



FINANCIAL LIFE SKILLS CURRICULUM

Module 1

Eyes on the Prize

Goal Setting

“Obstacles are those frightful things you see when you take your eyes off your goal.”

--Henry Ford

Lesson Overview:

The fundamental premise of financial education is the need to set goals and to budget effectively. Time and money are scarce resources and every educated consumer, however young or old, must understand how to allocate time and money in intelligent, efficient, and sustainable ways. Goals provide the decision-matrix to make conscious choices and shape behavior.

This introductory module begins with goal-setting to lay the foundation for students to understand the importance of financial education and mentorship in their personal lives. The core of the lesson encourages students to think differently about their everyday activities—schoolwork, sports teams, clubs, and social life. It is hoped that new patterns of thinking will translate into informed decisions

Equally important, this lesson is meant to initiate the peer-to-peer mentor relationship between high school students and Moneythink mentors. Such a relationship is only possible if Moneythink mentors take an active interest in the personal background, current thoughts, and future aspirations of their students. Delivering educational content exclusively through lecturing is insufficient to foster strong bonds in the classroom. This lesson hopes to break away from traditional models of teaching in order to provide education in more familiar and interactive ways.

Lesson Goals

- What are goals?
- Why set goals? How to effectively set goals.
- What are different categories of goals?

Key Terms:

- Goal-Setting
- SMART Goals
- Action-plan
- Deadlines

Opening Discussion:

- What are goals?
- Successful professionals—from Michael Jordan to Kanye West, Oprah, and Barack Obama always stress the importance of setting goals. Why might this be the case?
- What are some goals that successful men/women might set? Do those goals apply to students as well?

Mentor Note: Be sure to grab a marker and write ideas on the board to facilitate the discussion.

What are goals? Why set goals?

The dictionary definition of a goal is: *“The result or achievement to which effort is directed”*.

The definition of a goal explains the most basic principle of goal-setting: *goals guide action*. Goal setting is the process of making decisions on what results you want to accomplish and developing a plan to achieve those results. There are three equally important parts of goal setting:

- 1) Deciding the specific results you want to achieve
- 2) Creating a step-by-step action-plan for attaining those results
- 3) Developing a timeline and deadlines to achieve each step

It is important to remember from the beginning that the first step seems to be the easiest of the three steps. However, deciding the results you want to achieve requires meticulous precision. Unrealistic and unachievable goals can frustrate action; undemanding goals that are too simple will seem boring and leave you unsatisfied. Effective goal setting is something in the middle.

A common acronym used by many to set effective goals is SMART. SMART means that goals must be:

- Specific
- Measurable
- Attainable
- Relevant
- Time-Bound

These five characteristics can be used as a checklist to ensure to devise effective goals. When thinking about goals, always ask yourself if the goals you are setting are SMART. Here are some tips that will further explain the SMART process.

1) *Be precise and make sure your goals really matter to you.* At first this seems obvious, but it is very important to narrow down your goals to a very specific target set. Many people set meaningless goals which leave them disappointed. Make sure your goals will motivate and energize you throughout the difficult process in achieving them. For example, the goal of “getting good grades” is nice, but does not provide you the guidance needed to direct action. It is much easier to think of a goal that directly informs your action--your goal should be easily connected to a clear action-plan.

I want to get an A on my Science Test by taking diligent notes in class, reviewing them before the test, and practicing with a study group.

I want to run a mile in under 6 minutes by running long distances every weekday morning, practicing sprints every weekend, and eating healthier foods.

2) *Choose goals that are possible to achieve.* Everyone knows that it is important to set goals that are achievable, but the fine line between too little and too much is very difficult to identify. Goals definitely need to challenge you, and one way to learn the art of setting goals is through trial and error. Have a friend, teacher, or mentor look over your goals and ask you questions on them. Answering questions about your goals will help solidify the prospect of achieving them.

Once you have set your goals it is important be dedicated to achieving them. Writing down the goals is one of the first steps to maintain commitment. Maintaining patience is also very important; you need set a reliable, consistent schedule that will allow you to work towards your goal.

A common mechanism for accountability that we will be using is to make goals public. Knowing that others around you will be checking up on your goals maintains an external incentive to keep you in check. This can range from posting your goals on the classroom wall to pairing up with a goal-buddy. The goal buddy will monitor your results throughout the process.

3) Evaluate your goals

When setting multiple goals, it is important to prioritize the most important goals. It is very easy to take too many goals at one time, so one of the general principles we will follow is that for each time period, we will choose no more than three goals. Of the three, it is important to number each goal in order of priority. That way, if there happens to be a conflict between two goals, you can defer to your predetermined priorities.

You may be thinking: *this all sounds very abstract!* Goal setting is very effective and for many it is intuitive. At the same time, however, it is very abstract. One of the ways to get past the abstractness is to *visualize* goals. What does this mean? To visualize your goals is focus on the final situation where you have achieved the goal. This can be a very powerful exercise which will help you stay on track—especially in difficult situation.

Through the process, it is important to set smaller sub-goals and deadlines that will help you achieve the bigger, more long-term goals. Deadlines will shape your behavior, and abiding by deadlines creates discipline. Deadlines also help you evaluate the goals to see how you did in the process of achieving specific goals, what you learned, and what you could do better. These lessons will inform future goal setting behavior.

Famous Thoughts on Goals

Excerpt from Michael Jordan on Setting Short-Term Goals¹

I approach everything step by step....I had always set short-term goals. As I look back, each one of the steps or successes led to the next one. When I got cut from the varsity team as a sophomore in high school, I learned something. I knew I never wanted to feel that bad again....So I set a goal of becoming a starter on the varsity. That's what I focused on all summer. When I worked on my game, that's what I thought about. When it happened, I set another goal, a reasonable, manageable goal that I could realistically achieve if I worked hard enough....I guess I approached it with the end in mind. I knew exactly where I wanted to go, and I focused on getting there. As I reached those goals, they built on one another. I gained a little confidence every time I came through.

...If [your goal is to become a doctor]...and you're getting Cs in biology then the first thing you have to do is get Bs in biology and then As. You have to perfect the first step and then move on to chemistry or physics.

Take those small steps. Otherwise you're opening yourself up to all kinds of frustration. Where would your confidence come from if the only measure of success was becoming a doctor? If you tried as hard as you could and didn't become a doctor, would that mean your whole life was a failure? Of course not.

All those steps are like pieces of a puzzle. They all come together to form a picture....Not everyone is going to be the greatest....But you can still be considered a success....Step by step, I can't see any other way of accomplishing anything.

¹ Taken from Jordan, Michael. *I Can't Accept Not Trying: Michael Jordan on the Pursuit of Excellence*, Harper Collins: San Francisco, 1994

Discussion Questions:

- 1) Why do you think Michael Jordan failed to stay on the basketball team? How did goals help him get past the failure?
- 2) Would Michael Jordan have been as successful without goals? Why or why not?
- 3) How can we apply Jordan's lessons to our day-to-day lives?

Oprah on Setting Long-Term goals: An Excerpt²

"I always knew I'd be a millionaire by age thirty-two," said Oprah in 1987. "In fact, I am going to be the richest black woman in America." 19 years later, with a net worth of \$1.4 billion, Oprah has become not only the richest black woman in America, but also one of the richest people in the world. She ranks 235 on the Forbes 400 Richest Americans list and almost 30 million American houses tune in to her show daily to hear her talk about everything from relationship problems to business investments to human rights abuses around the world.

This success has not come by chance. Oprah has made her fortune by setting clear and ambitious goals on both the professional and personal levels. "The big secret in life is that there is no big secret," she says. "Whatever your goal, you can get there if you're willing to work."

According to Oprah, the biggest hurdle people need to overcome in order to be successful is their belief that there are limits to how much they can accomplish. Goals need to be set and set high; expectations need to be limitless; and ambition cannot be restrained. "If you believe you can only go so far, it is an obstacle."

Gut instinct has been one of the largest driving factors behind Oprah's success. "Be quiet," she says. "Part of your responsibility is to honor the quiet inside yourself so you can hear the call." Her prescription for doing so is to "take five minutes to center yourself in the morning...set your intention every day...if you don't have five minutes, you don't deserve to have the life of your dreams."

Oprah's gut instinct was responsible for the move of the entire production of The Oprah Winfrey Show from L.A. to Chicago. An impulse decision, Oprah and the crew then dedicated themselves to working around the clock, taping two shows every day, to successfully ensure their ratings did not slip by even one point. "Follow your instincts," she advises. "That's where true wisdom manifests itself."

When Oprah's impulse also told her to change the direction of the show and take the content to a higher ground, there was a real concern among the others involved who worried the show would drop in the ratings. But, Oprah trusted her gut, saying, "It took a lot of courage to take the high road, but I would rather be significant with six million people watching a show with meaning, than everyone watching a show with no meaning".

Her desire to set and have control over her own professional goals is evidenced by the

² From Carmichael, Evan. <http://www.evancarmichael.com/Famous-Entrepreneurs/514/Lesson-1-Set-High-Goals.html>

creation of Harpo Studios, a production company founded by Oprah herself to produce The Oprah Winfrey Show, among other pursuits. On a personal level, Oprah decided to finally conquer her lifelong challenge with weight by losing almost 70 pounds. "Whatever you fear most has no power," she says. "It is your fear that has the power."

When she first began her television career, Oprah established the goal of hosting a successful talk show for 20 years, after which time she would happily quit. That time has since come and gone and Oprah shows no signs of slowing down. She continues to be a hugely successful talk show host, actress, publisher, and producer and is constantly looking to the future for new opportunities. "You get in life what you have the courage to ask for," she says. "Always continue the climb."

Discussion Questions:

- 1) Oprah believes that a long-term vision is important. Do you agree? Why or why not?
- 2) How do you think one can motivate themselves when the goal seems so far away? Can you give an example of a personal experience?
- 3) Oprah encourages us to *visualize* goals for five-minutes every morning. Do you think this is effective? Why or why not?

Categories of Goals

All goals are not the same. There are two easy ways to differentiate various categories of goals: by type and by deadline.

Different Types of Goals:

- Educational Goals
- Physical/Athletic Goals
- Family/Friend Goals
- Financial Goals
- Social/Recreational Goals

Discussion Questions:

- 1) Why is prioritizing goals important when dealing with different types of goals?
- 2) Should everyone have goals from all the categories above? Why or why not?
- 3) Are there differences in the difficulties needed to achieve a certain category of goal?

Different Deadlines

- Short Term: Within 1 month
- Medium Term: Within 6 Months
- Long Term: Within 1 Year
- Life Goals: Within 4 Years

Discussion Questions:

- 1) How can shorter goals link to longer goals?
- 2) Why are goals too far in the future harder to achieve?
- 3) Why should you have different action-plans for each time period of goals?

Breakout Activity: After explaining the theory of goals, break the class up into smaller groups. Tell the class to pick a goal-buddy that will monitor results on goals throughout the program. This is a chance for the Moneythink mentors to get to know the students and break the ice. Use the three activities below.

Goal Setting: Activity 1

In the spaces below, write your goals for the given time period. Please go into some detail.

1 MONTH

6 MONTHS

1 YEAR

4 YEARS

Next, please write four action steps for each goal. Next to each, write the date by which each step should be accomplished.

Action Steps	Deadline
Goal: Steps 1) 2) 3) 4)	Dates 1) 2) 3) 4)
Goal: Steps 1) 2) 3) 4)	Dates 1) 2) 3) 4)
Goal: Steps 1) 2) 3) 4)	Dates 1) 2) 3) 4)
Goal: Steps 1) 2) 3) 4)	Dates 1) 2) 3) 4)

Action Steps	Deadline
Goal: Steps 1) 2) 3) 4)	Dates 1) 2) 3) 4)
Goal: Steps 1) 2) 3) 4)	Dates 1) 2) 3) 4)
Goal: Steps 1) 2) 3) 4)	Dates 1) 2) 3) 4)
Goal: Steps 1) 2) 3) 4)	Dates 1) 2) 3) 4)

What are some of the biggest hurdles that you anticipate in achieving your goals?

For 1 month:

For 6 months:

For 1 year:

For 4 years:

Who can you reach out to for help in accomplishing your goals? Please write down at least four names, and the relationship you share with each person.

Goal Setting: Activity 2

Please state your progress on your goals for one month, six months, and 1 year. Was your goal too ambitious? Have you met your first action step, or (in the case of 1 month) accomplished the goal? What would you change about your goals, or your actions steps?

1 MONTH
6 MONTHS
1 YEAR
4 YEARS

What was the hardest obstacle that you have encountered so far?

Have you fallen behind on your action steps? If so, what can you do to insure that you keep moving forward towards your goals?

Goal Setting: Activity 3

Setting New action steps:

Streamline and re-evaluate your actions steps for your goals. Think about developing a "plan of attack"- what is most efficient way to reach your goals?

