MANAGE YOUR MONEY

Table of Contents

Financial Literacy: The Money Knowledge You Can't Do Without 2

Resisting the Urge to Spend Money 4

Can Money Buy Happiness? 6

Building an Emergency Fund on a Tight Budget 7

Get in the Saving Habit 9

Life Events: When Your Financial Plans Change 10

Resources 11

© 2011 ValueOptions Inc. All rights reserved.

Financial Literacy: The Money Knowledge You Can't Do Without

When it comes to money, ignorance is anything but bliss:

… You could be wasting thousands of dollars a year by not knowing the interest rate on your credit cards.
… You could be throwing away your chance for a decent retirement by failing to save now, even if you're still in your 20s.
… You could be cheating yourself out of that house you've always wanted because you don't know how to create a budget.

Such are the costs of NOT achieving financial literacy. It's hard to put a number on them, but people pay an enormous price for shortfalls of essential money knowledge. A failure to save (along with too little appreciation for stock market risk) may force millions to delay their retirement. Too much debt and too little saving add to the stress of cash-strapped workers.

Life isn't always easy. But it does not have to be this tough, and the future does not have to be so uncertain. By learning some core concepts and getting in the habit of living by them, you can avoid the pitfalls and get the most out of the money you earn.

Learn the basics

Accountants, financial planners and other experts typically point to the following areas where knowledge is most needed and often lacking:

Saving. We all realize—eventually—how crucial it is to put money aside for retirement and other life events, such as buying a home and paying the kids' college bills. The problem is that too many people don't learn this lesson early enough.

"The basic idea of saving consistently, year in and year out, is especially important for younger people," says Adele Brady Bolson, a certified public accountant. Bolson recommends saving 20 percent of your earnings. Some other experts set a 10 percent minimum.

All agree that you should always put money in a 401(k) or similar plan up to the percentage that your employer will match. For instance, if your employer offers a 50 percent match up to 6 percent of your pay, you are turning down free money if you don't sign up for the full 6 percent.

Borrowing. Unless you're born into wealth, you will need credit for the biggest purchases in life, such as a house and probably your first car or two. Student loans are another form of credit you should not be afraid to take on, if you must. And you may need to borrow if you want to start a business. In all these cases, you're borrowing for a benefit that will outlast the time it takes to pay off the loan. That's smart use of credit.

It's also smart to use credit cards, but only if you pay off the balance in full every month, with no exceptions. This is the way to earn a good credit score, which then qualifies you for the best terms on auto or home loans. Having no credit record is equivalent to having poor credit, says Aaron Patzer, founder and CEO of the personal finance Web site Mint.com. "Even if you are opposed to the idea of debt, you still need it," he says.

Spending. A key to financial literacy is awareness of exactly how much you spend, and on what, from day to day and month to month. Tracking expenses is the first step to taking control of your finances. You can do it with old-fashioned paper and ink, with software such as Quicken and Microsoft Money or with online services such as Patzer's Mint.com. It shows you where you can cut back on things you don't really need and look for cheaper alternatives for necessities, such as telephone service. Taking the time to get the most out of your money pays off "no matter what you're buying," says Bolson.

Banking. Literacy here means, among other things, knowing how to balance a checkbook and avoid overdrafts. "Some young people don't know how to keep track of what their balance is," Bolson says. She also finds it "amazing" that many people keep money in a non-interest-bearing checking account when you can put the money in a savings account that pays interest. Unfortunately, she notes, "there's nothing organized in our society to teach people about these things."

Taxes. The financially literate know about the tax bite and plan around it. This means budgeting for spending and saving out of after-tax income, not your pay before taxes. They also know how to make the tax system work in their favor. Income tax law has "all sorts of public policy that people don't understand," says John McWilliams, an accounting professor at Golden Gate University in San Francisco and former chair of the California Society of CPAs' Financial Literacy Committee. "There are huge incentives for private retirement savings," he says, but too few people take advantage of them. This brings us back to those 401(k)s, which defer taxes as well as build up a nest egg.

