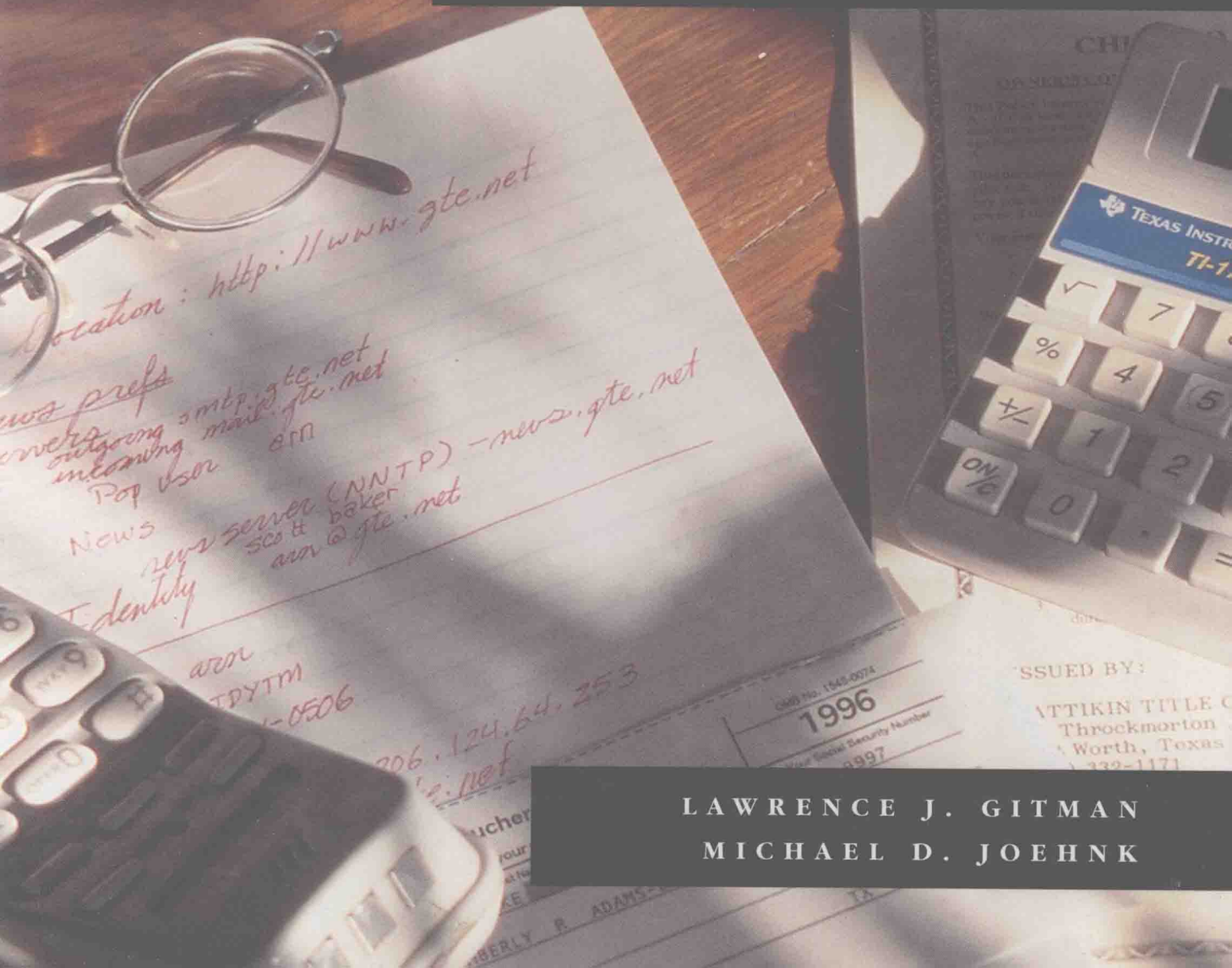


# PERSONAL FINANCIAL PLANNING

*Eighth Edition*



LAWRENCE J. GITMAN  
MICHAEL D. JOHNNK

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# PERSONAL

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# FINANCIAL

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# PLANNING

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**EIGHTH EDITION**

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End-of-Chapter Feature, *Money Online* prepared by Marilynn E. Hood, *Texas A&M University*



