

LESSON 12

ALL SAVINGS CHOICES INVOLVE RISK: GRANDMA'S GIFT

INTRODUCTION

In this lesson, students learn that all savings choices involve risk. Students evaluate various alternatives for saving money.

ECONOMICS BACKGROUND

Saving means setting aside some of today's income for future use. Various forms of savings allow people to earn money on their savings. However, all savings choices involve costs and benefits. There are no risk-free decisions about savings.

LANGUAGE OF ECONOMICS

Economize: To base decisions on an assessment of costs and benefits, choosing the best combination of costs and benefits among the alternatives.

Risk: The chance of losing money. Risk is the opposite of safety.

CROSS CURRICULUM SKILLS

Students develop skills in writing, speaking, and problem solving.

OBJECTIVE

Students explain the advantages and disadvantages of savings alternatives, using the criteria of safety, reward, ease of getting cash, and ease of opening an account.

MATERIALS

- ◆ Visual 1
- ◆ Activities 1* and 2

TIME REQUIRED

One class period

PROCEDURE

A. Explain to the students that in this lesson they will study the advantages and disadvantages

of various forms of savings. Imagine that you just received \$1,000 from your grandmother. She tells you that the money is yours to keep, but you may not spend it for at least two years. Ask: What are some ways in which you might save Grandma's gift?

(Accept a variety of responses. Students might mention such alternatives as placing the \$1,000 in a piggy bank, savings account, or checking account.)

B. Explain that there is no way to be completely sure that you will have the gift available to you in the future. Any decision you make involves a risk. The question is what level of risk you wish to take.

C. Display Visual 1, *No Risk-Free Decisions*. Ask the class to name the costs and benefits of saving the \$1,000 in a piggy bank or a savings account. Their analysis might look like this:

| | Benefits | Costs |
|-----------------|--|--|
| Piggy Bank | <ul style="list-style-type: none"> • You know where it is • Easy to get to | <ul style="list-style-type: none"> • No interest is earned • Might be lost or taken from your room |
| Savings Account | <ul style="list-style-type: none"> • Safe in your account • Earn some interest | <ul style="list-style-type: none"> • Low interest rate • Harder to get to |

D. Explain to the class that their task is to decide how best to use Grandma's gift. Distribute Activity 1, *Grandma's Great Gift*. Explain how to use the rating symbols of *high*, *moderate*, and *low* by using the example of the mattress.

E. Divide the class into five groups. Assign two types of saving to each group. Explain that each group should present its alternative uses for saving to the class, explain the benefits and costs of each choice considering safety, reward, ease of getting cash, and ease of opening the account, and then recommend how to use Grandma's gift. Invite each group to make its presentations.

F. Explain to the class that their task now is to give advice to others who are facing saving decisions. Distribute Activity 2, *The \$5,000 Question*. Reassign the students to their five groups and assign each group one case from Activity 2.

- G. Discuss the group recommendations for each case in Activity 2. Here are the suggested answers:

Case 1

Jerry wants his savings for emergencies, so he should look for low risk and ease of getting his cash back whenever he wants it. Alternative 1 meets both of these objectives, so Jerry should put his money in a savings account or money market account or divide his savings between the two.

Case 2

Rachel earns a high income and is interested in saving for retirement. Since she will not retire for several years, she might want to consider placing the \$5,000 in Alternative 3 because of the greater risk and the greater reward.

Case 3

Elaine does not want to lose the \$5,000 because she wants to buy a home. She plans to make the purchase in a few years, so she is not concerned about having quick access to her cash. Alternative 2 is her best alternative, since its risk is lower than the risk for Alternative 3 and its rewards are higher than the rewards for Alternative 1.

Case 4

George and Monica earn high incomes. They can take some risk with the \$5,000. In addition, their oldest child will not be ready for college for ten years. They do not need to worry much about getting their cash back for some time. They might want Alternative 3 because of the greater reward and the greater possible return.

