

Chapter 1

Improving Your Financial Literacy

In This Chapter

- ▶ Looking at what your parents and others taught you about money
 - ▶ Studying money management in schools
 - ▶ Hitting the books (and other sources): Questioning reliability
 - ▶ Overcoming real and imagined financial hurdles
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Unfortunately, most Americans don't know how to manage their personal finances because they were never taught how to do so. Their parents may have avoided discussing money in front of the kids, and nearly all our high schools and colleges lack even one course that teaches this vital, lifelong-needed skill.



Some people are fortunate enough to learn the financial keys to success at home, from knowledgeable friends, and from good books like this one. Others either never learn the keys to success, or they learn them the hard way — by making lots of costly mistakes. People who lack knowledge make more mistakes, and the more financial errors you commit, the more money passes through your hands and out of your life. In addition to the enormous financial costs, you experience the emotional toll of not feeling in control of your finances. Increased stress and anxiety go hand in hand with not mastering your money.

This chapter examines where people learn about finances and helps you decide whether your current knowledge is helping you or holding you back. You can find out how to improve your financial literacy and take responsibility for your finances, putting you in charge and reducing your anxiety about money. After all, you have more important things to worry about, like what's for dinner.

Talking Money at Home

I was fortunate in that my parents instilled in me the importance of personal financial management. Mom and Dad taught me a lot of things that have been invaluable throughout my life, and among those things were sound principles for earning, spending, and saving money. My parents had to know how to do these things, because they were raising a family of three children on (usually) one modest income. They knew the importance of making the most of what you have and of passing that vital skill on to your kids.



In many families, however, money is a taboo subject — parents don't level with their kids about the limitations, realities, and details of their budgets. Some parents I talk with believe that dealing with money is an adult issue and that kids should be insulated from it so that they can enjoy being kids. In many families, kids may hear about money *only* when disagreements and financial crises bubble to the surface. Thus begins the harmful cycle of children having negative associations with money and financial management.

In other cases, parents with the best of intentions pass on their bad money-management habits. You may have learned from a parent, for example, to buy things to cheer yourself up. Or you may have witnessed a family member maniacally chasing get-rich-quick business and investment ideas. Now I'm not saying that you shouldn't listen to your parents. But in the area of personal finance, as in any other area, poor family advice and modeling can be problematic.

Think about where your parents learned about money management, and then consider whether they had the time, energy, or inclination to research choices before making their decisions. For example, if they didn't do enough research or had faulty information, your parents may mistakenly think that banks are the best places for investing money or that buying stocks is like going to Las Vegas. (You can find the best places for investing your money in Part III of this book.)

In still other cases, the parents have the right approach, but the kids go to the other extreme out of rebellion. For example, if your parents spent money carefully and thoughtfully and at times made you feel denied, you may tend to do the opposite, buying yourself gifts the moment any extra money comes your way.

Although you and I can't change what the educational system and your parents did or didn't teach you about personal finances, you now have the ability to find out what you need to know to manage your finances.



If you have children of your own, I'm sure you agree that kids really are amazing. Don't underestimate their potential or send them out into the world without the skills they need to be productive and happy adults. Buy them some good financial books when they head off to college or begin their first job.

Financial illiteracy: A costly situation

The lack of proficiency in personal financial management causes not only tremendous anxiety but also serious problems. Consider the following sobering statistics:

- ✔ Studies show that less than 20 percent of baby boomers are saving adequately for retirement and that one-quarter of the adults between the ages of 35 and 54 have not even *begun* to save for retirement.
- ✔ One out of every two marriages in America ends in divorce. Studies show that financial disagreement is one of the leading causes of marital discord. In a survey conducted by *Worth* magazine and the market research firm of Roper/Starch, couples admitted to fighting about money more than anything else (more than three times more often than they fight about their sex lives). And a staggering 57 percent of those surveyed agreed with the statement “In every marriage, money eventually becomes the most important concern.”
- ✔ Less than 10 percent of American adults understand a 401(k) well enough to explain it to someone else. Fewer than one in four can explain what a municipal bond is.
- ✔ Only 8 percent of investors knew that there’s not any agency or organization that “insures you against losing money as the result of fraud in your investment portfolio,” according to a survey conducted by the Securities Investor Protection Corporation and the Investor Protection Trust.
- ✔ Nearly 80 percent of consumers do not know how the grace period on a credit card works. An even greater percentage doesn’t understand that interest starts accumulating *immediately* for new purchases on credit cards with outstanding debts.
- ✔ Fifty-three percent of people who took a multiple choice investing quiz did not know that *total return* was the best measure of a mutual fund’s performance.

