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WOODY L. HUNT
COLLEGE OF BUSINESS

PERSONAL FINANCIAL LITERACY WORKSHOP

Session 2

Building Wealth Over Time

Center for Free Enterprise · Woody L. Hunt College of Business · The University of Texas at El Paso

Interactive tools: center-for-free-enterprise.github.io/PFL



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For learning only. This reading is educational material for the C4FE Personal Financial Literacy Workshop. It is not financial, legal, or tax advice. Figures are simplified examples; tax figures use 2026 federal rules for a single filer.

The interactive calculators mentioned in “Try it” boxes are free at **center-for-free-enterprise.github.io/PFL**. Nothing you type there is saved or sent anywhere.

INTRODUCTION

The Next Step

Session 1 covered how to manage the money you earn: budgeting, saving, and avoiding costly debt. Session 2 picks up where that left off. Once you have a budget that works, an emergency fund in place, and high-interest debt under control, the question becomes: what do you do with the money you are setting aside for the future?

The answer, for most people, is to invest it.

Investing can sound intimidating, like something reserved for wealthy people or financial experts. But the truth is that investing is one of the most accessible and important tools available to anyone who wants to build long-term financial security. You do not need a lot of money to start, and you do not need to be an expert. What you need is a basic understanding of how it works, a little patience, and the discipline to start early.

This session explains the fundamentals: why investing matters, how the most common investment products work, how to manage risk intelligently, how to think about two of the largest financial decisions you will face (student loans and a mortgage), how to actually open an account and start investing, how retirement accounts can work in your favor, what mistakes to avoid, and how to track your overall financial progress with a single number.

A USEFUL BENCHMARK:

Most financial experts suggest that to retire comfortably, a person needs to have saved roughly 10 to 12 times their annual salary by the time they stop working. For someone earning \$60,000 a year, that means accumulating \$600,000 to \$720,000. That is a large number, but it becomes far more achievable when you start early and let your investments grow over decades.

SECTION 1

Saving vs. Investing

Many people use the words “saving” and “investing” interchangeably, but they mean different things and serve different purposes. Understanding the distinction is the first step to putting your money to work effectively.

Saving means setting money aside in a safe, accessible place, typically a savings account. The money grows slowly through interest, the risk of losing it is essentially zero, and you can access it quickly when needed. Saving is ideal for short-term goals and your emergency fund.

Investing means putting money into assets (stocks, bonds, real estate, or other instruments) with the expectation that they will grow in value over time. Investments carry more risk than savings accounts, meaning their value can go up or down. But over long periods of time, they have historically generated significantly higher returns than savings accounts. Investing is best suited for long-term goals, particularly retirement.

The Problem with Keeping Everything in Savings

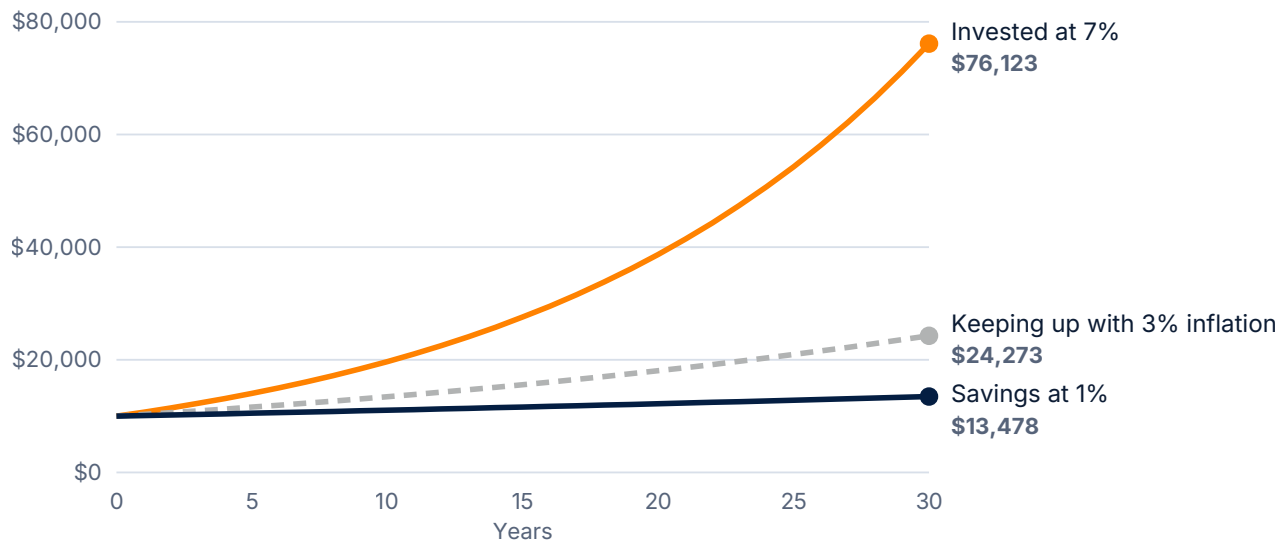
Keeping all your money in a savings account feels safe, and for short-term needs, it is. But for long-term goals, it carries a hidden cost: inflation.

Inflation is the gradual increase in the price of goods and services over time. When prices rise, each dollar you hold buys slightly less than it did before. The U.S. has historically averaged around 2–3% inflation per year. A traditional savings account often earns less than that, meaning the real purchasing power of your money, what it can actually buy, slowly erodes over time.

EXAMPLE:

Suppose you put \$10,000 in a savings account earning 1% interest per year. After 30 years, you would have about \$13,478. That sounds like growth. But if inflation averaged 3% per year over that same period, you would need about \$24,273 just to buy what your original \$10,000 bought. In real terms, you would have lost ground significantly.

Investing, by contrast, has historically outpaced inflation over long horizons. The U.S. stock market has returned an average of roughly 10% per year over the long run, well above the inflation rate. That gap, between what a savings account earns and what a diversified investment portfolio earns, is the core reason investing matters.



\$10,000 over 30 years. In savings at 1% it grows to \$13,478, short of the \$24,273 needed just to keep up with 3% inflation. Invested at an average 7% a year, it grows to \$76,123. Returns are averages; real markets go up and down.