6 MONTHS
1 YEAR
4 YEARS

Finding your Resources:

For each goal, compile a list of the resources that you will need to reach your action steps. The most important of these resources is your *network*. Make sure to include at least three names of people that will help you with these goals. There may be overlap between the names.

6 MONTHS

1 YEAR

4 YEARS

Module 2

Keeping it Even

Budgeting

"Don't tell me what you value, show me your budget, and I'll tell you what you value."
--Joe Biden

Lesson Overview:

To achieve personal and financial goals, it is important to maintain discipline with saving and spending. The first step to creating such a discipline is developing a budget—a step-by-step plan that shows how resources will be allocated within a specific time period. Though seemingly straightforward, to budget effectively is not an easy task. If financial goals are not realistic, specific, or actionable, it is unlikely that a clear budget will be formulated. Accounting for a variety of expenses can also prove to be very difficult, especially for students who do not have the necessary previous experience.

The purpose of this lesson is to extend the financial goals set in the first lesson into an actionable plan through budgeting. As students begin understanding their sources of revenue and spending patterns, they will be able to better visualize their financial situation. Of course, this first requires considering the difference between needs and wants. It is only after creating a clear distinction between needs and wants that various expenses can be prioritized.

Budgeting also requires considering what are the appropriate amounts to spend in a specific time period. This involves understanding how much to money to allocate to current expenses rather than saving and investing for the future. Appropriate amounts can only be determined based on short-term and long-term goals, and they must translated into line-items on the personal budget.

Lesson Goals

- What is a budget? How budgeting links to goal-setting.
- Identifying current resources and spending patterns
- Prioritizing personal and financial goals
- Creating a personal budget that supports personal goals

Key Terms:

- Budgeting
- Resources
- Income
- Expenses

Opening Discussion:

- What does budgeting mean to you?
- Have you ever budgeted in your life? If so, were you successful at maintaining your budget?
- Who do you think needs to budget? Does it matter how much money you have? Why or why not?

Mentor Note: Be sure to grab a marker and write ideas on the board to facilitate the discussion.

What is a budget? Why budget?

A budget is quite simply: *“The systematic plan of how you will spend and save income during a specific period of time”.*

A personal budget allocates future income into one of three categories: spending, savings, or repaying debt (i.e. loans or credit card repayments). The purpose of the budget is to answer the central question: Where does my money come from and where does it go?

The biggest limitation people face when constructing a budget is that they are not realistic with their financial goals and expectations. For example, instead of allocating enough funds to social expenses (i.e. dinners or holiday trips), they suddenly cut back on all of recreational spending. It is important not to make a budget that is overly optimistic about your savings abilities, as it will be frustrating—and will lead you to give up budgeting altogether.

An initial question may be asked: *Why budget at all?* Budgeting provides a tool-kit from which you can understand separate components of your savings and spending habits. A budget helps you answer the following questions:

- 1) How much money do I have available to spend?
- 2) Where do I want to spend my money?
- 3) When do I want to spend my money? Do I want to spend it right now or in the future?
- 4) Are my current expenses outweighing my current sources of income?

A budget allows you to *control* how you work with your personal and financial goals by providing a visual picture of your money. This is especially important to curtail certain activities like impulsive shopping or buying things that you cannot afford. By keeping track of your spending patterns, you can also determine how you will save. More importantly, budgeting provides you the opportunity to plan in advance for financial emergencies and other unforeseen events.

Current Spending Behavior

The first step to budgeting effectively is to identify current spending behavior. Namely, *what patterns do you see in the way you spend?* Places of spending range from smaller expenditures like food and drinks, to larger expenditures like cars and houses. It is important to determine how you decide what to purchase and when to purchase a specific item. The factors that influence your purchasing decisions are fundamentally linked to your spending behavior. One way to track your spending behavior is to keep all records of your spending—receipts, financial statements, invoices. This will provide the documentation for you to tally your spending for a specific time period.

One common issue regarding spending is the question of *needs vs. wants*. A need is by definition something you *have* to have, whereas a want is something you would *like* to have. The difference seems very obvious, but in practice it is sometimes hard to distinguish between needs and wants. If our only goal was survival then our set of needs could be minimized to four “basic needs”: shelter, food and water, health care, and clothing. Every additional need that is added to this basic list should correlate in some way to goals that we have in life. Life, after all, is more than simply survival. Education, for example, is not a “basic need”, but most would argue that it should undoubtedly be a major goal for a young person.

The Story of Scottie Pippen

“Known more for his on court defense than his off court business sense, former Chicago Bulls star Scottie Pippen lost \$120 million in career earnings due to poor financial planning and bad business ideas. Air Jordan’s sidekick blew \$27 million on bad investments and spent \$4.3 million on a Gulfstream II corporate jet. If you’ve read any of the numerous books about the Chicago Bulls of the 1990s then you know that Scottie Pippen is kind of funny about money. Raised in a poor household, Pippen jumped at the chance to sign a long-term contract prior to the 1991-92 season, choosing the security of a long deal over being paid what he was worth. Throughout his career, Pippen would endorse anything and everything, assuring that the money kept flowing in. Following the end of his playing career, Pippen was involved in a number of bad business deals that left him nearly broke. One of the notable money mistakes that Pippen made was the purchase of a \$4 million Gulfstream jet in 2002. Due to a missed inspection, the jet’s engine needed \$1 million worth of repairs shortly after the purchase. Rather than paying that, the jet was grounded, making it the world’s most expensive paper weight.”³

³ http://sports.yahoo.com/nba/blog/ball_dont_lie/post/Scottie-Pippen-is-a-little-less-broke-these-days?urn=nba-252310

Discussion Questions:

- 1) Did Scottie Pippen understand needs vs. wants? Why or why not?
- 2) How do you think budgeting would have affected Scottie Pippen's financial situation
- 3) What would you suggest to other current NBA stars regarding budgeting? How can you apply this to your own life?

Prioritizing Personal and Financial Goals

Turning back to a discussion on personal and financial goals, it is important to know which of your goals are most important. We already discussed in the goal-setting lesson that goals must be SMART. We also mentioned that having more than three goals for a specific time period will be frustrating and counterproductive. In this section, we want to take this idea one step further. Since time and money are scarce resources, it is also important to know which one of the three goals within the time-period are the most important. Of course, the priorities will shift over time, many times according to the deadline for the goal itself. However, it is still important to keep the broader picture in mind, so as to wisely spend the limited resources at your possession.

When walking through your personal and financial goals, it is also important to see how shorter-term goals link to longer-term goals. This will be one of the primary factors when prioritizing personal and financial goals. Usually, you will end up spending the most diligent and motivated time working with the shorter-term goals that lead to the more important longer-term goals.

Discussion Activity:

Have the class prioritize their various goals from the goal-setting lesson. If the class has already expressed the goals in order of preference, ask a few members of the class to explain why certain goals were a higher priority. Stress the importance between shorter-term goals and longer-term goals.

Creating a Personal Budget

The final part in the budgeting exercise is actually creating the personal budget. With the a baseline understanding of current spending behavior and a prioritized list of personal and financial goals, creating a personal budget is fairly simple. As you think about creating your personal budget, work through the following tasks:

- 1) Choose a Budget Period
- 2) Collect and organize all relevant financial documents (receipts, invoices, etc.)
- 3) Record the sources of income (i.e. paychecks)
- 4) List all your expenses for every month
- 5) Find out which of those expenses happen repeatedly (fixed vs. variable)
- 6) Estimate Total Expenses and Income
- 7) Balance Expenses and Income

As you list current aspects of your income and expenses, be sure to think of possible future situations. What do you expect to be your source(s) of income in the future? How do you anticipate costs to change over the next months or years? More generally, it is important to consider what being financially independent means to you. The budgeting exercise is meant to elicit new thoughts on such topics.

Monthly Budget

Income	Budget	Actual	Difference
Family			
Job			
Government			
Other			
Total monthly income			
Expenses	Budget	Actual	Difference
Repeated. Regular Expenses			
Rent			
Car insurance			
Car payment			
School			
Irregular expenses			
Food			
Clothes/Shoes			
Books/School Supplies			
Social Activities			
Other:			
Other:			
Total monthly expenses			

College Budget Sheet

Name: _____

Age: _____

Grade: _____

University of Choice: _____

Other Universities in Consideration: _____

Proposed Major: _____

How are you going to make your first \$ 1 million?

Do you have a bank account currently? If so, where? _____

What college bank account will you use? _____

Will you get a student credit card? If so, do you understand the costs and benefits?

If so, why or why not? Where will you use it?

Will you have student loans? If so, what is your plan to pay them off?

College Budget

Income	Total Budgeted (\$)	Monthly*
Scholarships		
Student Loans		
Family		
Campus Job		
Other:		
Other:		
Total income		
Expenses	Total Budgeted (\$)	Monthly*
Repeated. Regular Expenses		
Tuition		
Room & Board		
Books		
Transportation		
Irregular expenses		
Food		
Clothes/Shoes		
Books/School Supplies		
Social Activities		
Other:		
Total expenses		
Total Income less Expenses (Income – Expenses)		

* for monthly expense divide total by 12

Module 3

Stashing Cash

The Importance of Savings

"You do not plan to fail, you fail to plan."

–Anonymous

Lesson Overview:

It's difficult to begin to save. To have the mental fortitude to set aside \$50 when you could buy a brand new video game or a sweet pair of Nike's, is something very challenging. As a result of the goal-setting module, students should be more prepared to constructively think about saving. In this lesson, students will learn that saving even a little bit of money now will pay off significantly in the future because of the miracle of compound interest. Furthermore, students will learn what kind of account to deposit into and at what bank they want to deposit at as a result of our comparative analysis.

Many students do not realize the importance of saving, especially saving early and often. This lesson will show students the wonders of saving by explaining the underlining principle of compounding interest. The lesson will also describe the advantages and disadvantages of national banks versus local banks. The lesson will conclude with a discussion of the 3 most common types of bank accounts and the basic relationship between interest and ability to spend.

Lesson Goals:

- Describe perils of failure to save
- Derive formula for compound interest
- Theory of saving
- Advantages of National Banks
- Advantages of Local Bank
- Types of banks accounts
- Why should you save early and often?

Key Terms:

- Interest Rate
- Compound
- Future Value
- Present Value
- National Bank
- Local Bank
- Checking Account
- Savings Account
- Certificate of Deposit (CD)

The Story of Antoine Walker

An Example of Someone Who Failed to Plan

You are a star NBA Player, making some good money. Let say \$110 million over 13 years to be precise; that is about \$8.5 million a year! The more money you make the more you decide to spend. Pretty soon, you are supporting an entourage of 70 friends and family members in some way. You build your mom a mansion in the Chicago suburbs complete with an indoor pool, 10 bathrooms, and a full-size basketball court. You then decide that you have a passion for cars. You transform the pavement around your house into a luxury car lot—two Bentleys, two Mercedes, a Range Rover, a Cadillac Escalade, a bright Red Hummer. Most of the vehicles were tricked out with custom paint jobs, rims, and sound systems at considerable added expense. On top of this you have a top-line watch collection with Rolexes and diamond-encrusted Cartiers. Pretty soon, you realize that you are running low on money. The condos, luxury cars, and watches have forced you into bankruptcy. You try to go with your crew of ten buddies to Vegas for a good time to get away from your financial troubles. Half way through the trip – you cut a check to a casino for a few thousand dollars. They ask you to stay for a minute while they clear the check. Before you know it, police cars roll up to the casino and arrest you. Arrested, embarrassed, and broke – a long fall from being the star NBA player you once were.

This is the story of Antoine Walker, picked sixth overall by the Boston Celtics. Though now he is retired, in his heyday he was a great basketball player and made a lot of money. But making money doesn't cut it.

Discussion Question:

How many percent of NBA players do you think go broke after their paychecks stop rolling in? (The stat is 60%).

Opening Discussion:

- 1) Why do you think so many NBA players, after making tens of millions of dollars, go broke so fast?
- 2) If you were an NBA player, how would you make sure that you stay afloat? (Have the students take 3 minutes to write down a crude financial strategy)
- 3) The Notorious B.I.G. seem to think that "mo' money means mo' problems." What do you think about this?

Class Examples:

Question: Would you rather have \$10,000 per day for 30 days or a penny that doubled in value every day for 30 days?

Answer: Surprisingly, we should choose the doubling penny, because at the end of 30 days, we'd have about \$5 million versus the \$300,000 we'd have if we chose \$10,000 per day!

Question: You are given a regular 8 ½ x 11 sheet of plain white paper. Fold it once, fold it twice, and continue until you have folded the paper 50 times. How tall do you think the piece of paper is?

Answer: One inch? Two inches? Ok, two feet? Actually, the answer is about 100 million kilometers or about two-thirds of the distance to the sun!

The Miracle of Compounding

Compound interest is often called the eighth wonder of the world, because it seems to possess magical powers, like turning a penny into \$5 million or a paper stretch to the sun. The great part about compound interest is that it applies to money, and it helps us to achieve our financial goals, such as becoming a millionaire, retiring comfortably, or being financially independent.

