Section 5 | Strategies for Wealth Building

5 Strategies for Wealth Building

Objectives

- Participants will understand the concept of *net wealth* and how the decisions they make can cause their own net wealth to increase or decrease.
- Participants will explain why an early start in saving and investing increases a household's ability to build its wealth.
- Participants will understand that buying and holding financial assets leads to a greater long-term net wealth than frequent trading of assets.
- Participants will understand how diversification protects them from changes in the value of any one asset or asset class.

Materials

- Section 5 of the *Your Credit Counts Challenge* participant's guide.
- Transparencies or PowerPoint slides of Visuals 5.1 through 5.21.
- Net Wealth Triangles from Handout 5.1, duplicated on card stock, one per table or group.
- Duplicated copies of Floor Markers 5.1 through 5.5, listing alternative assets: Savings Accounts, Certificates of Deposit, Bonds, Stocks, Real Estate.

Procedure

Overview

Display Visual 5.1: The Idea of Building Wealth. Explain that this session is about how the participants can make their households better off, economically, over time.

Define *net wealth* as "what you own minus what you owe." Explain that in this session, participants will see that a few simple rules make it possible for even a household of modest means to improve its economic standing substantially.

Display Visual 5.2: What Builds Wealth? Remind the participants about what builds wealth (recall the discussion of good credit and bad credit from Section 3):

- When you do things that add to your assets, you're building net wealth.
- When you do things that take away from your assets, you're cutting net wealth.
- If you borrow to buy things that don't last, you reduce your net wealth.
- If you borrow to buy things that do last, over time you can increase your net wealth. *(Example: You borrow to buy a house. Over time you pay down the loan and your house may increase in value. Your net wealth increases.)*

Presentation

1. ***Display Visual 5.3:*** Cases in Net Wealth: Chad. Show how net wealth is easy to calculate for Chad, who owns only a car and owes only the amount due on his car loan.

2. ***Display Visual 5.4:*** Cases in Net Wealth: Craig. Show how Craig, the medical specialist, has a high income but a low net wealth.

3. ***Display Visual 5.5.*** Show how Gwen, the 59-year-old clerical worker, has a higher net wealth than the medical specialist.

4. Remind the participants that when households do things that add to their assets, they're building net wealth. When they do things that take away from their assets, they're cutting net wealth.

5. ***Distribute Handout 5.1:*** The Net Wealth Triangle, and ***Handout 5.2:*** Things That Affect Net Wealth, for each group or table. ***Display the matching Visual 5.6:*** Things That Affect Net Wealth.

6. The faces of the Net Wealth Triangle show a plus sign (+), a minus sign (–), and a question mark (?). The handout lists a number of possible decisions by a household. For each action, you'll ask the groups to confer and come to a judgment about whether the indicated action will increase net wealth, reduce net wealth, or have an uncertain effect. When each group has reached a decision, it should have a member hold up the Net Wealth Triangle with a +, - or ? facing forward to reflect its judgment.

7. You may have each group assemble its Net Wealth Triangle or you may pre-assemble all of them.

8. Read the first item from Visual 5.6 and wait until all groups, or almost all groups, are holding up a Net Wealth Triangle. Ask the groups to justify their opinions, particularly when they are in conflict. The items start off straightforwardly and become more difficult:

- Tanya buys gifts for all her family and puts all the charges on her credit card. *(This reduces net wealth because the charges remain, but Tanya doesn't own anything more.)*
- Terrence buys a lawnmower on credit for his landscaping business. *(This should increase Terrence's net wealth because he's buying an asset. It is possible that the mower might break down or be stolen, however.)*
- Martina decides to put all her overtime money this month into a savings account. *(This increases net wealth, as what Martina owns goes up without any increase in what she owes.)*
- Morgan gets six-year financing to buy a Porsche to drive to work. *(This probably reduces her net wealth because the car depreciates in value faster than she pays off the loan.)*
- Charles and Diamond refinance their mortgage at a lower interest rate. *(This increases net wealth, as long as Charles and Diamond don't go out and spend all the money they save.)*
- Yolanda borrows money to start her own business. *(This one is uncertain. If Yolanda's business succeeds, she will increase her net wealth, but she must also be aware of the possibility of failure and guard against it.)*

9. Summarize by reminding the participants that they increase their net wealth when they make smart financial decisions.

10. ***Display Visual 5.7:*** Three Rules of Investing. Explain that you're going into detail on each of three rules (rules that you're just introducing now):

- Start early.
- Buy and hold.
- Diversify.

