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| ☕ |  | *Essentials* |
| *of Personal* |
| *Finance* |
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ESSENTIALS OF PERSONAL FINANCE

EARN

SAVE

INVEST

PROTECT

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Introduction

## History of Retirement

1. **1700s-1900**
   1. 1776: US life expectancy is 23 years. (Edelman *Truth* 4)
   2. 1900: US life expectancy is 47 years. (Edelman *Truth* 4)
   3. 1900: of men 65 and over, 3.5 out of 10 retired.
   4. 1900: Civil War pensions “covered over half of elderly native-born Northern males” (42% of the federal budget) (“Social Security” *Barron*’*s*)
   5. almost 30% “of elderly households took in boarders” (“Social Security” *Barron*’*s*)
   6. Many lived in poverty, especially widows (who often moved in with a child) (“Social Security” *Barron*’*s*)
   7. 1900: 2% of the elderly lived poor houses run by run by a charity or a town.
      1. Conditions were often harsh. (“Social Security” *Barron*’*s*)
      2. It was “a deep humiliation.” (“Social Security” *Barron*’*s*)
2. **20th century**: **retirement as a three-legged stool**
   1. pension
   2. Social Security
   3. investments

leg 1: pensions

1. **pensions**
   1. 1930: 1 in 10 workers has a pension. (“Social Security” *Barron*’*s*)
      1. mostly government workers
      2. and railroad workers
   2. 1985: 2 in 3 workers have pensions (Lucia 6)
   3. 1992: (7 years later) 1 in 3 workers have pensions (Ernst & Young)
   4. 2005: (12 years later) 1 in 5 workers have pensions (Ernst & Young)
   5. why pensions disappeared
      1. Employees stay at firms for shorter periods. (Lucia 6)
      2. Some firms offer stock options instead. (Lucia 6)
      3. Low bond rates hurt pension funds. (Lucia 6)
      4. Many companies “failed to set aside sufficient assets . . .” (Lucia 6)
         1. 2005: US firms underfunded pensions by $500 billion dollars. (Lucia 6)
         2. 2006: the Pension Benefit Guaranty Corporation (PBGC) took over 120 pensions. (Lucia 7)

leg 2: Social Security

1. **welfare before Social Security**
   1. 1889: “Germany, under Chancellor Otto Bismarck, adopted the first modern social insurance plan[:] workers were taxed . . . for an old-age fund.” (“Social Security” *Barron*’*s*)
   2. 1910-1925: other countries followed suit: France, the Netherlands, Italy, Britain, many Latin American countries.
   3. US: there was little progress until the Great Depression.
      1. 1934: Congress establishes a retirement fund for railroad workers.
      2. 1935: the Social Security Act
2. **history of Social Security**
   1. “Retirement as an institution emerged in the 1920s and really got traction in the 1930s, primarily because of the emerging field of management science . . . All the early studies showed that if you were young and strong and quick, you were a valuable piece of the productivity engine. But if you were older and slower, it was a different story. So there was a rising feeling that older people should really be removed from the workforce.” (Brock 8)
   2. gerontologist Ken Dychtwald (Dychtwald, Ken, and Joe Flower. *Age Wave*: *How the Most Important Trend of Our Time Will* *Change Our Future*. J.P. Tarcher, 1989): Social Security solved two problems. “Older, less productive people could be removed from the workforce—thus boosting productivity—and younger people could be given a shot at a job . . .” (Qtd. in Brock 8)
   3. 1935: Franklin Roosevelt signs the Social Security Act
      1. Current workers’ payments supported the currently retired.
         1. The “lag between payments and promised benefits made it difficult” to repeal. (“Social Security” *Barron*’*s*)
         2. Roosevelt knew this: “no damn politician can ever scrap my social security program.” (Qtd. in “Social Security” *Barron*’*s*)
      2. “Alf Landon, the Republicans’ unsuccessful 1936 presidential candidate, criticized the Social Security Act as unjust, unworkable, stupidly drafted, and wastefully financed . . .” (“Social Security” *Barron*’*s*)
   4. 1939
      1. Congress adds spousal benefits.
      2. Congress adds dependent and survivor benefits.
   5. 1940: Social Security covers 43.5% of the labor force. (“Social Security” *Barron*’*s*)
      1. By 1968: Social Security covers 85% of the labor force. (“Social Security” *Barron*’*s*)
   6. 1950: Congress raises benefits for the first time, by 77%.
   7. 1950-1972: Congress raises benefits every few years.
      1. Often just before elections. (“Social Security” *Barron*’*s*)
      2. E.g., Sept. of 1952, 1954, 1972. (“Social Security” *Barron*’*s*)
   8. 1950-2000: Social Security is widely popular. (“Social Security” *Barron*’*s*)

In the 1930s, “retire” connoted “respite from toil . . .” (Brock 10)

In the 1970s, it connoted “a life of leisure . . .” (Brock 10)

* + 1. Dychtwald (*Age Wave*. 1989): “Leisure retirement became a mark of success, and the earlier you retired the more successful you were.” (Qtd. in Brock 10)
  1. 1965: Medicare is enacted; it provides health-insurance benefits (“Social Security” *West*’*s*)
  2. 1972
     1. Congress ties benefits to the inflation rate (COLAs, annual cost-of-living increases). (Brock 9)
  3. 1974: Supplemental Security Income (SSI), for blind, disabled, and elderly who are poor.
  4. by 1990s: worries “led policy makers to consider major changes in its operation.” (“Social Security” *Barron*’*s*)
     1. worker/retiree ratio
        1. 1950: 16 workers support 1 retiree
        2. 1990: 4 workers support 1 retiree
        3. 2030: 2 workers will support 1 retiree
     2. increasing life expectancy, decreasing retirement age
        1. 1940 (Brock 9)
           1. average life expectancy 63
           2. average retirement age 70
        2. 2001
           1. average life expectancy 77
           2. average retirement age 62
     3. 2002
        1. 46 million Social-Security recipients
        2. almost $454 billion (Brock 9)

leg 3: investments

1. **mutual funds**
   1. 1774: first mutual fund (in the Netherlands) (“Mutual Fund”)
   2. 1920s: mutual funds became popular in the US.
   3. 1970: about 360 mutual funds, with assets of $48 billion (“Mutual Fund”)
   4. 1979: US households holding mutual funds is 6%
   5. 1997: US households holding mutual funds is 37%
   6. 2010: 7,581 US mutual funds, with assets of $11.8 trillion (“Mutual Fund”)
2. **employer-sponsored retirement plans**: **two basic types**
   1. defined benefit plans (“the fancy name for *pension*”) (Quinn *Making* 1018)
   2. defined contribution plans (401(k)s, etc.)
3. **401**(**k**)**s**
   1. 1978: section 401(k) of the revised Internal Revenue Code says that “employees can avoid taxes on income they receive as deferred payment” (Fetini)
   2. 2008: 65 million US 401(k)s (40% of workers), with assets of $3 trillion (Fetini)
   3. “The accounts helped spark a financial-industry boom, funneling billions . . . into mutual funds and the stock market.” (Fetini)
      1. 1980-1998: annual trading volume on the New York Stock Exchange rose 15-fold (from 11.4 billion shares to 169 billion shares)
      2. 1989: US households owning stocks is 31%
      3. 1995: US households owning stocks is 41%