The Math Behind the Miracle

A dollar invested at a 10% return will be worth \$1.10 in a year. Invest that \$1.10 and get 10% again, and you'll end up with \$1.21 two years from your original investment. The first year earned you only \$0.10, but the second generated \$0.11. This is compounding at its most basic level: gains begetting more gains. Increase the amounts and the time involved, and the benefits of compounding become much more pronounced. Compound interest can be calculated using the following formula:

$$FV = PV (1 + i)^t$$

FV = Future Value (the amount you will have in the future)

PV = Present Value (the amount you have today)

i = Interest (your rate of return or interest rate earned)

t = Number of Years (the length of time you invest)

Who will be a Millionaire?

As a fun way to learn about compound interest, let's examine a few different ways to become a millionaire. First we'll look at a couple, Jack and Jill, and how they have chosen to accumulate \$1 million.

1. Jack puts \$25,000 under his mattress every year.
2. Jill starts with \$1 and doubles her money every year for 20 years by using a matched savings program.

How long does it take Jack to reach one million dollars? While most would love to be able to save \$25,000 every year like Jack, this is too difficult for most of us. If we earn an average of \$50,000 per year, we would have to save 50% of our salary! Ultimately, it will take Jack 40 years to earn \$1 million.

How long does it take Jill to reach one million dollars? Jill uses compound interest, saves only \$1, and earns 100% on her money for 20 consecutive years. The magic of compound interest has made it easy for Jill to earn her \$1 million and to do it in only half the time as Jack. However, Jill's example is also a little unrealistic since very few savings programs match 100% in any given year, much less for 20 consecutive years.

Mentor Note: A simple way to know the time it takes for money to double is to use the rule of 72. For example, if you wanted to know how many years it would take for an investment earning 12% to double, simply divide 72 by 12, and the answer would be approximately six years. The reverse is also true. If you wanted to know what interest rate you would have to earn to double your money in five years, then divide 72 by five, and the answer is about 15%.

Who has the better savings strategy?

Between the two extremes of Jack and Jill, there are realistic situations in which compound interest helps the average individual. One of the key concepts about compounding is this: The earlier you start, the better off you'll be.

Let's consider the case of two other savers, John and Max, who'd also like to become millionaires. Say John put \$2,000 per year into a savings account between the ages of 24 and 30 that earns 12% pretax, and that he continued to earn 12% per year until he retired at age 65. Max also put in \$2,000 per year, earned the same return, but waited until he was 30 to start and continued to invest \$2,000 per year until he retired at age 65. In the end, both would end up with about \$1 million.

However, John had to invest only \$12,000 (i.e., \$2,000 for six years), while Max had to invest \$72,000 (\$2,000 for 36 years) or six times the amount that John invested, just for waiting only six years to start saving! Clearly, saving early can be at least as important as the actual amount saved over a lifetime. Therefore, to truly benefit from the magic of compounding, it's important to start saving early.

How to Start Saving

Mentor Tip: Now that we have established the merits of saving early and often, we will now discuss how we can begin saving. A common misconception is that the hardest part of saving is opening a bank account. In fact, the hardest part of saving is putting the money in the bank – literally! It is hard to set aside even \$10 every month to put into your savings account instead of buying a cool new shirt. Since we have already gone through Module 1: Goal Setting, the students should be prepared with the mental discipline to begin saving, but now we need to equip them with the knowledge of how and what bank account to open. It is a good idea to remind students of the discipline and rigor that they now apply to goal setting and have the students relate that new discipline to savings.

National v. Local Banks

Deciding where to save your hard earned money can be almost as daunting as earning that money. There are a lot of important considerations when deciding which bank – depository institution – you should decide to store your money with. A key question that every saver should ask is should I stay local or go national? Here are some of the key components of a bank that every consumer should analyze when deciding which bank to deposit with:

Interest Rates: As a way to gain a competitive advantage in a cost-effective way, local banks will typically offer higher interest rates to attract customers. Because national banks have a perceived stability and powerful brand, local banks overcome this by offering higher interest rates.

Winner: Local Banks

Location: Obviously national banks benefit from being a nationwide bank. Therefore, they offer more ATMs and branches than a local bank could. Therefore, national banks make it more convenient for you to get money when you are traveling or away from home.

Winner: National Banks

Safety: While every deposit under \$250,000 is FDIC-insured, meaning that you will never lose your deposits if they total to less than or equal to \$250,000, national banks definitely provide more safety than local banks. Since national banks have larger networks and are typically tighter with politicians and regulators, they face a much lower probability of losing their deposits than a local bank.

Winner: National Banks

Loan Accessibility: Local banks typically aim to serve the communities they are in. Therefore, they are more likely to grant a loan to a consumer that may be at a higher risk of defaulting (failing to pay) on the loan. Also, local banks know the local economic situation – i.e. the challenges and financial needs of local people and businesses – and can lend accordingly.

Winner: Local Banks

Customer Service: National banks have a reputation for treating their customers as they do an account number on their revenue stream. Since local banks typically garner fewer total number of deposits, they typically offer better customer service to attract and retain depositors.

Winner: Local Banks

Technology: Since national banks tend to have a greater network and asset base, they are able to focus on technology development. That is why you see national banks offer more ATMs, better quality ATMs, and mobile/ online banking. A few national banks even allow you to check your statement balances by sending a text message!

Winner: National Banks

Size: Typically national banks have more deposits than local banks because they cover a larger demographic. Therefore, they have more money that they are able to lend out and invest. This means that if a national bank is performing well, they have increased loan accessibility.

Winner: National Banks

Mentor Tip: Have the students pick the 3 most important qualities to them of these six. Whichever 3 they choose, see whether they “winner” of these characteristics is a national or local bank. Based on the “winner” that was chosen the most, the students will be able to gauge whether they should deposit with a national or local bank.

3 Types of Bank Accounts

Checking Account: An account where you are allowed to deposit money and withdraw from at will. The depositor withdraws money by writing checks. Checks can be written to buy products and services, pay bills, send money to other people, and transfer money between institutions. Since the depositor is allowed unlimited checks, the ability to spend is infinite. However, depositors have to be wary of overdrawing their checking account (i.e. buying more than you have in the bank). If they do this, the bank typically charges a very large fee that is a percentage of how much you overdraw. As for interest rates, interest rates are typically very low with checking accounts.

Savings Account: An account that allows you to make withdrawals, but without the flexibility of using checks to do so. The number of withdrawals or transfers you can make on the savings account each month is limited. Since the amount of withdrawals is limited, the bank typically offers a higher interest rate than a checking account to encourage depositors to keep their money in a savings account.

Certificate of Deposit (CD): An account (could also be referred to as a note) that provides a guaranteed rate of interest for a specified term. Depository institutions offer certificates of deposit that allow you to choose the length of time, or term, that your money is on deposit. CD terms can range from several days to several years. Once you have chosen the term you want, the bank will generally require that you keep your money in the certificate of deposit account until the term ends, that is, until "maturity". Because you agree to leave your funds for a specified period, the bank may pay you a higher rate of interest than it would for a savings or other type of bank account.

What are the key relationships?

The key to understanding which of the 3 bank accounts to deposit into is to understand your preferences for money now versus money later. This table ranks the 3 types of accounts on ability for a depositor to spend the money in the account and the interest rate on the money in the account. The rankings are done with 1 being the highest and 3 being the lowest.

<i>Type of Account</i>	<i>Ability to Spend</i>	<i>Interest Rate</i>
<i>Checking</i>	1	3
<i>Saving</i>	2	2
<i>Certificate of Deposit (CD)</i>	3	1

More formally,

Ability to Spend $1/\propto$ Interest

Time \propto Interest Rate

Mentor Tip: The mentor should have knowledge of what current interest rates are on a checking and savings account. A mentor should check www.bankrate.com/checking.aspx a few days prior to their teaching session so that they are up-to-date on current rates. On www.bankrate.com/checking.aspx, Savings accounts are labeled as MMA, which stands for Money Market Account. A Money Market Account is synonymous with a Savings account for interest rate purposes.

Module 4

Who wants to be a Millionaire?

Assets, Liabilities, and Net Worth

"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it."

- Ralph Waldo Emerson

Lesson Overview:

The previous lesson demonstrated that savings is the first step towards wealth creation. In the lesson, we continued our discussion from the foundation of goal setting and budgeting—two activities which helped us reach financial goals. Certainly, savings was one of the key components of achieving future goals, for savings provides us with the resources and opportunities to pursue activities and purchase goods. In contrast, spending detracts from our ability to achieve future goals, taking away resources and limiting future consumption.

This lesson aims to provide an initial understanding of wealth, drawing from previous discussions of savings and spending. Particularly, the lesson unpacks the concepts of assets and liabilities, speaking to their relation with net worth. The basic principle explained by the lesson is that minimizing expenses is necessary to being wealthy. It is hoped that at the end of the lesson, the students will understand the importance of smart spending and savings as opportunities for future wealth-creation. With luck, the students will internalize the principle and apply it to their own personal finances.

Lesson Goals

- What is an asset? How budgeting links to goal-setting.
- Explain that: $\text{Assets} - \text{Liabilities} = \text{Net Worth}$
- Calculating Future Net Worth
- Minimizing Expenses for Wealth Creation

Key Terms:

- Assets
- Liabilities
- Net Worth
- Wealth

Opening Discussion:

- Who do you know that is wealthy? What does it mean to be wealthy?
- What items (assets) do these wealthy people possess that differentiate them from someone who is not wealthy?
- How do you think one can become wealthy?

Mentor Note: Be sure to grab a marker and write ideas on the board to facilitate the discussion.

What is an asset?

By definition, an asset is: *any item of economic value that could be converted to cash.*

There are various types of assets:

- Liquid assets: assets that are cash or can easily be converted to cash. Liquid assets include cash on hand, money in your savings or checking account,
- Marketable assets: financial assets that can be sold for their current market value. Marketable assets do not have a fixed price. Rather, their prices fluctuate with changes in the market. Marketable assets include stocks and bonds.
- Other Marketable Assets: assets that can be sold in the market but have special restrictions when selling.
 - Real Estate: Real Estate can be sold similar to marketable assets, but real estate does not sell as quickly.
 - Personal Property: Vehicles, furniture, and appliances can be re-sold. However, they usually *depreciate* in value. This means that, even if they are in perfect condition, they are worth less now than when they were purchased. They will also be worth less in the future than they are worth today.
- Non-Marketable Assets: assets that cannot be sold or are very difficult to turn into cash. Retirement plans, pension plans, and individual retirement accounts (IRA)s are examples of such assets.

Calculating the value of your assets

Calculating your assets varies based on the set of assets one possesses. However, as a general guideline, the following steps will suffice:

- 1) Write down the current amount of cash on hand. This includes the money you have in your wallet, at the safe at home, etc.
- 2) Then calculate the value of your other liquid assets: checking, savings, and money market accounts. To do this, consider all the financial statements from the banks that you have the accounts at.
- 3) Next, add the value of any government savings bonds. The value of a government savings bond can be calculated by calling the bank to figure out the current value of the bond.
- 4) If you own stocks, bonds, or mutual funds, check the current value in the newspaper and multiply it by the amount of shares you have.
- 5) To calculate the value of your real estate assets contact your local tax official—who will be able to tell you its full-assessed value. Add the value of your real-estate to your other assets.

- 6) To find out the value of your car, you can refer to a used car guide like Blue Book.
- 7) Add the value of your personal items: electronics, clothing, etc. Make sure to keep in mind that depreciation will affect such items. It is better to underestimate the value of such items

What is a liability?

A liability is an *obligation that binds an individual (usually legally) to settle a debt*. Usually this involves repaying the debt when it is due, honoring the financial promise you made when taking on the liability.

Short-Term Liability: A short-term liability is a debt you must repay in less than a year. This includes bills and income taxes.

Long-Term Liability: A long-term liability is one that you must repay after a year. This includes back taxes, mortgages, student loans, and credit card debt.

Calculating the Value of your Liabilities

When calculating your list of liabilities you must first compile a description of each liability. First, you must determine to whom you owe the debt to. It is also important to identify when you incurred the debt. When calculating, a very important feature of the debt is the interest rate that you must pay on the debt. The interest rate is the amount you must pay in addition to the money you borrowed (this is usually calculated as a percentage, as explained in the credit and loan lessons). It is also important to calculate the balance of debt that remains outstanding; this should be figured in along with the amount that you must repay and the frequency of repayments. In addition, it is important to include the security or collateral that was used to back the debt (especially if the debt is secured). Finally, write the date of which you expect to pay off all the debt.