11. Explain that it's possible to become a millionaire by regular saving, and we'll see how an ordinary wage earner, Charlayne, did it. Also note that things went well for Charlayne, but someone doing only half as well could still build up a half million dollars ($500,000) in lifetime wealth.

12. ***Display the first line of Visual 5.8:*** Charlayne Accidentally Becomes a Millionaire. Hide the other lines. Explain that $20 per week, matched by an employer's $20 per week, comes to $2,080. Show how that money can grow to $2,168.40 at the end of a year.

13. Show the next line and indicate that the second-year total would be $4,521.11. Note that because all the earnings stay in the account, Charlayne is now receiving "earnings on earnings."

14. Go down to year 9 and show that Charlayne's account is then worth $32,168.43. Point out that this year, Charlayne lost her motivation and stopped saving. But because she had started early and allowed her money to continue to grow and compound, she did amazingly well. Display the last year and show that she then has an account worth more than $1 million by retirement age.

15. Some participants will be skeptical. Tell them that most people find the numbers hard to believe, but the numbers are accurate. Remind them that if you do only half as well as Charlayne, you can become a half-millionaire; or doing one-quarter as well still gives you net wealth of a quarter million dollars ($250,000). Also tell them that Charlayne had to follow those three rules, which you'll now explain in more detail.

16. ***Display Visual 5.9:*** The Magic of Compounding. Explain that when you leave money in an account to earn a return for a long time, it's not just your original money that's working for you. Instead, you get interest on interest, or earnings on earnings.

17. ***Display Visual 5.10:*** Marcus's Mistake. Explain that Charlayne's co-worker Marcus had the same opportunity that Charlayne had. But Marcus didn't get an early start, and he tried to make up for his later start by saving diligently for 35 years. Although he accumulated an impressive $600,000 plus, he never caught up with Charlayne.

18. ***Display Visual 5.11:*** Avoiding Scams and Frauds. Explain that never losing money to a fraud was very much in Charlayne's favor. If she had saved a similar amount of money but put it into a pyramid scheme, she probably would have lost it all.

19. ***Display Visual 5.12:*** The Foundation of Buy and Hold. Tell the participants that this is a review showing how to get into a position to leave money in the market. From the first four sections of the training materials, the key ideas are:

- Section 1. Spend less than you receive.
- Section 2. Make intelligent choices about financial institutions.

- Section 3. Manage your credit properly.
- Section 4. Consider homeownership when the time is right.

20. ***Display Visual 5.13:*** The Stock-Market Roller Coaster. Explain that Charlayne just held on to her investments as financial markets went up and down. Remind the participants that:

- It's easy to get overly pessimistic when financial assets go down, but that's a bad time to sell.
- It's easy to get overly optimistic when financial assets go up, but that's a bad time to buy.
- Historically, the stock-market roller coaster ends up higher than it started out. Although there are no guarantees about the future, over long periods of time people have done well by leaving their money in.

21. ***Display Visual 5.14:*** Don't Put All Your Eggs in One Basket. Explain that people have long known it is unwise to concentrate risk. For investors, avoiding that risk involves holding different assets instead of concentrating wealth on a single asset. Diversifying is taking on many small risks rather than one large risk.

22. ***Display Visual 5.15:*** Forms of Saving and Investing. Explain that you're going to show the participants different places where they can put their money; they'll be called on to make some decisions when you're done. Read and explain the different investment categories:

- Savings accounts
  (They provide a small but steady return.)
- Certificates of deposit (CDs)
  (They're very safe, but instant access carries a penalty. CDs pay a little more than savings accounts.)
- Bonds
  (Buying bonds is in effect lending money to a corporation or government. The return is higher than the return on bank savings and CDs, but there is also more risk.)
- Stocks
  (Owning stock actually means having part ownership in a company, with higher risks and returns.)
- Real estate
  (This comes with all the risks and benefits of being a landlord. Note that here we're talking about real estate as an investment — not owning our own homes.)