Picking Up on Personal Finance in the Classroom

In schools, the main problem with personal finance education is the lack of classes, not that kids already know the information or that the skills are too complex for children to understand.

Nancy Donovan teaches personal finance to her fifth-grade math class as a way to illustrate how math can be used in the real world. “Students choose a career, find jobs, and figure out what their taxes and take-home paychecks will be. They also have to rent apartments and figure out a monthly budget,” says Donovan. “Students like it, and parents have commented to me how surprised they are with how much financial knowledge their kids can handle.” Donovan also has her students invest \$10,000 (play money) and then track the investments’ performance.

Urging schools to teach the basics of personal finance is just common sense. We should be teaching our children how to manage a household budget, the importance of saving money for future goals, and the consequences of over-spending. Unfortunately, few schools offer classes like Donovan's. In most cases, the financial basics aren't taught at all.

In the handful of schools that do offer a course remotely related to personal finance, the class is typically in economics (and an elective at that). "Archaic theory is being taught, and it doesn't do anything for the students as far as preparing them for the real world," says one high school principal I know. Having taken more than my fair share of economics courses in college, I understand the principal's concerns.

Some people argue that teaching children financial basics is the parents' job. However, this well-meant sentiment is what we're relying on now, and for all too many, it isn't working. In some families, financial illiteracy is passed on from generation to generation.

We must recognize that education takes place in the home, on the streets, and in the schools. Therefore, schools must bear some responsibility for teaching this skill. However, if you're raising children, remember that no one cares as much as you do or has as much ability to teach the important life skill of personal money management.

Identifying Unreliable Sources of Information

Some people are smart enough to realize that they're not financial geniuses. So they set out to take control of their finances by reading or consulting a financial advisor. Because the pitfalls are so numerous and the challenges so mighty when choosing an advisor, I devote Chapter 18 to the financial planning business and tell you what you need to know to avoid being fooled.

Reading is good. Reading is fundamental. But reading to find out how to manage your money can be dangerous if you're a novice. Misinformation can come from popular and seemingly reliable information sources, as I explain in the following sections.

Recognizing fake financial gurus

Before you take financial advice from anyone, examine his or her background, including professional work experience and education credentials. This is true whether you're getting advice from an advisor, writer, talk show host, or television financial reporter.

If you can't easily find such information, that's usually a red flag. People with something to hide or a lack of something redeeming to say about themselves usually don't promote their background.

Of course, just because someone seems to have a relatively impressive sounding background doesn't mean that she has your best interests in mind or has honestly presented her qualifications. *Forbes* magazine journalist William P. Barrett presented a sobering review of financial author Suze Orman's stated credentials and qualifications:

“Besides books and other royalties, Orman's earned income has come mainly from selling insurance — which gets much more attention in her book than do stocks or bonds. . . . The jacket of her video says she has '18 years of experience at major Wall Street institutions.' In fact, she has 7. The 'nearly 1,000 new clients each year' touted on her publisher's Web site are simply fans making inquiries by mail.”

When the *Forbes* piece came out, Orman's publicist tried to discredit it and made it sound as if the magazine had falsely criticized Orman. In response, the *San Francisco Chronicle*, which is the nearest major newspaper to Orman's hometown, picked up on the *Forbes* piece and ran a story of their own — written by Mark Veverka in his “Street Smarts” column — which substantiated the *Forbes* story.

Veverka went through the *Forbes* piece point by point and gave Orman's company and the public relations firm numerous opportunities to provide information contrary to the piece, but they did not. Here's some of what Veverka recounts from his contact with them:

“If you want your side told, you have to return reporters' telephone calls. But alas, no callback.

“. . . On Wednesday, December 6, Orman's publicist said a written response to the *Forbes* piece and the 'Street Smarts' column would be sent by facsimile to the *Chronicle* that day. However, no fax was ever sent. They blew me off. Twice.

“In what was becoming an extraordinary effort to be fair, I placed more telephone calls over several days to Orman Financial and the publicist, asking for either an interview with Orman or an official response. If Orman didn't fudge about her years on Wall Street or didn't let her commodity-trading adviser license lapse, surely we could straighten all of this out, right?

