LEARNING MADE EASY

Financial Literacy Essentials

for dummies®

A Wiley Brand

Get to know core financial literacy concepts

Jump start your financial know-how

Identify the mistakes that cause financial woe

Eric Tyson, MBA

Author of *Personal Finance For Dummies*

with Ray Brown, Bob Carlson, Robert S. Griswold, and Margaret Atkins Munro

Financial Literacy Essentials

by Eric Tyson, MBA
with Ray Brown, Bob Carlson, Robert S. Griswold MSBA CRE CPM, and Margaret Atkins Munro EA

for dummies®
A Wiley Brand

Financial Literacy Essentials For Dummies®

Published by: **John Wiley & Sons, Inc.,** 111 River Street, Hoboken, NJ 07030-5774, www.wiley.com

Published simultaneously in Canada

For general information on our other products and services, please contact our Customer Care Department within the U.S. at 877-762-2974, outside the U.S. at 317-572-3993, or fax 317-572-4002. For technical support, please visit https://hub.wiley.com/community/support/dummies.

Wiley publishes in a variety of print and electronic formats and by print-on-demand. Some material included with standard print versions of this book may not be included in e-books or in print-on-demand. If this book refers to media that is not included in the version you purchased, you may download this material at http://booksupport.wiley.com. For more information about Wiley products, visit www.wiley.com.

Library of Congress Control Number: 2025933227

ISBN 978-1-394-32616-7 (pbk); ISBN 978-1-394-32618-1 (ePDF);
ISBN 978-1-394- 32617-4 (epub)

Table of Contents

Introduction

Possessing financial literacy helps you understand the relationship between the money you earn, the money you save and spend, and the money you invest. With this knowledge, you can make informed financial decisions to meet your short- and long-term financial goals.

You may want to buy a home, plan to finance a child's higher education, retire and travel the world by a certain age, or all these things and more. Because you understand the basics of how money works, you can create an effective financial strategy toward meeting these goals.

Part of increasing your financial literacy requires considering your own experience with money. Although you can't change what the educational system and your parents did or didn't teach you about personal finances, you now have the ability to find out what you need to know to manage your finances. Reading this book is a good place to start.

About This Book

This book helps you develop a basic understanding of financial literacy. Aside from being packed with updated information, another great feature of this book is that you can read it from cover to cover if you want, or you can read a particular chapter or part without having to read what comes before it. Handy cross-references direct you to other places in the book for more details on a particular subject.

Foolish Assumptions

In writing this book, I have assumed that you want to learn the basics of financial literacy while also receiving expert advice about important financial topics (such as paying off and reducing the cost of debt, planning for major goals, making wise investments). I also assume that you want quality information and answers presented as efficiently as possible.

Icons Used in This Book

The icons in this book help you find particular kinds of information that may be useful to you.

TIP

This target flags strategy recommendations for making the most of your money.

REMEMBER

This icon points out information that you'll definitely want to remember.

WARNING

This icon marks things to avoid and points out common mistakes people make when managing their finances.

Where to Go from Here

This book is organized so you can go wherever you want to find complete information. Want to read about investing strategies, for example? Go to Chapter 5 for that. Feel the urge to get your insurance needs in order or to check on what type of insurance you really need? Head to Chapter 8. You also can check out the table of contents to find broad categories of information and a chapter-by-chapter rundown of what this book offers, or you can look up a specific topic in the index.

If you're not sure where you want to go, you may want to start at the beginning with Chapter 1. It gives you all the basic info you need to assess your financial literacy and points to places where you can find more detailed information for improving it.

IN THIS CHAPTER

- » Understanding the basics of financial literacy
- » Identifying hurdles to financial success
- » Recognizing and avoiding bad advice and information
- » Avoiding common money mistakes

Chapter 1 Introduction to Financial Literacy

Personal finance involves much more than managing and investing money. It also includes making all the pieces of your financial life fit together; it means lifting yourself out of financial illiteracy.

