

# Personal Finance

*Turning Money into Wealth*

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ARTHUR J. KEOWN



# PERSONAL FINANCE

*Turning Money  
into Wealth*

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*Virginia Polytechnic Institute and State University  
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Prentice Hall

*Upper Saddle River, New Jersey 07458*

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 A Simon & Schuster Company  
 Upper Saddle River, New Jersey 07458

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#### Library of Congress Cataloging-in-Publication Data

Keown, Arthur J.

Personal Finance: Turning Money into Wealth/Arthur J. Keown.

p. cm.

Includes index.

ISBN 0-13-616442-0

1. Finance. Personal. 2. Investments. I. Title.

HG179.K47 1998

332.024—dc21

97-40198

CIP

Prentice-Hall International (UK) Limited, London  
 Prentice-Hall of Australia Pty. Limited, Sydney  
 Prentice-Hall Canada, Inc., Toronto  
 Prentice-Hall Hispanoamericana, S.A., Mexico  
 Prentice-Hall of India Private Limited, New Delhi  
 Prentice-Hall of Japan, Inc., Tokyo  
 Simon & Schuster Asia Pte. Ltd., Singapore  
 Editora Prentice-Hall do Brasil, Ltda., Rio de Janeiro

Printed in the United States of America

10 9 8 7 6 5 4 3 2

# **PERSONAL FINANCE**

*Turning Money  
into Wealth*

*To Barb, my partner and my love—  
for showing me happiness that money can't buy.*



# About the **AUTHOR**

Arthur J. Keown is the R. B. Pamplin Professor of Finance at Virginia Polytechnic Institute and State University. He received his bachelor's degree from Ohio Wesleyan University, his M.B.A. from the University of Michigan, and his doctorate from Indiana University. An award-winning teacher, he is a member of the Academy of Teaching Excellence at Virginia Tech, has received five Certificates of Teaching Excellence, the W. E. Wine Award for Teaching Excellence, and the Alumni Teaching Excellence Award. Professor Keown is widely published in academic journals. His work has appeared in *The Journal of Finance*, the *Journal of Financial Economics*, the *Journal of Financial and Quantitative Analysis*, *The Journal of Financial Research*, the *Journal of Banking and Finance*, *Financial Management*, the *Journal of Portfolio Management*, and many others. Two of his books are widely used in college finance classes all over the country—*Basic Financial Management* and *Foundations of Finance: The Logic and Practice of Financial Management*. Professor Keown is a Fellow of the Decision Sciences Institute and former head of the finance department. In addition, he was recently appointed co-editor of the Financial Management Association's Survey and Synthesis Series. He is also the co-editor of *The Journal of Financial Research*. He lives with his wife and two children in Blacksburg, Virginia, where he collects original art from *Mad Magazine*.

# PREFACE

*Personal Finance: Turning Money into Wealth* introduces the student to the concepts, tools, and applications of personal finance and investments. It's written as an introduction, assuming little or no prior knowledge of the subject matter, thereby allowing the student to take the first steps toward understanding the process of financial planning and the logic that drives it. In so doing, this text will provide coverage of the planning process itself, as well as insurance, investments, and estate planning.

For many students this course is their initial and only exposure to personal finance, and as such, the material must be presented in a way that leaves a lasting understanding. Tools, techniques, and equations are easily forgotten, but the logic and underlying fundamentals that drive their use, if stressed and presented in an intuitive way, will stay. Moreover, once the student understands the underlying principles, learning the techniques and tools is much easier. In effect, if the student knows *why* something is being done, it makes much more sense. For this reason the text centers around 15 fundamental axioms of personal finance that are introduced in an intuitive manner in chapter 1 and then reappear in every chapter. By first presenting the student with the principles that drive the techniques, the student is afforded the opportunity to see the “big picture,” or distinguish the “forest from the trees,” as you will. As we all know, after an introductory course is over, there's a rush to forget. Unfortunately, this is many times the case with personal finance—“I don't have any money now, so this isn't important.” However, although it's relatively easy to forget tools and techniques, it's much more difficult to forget underlying principles. Once the principles are known, they become a part of the student's “financial personality” and are applied unknowingly. The end result is that in the future, when the student is far removed from this course, an understanding of these fundamental principles of personal finance will allow the student to effectively deal with the ever-changing financial world.

Tying the topics of personal finance together through the use of basic principles or axioms is a radical change from the presentation provided in alternative personal finance texts. The present generation of these texts tend to be descriptive in nature, emphasizing listings and procedures. The chapters appear to be unrelated to each other—bound together only by the book's binding. The purpose of this text is to educate the student in the discipline of personal finance. It is only through an understanding of the principles that students can adapt to the changing world that they'll face.

## FEATURES

**Axioms.** Fifteen axioms are introduced in an intuitive manner in chapter 1 and appear throughout the text, tying the topics together.



**In the News.** Boxes with excerpts from such periodicals as *Smart Money*, *Money*, *The Wall Street Journal*, and the *Washington Post* are provided with annotated commentary, tying the boxes to the chapter material. The excerpts appear as clippings torn out of the paper marked with magic marker to note the comments.