23. Now place ***Floor Markers 5.1 through 5.5*** on the floor at the edges of the room. Tell the participants that each of them has $5,000 to invest and ask them to show where they would put the money. For example, those who prefer stocks will walk over to the floor marker that says "Stocks."

24. When all the participants have chosen a position, go around to the floor markers and ask for justifications. Then have the participants sit down again. In their explanations, participants will usually mention both risk and return. Some will insist they need more information to make a decision.

25. ***Distribute Handout 5.3:*** Investment Situations and ***display the matching Visual 5.16.*** Explain that you can make better decisions when you know more about the situation. The first item in the handout is the $5,000 generic decision the participants just made. Now read the second item and ask the participants to stand up and show where they would put the money. Some participants will return to the same floor marker as before, but some will make different decisions. Go through the other items, showing how the participants' movements correspond to investors making different decisions, depending on the circumstances.

26. ***Display Visual 5.17:*** The Pyramid of Risks and Reward. Explain that the participants have just been illustrating the trade-off between risk and return. If you want a safe investment, you have to settle for a low return (at the bottom of the pyramid). If you want the prospect of higher returns, you have to take risk (move toward the top of the pyramid).

27. ***Display Visual 5.18:*** Mutual Funds. Explain that a mutual fund pools investors' money and puts it into the markets on their behalf. Tell the participants that mutual funds allow people in effect to conveniently own small amounts of many different assets. This means that they can easily diversify by owning mutual funds.

28. ***Display Visual 5.19:*** How to Get Started. Show the participants that they can get started investing with small amounts, but that it's important to have their finances in order so they won't have to pull the money out.

Show the participants three low-cost ways of getting started:

1. Employer plan with payroll deduction.
2. Mutual fund account that they open.
3. Investment club.

(Refer the participants interested in investment clubs to the National Association of Investors Corp., P.O. Box 220, Royal Oak, MI 48068. NAIC's toll-free number is 877-275-6242, and its Web site is www.better-investing.org.)

29. ***Display Visual 5.20:*** Paying for College. Emphasize that college funds are a great way of building a family's wealth over time because of the extra earnings that students who go to college will receive. Review how college funds fit the three rules laid out:

- Start early. College funds are the least expensive way to save for a newborn because of the long time period (from infancy to the age at which the young adult enrolls in college) during which earnings can compound.
- Buy and hold. You leave your money in a college fund; you don't switch it in and out of the market.
- Diversify. The administrators of college funds put them into a wide variety of financial assets.

Review

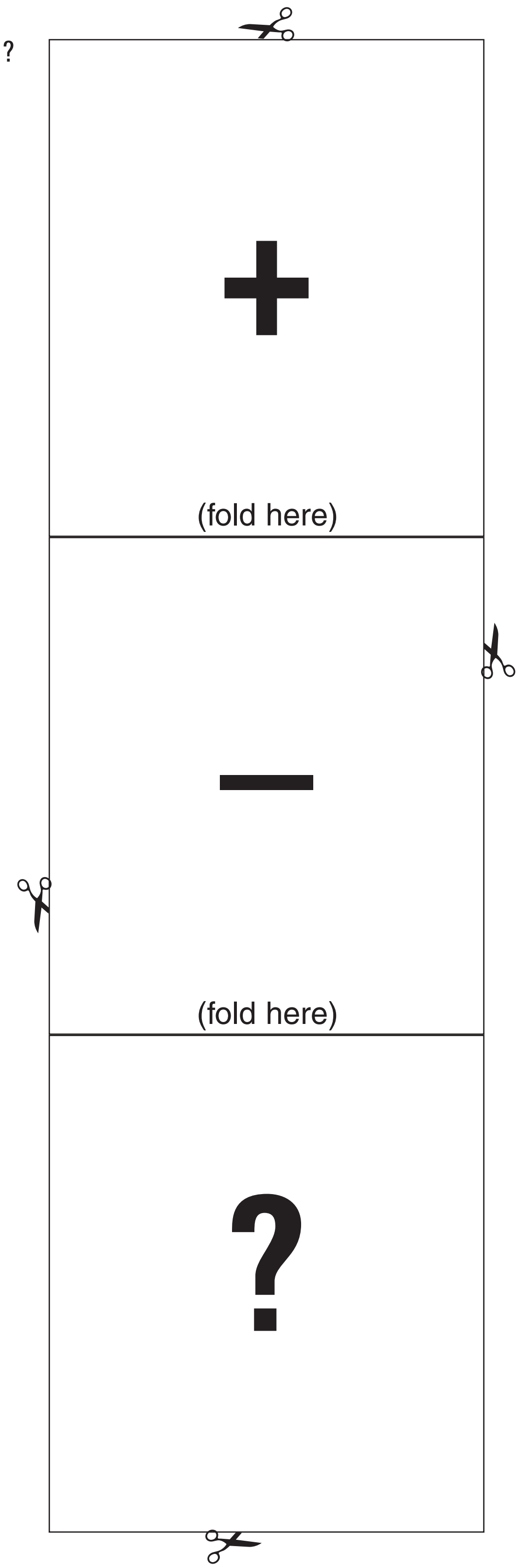
Display Visual 5:21: Review. Summarize by saying that, over time, it is possible for ordinary people to become well off. Remind the participants that they build their net wealth when they use borrowing to buy quality assets. Remind them that there are considerable advantages to starting early, and that to build wealth over time they should buy and hold diversified assets.

