Understanding Money

Money 101

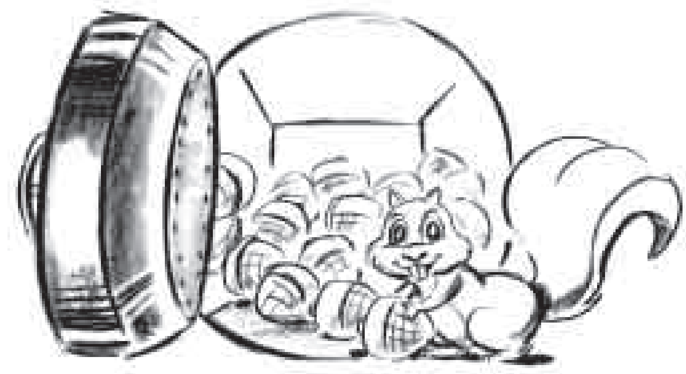
Let's face it, you need money.

To get it, you will need to earn it.

How much you need depends on where you live, your expenses, the size of your family, and many other factors. (See page 17 at the beginning of this book.)

How much you earn depends on your education, your skills, and how much your parents can help. (Of course, it also depends on how much ambition you have, and how committed you are to success.)

You need to earn money, not only for your day-to-day expenses, but also to save for the future. Savings are important. Even animals save. A squirrel knows (thanks to nature) that it's hard to find food in the winter months. The squirrel stashes food so it can eat when food is hard to find.



As a human being, you can learn a thing or two from the animal kingdom. *Savings are important*. They give you staying power. For example, suppose you hate your job, or your job is unstable. If you're fired or you decide to quit, you'll have no income. Who will pay for your day-to-day living expenses?

Unless you have parents or someone else to bail you out, you'll need your savings. You can't always run to your parents for help. They have their own share of expenses, and may not have enough to help you. You have to become financially independent some day.

So you need savings.

But before we talk further about savings, lets look at something really important — *staying out of debt*.

What is debt?

Simply put, debt is what you owe someone else (a friend, your parents, or banks).

You get into debt when you don't have enough to pay for what you buy, or when you don't want to pay money to buy it outright.

Here's another, simpler way to look at it. *You get into debt when you spend more than you earn.*

It's really simple to get into debt — thanks to all the people (banks, private lenders, other lending institutions) that want to lend you money. Ever wonder why your parents receive dozens of advertisements from credit companies, asking them to sign up for new credit cards?

Do you think these companies are doing it out of the goodness of their hearts? No way!

They want you to borrow money (and get into debt) because then you'll have to pay them *interest* (lots of it). Interest is money that banks make you pay when you borrow. It's extra money (a percentage) that you must pay, over and above the money you borrow.

Why do you think the banks are trying so hard to get you to borrow their money? You might think, "Yeah, sure, I'll borrow it. But I'll pay it back too." Unfortunately, it isn't quite so easy. The banks are betting that, because you need the money in the first place, you'll continue needing it for other things, *and won't have the discipline to pay it back*. That way, you'll continue to pay their interest charges.

The terrible thing about debt is that it tends to grow and grow. People who think they'll borrow just a little often end up borrowing a lot. As their debts grow, they almost become slaves to the lenders. Does that sound familiar? It should. In lots of ways, debt can be like an addiction to drugs, tobacco, or alcohol.

But before you think borrowing and paying interest is always bad, lets look at the concept of *good debt* and *bad debt.*

Good debt is money you borrow for a good purpose — buying a house, starting a business, or getting an education. These things can make you richer in the long run.

Bad debt is borrowing money for consumer items such as stereos, clothes, shoes, entertainment, dining out, and other consumer items. These things just drain your money away.

Why the distinction between good debt and bad debt?

Remember: Being in debt means you're paying others for using their money. For that reason, you should only borrow money (and pay the interest) for things you *really* need.

For example, most credit card companies charge around 18% per year in interest. If you borrow $1,000 on your card, the math works out like this:

- Annual interest charges of 18% on $1,000 come to $180 per year.
- $180 divided by 12 months is $15 per month in interest.
- The bottom line: You owe the credit card company $1,000, plus $15 per month until you pay them back.
- Even if you pay off your $1,000 debt six months later, you'll pay $1,000 plus $90, for a grand total of $1,090.

Think about it. You just paid out $90, and you got *nothing* for it! It's a lousy deal.

To stay out of debt, ask yourself one simple question before you buy anything: "Do I *need* it or do I *want* it?"

If you want it, ask yourself honestly why you want it. If you think you need it, do the same. The answer might save you some money.

For example, a certain sporting goods company introduces a new air-filled shoe. The product is heavily advertised, and a sports star endorses it. Your friends rush out and buy the shoes, which cost $150 per pair.