KEY TAKEAWAY:

Saving protects your money in the short term. Investing grows it over the long term. Both have a role, but relying only on savings for long-term goals means inflation quietly chips away at your purchasing power.

SECTION 2

Key Concepts Before You Invest

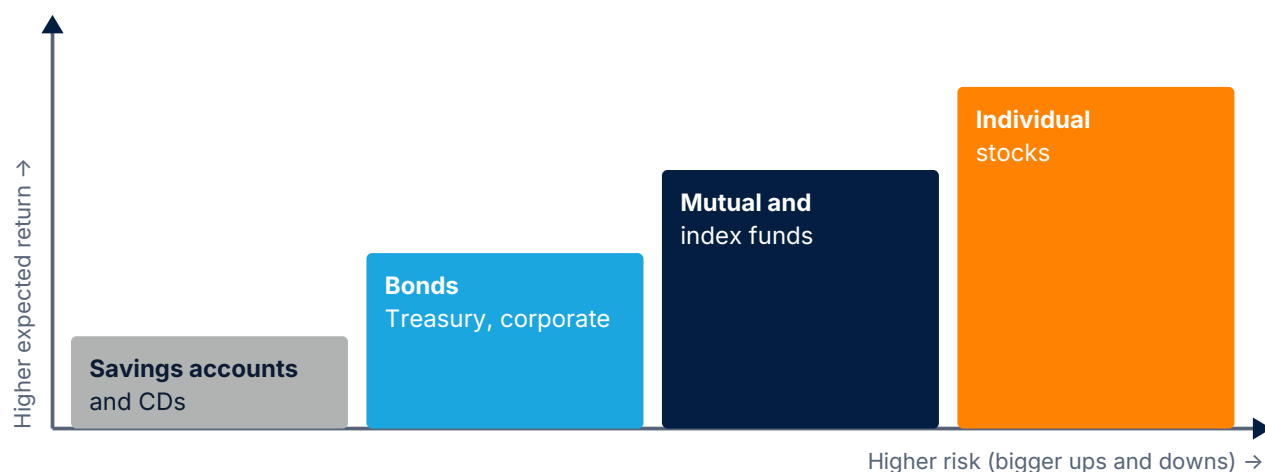
Before diving into specific investment products, there are several foundational concepts that will help you make sense of everything else.

Risk and Return

In investing, risk refers to the possibility that an investment will lose value. Return refers to the gain or loss that an investment generates over time.

These two concepts are inseparable: generally speaking, investments with higher potential returns also carry higher risk. A savings account has almost no risk but earns very little. A single company's stock can double in value, or lose most of it. Understanding this tradeoff is central to making good investment decisions.

The key insight is that risk is not the enemy. It is the price you pay for the opportunity to earn higher returns. The goal is not to avoid risk entirely but to take on the right amount of risk for your situation.



The risk-return spectrum. Investments that can earn more over time also swing more along the way. The goal is the right amount of risk for your situation, not zero risk.

Time Horizon

Your time horizon is how long you plan to leave your money invested before you need it. This is one of the most important factors in deciding how to invest.

If you are investing money you will need in two years, for a car or a move, you want low-risk investments, because you cannot afford to wait out a market downturn. If you are investing for retirement 40 years from now, you can afford to take on more risk, because even if the market drops sharply in any given year, you have decades for it to recover and grow.

A longer time horizon allows you to absorb short-term volatility in exchange for higher long-term returns. This is one of the great advantages young investors have: time itself is a financial asset.

Risk Tolerance

Risk tolerance is your personal ability to handle the stress of watching your investments lose value temporarily. Even if you know that markets recover over time, watching your account drop 30% in a bad year can cause panic, and panic leads to poor decisions like selling at the worst possible moment.

Risk tolerance is partly practical (how long until you need the money?) and partly psychological (how will you react to a sharp drop?). Being honest about both is important. An investment strategy you cannot stick to through a bad year is not the right strategy, regardless of its theoretical returns.

DID YOU KNOW?

During the 2008 financial crisis, the U.S. stock market lost nearly 40% of its value. Many investors panicked and sold everything, locking in their losses. Those who held on saw the market recover fully and then some: stocks gained 23% the very next year, and over the following decade the market more than doubled. Patience was worth more than any clever trading strategy.

Liquidity

Liquidity refers to how quickly and easily you can convert an investment into cash without significant loss of value. A savings account is highly liquid: you can withdraw money instantly. A retirement account is far less liquid: withdrawing early comes with taxes and penalties.

Understanding liquidity matters because different goals require different levels of access to your money. Your emergency fund should always be in a highly liquid asset. Long-term investments can afford to be less liquid in exchange for better returns.

The Power of Compound Interest, Revisited

Session 1 introduced compound interest in the context of savings. In investing, compounding is even more powerful because the returns are higher.

When your investment earns a return, that return gets added to your balance. The next period's return is then calculated on the larger balance, so your earnings begin to earn their own earnings. Over long periods, this creates exponential growth rather than linear growth.

EXAMPLE:

Suppose you invest \$100 per month starting at age 18 and earn an average annual return of 7%. By age 65, 47 years later, you would have contributed \$56,400 of your own money. But thanks to compounding, your account would have grown to approximately \$439,000. The difference, more than \$380,000, comes entirely from compound returns over time. Now suppose you wait until age 30 to start. With the same \$100 per month and the same 7% return, by age 65 you would have around \$180,000. Starting 12 years later costs you about \$260,000 in final wealth.

This is why financial advisors repeat the same advice endlessly: start early. The math is unambiguous.

TRY IT Investing and Compound Growth

See how time, fees, and market swings shape your savings.

center-for-free-enterprise.github.io/PFL/invest.html

KEY TAKEAWAY:

Risk and return are linked: higher potential rewards come with higher risk. Your time horizon and risk tolerance should guide how you invest. Compound interest rewards patience and punishes delay.

SECTION 3

Student Loans and Mortgages

Before talking about investment products and retirement accounts, it is worth addressing two of the largest financial commitments most people face: paying for college and buying a home. Both involve borrowing significant amounts of money, and both have long-term consequences for your financial health. Understanding them early puts you in a far better position to make good decisions.

