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Good Advice during a Bad Economy

The Federal Government is responsible for fiscal policy, which includes how federal and local governments tax and spend money. The Federal Reserve is responsible for monetary policy, which includes loosening or tightening credit by changing the interest rates and the money supply.

When reports say the economy is growing and doing well, the Federal Reserve may raise interest rates or reduce the money supply. This is intended to slow the economy and prevent too much inflation. When the growth of the economy slows or stops growing at all, The Federal Reserve may lower the interest rates to encourage businesses and consumers to borrow. Buying and selling is what keeps the economy alive, and keeping the economy healthy is a delicate balancing act.

When the economy stops growing and consumers spend less each month than they did the month before for several months, the country falls into a recession. A recession tends to perpetuate itself because as jobs are lost, people become more and more conservative about what they spend, and the economic decline continues until it eventually becomes a depression in extreme circumstances.

One of the biggest threats to your financial health is inflation. Take a look at the numbers below to see how much the value of the dollar has dwindled over the last forty-five years. In 1968, the dollar was worth more than six times what it is today. In other words, you would have to pay $66.17 today (2012) for the same amount of goods and services purchased for consumption by urban households you would have paid $10.00 for in 1968.

Based on the figures for the past twenty years, a person will need to increase his income by about 50% every 10 years to maintain the same standard of living, including during retirement. Income increases are more likely before retirement, but maintaining a standard of living after retirement takes careful planning and self-discipline.

Smart Money Ideas for a Bad Economy

Economic hardship can be the result of the country's economic climate or it can be the result of individual changes, such as job loss, catastrophic illness, or natural disasters. The best way to survive economic downturns is to be prepared before they happen. In tough economic times, it is imperative that you do everything you can to protect your finances. When tough times are caused by a bad economy countrywide, they require extra discipline on your part to ensure that you survive the bad patch. There are a few things you can do to shore up your finances and actually improve things once the tough times have passed. In this volume we will discuss ways

Inflation Table

YEAR	Worth of the $*
1968	$66.17
1973	$51.86
1978	$35.32
1983	$23.12
1988	$19.47
1993	$15.94
1998	$14.13
2003	$12.52
2008	$10.70

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Protect Your 401(k) Money

Don't panic if you see the numbers dwindling in your 401(k) account when the country's economy takes a nosedive. If you have to, just stop looking at it for awhile so that you're not tempted to make any rash decisions out of panic. Remember that there will be downward spirals periodically, but those downward spirals are usually followed by upward climbs, sometimes quite significant climbs, so be patient. If your employer offers matching funds, you will most likely continue to receive those funds even in a bad economy.

At the same time, don't assume that your plan manager is watching over your 401(k) for you. You need to be aware of what options are available for customizing your plan and learn to make smart choices. It's true that some 401(k) plans are take-it-or-leave-it plans, meaning that your employer picks a mix of stocks and other options for your money to be invested in. But these days, at least six out of ten plans allow you to make some choices of your own.

An advantage of a 401(k) plan is that it provides you with the option to allocate your money to the investments you want. It is certainly advisable to talk with the organization that manages the plan and discuss what your investment options are. Stocks, mutual funds, and bonds are usually among the options. Many people do not like the idea of stock market investments and consider them to be risky. They prefer to put their money in CDs, insured savings accounts, or U.S. Treasury bills. These investments, however, are not designed for growth or keeping up with inflation. They do guarantee you the return of your initial investment plus a small amount of interest. A 401(k) is usually safer than attempting to invest in the stock market on your own unless you are very knowledgeable or have a good stock broker.

Your 401(k) portfolio is a collection of investments you assemble by selecting among the choices your plan manager offers when you make your initial contribution. Most plans allow you to make changes to your portfolio anytime you want as the economy gets stronger or weaker. You can also redistribute your money from one investment to another without owing income tax on any gain in value, and in most cases there is no penalty for transferring out of an investment. .

Is Borrowing from a 401(k) Plan a Good Strategy When Times are Hard?

It is rarely a good idea to borrow from your 401(k) and especially during difficult economic times. The main reasons for that are:

- If you are unfortunate enough to lose your job, you may have to pay back what you have borrowed. If you are not able to pay it back and you are under age 59 ½, you will have to pay income tax on it plus an additional 10% penalty.
- The money that you borrow stops compounding interest. That's money for your retirement that you will not have and will never see.