Baby Boomers

1. **number of boomers**
   1. 2011: 77 million baby boomers
   2. This demographic bulge is like an egg down a python who swallowed the egg.
   3. 2011: first baby boomers turn 65
   4. 2029: all 77 million (minus those who’ve died) will be over 65 (Ernst & Young)
2. **US personal savings rate**
   1. 1973: Americans are saving 9% of their income, “an all-time high”
   2. 2000: -0.1% (Americans are going into debt)
   3. 2005: 92% of baby boomers have a net worth under $100,000 (Ben Stein)
   4. 2008: more than 25% of eligible employees do not contribute to defined-contribution plans. (Ernst & Young n. 4)
   5. 2010
      1. “About 33% of people older than 62 are living on Social Security alone.” (Phipps)
   6. 2016: the average Social Security monthly payment is $1,368: $16,416 a year. (Maranjian)
   7. 2015: the US poverty line is $11,770 ($24,250 for a family of four) (“Poverty Threshold”)
   8. On average Social Security pays only 28% of retirees’ expenses.
   9. 2018: of households headed by someone aged 55 and over, those without retirement savings are 48%. (“Government Accountability Office”)
3. **retirement risk**
   1. 2008: Americans for Secure Retirement engaged Ernst & Young, one of the big four accounting firms, to assess retirement vulnerability. (Ernst & Young)
   2. probability of a married couple outliving their assets, if they are near retirement and without a pension: 90%
4. **longevity**
   1. “Now folks are . . . living much longer . . . And that change comes when the one traditional pillar of retirement income—the pension—is vanishing, and the other pillar—Social Security—is showing some cracks. Therein lies the problem.” (Lucia 15)
   2. historical life expectancies
      1. 1776: 23 years (Edelman *Truth* 4)
      2. 1900: 47 years (Edelman *Truth* 5)
      3. 2007: 77 years (Lucia 16)
      4. 2050: around 140 (Edelman *Truth* 5)
5. **effects of the Great Recession** (Dec. 2007 to Mar. 2009) (Munnell and Golub-Sass)
   1. Direct equity holdings lost $7 trillion.
   2. Housing values lost $3 trillion.
   3. Households at risk of a lower standard of living in retirement rose to 51%.

Step 1: Earn

Earning in America

1. **median US per-capita income** (“Per Capita”) (2010 is from Wolf)
   1. 1980 $9,494
   2. 1990 $18,667
   3. 2000 $29,469
   4. 2010 $24,889
2. **Go to college**.
   1. 2006: median annual income of males 25 and older (Baum)
      1. professional degree $100,000
      2. Ph.D. $87,100
      3. master’s $70,600
      4. B.A. $56,500
      5. A.A. $42,900
      6. some college $41,300
      7. high school $35,400
      8. some high school $24,100
   2. By age 33, “the typical college graduate has earned enough to compensate for both paying full tuition and fee charges at the average public four-year college and forgoing earnings for four years.” (Baum)
3. **ways to increase earnings** (O’Neill 59)
   1. Get a raise.
   2. Moonlight at a second job.
   3. Add a spouse to the labor force.
   4. Put your teenage children to work.
   5. Do free-lance consulting.
   6. Turn a hobby into a business.
   7. Hold a garage sale.
   8. Watch other people’s children.

Step 2: Save

Frugality

1. **introduction**
   1. In wealth-building, *offense* is earning a lot, and *defense* is saving a lot. (Stanley and Danko 38)
   2. “You can’t invest without something. . . . The first thing is to save.” (Stanley and Danko 79)
2. **earning vs**. **saving**
   1. “The majority of people do not have the ability to increase their incomes significantly. [130] . . . If you cannot increase your compensation significantly, become wealthy . . . defensively.” (Stanley and Danko 130-31)
3. “**Live a little *beneath* your means**.” (Tobias 55)
   1. To save, simply “Spend less than you earn.” (Tobias 55)
   2. Planning for retirement is “about spending less and saving more. [46] . . . How much of your current lifestyle are you willing to sacrifice for the promise of a more secure future?” (Lucia 46-47)
   3. “. . . all a family struggling to get by on $190,000 a year need do is look down the street to see a family that—somehow—manages to get by on $165,000 a year. . . . A family struggling on $24,000 need only look down the street to see one surviving—don’t ask me how—on $18,500. The point is that you *can* save money if you’re willing to make some sacrifices.” (Tobias 53)
   4. “Simply live as if you are making $18,000 instead of $20,000; $45,000 instead of $50,000; $135,000 instead of $150,000.” (Tobias 56)
4. **2008**: **number of millionaires** (“Millionaires”)
   1. worldwide: 8.6 million
   2. US: 6.7 million (down 27%)
   3. billionaires (worldwide): 1,125
5. **the survey**
   1. 1995: Thomas Stanley and William Danko (*The Millionaire Next Door*, 1996) put 249 questions to
      1. 385 millionaires
      2. 1115 other “high-net worth and/or high-income respondents.” (Stanley and Danko 4)
6. **the claim**
   1. “We have determined how ordinary people can become wealthy.” (Stanley and Danko 1)
      1. It is not luck or inheritance. (Stanley and Danko 1-2)
      2. It is a certain lifestyle. (Stanley and Danko 1-2)
   2. The lifestyle is: (Stanley and Danko 1-2, 21, 23, 30)
      1. hard work
      2. frugality
      3. low status
      4. self-discipline
      5. perseverance
      6. planning
      7. risk
      8. sound investment habits
         1. Those surveyed invested almost 20% each year. (Stanley and Danko 10)
7. **self-employment**
   1. 3 in 4 millionaires are entrepreneurs.
      1. Their businesses are often “dull-normal . . . welding contractors, auctioneers, rice farmers, owners of mobile-home parks, pest controllers, coin and stamp dealers, and paving contractors.” (Stanley and Danko 9)
   2. 1 in 4 millionaires is a professional. (Stanley and Danko 9, 120-21, 127)
      1. doctors, dentists, lawyers, architects
      2. executives, accountants
      3. professors. Example:
         1. “How did Dr. Bill, an engineering professor who never had a total household income of more than $80,000, become a millionaire?” (Stanley and Danko 137)
         2. Dr. Bill “never wanted to become an entrepreneur. . . . Dr. Bill was never cut out to be anything but a professor. He is not alone. *Most people in this country are not the entrepreneurial type. But this does not mean that they can*’*t become millionaires*.” (Stanley and Danko 137)
8. **How do millionaires control their spending**? (Stanley and Danko 41)
   1. “They create an artificial economic environment of scarcity for themselves . . .” (Stanley and Danko 41)
   2. “Being frugal is the cornerstone of wealth-building.” (Stanley and Danko 29)
   3. 1 in 2 millionaires never paid more than $400 for his most expensive suit. (Stanley and Danko 31)
   4. spouse’s frugality
      1. Most “wives are planners and meticulous budgeters.” (Stanley and Danko 10)
      2. “How did the wife of a millionaire respond when her husband gave her $8 million worth of stock in the company he recently took public? According to her husband of thirty-one years, she said, “I appreciate this, I really do.” Then she smiled, never changing her position at the kitchen table, where she continued to cut out twenty-five- and fifty-cents-off food coupons . . .” (Stanley and Danko 37)
   5. Scots
      1. Scots are disproportionate among millionaires.
         1. They’re 1.7% of US households. (Stanley and Danko 19)
         2. But 9.3% of millionaires. (Stanley and Danko 18)
         3. So 1 in 5 Scottish households is millionaire. (Stanley and Danko 19)
      2. Why? They’re frugal! (Stanley and Danko 20)

How Much Must You Save?

1. **You**’**ll spend less in retirement**.
   1. travel and entertainment: may increase, early in retirement
   2. car expenses: you no longer commute to work (Battersby 18)

you no longer need two vehicles (Brock 163)

* 1. clothes: surely less (Battersby 18)
  2. personal loans: hopefully paid off by retirement (Battersby 18)
  3. mortgage: maybe paid off by retirement (Battersby 18)
  4. Social Security payroll tax: none, if you don’t work (Battersby 18)

(2018 payroll tax is 6.2% each from employer and worker.)