Net Worth

(see Famous Billionaires Activity below)

Net Worth can be easily calculated using the following formula:

$$\text{Assets-Liabilities} = \text{Net Worth}$$

The formula above simply indicates that your net worth is what you owe minus what you own. As you may notice, the more you own and the less you owe, the more your net worth:

$$\text{Assets-Liabilities} = \text{Net Worth}$$

Ironically, one of the most interesting and basic principles is rarely followed in practice. Many seemingly rich stars, from pop stars to athletes, have excessive spending habits. At the heart of their financial behavior is the inverse of the statement above. Indeed many of these stars cannot even be termed wealthy, as they have negative net worth:

$$\text{Assets} - \text{Liabilities} = \text{Net Worth}$$

Constructing a Personal Financial Statement

(see Personal Financial Statement Activity below)

Calculating net worth is the first step in constructing a personal financial statement. A personal financial statement is a balance sheet that shows what the person owns and what she owes. By listing assets and liabilities, the personal financial statement shows the financial health of the individual. In doing so, the personal financial statement not only provides visual proof of the individual's current financial situation, but also provides the credibility important in most financial negotiations.

You can think of a financial statement as the stats on the back of a baseball card. It gives a concise itemized list of all the relevant information. This is very important to anyone who wants to lend to you (i.e. your relative or your bank), because it demonstrates to them your ability to repay the loan. Many financial institutions use this personal financial statement in deciding whether or not to approve your loan application.

In many ways the personal financial statement takes budgeting to the next level (at least financially). Your budget focused on your income and costs. In doing so, you could see how much money you were making each month, and how much money you would be able to put aside based on your spending habits. The personal financial statement compiles all the times you put your money aside into one large list of items. For example, in June, you may have decided to put away \$100 in the bank. In September, after getting a large paycheck, however, you decide to put the \$300 into a savings bond. All these items are listed under assets. In contrast, there are times where you have to borrow money from others—whether it be borrowing \$1 from a friend to buy candy because you forgot your wallet at home or borrowing \$1000 from your parents to buy a car. It is important to remember that though you may have the cash in your hands, at some point you have to return that cash. Other friends, family members, or even banks may ask how much you owe others. If you have a clean balance sheet, you can prove to them that they should provide you money in the future.

Maximizing Net Worth

Constructing a personal financial statement is definitely the first step to maximizing your net worth. You cannot know how financially healthy you are until you sit down and list everything out on a piece of paper. However, there are a few other tips to remember to maximize net worth:

- 1) Always be able to know where most of your assets are located. Are they in your bank account, your house, the stock market?
- 2) Be careful to be able to determine how *liquid* your assets are. Namely, how fast they can turn into cash. If you don't have *liquid* assets in certain situations, you may be prone to taking out unnecessary liabilities.
- 3) What financial assets do you have that you are not using? It could be a car, computer, etc. Try to minimize keeping those assets around as they will *depreciate* (as mentioned above).
- 4) Make sure you are on time with your payments. Though much of this comes your personal budget, remember that what you save becomes your net worth.

Familiar Billionaires

Fill out the chart ranking each billionaire and estimating how his or her net worth.

Ranking	Net Worth (Billions)	Name	Citizenship	Residence	Known For
		Alice Walton	United States	United States	Wal-Mart (inheritor)
		Carlos Slim Helu & family	Mexico	Mexico	Mexican Telecom
		Donald Trump	United States	United States	Trump
		George Lucas	United States	United States	Lucasfilm
		Jim Walton	United States	United States	Wal-Mart (inheritor)
		Joanne (J.K.) Rowling	United Kingdom	Scotland	Harry Potter
		John Marriott Jr	United States	United States	Marriott (inheritor)
		Larry Page	United States	United States	Google
		Mark Zuckerberg	United States	United States	Facebook
		Michael Bloomberg	United States	United States	Bloomberg
		Michael Dell	United States	United States	Dell
		Oprah Winfrey	United States	United States	Oprah
		Philip Knight	United States	United States	Nike
		Richard Branson	United Kingdom	United Kingdom	Virgin
		S. Robson Walton	United States	United States	Wal-Mart (inheritor)
		Sergey Brin	United States	United States	Google
		Steven Spielberg	United States	United States	Amblin Entertainment
		Warren Buffett	United States	United States	Berkshire Hathaway
		William Gates III	United States	United States	Microsoft
		William Wrigley Jr	United States	United States	Wrigley (inheritor)

Answer Key: Famous Billionaires

Ranking	Net Worth (Billions)	Name	Citizenship	Residence	Known For
16	20.6	Alice Walton	United States	United States	Wal-Mart (inheritor)
1	53.5	Carlos Slim Helu & family	Mexico	Mexico	Mexican Telecom
488	2	Donald Trump	United States	United States	Trump
316	3	George Lucas	United States	United States	Lucasfilm
15	20.7	Jim Walton	United States	United States	Wal-Mart (inheritor)
937	1	Joanne (J.K.) Rowling	United Kingdom	Scotland	Harry Potter
773	1.3	John Marriott Jr	United States	United States	Marriott (inheritor)
24	17.5	Larry Page	United States	United States	Google
212	4	Mark Zuckerberg	United States	United States	Facebook
23	18	Michael Bloomberg	United States	United States	Bloomberg
37	13.5	Michael Dell	United States	United States	Dell
400	2.4	Oprah Winfrey	United States	United States	Oprah
62	10.2	Philip Knight	United States	United States	Nike
212	4	Richard Branson	United Kingdom	United Kingdom	Virgin
18	19.8	S. Robson Walton	United States	United States	Wal-Mart (inheritor)
24	17.5	Sergey Brin	United States	United States	Google
316	3	Steven Spielberg	United States	United States	Amblin Entertainment
3	47	Warren Buffett	United States	United States	Berkshire Hathaway
2	53	William Gates III	United States	United States	Microsoft
463	2.1	William Wrigley Jr	United States	United States	Wrigley (inheritor)

Personal Financial Statement

Assets	Amount in Dollars
Cash - checking accounts	\$ -
Cash - savings accounts	-
Certificates of deposit	-
Securities - stocks / bonds / mutual funds	-
Notes & contracts receivable	-
Life insurance (<i>cash surrender value</i>)	-
Personal property (<i>autos, jewelry, etc.</i>)	-
Retirement Funds (<i>eg. IRAs, 401k</i>)	-
Real estate (<i>market value</i>)	-
Other assets (<i>specify</i>)	-
Other assets (<i>specify</i>)	-
Total Assets	\$ -
Liabilities	Amount in Dollars
Current Debt (<i>Credit cards, Accounts</i>)	\$ -
Notes payable (<i>describe below</i>)	-
Taxes payable	-
Real estate mortgages (<i>describe</i>)	-
Other liabilities (<i>specify</i>)	-
Other liabilities (<i>specify</i>)	-
Total Liabilities	\$ -
Net Worth	\$ -

Module 5

The Good, the Bad, and the Ugly of Plastic Money

Understanding the Financial Risk and Liability of Credit

"The most important thing for a young man is to establish credit - a reputation and character."

-John D. Rockefeller

Lesson Overview:

It's difficult to imagine a world without credit. Essentially, everything would have to be paid at the moment of purchase, whether you are purchasing a candy bar or purchasing a house! Luckily, credit does exist. In fact, it has become a crucial part of society. Credit can be obtained to make business transactions, rent apartments, and fund education; however, not everyone can successfully obtain an apartment lease or student loan. The fact of the matter is that some people are more reliable than others. The gauge that we use to measure a person's reliability is called credit. More formally, credit measures how likely we are to pay back loans plus interest by assigning every person a grade (credit score). It is our financial report card and affects many aspects of our lives.

Many students have not only minimal knowledge but also misinterpretations of credit and its important role in our daily lives. This lesson is meant to introduce the idea of credit and how it relates to our decisions. The goal is for students to have a basic understanding of credit cards, credit scores, how to personally manage credit, and what are the potential risks and benefits of using and misusing credit.

Lesson Goals:

- Defining credit
- Theory of credit: from both lender and borrower
- Types of credit
- Credit Cards: Benefits and Risks
- What is a credit score? How do we calculate it?
- Why your credit score matters and who will see it?

Key Terms:

- Credit
- Borrower (Debtor)
- Lender (Creditor)
- Credit Card
- Interest
- Credit Report
- Credit Score
- Debt

Opening Discussion:

- What is credit?
- What are some forms of credit?
- What are common ways in which we use credit?

What is credit?

Credit is defined as an agreement between a lender – usually a bank or institution – and a borrower – usually a person or company – in which the borrower assumes something of value *now* with the promise of repaying the lender *later*.

- Most Common Types of Credit
 - Credit card
 - Most common type of personal credit
 - Allows repeated transactions up to a maximum credit limit
 - Each time you charge something to the card, you are borrowing money until you pay it back
 - Credit card company adds *interest* (extra money paid at a particular rate of the money borrowed) to late payments
 - Examples: Visa, MasterCard, Discover, American Express, department store cards, gas cards, etc.)
 - Loans
 - Allow you to borrow money that must be repaid plus interest
 - Examples: paying for a new car, college tuition or buying/renovating a home
 - Installment loans: repaid in fixed monthly payments over a specific period of time (car loans and home mortgages) with interest charges included in payments

How does this all work? When you, the borrower, apply for credit, the lender has to decide if you are a good candidate for receiving the loan or line of credit. Using your credit history, lenders have to assess the level of risk involved if they do choose to grant you credit. For instance, if you have displayed a poor repayment history, you are less likely to be approved.

Benefits and Consequences

As you can imagine, using credit rather than cash can make life a lot easier. Most people do not have \$100,000 on hand to purchase a house and some may still choose to use credit to make small purchases such as a smoothie. The main benefit of using credit is convenience: it's easy to make purchases and keep record of those purchases. If you can pay on time then interest will not accumulate and you can enjoy all the benefits and none of the consequences. Credit card companies frequently offers perks such as airline miles, discounts at stores, or points towards buying other items as additional benefits and lures for consumers to use their credit cards. Some credit cards also offer insurance if your card is lost or stolen so that you are not held

responsible for any fraudulent charges. Therefore, if you are a careful consumer and only use as much credit as money you have in your checking account, you will never pay a dime of interest! – assuming you pay your statements on time. For paying on time and using your credit wisely, the credit card companies reward you with cash back, discounts at stores, and other great perks!

It's easy to see why most people would rather carry a plastic card rather than paper bills in their wallet; however, there are consequences for misusing credit. Remember: Credit is money! Everything you borrow must be paid back. Many times people forget this and reach their credit limit or fail to make payments on time. Just as much power as you have to get great rewards, the credit card companies have the power to charge you interest. As we have already learned, compounding interest is a very powerful tool! If you accumulate a history of late payments and spending too much money, you will be swamped in interest and soon find you owe more interest than money you spent!

All of these decisions are documented and create your credit score.

What is a credit score?

In school, your performance in class is evaluated using a grading system (A-F). Similarly, credit reports portray a financial image of you and assign a grade using a credit score, ranging from 300 to 850. *The higher the number, the better the score.*

- Anatomy of a credit score
 - Payment history (35% of the rating)
 - Length of credit history (15% of the rating)
 - New credit (10% of the rating)
 - Types of credit used (10% of the rating)
 - Debt (30% of the rating)

Who has the better credit?

Jill is a 24-year old teacher. She worked throughout her four years of college and paid off her student loans when she graduated. She makes \$30,000 a year teaching elementary school children and has chosen to live in a one-bedroom apartment until she can save enough money to purchase her own house. Keeping life simple, Jill has a savings account, checking account, and one credit card. Jill lives within her means and always pays her bills in full a week before they are due.

55-year old Jack is the best heart surgeon in the state. He really wanted to focus on his studies and thus chose to defer all of his student loan payments until after medical school - 8 years later. He makes \$500,000 a year now, is leasing a Porsche, BMW, and Mercedes, is married to another doctor, has 2 kids in college, and just signed a 30-year mortgage for his new 6-bedroom house. With his busy work schedule, he

often forgets to pay his multiple credit card bills. Jack currently has \$300,000 left on his student loans.

Calculating their credit scores

*Questionnaire

- How many credit cards do you have?
 - Jill: 1
 - Jack: 6
- How long ago did you get your first credit card?
 - Jill: 3 years ago
 - Jack: 37 years ago
- How long ago did you get your first loan?
 - Jill: 6 years ago
 - Jack: 37
- How many loans or credit cards have you applied for the last year?
 - Jill: 0
 - Jack: 2
- How recently have you opened a new loan or credit card?
 - Jill: more than 6 months ago
 - Jack: less than 3 months ago
- How many of your loans and/or credit cards currently have a balance?
 - Jill: 0 to 4
 - Jack: 9 or more
- Besides any mortgage loans, what are your total balances on all other loans and credit cards combined?
 - Jill: Less than \$500
 - Jack: \$20,000 +
- When did you last miss a loan or credit card payment?
 - Jill: I have never missed a payment
 - Jack: in the past 3 months
- How many of your loans and/or credit cards are currently past due?
 - Jill: 0
 - Jack: 2 or more
- What percent of your total credit card limits do your credit card balances represent?

