PERSONAL FINANCE

TENTH EDITION

JACK R. KAPOOR

College of DuPage

LES R. DLABAY

Lake Forest College

ROBERT J. HUGHES

Dallas County Community Colleges



Brief Contents

1	Planning Your Personal Finances
	 Personal Finance Basics and the Time Value of Money 1 Appendix: The Time Value of Money 31
	 Financial Aspects of Career Planning 41 Appendix: Résumés, Cover Letters, and Interviews 67
	3 Money Management Strategy: Financial Statements and Budgeting 77 4 Planning Your Tax Strategy 105
2	Managing Your Personal Finances
_	 Financial Services: Savings Plans and Payment Accounts 139 Introduction to Consumer Credit 170 Choosing a Source of Credit: The Costs of Credit Alternatives 212
2	Making Your Purchasing Decisions
	 8 Consumer Purchasing Strategies and Legal Protection 252 9 The Housing Decision: Factors and Finances 282
4	Insuring Your Resources
7	 10 Property and Motor Vehicle Insurance 316 11 Health, Disability, and Long-Term Care Insurance 346 12 Life Insurance 387
5	Investing Your Financial Resources
	13 Investing Fundamentals 423
	14 Investing in Stocks 46015 Investing in Bonds 499
	16 Investing in Mutual Funds 53517 Investing in Real Estate and Other Investment Alternatives 570
6	Controlling Your Financial Future
	18 Starting Early: Retirement Planning 59319 Estate Planning 634
	Appendixes
	 A Financial Planners and Other Information Sources A-1 B Consumer Agencies and Organizations B-1 C Daily Spending Diary C-1
	Endnotes _{N-1}
	Photo Credits PC-1
	Index I-1
	Personal Financial Planner

Contents

Planning Your Personal Finances 1 Personal Finance Basics and the Time Value of Money 1 Career Choice Factors 42 Trade-Offs of Career Decisions 42 Career Training and Skill Development Personal Factors 43 Career Decision Making 44 Career Opportunities:	42
1 Personal Finance Basics and the Time Value of Money 1 Career Decision Making 44	
Career Opportunities:	
The Financial Planning Process 2 Step 1: Determine Your Current Financial Situation 3 Step 2: Develop Your Financial Goals 4 Step 3: Identify Alternative Courses of Action 4 Step 4: Evaluate Your Alternatives 5 Step 5: Create and Implement Your Financial Action Plan 6 Step 6: Review and Revise Your Plan 7 Developing Personal Financial Goals 8 Types of Financial Goals 8 Goal-Setting Guidelines 9 Now and in the Future 46 Social Influences 46 Economic Conditions 46 Industry Trends 47 Employment Search Strategies 49 Obtaining Employment Experience 49 Using Career Information Sources 49 Identifying Job Opportunities 52 Career Strategies in a Weak Job Market Applying for Employment 54 Financial and Legal Aspects of Employment Accepting an Employment Position 54 Evaluating Employee Benefits 55	
Influences on Personal Financial Planning 11 Your Employment Rights 57	
Life Situation and Personal Values 11 Long-Term Career Development 58 Economic Factors 12 Training Opportunities 59 Opportunity Costs and the Career Paths and Advancement 59 Time Value of Money 16 Changing Careers 59	
Personal Opportunity Costs 17 Appendix: Résumés, Cover Letters, Financial Opportunity Costs 17 and Interviews 67	
Achieving Financial Goals 21 Components of Personal Financial Planning 21 Developing a Flexible Financial Plan 24 Implementing Your Financial Plan 24 Components of Personal Financial Statements and Budgeting 77 Successful Money Management 78 Opportunity Cost and Money	ancial
Studying Personal Finance 25 Appendix: The Time Value of Money 31 Components of Money Management	'9