If you do lose your job, you have four options to choose from when it comes to your 401(k):

1. Don't change a thing. Leave your money invested in your existing plan if that is permitted.

2. Do a rollover. That means that your 401(k) dollars are taken from the existing account and deposited directly into another qualified 401(k) plan. You won't lose any of your money due to fees or penalties.

3. Do an indirect rollover. In this case, you must take care of rolling over your funds yourself and you run the risk of paying a penalty. An indirect rollover may be useful if you need the money from your 401(k) as a short-term loan, but only if you'll have the money back in time to make the deposit.

The trick is that when you deposit your money into a new account, you must roll over the full balance of your original 401(k) so you'll have to fund the 20% that your employer withheld from your own savings or by borrowing it from someone to cover the full amount of your original 401(k) balance.

If you complete the full rollover within the time limit, the 20% withholding will be returned to you when you file your tax return for the year. Otherwise, the 20% withholding will be treated like an early distribution, and you'll have to pay the taxes, a possible penalty, and the money will no longer be tax deferred. These factors can make an indirect rollover unappealing.

4. Cash in your account. You will receive the vested amount of your 401(k) minus the penalties and taxes. Keep in mind that the vested amount may not be the full amount of your 401(k) as it appears on your quarterly statement.

The amount you are vested usually depends on how many years you have been employed by the company. For example, if your statement shows that the market value of your 401(k) is $8,000 but you are only 40% vested, you will only receive $3,200 minus taxes and penalties. Taxes and penalties could be as much as 22% so the total amount you would receive would only be $2,816.

The best option is to Do a direct rollover. If at all possible, it is best to retain the tax-deferred status of your plan by moving all the money into a new plan. This also allows you the possibility of an employer match from your new employer. ■

Alternatives to Credit Cards: Layaway Makes a Comeback

With the severe economic downturn that occurred throughout most of 2008 and which culminated in an official recession by December of the year, there's one type of purchase method making a noticeable comeback. It's called layaway.

Also referred to as "lay-by" in English speaking countries such as Britain, Australia, New Zealand and South Africa, layaway is a method of purchasing an item without having to pay the entire cost at once. However, rather than taking the item home and then repaying the debt on a regular schedule, you don't receive the item until it is completely paid for.

Layaway Is Not a Credit Purchase

As the Federal Trade Commission (FTC) (www.ftc.gov) explains, layaway purchase plans are designed for customers who want to buy merchandise without having to resort to credit cards or having to pay the full price immediately. It's important to remember that layaways are not credit purchases.

For example, when you buy an item on credit, you hand over the plastic and take the merchandise home with you. By contrast, when you use layaway, you typically make a deposit—usually a percentage of the purchase price—and pay over time until you have paid for the item in full. In exchange, the retailer holds the merchandise for you.

Writing for the San Francisco Chronicle (November 28, 2008), staff writer Victoria Colliver reports that Sears Holdings Co., the parent company of both Sears and Kmart stores, started offering layaway at Sears after almost 20 years after it last provided the service. On the other hand, Kmart, which has always offered layaway, is making the service a key part of its advertising campaign for the holidays.

Colliver says there are only a handful of national retailers that offer layaway. Sears, which discontinued its layaway program in 1989 because customers weren't using it, restarted the service on November 16, 2008 in response to demand. The program is not available for appliances and home electronics. It allows customers to put merchandise on layaway until December 22, but all purchases must be paid for by Dec. 23.