Student Loans

For many students, college, a trade school, or another post-secondary program is the next step after high school. Higher education can be a sound investment: people with college degrees earn significantly more over their lifetimes than those without. But borrowing to pay for it introduces real financial risk, and the decisions you make now about student debt can follow you for a decade or more.

Federal vs. Private Loans

Not all student loans are equal. The most important distinction is between federal loans, issued by the U.S. government, and private loans, issued by banks and other lenders.

Federal student loans should always be your first option. They offer fixed interest rates set by a formula in federal law, a repayment plan that adjusts your monthly payment to what you earn, and in some cases, forgiveness for people who work in public service. You do not need a credit history or a co-signer to qualify. The two main types are Direct Subsidized Loans, where the government pays the interest while you are in school, and Direct Unsubsidized Loans, where interest starts accruing immediately, even before you graduate.

Private student loans are issued by banks and other lenders, often at variable interest rates and with fewer consumer protections. They may require a co-signer, often a parent. Repayment terms are less flexible, and there are no forgiveness options. Private loans should only be considered after you have exhausted federal options and any scholarships or grants available to you.

How Interest Accrues

One aspect of student loans that surprises many borrowers is how interest works during and after school. With unsubsidized federal loans, interest begins accruing from the day the loan is disbursed. If you borrow \$20,000 at 5.5% interest and take four years to finish school, about \$4,400 of interest builds up by graduation, so you owe roughly \$24,400 even though you never spent a dollar more. When repayment begins, that unpaid interest can be added to your principal in a process called capitalization, meaning you then pay interest on the interest.

This is not a reason to avoid student loans when they are genuinely necessary, but it is a reason to borrow only what you truly need and to make interest payments during school if you can afford to.

Borrowing Only What You Need

The single most important principle of student borrowing is this: borrow only what you need, not what you are offered. Lenders and schools will often present you with the maximum amount you qualify for, which can be significantly more than your actual costs. Accepting the full amount because it is available, and spending the excess on living expenses or non-essentials, is one of the most common and costly mistakes students make.

Before borrowing, calculate your expected total cost for the year: tuition, housing, food, books, and transportation. Then subtract any scholarships, grants, work-study income, and family contributions. Borrow only the gap.

If your family set up a 529 college savings plan on your behalf, those funds grow tax-free and can be withdrawn tax-free when used for qualified education expenses. Funds from a 529 plan should typically be used before taking on any student loan debt, since they carry no interest or repayment obligation.

The Return on Investment Question

Student debt is only a good investment if the degree it funds leads to earnings that justify the cost. This sounds obvious, but many students borrow without doing this math.

A useful rule of thumb: your total student loan debt at graduation should not exceed your expected first-year salary. If you are pursuing a degree in a field where starting salaries average \$45,000, borrowing more than \$45,000 total will make repayment genuinely difficult. If you are pursuing a field with starting salaries of \$75,000, you have more room.

EXAMPLE:

If you borrow \$30,000 in federal student loans at 5.5% interest and repay it over 10 years, your monthly payment will be approximately \$325. On a \$40,000 starting salary, about \$2,860 per month after federal taxes, that payment is about 11% of your take-home pay. It is manageable, but it will significantly constrain your budget, especially when combined with rent, food, and other expenses. If that same \$30,000 in debt came with a starting salary of \$65,000, the picture is much more comfortable. The debt is the same, but the ability to repay it without sacrificing everything else changes entirely.

TRY IT

Loan Calculator: Student Loans

See how interest builds while you are in school and what each repayment term costs.

center-for-free-enterprise.github.io/PFL/loans.html#student

Repayment Options

Federal student loan repayment changed for loans made on or after July 1, 2026. If you borrow from now on, you will choose between two plans:

- ◆ **Standard Plan:** fixed monthly payments over a term set by how much you owe: 10 years for balances under \$25,000, 15 years from \$25,000 to \$49,999, 20 years from \$50,000 to \$99,999, and 25 years for \$100,000 or more. A longer term means a smaller payment but more total interest. In the example above, the 15-year term would lower the payment to about \$245 a month but raise the total interest from about \$9,100 to about \$14,100. You can always pay faster than your plan requires; there is no penalty.
- ◆ **Repayment Assistance Plan (RAP):** your payment is 1% to 10% of your income, depending on how much you earn, with a \$10 minimum. Unpaid interest is waived as long as you make your payments, and any balance left after 30 years is forgiven (forgiven amounts may be taxable).
- ◆ **Public Service Loan Forgiveness (PSLF):** cancels remaining federal loan balances after 10 years of qualifying payments for people working in government or nonprofit jobs. Payments under RAP count toward it.

Rules like these change with new laws, so always confirm the details at [StudentAid.gov](https://studentaid.gov) before you borrow.

KEY TAKEAWAY:

Student loans can be a worthwhile investment in your future, but only if you borrow wisely. Use any 529 funds and federal options before private loans. Borrow only what you need. And make sure the degree you are financing leads to earnings that make repayment realistic.

Mortgages: Buying a Home

Buying a home is likely the largest single financial transaction most people will ever make, and a mortgage is the loan that makes it possible. While homeownership may be years away for most students reading this, understanding how mortgages work is useful now, because the decisions you make in your twenties about credit, savings, and debt directly affect your ability to buy a home later.

What a Mortgage Is

A mortgage is a long-term loan used to purchase real estate. The home itself serves as collateral, meaning if you stop making payments, the lender can take the property through a process called foreclosure. Mortgages typically run for 15 or 30 years, during which you make monthly payments that cover both principal and interest.

Because mortgages are amortized, early payments are weighted heavily toward interest, with only a small portion reducing the principal. Over time, this flips: later payments go mostly toward principal. This is why paying a little extra each month early in the loan can save a significant amount of total interest over the life of the mortgage.

Renting vs. Buying

One of the most common financial debates is whether it is better to rent or buy a home. There is no universal answer; it depends on your circumstances, your local housing market, how long you plan to stay in one place, and your financial readiness.

