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FINANCIAL CONCEPTS

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How to Save More: Step by Step

For many of us, saving money is very difficult. The truth is that most people don't keep careful track of how much they spend and thus, don't do enough to find ways to save. If that describes you, here's an eight-step program to help you find more savings in your household income.

Step 1: Create a budget. Don't think of a budget as a way to scrimp, but as a log that keeps you aware of where your money is going and enables you to manage it better. The key is to keep it organized and in a format that you can return to again and again.

Make a single sheet for each month. Organize it into two sections, one for expenses and the other for income. Divide the expenses section into two parts: the ones you pay for out of your checking account and the ones you pay for at a cash register. Then create a line for every kind of recurring expense you have, from your mortgage or rent, to your utilities, phone, and cable, your memberships and subscriptions, life insurance, and payments for loans and credit cards.

For out-of-pocket expenses, make estimates in advance and create line items for lunches out, personal care like the hairdresser or beauty shop, gas and oil, prescriptions, clothing, and entertainment. In each part, do your best to include everything, but your budget is a living document that you can add to as you remember items.

Devote another column to the net income you expect to receive for the month from all sources. Then, subtract your total expenses from your income. If the result is negative, you've discovered a problem. Fixing

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It's 2015 Already?

Can you believe that 2015 is almost here? I would like to take this opportunity to thank you for your continued trust in my staff and me. My first priority is to work with you, monitor and adjust your investment plan as needed, and help you pursue your financial goals. Providing you with quality financial service is my commitment to you.

I appreciate all the referrals you provided throughout the past years. It is a great compliment. I feel privileged working with you, and look forward to continuing our relationship in 2015 and in the future.

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How to Save More

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it, either by spending less or earning more, will bring your spending in line with what you make.

Step 2: Track your spending. What you've created in the first step is a master budget. Now you have to start tracking what you actually spend. That's not too hard when making payments out of your checking account. The challenge is when you pay for things at a cash register, whether you use cash or a card.

Keep all your receipts and make a daily record of any expenses for which you don't receive a receipt. Then, once a week, enter what you actually spent into your budget. Look for how your actual spending affects the balance between your expenses and total income for the rest of the month.

Step 3: Set a saving goal. As you make your master budget, you need to think about a goal for the extra savings you want to achieve. Enter that amount as a line item in your column of recurring monthly expenses.

Step 4: Make the savings automatic. The key to actually saving what you intend to save is to make the transfer from your paycheck automatically. It's best to do one of three things: increase the amount that you contribute to a workplace savings plan by payroll deduction, authorize a deduction every month from your checking account, or write and deposit a check into your saving account as soon as you get paid.

Step 5: Cut down on discretionary spending. The places you'll find savings are from things you can really do without. These range from snacks at vending machines to meals out, movies, shows and concerts, premium TV channels, expensive smart phone data plans, and even vacations. It can be difficult to say no to yourself, but with practice it gets easier, especially when you see your savings balances start to grow faster.

Step 6: Review your big-ticket finances — mortgage, car loans, or lease. You can find your biggest savings by carefully reviewing your biggest expenses. With mortgage rates near record lows, refinancing could save you hundreds of dollars a month. If you're leasing a luxury vehicle, consider going down a notch or two when it expires, or buy a recent-year used car — you'll save thousands on the depreciation and could lower your monthly spending.

Step 7: Avoid late payment penalties and overdraft fees. Pay all your bills on time so you avoid being charged costly late charges and fees, and keep your checkbook up to date to avoid overdraft charges.

Step 8: Buy only with cash. As much as possible, make your purchases with cash instead of using high-interest credit cards. The idea is to force yourself to postpone impulse purchases that increase your balance and interest charges.

Gauging just how much you really need is more art than science, so please call if you would like to discuss this in more detail. ❍❍❍

Selecting the Right Guardian

For parents with minor children, the most important reason for estate planning is to ensure that provisions have been made for their children. Some items to consider include:

❍ **Carefully select a guardian.** While your first inclination may be to select your parents, make sure they have the energy to raise your children. A better alternative may be a sibling or friend. If you have several children, decide whether it is reasonable to expect one person to raise them all. You may want to name more than one guardian, but make sure the guardians will work together to keep the children as close as possible. If the person lives in another city or state, consider whether you want to uproot your children while they are going through the trauma of their parents' death.

❍ **Talk to your selected guardian.** Once you've settled on a guardian, discuss your decision with that person to make sure he/she is willing to take on the responsibility. Name a contingent guardian in case your first choice is unable to serve.

❍ **Make adequate financial arrangements.** You wouldn't want your children to be a financial burden, or their presence may be resented. Determine how much is needed for living expenses, hobbies, medical expenses, and college. Other items need to be considered as well. For instance, will your guardian's home comfortably accommodate your children, or should you leave funds for an addition to the home? Include a financial cushion so there is plenty of money until your children reach adulthood.

❍ **Decide who should manage your children's finances.** The person with physical custody of your children may not be the best person to handle their finances. Thus, you may want to select another individual for that role. You should also consider whether trusts will need to be set up and how money should be distributed when your children reach adulthood.

