

Financial Planning for the Next Decade

Some Basic Steps for Taking Control of Your Money

By DOUG WHEAT

If you are like most people, you are anxious and concerned about the economy, your job, and the future. While we may have a limited impact on the world around us, we can each take control of our own financial situation to ease our concerns. Whether you are wealthy or not, having specific financial goals and a plan for achieving them will help you be more in control of your financial life.

If you have a financial plan in place, make sure you review it on a regular basis. Life can take unexpected turns, and your financial planning may need to be appropriately altered. If you started implementing some changes to your finances but ran into a roadblock, got bogged down in the details, or your life got too busy, now is a great time to pick up where you left off.

Here is a challenge for you to complete this summer. Read through this article detailing nine basics of financial planning. Pick two action items that would be helpful to you, and implement them in June. In July, read a personal-finance book and pick two more action items to implement. You will be on your way to taking control of your finances for the next decade.

• Spend Less Than You Earn: While there are many different strategies for financial planning, no strategy will work unless you spend less than you earn. It doesn't matter if you make \$30,000, \$100,000, or \$250,000 per year; spending more than you take home each month will make all of your plans collapse. The amount you spend in a year is the result of hundreds of independent decisions. How are you making these decisions? Do you know the difference between your wants and your needs? If you have trouble spending less than you earn, it's time for you to do some research and some experimentation to find a system that helps you have some money left at the end of every week. One alternative to a traditional budget is the 'first-step cash management' system that suggests dividing your money into separate bank accounts, each with a different purpose.

• Have a Cash Reserve: Having cash in the bank is a type of insurance against the unexpected. At some point everyone will face

an unexpected large bill, possibly a car-repair bill or a hole in the roof. If you have cash on hand, you can pay the bill without going into debt. Should you lose your job, it is doubly important to have resources available until

other choice, don't use credit to make additional purchases.

• Establish Specific Goals: Too many people live on a day-to-day basis without thinking about their priorities and developing plans to reach them. The more specific you can make your goal, the easier it becomes to measure your progress. For example, instead of simply having a goal of paying off your credit-card debt, add a date by which you want to have a zero balance and figure out your monthly payment to make it happen.

• Multiply Your Money: We all know the best time to start saving is early, and the second-best time is now. There are lots of compet-

ing uses for our money, but the power of compounding is not available to us until our money is invested and earning money. When our money is earning money, then our wealth can build much more rapidly. A 25-year old who saves \$1,000 per year for 40 years and earns 5% interest will have \$133,880 at age 65. A 35-year-old who saves \$1,000 per year for 30 years and earns 5% interest will have \$74,083 at age 65. Starting to save early can

give you a big jump on meeting a long-term goal.

• Understand Account Types: Tax-advantaged accounts are available to help all of us meet some of our most important goals. Understanding the difference between these accounts will help you minimize the taxes you pay and maximize the money you have available to reach your goals. There are essentially three types of accounts: tax-free, tax-deferred, and taxable. With tax-free accounts, both the money you put in the account and the



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you can secure new employment. A good goal is to have three months of expenses available in cash; six months would be even better. It is helpful to put your cash reserve in a place that makes it difficult to spend, such as a separate bank.

• Pay Off Debt: Debt can be useful and sometimes unavoidable whether you are paying for college, a medical bill, or a new refrigerator. The average American household with credit-card debt owes \$14,743 and pays nearly \$2,000 in interest expense per year, according to creditcards.com. It is no surprise that 69% of people with credit-card debt find it difficult to save, according to a 2011 America Saves survey. Whatever the source, you will be better served by paying it off as quickly as possible. You might try the 'snowball' method of debt repayment. With this strategy, after you pay off one debt, you add its monthly payment to the next debt on your list until all debts are paid off. Unless you have no

EARLY-CAREER (APPROX. AGE 23-35) ACTION ITEMS:

- Establish a cash reserve equal to 3-6 months of expenses.
- Make a plan to pay off non-mortgage debt by a specific date.
- Invest in a 401(k) retirement account at least up to your employer's match but hopefully 10% of your salary or more.
- Utilize a Roth IRA retirement account if you don't have a retirement plan at work.
- Pay yourself first by setting up automatic transfers into a long-term savings or investment account.
- Watch your expenses. It is easy to burn through money on nights out or daily coffee. Make sure you are spending less than you are taking home.