* 1. income tax: lower because of only part-time employment (Battersby 18)

lower because not all Social-Security income is taxed

* 1. saving for retirement: no more 401(k) or IRA contributions
  2. death of a spouse: 80% of Americans enter retirement married. (Munnell 6)

But consumption falls 25% when a spouse dies. (Ernst & Young)

1. **taxation of Social Security benefits**
   1. 2016: about “63 million people received old age, survivors, and disability insurance (OASDI) benefits [and] 42 percent of them will pay income tax on at least a portion of their benefits.” (“Information for Tax Preparers”)
   2. Your Social Security benefits will be taxed if your “combined income” is too high. (“Combined income” is: your adjusted gross income + nontaxable interest + ½ of your Social Security benefits.) (“Income Taxes and Your Social Security Benefit”)
   3. Here are the thresholds as of 2018 (they rise each year to keep up with inflation). (“Income Taxes and Your Social Security Benefit”)
      1. below first threshold
         1. singles < $25,000
         2. marrieds filing jointly < $32,000
         3. If you’re below the first threshold, 0% of your benefits will be taxed.
      2. between first and second thresholds
         1. singles ≥ $25,000
         2. marrieds filing jointly ≥ $32,000
         3. If you’re in between the thresholds, up to 50% of your benefits will be taxed.
      3. above second threshold
         1. singles ≥ $34,000
         2. marrieds filing jointly ≥ $44,000
         3. If you’re above the second threshold, up to 85% of your benefits will be taxed.
2. **You need a BIG nest egg**.
   1. “How much money will you need when you retire? Plenty.” (Quinn *Making* 1013)
   2. “It takes large amounts of money to live well without a paycheck . . .” (Quinn *Smart* 26)
   3. inflation
      1. Suppose your nest egg is $1 million.
      2. Suppose inflation is 3% a year.
      3. In 20 years inflation by itself will reduce your purchasing power to $527,481.
   4. withdrawals from your nest egg (let’s say $40,000 a year)
      1. In 20 years, withdrawals by themselves would reduce your nest egg to $160,000.
      2. In 20 years, combined inflation + withdrawals will reduce your million to -$64,480.
   5. And this does not even consider the effect of taxes.
3. **Even then**, **you may not be able to retire when you want**. You may have
   1. health problems to pay for
   2. an aging parent to support
   3. a divorce
   4. children in college (“Many baby boomers . . . postponed childbearing”) (Brock 6)
4. **estimates of your needed nest egg**
   1. Your nest egg should be $500,000 per person. (PBS special on retirement, aired 2010)
   2. Your nest egg should be 15-20 times annual retirement expenses. (economist Ben Stein)
      1. example: $50,000 x 20 = $1 million
   3. Your nest egg should be 25 times annual retirement expenses. (Quinn *Making* 1013)
      1. example: $50,000 x 25 = $1.25 million
5. **suggested savings rates**
   1. 10%
      1. 10% “is woefully insufficient.” (Lucia 18)
      2. The “old rule of thumb about socking away 10 percent of your pretax income every year . . . probably stems from the days when most retirees had company pensions.” (Lucia 18)
   2. 15%
      1. After establishing an emergency fund and paying off credit cards, “go to 15 percent or more . . .” (Quinn *Smart* 36)
   3. 20%
      1. Lucia suggests a minimum of 20%. (Lucia 18)
   4. 25%
      1. In your 40s, put away 25%. (Quinn *Smart* 26)
      2. That’s “probably not possible . . . if you have kids . . .” (Quinn *Smart* 26)
      3. “Slow savers [will] need to work until 70 or later.” (Quinn *Smart* 14-15)

Saving Early vs. Saving Late

(Quinn 15-16, citing Richard L.D. Morse)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | *Early Saver* | | *Late Saver* | |
|  | Deposits $1,000 a year at 5% | | Deposits nothing | |
|  |  |  |  | |
| Year 1 |  | $1,051 |  | $0 |
| Year 5 |  | $5,824 |  | $0 |
| Year 10 |  | $13,301 |  | $0 |
| Year 15 |  | $22,903 |  | $0 |
|  |  |  |  | |
|  | Stops depositing | | Deposits $1,000 a year at 5% | |
|  |  |  |  | |
| Year 16 |  | $24,077 |  | $1,051 |
| Year 20 |  | $29,407 |  | $5,824 |
| Year 25 |  | $37,758 |  | $13,301 |
| Year 30 |  | $48,482 |  | $22,903 |
| Year 35 |  | $62,251 |  | $35,230 |
| Year 40 |  | $79,931 |  | $51,060 |
| Year 45 |  | $102,631 |  | $71,384 |
| Year 50 |  | $131,779 |  | $97,482 |
| Year 55 |  | $169,205 |  | $130,990 |

The Early Saver deposited $15,000. The Late Saver deposited $40,000 but will never catch up. Why? Compound interest (interest not just on principal but on interest constantly being added).

“. . . *procrastination* is the most common cause of financial failure.” (Edelman *Truth* 14)

Do Three Planning Documents

1. **net worth statement** (aka “balance sheet”)
   1. “net worth”: everything you own (assets) minus everything you owe (liabilities)
   2. “If you own more than you owe, you have a positive net worth.” (Tobias 46)
   3. “Take a net-worth snapshot when you first set up your plan, to know your starting point.” (Quinn *Smart* 208)
      1. List your assets (everything you own) and their approximate values.
         1. home equity, car, bank accounts, insurance, college savings, retirement accounts, etc.
         2. When uncertain, estimate your assets low. (Tobias 47)
      2. List your debts (everything you owe) and their approximate amounts.
         1. credit-card balances, student loans, car loan, mortgage, home-equity loan, etc.
         2. When uncertain, estimate your expenses high. (Tobias 47)
      3. Subtract liabilities from assets.
   4. “Every couple of years, on a rainy Saturday afternoon, . . . update it.” (Quinn *Smart* 208)
   5. What should your net worth be?
      1. 2016 median net worth of US households: $97,300 (Yochim)
      2. 2016 median net worth of US households with heads aged 55-64: $187,300 (Yochim)
      3. wealth equation
         1. Median net worth is the “expected value for people in [your] income/age category . . .” (Stanley and Danko 109)
         2. Your median net worth should be your income times 1/10 of your age. (Stanley and Danko 13-15, 50, 56, 97)
            1. A 62-year-old makes $100,000 a year.
            2. $100,000 x 6.2 = $620,000.
2. **cash flow statement** (track income and expenses)
   1. *cash flow statement*: “your cash inflow (income) and your cash outflow (expenses) over a period of time . . .” (Battersby 3)
   2. Track it for a month, once a year.
   3. It “makes you aware of how you spend your money.” (O’Neill 60)
   4. It helps you “make realistic estimates of future income and expenses.” (O’Neill 60)
3. **budget**
   1. A budget is based on a cash flow statement.
   2. It projects upcoming income and expenses.
   3. But often “budget” refers to “cash flow statement.”
   4. for comparison: a US family’s average expenses in 2009
      1. housing 34%
         1. mortgage interest and charges 7%
         2. rented dwellings 6%
      2. transportation 16%
         1. gas and oil 4%
      3. food 13%
         1. food at home 8%
         2. food away from home 5%
      4. insurance premiums 11%
      5. health care 6%
      6. entertainment 6%
      7. clothing 4%
      8. everything else 10%
4. **Or don**’**t do a budget**: **use** “**an altogether different system** . . .” (Tobias 51)
   1. “Destroy all your credit cards.” (Tobias 51)
   2. “Deposit the first 20% of each paycheck in one or more investment accounts that you never, ever touch . . .” (Tobias 51-52)
   3. “Put the remaining 80% in a single checking account and make do, no matter what, with the balance in that account.” (Tobias 51)
   4. “Who cares if you forget to jot down every last expense? Who cares if you go over budget from time to time? The idea isn’t to account for every penny . . . The idea is to spend less than you earn each year, get out of debt, and build a secure, comfortable future.” (Tobias 51)