**Accessible Writing Style.** Attempts were made to keep the writing style as accessible to the student as possible, keeping it as interesting, fluid, and loose as possible while making sure that no assumptions were made with respect to terminology—terms were not used before they were introduced. A book is no good unless the student is willing to read it.

**Complete and Integrated Coverage of the Taxpayer Relief Act of 1997.** The Taxpayer Relief Act of 1997 had a dramatic effect on personal finance, making IRAs more attractive for millions of Americans, changing the capital gains tax rate, and affecting estate and retirement planning. These changes are fully integrated within the text.

**Chapter Vignettes Featuring Famous People.** Again, to keep the book as interesting as possible, opening vignettes feature the likes of Elvis, Dennis Rodman, Willie Nelson, Meatloaf, Jerry Garcia, Tina Turner, Carol Hathaway (the nurse from *ER*), Christopher Reeve, and Johnny Depp.

**Learning Objectives at the Beginning of Each Chapter.** Each chapter opens with a set of action-oriented learning objectives. As these learning objectives are covered in the text, an icon identifying the objective appears in the margin. In addition, all the end-of-chapter problems and questions are linked back to the learning objectives.

**Margin Glossary.** Key terms are defined in the margin as they first appear, allowing students to read through the chapter without becoming stumped by technical terms.

**Stop and Think.** These short boxes provide the student with insights as to what the material actually means—implications and the big picture.

**The Facts of Life.** These short boxes present interesting “real-life” facts related to the material being presented.

**Take It to the Net.** This feature, which appears in the margins at the end of each chapter, provides interesting Internet sites related to the material in the chapter.

**Just Do It!** At the end of each chapter, there is a box written by Marcy Furney (“From the Desk of Marcy Furney, CFP”), which provides a checklist of things you should do—in effect, free advice from a certified financial planner.

**Decision-Making Worksheets.** Worksheets that allow for a step-by-step analysis of many personal finance decisions are provided at the end of the text.

**Mini-Cases.** Each chapter closes with a set of mini-cases that provide students with a real life setting that ties together the topics in the chapter and allows for a practical financial decision.

**The Continuing Case—Don and Maria Chang.** At the end of each section in the book, the continuing case of Don and Maria Chang appears, providing the student with the opportunity to synthesize and integrate the many different financial planning concepts presented in this book. It gives the student a chance to construct financial statements, analyze a changing financial situation, calculate taxes, measure risk exposure, and develop a financial plan.



**PERSONAL WEALTH NAVIGATOR Web Site (<http://www.prenhall.com/persfin>).** Developed specifically for this text is the much acclaimed **PERSONAL WEALTH NAVIGATOR** Web site. This activity-based site guides you to the most current financial information possible. As a companion site to the text, the activities and source data have been organized to follow the chapter sequence identical to the text with separate listings of links to other sites, articles, and exercises, all aimed at getting you financially organized. These listings are continuously monitored to ensure that they are both current and accurate. Click onto Internet sites and articles of interest to help you plan your college finance requirements, make a lease-versus-purchase decision on that new car, get job-hunting and investment information, understand tax changes, find out where to get the best loan deal, and much more. In addition to enlivening material in the text, **PERSONAL WEALTH NAVIGATOR** has been designed for your personal use and for in-class activities your instructor may wish to assign.

## SUPPLEMENTARY MATERIALS

The following supplements are available with *Personal Finance: Turning Money into Wealth*:

- **Instructor's Manual.** The Instructor's Manual was written by Ruth Lytton at Virginia Tech, John Grable at Texas Tech University, and Derek Klock at Virginia Tech and provides chapter summaries along with solutions to the questions, problems, and cases that appear in each chapter.
- **Student Study Guide.** The student study guide was prepared by Ruth Lytton at Virginia Tech, John Grable at Texas Tech University, and Derek Klock at Virginia Tech and includes chapter summaries, highlights, key terms, and practice test questions.
- **Test Item File.** The test item file was prepared by David W. Murphy at Madisonville Community College. These questions vary in type and degree of difficulty, covering all topics.
- **PowerPoint Lectures.** A set of PowerPoint Lectures developed by Derek Klock of Virginia Tech with lectures corresponding to all chapters is available to adopters.

