The Investment Fund for Foundations (TIFF) in 2009

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Chapter 2: Saving

This chapter emphasizes the importance of saving and explains the three reasons to save: emergencies, large purchases, and wealth building.

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Chapter 2: Savings

Key Terms

» Compound interest: Interest paid on interest previously earned; credited daily, monthly, quarterly or semiannually
» Emergency fund: Five hundred dollars in readily available cash to be used only in the event of an emergency; the goal of the First Foundation
» Interest rate: Percentage paid to a lender for the use of borrowed money (in debt); percentage earned on invested principal (in investing)
» Five Foundations: The five steps to financial success
» Sinking fund: Saving money over time for a large purchase

Rate of Return Exercise

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- Work with a partner or small group to calculate the future value of a one-time investment using the formula for compound interest.
- The calculations will be based on the following interest rates, and you will create a graph to show that the rate of return does matter:
  • Interest Rate 1: 1.5%
  • Interest Rate 2: 2%
  • Interest Rate 3: 2.5%
- Initial investment: $250
- Time Frame: 40 yrs
- After you compute the first investment at the three different interest rates:
  • double the investment, and make new computations
- Abbreviation Definition
  - \( PV \) is the future value
  - \( PV \) is the present value (the principal you start with)
  - \( i \) is the annual rate of interest (as a decimal, 5% is expressed as the decimal .05)
  - \( m \) is the number of times per year the interest is compounded (monthly, annually etc.)
  - \( t \) is the number of years you leave it invested
- For this exercise, interest will be compounded once a year

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BANK TIPS

REMEMBER: The emergency fund is not intended to grow wealth, so interest earned is not a factor.
- A bank is one of the safest places to keep your money. Since the financial crisis of 2008, the federal government (Federal Deposit Insurance Corporation or FDIC) increased the level of insurance on bank accounts to $250,000 per depositor.
- An interest-bearing account is an account that generates interest income on the available balance in the account.
- The convenience of a bank account comes at a cost. Banks generally pay lower rates on interest-bearing accounts than other financial institutions that offer accounts that resemble bank services: The most common are brokerage cash management accounts, credit union accounts, and mutual fund money market accounts.
- Inflation can eat up the interest you earn on an interest-bearing bank account. Even a low rate of inflation (a persistent rise in the cost of goods and services or the decline in the purchase power of money) generally outpaces what banks pay on interest-bearing accounts.
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» Compound interest: Interest paid on interest previously earned; credited daily, monthly, quarterly or semiannually

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• Abbreviation Definition
  • »» FV is the future value
  • »» PV is the present value (the principal you start with)
  • »» r is the annual rate of interest as a decimal (5% is expressed as the decimal .05)
  • »» m is the number of times per year the interest is compounded (monthly, annually etc.)
  • »» t is the number of years you leave it invested
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