This chapter introduces the basics of financial literacy. It explains why possessing financial literacy helps pave the road to financial success and some pitfalls you may encounter along the way.

What Is Financial Literacy, Anyway?

To be literate in personal finance, you need to get a handle on these topics:

- » **Managing your everyday transactions:** Accounting for money that passes through your hands and your transaction accounts in the short term

» **Investing for the long term:** Knowing the best ways to invest money for better returns and longer-term purposes

» **Protecting your money:** Protecting your income and assets with insurance

Budgeting and transaction accounts

If you're like most people, as you earn money, much of it too quickly passes through your hands or, more specifically, into and out of your transaction accounts. In addition, a hefty chunk of money you earn is siphoned off to federal, state, and local taxes. What's left is used to pay your monthly living expenses, such as housing, food, utilities, clothing, and hopefully for some entertainment and recreation.

Managing your monthly living expenses (including taxes) and budget and establishing and working toward financial goals takes time and effort. Chapter 2 describes the basics of creating a budget and tracking expenses.

Investing

When you're spending less than you earn and able to save new money each month, you have the pleasant but challenging problem of deciding where and when to invest your savings. Or maybe you already have additional money you want to invest and make work harder for you.

The world of investments is complicated and filled with pitfalls. That contributes to some folks leaving their excess money sitting in their low-interest transaction accounts by default. While you could do worse (by losing money in poor investments), you can certainly do better — and you probably need to do better in order to accomplish your financial goals. Chapter 5 covers investing and helps you grasp the essentials of that important task.

Insurance

When you're earning money and have some assets (for example, a car, house, and so on), insurance protects against the loss of that income and your assets. If others are dependent upon your employment income, you likely need some life insurance. Even without dependents, you're probably dependent on your own income and thus should have adequate disability insurance.

Assets like a car and home require sufficient insurance protection. And, as your investments and net worth grow, having some excess liability insurance makes sense as well. See Chapter 8 for important details on insurance.

Why It Matters: The Power of Knowing Your Money Stuff

Understanding the relationship between the money you earn, the money you save and spend, and the money you invest helps you make informed financial decisions to meet your short- and long-term financial goals.

Think about where your parents learned about money management, and then consider whether they had the time, energy, or inclination to research choices before making their decisions. For example, if they didn't do enough research or had faulty information, your parents may mistakenly have thought that banks were the best places for investing money or that buying stocks was like going to Las Vegas. (You can find out more about where to invest your money in Chapter 5.)

TIP

If you have children of your own, don't underestimate their potential or send them out into the world without the skills they need to be productive and happy adults. Buy them some good financial books when they head off to college or begin their first job.

Identifying hurdles to financial success

Perhaps you know that you should live within your means, buy and hold sound investments for the long term, and secure proper insurance coverage; however, you can't bring yourself to do these things. Everyone knows how difficult it is to break problematic habits that have been practiced for many years. The temptation to spend money lurks everywhere. Ads show attractive and popular people enjoying the fruits of their labor — a new car, an exotic vacation, and a lavish home.

Maybe you felt deprived by your tightwad parents as a youngster, or maybe you're bored with life and like the adventure of buying new things. If only you could hit it big on one or two investments, you think, you could get rich quick and do what you really want with your life. As for disasters and catastrophes, well, those things happen to other people, not to you. Besides, you'll probably have advance warning of pending problems, so you can prepare accordingly, right?

Your emotions and temptations can get the better of you. Certainly, part of successfully managing your finances involves coming to terms with your shortcomings and the consequences of your behaviors. If you don't, you may end up enslaved to an unsatisfactory job so that you can keep feeding your spending addiction. Or you may spend more time with your investments than you do with your family and friends. Or unexpected events may leave you reeling financially; disasters and catastrophes can happen to anyone at any time.

REMEMBER

Intelligent personal financial strategies have little to do with your gender, ethnicity, or marital status. All people need to manage their finances wisely. Some aspects of financial management become more or less important at different points in your life, but for the most part, the principles remain the same for everyone.