Ask:

1. If saving when you're young can make you wealthy, why do people find it hard to save when they're young? *(Because they feel they have many pressing needs and they are focused on the here-and-now rather than the future. Some young people can't imagine themselves ever reaching retirement age.)*
2. Most people naturally suspect that an investment isn't a good deal if it's pushed on them with a very short time to decide. Why, then, does pushing investments with time pressure work so well? *("Lack of information" and "greed" are two possible answers, but it's still surprising how well high-pressure sales pitches work, even on people who sense something is wrong.)*
3. Why do safe investments usually have a lower rate of return than riskier ones? *(Because no one would hold a risky investment if it didn't promise a higher rate of return than a safe one.)*

Handout 5.1: The Net Wealth Triangle

Cut out and fold into a triangle shape, with the +, -, and ? facing outward so that you can display one face of the triangle forward. This triangle will show whether you think net wealth will increase (+) or decrease (-). If it's uncertain, display the ? face.



Handout 5.2: Things That Affect Net Wealth

+	-	?	
			1. Tanya buys gifts for all her family and puts all the charges on her credit card.
			2. Terrence buys a lawnmower on credit for his landscaping business.
			3. Martina decides to put all her overtime money this month into a savings account.
			4. Morgan gets six-year financing to buy a Porsche to drive to work.
			5. Charles and Diamond refinance their mortgage at a lower interest rate.
			6. Yolanda borrows money to start her own business.

Visual 5.1: The Idea of Building Wealth

Over time, your household can become better off.

It does this by building wealth, defined as:

What you own

— minus —

What you owe

Visual 5.2: What Builds Wealth?

- When you do things that add to your assets, you're building net wealth.

- When you do things that take away from your assets, you're cutting net wealth.

- If you borrow to buy things that don't last, you reduce your net wealth.

- If you borrow to buy things that do last, over time you can increase your net wealth.

Visual 5.3: Cases in Net Wealth: Chad

Chad, age 21, owns nothing but a car and owes nothing but the payments on his car loan.

- Value of car: $7,865
  (from "Blue Book")

- Balance on car loan: $5,303
  (from calling bank)

- Chad's net wealth is $7,865 - $5,303,
  or $2,562

- Chad has many wealth-building opportunities as he begins a career.

Visual 5.4: Cases in Net Wealth: Craig

- Craig, age 38, is a medical specialist who makes $142,000 per year.

What Craig owns		What Craig owes	
House	$416,000	Mortgage	$362,000
Cars	84,450	Car loans	81,040
Real Estate	248,500	Real Estate loans	204,970
		Personal loans	53,700
		Credit card debt	34,240
Totals	**$748,950**		**$735,950**

- Craig's net wealth is $748,950 minus $735,950, or just $13,000.

- He has a high income but low net wealth.

Visual 5.5: Cases in Net Wealth: Gwen

- Gwen, age 59, is a clerical worker who has been earning an income and saving for a long time.

What Gwen owns		What Gwen owes	
House	$78,000	Mortgage	$12,500
Cars	11,820	Car loans	8,770
Retirement	88,500	Personal loans	1,140
Totals	**$178,320**		**$22,410**

- Gwen's net wealth is $155,910.