Investing. It's easy to suffer from information overload here. You can find hundreds of books and countless opinions on the topics of where to put your money and how to make it grow. But the basic concepts are simple. (It just takes discipline to follow them.) First, stocks do perform best in the long run—like 10 years or more. For shorter term, their risks outweigh their potential rewards. On the other hand, bonds and cash are less volatile in their price but are more vulnerable to inflation.

As a general rule, if you are saving for a long-term goal such as retirement, the younger you are, the more you should invest in stocks. Dollar-cost averaging, in which you invest the same amount at a same interval (monthly or quarterly, for instance) is a good way to do this, and 401(k)s will do it for you. By the same principle, you need to shift money out of the stock market as you get closer to retirement. If you need the funds in 10 years or less, you can't count on them if they're in stocks.

Armed with this essential knowledge, the financially literate need to develop good habits, such as learning to live below their means. It takes brainpower to handle the more complex side of investing, taxes and other financial matters. But as McWilliams points out, "Once you have the willpower, you can hire the brainpower."

Literacy also means being realistic in your expectations for work, retirement and other phases of life. Realists, for instance, know that they probably won't be able to keep working for the rest of their lives, even if they have failed to save for retirement. "Often I hear people say, 'Oh, I'm just never going to stop working,'" says Bolson. But the fact, she says, is that "people have to stop working before they die." That's a sobering thought, but it's typical of how the financially literate think.

By Tom Gray
© 2008-2012 Achieve Solutions®

Resisting the Urge to Spend Money

When you feel like spending money, what usually happens? Do you ever resist the urge to spend? Do you ever stop yourself before you make a purchase to really think about it? Resisting the urge to spend money can be tough! Try to think in terms of needs versus wants, or take notice of your thoughts, and use logic to override the urge.

What is a need?

One major step is to think about whether the items you want to buy are needs or wants. Psychologist Abraham Maslow, in his 1943 paper, "A Theory of Human Motivation," identified a hierarchy of needs. He wrote about the human motivation to satisfy basic survival needs, such as food, before moving on to satisfy other needs that are not as closely tied to survival, such as social supports.

Suppose you have prescription drug co-payments to pay, food to buy and utility bills to pay. You also have your mind set on buying a new face cream from a department store, and you feel a strong need to take a vacation. You can probably identify priorities for where your money should go first.

Primary needs involve your survival at the most basic level. Usually, these are expenses that relate to food, shelter, medical care, safety and other necessary expenses. However, there are times where needs may become blurry. Here's an example:

- You are starting a business and money is tight. The business would benefit from you attending a conference far away. You want to attend the conference but the travel may cost more than what you hope to gain by traveling to the conference. Is the travel a want or a need?

We would have to know more about the above situations to determine which need is more essential. It can be confusing to figure out at what point travel becomes more of a need and less of a want.

What is a want?

A want is something you don't have to have. An example of a want is music. Most people enjoy music, but music is not necessary for survival. A want can be confused with a need when we forget to consider to what degree something is essential. Asking whether something is a want or a need may stimulate you to think of an alternative to spending.

- New jeans may feel like a need if you have a special casual social event coming up and you aren't excited about any of your current outfits. You may need to consider what you already own that might give you the same sense of confidence as a new pair of jeans. Another alternative to "new" is a "pre-owned" pair of jeans, which will be new to you but cost less than brand new jeans.
- A vacation may be needed for good mental health, but if resisting the urge to spend, consider a "stay-cation." Use the time at home to take day trips and explore affordable local events or historical places in your town or region.

Sometimes it is difficult to think differently about resisting spending money. Even though you may realize you are craving something that is not a need, it may feel impossible to have to use willpower.

Use cognitive reframes

A cognitive reframe is a way of changing thoughts from automatic thoughts to wiser, more mindful thoughts. By changing thoughts, you can change your feelings. You don't have to listen to your impulses to spend. You can notice what your thoughts are and then reframe them to reflect your situation and your honest intentions. It's a way of harnessing your logical mind to help out your emotional mind.

When you have a burst of desire to spend money, notice what your first thoughts are, and then try to reframe your thoughts to reflect logic and reality. Notice how reframed thoughts give you a less intense feeling of urgency about spending.

Old thinking: "I love this purse! I have to have it!"
Reframed thinking: "I love this purse! I know I will find one I love just as much when money is not as tight and I can justify the expense. I don't have to have it."