As an example, let's say you have two credit cards:

- 1) *One with balance of \$250 and limit of \$1,000*
- 2) *One with balance of \$750 and limit of \$4,000*

Your total credit card balances would be \$1,000 (\$250 + \$750), your total credit limits would be \$5,000 (\$1,000 + \$4,000), and the percent of your total credit limits that your credit card balances represent are: $\$1,000/\$5,000$, or 20%

- Jill: 0 to 9%
- Jack: 70 to 89%

- Have you ever gone through any of the following negative financial events in the past 10 years: bankruptcy, home foreclosure or repossession?
 - Jill: No
 - Jack: No

The verdict....

- Jill: 730-780
- Jack: 535-585

As you can see, even though Jack has a considerable amount of wealth, his poor decisions and long history of missed payment deadlines have resulted in a low credit score. On the other hand, not only does Jill have one credit card and no student loans to worry about, but she also has a perfect repayment history. The verdict is: Jill is a more credible consumer!

In reality, credit affects everyone - from the average Joe to the highest-paid athlete. Fame does not protect a person from misusing credit and therefore facing the consequences. Here are two examples of celebrities who failed to manage their credit, even with all the tools to do so.

The Story of Mike Tyson

What does a legendary boxer spend his \$350 million to \$400 million-dollar fortune on? The answer is everything and anything that he desired at the moment. For instance, he spent half a million dollars on a 420-horsepower Bentley Continental SC with lamb's wool rugs, a phone and a removable glass roof. It is one of only 73 Bentley Continental SC cars ever built; however, it was not the only Bentley that he owned! Tyson spent over \$4.3 million dollars on cars alone. Other additional luxuries included a \$2 million dollar bathtub and two Bengal tigers worth \$75,000 dollars each. It is no surprise that he filed for bankruptcy in 2003. We can only imagine his credit score!

Key Lesson: Even though Tyson had a lot of money, he did not know how to manage it. At the end of the day, he ended up owing more than he actually had and was unable to pay what he had borrowed (over \$27 million dollars). Being unable to pay his debt, Tyson accumulated large amounts of interest. Many times, a person's debt is so large that he or she can only make monthly payments that only cover the interest, meaning the overall balance is not decreasing. With debt and payment history comprising 65% of one's credit score alone, Tyson's debt and inability to repay what he had borrowed in credit to make his luxury purchases greatly affected his credit score. With his large debt, poor repayment history, and documented bankruptcy, Mike Tyson's credit score is far from perfect.

The Story of Kim Kardashian

Do reality TV stars misuse credit cards? Of course! When Kim Kardashian was hired as a stylist for R&B singer Brandy Norwood, Norwood's mother gave Kardashian her American express card and permission to make one and only one purchase. Kim made this purchase, but decided to share the card with her sisters Chloe and Courtney. At the end of the day, she managed to spend more than \$120,000! Even worse, it wasn't her money.

Key Lesson: In Kim's case, her irresponsible use of another person's credit card is a strong indicator of her own spending habits and repayment history. It is safe to assume that Kim owns more than just one credit card and that the card balances run close to the credit limit. Even though she is wealthy, she also may not pay off her accumulated debt and interest in a timely manner. Recalling the anatomy of a credit score, these are all major factors that affect her score, which in her case, will most likely be relatively low.

Who is actually looking at your credit record and why?

A key fact to remember is: *our credit record says a lot about who we are.* Not only credit card companies, but also employers, landlords, and insurance companies can gain access to your credit record in order to determine if you are a responsible financial consumer. If you have demonstrated an inconsistent payment history in the past, then there is a high possibility that you will do the same in the future!

Teaching Tip: *The most important thing to stress is the great power of credit. A solid credit history and the ability to pay all your debts on time, then you have access to wonderful benefits (airline miles, discounts, etc.) and you don't have to pay interest! By the same token, a poor credit history and late payments will drown you interest payments that compound over time. Credit functions by the same cliché law that every powerful tool does in our society: with great power comes great responsibility.*

Module 6

Avoiding the Loan Trap

A Walk-Through Loans, Mortgages, and Student Loans

"When you call your children and you say 'How are you?' – what you are really asking is 'Do you still have your job? And are you able to make the mortgage payment?'"–
Sharron Angle

Lesson Overview

There are few things in the world that scare people more than lending or borrowing money. But, if you simplify the subject, loans can be a very helpful and powerful tool. A loan is simply an advancement of money from one agent to another now with the promise of repayment in the future. However, very few people are generous enough to lend \$5,000 now and expect just \$5,000 back in 5 years – most people want \$5,000 plus interest! That is because the present value of money is greater than the future value of money; therefore, we value \$5,000 more now than we do \$5,000 in 5 years. Sound familiar? Yes, it is very similar to what we learned with credit. What makes loans an interesting and challenging subject is the whole set of confusing terms, applications, and structures of the loans. Despite all of these confusing things, if we just remember to SCAN every loan, then we will make a proper, financially educated decision every time!

In this section, students will learn how loans work, what is required of you to be eligible to receive them, and more in-depth information about different types of loans and their terms. By introducing students to interest rates, repayment options, federal vs. private loans, down payments, and other key terms, we will equip them with the proper knowledge to approach loans and loan applications. The lesson will focus on the two most common types of loans: student loans and mortgages. Even though understanding loan terminology is critical, the most important thing the students should take away from the lesson is the relationships between risk, rates, and time.

Objectives

1. Discuss why loans exist; parallel to credit
2. Introduce Loan Terminology
3. Compare and contrast loans
4. Obtaining a loan

Key Terms

- Principal
- Interest Rate
- Amortization
- Credit Spread
- Fixed vs. adjustable
- Repayment options
- Federal vs. Private loans
- SCAN
- Mortgage
- Down Payment

Class Discussion

- What is the similarity between credit and loans?
- What do you think a loan-shark is?
- What kind of risks are involved with loans?

Why do loans exist?

People don't always have enough savings to do the things they want in life like buying a house, starting a business, or going to college. They are not always able to pay for the entire sum of these things at the moment of purchase. Loans exist so that one can gradually make these payments over a certain amount of time. People borrow money from a financial institution-like a bank-and gradually pay the financial institution back. Just like credit, one agent is using money that they do not currently have to purchase something now by borrowing money from another agent with the promise to pay them back. The creditor (lender) grants them a loan because the debtor's (borrower) credit history shows that they make timely payments. In essence, we can think of each credit-card purchase as a mini-loan. This lesson will focus more on the bigger loans, like the following examples:

Mortgage is a loan to purchase property. People get mortgages because they do not have enough savings to buy property all at once, so they borrow money to pay for it gradually.

Business loans are loans taken to start a business, typically a small business. To create income, a business needs to start with some money, but they do not always have the savings to do so. Being able to borrow money is key for a business to grow financially.

Student loans are loans taken to pay for school. College is expensive, and many students don't have the money to pay the full price of an education immediately. Young adults take out student loans to get them through college. Once they get a degree and a job as a result, they are able to pay back the loan. A student loan helps people increase their human capital so that they can make money in the long-run.

(Advanced) A *parallel loan* is a transaction where two companies operating in different countries agree to lend each other money in their respective currencies. The purpose of the arrangement is to reduce the risk of financial loss related to changes in foreign exchange rates.

So what exactly is the difference between a loan and a credit card? It is correct to note that both a credit card and loan essentially accomplish the same thing: the borrower is granted access to more money than they currently have with the promise to repay the lender the principal plus interest. However, with a credit card you can avoid paying interest by making your payments on time. With a loan, you cannot avoid paying interest by making your payments on time, because the interest is already factored into your payments. So why would anyone take out a loan? Remember that credit cards have a limit—therefore, loans are necessary for large purchases—like a house, car, tuition, etc.—and typically have higher interest rates because the risk for the lender is greater. Recall: interest \propto 1/ability to pay; interest \propto risk.

Loan Terminology

Properties of loans distinguish them from one another, and one of the most important properties is the interest rate. The interest rate is the rate at which you pay extra for borrowing an institution's money over a period of time. It is in your interest to find a loan with a low interest rate. Then, you don't have to pay as much extra money for borrowing money. Each lender is required to show the annual percentage rate (APR) of the loan, which can be thought of as the amount of interest that a borrower will pay annually. The principal is the original amount borrowed from the lender, without interest factored in. The APR is calculated as a percentage of the principal. Just like with credit, after taking out a loan, you are paying the principal back plus interest.

Ex. Suppose that John wants to borrow \$1,000, and must pay the principal plus the interest back in 5 years. He is choosing between a loan with 5% annual interest rate and 10% annual interest rate. Which should he choose? Use a simple interest calculation.

Principal: \$1,000

APR: .05 vs. .10

A simple interest calculation determines the total amount of interest John must pay, and then it is divided into each of the payments. To determine the total amount John

must pay at the end of 5 years, take the interest rate percentage of the principal and add this to the principal.

5% APR	vs.	10%APR
$.05 \times 1000 = 50$		$.10 \times 1000 = 100$
$50 + 1000 = \$1,050$		$100 + 1,000 = \$1,100$

Clearly, John is better off with the lower interest rate, because he pays \$50 less overall. Interest is not always calculated like this for every loan. In a compounding interest calculation, the interest is added to the principal after each payment, which creates more interest on the upcoming payments. Being able to understand how the interest rate is calculated makes it easier to compare and contrast loans with the same type of interest calculation.

Another property of a loan is amortization, which is the decreasing of a loan's principal over time through regular payments. As a lender pays off the loan, part of the payment pays off the principal and part of the payment pays off the interest. This way, the lender is paying the loan back gradually rather than all at once.

Now that students know the basic properties of a loan, it is time to introduce fundamental differences in loans. Borrowers can also choose between a federal loan and a private loan. The main difference between them is that the government imposes many caps and restrictions on federal loans. In a federal loan, the government is the lender, and it heavily regulates the amount of principal for the loan and the interest rate. In a private loan, a bank is usually the lender, and the interest and principal for the loan are based on the borrower's specific needs and financial background.

People typically take loans from banks, but banks also borrow money from people when they open up savings accounts. Banks in return pay people to use their accounts. Then, banks make loans at higher interest rates and collect more interest than they owe. The difference between what banks owe in interest and what they accumulate is called the credit spread.

Borrowers can also choose whether the loans are fixed-rate or adjustable-rate, meaning that the interest rate either stays the same or changes periodically. A fixed rate has an interest rate that is fixed for the term, which is usually up to 30 years. An adjustable-rate plan is fixed for some time, but the rate will periodically adjust to some market interest rate. *Side note: This market interest rate is determined by multiple things – one being the economic climate and the other being a change in your credit score (reliability to pay back the loan). As you can infer, having an adjustable-rate loan during the recession of 2008 – 2010 probably caused your interest rate to increase as banks struggled to make their own payments.*

Fixed-rate and adjustable-rate plans factor into a borrower's repayment options. A repayment plan covers how often the borrower will make payments, how often the interest changes, and the amount of time the borrower has to pay off the loan. It also includes additional fees that the borrower must pay. The borrower has repayment options so that he can find a plan that suits his situation. For instance, some people would rather pay larger monthly payment over a shorter period of time while others would pay smaller monthly payments.

Now that students can assess the differences between loans, it is important for them to understand that there are many different types of loans that are specific to the borrower and his reason for borrowing money. Not every lender may be the right one, so it is important to shop around, or SCAN your options. SCAN stands for shop, compare, apply and negotiate.

- Shop: Shopping for loans means talking to different lenders, focusing on those who specialize in the type of loan you want. Typically, borrowers should collect quotes from 3-5 different sources. Quotes contain the information about the loan that borrowers will compare to find their best option.
- Compare: Now that the borrower understands the different properties of a loan, he must compare the terms of the different quotes that he collected. This includes things such as the interest rate, payment plan, and extra fees.
- Apply: Lenders require a lot of information from the borrower, so it is necessary to apply for a loan. Mentors will later discuss the loan application process and what a lender looks for in a borrower.
- Negotiate: Borrowers can always negotiate the final terms of the loan with the lender, vying for lower interest rates and minimal extra fees.

We will revisit mortgages, one of the most important types of loans. A mortgage is money borrowed to purchase real property from a financial institution, such as a house. In return, the borrower makes monthly mortgage payments to the lender. Mortgages have the same principals of loans previously discussed. They vary in size, interest rate, and repayment plan.

After a borrower has established a relationship with the lender and is prepared to make an agreement for a loan on property, one of the first things they discuss is the down payment the borrower will put down. The down payment is a payment of the portion of the cost of some kind of property before the loan is made. A borrower can make a down payment on expensive items like a car or a house. The greater the down payment, the smaller the loan compared to the value of the property (loan to value

ratio). Making a down payment is also an indication that the borrower can raise money for long-term investment, making the loan less risky for the lender. A lender is more likely to approve a mortgage if the borrower is willing to increase the down payment.