Renting offers flexibility. You are not tied to a location, you are not responsible for maintenance and repairs, and you do not need a large down payment. Renting is often the smarter choice early in your career, when your life situation is likely to change.

Buying builds equity: the portion of the home's value that you actually own, as opposed to what you still owe the bank. As you pay down the mortgage, and if the home appreciates in value, your equity grows. Home equity can eventually be a significant component of long-term wealth. Buying also provides stability: a fixed-rate mortgage locks in your housing payment, unlike rent, which can increase over time.

However, buying requires significant upfront costs (a down payment, closing costs, inspection fees, and more) as well as ongoing costs that renters do not face: property taxes, homeowners insurance, and maintenance. The common advice that buying is always better than renting is not universally true. It depends heavily on how long you stay, local market conditions, and whether you are financially ready.

Down Payments and Why They Matter

A down payment is the portion of the home's purchase price you pay upfront, out of pocket. The remainder is covered by the mortgage. Down payments are typically expressed as a percentage of the purchase price.

A 20% down payment has long been considered the standard for good reason: it means you borrow less, which lowers your monthly payment and total interest paid. It also means you avoid Private Mortgage Insurance (PMI), an additional monthly charge lenders require when the down payment is less than 20%, designed to protect the lender if you default. PMI typically adds 0.5% to 1% of the loan amount per year to your costs.

Some loan programs, including FHA loans backed by the federal government, allow down payments as low as 3.5%. While these programs make homeownership more accessible, they come with higher total costs over time. A larger down payment, built up through disciplined saving, is nearly always the better financial position.

Interest Rates and Credit Scores

The interest rate on your mortgage has an enormous impact on how much the home ultimately costs you. Even a small difference in rate, such as half a percentage point, can add up to tens of thousands of dollars over the life of a 30-year loan. And one of the biggest factors in the interest rate you are offered is your credit score.

This is one of the most concrete reasons to build and protect your credit score from a young age. A borrower with an excellent credit score may qualify for a mortgage rate meaningfully lower than someone with a fair score, on the same home, in the same market. That difference, compounded over 30 years, can be staggering.

EXAMPLE:

On a \$250,000 mortgage over 30 years, the difference between a 6.5% interest rate and a 7.5% interest rate is approximately \$170 per month. Over the full life of the loan, that is about \$60,000 in additional interest, for the exact same house.

TRY IT **Loan Calculator: Mortgages**

See how the price, down payment, rate, and PMI change your monthly payment.

center-for-free-enterprise.github.io/PFL/loans.html#mortgage

KEY TAKEAWAY:

A mortgage is a powerful tool for building long-term wealth through home equity, but only when you are financially ready. Build your credit score, save for a meaningful down payment, and understand the full costs of homeownership before committing. And remember: the interest rate you are offered depends significantly on the financial habits you build today.

SECTION 4

Investment Options

There are many ways to invest money, but a handful of core instruments account for most everyday investing. Here is a plain-language guide to each.

Stocks

A stock represents a small ownership stake in a company. When you buy a share of Apple, for example, you become a part-owner of Apple: a very small part, but an owner nonetheless. If the company grows and becomes more valuable, your shares increase in value. If the company struggles, your shares lose value.

Stocks can also pay dividends, which are periodic cash payments to shareholders, typically from a portion of the company's profits. Not all companies pay dividends; many reinvest their profits into growth instead.

Historically, stocks have offered the highest long-term returns of any common investment class. But they also come with the most short-term volatility. The value of any individual stock can swing dramatically based on company news, economic conditions, or market sentiment.

AN IMPORTANT DISTINCTION:

Owning a single company's stock is very different from owning a broad collection of stocks. The former is risky; the latter is how most ordinary investors should approach the stock market. More on this in the diversification section.

Bonds

A bond is essentially a loan you make to a government or corporation. When you buy a bond, you are lending money in exchange for regular interest payments and the return of your principal at the end of a specified period, called the maturity date.

Bonds are generally less risky than stocks because the payments are fixed and contractually obligated. A U.S. government bond (called a Treasury) is considered one of the safest investments in the world, because the federal government has never defaulted on its debt. Corporate bonds carry more risk, depending on the financial health of the company issuing them.

The tradeoff is that bonds typically offer lower returns than stocks over the long run. They are often used to add stability to a portfolio, particularly as investors get older and want to protect what they have built.

Bond ratings, assigned by agencies like Fitch, Moody's, and S&P, indicate the creditworthiness of the bond issuer. Investment-grade bonds are considered relatively safe. Below-investment-grade bonds (sometimes called "junk bonds") offer higher interest rates to compensate for higher default risk.

Mutual Funds

A mutual fund pools money from many investors and uses it to buy a collection of assets, typically stocks, bonds, or both. When you invest in a mutual fund, you are buying a share of that collection.

The key advantage of a mutual fund is instant diversification. Instead of buying one company's stock, you might own small pieces of hundreds of companies through a single fund. This significantly reduces the risk that any one company's poor performance will damage your investment.

Mutual funds are managed by professional investment managers who decide what to buy and sell within the fund. This active management comes at a cost: the management fee or expense ratio, charged as a percentage of your investment each year. Even a seemingly small fee difference can have a large impact over decades.

EXAMPLE:

On a \$100,000 investment over 30 years at a 6% annual return, a fund with a 0.10% annual fee leaves you with about \$70,000 more than a fund charging 0.57% annually. Fees matter: always check the expense ratio before investing.

Index Funds

An index fund is a type of mutual fund designed to replicate the performance of a specific market index, such as the S&P 500, which tracks 500 of the largest publicly traded companies in the United States. Rather than having a manager pick and choose investments, an index fund simply buys all (or most) of the securities in the index.

Because there is no active management, index funds typically charge very low fees, sometimes as little as 0.03% per year. And because they track the broad market rather than trying to beat it, they tend to outperform most actively managed funds over long periods.

Index funds are widely considered the most sensible investment vehicle for most ordinary investors. They are diversified, low-cost, and require no expertise to use effectively. Many financial experts, including Warren Buffett, have publicly recommended low-cost index funds as the best approach for the average person.