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**EIGHTH EDITION**




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# Preface

“Consumer Prices Continue Their Slow Growth”

“Major Tax Overhaul Becomes Law”

“Short-Term Interest Rates Drop”

“Mortgage Rates Hit New Low”

“Major Insurers Cut Rates in Price War”

“The DOW Continues to Hit New Highs”

During recent years we have seen numerous headlines similar to these. Continuous changes in the financial environment, along with changes in our own lives—family, health, job—make personal financial planning both necessary and challenging. This textbook, *Personal Financial Planning*, Eighth Edition, provides the framework and tools for preparing personal financial plans that serve as road maps for goal achievement. *Personal Financial Planning* emphasizes the dynamics of the personal financial planning process by considering the impact of life changes—birth, marriage, divorce, job and career, and death.

The book serves individuals who are, or will be, actively developing their own personal financial plans. It meets the needs of instructors and students in the first course in personal financial planning (often called “personal finance”) offered at colleges and universities, junior and community colleges, professional certification programs, and continuing education courses. The experiences of individuals and families are used to demonstrate successes and failures in various aspects of personal financial planning. A conversational style and liberal use of examples and worksheets guide students through the material and emphasize important points. Clearly the benefits of the book’s readability accrue not only to students but also to their instructors.

## MAJOR CHANGES IN THE EIGHTH EDITION

The eighth edition has been thoroughly updated to reflect the cutting edge of contemporary personal financial planning. It reflects feedback from past users as well as nonusers, practicing financial planners, students, and our own research. It provides helpful new approaches, expanded coverage in certain areas and streamlined coverage in others, and enhanced pedagogy anchored by a state-of-the-art integrated learning system. The basic organizational structure, topical coverage, superior readability, and useful instructional aids that marked the success of the first seven editions have been retained. The engaging chapter opening profiles that describe a person or family who is dealing with a financial planning issue related to the chapter content have been retained. Important changes in this edition will be described first as general changes and then as specific chapter-by-chapter changes.

### GENERAL CHANGES

- The *book has been reformatted* from a two-column page layout to a single-column format. This change was made for pedagogical rather than strictly visual reasons.



Consistent with the research, a more open single-column layout is more readable than the more crowded two-column format. Although the change in format benefits the students in terms enhanced readability, the cost is more pages. *The book's page count increase of about 25 percent is solely the result of reformatting; the text's actual content has not grown and is somewhat shorter than that in the seventh edition.*

