

Set Your Teenager Up For Success by Teaching Financial Literacy

TEEN GUIDE TO FINANCIAL LITERACY

SET YOUR TEEN UP FOR SUCCESS



ANAHEIM EDUCATION BULLETIN

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Introduction

There are only a few things that are guaranteed to make anyone's life harder. The most common include:

- ▶ Choosing the wrong spouse
- ▶ Not paying attention to your health as you age
- ▶ Financial challenges

The vast majority of financial challenges are avoidable. *But most teenagers lack the basic literacy to avoid the most common financial difficulties.* As a parent, teaching your child about money in general, budgeting, debt, credit, and investing can be some of the most important lessons you provide.

Imagine if you knew everything you know about money when you were 18 that you know now. How much different would your life be?

Financial literacy is the knowledge and skills needed to handle your personal financial resources effectively over your lifetime. It's also the ability to apply those

skills. You're not financially literate if you know the information but are unable to apply it consistently.

Odds are that your parents provided minimum guidance regarding financial issues. You can help your teen to avoid the financial challenges that you've faced.

*"Money is only a tool. It will take you wherever you wish,
but it will not replace you as the driver."*

- Ayn Rand

Working for Money

Perhaps you give your teenager an allowance or occasionally pay them for odd jobs around the house. If your child is able to work without compromising his schoolwork, consider encouraging him to get a part-time job.

All teens should be working during the summer if at all possible. *It's difficult to teach a teen the value of money unless they're working for it.* You'll notice their spending decisions change when they begin to realize that a particular purchase is equivalent to X-number of hours of work at a job they probably don't love.

Your teen will enjoy several benefits from working:

1. Their own money. Not that most teens have difficulty asking for money, but having a little money in one's pocket is an enjoyable feeling.
2. Experience in the real world. School is school. School is not an accurate representation of the real world. The strategies and tactics that work within education

don't always apply outside of that environment. The social structure alone is very different.

3. Discipline. Most jobs are less than thrilling. Discipline is required to show up to work on time and give a good effort.
4. Acquire new skills. Every job will require learning something new. Whether it's learning how to operate a cash register, take inventory, or manage children, there's no disadvantage to learning something new.
5. Make contacts. It's impossible to predict what others can do to help your teen. Your teen might be moving boxes around in a warehouse, but his boss's brother might be the dean of the local medical school. Your teenager's coworker might have contacts in Hollywood. People can be a huge resource.
6. Gaining an appreciation for taxes. Explain to your teen where all that tax money goes. It pays for the military, schools, roads, social security, Medicare, government workers, and a multitude of government programs. Explain all the terms that appear on a paystub.

It's important to be careful with regards to working during the school year. Many students can't deal with the stress of full-time school and a part-time job. Working during the summer may be more appropriate.

Many of the jobs in the summer are more interesting! During the school year, your child will most likely end up with a job in retail or food service.

There are a few more interesting options available in the summer:

- ▶ Lifeguard
- ▶ Landscaping
- ▶ Pet sitting
- ▶ Camp counselor
- ▶ Interning at a "real job"

Working for a living can consume most of adulthood, so avoid pushing your teen to work too much, too soon. However, those teens that never work can struggle when faced with their first employment experience. It's better to get it out of the way while

working at a local fast food restaurant rather than during their first real position as a college graduate.

Encourage your teen to earn their own money.

Summer jobs are a source of enjoyment and independence.

"My life changed the day I moved beyond just wishing for things and I started earning them. That is the day I learned that we don't get what we wish for, we get what we work for."

- Steve Maraboli

Budgeting

Regardless of your income, you need a budget. *Even billionaires need a budget.* Since teens have few, if any, financial obligations, they won't learn about budgeting on their own anytime soon. If you already have a budget, you can provide guidance to your child on the subject.

If you don't have a budget, you now have another reason to develop one!