Understanding your personal and emotional hurdles

Avoid the psychological trap of blaming something else for your financial problems. For example, some people believe that adult problems can be traced back to childhood and how they were raised. Particular backgrounds certainly can have a negative impact on some people's tendency to make the wrong choices during their lives. Exploring your personal history can yield important clues to what makes you tick. But adults make choices and engage in behaviors that affect themselves as well as others. They shouldn't blame their parents for their own inability to plan for their financial future, live within their means, and make sound investments.

Some people also tend to blame their financial shortcomings on not earning more income. Such people believe that if only they earned more, their financial (and personal) problems would melt away. My experience working and speaking with people from diverse economic backgrounds has taught me that achieving financial success — and more importantly, personal happiness — has much less to do with how much income a person makes but rather much more to do with what they make of what they have. I know financially wealthy people who are emotionally poor even though they have all the material goods they want. Likewise, I know people who are quite happy, content, and emotionally wealthy even though they're struggling financially.

Americans — even those who have not had an "easy" life — ought to be able to come up with numerous things to be happy about and grateful for: a family who loves them; friends who laugh at their stupid jokes; the freedom to catch a movie, play some pickleball, or read a good book; or a great singing voice, a good sense of humor, or a full head of hair.

Developing good financial habits

To successfully implement an intelligent personal financial strategy, you have to practice good financial habits just as you practice other good habits, such as brushing your teeth or eating a healthy diet and getting some exercise.

Regardless of your income, you can make your dollars stretch further if you practice good financial habits and avoid mistakes, such as the common ones I discuss in Chapter 2. In fact, the lower your income, the more important it is that you make the most of your income and savings (because you don't have the luxury of falling back on your next big paycheck to bail you out).

TIP

Throughout this book, I highlight ways you can overcome temptations and keep control of your money rather than let your emotions and money rule you. As you read, make a short list of your financial marching orders and then start working away.

How to Avoid the "Oops, I Bought a Timeshare" Scenario

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

But reading and seeking advice to find out how to manage your money can be dangerous if you're a novice. Misinformation can come from popular and seemingly reliable information sources, as I explain in the following sections.

Assessing free financial content online

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

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

- **Advertising:** Any publication that accepts advertising has a potential conflict of interest because it may not want to publish articles that would upset its advertisers. Such a mindset, however, can stand in the way of telling consumers the unvarnished truth about various products and services. For example, credit card companies aren't very interested in advertising someplace that publishes articles highlighting the negatives of credit cards. (Check out the section "Considering the influence of advertising" later in this chapter for more on the power of advertising to influence the financial information you encounter online, on TV, and elsewhere.)
- **Advertorials:** Too many website owners are unwilling or unable to pay real writers for quality content and instead publish articles that are written and provided by advertisers. These pieces of "content" are known as *advertorials* and, in the worst cases, aren't even clearly labeled as advertisements, which is precisely what they are.
- **Affiliate relationships:** Many companies pay "referral fees" to websites that bring in new customers. Here's how that practice causes major conflicts of interest. On a financial website, you read a glowing review of a particular financial product or service. And the site provides a helpful link to the website of the provider of that product or service. Unbeknownst to you, when you click on that link and buy something, the seller kicks money back to the "affiliate" who reeled you in. At a minimum, such relationships should be clearly disclosed and detailed in any review.
- **Insufficient editorial oversight:** At most established, quality print publications, there are usually numerous editors who oversee the publication and all its articles.

This structure helps ensure the accuracy of what gets into print (although bias, such as political bias, isn't necessarily controlled). Unfortunately, the shoestring budget on which many websites operate precludes these quality-control checks and balances. Thus, sites operated by nonexperts proffering advice place you at great risk.

- **Lack of accountability:** In part because of a lack of editorial oversight, there's also often a lack of accountability for advice given online. This situation is especially problematic on the numerous sites that are run without disclosure of who is actually in charge of the site and/or who is writing the articles. Although such anonymity may be helpful to the site and its content providers, it's certainly not in your best interests because it prevents you from checking out the background, qualifications, and track record of the providers.