- New to this edition is an *emphasis on the use of the Internet*. Where appropriate, Internet addresses are attached to relevant discussions that can be enhanced by visiting a particular site. At the end of each chapter a new Internet feature, *Money Online*, is included. This end-of chapter element includes a brief discussion of an interesting and useful Web site related to the material in the chapter followed by the Web address and specific links to use at the address. In addition, the home page for the given site is shown, followed by *Web Exercises* that instruct the students on how to use the site effectively. Some exercises direct students to other useful sites. The final element of *Money Online* is *Topics to Search* which provides key words that can be used on the Internet to search for additional information related to the topic being studied.
- Step-by-step *use of a business calculator* to make time value of money calculations has been integrated into relevant discussions in this edition. The basics of using a financial calculator are initially introduced in Chapter 2 and then reinforced in later chapters where time value techniques are applied. For example, the use of a calculator to find the future value of a deposit given various compounding periods is shown in Chapter 4 on managing your cash and savings, and in Chapter 5 on making housing and automobile decisions, the use of a calculator to find mortgage payments is explained. The addition of calculator keystrokes should help the reader learn how to more effectively develop financial plans using an important tool of the trade.
- This edition includes 2 to 3 *Money in Action* boxes in each chapter. These new boxed items replace the thematic boxes included in recent editions. The use of a broad descriptor for all boxes has allowed us to better link the interesting and informative sidebar material contained in each box to the text discussions. These boxes address a variety of informative topics that help to ground many of the text discussions to actual financial planning ideas, experiences, practices, and events—all intended to fully engage readers in the personal financial planning process. Examples of the *Money in Action* boxes include those on hot careers (Chapter 1, page 31), auto leasing (Chapter 5, page 259), health insurance tips for the recent grad (Chapter 9, page 472), and excerpts from Babe Ruth's will (Chapter 15, page 782). The 30 plus boxes included in the text are drawn from recent articles in the popular press, thereby providing both relevant and timely information.
- The *integrated learning system* has been refined in this edition to help students better anchor their study to a set of chapter learning goals. Each chapter begins with a list of six numbered learning goals, LG 1 through LG 6. The learning goal numbers are tied to first-level chapter headings and restated and reviewed point-by-point in the end-of-chapter summary. Another element of this system is the *Concept Check* questions that appear at the end of each section of the chapter (located ahead of the next first-level heading). As students read through the chapter, they can test their understanding of the material in each section. The numerous other advanced pedagogical features from the seventh edition—critical thinking passages, chapter-end glossary, exhibit and worksheet captions, and end-of-chapter questions, problems, and cases have also been retained as part of the integrated learning system.

- *Each chapter continues to open an engaging profile* of an individual's or family's experience with an important financial planning issue related to the chapter content. The profiles, which have been refined in this edition, involve both traditional and non-traditional family situations. In addition, several further highlight the text's "change" theme by describing how families and individuals adapt to change. The profiles provide interesting personal insights into the back-grounds, motivations, strategies, and outcomes of the personal financial planning process.
- The highly regarded *Worksheets* continue to be included with this edition. The expanded and revised worksheets are separately labeled and numbered as "Worksheet X.Y." The labels make text references to the worksheets much clearer. All end-of-chapter problems that can be solved using a given worksheet, provide the worksheet reference which directs the student to its application.
- In addition to the worksheets, *Financial Planning Software (FPS)*, a software program developed by Kathryn E. Coates and David Geis of KDC Software Solutions is available. Students will find that the chapter concepts, worksheets, cases, and problems that are accompanied by this symbol  can be solved with the use of FPS. We feel that students using FPS will be more inclined to begin and continue their own financial planning given the ease of using this software program.
- *A completely new continuous case, The Lee Case*, has been written for the eighth edition. It provides personal and financial information about a real-life young couple and challenges students with the task of developing a specific comprehensive financial plan. Unlike the Larkin case from the previous edition, the Lee case begins with Megan and Kevin Lee, a newlywed couple who subsequently have relevant life experiences and a number of other financial "shocks" as their story unfolds and the textual material progresses. This case, therefore, is consistent with the theme of change that is integrated throughout the text.
- "Getting a Handle on Your Financial Future," has been tightened to focus more clearly on the topic of concern. These sections, prepared by a practicing financial planner, provide advice and checklists that help students, both those "just starting out" and those who are "thirty-something," to immediately apply the chapter concepts to their own financial planning.

## SPECIFIC CHAPTER-BY-CHAPTER CHANGES

Because users often like to know where new material appears, the significant but less sweeping changes that have been made in the eighth edition are summarized below, on a chapter-by-chapter basis.