Ways to Save

1. **Small savings add up**.
   1. “Do you spend $10 a day on lunch? Bring your lunch for a cost, say, of $2 and save the $8 difference. . . . in twenty years, almost $77,000! Again, you haven’t given up anything.” (Brock 64)
   2. Jeff Brown, *Philadelphia Inquirer* columnist, has what he calls the “Whopper Test”: “if you pay $40 for a meal, is it ten times better than a Burger King Whopper with cheese?” (Brock 66)
2. **Save change in a jar**.
   1. When full, put the money in a savings account. (O’Neill 62)
3. **When you pay off your car loan**, **continue payments**, **but to your savings**.
4. **Break costly habits**. (O’Neill 63)
   1. In 20 years, smoking a pack a day will cost you $22,000.
5. **Use direct deposit**. So you don’t see the money and won’t be tempted to spend it.
6. **Participate in an employer**’**s thrift plan**.
7. **Withhold taxes correctly**.
   1. Overwithholding lends money to the government, interest free. (O’Neill 65)
8. **Or have Uncle Sam save for you**.
   1. “. . . overwithholding is not the best savings method available . . . it is, nevertheless, one method . . .” (O’Neill 66)
9. **Devote extra money to savings**. (O’Neill 67)
   1. Devote refunds and rebates to savings.
   2. Devote raises to savings.
   3. Devote a windfall to savings.
      1. an inheritance
      2. bingo or raffle winnings
      3. retroactive pay
      4. an award
      5. a bonus
      6. a lump-sum pension or retirement-plan distribution when you change jobs
         1. ⅔ of workers spend the money instead of rolling it into another tax-deferred account.
   4. Crash save.
      1. For two months you’ll buy only absolute necessities. (O’Neill 67)
   5. Devote travel or expense-account reimbursements to savings.
   6. Reinvest interest and dividends automatically.
   7. Keep checking account balances to a minimum.
10. **Drive economically**.
    1. Combine short trips. (“Get the Most Mileage”)
    2. Drive smoothly.
       1. Accelerate slowly: “The harder you accelerate, the more fuel you use.” (“Get the Most Mileage”)
       2. Brake slowly: “Unnecessarily hard braking wastes the fuel you use to get up to speed.” (“Get the Most Mileage”)
    3. “Turn off your engine if you’ll be idling for more than 30 seconds. Starting your vehicle does use a burst of fuel, but not as much as allowing the engine to idle . . .” (“15 Tips”)
    4. Reduce drag: a car-top carrier cuts 6 mpg. (“Get the Most Mileage”)
    5. Slow down: “Aerodynamic drag exponentially increases” fuel use. (“Get the Most Mileage”)
    6. Empty your trunk: every “250 pounds your engine hauls, the car loses about one mile per gallon . . .” (“15 Tips”)
    7. The good news: air conditioning only negligibly reduces mileage. (“Get the Most Mileage”)

Priorities

1. **bad**, **mediocre**, **and good debt**
   1. bad debt
      1. Bad debt is consumer debt. (Quinn *Smart* 39)
         1. credit cards
         2. installment loans
         3. home-equity loans
      2. These are non-deductible debts.
      3. They’re for a depreciating asset.
      4. They’re optional (you could do without).
      5. Charles Ellis (author of *Winning the Loser*’*s Game*): “The interest expenses and then the penalty charges . . . are ferocious.” (Katz, Malkiel, and Ellis)
   2. Mediocre debt is auto loans.
      1. They’re non-deductible.
      2. They’re for a depreciating asset.
      3. But they’re “usually not optional.” (Quinn *Smart* 39)
      4. And their interest is low compared to credit cards.
   3. Good debt is mortgage.
      1. It’s “usually not optional.” (Quinn *Smart* 39)
      2. But mortgage debt is deductible.
      3. And a mortgage’s “underlying asset, a house, is presumably appreciating in value, effectively reducing the interest costs.” (Brock 67)
      4. Fred E. Waddell (a “money-management specialist who trains financial counselors,” 67): “Some advisers say pay off all debt, including mortgage debt. I would say pay off the mortgage debt [only] if possible.” (Brock 67)
2. **Pay off bad debt**, **then create an emergency fund**. (Battersby, Ellis, Tobias)
3. **Create an emergency fund**, **then pay off bad debt**. (Artzberger, Edelman)
4. **Pay off bad debt using retirement savings**?
   1. Quinn: yes, but only if retirement savings are not tax-deferred (Quinn *Smart* 41)
      1. If there’s a loss, you can write it off. (Quinn *Smart* 41)
      2. If there’s a gain, the tax will be small. (Quinn *Smart* 41)
      3. “You might think it’s smarter to keep your investments, because they’ll grow. But they’re unlikely to grow fast enough to make up for the money you’re losing by paying credit-card interest.” (Quinn *Smart* 41)
   2. Fred E. Waddell (trainer of financial counselors) (Brock 67)
      1. yes, even if retirement savings are tax-deferred
      2. but only if there’s no early-withdrawal penalty
5. **Save your 401**(**k**) **match**, **then pay off debt**, **then create an emergency fund**. (Spiegelman)
6. **Max out your 401**(**k**), **then pay off debt**, **then create an emergency fund**. (Quinn *Smart*)
   1. save 10%-15% for retirement (Quinn *Smart* 36)
   2. then pay off credit-card debt
   3. then create an emergency fund
   4. then save for kids’ colleges
   5. then make mortgage prepayments: this “comes last.” (Quinn *Smart* 37)

Credit Card Debt

1. **introduction**
   1. 1958: Bank of America (San Francisco) launches BankAmericard (later Visa) in Fresno, CA.
   2. 1998
      1. Americans have an average of 5.5 credit cards apiece. (Edelman *Truth* 4)
      2. The average balance per card is $1,700. (Edelman *Truth* 4)
      3. ⅔ “of credit-card holders fail to pay them off within the grace period.” (Tobias 18)
   3. “*The simplest*, *safest*, *most sensible way to earn 18% or 20% on your money is to pay off your credit cards*. *Not having to pay 18% or 20% is as good as earning 18% or 20%*. Tax-free! Risk-free!” (Tobias 18)
2. **Get rid of credit-card debt**.
   1. Call each credit-card company “and ask for a lower rate . . .” (Quinn *Smart* 42)
   2. “Switch to a cheaper credit card.” (Quinn *Smart* 42)
   3. Pay off “high-rate credit cards with a lower-rate loan . . .” (Quinn *Smart* 44)
      1. refinance an existing loan
      2. take out a home equity loan
   4. Set up automatic monthly payments. (Quinn *Smart* 46)
   5. Pay highest-interest cards first.
3. **Get help**: debtorsan­onymous.org

Tax Deductions and Credits

1. **standard deduction**
   1. US taxpayers choose to take either the standard deduction (calculated by the IRS yearly) or itemized deductions.
2. **deductions**
   1. refinancing costs
   2. investment fees, interest on money borrowed to invest, and tax preparation expenses
   3. moving expenses
   4. education expenses
   5. work-related expenses
   6. casualty and theft losses
   7. tax deduction for energy efficiency upgrades
   8. health insurance premiums for the self-employed
   9. self-employed home-office deduction
   10. property taxes
   11. itemized deductions
       1. charitable contributions (up to 30% or 50% of AGI, depending on recipients)
       2. either state and local income taxes, or sales taxes (capped at $10,000)
       3. medical expenses (if over 10% percent of AGI)
       4. miscellaneous deductions
          1. They must “total more than 2 percent of your adjusted gross income.” (Schlesinger 3)
          2. examples (Schlesinger 3)
             1. tax-preparation fees
             2. job-hunting expenses
             3. business car expenses
             4. professional dues
3. **credits**
   1. “Tax credits are even better than deductions, because they lower your taxes dollar for dollar, instead of being calculated based on your tax bracket.” (Schlesinger 2)
   2. biggies
      1. mortgage interest credit
      2. retirement savings contributions credit (IRAs, 401(k)s, etc.)
      3. child and dependent care credit
   3. others
      1. adoption credit
      2. American opportunity credit
      3. child tax credit
      4. credit for prior year minimum tax if you paid alternative minimum tax in an earlier year
      5. credit for the elderly or the disabled
      6. earned income credit
      7. education credits
      8. first time homebuyer credit
      9. foreign tax credit
      10. general business credit
      11. premium tax credit (Obamacare subsidy)
      12. savers tax credit