Kmart's layaway program has been in place for decades and allows shoppers to make biweekly payments during an eight-week period. Other major retailers that offer layaway include Burlington Coat Factory Warehouse Corp. and TJX Companies Inc., which owns Marshalls and TJ Maxx stores. Colliver summarizes the layaway plans of these stores as follows:

- **Sears:** For an 8-week plan, a down payment is required of $20 or 20 percent (whichever is greater). Terms include a nonrefundable service fee of $5 and a cancellation fee of $15. Home electronics, appliances, and automotive merchandise are excluded.
- **Kmart:** Offers an eight-week layaway contract. The down payment includes the $5 service fee and a $10 cancellation fee for new layaway contracts and is collected when merchandise is put on layaway. The biweekly payment for all new contracts is 25 percent of the original balance.
- **Burlington Coat Factory:** Layaway items are held for 30 days. A 20 percent deposit and $5 service fee is due at the time of purchase, another 25 percent payment is due in 14 days and the rest is due two weeks later. The $5 service charge is nonrefundable, and if you change the layaway in any way, a $10 cancellation fee is charged. No cash refunds are given.
- **TJ Maxx and Marshalls:** (Only available at some stores.) A deposit of 10 percent of the total is required along with a nonrefundable fee, which typically is $5. Layaway items must be picked up and paid for in full within 30 days. Customers should go to their store for details.

> Thrift was never more necessary in the world's history than it is today.
>
> —Francis H. Sisson

Avoiding Layaway Problems

The FTC says that to help avoid problems, you should obtain the store's layaway policy in writing. It should include:

- **the terms of the layaway plan:** how much time you have to pay for the merchandise; when your payments are due; the minimum payment required; and possible charges, like a service fee, for using the plan. Find out if there is a fee or a penalty for missed or late payments: Will your contract be cancelled? Will the merchandise be returned to the sales floor?
- **the refund policy:** If you decide you don't want the merchandise after you've made some or all the payments, you may expect a refund. But retailers' policies may differ: Some give you all your money back; others may charge a non-refundable service fee; and still others may offer a store credit for the amount you paid.

Online Layaway

Colliver reports that with the growing popularity of layaway, it's not all that surprising that the concept has be-

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you can prepare to survive such economic hardship and preserve your financial health as much as possible.

Stick to Your Budget

Someone once said that you should "watch every dime coming into your house, because tomorrow it could be a nickel." The best way to keep track of every dime coming in to your house is to stick to your budget. In Volume 2, Creating a Budget, we discussed in detail how to set up a workable budget for your household. Sticking to that budget may be the most important thing you do when times are tough. The basic premise of a budget is simple—make sure you don't allow your expenses to exceed your income. Check your budget breakdown against the rough guidelines below. Yours will probably vary 1-5% in each category.

Pay Yourself First

As well as sticking to your budget, you also need to find a way to save something. The best way to do that is to "pay yourself first."

Most people pay everyone else first. They try to budget each payday, hoping they'll have some money left over. This is actually backwards. What happens is that as we make more, we pay more because we tell ourselves that now we have more money to get the things we want.

At the end of the day, or the year, we still haven't saved anything. "Pay yourself first" means that when you earn a dollar, the first person you pay is you. Sounds easy, doesn't it, but most of us simply don't do it. Instead, the first person we pay is Uncle Sam. For every dollar we earn, we pay as much as 20 to 30 cents in federal income tax. On top of that, there's state income tax, Social Security, and Medicare.

The government didn't always take their money straight from our paychecks. Before 1943, people received their paychecks first and were responsible for paying their taxes later. That became a problem of course when people started not saving enough to pay their taxes and spent all their money instead. That's when the government developed the system that meant they get paid automatically every time you get paid, and they've been doing it ever since.

So why don't we learn from the government? You can pay yourself first by making an automatic deposit into a retirement account such as a 401(k) or an IRA right from your paycheck and you not only save, but you also won't have to pay taxes on that money now. ■

Budget by Percentage of Income

Budget Item	% of Income	Budget Item	% of Income
Housing	25%	Utilities	7%
Food	20%	Personal Care	4%
Transportation	5%	Misc. Items	4%
Medical	5%	Personal Debt	15% max.
Insurance	5%	Savings	10% min.

Layaway Makes a Comeback

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come popular online. She says ELayaway.com in Tallahassee, Florida never touches the merchandise but offers payment systems for about 1,200 retailers, including the Apple Store, Brookstone, Gap and Adidas.

For a 1.9% transaction fee, consumers can set up an online schedule that withdraws payments from their accounts automatically. The fee includes the cost of shipping the item to the customer when the payments are complete. ■

Our certified credit counselors can help you make sense of your finances, set good long and short term goals, and get you started on your journey to financial freedom.

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