“Still, no answer. Nada. On December 17, I called yet again. Finally, literally on deadline, a woman who identified herself as Orman's 'consultant' called me to talk 'off the record' about the column. What she ended up doing was bashing the *Forbes* piece and my column but not for publication. More importantly, she offered no official retort to allegations made by veteran *Forbes* writer William Barrett. I have to say, it was an incredibly unprofessional attempt at spinning. And I've been spun by the worst of them.”

Even then you can't always accept stated credentials and qualifications at face value, because some people lie. You can't sniff out liars by the way they look, their gender, or their age. You can, however, increase your chances of being tipped off by being skeptical. You can see a number of hucksters in the print publishing field for what they are by using common sense in reviewing some of their outrageous claims.



One formerly best-selling personal finance book (*Wealth Without Risk*, by Charles Givens) advises you to “Buy disability insurance only if you are in poor health or accident prone.” Putting aside the minor detail that no insurance company (that's interested in making a profit) is going to issue you a disability policy after you fall into poor health, how do you know when you're going to be accident-prone? Because health problems and auto accidents cause many disabilities, you can't see disabilities coming unless your horoscope happens to warn you!



Some sources of advice, such as Wade Cook's investment seminars, lure you in by promising outrageous returns. The stock market has generated average annual returns of about 10 percent over the long term. However, Cook, a former taxi driver, promoted his seminars as an “alive, hands-on, do the deals, two-day intense course in making huge returns in the stock market. If you aren't getting 20% per month, or 300% annualized returns on your investments, you need to be there.” (I guess I do, as does every investment manager and individual investor I know!)

Cook's get-rich-quick seminars, which cost more than \$6,000, were so successful at attracting people that his company went public in the late 1990s and generated annual revenues of more than \$100 million.

Cook's “techniques” included trading in and out of stocks and options on stocks after short holding periods of weeks, days, or even hours. His trading strategies can best be described as techniques that are based upon technical analysis — that is, charting a stock's price movements and volume history, and then making predictions based on those charts.



The perils of following an approach that advocates short-term trading with the allure of high profits are numerous:

- ✔ You're going to rack up enormous brokerage commissions.
- ✔ On occasions where your short-term trades produce a profit, you pay high ordinary income tax rates rather than the far lower capital gains rate for investments held more than 12 months.
- ✔ You're not going to make big profits — quite the reverse. If you stick with this approach, you'll underperform the market averages.
- ✔ You're going to make yourself a nervous wreck. This type of trading is gambling, not investing. Get sucked up in it, and you'll lose more than money — you may also lose the love and respect of your family and friends.

If Cook's followers were indeed earning the 300 percent annual returns his seminars claim to help you achieve, any investor starting with just \$10,000 would vault to the top of the list of the world's wealthiest people (ahead of Bill Gates and Warren Buffett) in just 11 years!

Understanding how undeserving investment gurus get popular

You may be wondering how Givens and Cook became so popular despite the obvious flaws in their advice. Givens made the most of his talent for working the media and his great self-promotion through seminars. One of the problems with the mass media is that hucksters can get good publicity because many members of the media are themselves financially illiterate, and they love a good story. So charming hucksters get all sorts of free coverage, getting quoted in the press and invited to appear on a number of national television and radio programs.

Thousands of people went to seminars conducted by Givens, partly because of the credibility Givens built through media appearances. As has now been well documented by some of those same members of the media, many unsuspecting investors were sold commission-laden products, including risky limited partnerships, through his organization.

Consider the case of Helen Giszczak, a 69-year-old retired secretary. She invested nearly two-thirds of her modest life savings in limited partnerships, which she said were described to her by Givens's associates as "probably the most conservative investments we know of." But some of her limited partnerships ended up in bankruptcy, while the others lost much of their value.

Helen Giszczak appeared on the *Donahue* show with John Allen, an investment broker turned securities lawyer who helped her sue Givens's organization to get her money back. After a lengthy dialogue with Giszczak and Allen, Phil Donahue asked Helen how a smart person like her could get sucked in like that. She replied, "He was on your show and Oprah's. You gave him credibility. You gave him free advertising."

Wade Cook, on the other hand, promoted his seminars through infomercials and other advertising, including radio ads on respected news stations. The high stock market returns of the 1990s brought greed back into fashion. (My experience has been that you see more of this greed near market tops than you do near market bottoms.)

