Financial Wellness
& Education

Your child graduated from college

Few things make parents prouder than seeing their child graduate from college. Your child has accumulated a wealth of new knowledge since he or she went through freshman orientation. But most colleges neglect to teach their graduates one important skill that is crucial to functioning as an adult in the real world: personal financial management.

This skill is becoming increasingly important. As your son or daughter completes the transition into adulthood, he or she will become fully responsible for many expenses that you used to cover or help with, such as rent, food, utilities, leisure, etc. Plus, it's likely that he or she also has heavy student loan obligations and possibly credit card debt as well.

Young adults need to take responsibility for their finances, creating a budget that allow them to pay their bills, reduce their debt and guard against a rainy day.

Setting a budget

The first, and perhaps most important, step to living a financially responsible life is setting a monthly budget. Until recently, this might not have been necessary for your child; his or her housing and utilities were paid on a by-semester basis and you were available to provide bailout money, if needed. But no more. Young adults need to take responsibility for their finances, creating a budget that allows them to pay their bills, reduce their debt and guard against a rainy day.

Debt and credit history

A good credit history is critical for obtaining loans and mortgages and renting decent apartments and can even play a role in some companies' hiring decisions. A recent graduate should be especially concerned with his or her credit score, because it is far easier to establish a good credit history at a young age than it is to try to correct past mistakes that may have lowered one's score.

Although the three main credit bureaus use a complex formula to determine a credit score, each bureau is generally looking for an established, ongoing record of taking on debt responsibly and paying it back in a timely, reliable manner. As such:

A more established, or older, record is better. That is one reason why older adults tend to have better credit scores.

A history of taking on debts is necessary to establish creditworthiness. You can't prove how responsibly you handle debt without first taking on some debt. Thus, although having too much debt can negatively affect a score, having existing lines of credit available will usually help it.

But the most important factor in calculating a credit score is a demonstrated reliability in repaying debts in a well-managed, timely manner. Prompt payment of debts is one of the most important obligations that a responsible adult faces. Of particular importance is student loan repayments. Failure to make such payments can have a particularly devastating effect on a young adult's credit report.

Prudent management of credit card debt is also critical. Many young people use credit cards to live beyond their means, accumulating high balances on their cards. Knowing this, credit rating bureaus view high levels of credit card debt as a sign that a person lacks financial discipline. Of course, another reason to keep an eye on credit card use is that credit cards generally charge very high interest rates; high balances can lead to a cardholder being charged correspondingly large fees every month just to finance his or her debt.

Savings

As a caring parent, it is natural for you to want to help your children financially, even after they've left the nest. But young adults need to learn to be self-reliant, even in cases of emergency, and they need to learn how to purchase big-ticket items without sacrificing the timely payment of their normal monthly expenses.

This can be accomplished with one simple tactic: regularly depositing a portion of each paycheck into a savings account. The goal is to accumulate at least six months' worth of income in savings,

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which can be used for emergencies or for living expenses in case of a job loss. Separately, your child should establish a stand-alone fund that can be used for large purchases such as a vacation or a new computer.

Life insurance

It might be surprising to learn that even young adults need life insurance. But even though your child might not have financial dependents just yet, his or her death could still have unexpected financial implications for your family. You could find yourself responsible for funeral and burial expenses, as well as any student loans issued by a bank, state government or private institution (such as a school) that you co-signed. (Loans sponsored by the federal government would likely be canceled.) Life insurance coverage could help cover these contingencies.

Also, buying life insurance at a young age is a good idea because that's generally when it is cheapest and easiest to obtain. Life insurance companies primarily base insurability and cost decisions on age and health. Since young adults tend to be in good health and are generally judged to have a low mortality risk, life insurance companies tend to be willing to cover them at low premiums. In contrast, people who put off getting life insurance will be older and possibly less healthy when they try to do so, so they will find it more expensive or even impossible to get coverage.

Investing

It's easy to see why young adults might not be that interested in personal investing when they finish school. Since they're just starting out in their careers, new graduates probably don't have much money to spare — what with an entry-level income, college loans to repay, new expenses, and a social life to support. And the big goals that investing is supposed to fund — buying a home, starting a family, retirement, etc. — all seem far in the future. Why worry now?

Simple. Although a recent graduate might not have much money to invest, he or she has one major advantage: time. The potential for growth increases with extra time due to the power of compounding.

To illustrate this power, consider this hypothetical example.[1] Assume you have a daughter who begins investing at age 22. At the beginning of every month, she puts $100 into an investment account that earns a constant annual 8 percent return. She continues her monthly contributions without fail for 20 years. At age 42, your daughter stops making contributions, but leaves the money in the account to grow – still at a constant 8 percent rate – until age 62, when she decides to retire. From her $24,000 cumulative contribution, her account will have grown to $292,133, based on our assumptions.

But what if—hypothetically—your daughter waits 20 years? Assume that she starts investing at age 42. She realizes that she needs to catch up, so she contributes $300 every month, and she continues to do so for the next 20 years, until the age of 62. She achieves an 8 percent rate of return, just like in the previous hypothetical example. When she turns 62 and retires, her account will total $177,886. Despite tripling her investment, her procrastination will reduce the size of her nest egg by nearly 40 percent.

Make investing automatic

Even though young adults lead busy lives, there are ways they can use the power of compounding to their advantage without adding to their list of monthly chores. One of the easiest is through a workplace-sponsored retirement plan such as a 401(k) or — if your son or daughter works for a nonprofit organization — a 403(b). Many employers offer this benefit, allowing their employees to automatically have pretax contributions deducted from each paycheck and put into a retirement account that offers a varying array of investment options and tax-deferred growth. Because contributions are made before taxes are deducted, participating in such plans lowers an employee's tax burden and eases the contribution's effect on take-home pay. For instance, if someone in the 25 percent tax bracket contributes $100 per pay period to his or her 401(k), his or her "take-home" pay will be reduced by just $75.

Foresters Financial Services, Inc. offers similar "systematic investing" solutions that allow a set amount to be deducted from a paycheck or bank account on a regular basis to be invested according to pre-determined allocations. Such methods make investing an easy habit to form. Still, it is important to note that systematic investing does not guarantee a profit or protect against a loss in declining markets. Also, since systematic investing depends on continuous investment regardless of fluctuating price levels, investors should consider their ability to continue making investments through periods of low price levels.

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- Save and invest for retirement, education and other life events
- Create retirement income strategies
- Protect the ones you love
- Plan your legacy

Together, we can help you achieve financial and family well-being—now and tomorrow, this generation and the next.

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[1] This hypothetical example does not reflect the performance of any Foresters Financial product or any other actual investment. It does not reflect the impact of taxes and fees, values will be less. Changes in tax rates and tax treatment of investment earnings and applicable tax laws may also impact results.

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