- She has a higher net wealth than the medical specialist, Craig.

Visual 5.6: Things That Affect Net Wealth

+	-	?	
			1. Tanya buys gifts for all her family and puts all the charges on her credit card.
			2. Terrence buys a lawnmower on credit for his landscaping business.
			3. Martina decides to put all her overtime money this month into a savings account.
			4. Morgan gets six-month financing to buy a Porsche to drive to work.
			5. Charles and Diamond refinance their mortgage at a lower interest rate.
			6. Yolanda borrows money to start her own business.

Visual 5.7: Three Rules of Investing

1. Start early
   (give money time to grow)

2. Buy and hold
   (keep your money invested)

3. Diversify
   (don’t put all your eggs in one basket)

Visual 5.8: Charlayne Accidentally Becomes a Millionaire

Year	Beginning Balance	Addition to Principal	Return	Ending Balance
0	$0.00	$2,080.00	$88.40	$2,168.40
1	$2,168.40	$2,080.00	$272.71	$4,521.11
2	$4,521.11	$2,080.00	$472.69	$7,073.81
3	$7,073.81	$2,080.00	$689.67	$9,843.48
4	$9,843.48	$2,080.00	$925.10	$12,848.58
5	$12,848.58	$2,080.00	$1,180.53	$16,109.11
6	$16,109.11	$2,080.00	$1,457.67	$19,646.78
7	$19,646.78	$2,080.00	$1,758.38	$23,485.16
8	$23,485.16	$2,080.00	$2,084.64	$27,649.80
9	$27,649.80	$2,080.00	$2,438.63	$32,168.43
10	$32,168.43	$2,080.00	$2,822.72	$37,071.15
11	$37,071.15	$2,080.00	$3,239.45	$42,390.59
12	$42,390.59	$2,080.00	$3,691.60	$48,162.19
13	$48,162.19	$2,080.00	$4,182.19	$54,424.38
14	$54,424.38	$2,080.00	$4,714.47	$61,218.85
15	$61,218.85	$2,080.00	$5,292.00	$68,590.85
16	$68,590.85	$2,080.00	$5,918.62	$76,589.48
17	$76,589.48	$2,080.00	$6,598.51	$85,267.98
18	$85,267.98	$2,080.00	$7,336.18	$94,684.16
19	$94,684.16	$2,080.00	$8,136.55	$104,900.72
20	$104,900.72	$2,080.00	$9,004.96	$115,985.68
21	$115,985.68	$2,080.00	$9,947.18	$128,012.86
22	$128,012.86	$2,080.00	$10,969.49	$141,062.35
23	$141,062.35	$2,080.00	$12,078.70	$155,221.05
24	$155,221.05	$2,080.00	$13,282.19	$170,583.24
25	$170,583.24	$2,080.00	$14,587.98	$187,251.22
26	$187,251.22	$2,080.00	$16,004.75	$205,335.97
27	$205,335.97	$2,080.00	$17,541.96	$224,957.93
28	$224,957.93	$2,080.00	$19,209.82	$246,247.75
29	$246,247.75	$2,080.00	$21,019.46	$269,347.21
30	$269,347.21	$2,080.00	$22,982.91	$294,410.12
31	$294,410.12	$2,080.00	$25,113.26	$321,603.38
32	$321,603.38	$2,080.00	$27,424.69	$351,108.07
33	$351,108.07	$2,080.00	$29,932.59	$383,120.66
34	$383,120.66	$2,080.00	$32,653.66	$417,854.31
35	$417,854.31	$2,080.00	$35,606.02	$455,540.33
36	$455,540.33	$2,080.00	$38,809.33	$496,429.66

Visual 5.8: Charlayne Accidentally Becomes a Millionaire (cont.)

