

# What Should Every Student Know?

## A Review Essay

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What should every student know about financial counseling and planning? To some extent, the minimum requirement is determined by accreditation and certification program requirements, such as the Accredited Financial Counselor program and the Certified Financial Planner (CFP) program. In particular, undergraduate programs in financial planning are influenced by the comprehensive CFP test. However, only a minority of those getting jobs in the financial services industry will obtain the CFP certification. Furthermore, such testing tends to reflect what current practitioners are expected to know, rather than the underlying concepts that ideally should be understood.

When financial counseling is added to financial planning, the range of possible topics to cover is enormous. This essay will not attempt to cover much even within the areas of financial planning, although readers are encouraged to contribute relevant essays to this journal. There are two recent texts that may help fill some gaps in preparation of students for long careers in financial services. One text is *The Mathematics of Personal Finance: Using Calculators and Computers*<sup>(1)</sup> attempts to cover a range of mathematical techniques. Since I wrote one of the chapters, I will not review the book, but you can find out more about the book including the table of contents, at the [web site www.damepub.com](http://www.damepub.com). The book is especially clear in its treatment of the time value of money by tables, financial calculators, and spreadsheets, and the way this treatment is carried throughout most of the chapters. The approach makes the book more useful than the typical personal finance book to students outside of the United States. My own contribution involves an approach to household accounting for financial planning. This book will become more valuable to teachers if users of the book provide feedback to the editors and chapter authors.

*Undergraduate financial planning students and graduate students interested in financial management typically take courses in finance, which may focus on corporate finance. While many of the topics of introductory finance courses are relevant to household financial decisions, some finance textbooks give little attention to topics of importance to moderate and middle income households. The new textbook Finance*<sup>(2)</sup> *provides much more coverage of topics relevant to financial planning than does the typical finance textbook, and in a way that should provide better long term understanding of concepts. The authors are eminent, with Merton sharing the 1997 Nobel Prize in Economics for his work in options pricing.*

*Finance provides an excellent explanation of the difference between the real rate of return and the nominal rate of return. On most personal finance topics, the discussion is clear and appropriate. For instance, the discussion of index mutual funds is very good. The treatment of human capital as part of total household wealth is excellent, including a nice graph by age (p. 130). The authors state:*

*"In making lifetime saving/consumption decisions:*

*1. Try to do the analysis in real terms (constant dollars) to simplify the calculations and to avoid having to forecast inflation.*

*2. Start by computing the present value of your lifetime resources. The present value of your lifetime spending cannot exceed this amount." (p. 131).*

*This is the approach I have used with the Life Cycle Savings program (Hanna, Chang & Fan, 1995) in my classes, so it is nice to have validation in this textbook.*

*I take issue with the treatment of risk tolerance, which is similar to the financial planning approach rather than economic approach I would expect from two MIT-trained economists. "When we refer to a person's risk tolerance, we do not distinguish between a capacity to bear risk and attitude toward risk." (p. 271). This is fuzzy thinking, which Chen and I try to address in an article in this issue (Hanna & Chen, 1997).*

*Nevertheless, I will probably use Finance as a supplementary text in a graduate course, as it covers the essence of enough fundamental concepts to make it essential reading graduate students. For graduate students with limited time, I would prefer that they master Bodie and Merton's Finance rather than an investments textbook. Investments will change form over the years, but many of the concepts covered in this textbook will still be relevant through the next millennium.*

## ***References***

*Hanna, S. & Chen, P. (1997). Subjective and objective risk tolerance: Implications for optimal portfolios. Financial Counseling and Planning, 8(2), 17-25.*

*Hanna, S., Fan, X.J. & Y. R. Chang (1995). Optimal life cycle savings, Financial Counseling and Planning, 6, 1-15.*

*1. E. Thomas Garman and Jing J. Xiao (eds.) The Mathematics of Personal Finance. Houston, TX: Dame Publications, \$46.95 (ISBN 0-87393-533-0 ). (800) 364-9757.*

*2. Zvi Bodie and Robert C. Merton, Finance. Upper Saddle River, NJ: Prentice Hall. Preliminary edition of paperback edition, \$36.87. (ISBN: 0137813457).*