

# Savings will put you in the driver's seat.

**Simply put, saving is not spending.** Saving is the act of putting aside some of today's income for tomorrow's needs and goals: the down payment on a car, for example. Your ability to save will put you in the driver's seat, both literally and figuratively.

If you want the freedom to choose a lifestyle that comes from having money in the bank; read on. This chapter tells you how to save the down payment you'll need to buy a car, how you benefit from interest compounding, and how to choose the right savings account for your needs.

## How to Save

People save money for three reasons; they save for emergencies, for irregular or seasonal expenses, and for their

goals, including a financially secure future. While there are only three reasons to save, there are countless strategies for saving. Here are eight of them.

1. **Focus on reaching a goal.** Motivate yourself by keeping your reasons for saving always in the front of your mind. It helps to keep your goal literally in sight. For example, if you are saving to buy a computer system, cut out a picture of the computer and post it on the refrigerator or someplace where it will remind you to save every day.

2. **Use the "Pizza Principle."** In Chapter One, we used the pizza example to make the point that goals are accomplished by breaking them down into "bite-size" tasks which can be completed in sequence, starting now. When you apply this principle to your savings program, it means that the easiest way to save a large amount of money is to deposit small sums regularly into a savings account where it will grow. Here's how it works:

Suppose that computer system you want to buy costs \$1,500. Instead of aiming for the whole sum, which may seem huge and out of reach, break the total into 15 parts of \$100 each. Then challenge yourself to save \$100 every month. It is much easier to reach 15 small goals than to reach one big goal.

3. **Motivate yourself.** Use the technique professional fund-raisers use often. Make a "thermometer" chart like the one shown and

put it in a prominent place. When you save some money towards your goal, color in a proportionate segment on the thermometer and watch your money grow.

4. **Pay yourself first.** If YOU owed money to a friend, you would pay up, right? Just so, you owe it to yourself to save a portion of every dollar you receive. Aim to set aside 10% of your income before you spend money on anything else. Ten percent may sound like a hefty amount, but consider that the average Japanese citizen reportedly saves 153% of his or her disposable income and the average German saves 12.2%.

The painless way to do this is with an "automatic" savings program. New technology enables your financial service provider to electronically move a pre-authorized amount of money from checking into savings on a specific day each month.

5. **Comparison shop before you buy.** Compare prices on the same item of similar quality by different manufacturers to make sure you are getting the best deal.

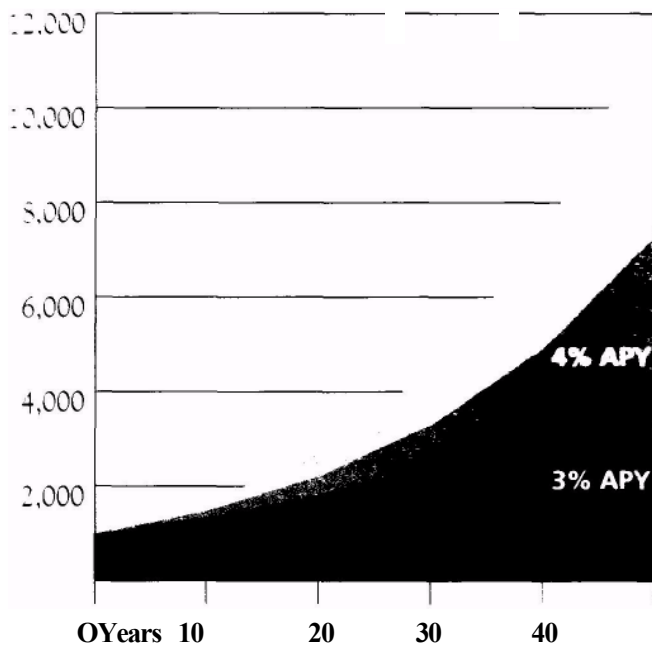
6. **Examine your spending habits.** How many of your purchases are made on impulse? How is your spending influenced by advertising? By your emotions? By your values? Explore these and other questions by keeping a money diary. Record every expenditure and note whether it was planned or unplanned. Examine your unplanned expenses carefully to discover what prompted them.

7. **Begin today and save regularly.** A proverb says, "The journey of a thousand miles begins with a single step." The sooner you start, the sooner you will get there. The same can be applied to savings: The down payment for your new car begins with the first deposit. How regularly you make deposits will affect how quickly you reach your goals.