ETFs (Exchange-Traded Funds)

An ETF, or exchange-traded fund, is like an index fund in that it tracks a collection of assets. The key difference is that ETFs trade on a stock exchange throughout the day, just like individual stocks, while traditional mutual funds are priced once per day after the market closes.

For most long-term investors, the practical difference between an ETF and an index fund is small. Both offer low fees and broad diversification. ETFs have become increasingly popular because they are flexible, tax-efficient, and accessible through most brokerage accounts.

Getting Started: How to Actually Invest

Understanding investment options is only half the picture; at some point, you need to actually open an account and put money to work. Fortunately, this has become dramatically easier and more accessible in recent years.

A brokerage account is the account you open to actually buy and sell investments like stocks, bonds, and ETFs. Major brokerages such as Fidelity, Charles Schwab, and Vanguard allow anyone to open an account online, often with no minimum balance required. You link a bank account, transfer money in, and you are ready to buy your first investment.

For anyone who feels overwhelmed by choosing individual investments, a robo-advisor is a useful starting point. A robo-advisor is an automated investment service that builds and manages a diversified portfolio for you based on your goals, time horizon, and risk tolerance, typically using low-cost index funds. You answer a short questionnaire, and the platform handles the rest, including periodic rebalancing. Robo-advisors charge a small annual fee, often around 0.25%, but remove the need to research and select individual investments yourself.

Custodial and Minor-Owned Accounts

If you have earned income from a job, even part-time or seasonal work, you may be able to open a custodial Roth IRA before you turn 18. These accounts are opened and managed by a parent or guardian on your behalf until you reach adulthood, at which point ownership transfers fully to you.

The advantage of starting this early is enormous, precisely because of the compounding effect covered earlier in this session. A 16-year-old who contributes even small amounts from a summer job, and lets that money grow untouched for 50 years, has an extraordinary head start compared to someone who waits until their late twenties to open their first retirement account.

KEY TAKEAWAY:

For most people just starting out, low-cost index funds or ETFs that track broad market indexes are the simplest and most effective choice. Actually opening an account is far more accessible than most people expect, with no large minimum balance and no special expertise required. If you have earned income, even from a part-time job, ask a parent about opening a custodial Roth IRA. Time is the most valuable asset you have, and the earlier you open an account, the sooner it starts working in your favor.

SECTION 5

Diversification

Diversification is one of the most important principles in investing, and also one of the most intuitive: do not put all your eggs in one basket.



Don't put all your eggs in one basket. With everything in one company, one failure can wipe you out; spread across many, a single failure costs you only a small share.

Why Diversification Matters

When you own a single stock, your financial outcome is tied entirely to that one company. If it does well, great. If it collapses, due to fraud, competition, poor management, or bad luck, you could lose everything you invested in it. History is full of companies that seemed invincible and then failed.

When you spread your money across many different investments, the poor performance of any one holding has a much smaller impact on your overall portfolio. Some investments will be down in a given year, while others will be up. Over time, the losses and gains partly offset each other, and the portfolio grows more steadily.

Diversification Within Asset Classes

The most basic form of diversification is owning many different stocks rather than just one or two. A mutual fund or index fund that holds hundreds of companies provides this automatically.

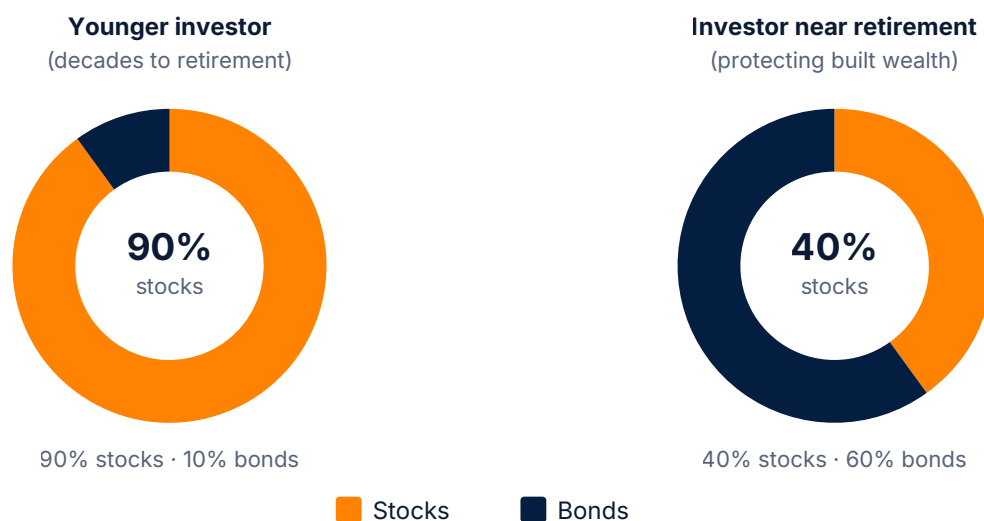
But diversification within stocks still leaves you exposed to broader market downturns: when the whole stock market falls, nearly all stocks fall together. This is why truly diversified portfolios also spread across different asset classes.

Diversification Across Asset Classes

Asset classes are broad categories of investment: stocks, bonds, real estate, cash equivalents, and others. Different asset classes tend to respond differently to economic conditions. When stocks are down, bonds often hold their value or even rise. When inflation is high, real estate tends to perform relatively well.

Owning a mix of asset classes smooths out the ride. A portfolio of 100% stocks will grow faster in a strong market, but it will also fall further in a crash. A portfolio that includes bonds alongside stocks will typically grow more slowly in good times but lose less in bad ones.

The right mix depends on your time horizon and risk tolerance. Younger investors with decades ahead of them can afford to hold more stocks. Investors closer to retirement typically shift toward a higher proportion of bonds to protect the wealth they have built.



Asset allocation shifts with age. With decades ahead, a young investor can ride out market drops and holds mostly stocks; near retirement, more bonds protect what has been built. These mixes are illustrations, not recommendations.

Dollar-Cost Averaging

One practical application of diversification thinking is a strategy called dollar-cost averaging: investing a fixed amount of money at regular intervals, say \$100 every month, regardless of what the market is doing.

