



Passing Good Money Habits on to Your Children

Five tips for instilling financial confidence in the next generation

It's never too soon to talk money with your kids. At some point teens and young adults will need to make their own spending decisions. They need to be prepared.

Arming youth with critical financial skills may enhance their quality of life and can help them pursue important life goals, such as college or owning a home. But money also has a ripple effect on other important aspects of their lives, such as marriage. If you are not having the money conversation with your kids, their narratives could be shaped by a consumer-oriented culture that tries to equate spending with personal happiness and fulfillment.

Good savings habits are best modeled, but there are at least five things that parents can do to teach kids how to be responsible:

- 1. Be specific when telling children what things cost** — Young children lack points of reference when understanding the true cost of a toy, electronic game or cell phone. The purchase price alone does not fully reflect total cost, particularly with cell phones that require activation and monthly charges.
- 2. Let them make choices with money beginning at a young age** — Consider starting kids out with a weekly allowance in elementary school, say \$5. Then ask probing questions: Is it better to save or spend an allowance? Would sharing their money for a good cause interest them? Help your kids open a bank savings account, showing them how regular savings build up over time. As they grow, consider raising their allowance, and encourage them to earn their own pocket money while in high school.
- 3. Weigh pros and cons before making a purchase** — Do children really need the most expensive pair of sneakers? Would checking a novel out from the public library for free be better than buying one at the local bookstore?



Comparing prices at a grocery store teaches children how to be savvy shoppers.

- 4. Set up "buckets" for short, intermediate and long-term goals** — Young teens should be able to differentiate between near-term needs (a movie this weekend), intermediate needs (back-to-school clothes), and long-term goals (college or buying a house). It's likely that their spending habits will begin to be forged for life in college. It's also when making smaller mistakes with money (blowing an allowance on a handbag, for example) has fewer long-term ramifications than, say, signing a mortgage that their income cannot support.

Continued on Page 2

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Why Do People Overspend?

New research on why we break the budget and how to fix it

Our tendency to break the bank is as much hard-wired into our psyches as it's learned from friends and family. Why is this so?

We fail to consider future expenses that come with future income

Our mental wiring is great at imagining future income, but very poor at projecting expenses.¹ Buying more car than one can afford is a good example, because we tend to de-emphasize the expected future costs of maintaining it. Set a realistic budget that forces you to spend no more than what you earn — and save regularly.



Saving while borrowing creates a false sense of security

Sometimes the sole element of a financial plan is socking away cash. But to achieve that level of savings, some borrow more than they need. A savings plan should allow spending to avoid expensive debt, such as a ballooning credit card balance.

Collapse of willpower

Some people view willpower as something that is a limited resource that's fairly quickly depleted. Others see it as not easily used up. Which are you? People who believe willpower is finite make impulsive decisions, such as overspending, eating junk food, and procrastinating.² If you find yourself in this category, why not reward yourself after hard work by doing something that doesn't involve spending much, such as engaging in sports, taking nature walks, or meditating?

We think rising home equity equals wealth

Sometimes the more a house is worth, the more money people feel they have to spend.³ In reality, the only way to access wealth from a house that has increased in value is to sell it. But in all likelihood, a comparable house would have gone up in value as well, erasing any advantage unless the homeowner decides to downsize.

¹ Charles Wells, "The Hidden Reasons People Spend Too Much," *The Wall Street Journal*, November 2, 2015.

² Veronika Job, Gregory Walton and Katharina Bernecker, "Implicit Theories About Willpower Predict Self-Regulation and Grades in Everyday Life," *Journal of Personality and Social Psychology*, April 2015.

³ John V. Duca, John Muellbauer and Anthony Murphy, "How Financial Innovations and Accelerators Drive U.S. Consumption Booms and Busts," *Dallas Federal Reserve Bank Economic Letter* (Vol. 11, No. 3), April 2016; <http://www.dallasfed.org/assets/documents/research/ecllett/2016/el1603.pdf>.

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(continued from Page 1)

5. Start early, but don't overstress — Toddlers quickly grasp that money is a tool of exchange, and by the time they are 8 or 10 they can learn that money has a time value. Young teens may be mature enough to manage a yard sale.

However, it's important that parents take care not to share their financial stresses with young children. Few kids have the emotional maturity to process information about a lost job or a market downturn.

Above all, don't expect children to be perfect with money from day one — for all of us, managing our financial lives is a "work in progress."



Financial IQ – A 10-Question Quiz to Test Your Money Smarts

See how much you know by taking this quick multiple-choice quiz
(Answers and scorecard provided at end.)

