# A Father's Financial Advice to His Daughters (and anyone else who cares to listen)

## Some general principles

There are two kinds of people: those who pay interest and those who earn interest. Every interest payment made by someone is going to someone else who is earning the interest. Which camp do you want to be in?

The harder a salesperson pushes you to buy something the greater must be the benefit to them. (Think life insurance salesmen and car salesmen.) Generally, what is good for them is not necessarily good for you.

## Credit Cards

There is no question that credit cards add greatly to our financial convenience. They are also an insidious threat to many peoples' financial security. Cards make it easy to make purchases that you don't have the resources to support. No surprise—that is exactly what they are designed to do. Once you fail to pay off the card at the end of a month, and instead make only the minimum payment, they have you hooked. You are paying their high rate of interest and, if purchases accumulate, the chances diminish that you will pay off the balance in following months. People who make only the minimum payment wind up paying as much, or more, interest as their original purchase, i.e., they pay double for their purchase. If you only make the minimum payment you will pay for years–long after the items purchased have faded from memory.

So, make the card work for you; don't you work for the bank. Use it to buy only what you can afford and pay off the balance in full each month.

## Buying a home/apartment

Buy a house as soon as you know you will be in one place for awhile. The (old) rule of thumb is you need to be in one place for three years to recoup the closing costs and come out ahead.

Why buy?

➔ Because real property generally appreciates in value over time and once the property is in your name the appreciation belongs to you, even though most of the purchase price may have been borrowed. In other words you are using the bank's money to enrich yourself. This is referred to as leverage.

➔ Because the government subsidizes home ownership by making home mortgage interest and property taxes tax-deductible. The subsidy is there; one is foolish not to take advantage of it. There is also a tax advantage when you sell.

➔ Because when you pay rent you are buying the building for someone else as opposed to buying it for yourself.

You may hear it said that renters do not pay property taxes, hazard insurance, maintenance, etc. Nonsense. Renters pay all of these, only indirectly through their rent.

In the item on credit cards above, I protested against paying interest. Home mortgage interest is the one exception. There are several reasons. One is that you have to live somewhere, so you will either be paying rent or paying interest. But the rent is not buying you anything except shelter for a month whereas paying interest (i.e., buying) allows you to take advantage of the appreciation. Real estate is about the only thing you can think of that does this–appreciates over time.

Should you make extra payments on the principal to pay off the mortgage sooner? You will find varying opinions on this topic among the personal finance gurus. I think it is best explained by this example. Suppose it is nearing the end of the month and you sit down to write your mortgage check. You notice that you have, say, $200 "extra" that you could send in as an additional payment to principal. Should you do it?

The answer depends on what you will do with that $200 if you didn't send it in as extra principal. If you would instead send it off to your mutual fund company to add to a good growth stock fund, then that would be the better choice. Interest rates on mortgage loans are relatively low and coupled with that is the tax deductibility of the interest, so you can earn a higher return investing the money somewhere else than you save by paying down the mortgage. This option also gives you more flexibility in that the money is available to you. Once you send it to the mortgage company it is tied up–the only way to get it back is to refinance (borrow it back).
If, on the other hand, you are going to look at that $200 as a windfall and blow it on something you would not ordinarily buy, then it would be better to store it in the equity in your real estate.

Exception: Some people have a strong psychological aversion to not owning the roof over their head (people who lived through the Great Depression are an example). For these folks, the benefit of seeing the principal balance on their mortgage decline may outweigh the purely financial considerations.

401(k), 403(b), or similar plan

Here is another situation where the government grants you a tax break; it allows you to defer taxes on these accounts until you are of retirement age. Because you invest with pre-tax dollars and the annual interest also is tax deferred, you will have considerably more, even after taxes are finally paid, than if you invest after-tax dollars.
Strive to contribute the maximum allowable amount to your 401(k) plan. Once invested NEVER touch this money. There is a substantial penalty for early withdrawal (before 59½) but even more important is that your retirement fund should be sacrosanct.
Some employers will match your contributions to this type of plan up to some limit. This is FREE MONEY. You are foolish not to take it.

