Talking Money With Teens

PARENTS: Please share this article with your teenagers.

MAKING IT

As a mother of teenagers myself, I can appreciate the importance of teaching your children the benefits of saving and spending sensibly to help set them on the path to financial well-being. This article can serve as a resource to begin laying the foundation for many financial discussions with your teenagers.

To help motivate your teens to take advantage of the concepts explained here, you might want to consider setting up a savings matching program similar to one you may have with your employer. For example, you could help open your teenager's first individual retirement account (IRA) and consider matching his or her contributions. Alternatively, you—or even a grandparent—could consider funding the total contribution. In either case, the maximum 2008 contribution is the lesser of your teen's 2008 earned income or $5,000. For shorter-term goals, you might want to add a specific amount to your teen's savings when he or she reaches key financial milestones.

Lessons on how to earn, save, and spend money wisely are learned through experience, so remember—it's never too soon to begin your child's financial education.

— Judith Ward, CFP®, a senior financial planner with T. Rowe Price

As a teenager, you may be earning some money of your own as well as making decisions on how to spend it. You might be making enough to cover tickets to a much-anticipated concert, or maybe you're saving for a new cell phone. Whether you realize it or not, you make choices about money every day—how to earn it, where to spend it, and whether to save it for a future purchase. The more thought you put into each of these choices, the more likely you will be able to meet your most important goals, which could include buying your first car or paying for some of your college expenses. But managing and even investing your money doesn't have to be complicated. Following are a few key concepts and tools to help you get started.

PHOTOGRAPH BY ISTOCK

WEEKLY BUDGET

Income List all the money you receive each week here. Be sure to include allowances, jobs, and gifts.	Amount (+)	Expenses In this column, list everything you buy. Try to be as detailed as possible—include meals at restaurants, music downloads, and any other expenses.	Cost (–)
	$		$
Total:	$		$

SAVINGS PLAN

	GOAL	COST	AMOUNT ALREADY SAVED	AMOUNT STILL NEEDED (Cost – Amount Already Saved)	TIME LINE (Weeks to Reach Goal)	AMOUNT TO SAVE WEEKLY (Amount Still Needed ÷ Time Line)
Example	*Cell Phone*	*$200*	*$50*	*$150*	*3*	*$50*

EARNING AND SPENDING

Good financial decisions are built around a solid financial plan, and the basis for any plan is your budget, which is any money you have coming in and how you are spending it.

Creating your budget is rather simple—you can use the Weekly Budget worksheet to the left. To begin, list any income that you receive. Do you get an allowance? Are you earning money from a part-time job, babysitting, or doing yard work in the neighborhood? Do you receive cash gifts from your parents or grandparents? Keeping track of all your sources of income allows you to see exactly how much money you're earning so you have a starting place for deciding what to do with it.

Next, list the major types of expenses you have (transportation, entertainment, etc.) and how much you spend per week in each category. Tracking your spending for a few weeks can help ensure you don't forget anything. You may be surprised to find that you spend a lot of your money on things that aren't very important to you—money that you could be setting aside for bigger-ticket, priority items.

SAVING FOR A PURCHASE

Once you have a budget in place, you're ready to start a savings plan. For example, say your goal is to purchase a new cell phone. In the Savings Plan worksheet to the left, write down the cost of the phone along with how much you already have saved and the amount you still need to save.

Next, figure out how long you have to meet that goal—in other words, when you want to make the purchase. This will establish your time line. You can then calculate the amount you should save weekly from your paycheck or allowance to meet your goal.

Also, look back at your weekly budget. Are you spending money on things that aren't important to you? Is there anything you want to eliminate from your expenses so that you'll have more money to put toward your other goals, enabling you to buy them sooner? For instance, can you eat out less or buy fewer clothes in a month? These are the kinds of adjustments that will help you determine your savings plan. The key is to become disciplined in your savings habits and to spend your money on the things that you've decided are most important to you.

KEEP UP THE GOOD WORK

Once you have established your budget and savings plan, you've taken a big step toward managing your financial future. Also, you'll probably find new goals you want to incorporate into your plan. Maybe you'll decide you want to go on a spring break trip with your friends or study abroad when you're in college. Learning to structure your financial plan so it can grow as you do is one of the best ways to achieve your goals.

Saving for the Future

After you've become familiar with creating a savings plan for a near-term purchase, it can be easier to start budgeting for mid- or long-term goals—such as buying your first car or investing for retirement. When you're a teenager it might seem like it's too soon to think about the day when you're retired, but it's never too early to start investing for a distant goal.

With investing, it's important to understand that it takes time for your money to earn a return. And the sooner you start investing, the greater your opportunity to earn more. In the charts at right, we show a few examples of how investing when you're young can make a big difference in how much you can earn over time.

These examples show how planning while you're still young can have a huge positive impact on your financial future. Remember, as a teenager, you can greatly benefit from the fact that time is on your side.