Teach your teen budgeting skills:

1. Show your teen how much your family spends on the basics. Let them see how much it can cost to run a household. It isn't necessary to get into the nitty-gritty details, but show your teen what a reasonable budget looks like. Include items like:
 - ▶ Food
 - ▶ Clothing
 - ▶ Utilities
 - ▶ Retirement
 - ▶ Mortgage
 - ▶ Insurance
 - ▶ Taxes
2. Help your child to create their own budget. They won't have all the expenses that an adult has. However, they do have an income, at least in the summer. They will also be spending at least some of the money. *Creating a budget is a great experience that can be applied later in life.* Some sample items for your teenager's budget:

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- ▶ College savings
 - ▶ Entertainment
 - ▶ Gifts for friends and family
 - ▶ Gas for the car
 - ▶ Clothing above and beyond what you are willing to purchase for them. They can purchase those \$200 shoes for themselves.
 - ▶ Anything else that applies to your situation: cell phone bill or data overages, car insurance, make-up or hair products beyond the basics, and so on.
3. Check up on your teen to see how well they are sticking to their budget. Be flexible. The first iteration of a budget is rarely on target. *There's a little fine tuning that needs to be done with any budget. Ask your teen what changes need to be made.*
 4. Use online budgeting tools to teach your teen. They might enjoy using online resources more than listening to you. Or maybe not.
 5. Budgeting permits saving. That's one of the primary goals of budgeting: you have money left over at the

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end of the month to save and invest. *Teach your child to save a minimum of 10% from each paycheck. More is even better.*

A simple understanding of budgeting can be sufficient. Most households fail to create or stick to a budget. *Even the simplest of budgets can be highly useful.* Work with your child to create their own budget. Ensure that they're following it.

"If you don't have the money management skills yet, using a debit card will ensure you don't overspend and rack up debt on a credit card."

- T. Harv Eker

The Equivalence of Value and Money

What is the purpose of money? Why was it even invented?

Money provides convenience.

Back in the day, bartering was common. You would fix your neighbor's fence and he'd give you a few chickens. But what if you already had plenty of chickens? You'd rather have a goat, but your neighbor doesn't have one. How do you deal with a situation like this? Go find someone who needs chickens and has an extra goat? The solution is money.

Money is way of transferring value from one person or business to another.

Chickens don't last forever. You might have considered yourself wealthy with your 1,400 chickens, but what happens in a few years when they all die?

Money is also a way of transferring wealth through time. You can put your money in the bank, and it will be safe indefinitely.

Since money is a representation of value, the way to earn a lot of money is to provide a lot of value. That's one of the reasons a neurosurgeon earns more than a garbage man. You're willing to pay your neurosurgeon thousands of dollars an hour for their time. You're not willing to do the same for your trash collector. They aren't providing the same value.

Those that earn the most are most often those who provide the most value. *Becoming more valuable is the key to generating a greater income.* That value can either be in large chunks to a single customer, like a brain surgeon, or in smaller amounts to multiple people. A best-selling author is providing a relatively small amount of value to millions of people. Either way works!

A job can also pay well because few people are willing to do it. Working on a crab boat can pay hundreds of thousands of dollars per year. Many of the workers can't read or write, but they're willing to do a dangerous job that few others want.

Explain to your teen that their income is a representation of the value they are providing with their time. It's not a representation of their value as a human or a measure of their potential. *It's a measure*

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of how they are spending their time. It's a valuable lesson to learn.

"Money differs from an automobile or mistress in being equally important to those who have it and those who do not."

- John Kenneth Galbraith

Debt

Few adults under retirement age are debt-free. Many retirees are still saddled with a considerable amount of debt. The ability to avoid bad debt and eventually become free of all debt is a worthy financial goal.

The best way to ensure your child can become debt-free later in life is to teach them just how crippling debt can be.

Not all debt is bad. There is good debt and bad debt.

Examples of good debt include:

- ▶ Student loan
- ▶ Mortgage
- ▶ Real estate investment loan
- ▶ Business loan

It's questionable if a mortgage is actually a good debt. It could easily be argued that it is not, but you have to live somewhere.