When prices are high, your fixed amount buys fewer shares. When prices are low, it buys more. Over time, this averages out your purchase price and removes the temptation to try to guess the perfect moment to invest. It also makes investing a habit rather than a decision, which is one of the most effective behavioral tools available.

KEY TAKEAWAY:

Diversification across individual securities and across asset classes is the most reliable way to manage investment risk without giving up long-term growth. Own many things, not one thing.

SECTION 6

Retirement Accounts

Investing for retirement deserves its own section because retirement accounts offer significant tax advantages that make them far more powerful than ordinary investment accounts. Understanding these accounts is one of the most valuable things a young person can learn about personal finance.

Why Retirement Accounts Are Special

Retirement accounts are not investments themselves; they are containers that hold investments and provide special tax treatment. The government created these accounts specifically to encourage people to save for retirement, and the tax benefits are substantial.

The general principle is this: money inside a retirement account grows without being taxed each year. In a regular brokerage account, you owe taxes on dividends, interest, and capital gains as you earn them, which reduces the amount available to compound. In a retirement account, all of that growth compounds tax-free (or tax-deferred) until you withdraw it.

The 401(k)

A 401(k) is a retirement account offered by employers. You choose a percentage of each paycheck to contribute, and the money is automatically invested in options your employer makes available, typically a selection of mutual funds.

Contributions to a Traditional 401(k) are made with pre-tax dollars, meaning they reduce your taxable income in the year you contribute. You pay taxes when you withdraw the money in retirement. The assumption is that most people will be in a lower tax bracket in retirement than during their working years.

One of the most valuable features of a 401(k) is the employer match. Many employers will match a percentage of what you contribute, for example, matching 100% of your contributions up to 5% of your salary. This is essentially free money. If your employer offers a match and you are not contributing enough to capture the full match, you are leaving part of your compensation on the table.

EXAMPLE:

Suppose your salary is \$50,000 and your employer matches 100% of your contributions up to 3% of your salary. If you contribute 3% (\$1,500), your employer adds another \$1,500, effectively doubling your contribution at no extra cost to you. Over a career, employer matching can add up to tens of thousands of dollars.

TRY IT Paycheck and Employer Match

See how a 401(k) changes your paycheck and what the match adds.

center-for-free-enterprise.github.io/PFL/match.html

The IRS sets annual contribution limits for 401(k) accounts and updates them most years. In 2026, you can contribute up to \$24,500 to a 401(k). In general, you cannot withdraw money from a 401(k) without a penalty until age 59½.

The Traditional IRA

An Individual Retirement Account (IRA) works similarly to a Traditional 401(k) but is opened directly with a bank, brokerage, or other financial institution, rather than through an employer. Anyone with earned income can open one, regardless of whether they have a 401(k) at work.

Like a Traditional 401(k), contributions to a Traditional IRA are made with pre-tax dollars (subject to certain income limits), reducing your taxable income in the year you contribute. Taxes are paid when you withdraw funds in retirement.

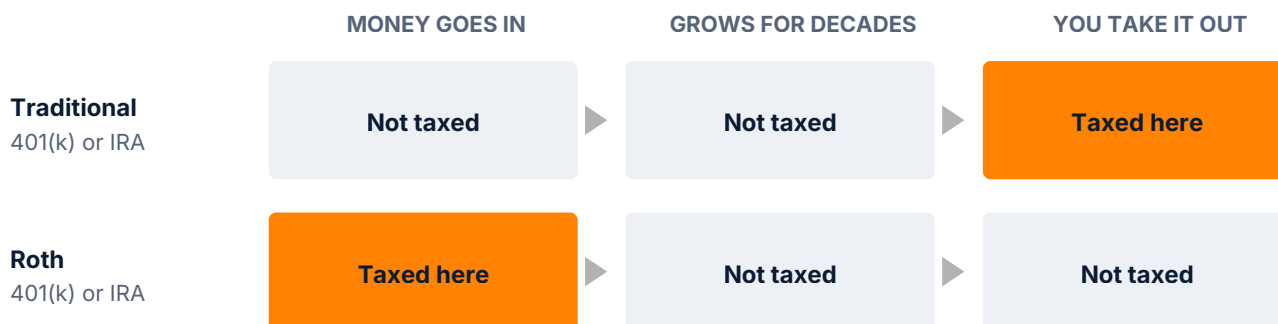
IRAs typically offer more investment choices than 401(k) plans, since you are not limited to the options your employer selected. Annual contribution limits are lower than 401(k) limits: \$7,500 in 2026.

The Roth IRA and Roth 401(k)

Roth versions of both accounts work in reverse from the tax perspective. Contributions are made with after-tax dollars, meaning you pay taxes on the money before it goes in. But the growth and all qualified withdrawals in retirement are completely tax-free.

This is a particularly attractive option for young people. If you are early in your career, you are likely in a lower tax bracket now than you will be later. Paying taxes now, at a lower rate, and then withdrawing everything tax-free in retirement, potentially after decades of growth, can save a significant amount of money.

There is also a practical advantage: since you have already paid taxes on the contributions, the government does not force you to start withdrawing money at a certain age as it does with Traditional accounts. Your money can continue to grow untouched for as long as you choose.



Traditional vs. Roth: when you pay taxes. A Traditional account lowers your taxes now and taxes withdrawals later; a Roth taxes the money going in, then the growth and qualified withdrawals are tax-free.

ROTH VS. TRADITIONAL: WHICH IS BETTER?