Year	Beginning Balance	Addition to Principal	Return	Ending Balance
37	$496,429.66	$2,080.00	$42,284.92	$540,794.58
38	$540,794.58	$2,080.00	$46,055.94	$588,930.52
39	$588,930.52	$2,080.00	$50,147.49	$641,158.01
40	$641,158.01	$2,080.00	$54,586.83	$697,824.84
41	$697,824.84	$2,080.00	$59,403.51	$759,308.35
42	$759,308.35	$2,080.00	$64,629.61	$826,017.96
43	$826,017.96	$2,080.00	$70,299.93	$898,397.89
44	$898,397.89	$2,080.00	$76,452.22	$976,930.11
45	$976,930.11	$2,080.00	$83,127.46	$1,062,137.57

Visual 5.9: The Magic of Compounding

- When you save, you get interest.
- When you take the interest out and spend it, it stops growing.
- But if you leave the interest in so it can grow…
  You start to get *interest on the interest you earned.*
- Interest on interest is money you didn't work for — your money made it for you!
- Over time, interest on interest can make your total savings huge… but only if you leave the interest to grow.

Visual 5.10: Marcus's Mistake

Year	Beginning Balance	Addition to Principal	Return	Ending Balance
0	$0		$0	$0
1	0		0	0
2	0		0	0
3	0		0	0
4	0		0	0
5	0		0	0
6	0		0	0
7	0		0	0
8	0		0	0
9	0		0	0
10	$0.00	$2,080.00	$88.40	$2,168.40
11	$2,168.40	$2,080.00	$272.71	$4,521.11
12	$4,521.11	$2,080.00	$472.69	$7,073.81
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35	$170,583.24	$2,080.00	$14,587.98	$187,251.22
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Visual 5.10: Marcus's Mistake (cont.)

Year	Beginning Balance	Addition to Principal	Return	Ending Balance
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45	$417,854.31	$2,080.00	$35,606.02	$455,540.33

Visual 5.11: Avoiding Scams and Frauds

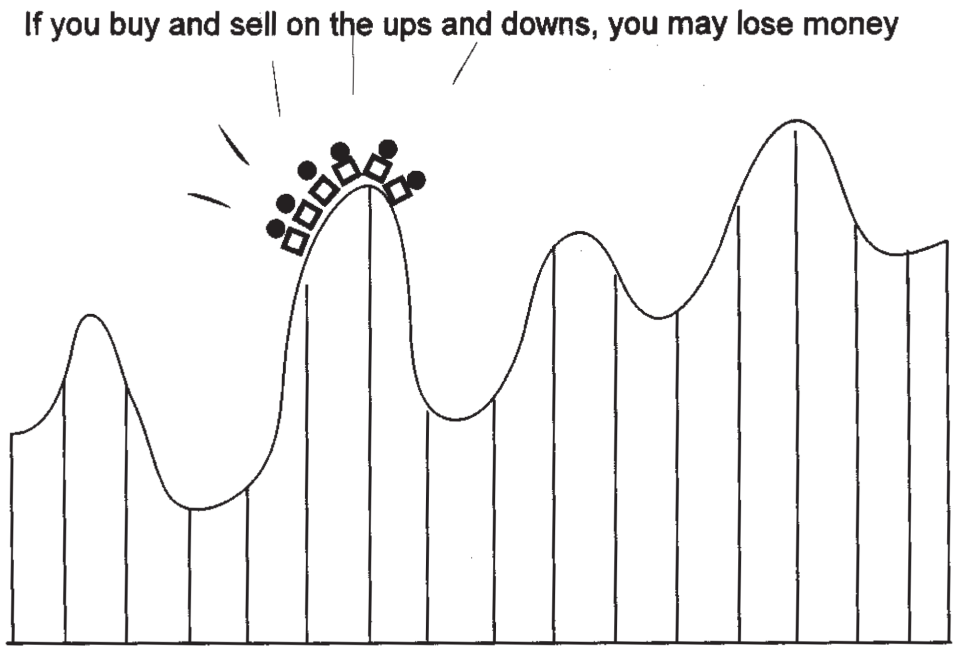
- It is easy to be impatient while watching money build slowly over time.
- Scam artists promise high returns instantly.
- Look out for pyramid schemes.
- No legitimate investment can promise high returns instantly.