- *Chapter 1* on understanding the financial planning process has been tightened throughout. Refinements and additions include illustrative goals in Worksheet 1.1, a brief retrospective on the 1990s economy, updated income and living cost data, and an improved discussion of some of the key determinants of personal income.
- *Chapter 2* on your financial statements and plans has been refined and explanations of the rationale for use of fair market value, the impact of taxes on take-home pay, and tracking both variable and cash expenses have been added. Discussion and demonstration of how to set up a business calculator to make personal financial calculations and the specific keystrokes required to make basic future and present value calculations are now included. All financial statement and cash budget data has been revised to better reflect current values.
- *Chapter 3* on managing your taxes has been completely updated to reflect the latest tax laws, rates, and procedures. In addition, the most recent tax forms

available in late 1998 are used to demonstrate the appropriate tax procedures and calculations. Also added are discussions of the new procedures for calculating the taxable gain, if any, on the sale of a home, and current procedures for electronic filing of tax returns.

- *Chapter 4* on managing your cash and savings includes the latest return and institutional data that accurately reflect current rates and structure in the financial marketplace. A list of strategies for getting started in building a nest egg has been added. The use of a business calculator to find future values for various compounding periods is now described. Recent changes in the denominations and purchase procedures for U.S. Treasury bills and the current treatment of Series EE Bonds are also included.
- *Chapter 5* on making housing and automobile decisions has been thoroughly updated to reflect today's housing market, housing costs, and interest rates. It includes new discussions on the drawbacks of cooperative apartments, an example of the mortgage insurance calculation, a demonstration of how to use a business calculator to calculate mortgage payments, and Internet Web addresses for car shoppers. Text descriptions of the worksheet examples for home affordability analysis and rent-or-buy analysis have been added. A new exhibit containing tips on how to avoid some common home-buying mistakes is now included.
- *Chapter 6* on borrowing on open account has been updated to reflect current developments in the consumer credit market, including expanded coverage of credit card fees and the cost of borrowing on open account. New to the chapter are some suggestions and tips on how to pick the right credit card, and recent changes and additions to major consumer credit legislation.
- *Chapter 7* on using consumer loans continues to emphasize the positive aspects of what it takes to build a strong credit history; in addition, the material on student loans has been thoroughly updated and expanded to reflect recent changes to these loan programs, including widespread use of the Net. A list of guidelines to follow when making loans to friends or family has also been added.
- *Chapter 8* on insuring your life now devotes considerable attention to the use of the Net in insurance planning. We've also updated social security benefits, and expanded the discussion of the advantages and disadvantages of various types of life insurance policies.
- *Chapter 9* on insuring your health has been streamlined and clarified throughout. It has been completely updated to include the latest industry and policy data and statistics. The list of typical provisions in long-term care insurance policies has been expanded and updated. The role of group health care insurance in one's insurance program has been clarified.
- *Chapter 10* on protecting your property has been both updated, as necessary, and tightened up throughout. But we've also made some important additions to the chapter—like a worksheet to help insurance buyers better compare homeowner's policies and policy coverages, and some pointers on keeping homeowner's insurance premiums in check; and we expanded the discussion of umbrella policies.
- *Chapter 11* on investing in stocks and bonds has been thoroughly updated and contains information on market performance through 1997 and the first quarter of 1998. At the same time, discussion about a popular trading strategy known as "Dogs of the Dow" has been added, along with new material on the inflation-indexed bonds issued by the U.S. Treasury.
- *Chapter 12* on making securities transactions has gone through major revisions to reflect the changing market structure and brokerage operations (such as the growth of online brokers and the growing role of the Net in the world of

individual investors). Also new to this chapter is some discussion of “Spiders” and “Diamonds”—shares of common stocks that actually track the behavior of major market indexes, like the S&P 500 and the Dow Jones Industrial Average.