Old thinking: "I'll put it on my credit card, and pay it off slowly."
Reframed thinking: "I could put this on my credit card, but when the bill comes I will be proud of myself if I can pay the whole balance."

Old thinking: "I'm having a bad day. I deserve to splurge on something."
Reframed thinking: "I'm having a bad day. I won't make it worse by spending money I don't have. There are many ways to treat myself without spending money."

Behavior choice

Just because you have a feeling of wanting, or an urge to spend, it doesn't mean you have to follow it. Keep your financial goals in mind, and don't let your emotional mind sway you or confuse wants with needs. An urge is like a wave. It will ebb and flow. If you have an intense desire to spend, make yourself wait a few minutes to allow that urge to subside. We always make better choices when we are not flooded with emotion.

By Rebecca Steil-Lambert, MSW, LICSW, MPH
© 2011-2012 Achieve Solutions®

Can Money Buy Happiness?

"If only I could have … ." Fill in the blank and you're repeating a wish that has been heard throughout history. Despite what philosophers and religious teachers may say in dissent, the belief that possessions are a path to happiness is widely held and deep-rooted. It undoubtedly upholds much of the modern consumer-driven economy. It spurs people to work harder and to raise their standard of living. It also stirs envy, greed and the frustration of trying to meet impossible material goals.

The search for contentment in possessions has its good and bad sides. Beyond that, there's the question of whether the prize is worth the quest. Is the promise of happiness in owning things a mirage?

Research into subjective well-being (SWB), the technical term for happiness or contentment, is relatively young and there is much to learn. The data so far suggest that possessions are a relatively weak force in producing happiness. There's more to SWB than pursuing "leisure of itself," but what one does in leisure time—such as socializing, worshipping or traveling—can have plenty of influence on one's state of mind.

Buying experiences more rewarding

Money buys more happiness if it buys experiences rather than things. Leaf Van Boven, a University of Colorado professor of psychology who has studied people's reactions to different kinds of purchases, says spending aimed at producing a life experience tends to make people happier than spending on material goods. Research conducted by Van Boven and Cornell University's Thomas Gilovich indicates that, after basic needs are met, buying a vacation tends to pay off more handsomely in SWB than spending a comparable amount on a new wardrobe or a kitchen upgrade.

One reason material purchases fail to produce much happiness is that the people who place great store in them tend to report low SWB. In other words, people who think things can make them happier tend not to be very happy in the first place, and tend to stay that way.

Van Boven also says experiences are richer in happiness-producing factors, such as socializing. "Experiences make people happier in large part because they foster social relationships," he says.

Quick to fade: satisfaction from purchases of things

Researchers also have found that the satisfaction from buying material goods is quick to fade. So is any perceived boost in status: You can move up the scale by trading in your Pontiac for a Porsche, but you'll find there is always someone with more to show off. But just as the novelty and emotional boost of things wears off, the pleasure of a remembered experience actually can grow with time.

Other determinants of happiness

If psychology sends one clear message about material possessions, it's that they're not a likely source of lasting emotional value for those who already have the necessities of life. "Necessity" is itself a highly subjective concept. Some need more than others to feel comfortable or secure, though having more can also raise the necessity bar upward, so that one never seems to have quite enough.

In general, though, the other determinants of happiness—friends, marriage, family, faith and fun—look like more proven routes to the good life.

By Tom Gray
© 2004-2012 Achieve Solutions®

Building an Emergency Fund on a Tight Budget

Think you're making too little money to save any? You may be selling yourself short. Even on a low income, it is possible to build up a cash cushion for emergencies. But it's not something you can do overnight. It takes planning and patience.

Of course, a key step of saving is to take control of your spending. But you should plan to save even if you have not yet drawn up a budget. Setting a saving goal can help motivate your cost-cutting task. When you commit to put money aside, you have one more good reason to watch your pennies.

So what should that savings goal be? How much is the right amount for an emergency fund? Here are some tips to help you make a saving plan that works for you.