The attorneys general of numerous states sued Cook's company and sought millions of dollars in consumer refunds. The suits alleged that the company lied about its investment track record (not a big surprise — this company claimed that you'd make 300 percent per year in stocks!).

Cook's company settled the blizzard of state and Federal Trade Commission (FTC) lawsuits against his firm by agreeing to accurately disclose its trading record in future promotions and give refunds to customers who were misled by past inflated return claims.

According to a news report by *Bloomberg News*, Cook's firm disclosed that it lost a whopping 89 percent of its own money trading during the last reporting year. As Deb Bortner, director of the Washington State Securities Division and president of the North American Securities Administrators Association observed, "Either Wade is unable to follow his own system, which he claims is simple to follow, or the system doesn't work."



Don't assume that someone with something to sell, who is getting good press and running lots of ads, will take care of you. That "guru" may just be good at press relations and self-promotion. Certainly, talk shows and the media at large can and do provide useful information on a variety of topics, but bad eggs sometimes turn up. These bad eggs may not always smell bad upfront. In fact, they may hoodwink people for years before finally being exposed. Please review Part V for the details on resources you can trust and those that could cause you to go bust!

Pandering to advertisers



Thousands of publications and media outlets — newspapers, magazines, Web sites, radio, television, and so on — dole out personal financial advice and perspectives. Although many of these "service providers" collect revenue from subscribers, virtually all are dependent — in some cases, fully dependent (especially on the Internet, radio, and television) — on advertising dollars. Although advertising is a necessary part of capitalism, advertisers can taint and, in some cases, dictate the content of what you read, listen to, and view.

Consider this case from a nonfinancial publication — *Modern Bride* magazine. *Harper's* magazine got ahold of an apologetic letter (which it humorously entitled "To Love, Honor And Obey Our Advertisers") that *Bride's* fashion advertising director sent to the magazine's advertisers. Here's an excerpt of that letter:

"*Bride's* recommends that its readers (your customers) negotiate price, borrow a slip or petticoat, and compare catalog shoe prices, and tells its readers that the groom's tuxedo may be free. It is difficult to understand why *Bride's* was compelled to publish this information. With 57 years of publishing experience and support to the bridal industry, *Bride's* could and should have been more sensitive to the retailers that it purports to serve. All of us in the bridal business must concentrate on projecting full-service bridal retailing in a positive light."

I don't find it difficult to understand why the writer of the criticized *Bride's* article suggested cost-saving strategies to its readers — she was trying to give them useful information and advice! Now, revealing letters like this one are hard to come by, so how can you, a consumer of financial information, separate the good publications from the advertiser-biased publications? After writing and working for a number of publications, and observing the workings of even more, I've developed some ideas on the subject.

Be sure to consider how dependent a publication or media outlet is on advertising. I find that “free” publications, radio, and television are the ones that most often create conflicts of interest by pandering to advertisers. (All three derive all their revenue from advertising.)

Much of what's on the Internet is advertiser-driven, as well. Many of the investing sites on the Internet offer advice about individual stocks. Interestingly, such sites derive much of their revenue from online brokerage firms seeking to recruit customers who are foolish enough to believe that selecting their own stocks is the best way to invest. (See Part III for more information about your investment options.)

As you read various publications, watch TV, or listen to the radio, note how consumer-oriented these media are. Do you get the feeling that they're looking out for your interests? For example, if lots of auto manufacturers advertise, does the media outlet ever tell you how to save money when shopping for a car or the importance of buying a car within your means? Or are they primarily creating an advertiser-friendly broadcast or publication?

Jumping over Real and Imaginary Hurdles to Financial Success

Perhaps you know that you should live within your means, buy and hold sound investments for the long term, and secure proper insurance coverage; however, you can't bring yourself to do these things. We all know how difficult it is to break habits that you've practiced for many years. The temptation to spend money lurks everywhere you turn. Ads show attractive and popular people enjoying the fruits of their labors — a new car, an exotic vacation, and a lavish home.

Maybe you felt deprived by your tightwad parents as a youngster, or maybe you're bored with life and you like the adventure of buying new things. If only you could hit it big on one or two investments, you think, you could get rich quick and do what you really want with your life. As for disasters and catastrophes, well, those things happen to other people, not to you. Besides, you'll probably have advance warning of pending problems, so you can prepare accordingly, right?