Protecting yourself from supposed financial gurus

While new mediums may come while others fade, the same types of dangers continue to trip up people with their money. In this section, I highlight what you can do to protect yourself from being led astray by supposed financial gurus and celebrities.

Checking professional work experience and education credentials

TIP

Before you take financial advice from anyone, examine their background, including professional work experience and education credentials. This is true whether you're getting advice from an advisor, writer, talk show host, or TV financial reporter.

If you can't easily find such information, that's usually a red flag. People with something to hide or a lack of something redeeming to say about themselves usually don't promote their background.

Of course, just because someone seems to have a relatively impressive-sounding background doesn't mean that they have your best interests in mind or have honestly presented their qualifications.

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

Resisting the attraction of celebrity endorsers

Celebrities were used big-time as endorsers in recent years in the problematic cryptocurrency space. You've perhaps heard of the now defunct and bankrupt offshore cryptocurrency exchange FTX, which spent hundreds of millions of dollars on advertising and paying celebrity endorsers like basketball stars Shaquille O'Neil and Stephen Curry, NFL quarterbacks Trevor Lawrence and Tom Brady, comedian Larry David, supermodel Gisele Bündchen, tennis great Naomi Osaka, baseball stars David "Big Papi" Ortiz and Shohei Ohtani, and Shark Tank's Kevin O'Leary.

In some of the advertisements for FTX, the well-paid celebrity endorsers joked about not knowing much about cryptocurrencies but then suggested that that was why they used FTX, implying that FTX was the expert. In other ads, some celebrities acted like they were calling friends to ask if they too were "in" to invest through FTX. Lawyers have filed a class action lawsuit against the celebrities for being bought off, failing to disclose large endorsement fees, and misleading the public to invest billions of dollars in FTX, which turned out to be a fraud.

Always remember that celebrities may have a talent that brings them notoriety, fame, and fortune, but they are no smarter than anyone else when it comes to their personal finances. Furthermore, and too often, they have enormous (and rarely well disclosed) conflicts of interest in what they tout.

Watching for outrageous performance claims

You can see a number of hucksters for what they are by using common sense in reviewing some of their outrageous claims.

Some sources of advice lure you in by promising outrageous returns. The stock market has generated average annual returns of about 9 percent over the long term. The perils of following an approach that advocates short-term trading (as an example) with the allure of high profits are numerous:

- You'll rack up enormous brokerage commissions.
- On occasions where your short-term trades produce a profit, you'll pay high ordinary income-tax rates rather than the far lower capital gains rate for investments held more than 12 months.
- You won't make big profits — quite the reverse. If you stick with this approach, you'll underperform the market averages.
- You'll make yourself a nervous wreck. This type of trading is gambling, not investing. Get sucked up in it, and you'll lose more than money — you may also lose the love and respect of your family and friends.

Considering the influence of advertising

WARNING

Thousands of publications and media outlets — websites, blogs, podcasts, radio, TV, magazines, and even some newspapers — dole out personal financial advice and perspectives. Although some of these "service providers" collect revenue from subscribers, virtually all are dependent — in some cases, fully dependent (especially the internet, radio, and TV) — on advertising dollars. Although advertising is a necessary part of capitalism, advertisers can taint and, in some cases, dictate the content of what you read, listen to, and view.

Be sure to consider how dependent a publication or media outlet is on advertising. I find that "free" publications, websites/blogs, podcasts, radio, and TV are the ones that most often create conflicts of interest by pandering to advertisers. (All derive all their revenue from advertising.)

Much of what's on the internet is advertiser-driven as well. Many of the investing sites on the internet offer advice about individual stocks. Interestingly, such sites derive much of their revenue from online brokerage firms seeking to recruit customers.

Keep in mind that you have virtually zero privacy on "free" websites because they make money by selling access to website visitors like you to companies and people with something to sell.

As you read various publications, watch TV, or listen to podcasts and radio, note how consumer-oriented these media are.