Now think. Do you want the shoes, or do you need them?

Some important facts you need to keep in mind as you develop your spending habits:

- Advertisers have only one purpose in mind. They want you to buy what they have to sell. To put it bluntly, they want to transfer money from your pocket into their pockets.
- When advertisers want you to buy something, they use every trick.
- Typical tricks used by advertisers include glamor,

image, endorsements, and (of course!) *sex*.

As we discussed earlier, tobacco companies are notorious for targeting teenagers as new smokers. Do they care about your health? No way!

They use pretty women and handsome men to convince you that smoking is cool, or that smoking will somehow give you sex appeal. But do you really believe, even for a minute, that smoking will make you look sexy? Smoking does just the opposite; it blights your life. Your health suffers, your body reeks of cigarette smoke, your teeth are stained…so where is the sex appeal? *Chances are that by the time you separate hype from reality, you'll be addicted*.

Incredibly, many people go into debt to support their nicotine addiction, which can cost hundreds of dollars per month. And all because they let the advertisers get under their skins.

So before some slick ad campaign cons you into buying something, think a little. And before you borrow money to buy something, think even harder.

Other ways you can get taken:

Buying consumer items on a "low monthly payments" plan. You could very well end up paying twice the price just by falling for a pay-by-the-month plan. Think about it from the store's point of view. Why would they let you use something for free? Surely they *have* to get their investment back for the item they just sold you. And the best way to do it is to make you pay hefty interest on the item you bought.

Here are some smart shopping strategies you can use:

Unless you absolutely need it right away, wait a little before buying (remember, if something is worth having, it's worth waiting for).

Chances are, with time you'll really be sure you want the item in the first place. Go to one of those used sports equipment shops and see for yourself the large quantities of unused items sold back to the store at heavily discounted prices. (The stores mark up the prices and resell the products to others at a hefty profit.)

The prices for electronic items such as computers, CD/DVD players, and TVs continue to drop. Unless you need the item in a hurry (for a gift or a school project), you're much better off waiting. One of the biggest advantages of waiting is that you might get something better for a lower price.

As you start working, you'll realize that earning money is not easy, and that life has surprises and shocks in store. You need to save money. And you need to stay out of debt.

Savings and investments

You should approach money with one question uppermost in mind: "Will I control my money, or will money control me?"

Interesting question. Think about it.

If something happens to your job or some emergency requires a chunk of money, savings give you reserves to tide you over. But if you don't have savings and you need money urgently, you'll have to borrow and pay interest. You could land in an ugly mess if you borrow money and find you can't pay it back. This could ruin your credit rating, making it very difficult to borrow later for a house, a car, or some other necessity.

So it's critical that you learn to save.

You don't have to wait until you're on your own to start saving. If you receive an allowance, you can decide — right now — to start putting some of it aside as savings.

Reward yourself for saving. When you find the self-discipline to put some money aside, go ahead and buy something for yourself (without dipping into your savings, of course).

The next step after savings is investing. Although you might not be ready yet to invest money, you do need to understand what it means and how it affects your finances in the long run.

Investing is putting money into real estate or securities such as stocks and bonds. The main purpose is to earn *interest*, *dividends*, and *capital appreciation*.

- We've already discussed interest — it's money *you* pay to *others* when you borrow from them. But others will pay *you* interest if you lend *them* money. A good way to lend money is to buy bonds. A bond is a document that says someone (a borrower) owes you money, and must pay you interest.
- Dividends, which you usually earn by owning stocks, are a bit like interest. A stock is a certificate that says you own part of a company. Sometimes it entitles you to some of the company's profits, which the company pays you as dividends.
- Capital appreciation happens when stocks, bonds, real estate, or other securities increase in value after you buy them. For example, even if a stock does not pay dividends, it could still go up in value.

Of course, all investments have some risk, and some investments are riskier than other investments. For example, some bonds (known as *junk bonds*) pay high rates of interest compared to other bonds. Junk bonds have a higher risk. Some people have made a lot of money with junk bonds, and others have lost. So you have to be careful, and learn all you can before investing.

The biggest reason to invest is simple: It's the only way your money will grow. If you keep $1,000 under your mattress, then after 15 years you'll still have $1,000 under your mattress. And it probably won't be worth as much.

On the other hand, if you put that money in a regular savings account earning 5% compound interest, then your money grows to $2,117 in those same 15 years.

So which is better, putting money under your mattress or in an investment?

Of course, the explanations above are a bit simplified. There are many kinds of investments, each with a different set of rules. As time goes on, you'll learn what the differences are and which investments are right for you. You just have to keep an open mind and remember that investments play an important role in how you manage your money.