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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.

Do you get the feeling that they're looking out for your interests? For example, if lots of auto manufacturers advertise, does the media outlet ever tell you how to save money when shopping for a car or the importance of buying a car within your means? Or are they primarily creating an advertiser-friendly broadcast or publication?

Preventing Common Money Mistakes

Financial problems, like many medical problems, are best detected early. And as with your personal health, the best “problems” are those avoided — clean living is a good thing, right? Here are the common personal financial problems I've seen in my work as a financial counselor:

- » **Not planning:** Most of us procrastinate. That's why we have deadlines (like April 15) — and deadline extensions (need another six months to get that tax return done?). Unfortunately, you may have no explicit deadlines with your personal finances. You can allow your credit card debt to accumulate, or you can leave your savings sitting in lousy investments for years. You can pay higher taxes, leave gaps in your retirement and insurance coverage, and overpay for financial products. Of course, planning your finances isn't as much fun as planning a vacation, but doing the former can help you take more of the latter. See Chapter 7 for details on setting financial goals.
- » **Overspending:** Simple arithmetic helps you determine that savings is the difference between what you earn and what you spend (assuming that you're not spending more than you're earning!). To increase your savings, you either have to work more, increase your earning power through education or job advancement, get to know a wealthy family who wants to leave its fortune to you, or spend less. For most people, especially over the short term, the thrifty approach is the key to building savings and wealth.
- » **Buying with consumer credit:** Carrying a debt balance from month to month on your credit card or buying a car on credit means that even more of your future earnings are going to be earmarked for debt repayment. Buying on credit, including the recent trend of “Buy Now, Pay Later,”

encourages you to spend more than you can really afford. Chapter 4 discusses debt and credit problems.

» **Delaying saving for financial independence/retirement:**

Most folks say that they want to achieve financial independence/retire by their mid-60s or sooner. But to accomplish this goal, they need to save a reasonable chunk (around 10 percent) of their incomes starting sooner rather than later. The longer you wait to start saving for retirement, the harder reaching your goal will be. And you'll pay much more in taxes to boot if you don't take advantage of the tax benefits of investing through particular retirement savings accounts. For information on planning for retirement, see Chapter 7.

» **Falling prey to financial sales pitches:** Steer clear of people who pressure you to make decisions, promise you high investment returns, and lack the proper training and experience to help you. Supposed great deals that can't wait for a little reflection or a second opinion are often disasters waiting to happen. A sucker may be born every minute, but a slick salesperson is pitching something every second! For important investment concepts and which kinds of investments to avoid, turn to Chapter 5.

» **Not doing your homework:** To get the best deal, shop around, read reviews, and get advice from objective third parties. You also need to check references and track records so that you don't hire incompetent, self-serving, or fraudulent financial advisors. (For more on hiring financial planners, see Chapter 10.)

» **Making decisions based on emotion:** You're most vulnerable to making the wrong moves financially after a major life change (a job loss, divorce, or death in the family, for example) or when you feel pressure. Maybe your investments plunged in value. Or perhaps a recent divorce has you fearing that you won't be able to afford to retire when you planned, so you pour thousands of dollars into some newfangled financial product. Take your time and keep your emotions out of decisions.

» **Not separating the wheat from the chaff:** In any field in which you're not an expert, you are at risk of following the advice of someone you think is an expert but really isn't. This book shows you how to separate the financial fluff from the

financial facts. You are the person who is best able to manage your personal finances. Educate and trust yourself!

- » **Exposing yourself to catastrophic risk:** You're vulnerable if you and your family don't have insurance to pay for financially devastating losses. In the worst cases, folks without a savings reserve and a support network can end up homeless. Many people lack sufficient insurance coverage to replace their income. Don't wait for a tragedy to strike to find out whether you have the right insurance coverage. Check out Chapter 8 for more on insurance.
- » **Focusing too much on money:** Placing too much emphasis on making and saving money can warp your perspective on what's important in life. Money is not the first — or even second — priority in happy people's lives. Your health, relationships with family and friends, career satisfaction, and fulfilling interests are more significant. That's not to say that it's okay to ignore or give insufficient attention to your personal finances and associated decisions.



REMEMBER

Money problems can be fixed over time with changes in your behavior. This book helps you gain the financial literacy you need to build habits to address any money problems you have and avoid developing money problems in the future.