Case 5

Joey and Phoebe do not want to lose the \$5,000, because of their plans to buy a town house and have children. They plan to make these changes in a few years, so they do not need quick access to their cash. Alternative 2 is their best alternative, since its risk is lower than the risk for Alternative 3 and its rewards are higher than the rewards for Alternative 1.

CLOSURE

Review the key points of the lesson. Ask:

What are savings alternatives that tend to provide safety of cash?

(Regular savings account, money market account, certificate of deposit)

What are savings alternatives that tend to reward taking risks?

(Corporate bonds and stocks)

ASSESSMENT

Multiple Choice Questions

1. Which form of savings is considered to be the safest?
 - a. Stock
 - b. Bonds
 - *c. Treasury Bills
 - d. Junk Bonds
2. A key advantage of buying stocks and bonds is
 - a. safety.
 - *b. reward.
 - c. unlimited liability.
 - d. ease of opening an account.

ESSAY

👉 Rachel earns \$40,000 per year working as an accountant. She is 35 years old and married, with one young child. Her husband Tom currently stays at home to look after their child. Rachel and Tom have inherited \$5,000 that they plan to save. How would you suggest they use the \$5,000? Rachel and Tom have just read about the increasing cost of college tuition and can't sleep nights. *(Since their child will not be ready for college for several years and they are very worried about saving for college, they might want to place their savings in stocks or bonds or some combination because of the greater possible return.)*

👉 Imagine that you did receive \$1,000 as a gift from your grandmother. If saving the money is your best choice, what type of saving alternative would you consider? What would be the advantages of the alternative you selected? What would be the disadvantages? Why is this combination of advantages and disadvantages right for you?

VISUAL 1
NO RISK-FREE DECISIONS

| | Benefits | Costs |
|-----------------|-----------------|--------------|
| Piggy Bank | | |
| Savings Account | | |

ACTIVITY 1

GRANDMA'S GREAT GIFT

Name _____

Date _____

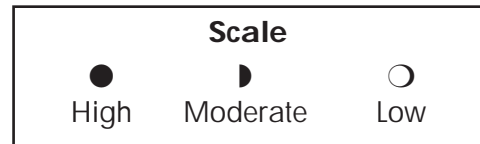
Your grandmother has given you a gift of \$1,000. However, there is one condition on the use of the money. You may not spend the money immediately. It must be set aside today for spending some time in the future. Your task today is to decide how to use the \$1,000.

Each type of savings listed below is rated according to the following criteria:

1. Safety
2. Reward
3. Ease of getting your cash back
4. Ease of opening up an account, which relates to the amount of money you need to open the account.

Your groups will be assigned two saving alternatives. After you have studied the alternatives, do the following:

1. Present the alternative uses for saving to the class.
2. Explain the advantages and disadvantages of each choice, considering safety, reward, ease of getting cash, and ease of opening the account.
3. Tell how your group wishes to use the gift.



| Type of Saving | Description | Safety | Reward | Ease of Getting Cash | Ease of Opening Account |
|---|---|--------|--------|----------------------|-------------------------|
| Mattress | You could hide your money under a mattress. | ○ | ○ | ● | ● |
| Regular (Passbook) Savings Account | The Federal Deposit Insurance Corporation (FDIC) insures savings accounts for up to \$100,000. Interest rates are usually lower than rates for other types of savings choices, but you can open an account with very little money. You can also withdraw your money whenever you like. | ● | ○ | ● | ● |
| Money Market Account | The FDIC also insures these special bank accounts for up to \$100,000. Your interest rates go up and down, but they are higher than those on regular savings accounts. Banks often require that you deposit \$100 or more, and you can quickly get your money by writing checks or by withdrawing cash. | ● | ○ | ● | ◐ |