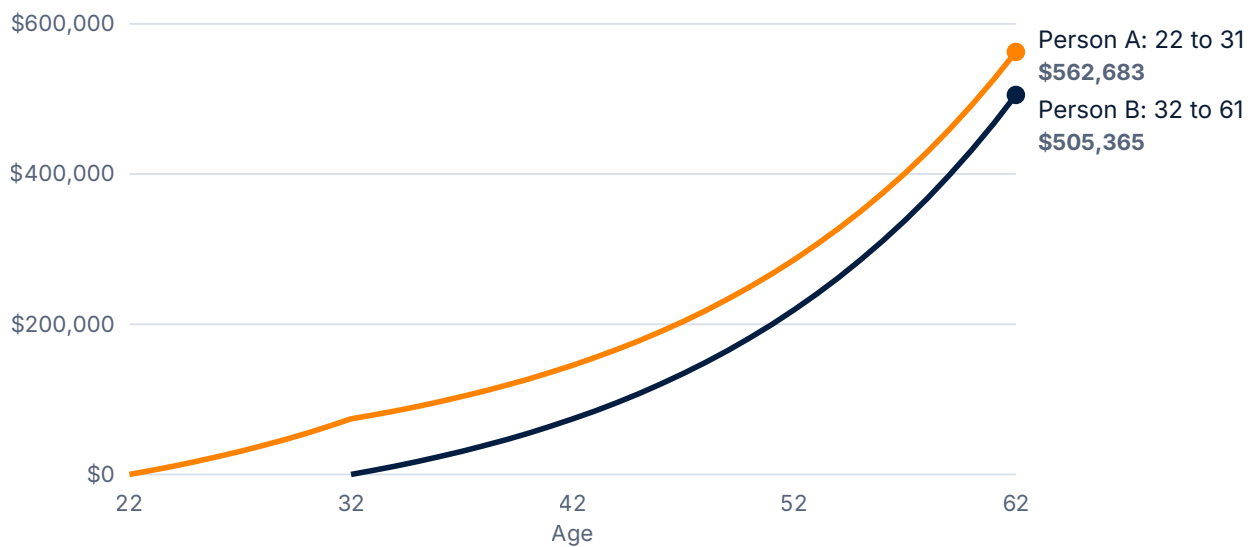
For most high school and college students or early-career workers, a Roth account is generally the better choice. You are likely in a low tax bracket now, tax rates may rise in the future, and locking in tax-free withdrawals on decades of growth is enormously valuable. As your income grows and your tax situation becomes more complex, the calculus may shift.

The Power of Starting Early

The retirement account section would be incomplete without returning to the central theme of compounding. The earlier you start contributing to a retirement account, the more time your money has to grow, and the difference is staggering.

EXAMPLE:

Suppose two people both invest \$5,000 at the start of each year in a Roth IRA earning an average 7% annual return. Person A starts at age 22 and stops after 10 years, at 32: contributions totaling \$50,000. Person B starts at age 32 and contributes every year for 30 years, until 62: contributions totaling \$150,000. At age 62, Person A, despite contributing far less, ends up with more money than Person B, because those early contributions had so many more years to compound. Person A ends up with roughly \$563,000, while Person B ends up with around \$505,000. Person A contributed \$100,000 less and still came out ahead. That is the power of starting early.



Person A puts in \$5,000 a year for 10 years (\$50,000) and then stops; Person B starts 10 years later and puts in \$5,000 a year for 30 years (\$150,000). Both earn 7% a year. At 62, A has \$562,683 and B has \$505,365.

KEY TAKEAWAY:

Take full advantage of retirement accounts, especially if your employer offers a match. Prioritize Roth accounts early in your career. And start as soon as you can; no other single factor matters more than time.

SECTION 7

Common Investing Mistakes

Understanding what not to do is just as important as knowing what to do. Here are the most common and costly mistakes new investors make.

Waiting for the “Perfect” Time to Invest

One of the most common reasons people delay investing is the belief that they should wait for the right moment: when the market is lower, when the economy looks more stable, when they feel more certain. This is called timing the market, and decades of research consistently show that it does not work.

Short-term market movements are unpredictable. People who try to time the market typically end up buying high and selling low, the opposite of what they intend. Meanwhile, people who simply invest consistently regardless of market conditions, riding the long-run trend, tend to come out ahead over time.

The best time to start investing is as soon as you have your emergency fund in place and high-interest debt under control. Not next year. Not after the next election. Now.

Panic Selling

Related to timing the market is the mistake of panic selling: selling investments when the market drops sharply. Markets go through downturns regularly. Recessions happen. Crashes happen. Every time so far, the broad U.S. stock market has eventually recovered and gone on to reach new highs.

When you sell during a downturn, you turn a temporary paper loss into a permanent real loss. You also typically miss the recovery, which often happens quickly and unexpectedly. The investors who came out of the 2008 financial crisis in the best shape were not the ones who sold at the bottom; they were the ones who held on, or even bought more.

RULE OF THUMB:

If you are invested in a diversified portfolio for the long term and the market drops, the correct response is almost always to do nothing. Volatility is the price you pay for long-term returns.

The Tax Cost of Frequent Trading

There is another reason, beyond the behavioral risks already discussed, that frequent buying and selling is a poor strategy: taxes.

When you sell an investment for more than you paid for it, the profit is called a capital gain, and it is taxable (outside a retirement account). The tax rate you pay depends on how long you held the investment before selling.

If you hold an investment for more than one year before selling, your profit qualifies for the long-term capital gains tax rate, which is significantly lower than ordinary income tax rates: typically 0%, 15%, or 20% depending on your income. If you hold an investment for one year or less, your profit is taxed as a short-term capital gain, at your regular income tax rate, the same rate applied to your paycheck, which can run as high as 37%.

EXAMPLE:

Suppose you buy a stock for \$1,000 and sell it for \$1,200, a \$200 profit. If you held it for more than a year, you might owe around \$30 in taxes at a 15% long-term rate. If you held it for a year or less, that same \$200 profit could be taxed at a rate of 24% or more depending on your income, costing you \$48 or more on the exact same gain.

This is one more reason, on top of the behavioral and statistical evidence already discussed, that long-term investing consistently outperforms frequent trading: the tax code quite literally rewards patience with a lower bill.

Ignoring Fees

Investment fees are easy to overlook because they are small percentages deducted quietly, without you ever writing a check. But over decades, they build up to an enormous impact.

A 1% annual fee on a \$100,000 portfolio might seem trivial. But over 30 years at a 7% return before fees, that 1% fee reduces your final balance by roughly \$166,000 compared to a fund charging 0.1%. Low-cost index funds and ETFs exist precisely to give ordinary investors access to the market without paying for active management that, on average, does not beat the market anyway.