Mentor note: Many of these topics will be revisited in the next two sections. Focus on the vocabulary, because you will go into the concepts more in-depth later

Compare and contrast loans

There is no one right answer for what loan a borrower should take. To determine which loan is right for you, consider the following questions:

1. *What kind of trade-offs am I willing to make?*

Often, a borrower will have to make tradeoffs with loans. For instance, he may make small monthly payments, but he has to pay back a loan over a longer period of time. The decision to make trade-offs depends on the nature of your income. If you have a consistent income, you should probably pick a loan with the small monthly payments even if it's for a longer period of time. If your job is more unpredictable, you should probably pay larger payments over a shorter amount of time. You may not get everything you want from a loan, but it is important to pick the loan that is appropriate for your financial situation.

2. *How much risk am I willing to take?*

Taking out a loan has some risk to it, and certain loans have more risk than others. When evaluating the risk, it is important to consider your consistency of income. Do you have a job where income is unpredictable? If there is a drastic change in your life, will you still be able to pay the loan back? There is also a risk for the lender, and he compensates for this by increasing the interest rate if there is more risk (lender's risk \propto interest rate). An example of this is a sub-prime mortgage, which is a risky mortgage with a high interest rate. *A case study of the sub-prime mortgage crisis comes later in the lesson.* If there is more risk for the borrower, he must have an incentive to choose the plan, usually a lower interest rate ($1/\text{borrower's risk} \propto \text{interest rate}$). Also, certain properties of a loan are often proportional to the interest rate. A long term loan is riskier than a shorter loan, because they are often large and demand a consistent financial situation. Therefore, term time \propto risk and term time \propto interest rate.

Should I get a federal or a private student loan?

Deciding whether to receive a loan from the government or from a bank is different for each individual circumstance. We mentioned that federal loans have more restrictions; sometimes, the restrictions work in the borrower's favor (by giving them access to a lower interest rate), but sometimes the borrower needs more flexibility. In that case, they should turn to a private loan. One of the most common types of federal loans is a student Federal Stafford loan. Here, we compare the eligibility, interest rates, loan amounts, and repayment options of a Stafford student loan and a private student loan.

Federal Stafford loan

Private student loan

Eligibility:

No credit check required

Credit check required. Must fill out a federal application

Interest rate:

Set by federal government

Set by lender

Not based on credit

Based on credit

Variable, capped

Variable, no cap

Loan amounts:

Loan limits set by Congress

May borrow up to the cost of attendance minus financial aid

Repayment:

Standard is a 10 year repayment term

15 year repayment term standard

What kind of repayment plan works for me?

When choosing the ideal loan, you must also consider the repayment options. Depending on the nature of your job, you may want a payment plan with a longer term and smaller monthly payments or one that starts off with lower payments and increases as your income increases. Again, evaluate the nature of your short-term and long-term income to make a decision. The following are examples of repayment plans for federal student loans:

1. Standard: A fixed monthly amount for a loan term up to 10 years. This plan is for a borrower with a consistent income.
2. Extended Repayment: A fixed monthly amount for a loan term of 12-30 years. This reduces the size of each payment but increases the total amount paid over the term of the loan. The trade-off the borrower has to make is making small payments but for a longer period of time. This plan also demands consistency in the borrower's income.
3. Graduated Repayment: This plan starts off with lower payments, which gradually increase every 2 years. The loan term is 12-30 years. This plan is typically for young borrowers who increase their income as time goes on and as they gain more experience in the work force. Their income also needs to be steady near the end of the loan's term time.

Fixed-rate or adjustable rate?

The decision between a fixed-rate or adjustable-rate loan depends on how much risk the borrower is willing to take. Recall that in an adjustable rate mortgage, the interest rate changes periodically. This is unpredictable for the borrower and therefore riskier for him. As an incentive for the borrower to choose this plan, an adjustable-rate plan typically has a lower interest rate than that of the average fixed rate plan. Recall that $1/\text{borrower's risk} \propto \text{interest rate}$ (inversely proportional). Adjustable-rate plan has a higher risk for the borrower and a lower average interest rate. Fixed-rate plan has a lower risk for the borrower and a higher average interest rate.

Case Study: The Sub-Prime Mortgage Crisis

Discussion:

1. What did banks (lenders) do wrong to cause the mortgage crisis?
2. What did people (borrowers) do wrong to cause the mortgage crisis?
3. What is a sub-prime mortgage? What is the difference between prime and sub-prime?

The mortgage crisis of 2006 greatly contributed to the financial crisis of 2007-2010. It started when about 80% of sub-prime mortgages issued to U.S. borrowers were adjustable-rate mortgages. As we have discussed, these interest rates fluctuate, so there is more risk for the borrower. House prices had reached their peak at the same time, and they were beginning to fall. When it was time for the interest rate to change under these mortgages, they reset at a high rate, and many people could not pay back their loans. Mortgages are also backed by securities, which are traded between investors. Once people could not pay their mortgages, many of these securities lost their value. In the meantime, houses were being repossessed as more people did not

pay their mortgages. As a result, banks were more reluctant to lend money, which slowed financial growth.

A sub-prime mortgage is normally made out to borrowers with a low credit rating. This means that these borrowers are more than likely to default on their mortgages, and the lenders are taking a lot of risk. Usually, they set these interest rates higher to compensate themselves for taking a risk with these borrowers. Coupled with the risk of adjustable-rate mortgages, there was a possibility that interest rates could reach astronomical heights, which is exactly what happened.

People blame this on a number of factors such as predatory lending and excessive risk taking. Ultimately, the problem boils down to a simple relationship. Lenders were accepting risky loans from borrowers with poor credit histories because they could charge a higher interest rate. The borrowers were, likewise, accepting the loans even though they knew that they possibly could not pay the high interest rates. Thus, lenders were making risky loans in search of high returns and borrowers were accepting the loans even though the risk of foreclosure was great. In this case, two negatives do not make a positive. Both parties were assuming unprecedented risk and, ultimately, both parties paid for it during the sub-prime mortgage crisis.

The mortgage crisis shows how great of an impact loans have on the economy, and how taking risky loans can backfire, resulting in a nationwide financial crisis. It is possible that many borrowers did not think that the interest rate would reach such a height, but that is the risk they signed up for when they chose an adjustable-rate mortgage, sub-prime mortgage

Mentor note: The important things in this lesson are not necessarily the specific details. Make sure students understand the fundamentals behind the different choices that they have to make. They should understand the risk factor involved in each choice and the tradeoffs that they encounter.

Obtaining a Loan

There are many factors that lenders look at when giving out loans. The lenders take a look at as much as possible so that they can minimize their risk. They give loans to the people that they think they will get the best return from, while keeping risk as low as possible. Keep in mind these 3 basic questions when applying for a loan:

- ❖ What does a lender look for?
- ❖ What documents does the lender require from me?
- ❖ What can I do to get and maintain the loan?

What does a lender look for?

Lending institutions look at the 4 C's of credit: Credit rating, capacity, collateral, and character when assessing whether or not a borrower is capable of repaying their loan.

- Credit rating: Lenders check credit scores to assess the risk of loaning money to a borrower.
- Capacity: Do you have the capacity to cover your assets? This means that the lender wants to make sure the borrower will generate sufficient cash flow to pay back the loan.
- Collateral: Do you have anything to securitize your loan, such as inventory, equipment, real estate? The borrower must have things that will cover the loan if something goes wrong and they "default" on the loan (in other words, fail to pay it back). If they are not able to pay it back, the lender will seize some of their assets to turn into cash as a replacement.
- Character: Do you have any lawsuits, bankruptcies, a criminal record? Lenders will make loans to people that are trustworthy financially and personally. These people pay their bills on time, they've paid back any previous loans, and they know how to handle their money.

What documents does the lender require from me?

Different loans will require different information. A mortgage will need information about the property while a student loan needs information about the borrower's future plans and intended college. It is important to have all financial statements ready as the lender requests them. Some documents they typically look at include (but are not limited to)...

- Credit score
- List of past landlords, employers
- Car payments
- Student loans
- Bank statements
- Personal tax returns
- Paycheck stubs

What can I do to get and maintain the loan?

- Create a good relationship with your lender. The lender has to be able to trust the borrower, so maintaining frequent communication and being honest are ways to gain that trust.
- Be familiar with holes in your financial documents and be able to explain them to the lender. Obtain your credit score beforehand to look at ways you can improve it, which will increase your chances of getting a loan.
- Understand the responsibilities of your loan. Often, both the borrower and the lender are overeager to make the agreement. The borrower then does not closely read the contract and finds out that he is not completely happy with it. Make sure you read the fine print, especially acknowledging all hidden fees. Don't wait for an unpleasant surprise later.

Mentor Tip: Print out a typical, current student loan application and bring it into class with you. If possible, print out a few pages of the FAFSA forms you filled out the past year. Since the applications change so frequently, it is difficult to predict everything that the students will face when they are applying for a loan the first time. However, having a more recent copy of a loan application will allow you to cover the things that financial institutions are interested in now. That's why it is critical to stress the theory of loans and the relationships between risk, interest rates, and time to the students. If the students understand these relationships and the basic terminology, they will be able to make a proper, financially informed decision regardless of how the bank structures its application or presents its loan.

Module 7

LeBron James' Money Manager

An Introduction to Investments: Stocks, Bonds, and Mutual Funds

"In the business world, the rearview mirror is always clearer than the windshield."

–Warren Buffet

Lesson Overview:

It is always tough for the casual market observer to make the jump into investing real money, even in a company they feel strongly about. The objective of this lesson is not to describe how to make a killing in the stock and/or bond market; it is rather to prepare the students to think about investments and the news in a disciplined, knowledgeable manner. Oftentimes, people get scared away from investments because of the confusing lingo and fear to ask stupid questions. However, every student of investments had to learn that a stock was part ownership in a company at some point in their life. Despite this great fear of the technical aspect of investing that most people have, the most valid fear should be a mental one. What most casual investors do not realize is that the pain of 50% down far outweighs the joy of 50% up. For that reason, many casual investors end up checking their returns everyday to see if their portfolio was up or down for the day. If the investor has a really bad day, then he or she can make a very irrational decision as a result (such as pulling the price on a good idea rather than doubling down). Therefore, this lesson will cover not only the technical aspect, but also the mental aspects to successful investing. Again, this lesson and the following are not meant to be get-rich-quick handbooks. Alternatively, they are meant to introduce students to the basics of stocks, bonds, and mutual funds while preparing them to invest from a mental perspective.

In this lesson, students will be introduced to the basics of stocks, bonds, and mutual funds. Through comparisons and examples, students will grasp the basics of stocks and bonds. In the following lesson, students will be able to draw on this knowledge as they learn how to differentiate good from bad news. In this lesson, students will also see why mutual funds have become increasingly popular in today's world. Students will finally see the kind of personality traits that are necessary to adopt for success in the financial markets – as either a casual or professional investor.

Lesson Goals:

- Define stocks, bonds, and mutual funds
- Explain portfolios, diversification, and returns
- Benefits and risks of financial markets
- What kind of personality do you need to invest?
- LeBron James Money Manager Activity

Key Terms:

- Stocks – Equity
 - Share
 - Economic Moat
- Bonds – Debt
 - Interest
 - Maturity
 - Municipal Bonds
 - Corporate Bonds
- Mutual Fund
- Portfolio and Diversification

Opening Discussion:

- What is stock? What is a bond?
- What is the difference between a good stock and a good company?
- What are the different strategies to making money with stocks, bonds, etc?

What is a stock?

A stock is a type of security that signifies ownership in a corporation and represents a claim on part of the corporation's assets and earnings. A holder of stock (a shareholder) has a claim to a part of the corporation's assets and earnings. In other words, a shareholder is an owner of a company. Stocks are also known as “shares” or “equity.”

Types of stocks: common and preferred. Common stock usually entitles the owner to vote at shareholders' meetings and to receive dividends. Preferred stock generally does not have voting rights, but has a higher claim on assets and earnings than the common shares. For example, owners of preferred stock receive dividends before common shareholders and have priority in the event that a company goes bankrupt and is liquidated.

What is a bond?

A debt investment in which an investor loans money to an entity (corporate or governmental) that borrows the funds for a defined period of time at a fixed interest rate. A bonds' basic function is very similar to a loan – a simple I.O.U. (I owe you) of money now for more money later. Bonds are commonly referred to as fixed-income securities. The fixed-income name originates because the lender knows exactly how much money they are going to receive in return for their investment – principal + interest.

Introduction to Bond Terminology: The indebted entity (issuer) issues a bond that states the interest rate (coupon) that will be paid and when the loaned funds (bond principal) are to be returned (maturity date). Interest on bonds is usually paid every six months (semi-annually). The main categories of bonds are corporate bonds, municipal

bonds, and U.S. Treasury bonds. Two features of a bond - credit quality and duration - are the principal determinants of a bond's interest rate. Bond maturities range from a 90-day Treasury bill to a 30-year government bond. Corporate and municipals are typically in the three to 10-year range.