Step 3: Invest

Introduction

1. **saving vs**. **investing**
   1. saving: not spending money (Battersby 24)
   2. investing: doing something with saved money to earn a return (Battersby 24)
   3. An investment risks money for a possibly higher return. (Battersby 75)
2. **two kinds of wealth**: **tangible and financial**
   1. Tangible assets (hard assets, fixed assets) exist in three dimensions. (Saut)
      1. real estate, buildings
      2. mineral rights
      3. precious metals
      4. works of art
      5. commodities
      6. past wares (antiques, collectibles)
   2. Financial assets (paper assets, liquid assets) are “a pledge of future production.” (Saut)
      1. bonds (also called debts)
      2. stocks (also called equities)
      3. other securities (a security is a tradable financial asset)
3. **two kinds of financial assets**: **debt and equity** (Tobias 68)
   1. Debt is when “you *lend* your money . . .” Debt is an IOU. (Tobias 68)
      1. Common debt investments are
         1. money lent to banks: checking accounts, savings accounts, and certificates of deposit (CDs)
         2. corporate bonds (lent to corporations)
         3. municipal bonds (lent to local or state governments)
         4. Treasury bills (3-6 months), notes (2-10 years), and bonds (10+) (lent to the feds)
      2. Return on a debt investment is “interest.”
         1. Interest is their cost of using your money. (Battersby 74)
         2. (Sometimes “debt” is used to mean any return on any investment. Battersby 74)
   2. Equity is the “general word for ownership . . .” (Quinn *Smart* 156)
      1. Common equity investments are
         1. real estate (your “home equity” is the portion of your house that you own)
         2. stocks (or “shares”), “tiny bit[s] of ownership in a corporation.” (Quinn *Smart* 156)
      2. Return on an equity investment is called “earnings,” which are of two types.
         1. dividends: “a small piece of the profits that some companies pay out to investors” (Quinn *Smart* 157)
         2. capital gains: “An increase in the value of [an] asset” (“Capital Gains,” *Investo­pedia*)
4. **Capital gains have advantages over ordinary income**.
   1. A capital gain is “An increase in the value of [an] asset.” (“Capital Gains,” *Investopedia*)
   2. Capital gains are tax-deferred.
      1. Long-term capital gains are taxed at a lower rate than ordinary income.
      2. short-term capital gain: the increase in value of an asset held one year or less (taxed at your income-tax rate)
      3. long-term capital gain: the increase in value of an asset held more than one year (taxed at a 15% tax rate)
   3. Capital gains pass “to heirs tax-free at death.” (Edelman 124)
      1. “Say you invest $10,000 in stocks and watch them grow to $25,000. Say you then die. Since you never sold the stocks, you never paid the capital gains tax.” (Edelman 124)
      2. But when your heirs “sell them, they will not pay a tax on the capital gains [accured in your lifetime.] . . . capital gains pass tax-free to heirs at death.” (Edelman 124)

Asset Allocation and Diversification

1. “**asset allocation**,” “**diversification**”
   1. “asset allocation”
      1. how you “split your money among various types of investments . . .” (Quinn *Smart* 158)
      2. “. . . how you divide your money up among broad categories or classes of assets . . .” (Lucia 62)
   2. “diversification”
      1. Spreading your money over many investments within an asset class.
      2. But often “asset allocation” and “diversification” are used interchangeably.
2. **asset classes**
   1. stocks
   2. hard assets (except real estate): commodities, precious metals, collectibles, etc.
   3. real estate
   4. bonds
   5. cash and cash equivalents
      1. cash: coins, currency, money orders
      2. cash equivalents
         1. checking account (aka “demand deposits”)
         2. savings account
         3. online checking or savings account (e.g., ingdirect.com)
            1. Internet banks offer a bit more interest because their overhead is low.
            2. Go to bankrate.com for comparisons of accounts.
         4. credit union (a bit more interest because they’re nonprofit)
         5. money market mutual funds (a bit more risk, so a bit more interest, but less liquid)
         6. Treasury bills
         7. short-term certificate of deposit (CD)
3. **asset allocation**
   1. Asset allocation is allocating assets to asset classes.
      1. One could be 100% real estate.
      2. One could be 60% stocks and 40% bonds.
   2. Asset allocation determines almost 94% of your portfolio’s return. (Brinson, Hood, and Beebower. “Determinants of Portfolio Performance.” *Financial Analysts Journal* [July/Aug. 1986].) (Smith)
   3. “. . . what influences the rest? . . . security selection and market timing.” (Smith)

Risk

1. **risk**
   1. “risk”: a combination of possible loss and the probability that it will occur (Huning)
   2. “risk-reward concept”: the higher the risk, the higher the possible return
2. **investments** (**asset classes**), **most to least risky**
   1. stocks
   2. hard assets (except real estate): commodities, precious metals, collectibles, etc.
   3. real estate
   4. bonds (corporate, Treasuries, municipal)
   5. cash and cash equivalents
3. **reducing risk**
   1. Each asset class has “certain return and volatility characteristics over time.” (Smith)
   2. You can combine asset classes “to produce . . . risk/return portfolio profiles.” (Smith)
   3. Base your asset allocation policy on
      1. an asset class’s risk
      2. your risk tolerance
   4. “. . . seeking effective *risk-adjusted returns* is a far more important goal than seeking *returns* alone . . .” (Edelman *Financial Security* 115)

Arguments for Stocks over Bonds

1. **1926-2000**: **annual rates of return** (“Stocks, Bonds” Ibbotson)
   1. small-company stocks 12.4%
   2. large-company stocks 11.0%
   3. government bonds 5.3%
   4. Treasury bills 3.8%
   5. inflation 3.1%
2. **Stocks are more volatile**.
   1. “volatility”: “day-to-day fluctuations in . . . price” (“Risk and Diversification”)
   2. types of market trend (“Market Trends”)
      1. *secular*: long time frames (5-25 years)
      2. *primary*: medium time frames (1 or more years)
      3. *secondary*: short time frames (weeks to months)
   3. 1890-2007: 26 recessions (Romer)
      1. average length: 15.24 months (Romer)
      2. average decline: 14.67% (Romer)
3. **But time mitigates volatility**.
   1. “The risk of a high fluctuation (gain or loss) in every asset class decreases dramatically over time.” (Ahl)
      1. Over any 5-year period, the risk of a major loss is very low . . .” (Ahl)
      2. Over any 10-year period, “it’s practically zero.” (Ahl)
      3. Over any 15-year period, “With dividends and capital gains reinvested, the S&P 500 Index has never lost money . . .” (Lucia 8, 64, citing Ibbotson Associates)
   2. “Stocks are perceived to be riskier than bonds—and over relatively short periods of time . . . they certainly are.” (Tobias 83)
   3. But “over the really long run, people who buy equities—stocks—will almost surely make a lot more money . . . than people who make “safer” investments.” (Tobias 68)
   4. Over time, stocks are actually less risky.
      1. 1802-2001 (Siegel, *Stocks for the Long Run*)
         1. holding for 1 year
            1. worst stock return: -38.6%.
            2. worst bond return: -21.9%.
         2. holding for 10 years
            1. worst stock return: -4.1%.
            2. worst bond return: -5.4%.
4. **And diversification mitigates volatility**.
   1. Diversify among basic stock categories.
      1. classification of stocks by capitalization (amount of assets)
         1. large-cap ($10 billion up)
         2. mid-cap ($2-$10 billion)
         3. small-cap ($300 million-$2 billion)
      2. classification of stocks by location
         1. US
         2. international (foreign)
            1. developed economies (e.g., Europe, Japan)
            2. emerging markets (e.g., Nigeria, Brazil)
      3. classification of stocks by sector
         1. growth sectors
            1. consumer discretionary
            2. healthcare
            3. information technology
         2. core sectors
            1. consumer staples
            2. industrials
            3. materials
            4. telecommunication services
         3. value sectors
            1. energy
            2. financial services
            3. utilities
      4. income (high-dividend) stocks
   2. Add bonds and real estate for more diversity.
5. **stock market performance one year after major crises** (Edelman *Financial Security* 119)
   1. 1941-12-07 (Pearl Harbor is attacked): down less than 1%
   2. 1950-06-25 (North Korea invades South Korea): up 14%
   3. 1963-11-22 (John F. Kennedy is assassinated): up 23%
   4. 1974-08-08 (Richard Nixon resigns): up 7%
   5. 1986-01-28 (space shuttle *Challenger* explodes): up 31%
   6. 1991-01-16 (Gulf War starts): up 32%