- 1. What percentage of your FICO credit score is calculated based on your track record of paying bills on time?**
 - a. 0%
 - b. 15%
 - c. 25%
 - d. 35%
- 2. What is the best way for most people to finance a new car purchase?**
 - a. A three-year loan
 - b. A five-year loan
 - c. A loan from your 401(k) account
 - d. A lease
- 3. Which of the following statements is true about your credit score?**
 - a. You get 200 points for correctly entering your name online.
 - b. It's the same as the balance on your highest interest rate credit card.
 - c. Employers are not allowed to view it.
 - d. It can help you negotiate a lower financing rate on a car or home loan.
- 4. Which of the following will improve your credit score?**
 - a. Paying your bills on time
 - b. Opening and closing multiple credit card accounts
 - c. Keeping your amount of total debt large
 - d. Changing jobs and addresses frequently
- 5. Which retirement-oriented investment vehicle is specifically designed to minimize the need to make changes as you approach retirement?**
 - a. Roth IRA
 - b. Variable annuities
 - c. Target-date funds
 - d. Money market funds
- 6. Which of the following statements is true?⁴**
 - a. Only 57% of the U.S. population is financially literate.
 - b. The financial literacy gap between men and women in the U.S. is 10%.
 - c. Only (a) is true.
 - d. Both (a) and (b) are true.
- 7. Which of the following statements is true of investment products, including bonds, stocks and mutual funds?**
 - a. They are available through a bank or brokerage firm.
 - b. They can lose value.
 - c. They are not insured by the FDIC.
 - d. All of the above.
- 8. What's the optimal outcome for a \$1,000 investment portfolio held over a two-year period?**
 - a. Its value increases 100% the first year, then drops 50% the second year.
 - b. Its value goes up 10% the first year and remains unchanged in the second year.
 - c. Its value increases 5% each year.
 - d. Its value goes down 50% the first year, but then increases 120% the second year.
- 9. Let's say that the interest rate on your savings account was 1% per year and inflation was 2% per year. After one year, would you be able to buy more than, exactly the same as, or less than today with the money in your account?**
 - a. Less than today
 - b. More than today
 - c. Exactly the same as today
 - d. Do not know
- 10. If interest rates fall, what should happen to bond prices?**
 - a. They will rise.
 - b. They will fall.
 - c. They will stay the same.
 - d. I don't know.

Answers:

1. d; 2. a; 3. d; 4. a; 5. c; 6. d; 7. d; 8. c; 9. a; 10. a.

Score yourself!

Eight to 10 answers correct: You are brilliant when it comes to money. Keep it up!

Four to seven answers correct: Brushing up on a few basic concepts will improve your confidence in financial matters.

Zero to three answers correct: You need to take more time to master the complexities of your financial life. Taking even small steps helps.

⁴ Source: S&P Ratings 2015 Financial Literacy Survey.

Retirement in Motion

TIPS AND RESOURCES THAT EVERYONE CAN USE

Catch-up Contributions

Need to save more for retirement? If you are 50 or older and participate in your company's 401(k), 403(b) and most 457 plans, you can make additional "catch-up" contributions of \$6,000 to your account in 2016. That's in addition to the \$18,000 in annual salary that you may elect to defer into your plan. The annual contribution limit to an Individual Retirement Arrangement (IRA) is \$5,500, with a \$1,000 additional catch-up contribution allowed if you are 50 or over.

Q&A

How to pay for investment advice — fees or commissions?

A common misperception among investors is that financial advisors provide their services for free, and that mutual funds do not charge expenses. But when some advisors recommend buying a stock or fund, they can receive a commission for that purchase. Other advisors charge a fee, either by the hour or for a-la-carte services, a model that ideally provides the investor with objective advice.

Quarterly Reminder

Don't let the holidays derail your savings goals

While the end of the year is a wonderful time to reconnect with friends and family, it also can be a tempting time to suspend your retirement savings program and be more lavish with entertaining and gifts. But don't get distracted from your savings goals. Let's assume you decide to put \$250 in a retirement savings account rather than spend it over the holidays. You also

commit to adding \$25 per month to this account, which earns an average 6% return. Thanks to monthly compounding, you would have saved more than \$12,300 after 20 years!⁵

Tools & Techniques

Money market accounts vs. savings accounts

For investors who are looking for a higher interest rate than is available through a traditional savings or checking account, a money market account may be just the ticket. A money market account is an interest-bearing account that pays a higher rate of interest than a savings account, and it can offer limited check-writing privileges. It usually requires the account holder to maintain a higher monthly account balance (usually \$2,500) in exchange for providing a higher taxable yield. Money market accounts are FDIC-insured, just like savings and checking accounts.

Corner on the Market

Basic financial terms to know

Management fee

A management fee is a charge incurred by an investment manager for managing an investment fund. The fee compensates the manager for the time and expertise it takes to research securities and to make investment decisions on behalf of the fund. Management fees can include other items, such as the cost to print and mail statements and reports and certain other fund administrative costs.

⁵ Bankrate.com, Simple Savings Calculator, <http://www.bankrate.com/calculators/savings/simple-savings-calculator.aspx>.