Women's Guide to Financial Literacy

Meritus Media January 19, 2018

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(Newswire.net -- January 19, 2018) Syosset, New York --

There has been a lot of discussion about women's rights in the past year. One issue that hasn't received much attention is financial literacy and a woman's ability to make her own financial decisions. While the other issues are important, this one could be the most important of all. The ability to make wise financial decisions affects everything else you do for the duration of your lifetime.

Almost half (46.8%) of the U.S. labor force is women. Fewer companies offer a guaranteed pension and even Social Security may not be as secure as we once believed it to be. And, as a woman, you're likely to be single at one time or another due to divorce or the death of a spouse. So understanding financial basics and learning to manage your finances is essential. To do this you need to be financially literate.

What exactly is Financial Literacy?

The FINRA Investor Education Foundation's annual *National Financial Capability St*udy tests financial literacy based on three concepts that are fundamental to how you manage resources and make financial decisions.

1. Interest rate calculations
2. How Inflation works
3. Risk diversification

Financial Literacy and Women

Several studies show that when asked just three questions that measure knowledge of basic financial concepts, women are less likely than men to answer correctly and more likely to indicate that they don't know the answer. In the U.S. the overall financial literacy rate is generally low, but women are lagging behind the men.

The Financial Literacy Test

Here are the questions:

Question 1

Suppose you had $100 in a savings account and the interest rate was 2% per year. After five years, how much do you think you would have in the account if you left the money to grow? (A) More than $102. (B) Exactly $102. (C) Less than $102.

Question 2

A 15-year mortgage typically requires higher monthly payments than a 30-year mortgage but the total interest over the life of the loan will be less.

(A) True

(B) False

Question 3

Imagine that the interest rate on your savings account was 1% per year and inflation was 2% per year. After one year, how much would you be able to buy with the money in this account?

(A) More than today.

(B) Exactly the same.

(C) Less than today.

Question 4

Buying a single company's stock usually provides a safer return than a stock mutual fund.

(A) True

(B) False

Question 5.

If interest rates rise, what will typically happen to the bond price

(A) Rise

(B) Fall

(C) Stay the same

(D) There no relationship

How did you do? (See the answers at the end of this Guide.)

Increase your Financial IQ

Interest Rates:

Interest rates affect the decisions you make about car loans, mortgages, credit cards, savings and investments. It's usually expressed as APR – Annual Percentage Rate. So when you see that on a loan or savings promotion it means that is the rate you pay or earn every year.

In the first question, you put $100 in a savings account and earn 2 percent interest per year. 2 percent of $100 is $2. So now you have $102. If you leave that money in the savings account the next year you also earn 2 percent, but now it's on $102, not $100.

This is the concept of compound interest - you earn interest on interest. So at the end of the second year you have $104.04. The third year you have $106.12. Each year it grows a little bit more.

This also applies to loans, credit cards and mortgages. Let's say you borrow $1000 on a credit card with an 18% APR. If you don't pay off any of the debt, at the end of one year you'd owe $1180. And since credit card companies calculate their interest every month, when you pay only the minimum amount due each month you get charged interest upon interest.

It's compound interest at work again, but this time it's not working in your favor. Ifyou were to pay only the minimum amount due each month it would take you 151 months (more than 12 years) to pay off this debt and you'd pay $1,396 in interest. (7)

Look at the "Minimum Payment Warning" on your credit card bill advises NerdWallet. Your statement has a table that shows how much money and how many years you'll need to pay off your balance if you pay only the minimum each month. (8)

Interest and Bonds

A fundamental principle of bond investing is that market interest rates and bond prices generally move in opposite directions. When market interest rates rise, prices of fixed-rate bonds fall. This is known as "interest rate risk." (Securities & Exchange Commission)

Why is that? When companies or other entities such as municipalities need to raise money to finance new projects, maintain ongoing operations, or refinance existing debts, they may issue bonds directly to investors instead of obtaining loans from a bank. The bond is an investment where the investor loans money to that entity (typically corporate or governmental) for a defined period of time at either a fixed or variable interest rate.

A fixed-rate bond pays the same interest percentage throughout the life of the bond. So when interest rates rise or fall it affects the value of the bond. For example, if a bond for $1000 is issued when prevailing interest rates are 5% it will generate $50 per year to the bondholder. If interest rates drop to 4% the bondholder is getting a better return on investment. But should the rate go to 6 or 7% the bondholder will still get only 5%, because it's a fixed-rate bond. If they put the money in other investments the interest return would be higher, so the value of the bond declines.(9)

How inflation works

Inflation is defined as a sustained increase in the general level of prices for goods and services. It is measured as an annual percentage increase. As inflation rises, every dollar you own buys a smaller percentage of a good or service. The value of a dollar does not stay constant when there is inflation. (10)

The CPI, or Consumer Price Index , is the most popular inflation index in the United States. It takes the prices for certain goods and services and compares them to the same things on a baseline year. Then it calculates the inflation rate year over year. These are the items considered for the CPI. (11)

- Food and Beverages: Milk, coffee, wine, snacks, chicken, breakfast cereal, etc.
- Housing: Rent, heating oil, bedroom furniture
- Apparel: Shirts, sweaters, jewelry
- Transportation: New vehicles, airline fares, car insurance, gasoline
- Medical Care: Prescription drugs, medical supplies, doctor visits, eyeglasses, hospital bills
- Recreation and Entertainment: Televisions, toys, pet products, sports equipment, admissions
- Education and Communication: College tuition, postage, telephone service, computer software
- Other Goods and Services: Tobacco, haircuts, funeral expenses,

What does that mean for your wallet? If the cost of those goods was $1000 in 2015 and it now costs $1010 the inflation rate is 1%. So your dollar buys 1% less than it did two years ago.

The inflation rate for 2017 was 2.1%.

Diversification of Risk

There's an old saying about risk and diversification: "Don't put all your eggs in one basket." It means that you shouldn't concentrate all efforts and resources in one area, as you could lose everything.

Financial risk is defined as the chance that an investment's actual return will be different than expected. This includes the possibility of losing some or all of the original investment.

Diversification is a way to manage investment risk. It aims to spread your money across a wide variety of investments. The idea behind this is that this will, on average, yield higher returns and pose a lower risk than any individual investment found within the portfolio.(14)

Test Answers:

1. A
2. A True
3. C
4. B False
5. B

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