Examples of bad debt include:

- ▶ Car loan, but again, a person requires transportation, and not all of us have access to public transportation. So a car loan might be good in your circumstances.
- ▶ Credit card
- ▶ Any loan to purchase anything that isn't expected to provide a positive financial return

Good debt creates income or a positive financial return down the road. Bad debt does not.

Most people would have to save an excessive period of time to purchase a home. But most other debt can be avoided with good planning and discipline.

See why most debt is bad for you:

1. Debt is very expensive. Even a mortgage at 4.0% is expensive. The total interest paid on a \$200,000 mortgage over 30 years is almost \$144,000! Credit card interest rates can be over 20%.

- ▶ It's not just the money that's paid to interest, but also the opportunity cost. Imagine how much that \$144,000 would be worth if it had been invested. During the early part of the loan payback period, the interest payments are over \$600 per month. Several years of investing \$600+ each month can add up, especially after 20+ years of investment returns.
 - ▶ Five years of investing \$600/month at 10.5% return is worth over \$650,000 after 30 years. In 40 years, it would be worth close to \$2 million.
 - ▶ *Debt is expensive and can debilitate your whole financial future.*
2. Every time you borrow money, you're stealing from your future. When you spend money you don't have, you're choosing how you're going to spend your future earnings. This is especially painful when the thing you purchased is no longer useful, but you're still paying for it.
- ▶ Explain this to your teen. Give them a hypothetical example. Borrowing money to pay for shoes that will be worn out in a year doesn't make a lot of sense.

3. Debt is a thief. It steals from your retirement. It steals from your vacation plans. It robs you of the ability to care for yourself and others. It's not easy to get your teen to care about retirement, but it's worth a good try.
4. Debt can damage your health. It's not hard to see that debt can affect your ability to sleep, blood pressure, digestion, and lead to many stress-related diseases.
5. Debt can prevent home-ownership. Too much debt can limit your ability to borrow additional money in the future. Ask your teen if they'd rather have expensive clothes or a home when they're 25.

You already know how damaging debt can be. If not through your personal experience, you've seen friends with debt issues and the damage it can cause. Get this through to your teen. Credit card companies love to offer cards to college students. Teach them to be very cautious.

"Nobody had a credit card when I was a kid. No one had credit card debt. But these big companies and banks wanted to know how to get more money out of people - get them charging things."

- *Michael Moore*

Credit Scores

Borrowing money is best avoided in most cases, but there are exceptions. When borrowing is necessary, your credit score is crucial. *The vast majority of lenders rely heavily on credit scores to make lending decisions.* It only makes good financial sense to ensure your teen maximizes their credit scores by the time they have their first real job.

Help your teen to earn a high credit score:

1. Help your child manage a credit card. You could also add them to one of your credit cards. This isn't intended to provide your child with a way to spend. The card is to be used wisely. Even the simple purchase of a tank of gas each month is enough to help your child's credit score, provided the bill is paid on time.
2. Help them get a car loan. With a large down payment, your teenager might be able to qualify for a loan on their own, assuming they have a job.

Ensure that the payments are made in a timely fashion.

3. Help them acquire a secured bank loan. A savings account with \$500 is enough to take out a small loan. The account is used as collateral. Again, be certain your teen is making the payments on time.
4. Teach your child the ingredients of a credit score. *The exact formula is a secret, but the critical basics are well-known:*
 - ▶ *Payment history is 35% of a credit score.* Paying bills on time is over a third of any credit score.
 - ▶ *Credit utilization accounts for 30%.* This is the percentage of available credit being used. If a credit card has a limit of \$4,000, and the balance is \$1,000, the utilization rate is 25%.
 - ▶ *Length of credit is 15% of a credit score.* This is one of the reasons it's important to get started early. The longer the credit history, the higher the score will be. Credit bureaus are more comfortable with someone that has a longer, positive history than with someone that just received their first credit card last month.

