broad market index (includes the 500 largest stocks).
- Russell 2000: considered a small stock index.

### Risk, Return, and Liquidity

- To gain more return on an investment, you take on more risk OR you give up liquidity (ability to get your money back quickly). Example: riskier stocks are more likely to have higher returns; CDs pay higher interest (can't access \$ quickly)
- A list of investments from the least risk to the most risk is:
  - Low Risk: Savings Accounts, CDs, Treasury Securities, Savings Bonds
  - Medium Risk: Mutual Funds, Corporate Bonds (Highly-Rated), Preferred Stock
  - High Risk: Stocks, Junk Bonds, Real Estate
- Diversification & Mutual Funds: to reduce risk, investors buy a variety of investments (diversify); an easy way of doing this in through Mutual Funds and ETFs

### Regulating Financial Markets

- FDIC (banks) and NCUA (credit unions): insurance up to \$250,000 per depositor per account
- FINRA and SEC: regulate securities markets and brokers
- IRS (internal revenue service): regulates and collects taxes
- Federal Reserve (The Fed): regulates banks; sets reserve requirements for banks (currently 10%); also sets the margin requirements for purchasing stock on margin (currently 50%).

### Stock Basics

- Ticker Symbol: typically 1, 2, 3, or 4 letters representing the stock
- Price (Last Trade, 52-Week High-Low)
- Volume and Average Volume – the amount of shares that traded today and on an average day
- Market Cap – The value of all the shares of a stock; calculated by stock price x total shares outstanding
- EPS – earnings per share; calculated by net income / total shares outstanding

- P/E Ratio (represents stock valuation; how expensive it is compared to similar stocks) – calculated by stock price / EPS
- This type of stock includes voting rights: common stock.

### People

- Full-Service Broker – a stockbroker that provides advice; highest commissions
- Discount Broker – a stockbroker that offers no advice; lower commissions
- Online Broker – strictly online orders; lowest commissions (typically a flat fee)
- Investment Bankers – assist companies with issuing stocks and bonds; these are the people who issue IPOs for companies in the primary market.

### Stock Exchanges and Markets

- Securities Exchanges (auction markets): NYSE, AMEX
- Securities Exchanges (over-the counter market): NASDAQ
- Primary Market (where companies raise \$ through new stock offerings - IPOs)
- Secondary Market (buys & sellers exchange “used stocks” – stock exchanges)

### Stock Indexes

- Stock Indexes are groups of stocks ... this is NOT the same as stock exchanges or markets.
- What is the name given to the index that uses 30 stocks to represent the thousands of stocks listed on the New York Stock Exchange? The Dow Jones Industrial Average

### Buying & Selling

- Buy and Hold (buy a stock and hold it) – bullish
- Buying on Margin (borrow money to buy stock) – very bullish
- Selling Short (borrow stock, sell it, and repurchase at a lower price) – bearish
- Direct Investing (purchasing stock directly)
- Indirect Investing (owning stock indirectly, like through a mutual fund)
- Commission (fee you pay to a stockbroker to buy or sell stock)
- Round Lot (100 share increments) & Odd Lot Orders (less than 100 shares)
- Which type of investment is most likely to contain the highest risk? Stock of a startup company
- You buy 50 shares of a stock on October 1 @ \$72.30 per share. You sold those same shares on December 15 for \$83.13 per share. What was your percentage gained on the transaction, ignoring fees and commissions?  $15.0\%$  ( $83.13/72.30 - 1 = .1497 = .15 = 15.0\%$ ).
- You have owned 50 shares of Summit Corp. for the past three years and own those shares for all of 2016. Summit Corp. pays quarterly dividends of \$1.25 per share. How much will you receive in dividends for 2016? \$ 62.50 ( $50 * 1.25$ , since you owned them for the entire year ... it gets tricky when you only own for a partial year)
- You use a broker to invest in the stock market, who charges a 2% commission on all trades. If you buy 75 shares of a stock trading @ \$43.39 through your broker, what will your total cost be? \$3319.34 ( $75 * 43.39 = 3254.25 * 1.02 = 3319.34$ )
- The maturity value of a loan is equal to: Principal + Interest

### Sources of Investment Info

- Annual Reports
- Online Financial Tables & Research
- Magazines, Newspapers, Newsletters

### Mutual Funds

- The primary advantage a mutual fund gives an investor over an individual stock is diversification.
- A mutual fund shows a NAV (net asset value, like a stock price) of \$32.65 and a minimum initial investment of \$5,000. To invest in this fund, how many shares must you buy? 154 ( $5000/32.65 = 153.14$  ... you can't buy fractional shares, so you need to buy 154).