Set goals you can reach

Most financial planners say you should have an emergency fund to cover at least 3 months of your normal earnings. This is your cash "cushion" for unpleasant surprises—losing a job, sickness or injury, major car repairs, and the like. For many people, whatever their income, saving that much is easier said than done. One problem is that it takes time. If you're on a low, fixed income and can set aside 10 percent of that money each month, you're a good saver. But even at this rate, it will take you 2.5 years to get 3 months of cash flow in the bank.

That can be discouraging. You are less likely to give up if you break it up into small, achievable bites. "I'm a big fan of starting small and having some successes," says Jerry Love, a certified public accountant in Abilene, TX.

Love suggests saving at first for rare but large expenses. If you know you'll get a $600 bill for car insurance a year from now, set aside $50 a month for it starting now. Then add a monthly amount to cover next year's holiday shopping. If you can handle 3 or 4 items like these, you're close to saving a month's income. You have a cushion, and you have also developed a saving habit.

Build a moat on all sides of your savings

Your emergency funds have to be on hand when you need it. So don't put it in any investment, like stocks, that can lose value. But you don't want the money to be too close by. It's only for emergencies, after all. If you don't separate it from your checking or debit-card account, the temptation to spend it will be too great.

Think about those old-fashioned piggy banks—the ones you had to break to get at your money. They were designed to make saving easy and spending a little harder. Your own savings vehicle should work the same way. It needs to be set apart from the account you use for everyday spending. But it may still be too easy to tap. Cathi Brese Doebler, author of *Ditch the Joneses: Discover Your Family*, says you should think about saving at some other institution, such as a credit union. If it is in some other town and you need to make withdrawals by mail, so much the better. "A savings account at a local bank is easy to get to," she says, and in this case that's not an advantage.

Shopping around for savings vehicles can also pay off in better rates of return. The more interest you get, the more you are being rewarded for saving. Try to find an institution that pays higher interest for larger balances. This also rewards you for saving more.

One more way to build a moat around your money is to have someone else, such as an employer, put money directly into your savings account. Love says many companies now do this. If you are working, find out if a share of each paycheck can be sent to savings, with the rest going to your checking account.

This is a good way to "pay yourself first." Once the system is set up, saving just happens. You don't have to do anything more. If you are getting payments from a government program, check to see if a similar service is available.

Pay down debt, but keep the cushion growing

It gets harder to save if you're trying to pay down debt at the same time. Credit cards charge high interest, so it's good to pay them down as soon as you can. But if you have cash for emergencies, you can avoid using the plastic so it's best to do both. Build the cash cushion while reducing debt. Split your money between the two. If you make weekly deposits to your savings, Doebler says, you might redirect one of these each month toward paying off credit cards. If you have more than one card, Love advises paying off the one with the smallest balance first.

By Tom Gray
© 2011-2012 Achieve Solutions®

Get in the Saving Habit

How much can you afford to save? The answer depends not so much on your income, your spending and your saving, but on the order in which you put those 3 things.

Everyone has to start with income, since you can hardly set something aside when you have nothing coming in. But then the paths of habitual savers and spenders diverge. The savers pay themselves first, regularly putting money into a savings plan and adjusting their spending.

The spenders turn this process around. They write the checks, flash the plastic and tap the ATMs first. Then they see if they have anything left over at the end of the month to stick in a savings account.

Guess which method works.

Start small, but be sure to start

Experts (with plenty of common sense on their side) say the best way to start saving is, simply, to start saving. Start small if you must, but develop the discipline. “I firmly believe that just starting the routine of saving is very important,” says Georgetown, Texas fee-only financial planner Naomi Scrivener.

Like other planners, Scrivener suggests setting up some form of automatic saving system so that you don’t have to rely on your willpower alone. Tax-deferred retirement accounts at work, such as 401ks, are a natural place to start doing this. Given their tax benefits, these accounts are essential even if you’re the type who saves without being forced.

When willpower isn’t enough

You can also do such autopilot saving for shorter-term goals, such as college, a new home, a new car or a big vacation. Banks, brokerages and mutual-fund families have automatic withdrawal programs in which you arrange to have a certain amount taken from your checking account regularly (each month or quarter, for instance) and put into some longer-term investment. This can be a bank money-market account, a mutual fund or a brokerage account.

