Personal Finance Test 1 Study Guide

Budgets

* Disposable income (after taxes)- expenses= savings
* Opportunity costs- things we give up now to get something else later (example- not going out to dinner to save up for a TV)
* Nominal value of money- the number value of money
* Real value of money- after inflation
* Nominal – inflation= real

~Cash Flows~

* Cash Flow Statement- shows us what we are **saving** (for an individual)
  + Done monthly or on an annual basis
* Disposable income- after taxes
* Gross income- before taxes are subtracted out
* Inflows
  + Income
  + Interest
  + Dividends
  + Welfare
  + Capitol gains
  + Gifts
* Outflows (expenses)
  + Car payment
  + Phone bill
  + Insurance
  + Rent
  + Food
  + Gas
  + Medical
  + Vacations
* Difference between business and personal Cash Flow statement= Business have depreciation and show profit & personal don’t have depreciation and show savings
* Cash flows are looked at historically, shows what you are going to spend (future budget)
* Savings rate= savings / gross income
* National Average savings rate= 5%
* Facts that affect:
  + Inflows:
  + Type of job
  + Career
  + Outflows:
  + Family size
  + Health
  + age

Balance Sheet

* balance sheets shows a snap shot in time (on a particular date)
* NET WORTH
* Assets vs Liabilities
* Assets- things you own
* Liabilities- things you owe
* Personal
  + Assets- liabilities= net worth
* Business
  + Assets- liabilities= equity
* Balance sheets shows what you are worth on a particular date
* NO EXPENSES ON A BALANCE SHEET
* Current Assets- things that are the most liquid, current ( example- savings account)
* Long term assets- examples like real estate investments and car
* Current Liabilities- have to be paid within the year
* Long term liabilities- examples- mortgage, loans
* Liquidity Ratio= liquid assets/ short term liabilities (shows ability to pay off short term debts)
* Debt ratio= liabilities/ assets- shows what kind of financial risk you are in
* Savings rate= savings/ disposable income (15% is a good rate)- shows us when we will reach financial freedom

Interest

* Interest= cost of money
* Interest rate- risk free rate of return + inflation risk+ maturity risk + defult risk
* US Treasury bills are risk free assets

Future value of money

(charts)

Present Value of Money (charts)- questions like- would would you pay today? What is it worth to you?

* Present value is going to be less than future value
* The longer the period the more money
* Higher interest rate- higher value

Taxes

* FICA
* Social Security- 6.2%
* Medicare 1.45%
* Sales Tax- 6.75%
* Income- state & federal
* Property tax- for schools and hospitals
* Estate tax- Taxes on legacy
* Inheritance tax- only