8. Deposit your savings in a savings account at your financial institution. **Here's how you benefit.**

- **Your money is safe. The financial institution physically protects your money from fire, theft and the possibility that you will misplace it – or spend it.**
- **Your money earns interest. See the section on interest compounding below to see how you benefit.**
- **Your money is insured when the financial institution is a member of the Federal Deposit Insurance Corporation (FDIC). FDIC insurance means that, even if financial institutions fail and the nation experiences another great economic depression like the one in the 1930s, you will not lose any money in your account, up to the \$200,000 limit.**

50 Year Return on a \$1,000 Lump-Sum Investment at Different Interest Rates (Compounded Quarterly)



### Put Your Money to Work for You

The best reason for opening a savings account is that the financial institution pays you interest to keep your money on deposit. Here's why.

Your financial institution is a business just like any other business. Just as a shoe store buys shoes from the manufacturer at one price and sells them at a higher price in order to make a profit, the institution "buys" the use of your money by paying you interest on the funds in your savings account. Then it "sells" or lends the use of your money to a borrower for a higher amount of interest.

You can put your money to work for you by having it earn interest. The amount of interest you are paid is figured

Here is how to figure the future value in ten years of \$1,000 deposited in a certificate of deposit paying 5% interest compounded annually.

<b>Year One:</b>
<b>Initial balance</b> \$1,000 + (\$1,000 x .05) = <b>\$1,050</b>
<b>Year Two:</b>
<b>Beginning balance</b> \$1,050 + (\$1,050 x .05) = <b>\$1,102.50</b>
<b>Year Three:</b>
<b>Beginning balance</b> \$1,102.50 + (\$1,102.50 x .05) = <b>\$1,157.63</b>
<b>Year Ten:</b>
<b>Beginning balance</b> \$1,551.33 + (\$1,551.33 x .05) = <b>\$1,628.90</b>

by multiplying a number (called the **interest rate**) by the amount of money in your account. You earn **compound interest** when the interest you earn also earns interest.

$$\text{Compound Interest} = P(1+r)^n - P$$

**P = Principal**

**r = Annual interest rate divided by number of compounding periods per year n = Total number of interest-compounding periods**

Interest compounding makes your savings grow much faster. Compounding can take place at different periods of time: once a day, once a month, once a quarter or once a year as in the example. The more often interest is compounded, the faster your money grows.

### The Rule of 72

Interest Percentage	Years for principal to double
2	36.00
3	24.00
4	18.00
5	14.40
6	12.00
7	10.29
8	9.00

The *Rule of 72* is a quick way to estimate the amount of time it will take for your money to double when placed in a savings account at a given interest percentage. To calculate that length of time in years, divide the interest percentage into the number 72.

## How to Choose the Right Savings Account for You

Your job of choosing the right account is made easier by the **Truth in Savings Act**, a law that requires financial institutions to present the interest rate on a savings account in terms of its **annual percentage yield (APY)**. The APY is the yearly rate of return you will get on your interest-paying account. Truth in Savings makes it easy for you to compare the interest you will earn from different savings account offers from various institutions.

There are several different types of savings accounts, so you will have to choose the one best suited to your needs. Your choice will depend on which of two advantages you want most.

- **The growth of your savings.** Do you want to earn the highest APY?

- **The "liquidity" of your savings.** Do you want to be able to take your money out whenever you want to without penalty? (**Liquidity** refers to how quickly and conveniently you can retrieve your money from an investment, and at what cost, if any.)

Unfortunately, you cannot maximize both of these advantages at once. The longer you promise to leave your money in a savings account without touching it, the more the institution pays you in the form of a higher interest rate.

The opposite is also true. The more liquid (or available) your funds are, the less the institution pays. You'll receive a lower interest rate. (**It is important to note that you can *always* take your money out of any savings account at any time. If you take your money out sooner than you promised to, however; you will lose some of the interest earned and may have to pay a penalty.**)

The best strategy **when choosing** an account is to ask your customer service **representative** for help. Explain your savings goals and ask for **advice**. Their representative is trained to help you analyze the **trade-offs** and will recommend the account that suits your **situation**. **Here** are your basic choices.

- **Statement savings** offers you liquidity in exchange for a lower interest rate. This **means** you can deposit or withdraw money whenever **you wish** without penalty. The account is so **named because your transactions are reported on a periodic statement**.

- **A certificate of deposit (CD)** offers a higher interest rate in exchange for less liquidity. A CD is a

contract with the financial institution whereby you agree to keep a certain amount of money on deposit for an agreed upon length of time. You will pay a penalty if you take your money out before the agreed date.

- **Money market savings** offers you both higher interest and liquidity in exchange for maintaining a high minimum balance (typically \$1,000 to \$2,500). When the balance is maintained, the financial institution pays what it calls the money market interest rate.