xxx Contents

A System for Personal Financial Records 80	Investment Decisions 130
Personal Financial Statements 82	Retirement Plans 131
The Personal Balance Sheet: Where Are You Now? 82	Tax-Saving Strategies: A Summary 133
Evaluating Your Financial Position 85	7
The Cash Flow Statement: Where Did Your Money Go? 85	Managing Your
Budgeting for Skilled Money Management 88	Managing Your
The Budgeting Process 89	Personal Finances
Characteristics of Successful Budgeting 95	5 Financial Services: Savings Plans and
Money Management and Achieving Financial Goals 96	Payment Accounts 139
Identifying Saving Goals 97	A Cash Management Strategy 140
Selecting a Saving Technique 97	Meeting Daily Money Needs 140
Calculating Savings Amounts 98	<i>Types of Financial Services</i> 141 Online Banking 142
4 Planning Your Tax Strategy 105	Opportunity Costs of Financial Services 143
Taxes and Financial Planning 106	Financial Services and Economic Conditions 144
Taxes on Purchases 106	Financial Institutions 144
Taxes on Property 106 Taxes on Wealth 106	Deposit Institutions 145
Taxes on Earnings 107	Other Financial Institutions 148
Income Tax Fundamentals 107	Comparing Financial Institutions 148
Step 1: Determining Adjusted Gross	Savings Plans 150
Income 108	Regular Savings Accounts 150
Step 2: Computing Taxable Income 109	Certificates of Deposit 150
Step 3: Calculating Taxes Owed 112	Money Market Accounts and Funds 152
Making Tax Payments 114	U.S. Savings Bonds 152
Deadlines and Penalties 116	Evaluating Savings Plans 154
Filing Your Federal Income Tax Return 116	Rate of Return 154
Who Must File? 116	Inflation 156
Which Tax Form Should You Use? 117	Tax Considerations 156
Completing the Federal Income Tax Return 117	Liquidity 156 Safety 157
Filing State Income Tax Returns 119	FDIC Coverage 157
Tax Assistance and the Audit Process 121	Restrictions and Fees 158
Tax Information Sources 121	Payment Methods 158
Tax Preparation Software 124	Electronic Payments 158
Tax Preparation Services 124	Types of Checking Accounts 159
What If Your Return Is Audited? 127	Evaluating Checking Accounts 160
Tax Planning Strategies 128	Managing Your Checking Account 162
Consumer Purchasing 129	Other Payment Methods 164

Contents xxxi

Phase 2—Evaluating Alternatives 261

6 Introduction to Consumer The Cost of Credit 218 Credit 170 Finance Charge and Annual Percentage Rate (APR) 219 What Is Consumer Credit? 171 Tackling the Trade-Offs 220 The Importance of Consumer Credit in Our Calculating the Cost of Credit 222 Economy 172 When the Repayment Is Early: Uses and Misuses of Credit 172 The Rule of 78s 228 Advantages of Credit 173 Credit Insurance 231 Disadvantages of Credit 174 Cost of Credit and the Credit Card Accountability, Summary: Advantages and Disadvantages Responsibility, and Disclosure Act of 2009 of Credit 174 (the Credit Card Act) 231 Types of Credit 175 Managing Your Debts 232 Closed-End Credit 175 Debt Collection Practices 232 Open-End Credit 176 Warning Signs of Debt Problems 233 Measuring Your Credit Capacity 183 The Serious Consequences of Debt 235 Can You Afford a Loan? 183 **Consumer Credit Counseling** General Rules of Credit Capacity 183 Services 237 Cosigning a Loan 185 What the CCCS Does 237 Building and Maintaining Your Credit Alternative Counseling Services 238 Rating 185 Declaring Personal Bankruptcy 239 Applying for Credit 189 The Bankruptcy Abuse Prevention and A Scenario from the Past 189 Consumer Protection Act of 2005 241 What Creditors Look for: The Five Cs of Credit Effect of Bankruptcy on Your Job Management 191 and Your Future Credit 242 What If Your Application Is Denied? 194 Should a Lawyer Represent You in a Avoiding and Correcting Credit Mistakes 194 Bankruptcy Case? 243 In Case of a Billing Error 196 Your Credit Rating during the Dispute 196 Defective Goods or Services 197 Identity Crisis: What to Do Making Your If Your Identity Is Stolen 198 **Purchasing Decisions** Complaining about Consumer Credit 200 8 Consumer Purchasing Strategies and Complaints about Banks 200 **Legal Protection** 252 Protection under Consumer Credit Laws 200 Consumer Buying Activities 253 Your Rights under Consumer Financial Implications of Consumer Credit Laws 202 Decisions 253 7 Choosing a Source of Credit: The Practical Purchasing Strategies 254 Costs of Credit Alternatives 212 Warranties 258 Sources of Consumer Credit 213 Major Consumer Purchases: Buying Motor Vehicles 260 What Kind of Loan Should You Seek? 213 Phase 1—Preshopping Activities 260 Student Loans: Impact of the Financial