- ▶ *New credit counts for 10%*. Anytime a new source of credit is acquired, a credit score takes a small dip.
- ▶ *Credit mix is also 10%*. Help your teen to mix up their credit sources. A car loan, credit card, and bank loan is a nice mix. It would be advantageous for your teen to have at least three credit sources by the time they graduate from college.

Credit scores are important. *A high credit score not only helps your child to borrow money when they need it later in life, it also makes borrowing money much less expensive.* Qualifying for the best interest rates requires a much higher credit score than in the past.

As soon as your child is able to deal with the responsibility, begin helping them to build a great credit score.

"Financial literacy is an issue that should command our attention because many Americans are not adequately organizing finances for their education, healthcare and retirement."

- Ron Lewis

Investing

It's not enough to save money. *Money has to be invested wisely if it's going to be maximized.* A wise investment at 22-years of age isn't necessarily a wise investment at 62-years of age. It's important to choose the right investment for the situation. The basics are the best place to start.

Begin to teach your child about investing:

1. Teach your teen about the various types of investments. You can leave the more complicated investments alone, but cover the basics:
 - ▶ Stocks
 - ▶ Bonds
 - ▶ Mutual funds
 - ▶ CDs
 - ▶ ETFs

2. Time horizon. The proper investments will depend on the expected future. For example, stocks make more sense over the long-term than bonds. Bonds are a better short-term option. Retirees are often more interested in the income that bonds provide.
 - ▶ *Teach your child when the various investment opportunities make the most sense.*
3. Diversification. Putting all of your money in a single investment is risky. Teach your teen to spread their investments around within reason. Diversification limits risk. It also limits returns. With enough diversification, a portfolio exactly matches the overall market. That's still better than most professionals can do.
4. Investing consistently is critical. *Regardless of how much your brilliant teen earns one day, it's important to save and invest regularly.* Even those with the high incomes can have financial difficulties. It's almost always the result of too much spending and not enough saving.
 - ▶ A small, monthly investment can result in a large nest-egg at retirement.

5. Time is critical. Most young adults avoid saving and investing. They believe that there will be time in the future. But it actually becomes harder to save. Marriage, children, a mortgage, and multiple car payments make saving more challenging, not less.
 - ▶ The value of investments grows, on the average, about 10% each year. That means they double every seven years. *Waiting seven years to get started cuts your investment portfolio by 50%. Waiting 14 years cuts it by 75%.*
 - ▶ Teach your teen that it's never too soon to begin saving money for the future! Use a savings calculator to demonstrate how much money he can have in the future by saving a little right now.

It's not necessary to teach your child about options, derivatives, or currency trading. *The simple information is the information that matters the most.* Teach your child the basics. They can fill in the details on their own if the need ever arises.

You don't need to be an investment expert to teach your child about investing. Consistently saving money

and investing in an index fund is 90% of the battle, and most people fail to do even that.

"When I was a kid, there were no credit cards. Instead, retailers offered layaway plans. My mom would go to a store, such as a furniture outlet, choose the sofa she wanted, and put it on layaway. That meant she put a little money down to hold the sofa, and every payday she'd pay a little toward the purchase."

- Robert Kiyosaki

Conclusion

Give your child the basic financial knowledge they need to avoid the most common financial mistakes.

Good financial literacy can be summed up in a few important points:

- ▶ Create a budget and spend less money than you make.
- ▶ Save the excess and invest it wisely.
- ▶ Avoid buying things you don't need.
- ▶ Avoid unnecessary debt.
- ▶ Assume you're going to live forever, but that you won't earn an income forever.
- ▶ Build a high credit score and protect it.

While determining what you'd like to teach your child about personal finances, consider your own experiences. What caused your own financial

struggles? What do you wish you had known that would have prevented your challenges?

Use your own experiences to guide your teaching decisions.

Make a list of your biggest financial mistakes. Then make a list of preventative solutions for each one. Include these lessons while teaching your child the financial skills that will benefit them for the rest of their life.