- *Chapter 13* on investing in mutual funds has been revised and updated to reflect the growth in this form of investing in the past few years. Coverage now includes discussion of index funds, information on reading fund profiles and prospectuses, and a piece of “funds of funds”—mutual funds that invest in other mutual funds.
- *Chapter 14* on meeting retirement goals has gone through some extensive revisions, in keeping with major legislative changes and their impact on related investment strategies. Discussion of 401(k) and Keogh plans has been revised and updated, and the discussion of IRAs has been thoroughly reworked to reflect the impact of the new tax law on them, including the creation of Roth IRAs and Education IRAs.
- *Chapter 15* on preserving your estate has been significantly revised to reflect the impact of recent tax law changes on estate planning and taxation. Discussion of self-proving wills, the unified rate schedule, reasons for making lifetime gifts, and the use of discounting in estate planning have been expanded and clarified. The worksheet and related example of the procedures for computing federal estate taxes due have been completely overhauled to reflect the significantly revised laws. The transitional amounts (to 2006) of the exclusion amount, unified credit, and “end of bubble” amount are included in a table.

## ORGANIZATION OF THE BOOK

*Personal Financial Planning* addresses all of the major personal financial planning problems that individuals and families encounter. It presents a model of the major elements of effective money management. All of the latest financial planning tools and techniques are discussed. Most of the profiles and widely used examples involve relatively young people so that the student reader may more easily identify with each situation.

This comprehensive text is written in a low-key, personal style and uses state-of-the-art pedagogy to present the key concepts and procedures used in sound personal financial planning and effective money management. The roles of various financial decisions in the overall personal financial planning process are clearly delineated.

The book is divided into six parts. Part One presents the foundations of personal financial planning, beginning with the financial planning process and then covering financial statements and plans, and taxes. Part Two concerns the management of basic assets, including cash and savings instruments, housing, and automobiles. Part Three covers credit management, including the various types of open account borrowing and consumer loans. Part Four deals with managing insurance needs, and considers life insurance, health care insurance, and property insurance. Part Five concerns investments, including stocks, bonds, and mutual funds, and how to make transactions in securities markets. Part Six is devoted to retirement and estate planning. All these parts are tied together via the *Lee continuous case*, which begins at the end of Chapter 1 with an extensive inventory of personal and financial data. Additional elements of the Lee’s financial plans are then introduced at the ends of

Parts One through Five, and Chapters 14 and 15 so that the students can deal with the unfolding elements of a complete personal financial plan.

## PEDAGOGY

Each chapter opens with a *Profile*, a description of an individual's or family's experience with an important financial planning issue related to the chapter content. Along with the profile are six learning goals that link the material covered to specific learning outcomes and, as noted earlier, anchor the text's *integrated learning system*. In addition, each major section of the chapter begins with a *critical thinking question* designed to stimulate interest in the material that follows by challenging the student to relate it to his or her personal life. At the end of each of the major sections are *Concept Check* questions that allow the student to confirm their understanding of the material before moving on to the next section.

Each chapter contains at least two *Money in Action* boxes set off from the text material and containing brief discussions of relevant personal financial planning material that serve to enrich the topical coverage. *Worksheets*, which are typically filled out and discussed, are included to simplify demonstration of various calculations and procedures and to provide students with helpful materials they can use in managing their own personal finances. The worksheets are numbered to provide convenient reference to them in the end-of-chapter problems, and they include descriptive captions. Numerous exhibits, each containing descriptive captions, are used throughout to more fully illustrate key points in the text.

Many chapters contain discussions and illustrations of how both the Internet and the personal computer can be used in various phases of personal financial planning and, where appropriate, brief descriptions of some of the more popular Internet sites (with addresses) and computer software are included. End-of-chapter material includes a *summary* that restates each learning goal and follows it with a summary of the material related to it. A *glossary* that provides brief definitions of all highlighted key terms follows the summary. The next element is *questions and problems* that students can use to test their grasp of the material. Two or more *case problems* highlighting the important analytical topics and concepts are also supplied.

Following the cases is the financial advisory section, "Getting a Handle on Your Financial Future," which provides helpful checklists for students who are just starting out and for those who are more established. The *Money Online* Web material, which includes an important homepage description and link, related Web exercises, and topics to search is the next element in each chapter. And of course, as noted before, each part of the book ends with the *Lee continuous case*.