Crisis 215

xxxii Contents

Phase 3—Determining Purchase Price 264 Phase 4—Postpurchase Activities 266	Determining the Selling Price 309 Sale by Owner 309
Resolving Consumer Complaints 269	Listing with a Real Estate Agent 310
Step 1: Return to Place of Purchase 270 Step 2: Contact Company Headquarters 271 Step 3: Obtain Consumer Agency Assistance 272 Step 4: Take Legal Action 272 Legal Options for Consumers 273	4 Insuring Your Resources
Small Claims Court 273 Class-Action Suits 273 Using a Lawyer 273 Other Legal Alternatives 274 Personal Consumer Protection 275	10 Property and Motor Vehicle Insurance 316 Insurance and Risk Management: An Introduction 317
9 The Housing Decision: Factors and Finances 282	What Is Insurance? 317 Types of Risks 317 Risk Management Methods 318
Housing Alternatives 283 Your Lifestyle and Your Choice of Housing 283 Opportunity Costs of Housing Choices 283	Planning an Insurance Program 319 Property and Liability Insurance 322 Potential Property Losses 323
Renting versus Buying Housing 284 Housing Information Sources 286	Liability Protection 323 Home and Property Insurance 324 Homeowner's Insurance Coverages 324
Renting Your Residence 286 Selecting a Rental Unit 287 Advantages of Renting 288 Disadvantages of Renting 289 Costs of Renting 290	Renter's Insurance Coverages 324 Renter's Insurance 327 Home Insurance Policy Forms 328 Home Insurance Cost Factors 330 How Much Coverage Do You Need? 330 Factors That Affect Home Insurance
The Home-Buying Process 291 Step 1: Determine Home Ownership Needs 291 Step 2: Find and Evaluate a Property to Purchase 295 Step 3: Price the Property 296	Costs 331 Reducing Home Insurance Costs 331 Automobile Insurance Coverages 332 Motor Vehicle Bodily Injury Coverages 333 Motor Vehicle Property Damage
The Finances of Home Buying 298 Step 4: Obtain Financing 298 Step 5: Close the Purchase Transaction 306 Home Buying: A Summary 307	Coverages 335 Other Automobile Insurance Coverages 336 Automobile Insurance Costs 337 Amount of Coverage 337 Automobile Insurance Premium Factors 338
Selling Your Home 309 Preparing Your Home for Selling 309	Reducing Automobile Insurance Premiums 339