You don’t need to set much aside at the start. Scrivener says the amount depends to some degree on the would-be savers’ debt situation, but “if they start with 3 percent and 5 percent [of their gross income], it shouldn’t be that painful.”

Whatever form your savings commitment takes, you still face the task of bringing your spending into line. It makes no sense to put money aside if the result is just higher credit-card bills.

By Tom Gray
© 2001-2012 Achieve Solutions®

Life Events: When Your Financial Plans Change

Just as life goes naturally through stages, so should your financial planning. Even if you've planned wisely at 25, by the time you're 65 you will have to make some changes in the way you manage your money. And common life events, such as marriage, the birth of children and retirement, all may force you to revisit and possibly revise any life-blueprint you may have made earlier. Here are some of the events that can change your planning as well as your life:

Marriage

When 2 young people get married for the first time, they start learning what it means to be responsible for someone other than themselves. This may not require a change in plans, but it does raise the need for life insurance. Disability insurance already may be in place.

Children

You may have figured all along on having children, but you might not have started a college saving plan until they arrived. Along with raising the issue of paying for college, having children also means making sure you have a will, which should make provisions for guardianship if both parents die while the children are still minors. In the shorter term, raising a family leads to plenty of new budgeting challenges.

Divorce scrambles the deck

If a marriage ends in divorce, the financial issues can be very complicated and treacherous for those without expert help. Old financial plans based on 2 incomes have to be discarded; new ones will depend on property settlements, alimony and child support. Remarriage can add to the complexity, especially when the new husband and wife already have children and substantial assets.

Middle age

If you've started saving early and have invested well, you start to reap the reward of expanding wealth in your pre-retirement years. On the other hand, your working years are drawing to a close and future earning power is dwindling. It's harder to make back money you lose in the stock market. Your investing style shifts toward less risk, and you probably can expect lower returns as well. This is also a good time to look into long-term care insurance and to decide if you need this coverage for your later years.

Retirement

Issues of aging, such as estate planning and the cost of long-term care, take on new urgency here. By now, you're probably investing mostly to preserve capital and draw income, but you still have to make sure you can keep up with inflation for at least a couple of decades after you turn 65. To get that growth, you can't entirely turn your back on investment risk.

In or around your retirement years, you also enter the distribution phase of your tax-deferred retirement plans. You can start taking money out of these without penalty (other than ordinary income taxes) at age 59 1/2. At 70 1/2, you must start taking money out, with the minimum withdrawal based on the average life expectancy for your age. The tax bite can be painful. According to David Maloney, a professor of commerce at the University of Virginia and an author/editor in the *West Federal Taxation Series*, Roth IRAs have an advantage at this point because you are never required by law to take money out of them. And when you do, the withdrawn amounts are tax-free.

By Tom Gray
© 2001-2012 Achieve Solutions®

Resources

Print resources

The AARP Retirement Guide: How to Make Smart Financial Decisions in Good Times and Bad by Julie Jason. Sterling, 2009.

Getting Started in a Financially Secure Retirement: Pre- and Post-Retirement Planning in a Time of Great Uncertainty by Henry K. Hebeler. John Wiley & Sons, 2007.

The Only Investment Guide You'll Ever Need (revised and updated edition) by Andrew Tobias. Mariner Books, 2011.

A Random Walk Down Wall Street: The Time-Tested Strategy for Successful Investing (completely revised and updated edition) by Burton G. Malkiel. W.W. Norton, 2011.

Smart Couples Finish Rich: 9 Steps to Creating a Rich Future for You and Your Partner by David Bach. Crown Business, 2002.

Stocks for the Long Run, 4th ed., by Jeremy J. Siegel. McGraw Hill, 2007.

Internet resources

360 Degrees of Financial Literacy (The American Institute of Certified Public Accountants), www.360financialliteracy.org

The American Savings and Education Council, www.choosetosave.org

Consolidated Credit Counseling Services Inc., www.consolidatedcredit.org

Money Matters, Federal Trade Commission, http://ftc.gov/bcp/edu/microsites/moneymatter/index.html

Savings Tips, FeedthePig.org from the American Institute of CPAs, http://www.feedthepig.org/savingstips