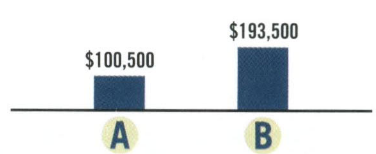
EXAMPLE 1 **In this example, we assume you're earning some income through a part-time job and your parents decide to help you set up an account—called an individual retirement account (IRA)—that is earmarked for your retirement years. The account is opened with $2,500 when you're age 17. Bar A shows how even if you don't add anything more and leave the original $2,500 in the account, that modest $2,500 investment could grow to $100,500 by the time you turn age 65. Bar B shows what would happen if you contributed another $2,500 at age 18, then never added anything more: you could have $193,500 at age 65!**

EXAMPLE 2 **Next, consider what happens when you open a retirement account after finishing college. Bar C shows how that account could grow if you were to contribute $4,000 a year for 10 years—from age 22 through age 31—and never contribute anything else after that point. Your $40,000 could grow to $793,000 by the time you reach age 65. Of course, in real life, you should continue contributing to your retirement account beyond the first 10 years. If you kept contributing $4,000 a year until age 65, your account could potentially be worth $1,586,000, as shown by bar D!**

Now, consider your friend who doesn't open a retirement account until after he's been working for a while, at age 30. He contributes $4,000 a year for 10 years just like you—from age 30 through age 39. Bar E shows how his $40,000 investment might grow to only $428,500 when he reaches age 65. And if your friend continued contributing $4,000 a year until age 65, he potentially would have $744,409 (shown in Bar F)—less than half of your $1,586,000.

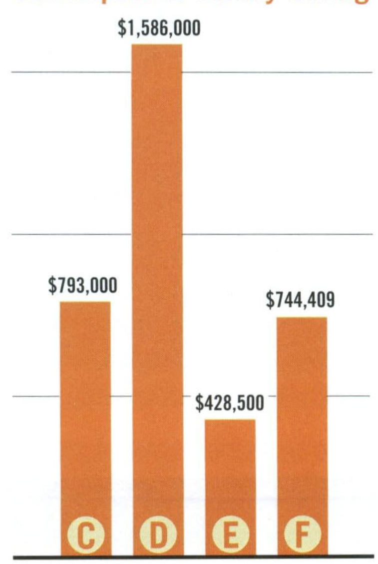
EXAMPLE 1

The Power of Investing Early



EXAMPLE 2

The Impact of Steady Saving



These charts are for illustrative purposes only and do not represent the performance of any specific investment. Examples assume an 8% annual rate of return in a tax-deferred account.

Considering Market Risk

It's important to know that not all investments will gain money all the time. The stock and bond markets move up and down every day, so you must be prepared for occasional periods when your investments don't perform as positively as you'd like. Even so, given the potential for growing your money, especially with your long-term investments, the biggest risk you face could be *not* investing.

Types of Investments

There are three basic types of investments: stocks, bonds, and short term.

1 STOCKS represent ownership of a company and are bought and sold in units called shares. Stocks can gain or lose value over time, and their prices tend to go up and down over the short term more often and more dramatically than bonds. Some stocks may pay a dividend (part of the company's earnings that is paid to the shareholder on a regular basis), which can provide income even if the stock decreases in value. Historically, stocks have offered a higher average return than other types of investments, but the risk of losing money is also greater.

2 BONDS are securities sold by the government or companies. The company "borrows" your money and agrees to pay you a specific interest rate up to the maturity date of the loan (when it will pay back the money you loaned). Much of the return (what you earn) on bonds is from the interest that is paid, but bonds can also increase or decrease in value over time for a variety of reasons, such as how the company that issued the bond is doing financially. Over the short term, bond prices tend to go up and down less than stocks, but bonds historically have offered a lower average return than stocks.

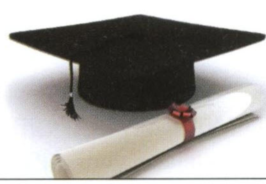
3 SHORT-TERM investments tend to be more stable than stocks or bonds, meaning they don't fluctuate in value as much. Although short-term investments generally don't decrease in value, they tend not to generate large returns like stocks and bonds may. These investments include money market securities, savings accounts, and short-term certificates of deposit (CDs).

Investing Your Money

YOUR TIME LINE—how long you have until you reach your goal—should determine how you invest your money. Here are some examples of goals and time lines you may have along with the investment mixes that are most appropriate. You'll notice that the further away the goal is, the more you should consider investing in stocks.

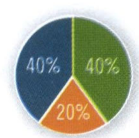
SAMPLE GOAL: **A NEW CAR**

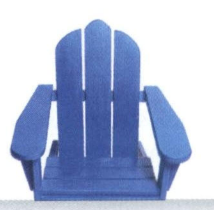
Time Line: Less Than 2 Years
Investment: 100% Short Term



SAMPLE GOAL: **COLLEGE COSTS**

Time Line: 3 to 5 Years
Investment: 20% Short Term
40% Bonds
40% Stocks





SAMPLE GOAL: **RETIREMENT**

Time Line: 16 Years or More
Investment: 100% Stocks

Short Term Bonds Stocks

Making It Simple

MUTUAL FUNDS make it possible to own a little bit of many different types of investments. Your money is combined with that of other individual investors, and that pool of money is used to buy stocks, bonds, and/or short-term investments. Mutual funds are very easy to invest in—each fund has a portfolio manager who makes the investment selections so you don't have to figure out which specific stocks or bonds to buy. You can simply select a mutual fund with an investment objective that matches your goal and time line.

The fund prospectus includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing. Keep in mind that all funds are subject to risks, including the potential loss of principal.

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