- Comparing Stocks and Bonds
 - Stocks
 - *What is it:* Part ownership of a company
 - *Voting Privileges:* Yes
 - *How do you receive income:* dividends
 - *Risk Level:* Relatively High – company could go bankrupt at anytime and you lose all money
 - *Expected Return:* Relatively High – if the company grows, then stock will grow in proportion; potential for very high returns
 - *Types:* Common and Preferred, (Growth), (Value), etc.
 - Bonds
 - *What is it:* Fixed amount of money returned over fixed time frame
 - *Voting Privileges:* No
 - *How do you receive income:* interest payments
 - *Risk Level:* Relatively Low – company will attempt to pay out even in event of bankruptcy
 - *Expected Return:* Relatively Low – because lower risk and known cash flow, company offers low interest rates
 - *Types:* Municipal, Corporate, Treasury, (TIPS), (CMBS), etc.
 - The Key Relationship!
 - Risk \propto Return

How do I make money with this knowledge? There are generally two strategies that people employ when trying to take advantage of their knowledge of certain stocks or bonds (collectively known as securities). They either a) trade or b) invest in securities.

In trading, you generally buy the stocks and hold them for no more than 30 days and try to sell them at a higher price. Successful traders follow the news very carefully and buy a stock before they expect really good news to come from that company. Then when the company releases the good news, the stock appreciates (price goes up), and the trader sells the stock at a higher price and pockets the difference in the prices as his profit.

In investing, you generally buy the stocks and hold them for 1 – 3 years and still try to sell the stock at a higher price. Investors believe it is impossible to time the market – like traders – and generally invest in good, solid companies. Instead of looking for a company they expect will release good news in the next month, investors look for companies that can consistently release good news and profit over many years. A

company's ability to keep a high profit margin despite increased competition is known as its "economic moat." The wider a company's moat, the more powerful its brand is and therefore its ability to sustain its profits. McDonalds and Wal-Mart both have very strong brands and high profits, therefore they have very wide economic moats. Whereas, a company like Sony, who definitely has a very recognizable brand, has a narrower moat because a lot of other companies like Toshiba and Panasonic put out very similar products of comparable quality. Most investors also abide by the theory of diversification, which basically states that if you diversify your allocations among many industries and securities, and then you minimize your risk. Then, in the even of a horrible technology crunch, your portfolio will not be killed because you also hold healthcare, retail, and energy stocks.

Relationship: greater diversity $1/\infty$ greater risk.

However, much of this work is very difficult and time consuming and therefore cannot be done by a full-time student or professional who is not dedicated to studying securities prices all day. Because of this problem, the market created a very simple solution: a mutual fund!

Mutual Funds

A mutual fund is an investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities. Mutual funds are operated by money managers, who invest the fund's capital and attempt to produce capital gains and income for the fund's investors. One of the main advantages of mutual funds is that they give small investors access to professionally managed, diversified portfolios of equities, bonds and other securities, which would be quite difficult – if not impossible – to create with a small amount of capital. Each shareholder participates proportionally in the gain or loss of the fund. Mutual fund units, or shares, are issued and can typically be purchased or redeemed as needed at the fund's current net asset value (NAV) per share.

So you can see why an average person would more likely invest in a mutual fund than directly in a stock or bond. The average person is handing their money over to a professional money manager that studies the intricacies of the market and works very diligently to make every investment decision. At the same time, an investor can still play a pivotal role in their investment portfolio even if they invest solely in mutual funds. How is that? – well, most mutual funds specialize in one area and therefore to remain properly diversified (so as to minimize risk) you need to invest in many different types of mutual funds.

Types of Mutual Funds

Bond Fund: A fund invested primarily in bonds and other debt instruments. The exact type of debt the fund invests in will depend on its focus, but investments may include government, corporate, municipal and convertible bonds, along with other debt securities like mortgage-backed securities.

Equity Fund: A mutual fund that invests principally in stocks. It can be actively or passively (index fund) managed.

Target-Date Fund: A mutual fund in the hybrid category that automatically resets the asset mix (stocks, bonds, cash equivalents) in its portfolio according to a selected time frame that is appropriate for a particular investor. A target-date fund is similar to a life-cycle fund except that a target-date fund is structured to address some date in the future, such as retirement. While proponents cite the convenience to investors of putting their investing activities on autopilot in one fund, critics are wary of these funds' one-size-fits-all approach.

Index Fund: A type of mutual fund with a portfolio constructed to match or track the components of a market index, such as the Standard & Poor's 500 Index (S&P 500). An index mutual fund is said to provide broad market exposure, low operating expenses and low portfolio turnover. Investing in an index fund is a form of passive investing.

International Fund: A type of mutual fund that can invest in companies located anywhere outside of its investors' country of residence. Many people confuse an international fund with a global fund. The difference is that a global fund includes the entire world, while an international fund includes the entire world excluding the investor's home country.

Growth Fund: A diversified portfolio of stocks that has capital appreciation as its primary goal, with little or no dividend payouts. Portfolio companies would mainly consist of companies with above-average growth in earnings that reinvest their earnings into expansion, acquisitions, and/or research and development.

Value Fund: A stock mutual fund that primarily holds stocks that are thought to be undervalued in price and that are likely to pay dividends. Value funds are one of three main mutual fund types; the other two are growth and blend (a mix of value and growth stocks) funds.

Specialty Fund: A type of stock mutual fund that targets a specific sector – such as healthcare – and invests in only companies in that sector.

Sorting Through All of the Information – The Most Important Part of Investing!

While this is a lot of information, you need to keep in *mind* a few things when you begin investing:

1. What are your investment objectives?
 - a. What is the safety of the capital you invested? Can you pull it out now?
 - b. What is your current income? What if it all went away? – would you be able to support yourself with your investments and returns?
 - c. Are you aiming to build your retirement account or your money now?

2. Know your personality
 - a. "The key organ for investing is the stomach, not the brain"
 - Peter Lynch, Legendary Stock Investor
 - b. What's your style? Do you love fast cars, extreme sports and the thrill of a risk? Or do you prefer reading in your hammock while enjoying the calmness, stability and safety of your backyard?
 - c. How much volatility you can stand to see in your investment?
 - d. Do you prefer digging into financial statements and crunching numbers? To some, the terms balance sheet, income statement and stock analysis sound as exciting as watching paint dry. Others just might not have the time to plow through prospectuses and financial statements
3. Know your risk tolerance
 - a. The joy of 50 percent up does not equal the pain of 50 percent down!
4. Be prepared for contradictions
 - a. Economics and finance are social (or soft) sciences. In a hard science, like physics or chemistry, there are precise measurements and well-defined laws that can be replicated and demonstrated time and time again in experiments. In a social science, it's impossible to "prove" anything. People can develop theories and models of how the economy works, but they can't put an economy into a lab and perform experiments on it

Now you are ready to begin building your portfolio! Use this activity to get them to analyze their knowledge of the different types of securities:

LeBron James Money Manager:

This is an activity designed to introduce students to investment vehicles by engaging them in a discussion of investing LeBron James' money. Students and mentors will review why most NBA players go bankrupt five years after retirement. Just as they did with savings, students will discuss the different strategies for how to successfully invest money while keeping in mind the principles they learned from the lesson on Savings.

Remind students of the story of Antoine Walker

You are a star NBA Player, making some good money. Let say \$110 million over 13 years to be precise; that is about \$8.5 million a year! The more money you make the more you decide to spend. Pretty soon, you are supporting an entourage of 70 friends and family members in some way. You build your mom a mansion in the Chicago suburbs complete with an indoor pool, 10 bathrooms, and a full-size basketball court. You then decide that you have a passion for cars. You transform the pavement around your house into a luxury car lot—two Bentleys, two Mercedes, a Range Rover, a Cadillac Escalade, a bright Red Hummer. Most of the vehicles were tricked out with custom paint jobs, rims, and sound systems at considerable added expense. On top of this you have a top-line watch collection with Rolexes and diamond-encrusted Cartiers. Pretty soon, you realize that you are running low on money. The condos, luxury cars, and watches have forced you into bankruptcy. You try to go with your crew of ten buddies to Vegas for a good time to get away from your financial troubles. Half way through the trip – you cut a check to a casino for a few thousand dollars. They ask you to

stay for a minute while they clear the check. Before you know it, police cars roll up to the casino and arrest you. Arrested, embarrassed, and broke – a long fall from being the star NBA player you once were.

This is the story of Antoine Walker, picked sixth overall by the Boston Celtics. Though now he is retired, in his heyday he was a great basketball player and made a lot of money. But making money doesn't cut it.

The Activity – LeBron James Money Manager

LeBron James, hearing about the bankruptcy problem from so many NBA players decides that he wants to hire you as his money manager. Fresh off his new maximum contract with the Miami Heat, he says that he will give you 1% of all the profit his money makes. But here's the catch. You have to make sure that he doesn't lose money. Where do you park his money?

The Contract: \$110 million over 6 years, or \$18.34 million a year. For simplicity, let's say LeBron will get a check for \$20 million at the beginning of each season.

Discussion Questions:

- 1) What would you do with the 20 million dollars? Let's say that it is in a bank account that will expire in 15 days. You can either withdraw 20 million dollars cash or transfer it to another investment?
- 2) If you are going to transfer it to another investment, what would you choose? How much money would you park there? (Use this discussion to go over a list of different investment vehicles—write them on the board).
- 3) What is the benefit of each place, what is the cost? What would LeBron think?

Debate which strategy is the best – try to come up with an efficient allocation as a class, or in groups if class has solid understanding of the concepts.

Moneythinking: You don't have as much money as LeBron does right now, but you have some cash on hand. What would you do with the money you have right now? What about the money you will have in 5 years? Ten Years? (Encourage the class to make a list of different investments they will park their money, including how much money will they park in the investments, what they need to do to put their money in those investments – they need to open a brokerage account at Fidelity, E-trade, etc. The purpose is to get students to start thinking of other assets other than cash.

Module 8

Wall Street from All Angles

An Introduction to the Financial Markets

"Wall Street is the only place that people ride to in a Rolls Royce to get advice from those who take the subway."

–Warren Buffet

Lesson Overview:

We see the headlines everyday that read something like “Stocks Soar on Manufacturing Data” or “Bonds Crushed Behind Record Unemployment Levels.” Generally, we can gain a sense of whether it was a good day or a bad day, but we can never say why. In this lesson, we will provide students with the tools to properly read, analyze, and formulate their own opinions on headlining news. The financial markets are an integral part to our society and it is critical that everyone understand its basic principles. The financial markets arose as the result of governments and companies needing to, essentially, borrow money from people. By issuing debt – bonds – or equity – stocks – governments and corporations are able to raise money. In the case of debt financing, the corporation will receive money now in exchange for giving up more money later. When we turn to equity financing, the corporation will receive money now in exchange for giving up some ownership of the company in the form of a share. The institutions that coordinate the offering of debt or equity financing for companies are known as investment banks. Now these are not the traditional commercial banks (Bank of America, Citibank, Chase, etc.) that we use to deposit money. One of the goals of this lesson is to show the delineation between a depository institution – more commonly referred to as just a “bank” – and an investment bank. Finally, we will tackle the big reason why everyone is so interested and infatuated with Wall Street: the prospect of making a lot of money.

The financial markets have always held a certain allure about them – a mystique that only the finest minds could truly grasp. While the various financial markets are certainly complex, their basics are exactly how they sound: basic. This lesson is designed to debunk the common misconceptions about the financial markets while giving students the tools to look at and properly analyze securities and companies. Through various case studies, students will see first-hand the wonders of the financial markets and why it is the place the brightest minds in the world go to make their money.

Lesson Goals:

- Understand beyond the headlines
- Differentiate noise from news
- Understand stock indexes
- Introduce the primary market
- How do I make money on Wall Street?

Key Terms:

- Dow Jones Industrial Average
- S&P 500
- The Nasdaq Composite
- Earnings per Share
- Market Cap
- Profit Margin
- Price/Earnings
- Dividend Yield
- Primary Market
- Investment Bank
- Underwriting

Opening Discussion:

- What is a headline you heard in the news last week?
- What is the importance of having a competitive advantage?
- What is a competitive advantage you have over a professional investment analyst?
 - You know the true news! – Emergence of social media.

Mentor Tip: It may be beneficial to recall some of the key points of Part A. Particularly, what defines a stock and bond as well as some of the key relationships (risk \propto reward).

Understanding the News

"The Dow continued its recent climb as Blue Chips show strong earnings."

"The S&P 500 dropped 27 points on tail-end of earnings season."

These are common statements you may hear on any given day as you flip past a financial news channel on your TV or scan the headlines in your newspaper. But what are the Dow and the S&P 500? What is the Nasdaq? What happens when a company misses earnings targets or gets upgraded or downgraded by analysts? What does any of this stuff mean to you, as an investor?

In this lesson, we are going to focus on building an understanding of some of the things you may typically hear in the financial news. Then we are going to learn how to separate what actually matters from what is nothing more than noise.

What is a stock index? A stock index is simply a grouping or a composite of a number of different stocks, often with similar characteristics. Stock indexes are typically used to discuss the overall performance of the stock market, in terms of changes in the market price of the stocks as well as how much trading activity there is in any particular period. Three of the most widely followed indexes are the Dow Jones Industrial Average, the S&P 500, and the Nasdaq Composite.