Your emotions and temptations can get the better of you. Certainly, part of successfully managing your finances involves coming to terms with your shortcomings and the consequences of your behaviors. If you don't, you may end up enslaved to a dead-end job so you can keep feeding your spending addiction. Or you may spend more time with your investments than you do with your family and friends. Or unexpected events can leave you reeling financially; disasters and catastrophes can happen to anyone at any time.

Discovering what (or who) is holding you back

A variety of personal and emotional hurdles can get in the way of making the best financial moves. As I discuss earlier in this chapter, a lack of financial knowledge (which stems from a lack of personal financial education) can stand in the way of making good decisions.

But I've seen some people caught in the psychological trap of blaming something else for their financial problems. For example, some people believe that all our adult problems can be traced back to childhood and how we were raised. Behaviors ranging from substance abuse and credit card addiction to sexual infidelity are supposedly caused by our roots.

I don't want to disregard the negative impact particular backgrounds can have on some people's tendency to make the wrong choices during their lives. Exploring your personal history can certainly yield clues to what makes you tick. That said, we are adults making choices and engaging in behaviors that affect ourselves as well as others. We shouldn't blame our parents for our own inability to plan for our financial futures, live within our means, and make sound investments.

Some people also tend to blame their financial shortcomings on not earning more income. Such people believe that if only they earned more, their financial (and personal) problems would melt away.

My experience working and speaking with people from diverse economic backgrounds has taught me that achieving financial success — and more importantly, personal happiness — has virtually nothing to do with how much income a person makes but rather with what she makes of what she does have. I know financially wealthy people who are emotionally poor even though they have all the material goods they want. Likewise, I know people who are quite happy, content, and emotionally wealthy even though they're struggling financially.

Americans — even those who have not had an “easy” life — should be able to come up with numerous things to be happy about and grateful for: a family who loves them; friends who laugh at their stupid jokes; the freedom to catch a movie or play or to read a good book; a great singing voice, sense of humor, or a full head of hair.

Developing good financial habits

After you understand the basic concepts and know where to buy the best financial products when you need them, you’ll soon see that managing personal finances well is not much more difficult than other things you do regularly, like tying your shoelaces and getting to work each day.



Regardless of your income, you can make your dollars stretch further if you practice good financial habits and avoid mistakes. In fact, the lower your income, the more important it is that you make the most of your income and savings (because you don’t have the luxury of falling back on your next fat paycheck to bail you out).

More and more industries are subject to global competition, so you need to be on your financial toes now more than ever. Job security is waning; layoffs and retraining for new jobs are increasing. Putting in 30 years for one company and retiring with the gold watch and lifetime pension are becoming as rare as never having problems with your computer.

Speaking of company pensions, odds are increasing that you work for an employer that has you save toward your own retirement instead of providing a pension for you. Not only do you need to save the money, you must also decide how to invest it. Chapter 11 can help you get a handle on investing in retirement accounts.

Personal finance involves much more than managing and investing money. It also includes making all the pieces of your financial life fit together; it means lifting yourself out of financial illiteracy. Like planning a vacation, managing your personal finances means forming a plan for making the best use of your limited time and dollars.



Intelligent personal financial strategies have little to do with your gender, ethnicity, or marital status. We all need to manage our finances wisely. Some aspects of financial management become more or less important at different points in your life, but for the most part, the principles remain the same for everyone.

Knowing the right answers isn't enough. You have to practice good financial habits just as you practice other good habits, such as brushing your teeth. Don't be overwhelmed. As you read this book, make a short list of your financial marching orders and then start working away. Throughout this book, I highlight ways you can overcome temptations and keep control of your money rather than let your emotions and money rule you. (I discuss common financial problems in Chapter 2.)



What you do with your money is a quite personal and confidential matter. In this book, I try to provide guidance that can keep you in sound financial health. You don't have to take it all — pick what works best for you and understand the pros and cons of your options. But from this day forward, please don't make the easily avoidable mistakes or overlook the sound strategies that I discuss throughout this book.

If you're young, congratulations for being so forward-thinking as to realize the immense value of investing in your personal financial education. You'll reap the rewards for decades to come. But even if you're not so young, you surely have many years to make the most of the money you currently have, the money you're going to earn, and even the money you may inherit!

Throughout your journey, I hope to challenge and even change the way you think about money and about making important personal financial decisions — and sometimes even about the meaning of life. No, I'm not a philosopher, but I do know that money — for better but more often for worse — is connected to many other parts of our lives.