Always check the expense ratio of any fund before investing. In general, lower is better. Many excellent index funds charge less than 0.1% per year.

TRY IT Investing and Compound Growth

See how time, fees, and market swings shape your savings.

center-for-free-enterprise.github.io/PFL/invest.html

Not Diversifying

Concentrating too much of your portfolio in a single stock, sector, or asset class is one of the most common and most dangerous mistakes. People often over-invest in what they know or what has recently performed well, which is not the same as what will perform well going forward.

A well-diversified portfolio in low-cost index funds requires no special knowledge and has historically outperformed most concentrated or actively managed portfolios over long periods.

Chasing Speculative Assets

Every generation has its version of speculative investment mania: assets that appear to offer extraordinary returns quickly attract enormous media attention and draw in new investors at the peak of their price. Cryptocurrency, certain tech stocks during the dot-com bubble, and various other assets have all played this role at different points in time.

Speculative assets can produce real gains for early investors, but they are characterized by extreme volatility and are driven more by sentiment than by underlying value. They are not a substitute for a diversified, long-term investment strategy. Many people who buy in near the peak of a mania end up losing money.

That does not mean speculative assets are always wrong, but any money allocated to them should be money you can afford to lose entirely without affecting your financial plan.

Not Starting Early Enough

This is the costliest mistake of all and the most common. People delay investing because they feel they do not earn enough yet, do not know enough yet, or have other priorities. Every year of delay has a compounding cost that cannot be recovered later.

You do not need to invest a large amount to start. Even \$25 or \$50 per month in a Roth IRA, invested consistently from a young age, builds meaningful wealth over time. The habit matters as much as the amount, and once the habit is established and your income grows, increasing your contributions becomes natural.

KEY TAKEAWAY:

The most damaging mistakes are waiting to start, panicking when markets drop, trading too frequently, paying high fees, and concentrating too heavily on a single investment. Selling investments you have held for a year or less also costs you a higher tax rate than holding for the long term, one more reason patience pays. Avoiding these behaviors puts you well ahead of the average investor.

SECTION 8

Bringing It Together — Your Net Worth

Throughout these two sessions, you have learned about income, budgeting, saving, debt, credit, insurance, and investing as if they were separate topics. In reality, they all feed into a single number that captures your overall financial health: your net worth.

Net worth is calculated as assets (what you own) minus liabilities (what you owe). Assets include things like cash in your bank accounts, the value of any investments, and larger possessions like a car or a home. Liabilities include any debt you owe: credit card balances, student loans, car loans, or a mortgage.

EXAMPLE:

Suppose you have \$3,000 in savings, \$2,000 invested in a Roth IRA, and a car worth \$8,000: total assets of \$13,000. You also owe \$1,500 on a credit card and \$5,000 on a car loan: total liabilities of \$6,500. Your net worth would be \$13,000 minus \$6,500, or \$6,500.

Assets what you own	Savings \$3,000	Roth IRA \$2,000	Car \$8,000
Liabilities what you owe	Card \$1,500	Car loan \$5,000	Net worth \$6,500
Assets \$13,000 – liabilities \$6,500 = net worth \$6,500			

Net worth is what is left when you subtract what you owe from what you own. Assets include cash, investments, a car, and a home (at market value); liabilities include credit card balances, student loans, a car loan, and a mortgage.

Net worth can be negative, especially early in life. Many people graduate from college with negative net worth because of student loans, and that is normal and not a cause for alarm. What matters is the trend over time, not the number at any single moment. Tracking your net worth once or twice a year is one of the simplest ways to see whether your financial habits are actually working: ideally, the number should be moving up, even slowly, year after year.

KEY TAKEAWAY:

Net worth is the single number that summarizes everything covered in these two sessions: your income, your saving habits, your debt, and your investments. Track it periodically, focus on the trend rather than the number itself, and let it guide whether your financial habits need adjusting.

SUMMARY

What to Take Away from Session 2

Investing is not about getting rich quickly or making clever predictions about the market. It is about putting your money to work steadily over a long period of time, using simple tools that are available to everyone. Earn money, manage it with a budget, protect it with savings and insurance, borrow wisely when necessary, grow it through patient long-term investing, and track your overall progress with your net worth.

Here are the key ideas to carry forward:

1. **Investing beats saving for long-term goals.** Inflation erodes the purchasing power of money left in savings. Investing has historically grown wealth at rates that significantly outpace inflation.
2. **Understand your risk tolerance and time horizon.** How you invest should match how long you have and how much volatility you can handle.
3. **Compound interest rewards early action.** Starting at 22 instead of 32 can mean hundreds of thousands of dollars in additional wealth at retirement.
4. **Borrow wisely for education.** Use 529 funds and federal loan options before private ones, borrow only what you need, and make sure the degree you are financing leads to earnings that make repayment realistic.
5. **Understand mortgages before you need one.** The financial habits you build now determine the terms you will be offered on the largest purchase of your life.
6. **Use simple, low-cost tools.** Index funds and ETFs that track broad markets are diversified, inexpensive, and have strong long-term track records.
7. **Getting started is easier than it seems.** Brokerage accounts require no large minimum and no special expertise. If you have earned income, ask about a custodial Roth IRA.
8. **Diversify.** Own many things across multiple asset classes. Do not concentrate your financial future in any single investment.
9. **Maximize retirement accounts.** Take the employer match if one is available.
10. **Hold for the long term, tax-wise too.** Investments held more than a year are taxed at a lower capital gains rate than those sold quickly.
11. **Avoid the big mistakes.** Do not try to time the market. Do not panic sell. Watch your fees. Stay away from speculative assets as a core strategy.
12. **Start now.** There is no perfect time, no minimum amount, and no prerequisite knowledge required to begin. The only thing you cannot recover is time.

A FINAL THOUGHT:

Wealth is not built by earning more than everyone else. It is built by spending less than you earn, saving consistently, borrowing only when it makes sense, and investing patiently over a long time. These are habits anyone can develop, and the earlier you start, the more powerful they become.



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