MID-CAREER (APPROX. AGE 36-50) ACTION ITEMS:

- Make specific mid- and long-range goals and develop a plan to meet them.
- Pay off non-mortgage debt and kick the debt cycle by building up your savings.
- Step up your retirement savings in your 401(k) to 10% or 15% of your salary if you are not already doing so. The default investment option can be a target date fund based on your age.
- Review your insurance needs, including term life insurance and disability insurance.
- Establish a will, health care proxy, and power of attorney.
- Start saving for your kids' college in a 529 account. The default investment option can be a target date fund based on your son or daughter's age.

money earned in the account can be taken out tax-free. Retirement Roth IRAs and 529 Educational Savings Accounts are two examples of tax-free accounts. If you make a contribution to a tax-deferred account, it will reduce your taxable income this year, but withdrawals of both your contributions and earnings in the future are considered income, and you will owe income tax on it. Traditional IRA accounts, 401(k) accounts, and 403(b) accounts are examples of tax-deferred accounts. For a taxable account, you owe income tax and capital-gains tax each year based on your earnings. Taxable accounts include savings accounts and brokerage accounts.

• **Invest in a Diversified Portfolio:** Since we cannot predict the future, investing in a diversified mix of assets will help you weather economic storms or drops in the market while

of your child. Try to find investment products with low fees.

• **Prepare for Pitfalls:** It is important to be prepared for unexpected events. Having a cash reserve is one way to be prepared. Having insurance and wills in place is another. Most people have health, automobile, and homeowners insurance because they are often mandatory and it is easier to see a relationship between risk and benefits. However, people

also having better growth potential than a savings account alone. Being diversified becomes more important as you get older and have accumulated money that you do not want to lose. There are many strategies for building a diversified portfolio. If you don't have the opportunity to research the subject, a default choice can be either a retirement fund based on your age or an educational fund based on the age

PRE-RETIREE (APPROX. AGE 51-64) ACTION ITEMS:

- Review your long-range goals and adjust your spending and savings to meet them.
- Develop a realistic budget.
- Consider fully funding your 401(k) with \$16,500 per year plus \$5,500 per year in step-up contributions for people over age 55.
- Make sure your investments are diversified.
- Review your Social Security benefit information.
- Consider paying off your mortgage before you retire to increase your cash flow when you don't have a job.
- Don't sacrifice your retirement to pay for your kid's college.
- Consider how you will pay for future health care costs, including long-term care.

RETIREE (AGE 65 AND UP) ACTION ITEMS:

- Determine your income, including pensions and Social Security.
- Set up your investments to transfer money to your checking account on a monthly basis. Starting with a 4% withdrawal rate can help make your money last.
- Finalize a realistic budget based on your income and asset withdrawals.
- Consider part-time work or delaying retirement if your numbers do not add up.
- Review your will, health care proxy, and power of attorney.

often don't realize their vulnerability to misfortune in other areas of their lives. According to the Social Security Benefit Administration, approximately 30% of 20-year olds entering work today will become disabled before they retire, and 1 in 6 Americans will die before reaching age 67. Finding cost-effective means to insure against the risks we all face will provide you and your family financial security if the unexpected happens.

• **Expand Your Learning:** Personal finance is a complicated subject with a number of different facets. There is a wealth of information available on the Internet as well as in publications such as *Money*, *Kiplinger Personal Finance*, and *Smart Money*. Basic books on financial planning include *Personal Finance for Dummies* by Eric Tyson, *The Millionaire Next Door* by Thomas Stanley and William Danko, and *The 9 Steps to Financial Freedom* by Suzy Orman. Even if you don't like dealing with money, reading a few personal-finance items every year will help keep you up-to-date and better-able to plan for your future. ■

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