### **RETIREMENT**

- Typical retirement accounts include: IRA (individual retirement account), Roth IRA, 401(k), 403(b).
- Teachers and other public employees CANNOT invest in a 401(k) – these are provided by businesses only.
- An advantage of a Roth IRA is: you pay taxes on your earnings up front and then when the money is withdrawn it's tax-free (it's the opposite of a regular IRA).

- Once you turn age 59 1/2, you can withdraw any amount from your IRA without having to pay the 10 percent penalty. But regular income tax will still be due on each withdrawal. IRA distributions are not required until after age 70 1/2 (you may contribute into an IRA account up to the age of 70 1/2).
- A 401k is a retirement product that allow employees to make tax-deferred contributions, which are often matched by the company, to a trust
- 401ks are an excellent way to invest for your retirement ... these are offered by your employer and often the employer will match your payments into your 401k account.
- Wills are an important way to ensure your family is provided for. The people who you designate to receive your assets when you die are called your heirs.
- Which of the following individuals would be eligible for a 403(b) retirement plan? School Teacher

### INTEREST

- Calculating Simple Interest:  $PxRxT$
- Calculating Compound Interest:  $Px(1+R)^T$
- A finance charge is the amount of interest you pay on a loan. To calculate this amount, multiple the amount of each payment times the number of payments; then subtract the original amount of the loan; the amount remaining is your finance charge. To write as a percent, divide the finance charge by the original amount of loan.
- Rule of 72, which tells you how many years it takes to double your money ( $72 \div \text{Interest Rate}$ )

### INSURANCE

- Common types of insurance include: health, life, disability, auto, home, renters.
- Renters insurance covers the contents of your apartment; Homeowners insurance covers the house and the contents of your home.
- Auto - Collision Insurance: repairs your car if the accident was your fault (if it was the other person's fault, then THEIR insurance will cover it)
- Auto - Comprehensive Insurance: repairs your car if there is any damage to it as a result of vandalism, falling objects, fire, or hitting an animal while driving (pretty much everything except hitting another car)
- Premiums – the payments you must make to the insurance company each month
- Deductible – the amount that you must pay out of your own pocket on a claim before the insurance company starts to pay.
- The higher your deductible, the lower your premium will be. Other things that affect your premium include: auto: gender, age, type of car, driving history, credit history, etc.; Health: lifestyle (smoking, exercise), age, etc.; Home: type of home, age of home, location, security system, etc.
- The type of business insurance that pays for medical care and physical rehabilitation of workers injured on the job is called workers' compensation.
- A co-pay is a small, fixed amount required by a health insurer to be paid by the insured for each outpatient visit or prescription.
- The type of auto insurance that pays for the cost of damage to a car you hit is: liability.
- Which of the following health care services is most likely not covered by health insurance? Cosmetic surgery
- Which of the following people would not have a need for life insurance? Single person that owns a house but has no children (no dependents ... no wife, no children = no need for life insurance)
- You can reduce the cost of your homeowner's insurance by: installing dead bolt locks on your outside doors.
- Your homeowner's insurance policy includes a deductible of \$500. If your house receives wind damage from a recent storm estimated at \$2,100, how much will you have to pay out of pocket? \$ 500 (you pay the deductible; the insurance company pays the rest)

### TAXES

- The IRS (internal revenue service) processes income tax returns.
- W-4: The tax form completed upon employment claiming your number of allowances (before you start working).
- W-2: The tax form you receive from your employer at the end of the year; shows earnings and tax withholdings.
- Forms 1040EZ, 1040A, 1040: Tax forms that you must file; Personal tax returns must be filed with the federal government each year by April 15.
- Taxes withheld from an employee include all except: unemployment tax (this is paid by your employer, not the employee).
- Children can be claimed on a parent's taxes as long as they are still a dependent (living at home or at college and receiving financial support).
- The tax form sent to each employee in January showing the amount of wages earned and taxes withheld in the prior year is known as Form W-2.