## SUPPLEMENTARY MATERIALS

Recognizing the importance of outstanding support materials to the instructor and the student, we have continued to improve and expand our supplement package.

### WORKSHEETS

A packet containing *blank worksheets* identical to those presented and used in the text is included free of charge with each new copy of the book. Each worksheet provides a logical format for dealing with some aspect of personal financial planning

such as preparation of a cash budget, home affordability analysis, or automobile lease versus purchase analysis.

## **INSTRUCTOR'S MANUAL AND TEST BANK**

A comprehensive *Instructor's Manual*, compiled by Marilyn E. Hood of Texas A&M University, has been prepared to assist the teacher. For each chapter, the manual includes

- An outline
- Discussion of major topics
- A list of key concepts
- Solutions to all Concept Check questions, end-of-chapter discussion questions and problems, and cases
- *Outside projects* that can be assigned to students so that they can apply major concepts and techniques presented in the chapter (instructions for outside projects are printed on separate sheets to make duplication for classroom distribution a simple task)
- Solutions to all Lee continuous case questions.
- Two additional integrative cases, each with a detailed solution. One of the cases deals with a young couple, and the other addresses the financial concerns faced by single parents.

The *Test Bank* has been revised, updated, and expanded by Carlene Creviston of Ball State University. It includes true-false and multiple-choice questions, as well as four to six short problems for nearly every chapter.

## **COMPUTERIZED TEST BANK**

A computerized version of the printed test bank is available in Windows, Microsoft Word, or Macintosh featuring Dryden's computerized test bank program EXAMaster+. EXAMaster+ has many features that allow the instructor to modify test questions, select items by key words, scramble tests for multiple class sections, and test completely on-line.


## **WORKBOOK**

Carlene Creviston of Ball State University has updated the *Workbook* to assist students in mastering the information and techniques presented in the text, and to serve as a resource manual as they develop personal financial plans. Specific components for each chapter include

- A thorough outline of concepts discussed
- Completion exercises that stress vocabulary
- Comprehensive case problems (with solutions) that demonstrate the application of chapter concepts and utilize the worksheets

Most chapters include both problem-solving exercises (with solutions) and comprehensive cases.

## **PERSONAL FINANCIAL PLANNING SOFTWARE**

The Windows problem-solver—Financial Planning Software—was developed for this edition of the book by KDC Software Solutions. The disk performs like any of the widely used commercially available software packages and is completely interactive; best of all, being very user-friendly, it streamlines the recordkeeping and problem-solving activities presented in the text. A computer logo  is used in the



margin to identify sections of the book to which the disk is applicable. End-of-chapter problems and cases that can be solved with the disk are keyed with the same logo. Most of the worksheets used in the text are formatted on the disk to provide assistance in applying some of the more complex procedures, ranging from financial statement and budget preparation to investment management and retirement planning. The software has been extensively tested to ensure its accuracy and ease of use.

## **PRESENTATION SOFTWARE**

For instructors who enjoy working with computerized presentations, we have a complete lecture presentation in Microsoft PowerPoint, which has been revised by Marilyn E. Hood of Texas A&M University. Each chapter's file includes an outline, appropriate numerical concepts, and key topics. Instructors can easily modify the presentations using PowerPoint's many features.

## **WEB PAGE**

In order to provide the most current information and resources available related to financial planning we have developed a Web Page. Instructors and students can access up-to-date teaching and learning aids through **[www.dryden.com](http://www.dryden.com)**.

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In addition to the many individuals who made significant contributions to this book by their expertise, classroom experience, guidance, general advice, and reassurance, we also appreciate the students and faculty who used the book and provided valuable feedback on it, confirming our conviction that a truly teachable personal financial planning text could be developed.

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The Dryden Press, which shared our objective of producing a truly teachable text, relied on the experience and advice of numerous excellent reviewers for the

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