Bonds

1. **if you do bonds**, **Tobias says** (Tobias 72-94):
   1. don’t invest in these
      1. corporate bond funds (includes munis)
      2. convertible bonds (corporate bonds)
      3. individual corporate bonds
      4. unit trusts (corporate bonds) (includes munis)
      5. Treasury bonds (long-term, 10-years or more)
   2. invest in these only as speculations
      1. zero-coupon bonds (corporate bonds)
      2. junk bonds (corporate bonds)
   3. invest in these
      1. municipal bonds (the only tax-free bonds)
      2. savings bonds, Series EE (okay, but Series I is better)
      3. savings bonds, Series I
      4. Treasury notes (intermediate-term, 2-10 yrs)
      5. Treasury bonds (long-term)
      6. Treasury bills (short-term, 3 months and 6 months) (maybe)
      7. Treasury inflation-protected securities (TIPS) (long-term)
2. **percentage of stocks**
   1. Malkiel: younger people should “have a larger proportion of equities . . . [They] have a long period of time” to mitigate market risk (volatility). (Katz, Malkiel, and Ellis)
   2. Malkiel: “But even in retirement, someone who retires in their 60s can look forward to perhaps 20 years or more of life expectancy. So even there you do want some equities . . .” (Katz, Malkiel, and Ellis)
   3. “. . . as you get nearer to your planned retirement date, you may find yourself pressed to seek a higher return to attain your goal.” (Battersby 116)
3. **bonds**, **stocks**, **and interest rates**
   1. Bond values generally move opposite to interest rates.
      1. If interest rates rise, bonds prices fall.
         1. Older bonds issued with lower interest rates are less attractive than new bonds.
      2. If interest rates fall, bonds prices rise.
         1. Older bonds issued with higher interest rates are more attractive than new bonds.
      3. Roughly, “for every 1% change in interest rates, there is a corresponding 10% *opposite* change in prices.” (Edelman *Truth* 103)
   2. Stocks prices generally move with interest rates.

Two Stock-Investing Strategies

1. **dollar-cost averaging**
   1. Dollar-cost averaging means investing the same amount of money every month or year.
   2. “This is a strategy of investing the same dollar amount in the same investment at fixed time intervals.” (Battersby 119)
   3. You “buy fewer shares when the price of shares goes up and more shares when the price goes down. (Battersby 119)
   4. “If the investment goes through a down cycle, you will be buying more shares while it is down, thus reducing the average cost per share over that time. If it goes up, you will be buying fewer shares at the higher price.” (Battersby 120)
   5. Dollar-cost averaging “results in a lower average cost per share . . . [because] when prices are lower, more shares are bought,” and when prices are higher, fewer shares are bought. The result is “a lower average cost per share.” (“Basic Economic Concepts”)
2. **Don**’**t try to time the market**.
   1. “Trying to time the stock market is a fool’s game. Numerous studies . . . have come to this same conclusion.” (Lucia 9)

Investment Vehicles

1. “**investment vehicle**”
   1. An investment vehicle is an investment that contains more than one investment.
      1. Examples are mutual funds, ETFs (exchange-traded funds), IRAs, 401(k)s, etc.
   2. A management company manages the account.
2. **expense ratios** (**management fees**)
   1. Expense ratios are “the fees and expenses you pay [the management company]. [They] reduce your investment returns (they’re deducted before you get your return) . . .” (“Check”)
   2. “*Cost is the single best predictor of future returns!*” (Quinn *Smart* 156)
   3. Suppose you put $25,000 in a fund with an expense ratio of 1.3%. (“Check”)

And you put $25,000 in a fund with an expense ratio of 0.3%.

After 20 years of 8% annual returns:

* + 1. the fund with the 1.3% expense ratio returns $89,997
    2. the fund with the 0.3% expense ratio returns $109,748
    3. difference: $19,751

1. **investment vehicles for college savings**
   1. 1996: Congress creates the “529 plan”
   2. 1997: Congress creates the “Education Individual Retirement Account” (Education IRA)
   3. 2001: Congress renames the latter the “Coverdell Educational Savings Account”
   4. differences
      1. contribution limits
         1. ESAs: currently $2,000 per year per child (“Coverdell”)
         2. 529s: no restrictions (“Coverdell”)
      2. types of investment
         1. ESAs: same as for IRAs: stocks, bonds, mutual funds
         2. 529s: only choices allowed by the state-run program
      3. withdrawals
         1. ESAs: to avoid taxes and penalties, money must be disbursed by age 30
            1. or be given to another family member below age 30
         2. 529s: no age limit
      4. expenses covered
         1. ESAs: elementary, secondary, or college expenses
         2. 529s: only college expenses
      5. income limits
         1. ESAs: $95,000 for singles, $190,000 for marrieds
         2. 529s: no limits
2. **annuities** (defined in English common law around 1615)
   1. Offered by insurance companies.
   2. disadvantages
      1. They are expensive.
      2. They have large fees (commissions for the salespeople).
         1. Hence brokers and planners strongly push them.
      3. They “offer mediocre insurance coverage . . .” (“Smartest”)
      4. They “restrict the owner’s investment choices . . .” (“Smartest”)
      5. They lack liquidity.
      6. Heirs pay ordinary income taxes on earnings.
      7. If you die, you may lose the remainder of your annuity.
   3. Avoid annuities.
3. **mutual funds**
   1. Mutual funds began in the Netherlands in 1774.
   2. They became popular in the US in the 1920s.
   3. Thousands of people pool their money.
      1. A fund manager invests the money.
      2. You own a proportionate piece of the fund’s investments.
      3. You receive a proportionate piece of the fund’s returns.
   4. There are many types of mutual funds.
      1. For stocks, you only need consider three relatively new types.
         1. index funds
            1. Stock-market indexes (Dow Jones Industrial Average, Standard & Poor’s 500, Wilshire 5000, etc.) track the performance of a set of stocks.
            2. An index mutual fund is “an investment designed to copy the performance of a particular market index.” (Quinn *Smart* 166)
            3. “Which index funds should you buy?” (Quinn *Smart* 171)

a total market fund, which tracks the entire American stock market

an international stock fund

a bond index fund

an “index fund for real-estate diversification.” (Quinn *Smart* 172)

* + - 1. lifecycle funds
         1. You “choose the specific mix of stocks and bonds you want.” (Quinn *Smart* 163)

a growth fund (about 75% stocks, 25% bonds) is for those 20-50

a moderate fund (about 60% stocks, 40% bonds) is for those 50-70

a conservative (about 25% stocks, 75% bonds) is for those over 70

* + - * 1. The fund never varies the asset allocation but constantly rebalances to it.
      1. target funds
         1. “Each fund owns a mix of stocks and bonds that is suitable for a person retiring in that decade.” (Quinn *Smart* 160)
         2. “Today, a 2025 fund is heavily into stocks. Ten years from now [it will own a] higher percentage of bonds.” (Quinn *Smart* 160)
         3. You “decide only one thing: when . . . you might retire.” (Quinn *Smart* 159)
  1. expense ratios
     1. The fees “you pay directly reduce your investment returns . . .” (“Check”)
     2. See “expense ratios” above.
     3. Vanguard funds have the lowest expense ratios. Then Fidelity.