- The United States uses a progressive income tax structure, meaning: the more money you make the higher percentage of taxes you will pay.
- When filing a federal tax return, what government agency do you file it with? Internal Revenue Service

### **CREDIT**

- Three C's of Credit: Character, Capacity, Collateral
- Five C's of Lending: Character, Capacity, Collateral, Capital, Conditions
- Which of the "Cs" of credit refers to property offered by the borrower to secure a loan? Collateral
- Revolving credit accounts include: credit cards, charge cards
- The minimum payment on a credit card is the smallest amount that you must pay in order to keep your account in good standing. You should try to pay more than the minimum payment each month.
- Installment credit accounts include: mortgages, car loans, student loans
- A "credit limit" or "line of credit" is the maximum amount you can borrow from a creditor.
- Secured loans – backed by assets (like a car loan); you can use any assets for collateral on a loan, including cash, accounts receivable, inventory, equipment, land, investments, etc.
- Unsecured loans – not backed by anything but the creditworthiness of the borrower
- A debit card directly transfers money from your checking account to the account of a store
- The smaller the payments that you make on a loan, the greater the interest you will need to pay on the loan (because it will take you longer to pay it back).
- Payday loans and check cashing services are expensive services and should be avoided.
- Your credit score (FICO score) places the most weight on your payment history
- A fixed rate mortgage has an interest rate that does not change for the term of the loan; the payments and terms are also fixed for the entire life of the mortgage
- On a mortgage, a point is equal to 1 percent of the loan
- A reverse mortgage is repaid when the borrower dies
- An SBA-backed loan may be used to purchase new equipment or expand operations. You may NOT use the funds to pay delinquent taxes, pay existing debt, or finance floor plan needs
- In business lending, a construction loan is often packaged with a real estate loan.
- Commercial lending (lending to businesses) is the largest dollar market for lending
- Which of the following is no longer allowed with the passing of the Credit Card Act of 2009? Credit card companies doing promotions on college campuses. (you now need to be 21 to get a credit card, unless you get a co-signer OR can prove financial independence to pay your bill).
- Which of the following would hurt your credit score? Applying for multiple credit cards
- Chapter 7 Bankruptcy: liquidation – forces the person filing to sell off their assets.
- Chapter 13 Bankruptcy: wage earner's plan – allows you to negotiate with creditors.
- Chapter 11 bankruptcy: for corporations declaring bankruptcy.
- Bankruptcy stays on a person's credit report for 10 years (most other negative info only stays on for 7 years).

### **PAYCHECKS, INCOME, BUDGETS, AND TAXES**

- Discretionary spending would be money you spend on: tickets for a basketball game.
- Direct deposit (or automatic deposit) is a service that employers provide to have your paycheck deposited automatically.
- Payroll cards are an alternative to direct deposit, where the employer gives you a debit card with the balance of your paycheck on it.
- Gross pay is calculated by multiplying the hours worked times the hourly pay. If you work more than 40 hours in a week, then you will be paid 1.5 times your hourly rate for those hours over 40.
- Typical taxes that are withheld from your paycheck include federal income taxes, state income taxes, local income taxes, Social Security/FICA, Medicare. These are REQUIRED deductions. The total tax obligation that you owe is called your tax liability.
- Other deductions from your paycheck might include: health insurance, vision insurance, dental insurance, 401K or other retirement deductions, etc. These are OPTIONAL deductions.
- In addition, you have sales taxes (paid on goods you purchase) and excise taxes on certain products (gasoline, cigarettes, alcohol, cars, boats, etc.)
- When you get a tax refund, it essentially means that you paid the government too much money out of your paycheck and essentially gave them an interest-free loan (in other words, it's a bad thing).
- Housing costs should not exceed 25%-28% of your total monthly income
- It is recommended to keep a budget for your entire lifetime (even in retirement).