Chapter 1

Improving Your Financial Literacy

In This Chapter

- Looking at what your parents and others taught you about money
- Questioning reliability and objectivity
- Overcoming real and imagined barriers to financial success

A recent Center for Economic and Entrepreneurial Literacy (CEEL) financial literacy survey showed that Americans lack basic math and personal finance skills. The national survey, conducted just before the holiday shopping season, found that an overwhelming number of Americans are unable to answer basic financial literacy questions. For example, the survey results revealed the following:

- Sixty-five percent answered incorrectly when asked how many reindeer would remain if Santa had to lay off 25 percent of his eight reindeer because of the bad economy.
- Seventy-five percent of people thought that it would take 15 years or less to pay off $5,000 in Christmas presents if they made the minimum payment on their credit card. In reality, it would take 46 years to pay off those holiday expenses!
- One in three people didn't know how much money a person would be spending on gifts if they spent 1 percent of their $50,000-per-year salary.

Sixteen percent of respondents admitted that they didn't expect to have their holiday debt paid off by the following March. I was tickled to see in CEEL's press release its antidote to dealing with gaps in personal financial knowledge: "Santa would be well advised to leave *Personal Finance For Dummies* in stockings across the country," said James Bowers, CEEL's managing director. "Many Americans don't even have the basic math skills required to balance their checkbooks; forget about understanding complicated mortgages or credit-card statements."

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 them, and most high schools and colleges lack courses that teach this vital, lifelong-needed skill.

Some people are fortunate enough to learn the financial keys to success at home, from knowledgeable friends, and from the best expert-written books like this one. Others either never discover important personal finance concepts, 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 — my parents 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.

However, my parents' financial knowledge did have some gaps. I observed firsthand the struggles my father endured handling some retirement money after being laid off from a job when I was in middle school. In subsequent years, this situation propelled me to learn about investing to help myself, my family, and others.

In many families 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 children should be insulated from it so that they can enjoy being kids. In many families, kids 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 have thought that banks were the best places for investing money or that buying stocks was like going to Las Vegas. (You can find the best places to invest your money in Part III of this book.)

Personal finance at school

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 by 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. Children need to be taught how to manage a household budget, the importance of saving money for future goals, and the consequences of overspending. Unfortunately, few schools offer classes like Donovan's. In most cases, the financial basics aren't taught at all.

In the minority 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.

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.

In still other cases, the parents had the right approach, but the kids do the opposite 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 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.

TIP

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.

Identifying Unreliable Sources of Information

Most folks know that they're not financial geniuses. So they set out to take control of their money matters by reading about personal finance or consulting a financial advisor.

But reading and seeking advice 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. (Because the pitfalls are numerous and the challenges significant 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.)

Understanding the dangers of free financial content online

In addition to being able to quickly access what we want, the other major attraction of the Internet is the abundance of seemingly free websites providing piles of free content. Appearances, however, can be greatly deceiving.

While there are exceptions to any rule, the fact of the matter is that the vast majority of websites purporting to provide a seemingly never-ending array of "free" content are rife with conflicts of interest and quality problems due to the following:

- **Advertising:** Any publication that accepts advertising has a potential conflict of interest because it may not want to publish articles that would upset its advertisers. Such a mindset, however, can stand in the way of telling consumers the unvarnished truth about various products and services. For example, auto leasing companies aren't very interested in advertising someplace that publishes articles highlighting the negatives of leasing. (Check out the section "Publishers pandering to advertisers" later in this chapter for more on the power of advertising to influence the financial information you encounter online, on TV, and elsewhere.)
- **Advertorials:** Too many website owners are unwilling or unable to pay real writers for quality content and instead publish articles that are provided and written by advertisers. These pieces of "content" are known as *advertorials* and, in the worst cases, aren't even clearly labeled as advertisements, which is precisely what they are.
- **Affiliate relationships:** Many companies now pay "referral fees" to websites that bring in new customers. Here's how that practice causes major conflicts of interest. On a financial website, you read a glowing review of a particular financial product or service. And, the site provides a helpful link to the website of the provider of that product or service. Unbeknownst to you, when you click on that link and buy something, the seller kicks money back to the "affiliate" who reeled you in. At a minimum, such relationships should be clearly disclosed and detailed in any review.
- **Insufficient editorial oversight:** At most established, quality print publications, there are usually several layers of editors who oversee the publication and all of its articles. This structure helps ensure the accuracy of what gets into print (although bias, such as political bias, isn't necessarily controlled). Unfortunately, the shoestring budget on which many websites operate precludes these quality control checks and balances. Thus, sites operated by non-experts proffering advice place you at great risk.
- **Lack of accountability:** In part because of a lack of editorial oversight, there's also often a lack of accountability for advice given online. This situation is especially problematic on the numerous sites that are run without disclosure of who is actually in charge of the site and/or who is writing the articles. Although such anonymity may be helpful to the site and its content providers, it's certainly not in your best interests because it prevents you from checking out the background, qualifications, and track record of the providers.

Recognizing fake financial gurus

Before you take financial advice from anyone, examine 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 TV 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."

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 its 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.
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> ". . . Orman's publicist said a written response to the *Forbes* piece and the 'Street Smarts' column would be sent by facsimile to the *Chronicle*. . . . However, no fax was ever sent. They blew me off. Twice.
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> "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 . . . 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."

You can't always accept stated credentials and qualifications at face value, because some people lie (witness the billions lost to hedge fund Ponzi-scheme-man Bernie Madoff, who was brought down in 2008). You can't sniff out liars by the way they look, their resume, their gender, or their age. You can, however, increase your chances of being tipped off by being skeptical (and by regularly reading the "Guru Watch" section of my website at `www.erictyson.com`).

You can see a number of hucksters for what they are by using common sense in reviewing some of their outrageous claims. 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 percent per month, or 300-percent 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 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'll rack up enormous brokerage commissions.
- On occasions where your short-term trades produce a profit, you'll pay high ordinary income tax rates rather than the far lower capital gains rate for investments held more than 12 months.
- You won't make big profits — quite the reverse. If you stick with this approach, you'll underperform the market averages.

- You'll 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 able to indeed earn the 300-percent annual returns his seminars claimed 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!

How some gurus become popular

You may be wondering how Wade Cook became so popular despite the obvious flaws in his advice (see the section "Recognizing fake financial gurus" for the goods on Cook). He 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.)

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. (That didn't stop Cook, however, from getting into more legal hot water — he's currently serving a seven-year prison term for failing to pay millions in personal income taxes.)

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 one year in which the stock market fared well. 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!

Publishers pandering to advertisers

Thousands of publications and media outlets — newspapers, magazines, websites, radio, TV, 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 the Internet, radio, and TV) — 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.

Be sure to consider how dependent a publication or media outlet is on advertising. I find that “free” publications, radio, and TV 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. Everyone knows how difficult it is to break habits that have been 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 may 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 adult problems can be traced back to childhood and how they were raised.

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, adults make choices and engage in behaviors that affect themselves as well as others. They shouldn't blame their parents for their own inability to plan for their financial futures, live within their 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 has. 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 — ought to 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. All people need to manage their 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.

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.