1. **ETFs**
   1. ETFs are “exchange-traded funds.”
   2. A mutual fund is cut into tiny pieces, which are then bought and sold like stocks.
   3. The net worth of mutual funds is calculated at the end of the day. Hence, they cannot be bought and sold throughout the day.
   4. The net worth of ETFs is calculated throughout the day. Hence, they can be bought and sold throughout the day.
   5. Direct investment in mutual funds is waning; investment in ETFs is growing.
2. **individual retirement accounts**
   1. traditional IRA (began in 1975)
      1. advantages
         1. You get a tax deduction on contributions.
         2. You get tax deferral: you don’t pay taxes on money in the account until you withdraw it in retirement.
      2. 2019 maximum contributions: $6000 ($7000 if you are over 50)
   2. Roth IRA (began in 1998)
      1. advantages
         1. tax-free growth on earnings
            1. Unlike a traditional IRA, a Roth IRA offers no tax deduction on contributions.
            2. But: there are no taxes on earnings when you withdraw.
            3. Tax rates are likely to rise. (See next page.)
         2. no mandatory distributions
            1. With traditional IRAs and traditional 401(k)s, after age 70½, you must begin required minimum distributions (RMDs) by April of the next year.
            2. With Roth IRAs, there are no RMDs. Even after retirement, you can leave the money in the Roth account, and its earnings will always be tax-free.
         3. no taxes when your children inherit Roth IRA money (presumably, whatever you don’t give to charity)
      2. potential disadvantages
         1. Congress may “decide to tax Roth IRA distributions . . .” (“Traditional IRA”)
         2. Congress may impose “a national Value Added Tax . . . on purchases.” (“Traditional IRA”)
         3. “Either alternative would subject the Roth beneficiary to effective double Federal taxation . . .” (“Traditional IRA”)
         4. So either alternative would be politically volatile; neither danger is likely.
      3. 2019 maximum contributions: $6000 ($7000 if you are over 50)
3. **employer-sponsored retirement plans**: **more common**
   1. 401(k)s (for businesses), 403(b)s (for non-profits), or 457(b)s (for government employees)
   2. The 401(k) began in 1978.
   3. advantages of most 401(k)s
      1. employer match: (free money! an immediate 100% return on your investment!)
      2. automatic investment: you never see the money and so aren’t tempted to spend it
   4. traditional 401(k)
      1. advantages
         1. tax deferral: you don’t pay taxes until you retire
   5. Roth 401(k)
      1. *tax-free earnings*
      2. *no taxes when your children inherit it*
      3. Unlike the Roth IRA, required minimum distributions must begin soon after 70½.
         1. So at retirement, convert a Roth 401(k) to a Roth IRA.
   6. 2019 maximum contributions: $19,000 ($25,000 with the over-50 catch-up)
4. **employer-sponsored retirement plans**: **less common**
   1. defined-benefit plans: pensions
   2. defined contribution plans
      1. federal thrift savings plans
      2. stock bonus plans
      3. ESOPs (employee stock ownership plans)
      4. SIMPLE plans (savings incentive match plan for employees)
      5. SEP-IRAs (simplified employee pensions)
      6. employee Keogh plans (rarely used today)

Tax Rates Are Likely to Go Up

tax rates, 2018 (Orem)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| tax  rate | single | married filing jointly,  or qualifying widow(er) | married filing  separately | head of household |
| 10% | $0 to $9,525 | $0 to $19,050 | $0 to $9,525 | $0 to $13,600 |
| 12% | $9,526 to $38,700 | $19,051 to $77,400 | $9,526 to $38,700 | $13,601 to $51,800 |
| 22% | $38,701 to $82,500 | $77,401 to $165,000 | $38,701 to $82,500 | $51,801 to $82,500 |
| 24% | $82,501 to $157,500 | $165,001 to $315,000 | $82,501 to $157,500 | $82,501 to $157,500 |
| 32% | $157,501 to $200,000 | $315,001 to $400,000 | $157,501 to $200,000 | $157,501 to $200,000 |
| 35% | $200,001 to $500,000 | $400,001 to $600,000 | $200,001 to $300,000 | $200,001 to $500,000 |
| 37% | $500,001 or more | $600,001 or more | $300,001 or more | $500,001 or more |

“There’s reason to believe tax rates in general will be higher in the future as the federal government grapples with various budget realities, including huge costs associated with the aging and retirement of the baby boom generation.” (Thomas “Guide to Roth”)

The Order to Invest in Investment Vehicles

1. **Roth 401**(**k**), **up to employer**’**s match**
   1. Many employers offer to match a percentage of the amount you contribute toward retirement.
      1. Different companies offer different matches, usually in the range of 3%-6%.
   2. The 2019 maximum contribution to a 401(k) is $19,000 ($25,000 if you’re over 50).
   3. Suppose your company offers a 6% match and you’re under 50.
      1. 6% of $19,000 is $1,140. Invest at least $1,140 to capture your employer’s 6% match.
      2. *An employer*’*s match is free money*. *Don*’*t leave it on the sidewalk*!
2. **Roth IRA**
   1. 2019 maximum contribution $6000 ($7000 if over 50)
3. **spouse**’**s Roth IRA** (if you have a spouse and the spouse won’t be contributing to an IRA)
4. **Roth 401**(**k**), **remaining contributions** ($19,000 [$25,000 if over 50] minus your earlier contribution to secure your employer’s match)
5. **taxable mutual fund** (any money left over)

Asset Allocation within Investment Vehicles

1. **primarily stocks**; **diversified** (growth and income, large-cap and small-cap, US and foreign)
2. **bonds to the extent that volatility scares you**
3. **perhaps a REIT** (real estate investment trust): like a mutual fund for real estate
4. **perhaps a gold fund**

“I’ve read dozens of books and hundreds of research papers . . . And what have I concluded? . . . buy quality, well-diversified investments, keep your trading fees and taxes low, and hold for the long term . . .” (Lucia xiv)

At Retirement

1. **typical severance packages** (Dickler, citing “human resources association WorldatWork”)
   1. “. . . 31% of employers offer one week’s salary per year of service . . .”
   2. “. . . 20% provide two week’s salary for every year served.”
   3. example
      1. I worked 20 years, with a weekly salary of $1365 in my 20th year ($70,980 annually).
      2. At one week per year of service, $1365 x 20 = $27,300.
      3. At two weeks per year of service, $2730 x 20 = $54,600.
   4. But 47% of employers “had their own formula for determining severance . . .” (Dickler)
   5. Only 30% “of employers offer any retirement health benefits . . .” (Brock 34)
2. **how much you can withdraw without depleting your next egg**
   1. 4% is what “a retiree can withdraw from a nest egg without depleting it.” (Brock 113)
      1. If you have $100,000, you can withdraw $4,000 a year.
      2. If you have $500,000, you can withdraw $20,000 a year.
      3. If you have $1 million, you can withdraw $40,000 a year.
3. **three strategies for spending in retirement** (Jaconetti and Kinirry)
   1. If you withdraw the same amount each year, with withdrawals indexed to inflation,
      1. you have a 71% chance your portfolio will exist after 35 years.
   2. If you withdraw the same percentage each year, with ceiling and floor,
      1. you have a 89% chance your portfolio will exist after 35 years.
      2. e.g.: you might let spending rise to no more than 5% and fall to no more than 2.5%.
   3. If you withdraw the same percentage each year, 4%,
      1. you have a 100% chance your portfolio will exist after 35 years.
4. **2010**: **sources of income in retirement** (“Financial Preparedness”)
   1. pensions available to only about ½ of US workers
   2. Social Security c. 40% of pre-retirement earnings (citing the SSA, 2009)
   3. investments and work must “make up the difference.”