- Dow Jones Industrial Average: Known as just the "Dow" for short, this index is not really an average, nor does it exclusively track heavy industry anymore. The index is composed of 30 large stocks from a wide spectrum of industries. The index is calculated by taking the 30 stocks in the average, adding up their prices, and dividing by a divisor. Since the prices of the 30 stocks are added and divided by the common denominator, stocks with larger prices have more weight in the index than stocks with lower prices. Thus, the Dow is a price-weighted index. It's also useful to remember that the 30 stocks that make up the Dow are picked by the editors of The Wall Street Journal, rather than by any quantitative criteria. The editors try to pick stocks that represent the market, but there's an inevitable element of subjectivity (and luck) in such a method. Despite its narrower focus, the Dow tracks quite well with broader indexes such as the S&P 500 over the long run.
- S&P 500: The Dow Jones Industrial Average usually gets most of the attention, but the S&P 500 Index is much more important to the investment world. Index funds that track the S&P 500 hold hundreds of billions of dollars, and thousands of fund managers and other financial professionals track their performance against this ubiquitous index. Although it's usually referred to as a large-cap index, the S&P 500 does not just consist of the 500 largest companies in the U.S. The companies in the index are chosen by a committee at investment company Standard & Poor's. The committee meets monthly to discuss possible changes to the list and chooses companies on the basis of "market size, liquidity, and group representation." New members are added to the 500 only when others drop out because of mergers or (less commonly) a faltering business.
- Nasdaq Composite: The Nasdaq Composite was formed in 1971 and includes the stocks of more than 3,000 companies today. It includes stocks that are listed on the technology-company-heavy Nasdaq stock exchange, one of the market's largest exchanges. (Other major stock exchanges include the New York Stock Exchange, or the NYSE, and the American Stock Exchange, or AMEX.) Like the S&P 500, the Nasdaq is a market-cap-weighted index. For a stock to be included in the Nasdaq Composite, it must trade on the Nasdaq stock exchange and meet other specific criteria. If a company fails to meet all of the criteria at any time, it is then removed from the composite.

Separating the News from the Noise

Other times investors will hear about events that have them running for cover, and rightfully so. One such event is the announcement of a regulatory investigation by an organization such as the Securities and Exchange Commission or the Department of Justice. While such announcements by themselves by no means predict impending doom, who knows what nasty surprises may lurk for investors as regulators start probing. Plenty of investors have been burned badly by the results of such investigations--just ask the shareholders of Enron, Tyco, or WorldCom.

Another item to be wary of is a significant lawsuit. Corporate litigation is almost everywhere you look (these days, it's almost a normal part of doing business), and estimates of any significant legal damage are usually already priced into a stock. However, lawsuits often attract others, which could place very large uncertainties on a company's performance.

Case Study: Merck MRK – Vioxx and Fosamax

Bellwether drug manufacturer Merck MRK is experiencing a double-whammy related to litigation. Vioxx, Merck's arthritis-pain-relieving drug that was once perceived as a blockbuster, has been linked to heart problems in patients taking it. The company had to recall Vioxx from the market, and it is facing serious legal liabilities. Shortly thereafter, a court ruling shortened the patent life on Merck's number-two-selling drug Fosamax, meaning competitors can introduce a substitute much quicker than previously thought. Both situations have the ability to seriously reduce Merck's future cash flows.

Accompanying article: <http://www.nytimes.com/2009/09/03/business/03drug.html>

Learning the Lingo

Headlines are typically marred with stock ratios, acronyms, and odd lingo. It is critical to understanding the headlines that you at least have a basic knowledge of the various ratios that journalists typically refer to. Here is a basic run-down of the most commonly referred to, and important, stock metrics.

Earnings per Share (EPS): Earnings per share (EPS) is a company's net income (typically over the trailing 12 months) divided by its number of shares outstanding. EPS comes in two varieties, basic and diluted. Basic EPS includes only actual outstanding shares of a company's stock, while diluted EPS represents all potential stock that could be outstanding with current stock option grants and the like. Diluted EPS is the more "conservative" number.

$$EPS = (\text{Total Company Earnings}) / (\text{Shares Outstanding})$$

Although EPS can give you a quick idea of a company's profitability, it should not be used in isolation without also looking at cash flow and other performance metrics.

Market Cap: Market capitalization is essentially the market value of a company. It is calculated by multiplying the number of shares outstanding by the current share price. For example, if there are 10 million shares outstanding of ABC Corporation and ABC's stock is currently trading at \$25 per share, the market capitalization of ABC is \$250

million. As we will find out shortly, market capitalization not only gives you an idea concerning the size of a company, it can also be used when calculating the basic valuation ratios.

$$\text{Market Capitalization} = (\text{Stock Price}) \times (\text{Shares Outstanding})$$

Profit Margin: Just as there are three types of profits--gross, operating, and net--there are also three types of profit margins that can be calculated to offer insight into a company's profitability. Gross margin is simply gross profits divided by revenues, and so on. Margins are usually stated in percentages.

$$\text{Gross Margin} = (\text{Gross Profits}) / \text{Revenues}$$

$$\text{Operating Margin} = (\text{Operating Profits}) / \text{Revenues}$$

$$\text{Net Margin} = (\text{Net Profits}) / \text{Revenues}$$

Price/ Earnings (P/E): A valuation ratio of a company's current share price compared to its per-share earnings.

$$\text{Price/Earnings} = \text{Market Value per share} / \text{EPS}$$

In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E. However, the P/E ratio doesn't tell us the whole story by itself. It's usually more useful to compare the P/E ratios of one company to other companies in the same industry, to the market in general or against the company's own historical P/E. It would not be useful for investors using the P/E ratio as a basis for their investment to compare the P/E of a technology company (high P/E) to a utility company (low P/E) as each industry has much different growth prospects.

Dividend Yield: A financial ratio that shows how much a company pays out in dividends each year relative to its share price. In the absence of any capital gains, the dividend yield is the return on investment for a stock. Dividend yield is calculated as follows:

$$\text{Dividend Yield} = \text{Annual Dividends per share} / \text{Price per share}$$

Mentor Note: The lesson will now take a little bit of a shift away from the secondary markets – which is the market which stocks and bonds are traded – and we will shift to the primary market. Even though this topic is a lot denser and more difficult to understand, the curriculum will not be as rigorous in this discipline. If the mentor wishes to teach this subject, the mentor must have a strong knowledge of finance and must feel comfortable that the class will be able to successfully learn and absorb the material.

The Primary Market

So far in this lesson, we have been discussing how to invest in securities – particularly, stocks and bonds. We will now shift to thinking about the market for securities *before* they hit the secondary market. Most basically, the primary market can be described as the part of the capital markets that deals with the issuance of new securities. This is the place where corporations, governments, municipalities, etc. go to raise money. They receive this funding through the sale of a new stock or bond issue. This process of selling new securities to investors is called underwriting. The financial institution that deals with the underwriting of new securities is called an investment bank.

What is an investment bank? An investment bank differs greatly from what we typically refer to as a “bank.” Remember, investment banking means the underwriting of securities; that is, arranging for the issuance by corporations of stocks and bonds. The term bank is misleading because we often use it when we refer to a depository institution. A depository institution is an institution that accepts deposits and makes loans or invests the money from the deposits. For example, if you go to a savings bank – or a savings and loan, or a commercial bank – and you say, “I want to open up a checking account” – that’s a deposit; or, “I want to open up a saving account” – that’s a deposit. The thing about a deposit is you deposit your money as an individual and there are millions of people that all deposit in a depository institution. Then, later on, whenever you want, you can take your money out. Meanwhile, the depository institution invests the deposits some way or another at a higher interest rate than they pay on the deposits and they make the difference and that’s how they make a profit.

What does it mean to underwrite a security? That means they arrange for the issuance by other institutions of securities. For example, if Nike wants to issue corporate bonds or they want to issue new shares, they would go to an investment bank and the investment bank would say, “Okay we can underwrite for you. We will find the value of a share in your company and sell to enough people so we raise enough money for you.”

Why does a company come to an investment bank? As we have established, the investment bank raises money for the corporation by issuing new stocks or bonds. The company comes simply because it needs more money than it currently has. Perhaps Nike is planning on creating a shoe that can monitor everything about your health based on a single, lightweight computer chip in the shoe. In order to create this chip, they will need to hire researchers, engineers, and computer programmers. They will also need to build a machine that can create a massive amount of these chips. All of these processed cost money and Nike only has a limited amount of money. Nike and the investment bank decide, together, that they need \$500 million dollars for this project. Then, the investment bank decides that the most cost-effective way for Nike to do this is by issuing a 5% interest, 10 year bond offering. (When an investment bank decides to issue a stock offering it is called an Initial Public Offering or better known as an IPO). Nike then approves and the investment bank then contacts the network of wealthy people that it knows and offers the bond issuance to them. Once the

investment bank persuades enough investors that the bond issue is a good investment, they transfer money for the bond. Now, Nike has the money it needs, the investors have an investment that will make them money in the future, and the investment bank has collected a handsome fee in the process.

What an investment bank does not do: A pure investment bank is not a depository institution and it's also not a broker-dealer. They're not trading in securities, although they would deal in securities as a part of the underwriting process. Which means that you wouldn't go to a pure investment bank and say, "I want to buy a hundred shares of Ford Motor Company, where is your stockbroker?" An investment bank's customers are companies – that is the key distinction.

Even though in the modern world many "banks" participate in depository activities, investment banking activities, and trading activities, the financial institution that we just examined is called an investment bank. The reason that "bank" has become such a colloquialism is exactly for the reason outlined above.

Activity

This activity will put the students in the position of a Nike (ticker: NKE) shareholder. The students should consider that they have a sizeable amount invested in Nike, say, \$5,000. As a result, they are glued to any news on the stock market and they are constantly thinking about how the news can effect their position in Nike. In this activity, mentors will present the students with a mock headline and the students are to decide if this piece of news will cause the Nike stock price to a) rise, b) fall, or c) remain neutral.

Headline: "The Dow fell by 500 points on jobless claims data."

Effect: C) Neutral

Explanation: The Dow (DJIA) is a stock index that does not have Nike as a constituent. Since the Dow Jones has a relatively large price, a 500 point drop is not terribly large drop. As a result, we can assume the market had a mildly poor day and the net effect of this news was neutral to Nike's stock.

Headline: "Domestic stocks rallied on GDP data."

Effect: A) Rise

Explanation: Since Nike is a domestic stock (domiciled in the United States), we can assume that it rallied along with the market. Although this could result in a neutral effect, generally a strong report, such as a release of GDP data, would result in a very broad, market-wide effect.

Headline: "The S&P fell by 500 points over the day."

Effect: B) Fall

Explanation: Although one might be fooled with the comparison to the first headline that mentioned the Dow, the S&P 500 actually has a smaller total value and this a 500 point drop is a very large percentage of the S&P 500's valuation whereas 500 points is relatively smaller for the Dow. Therefore, we can assume that such a big drop in the market would also cause Nike's stock to fall in sync with the market.

Headline: "Nike reports earnings \$.40/ share higher than analyst expectations."

Effect: A) Rise

Explanation: Since analysts, who study Nike's business everyday, predicted that it would make less money than it actually did, then the whole market valued the company at a lower price as well. Therefore, the market will see that Nike actually earns more money than they expected and the stock price will rise to reflect Nike's outperformance. Therefore, we can see the relationship that positive expectations μ higher stock prices.

Headline: "Nike raises its dividend yield to 5%"

Effect: A) Rise

Explanation: As a result of Nike raising its dividend yield, we know that the company has excess cash that they are willing to distribute to the investors. In essence, a dividend is giving back money to the shareholders to thank them for investing in the company. Therefore, if Nike increases its dividend, then it is giving investors an opportunity to collect more money and therefore more people will buy the stock, and the price will go up as a result of the increased demand.

Headline: "Nike Releases Newest Addition to the Air Jordan Series"

Effect: A) Neutral

Explanation: It may be the student's first instinct to think that this will cause the stock price to rise, and this is a legitimate argument. However, a stock price is generally not concerned with a release date but rather a report on how well the shoe release does. Perhaps when the news that Nike was developing a new addition to the series leaked, then the stock price may have gone up, but, in this case, there was no change in the company's business. On the next day, if the headline read "New Air Jordan Breaks all Records and Sells Out Nationwide in 15 minutes" then that may positively impact the stock price because we see the impact of the shoe release.

Mentor Tip: Remember that for this activity, these are just guidelines for the discussion and encourage the students to think about the news in a serious context. These answers will hold true many times in practice and there may be situations where they do not. These should just be a starting point for discussion. As long as an answer is properly justified, then no answer is necessarily incorrect. Therefore, encourage students not to just guess the right answer, but to think about the question and decide what assumptions are necessary to make and which are not.

