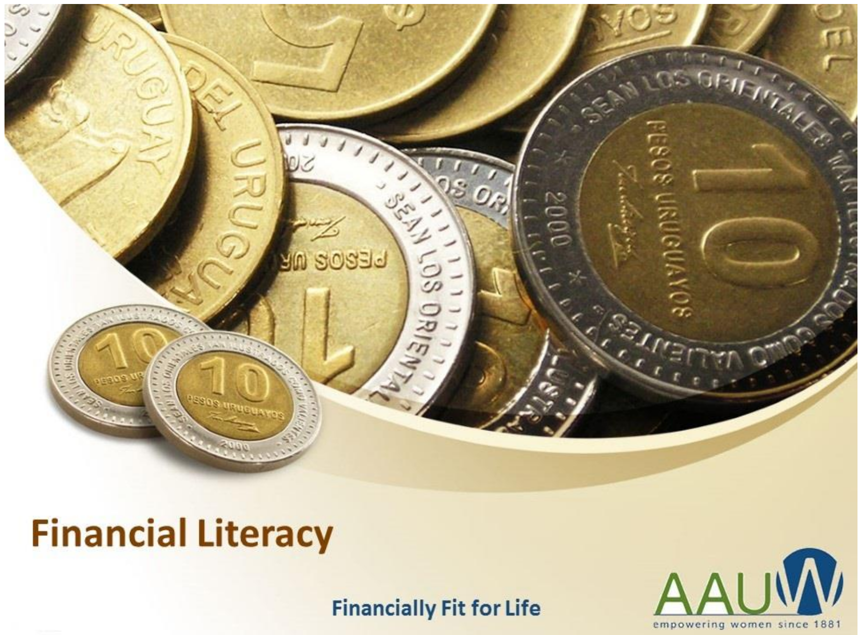
Financial Literacy

Money Trek Program



Module 5: Workbook

Saving & Investing

AAUW California Financial Literacy Committee

AAUW
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Module 5: Saving & Investing

Activity 1: Using compound interest to reach a financial goal

Suppose you are a college freshman and that you will need a car when you graduate to go to work. You need a good, reliable car, but not a new car. Your family, whose advice you trust, says to expect to spend about $20,000 for the car and that you should save $5,000 as a down payment. They will help you get started with $1,000 in the car fund. You have 4 years to save the rest of the down payment and interest rates are about 1.5%

Let's use Suze Orman's Compound Interest Forecaster to see how much you need to save every month to reach your goal.

Plan 1: What if you put $50/month into the car fund?
Result: Bad news! You're short! The forecaster says you'll have only $3536.76 in the car fund in 4 years.

Plan 2: What if you put $75/month into the car fund?
Result: Not bad! At the end of 4 years, you'll have $4,774.24 in the car fund. And you'll probably get some cash gifts for graduation, so you'll squeak by.

Plan 3: What if you put $100/month into the car fund?
Result: Great news! At the end of 4 years, you'll have $6011.72 in the car fund. A surplus!

Discussion

- Which of the plans makes the most sense to you? Why?
- What if you absolutely, positively cannot possibly save $75/month toward the new car? What can you do to have a car in 4 years?

Activity 2: Using asset allocation to buffer stock market swings

According to Wikipedia, asset allocation is an investment strategy that attempts to balance risk versus reward by adjusting the percentage of each asset in an investment portfolio according to the investors risk tolerance, goals and investment time frame.

This means that, to balance risk, an investor should own a mixture of stocks and bonds. And own a variety of stocks, not just one or two. And that this mix will vary over time.

Let's use CNNMoney's asset allocation wizard to see how they would "Fix the Mix" for a graduating college senior, with 20+ years to invest, medium risk tolerance, some flexibility as to date of retirement, and sticks to the plan in a sell-off.

Answer: 90% stocks, 10% bonds. Stocks are 50% large caps, 20% foreign, 20% small cap.

Activity 3: How much will you need to save for retirement?

Let's use CNNMoney's What you need to save calculator to see what a college graduate, who is age 25, wants to retire at 65, makes $85,000/year, has no pension, but has good social security, would need to save for retirement.

Answer: $9690/year or 11.4%/year

Activity 4: How much will you need in retirement?

Let's use CNNMoney's How much will you need for retirement? calculator to see what the same college graduate would need to save for retirement.

Answer: $3.1 million or $916,529 in today's dollars.

Activity 5: That's very scary, let's try a different calculator!

OK, OK CNN is a media company. Let's go to Vanguard, a mutual fund company, and see what they have to say. We'll use CNNMoney's recommended savings plan: college graduate, age 25, wants to retire at 65, $0 saved for retirement, makes $85,000/year, saves about $9,500/year toward retirement.

Answers: When you enter the CNNMoney recommended savings plan into the Vanguard calculator, it shows that our 25 year old should just about make it:

- At a 5% return on investments, including $2300/month Social Security income, our 25 year old *will need to learn to live on 60% of current income.*
- At an 8% return on investments, including $2300/month Social Security income, our 25 year old *will need to learn to live on 88% of current income.*
- **The message from both calculators is clear: save for retirement!**

Discussion

- Were you shocked to learn what's required for retirement savings?
- What can you do to make saving for retirement easier?

Brainstorm:

1. What is the Golden Rule of Savings?
2. What are various methods of Savings?
3. What are advantages and disadvantages of investing in stocks, bonds and mutual funds?