Visual 5.12: The Foundation of Buy and Hold

In order to leave money in the market:

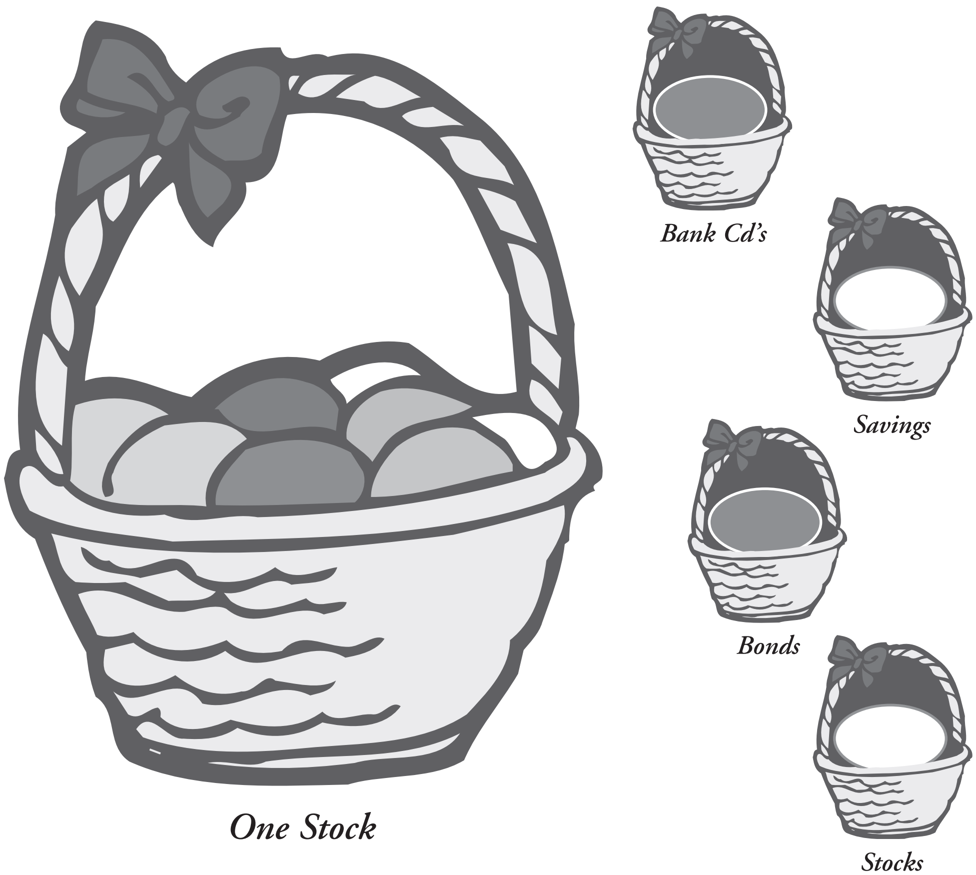
- Section 1. Spend less than you receive.
- Section 2. Make intelligent choices about financial institutions.
- Section 3. Manage your credit properly.
- Section 4. Consider homeownership when the time is right.

Visual 5.13: The Stock-Market Roller Coaster



But what if you buy and hold long-term? There are no guarantees, but historically the ups have been far greater than the downs.

Visual 5.14: Don't Put All Your Eggs in One Basket



With all your money in one stock, a disaster in that stock is like spilling all the eggs from a basket. With your money spread out across a variety of assets (stocks, bonds and cash), you're not hurt badly when any one asset does poorly.

Visual 5.15: Forms of Saving and Investing

- Savings accounts: provide a small but steady return.
- Certificates of deposit: very safe, but instant access carries a penalty.
- Bonds: lending money to a corporation or government, with higher return than the returns offered by bank savings and CD accounts.
- Stocks: part ownership in a company, with higher risks and returns.
- Real estate: the risks and benefits of being a landlord.