Contents xxxiii

11 Health, Disability, and Long-Term Care Insurance 346	Disability Insurance Trade-Offs 377 Sources of Disability Income 378	
Health Care Costs 347	Determining Your Disability Income	
High Medical Costs 348 Why Does Health Care Cost So Much? 350 What Is Being Done about the High Costs of Health Care? 351	Insurance Requirements 379 12 Life Insurance 387 Life Insurance: An Introduction 388 What Is Life Insurance? 388	
What Can You Do to Reduce Personal Health Care Costs? 351 Health Insurance and Financial Planning 353 What Is Health Insurance? 353	The Purpose of Life Insurance 389 The Principle of Life Insurance 389 How Long Will You Live? 389 Determining Your Life Insurance Needs 392 Do You Need Life Insurance? 392 Determining Your Life Insurance Objectives 392 Estimating Your Life Insurance Requirements 393	
Medical Coverage and Divorce 355 Types of Health Insurance Coverage 355 Types of Medical Coverage 356 Long-Term Care Insurance 358 Major Provisions in a Health Insurance Policy 359		
Which Coverage Should You Choose? 361 Health Insurance Trade-Offs 361	Types of Life Insurance Companies and Policies 395	
Health Information Online 363 Private Sources of Health Insurance and Health Care 364 Private Insurance Companies 364	Types of Life Insurance Companies 395 Types of Life Insurance Policies 396 Term Life Insurance 396 Whole Life Insurance 398	
Hospital and Medical Service Plans 364 Health Maintenance Organizations (HMOs) 364 Preferred Provider Organizations	Other Types of Life Insurance Policies 401 Important Provisions in a Life Insurance Contract 404	
(PPOs) 365 Home Health Care Agencies 367 Employer Self-Funded Health Plans 367 New Health Care Accounts 367	Naming Your Beneficiary 404 The Grace Period 404 Policy Reinstatement 404 Nonforfeiture Clause 404	
Government Health Care Programs 368 Medicare 369 Medicaid 372 Health Insurance and the Patient Protection and Affordable Care Act of 2010 374 Fight against Medicare/Medicaid Fraud and Abuse 374	Incontestability Clause 405 Suicide Clause 405 Automatic Premium Loans 405 Misstatement of Age Provision 405 Policy Loan Provision 405 Riders to Life Insurance Policies 406	
Government Consumer Health Information Web Sites 375 Disability Income Insurance 376 Definition of Disability 377	Buying Life Insurance 407 From Whom to Buy? 407 Comparing Policy Costs 409 Obtaining a Policy 411	

xxxiv Contents

Examining a Policy 412	Factors That Reduce Investment Risk 444	
Choosing Settlement Options 412 Switching Policies 413	Your Role in the Investment Process 444 Other Factors That Improve Investment	
Financial Planning with Annuities 414	Decisions 445	
Why Buy Annuities? 415	Sources of Investment Information 447	
Tax Considerations 415	The Internet 447	
	Newspapers and News Programs 447	
E	Business Periodicals and Government	
5	Publications 448 Corporate Reports 449	
Investing Your	Investor Services and Newsletters 449	
Financial Resources	14 Investing in Stocks 460	
13 Investing Fundamentals 423	Common and Preferred Stocks 461	
Preparing for an Investment Program 424	Why Corporations Issue Common Stock 461	
Establishing Investment Goals 424	Why Investors Purchase Common	
Performing a Financial Checkup 425	Stock 462	
Managing a Financial Crisis 426	Preferred Stock 466	
Getting the Money Needed to Start an Investment Program 427	Evaluating a Stock Issue 467	
The Value of Long-Term Investment	Classification of Stock Investments 468	
Programs 428	The Internet 468	
Factors Affecting the Choice of Investments 430	Stock Advisory Services 469 How to Read the Financial Section	
Safety and Risk 430	of the Newspaper 472	
The Risk–Return Trade-Off 431	Corporate News 472	
Components of the Risk Factor 433	Numerical Measures That Influence Investment	
Investment Income 436	Decisions 473	
Investment Growth 436	Why Corporate Earnings Are	
Investment Liquidity 436	Important 473	
Asset Allocation and Investment	Other Factors That Influence	
Alternatives 437	the Price of a Stock 475	
Asset Allocation and Diversification 437	Investment Theories 479	
An Overview of Investment Alternatives 440	Buying and Selling Stocks 480	
Stock or Equity Financing 440	Secondary Markets for Stocks 480	
Corporate and Government Bonds 441	Brokerage Firms and Account Executives 481	
Mutual Funds 441	Should You Use a Full-Service or a	
Real Estate 442	Discount Brokerage Firm? 482	
Other Investment Alternatives 442	Commission Charges 483	
A Personal Plan for Investing 443	Completing Stock Transactions 483	