## ACKNOWLEDGMENTS

I gratefully acknowledge the assistance, support, and encouragement of those individuals who have contributed to *Personal Finance: Turning Money into Wealth*. Specifically, I wish to recognize the very helpful insights provided by many of my colleagues. For their careful comments and helpful reviews of the text, I am indebted to:

Lynda S. Clark, Maple Woods Community College  
Bobbie D. Corbett, Northern Virginia Community College  
Charles P. Corcoran, University of Wisconsin–River Falls  
Kathy J. Daruty, Los Angeles Pierce College  
Richard A. Deus, Sacramento City College  
Marilynn E. Hood, Texas A&M University  
Edward Krohn, Miami-Dade Community College  
Dianne R. Morrison, University of Wisconsin–LaCrosse  
David W. Murphy, Madisonville Community College  
Irving E. Richards, Cuyahoga Community College  
Daniel L. Schneid, Central Michigan University  
Martha A. Zenns, Jamestown Community College

I would also like to thank a wonderful group of people at Prentice Hall. In a perfect world, Paul Donnelly would be every author's editor. He is creative and insightful, always with an eye toward delivering the student the finest possible textbook and supplementary package possible. Even more important, he is a wonderful person and a true friend. Also in a perfect world, David Cohen would be every author's developmental editor. If he were, there wouldn't be any more boring textbooks. His efforts go well beyond—both in magnitude and quality—what an author might ever expect of a developmental editor. Never one to hold back on criticism, he is responsible for making the book as student-friendly as it is. He was truly a collaborator on this book. I would also like to extend thanks to Gladys Soto for her administrative deftness. She offered insights and direction, often serving as a sounding board to new ideas—I cannot say enough good things about Gladys. Jodi Hirsch also deserves thanks for providing superb coordinating skills. To Louise Rothman, my production editor, I express a very special thank-you. Her skills in coordinating this book through a very complex production process and keeping it all on schedule while maintaining the highest quality was well “beyond the call of duty.” For his marketing prowess in locating potential adopters, I owe Patrick Lynch, the Marketing Manager, a debt of gratitude—he was great! I also am in debt to Janet Ferrugia, the Marketing Communications Director, for the amazing job she did in alerting the market—another of the “gifted ones.” My appreciation to the people at Prentice Hall would be incomplete without the mention of the highly professional Prentice Hall field sales staff and their managers. In my opinion they are the best in the business and I am honored to work with them. In particular I must single out Bill Beville, the regional acquisitions editor. To say the least, he is one of the most dogged and delightful people I have ever met. Bill relentlessly pursued me until I agreed to Paul's proposal to do this book. I will always owe Bill a debt of gratitude for this. Bill, I'm glad you're on my side. Thanks also go to Ruth Lytton, John Grable, Derek Klock, and Barbara O'Neil for their outstanding work on the cases and end-of-chapter material. They're always the professionals and the perfectionists, and their efforts have resulted in a pedagogy that works. Their comments and suggestions on earlier drafts of the book also added greatly to its value. Ruth, who is the consummate teacher, was also the perfectionist in reviewing chapters and writing problems and cases that teach—which is the ultimate goal of this text. Likewise, John wrote outstanding problems and cases, and contributed well more than I had ever anticipated. Indeed, Texas Tech is extremely lucky to have John joining them—my congratulations to Texas Tech. A salute goes also to Marcy Furney for her exceptional work on the “Just Do It!” boxes. She also read and reviewed the book, providing insightful comments that materially improved the book. I must also thank Glenn Furney at Texas Instruments for his help in bringing to life the use of calculators in the teaching of personal finance. Given the contributions of Marcy, Ruth, John, and Derek, I think it is only fitting that I provide a short biography of each. I thank you all.

**Marcy Furney**, Certified Financial Planner, is a Registered Representative of Allmerica Investments, Inc. She resides in Dallas, Texas, where she has been affiliated with Gekiere and Associates since 1990. With 12 years in the financial services industry, she has worked extensively in insurance, executive deferred compensation plans, retirement programs, small business benefits, and personal financial needs. Marcy graduated Summa Cum Laude with a Bachelor of Arts degree from Texas Tech University and attended graduate school at the University of Texas.

**Ruth Lytton** is an Associate Professor of Resource Management at Virginia Polytechnic Institute and State University where she works with the family financial management program, a Certified Financial Planner Board of Standards, Inc. registered program. Her personal finance course is a popular elective for students throughout the campus. Dr. Lytton received the 1994–95 College of Human Resources Certificate of Teaching Excellence and in 1995 was recognized by the Association for Financial Counseling and Planning Education (AFCPE) as the Mary

Ellen Edmondson Educator of the Year. Honorary memberships include Phi Upsilon Omicron, Phi Sigma Society, Kappa Omicron Nu, Phi Kappa Phi, and Golden Key National Honor Society.

**John Grable**, CFP, is an Assistant Professor of Family Financial Planning at Texas Tech University. He received his Ph.D. in Family Financial Management from Virginia Polytechnic Institute and State University, a Master's degree in Business Administration from Clarkson University, and a B.S. degree in business and economics from the University of Nevada. Dr. Grable received his Certified Financial Planner (CFP) designation in 1992, and in 1997 was awarded a research grant from the Certified Financial Planner Board of Standards, Inc.

**Derek Klock** completed a B.S. degree from Virginia Polytechnic Institute and State University in the family financial management program and is a personal banker with First American Savings Bank. Building on a 15-year history of tracking and analyzing investments, work on this project gave him the opportunity to share his enthusiasm for financial management and influence the materials used for instructing others.

As a final word, I express my sincere thanks to those using *Personal Finance: Turning Money into Wealth* in the classroom. I thank you for making me a part of your team.

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