Car purchase

This is a no-brainer. New cars depreciate faster than almost anything you can think of: twenty percent per year is the rule of thumb. Since the car has not lost twenty percent of

its serviceability in that year what has been lost is luster and the new car smell, neither of which affect its serviceability.
➜ The most economical way to buy a car is to buy one that is several (~3) years old, has reasonable mileage, and is in good mechanical condition. The original purchaser will have taken the hit of the depreciation of the early years. Have a trusted shop go over it or use the lot's warranty. Then drive it until "the wheels fall off."
Exception: If you must buy new, be conscientious about periodic maintenance, and drive it until "the wheels fall off."
➜ What does "the wheels fall off" mean? It means to realize that a car 5-6 years old and with 70K or 80K miles on it has a LOT of life left. It is to the point now that you own it outright (if it was financed) and the miles it is giving you are relatively cheap. Yes, there will be some repairs. But nothing compared to starting the process over. Even the insurance will be cheaper at this point. Wring all the value out of it before you start the process over.
➜ Conversely, the worst deal on a car is to buy it new and then "trade up" every 3-4 years. Each time you switch you suffer the extreme depreciation of the early years. People who do this often roll the remaining balance on their loan over into the next loan. The loans get bigger and the payments go on forever.

➜ To buy or to lease? "Lease" means "rent." When you lease you are essentially renting the car for a two- or three-year period. At the end of this period you will own nothing. You will also have paid other fees: start-up, extra mileage, damage, etc. If you spring for any options you may have bought them (not rented, bought) but they will go away along with the car.
Ask yourself: Why is there so much advertising going on for leased cars? Why are the car companies trying so hard? There must be huge profits in it for them. Huge profits for them do not translate into a good deal for you.

## Life insurance

### Is it needed?

When I think of the origins of life insurance I think of the Norman Rockwell post-war family: a husband, the sole wage-earner; a wife, with limited employment skills; and young children. Perhaps they are in a starter home and struggling to make ends meet. If the husband is killed in a factory accident, life insurance provides funds for several years until the family regains equilibrium.
As children become independent (or there are no children) the need for life insurance decreases. If both spouses have employment skills, the need for life insurance decreases. If there is family back-up/support there is less need for life insurance.
So, ideally, as a couple ages, pays off their home, and builds up assets, they can phase out most life insurance.

### What type? Term vs Whole-life?

All the financial writers agree: Buy term, not whole life. Term is pure life insurance, nothing else; whole-life is life insurance with an investment/savings component;. There is nothing to be gained by mixing saving/investing with life insurance, by trying to use one vehicle to accomplish two purposes. As the pundit says "You don't go to the bank to

buy a toaster, why would you go to a life insurance salesman to make an investment?" Why do you suppose life insurance salespersons try so hard to sell whole-life policies? Because it is profitable to them. And what is profitable to them is not the best deal for you.

Exception: Whole life insurance policies can have a place in estate planning strategies, since the proceeds pass outside of probate. That is another issue.

Your checking account

Sign up for overdraft protection. Overdraft protection is a line of credit that kicks in if you inadvertently overdraw your account. It sits there and costs nothing if it is not used. If you overdraw your account this feature covers the overdraft with a loan thereby saving you $35 or more for a bounced check. Straighten out the account as soon as possible, i.e., pay off the overdraft and return to a zero balance on your overdraft protection account. Do not let this loan build up–that is what the bank is hoping will happen. Beware of "Courtesy Overdraft Protection" which is a quite different thing.

Service contracts/extended warranties

Just say no. New appliances (washer, dryer, stove, fridge, etc.) come with a one (or more) year warranty. The appliance industry has a "Rule of 90" which is that if an appliance goes 90 days without needing repair it will likely go on for years without needing repair. The zeal with which an appliance salesperson will try to talk you into an extended warranty is evidence of what a money maker this is for them. A money maker for them translates into a money loser for you.

Statistics tell us that less than 20% of monies paid for service contracts is paid out in claims. Most (about 50%) is paid in commission to the store selling the contract. (Why does the word 'kickback' come to mind?)

Exception: if you live in a single family home in a part of the country that has cold winters and you have oil heat, a service contract on the furnace may be justified.