Contents xxxv

Long-Term and Short-Term Investment Strategies 484	Managed Funds versus Indexed Funds 548 The Internet 550	
Long-Term Techniques 485	Professional Advisory Services 552	
Short-Term Techniques 486	How to Read the Mutual Funds Section of the Newspaper 552	
15 Investing in Bonds 499	Mutual Fund Prospectus 552	
Characteristics of Corporate Bonds 500	Mutual Fund Annual Report 554 Financial Publications 555	
Why Corporations Sell Corporate Bonds 502	The Mechanics of a Mutual Fund	
Types of Bonds 502 Provisions for Repayment 504	Transaction 556 Return on Investment 557	
Why Investors Purchase Corporate Bonds 506 Interest Income 506	Taxes and Mutual Funds 558 Purchase Options 559 Withdrawal Options 561	
Dollar Appreciation of Bond Value 508 Bond Repayment at Maturity 508 A Typical Bond Transaction 509	17 Investing in Real Estate and Other Investment Alternatives 570	
The Mechanics of a Bond Transaction 510	Investing in Real Estate 571	
Government Bonds and Debt Securities 511	Direct Real Estate Investments 571 Indirect Real Estate Investments 575	
Treasury Bills, Notes, and Bonds 511 Federal Agency Debt Issues 514	Advantages of Real Estate Investments 577	
State and Local Government Securities 514	A Possible Hedge against Inflation 577	
The Decision to Buy or Sell Bonds 516	Easy Entry 578 Limited Financial Liability 578 No Management Concerns 579 Financial Leverage 579	
The Internet 517 Financial Coverage for Bond Transactions 518 Annual Reports 519		
Bond Ratings 520	Disadvantages of Real Estate Investments 579	
Bond Yield Calculations 522	Illiquidity 579	
Other Sources of Information 524	Declining Property Values 579 Lack of Diversification 579	
16 Investing in Mutual Funds 535	Lack of a Tax Shelter 580	
Why Investors Purchase Mutual Funds 536	Long Depreciation Period 580 Management Problems 580	
Characteristics of Mutual Funds 537	Investing in Precious Metals, Gems,	
Classifications of Mutual Funds 545	and Collectibles 580	
Stock Funds 545	Gold 581	
Bond Funds 546	Silver, Platinum, Palladium,	
Other Funds 546	and Rhodium 582	
How to Decide to Buy or Sell	Precious Stones 583	
Mutual Funds 548	Collectibles 583	

xxxvi	Contents	
6		Legal Aspects of Estate Planning 639 Wills 639
Controlling Your Financial Future 18 Starting Early: Retirement Planning 593 Why Retirement Planning? 594 Tackling the Trade-Offs 594		Types and Formats of Wills 642 Types of Wills 642 Formats of Wills 643 Writing Your Will 643 Altering or Rewriting Your Will 645 Living Will and Advance Directives 646 Ethical Will 648 Power of Attorney 648
Conducting a Financ Review Your Ass Your Assets after	ets 597	Benefits of Establishing Trusts 649 Types of Trusts 649 Estates 653
Retirement Living Ex	penses 600	Settling Your Estate 656
Planning Your Retire Type of Housing Avoiding Retiren	Adjust Your Expenses for Inflation 602 Ianning Your Retirement Housing 604 Type of Housing 604 Avoiding Retirement Housing Traps 605 Ianning Your Retirement Income 606	Federal and State Estate Taxes 656 Types of Taxes 657 Tax Avoidance and Tax Evasion 659 Calculating the Tax 660 Paying the Tax 660
Social Security Other Public Pen Employer Pensio Personal Retirem Annuities 620 Will You Have En Retirement?	nsion Plans 610 n Plans 610 nent Plans 615 nough Money during	Appendixes A Financial Planners and Other Information Sources A-1 B Consumer Agencies and Organizations B-1 C Daily Spending Diary C-1
Living on Your Retire	ement Income 623	
Investing for Ret	Retirement 624	Endnotes N-1 Photo Credits PC-1
19 Estate Plannir	ng 634	Index 1-1

Personal Financial

Planner

19 Estate Planning 634

Why Estate Planning? 635

What Is Estate Planning? 635 If You Are Married 636 If You Never Married 637 New Lifestyles 637 The Opportunity Cost of Rationalizing 637