Independent Investor

April 2014

Kids & Money: Nurturing Your Child's Financial Growth

"Reading, writing, mathematics"-- too bad that list doesn't include personal finance. Most kids learn the basics of money and making change in elementary school, but probably won't learn how to manage money unless they choose finance as a career path. That means it is up to all of us to see that our children reach adulthood prepared to face life's fiscal challenges.

Earlier Is Better

The benefits of teaching children about money early on are both immediate and long term. In the short term, they may develop strong saving habits, learn how to make smart purchases, begin to understand the true meaning of "investment" and perhaps even learn why they can't always get everything they want. In the long term, you can help them avoid accumulating debt. And by teaching the value of saving for the future, you can help them plan for financial security.

Where Does Money Come From?

Even very young children can begin to understand the concept of earning money. Explain that money is earned by working, and that you can only spend what you earn. To help them understand what it is like to get paid on a schedule, begin paying an allowance. Then help them to set goals for spending and saving their money. It is important, however, to make sure that you stick to the payment schedule; otherwise the lesson may be lost.

Experts differ on whether or not allowances should be tied to household chores. Although many people say children will learn more about personal responsibility if they do not receive money for pitching in around the home, others feel paying an allowance teaches them valuable lessons about working and earning. You also might consider paying your child for "extra credit" chores that they complete outside of their daily duties, such as helping out in the garden or washing the family car.

Make Saving Interesting

You hear it every time you enter a store with your child: "I want ... Buy me this ... !" Before reacting, pause and take a minute to collect your thoughts. This situation presents a great opportunity to teach another important lesson about personal finance: savings and interest.

Explain that people often save their money for items they want to buy. A simple savings lesson involves using a piggy bank, shoe box or empty peanut butter jar. Make the lesson fun by having your children decorate the "bank," while explaining to them how you also use a real bank to save your money. Encourage your children to save a portion of their allowance for a special goal. As they save money, you might reward them with a small additional amount, just like a bank pays interest. At the end of each month, calculate how much they have saved and then chip in a certain percentage as interest.

Last, to further encourage the learning process, you might consider plotting a visual chart of their savings (include the goal) so they can easily see their savings grow. Remember to keep it as simple as possible, geared toward each child's level of understanding.

Banking and Investing

Once your children have been saving enough to accumulate $50 or $100, take them to the bank to open their first savings account. Most community banks will allow children to open accounts with low minimum deposits. Some even have accounts especially marketed to kids to make the learning process fun. Make sure that your children receive a passbook so they can see the progress of their savings efforts, as well as the interest that accrues.

Once they have mastered banking with an institution, you can begin to teach kids about investing. For instance, when your child wants something that he or she can't quite afford, discuss the value of saving versus borrowing.

. If you do extend credit, use a written IOU, establish a repayment schedule and charge interest. By doing this, you establish the framework for teaching your children that bonds and certificates of deposit are IOUs representing loans from investors to institutions.

Compounding

As your children get older and perhaps take on part-time jobs, their savings will likely amass at a quicker rate. Now is the time to review the lesson of compounding, or the ability of earnings to build upon themselves. Explain how compounding can be more dramatic over time; the longer money is left alone, the greater the effect. This can lead into a discussion about investing and how certain investments can have a greater ability to compound over time.

Giving a gift of stocks of well-established or kid-oriented companies can be an ideal way to teach your children about investing.1 Most children would love to think of themselves as owners of McDonald's, Disney, or Toys "R" Us. Some companies even have shareholder meetings directed to children.

A Little Learning Can Pay Off

Teaching your children about our complex financial system may seem daunting, but you can help put them on the right track by encouraging smart habits now.

Is it worth your time and effort? As Benjamin Franklin once said, "An investment in knowledge always pays the best interest." Answering your children's questions honestly and in terms they will understand may set the stage for a lifetime of smart financial moves.

The Lesson Plan

- Ages 4 to 6 -- Introduce the concept of value--how money buys things. Point out the difference between nickels, dimes and quarters.
- Ages 7 to 9 -- Expand the money discussion with the notion of having short- and long-term savings goals.
- Ages 10 to 12 -- Consider opening a savings account in your child's name. By this age most kids are able to calculate interest and make a simple budget.
- Ages 13 to 15 -- Discuss the difference between saving and investing. Reward avid savers with a "grown up" investment in a kid-friendly stock.[1]
- Ages 16+ -- Get serious about checking accounts and possibly credit cards. Make sure your kids understand the difference between debit card and credit card transactions.

[1] *Investing in stocks involves risks, including loss of principal.*

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Tracking #: 1-257955