Visual 5.16: Investment Situations

1. You have $5,000 to invest.
   No other information is available.

2. You have $4,000 that you'll need six months from now.

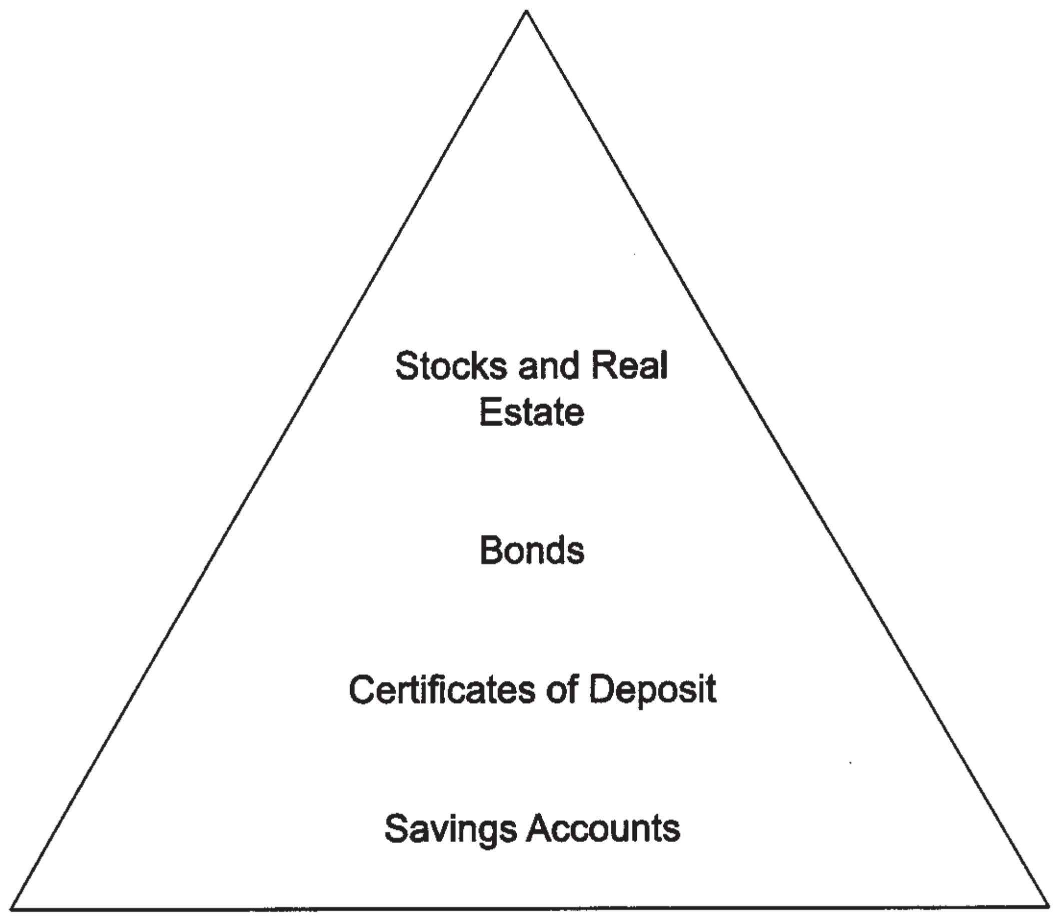
3. You inherited $10,000 from your great-aunt who had suggested that you save it for your old age.

4. You want to save for a 15-year-old's future college education.

5. You are just starting a career and can save $50 per month for retirement.

Visual 5.17: The Pyramid of Risks and Reward

Highest Risk, Highest Potential Return or Loss



Lowest Risk, Lowest Potential Return or Loss

Visual 5.18: Mutual Funds

- A mutual fund pools investors' money.
- The money is invested in the markets on behalf of investors.
- In effect, each investor owns small amounts of many different assets.
- For this reason, mutual funds may help investors to avoid the risk that comes from owning any one asset.
- This is one example of "diversifying."
- Remember Charlayne? Her retirement money was invested in mutual funds, as is common.

Visual 5.19: How to Get Started

1. Employer plan with payroll deduction
   (automatically comes out of your paycheck)

2. Mutual fund account that you open
   (can arrange for regular contributions)

3. Investment club
   (pool money with other members and invest)

Visual 5.20: Paying for College

1. Start early.
   (least expensive way of saving for a newborn)

2. Buy and hold.
   (don't switch in and out of the market)

3. Diversify.
   (college savings funds do this for you)

Visual 5.21: Review

- Over time, it is possible for ordinary people to become well off.

- You build net wealth when you use borrowing to buy quality assets:
  - ✔ Start early.
  - ✔ Buy and hold.
  - ✔ Diversify.

1. If saving when you're young can make you wealthy, why do people find it hard to save when they're young?

2. Why does pushing investments with time pressure work so well?

3. Why do safe investments usually have a lower rate of return than riskier ones?

Floor Marker 5.1

Savings Account

Floor Marker 5.2

Certificate of Deposit

Floor Marker 5.3

Bonds

Floor Marker 5.4

Stocks

Floor Marker 5.5

Real Estate