Social Security

1. **Social Security**
   1. 2019 payroll deduction 6.2% of your income
   2. 2019 average benefit $1,461 per month ($17,532 a year)
   3. 2019 maximum benefit $2,861 per month ($34,332 a year)
   4. “Full retirement age” (FRA) is currently 66 (set to increase gradually to 67).
   5. You can start benefits from age 62 to age 70, but they increase the longer you wait.
   6. Determine your optimal withdrawal time in relation to your spouse’s benefits.
   7. spouse benefit: 50% of your spouse’s FRA benefit; less if you claim before your FRA.
      1. When your spouse takes retirement benefits (62-70) doesn’t matter: you start with 50% of the spouse’s FRA benefit.
      2. When you take the spouse benefit matters: 62-66 reduces the 50% benefit, 66-70 yields 50%.
   8. survivor spouse benefit: your deceased spouse’s benefit amount when he or she claimed it; less if you claim it early
      1. When your spouse took retirement benefits matters: 62-66 reduces your survivor benefit, 66-70 increases your survivor benefit.
      2. When you take the survivor benefit doesn’t matter: 62-70 yields your spouse’s retirement benefit.

Medicaid and Medicare

1. **Medicare**
   1. Medicare is health insurance for
      1. people 65 or older
      2. people under 65 with certain disabilities
      3. people of any age with permanent kidney failure requiring dialysis or a transplant
   2. It covers almost 40 million Americans.
   3. parts of Medicare
      1. Medicare Part A (hospital insurance)
         1. helps cover inpatient care in hospitals
         2. helps cover skilled nursing facility, hospice, and home health care
      2. Medicare Part B (medical insurance)
         1. helps cover doctors’ services, hospital outpatient care, and home health care
         2. helps cover some preventive services
      3. Medicare Part C (private-insurance plans)
         1. Medicare Advantage Plans (like an HMO or PPO) are health plans run by Medicare-approved private insurance companies. Medicare Advantage Plans (also called “Part C”) include Part A, Part B, and usually Part D, often for an extra cost.
      4. Medicare Part D (prescription drug coverage)
         1. a prescription drug option run by Medicare-approved private insurance companies
         2. helps cover the cost of prescription drugs
2. **Medicaid**
   1. Medicaid is a welfare program for the poor.

Step 4: Protect

Emergency Fund

1. **example emergencies**
   1. home costs
      1. “damage to home (from flood, fire, vandalism, etc.)”
      2. “a broken furnace”
      3. “septic system malfunction”
      4. a broken appliance: “every single day in America, 15,000 washing machines break down (according to Sears . . .).” (Edelman *Financial Security* 11)
   2. car repairs
   3. illness
      1. “a sick family member”
      2. “disability due to accident or illness”
   4. “the death of a friend or relative who lives far away”
   5. “unemployment” (O’Neill 3)
2. **amount**
   1. The two criteria are:
      1. amount of monthly expenses
      2. stability of your income
   2. 3 months’ expenses (O’Neill 4) (Quinn *Smart* 23)
      1. “. . . until you have paid off your credit-card balances and have at least $5,000 or $10,000 someplace safe and liquid, like a savings account . . . you are crazy even to consider making riskier investments.” (Tobias 68)
   3. 3-6 months’ expenses (Edelman *Financial Security* 12) (Lucia 156)
   4. 6 months’ expenses (Artzberger)
   5. 1 year’s expenses (Edelman *Financial Security* 12) (Quinn *Smart* 23)
      1. if your income is very uncertain
      2. if someone in your family has health problems
3. **Pretend the money isn**’**t there**, once it’s topped off. (Quinn *Smart* 24)
4. **Replenish immediately**, if you have to use the account. (Quinn *Smart* 24)

KEEP AN EMERGENCY FUND IN CASH EQUIVALENTS

1. **cash equivalents**
   1. checking account
   2. savings account
   3. online checking or savings account (e.g., ingdirect.com)
      1. Internet banks offer a bit more interest because their overhead is low.
      2. Go to bankrate.com for comparisons of accounts.
   4. credit union (a bit more interest because they’re nonprofit)
   5. money market mutual funds (a bit more risk, so a bit more interest, but less liquid)
   6. Treasury bills
   7. short-term certificate of deposit (CD)
2. **comments**
   1. “Liquidity is the ability to readily convert an asset to cash without loss of principal.” (O’Neill 4)
   2. “By and large, the going rate [of interest] for safe, liquid funds will be about the same everywhere.” (Tobias 70)
3. **Which cash equivalents**?
   1. first $1,000 of emergency fund: a checking or savings account
   2. $1,000-$3,000: either
      1. bank money-market deposit account
      2. money-market mutual fund (these began 1968, in Brazil)
   3. over $3,000
      1. three-month or six-month CD (certificate of deposit)
      2. short-term bond mutual fund
      3. US Treasury bills (a type of bond)
         1. Treasury bills are short-term, 3-6 months.
         2. *Not* Treasury notes, which are intermediate-term, 2-10 years.
         3. *Not* Treasury bonds, which are long-term, 10 years+.

Protection: Insurance

1. **life**
   1. Buy term, not universal or whole life.
   2. Don’t insure if not needed.
2. **disability**
3. **health**
   1. *Never* be without health insurance.
4. **homeowner**’**s**
   1. *Never* be without homeowner’s insurance.
5. **car**
   1. *Never* be without car insurance.
6. **long-term-care insurance** (**LTCI**)
   1. mid-1980s: LTCI begins. (Lucia 202)
   2. It’s like disability insurance for the non-working.
   3. It pays for in-home care, adult day care, assisted living, and a nursing home. (Lucia 202)
   4. the danger
      1. “Arguably, the cost of long-term care is the biggest threat to [your] retirement assets, more so than the problems with Social Security, the prospect of another bear market, the falling dollar, energy prices, or even the federal budget deficit.” (Lucia 201)
      2. “Even a broken hip or a bout of pneumonia can devour decades of savings in a matter of months if you need home health care or must be admitted to a long-term care facility.” (Lucia 199)
      3. “Today’s extended lifespans have upped the odds of something like this happening.” (Lucia 199)
   5. average long-term care costs
      1. 2006: home health care: $20,000 (Lucia 201)
      2. 2009: one-bedroom unit in an assisted living facility: $37,500 (“Few Seniors”)
      3. 2006: semiprivate room in a nursing home: $74,000 (Lucia 201)
      4. 2006: average stay in a nursing home: 2.5 years (“Few Seniors”)
   6. when to buy
      1. *Consumer Reports* “recommends buying at around age 65 . . .” (Lucia 202)
      2. premiums are high: “A 60-year-old might pay $200 a month” (“Few Seniors”)

Estate Planning

1. **important documents**
   1. prenuptial agreement
   2. advanced directive
   3. durable power of attorney
   4. living will
   5. ethical will
   6. financial power of attorney
2. **wills**
3. **trusts**
   1. spendthrift and incentive provisions
   2. QTIP trusts
   3. irrevocable life insurance trusts (ILITs) for asset protection
   4. family limited partnerships (FLPs) to limit liability
   5. limited liability companies (LLCs) to limit liability
   6. AB trusts (tax-planning trusts to deal with estate taxes)
   7. trusts to help young children
   8. choosing an executor and trustee
   9. what to do if there is executor or trustee misconduct
   10. having wills and trusts work together
   11. living revocable trusts
       1. “living”: created while you’re alive
       2. “revocable”: you can change or cancel any time
       3. “trust”
          1. A trustee holds the title to the trust assets “for the benefit of another . . .” (*Random House Dictionary*. New York: Random House, 2009.)
          2. “The property or funds so held.” (*Random House Dictionary* 2009)
          3. A document that, like a will, designates who owns your assets.
             1. They are held for your benefit while you are alive.
             2. They are held for your beneficiaries’ benefit when you die.
       4. A living revocable trust is better than a will.
          1. The incapacity clause says who can sign for you if something happens to you.
          2. “A revocable living trust avoids probate because you have already transferred, while still alive, the titles of your property from your individual name to the title of the trust.” (Orman and Dobrovolny)
   12. charitable trusts
       1. (Or consider a donor-advised fund: put in a few thousand, *which you get to deduct*; it grows tax-free; decide when the charity gets it.)

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