ACTIVITY 1 (CONTINUED)

| Type of Saving | Description | Safety | Reward | Ease of Getting Cash | Ease of Opening Account |
|------------------------------------|---|--------|--------|----------------------|-------------------------|
| Certificate of Deposit (CD) | CDs are a special type of savings deposit that you must leave in the bank for a set amount of time during which you receive a fixed rate of interest. The FDIC also insures these accounts for up to \$100,000. Banks usually require that you deposit at least \$500. If you withdraw your money before the end of the given time, you must pay a penalty. | ● | ◐ | ○ | ◐ |
| US. Government Securities | Government securities are IOUs that the government issues when it borrows money. They are very low-risk because the government guarantees them. Below are four varieties. | | | | |
| Savings Bonds | You can buy savings bonds from the federal government for as little as \$50. You can't sell them to other people, but you can sell them to the government whenever you want cash. | ● | ◐ | ● | ● |
| Treasury Bills | Treasury bills are short-term IOUs that the government repays in one year or less. You can easily sell Treasury bills if you want cash. The government requires that you buy at least \$10,000 worth of bills at one time. | ● | ◐ | ● | ○ |
| Treasury Notes | Treasury notes are medium-term IOUs that the government repays after one year but within 10 years. You can easily sell Treasury notes if you want cash. The government requires that you buy at least \$1,000 worth each time that you make a purchase. | ● | ◐ | ● | ◐ |

LESSON TWELVE

ACTIVITY 1 (CONTINUED)

| Type of Saving | Description | Safety | Reward | Ease of Getting Cash | Ease of Opening Account |
|-----------------------|--|--------|--------|----------------------|-------------------------|
| Treasury Bonds | Treasury bonds are long-term IOUs that the government repays after 10 or more years. You can easily sell Treasury bonds if you want cash, but the government also requires that you buy at least \$10,000 worth. | ● | ◐ | ● | ○ |
| Corporate Bond | Corporate bonds are IOUs that corporations issue when they borrow money. Your risk of losing your money is higher than it is with other types of savings because companies can go bankrupt. You must have at least \$1,000 to buy a corporate bond, but you can easily sell corporate bonds if you want cash. | ◐ | ● | ● | ◐ |
| Stock | When you buy stock, you usually take a greater risk than you would with any of the other types of savings. Your reward will vary, depending on the prices you pay for your stocks and the dividends you receive. The amount of money you must have to buy stock depends on the prices of the stocks you buy and the number of shares you want. | ○ | ● | ● | ◐ |

ACTIVITY 2

THE \$5,000 QUESTION

Name _____ Date _____

What follows are five case studies concerning how families or individuals might use their savings. Each has \$5,000 to save. Each is considering only three alternatives:

Alternative 1 Savings account and money market account

Alternative 2 2.5 year certificate of deposit

Alternative 3 Corporate bonds or stocks

Case 1

Jerry earns \$35,000 a year as a performer at comedy clubs. He is 26 years old and single. He has \$2,000 in a bank account and rents an apartment. He plans to use the \$5,000 for emergencies and to help pay for living expenses.

Which alternative do you recommend? _____

Case 2

Rachel earns \$100,000 a year as a marketing and sales executive. She is 48 years old and single. She is interested in saving for her eventual retirement.

Which alternative do you recommend? _____

Case 3

Elaine is 25 years old and earns \$25,000 as a teacher. She is engaged to be married, has \$2,000 in savings, and rents an apartment. She wants to use the \$5,000 to help her buy a house.

Which alternative do you recommend? _____

Case 4

George is an attorney and earns \$75,000. He is married to Monica, who earns \$60,000 as a director of human resources. They have two children, aged 6 and 8 years old. They are making payments on their home and two cars. However, they both have excellent retirement plans and they have \$20,000 in savings. They are interested in saving money for their children's college educations.

Which alternative do you recommend? _____

Case 5

Joey is a 27-year-old construction supervisor earning \$40,000. He is married to Phoebe, who does volunteer work at a day care center. They are planning to have children soon and move out of their apartment and into a townhouse.

Which alternative do you recommend? _____