❍ **Express your wishes to your selected guardian.** This will help ensure your children are raised according to your beliefs. Make sure to indicate your preferences for education, religion, lifestyle, and other important issues.

❍ **Review your choice of guardian every year.** As your children grow, you may realize that the person you originally selected as guardian is no longer the right choice. ❍❍❍

Why Inflation Can Be Good

Most people don't have a kind word to say about inflation, and those on fixed incomes hate it. Why? Because it makes everything more expensive; and when you're living on an income that never rises, your standard of living suffers. But ask most economists and they'll tell you that within limits, inflation is a good thing and its opposite — deflation — is a very bad thing. How can that be?

The broad definition of inflation is a general increase in prices. Deflation is the opposite — a general fall in prices. When we say general, we're referring to the prices of most goods and services. This is an important distinction because prices of some things move in a different direction from most.

There can also be regional differences in the prices of some goods. An example is real estate, where prices may be falling in areas that are experiencing a high rate of job losses, while in areas where the job market is booming, housing prices are rising.

Three Measures of Inflation

1. The Consumer Price Index (CPI). This is the figure that most Americans think of when they think about inflation. It's calculated monthly by the Bureau of Labor Statistics, based on the prices of a basket of some 80,000 different goods and services that most consumers buy in markets all across the country. The Bureau of Labor statistics categorizes those goods and services as: food and beverages, housing, clothing, transportation, medical care, recreation, education and communication, and other goods and services. The CPI also includes sales and excise taxes, utility fees, and highway tolls. It excludes investments like stocks, bonds, and insurance, as well as income and Social Security taxes.

You'll sometimes hear the expression core inflation. This is a derivation of the CPI that excludes the goods that have very volatile prices, like food and fuel.

2. GDP deflator. Based on changes in Gross Domestic Product (GDP), this is a broader measure than the CPI because it includes every kind of good and service the economy produces and delivers. For example, it includes raw materials and industrial goods, like steel, factory equipment, and investment services. It's expressed as a percentage that reduces the nominal new price of a good or service to reflect the quantity of goods. The GDP deflator is regarded as a more accurate measure of price trends throughout the *entire* economy.

3. Producer Price Index (PPI). This measures changes in the wholesale prices of goods and services by manufacturers. It's often looked at as a leading indicator.

How Can Inflation Be a Good Thing?

Inflation is a byproduct of economic growth, which is the means by which the standard of living rises. Think of it this way: prices are a function of supply and demand; if businesses post higher prices for their goods and services and they stick, it's because demand is willing and able to pay those prices. One of the ways people can afford to pay more is if their incomes are rising, which is what happens when they are working for successful companies. Higher prices are also supported when there is a continually growing number of people with jobs and money to spend.

Inflation can also stimulate growth by making existing debt cheaper. Over time, if the economy grows, so does people's income. If they hold a fixed-rate mortgage, their monthly mortgage payment for principal and interest becomes a smaller percentage of their income. As a result, they have an increasing amount of free cash flow to spend.

The Destructive Power of Deflation

Deflation is a general decline in prices and is a destructive economic force. For one thing, it's a sign that businesses can't pass along higher costs of production. Second, it results in lower revenue and, if it lasts for several years, cutbacks in production and employment. When people lose their jobs, they spend less, have trouble keeping up with their bills, and even lose their homes.

Third, deflation makes debt more expensive. As incomes and business profits decline, fixed-rate loans become an increasingly larger percentage of cash flow. Banks make fewer loans because fewer borrowers qualify. This further reduces demand for goods and services, and the economy goes into a negative feedback loop, feeding negative growth and higher unemployment.

Deflation is one of the major causes of economic depressions. In the 13 years from 1927 through 1939, the U.S. experienced CPI deflation in eight years, with prices falling 8.9% in 1931, 10.3% in 1932, and 5.0% in 1933.

The Inflation Ideal: Low Single Digits

Is there an ideal rate of inflation? Economists suggest that a moderate rate of inflation — in the low single digits — is optimal for sustained long-term growth. Indeed, the Federal Reserve Bank has said that an inflation rate of 2% to 3% is ideal. ❍❍❍

Watch for These Estimating Mistakes

When determining how much to save by retirement age, several variables must be considered, some requiring estimates that will span decades. Err significantly on those estimates and you can end up with little or no money left during the later years of your life. Three of the most significant estimating mistakes to watch out for are:

- **Underestimating how much income you'll need in retirement.** The entire point of your retirement savings is to ensure you have sufficient income to spend your retirement doing the things you plan, so make sure you have a good estimate of how much that will cost. Various rules of thumb indicate you'll need anywhere from 70% to over 100% of your preretirement income. At first glance, it seems like you'll need less than 100%, because work-related expenses, lunches out, expensive clothes, and commuting costs will be gone. But look carefully at your current expenses and how you plan to spend your retirement years before deciding how much you'll need. If you pay off your mortgage, remain in good health, live in a city with a low cost of living, and engage in inexpensive hobbies, you might need less than 100% of your preretirement income. However, if you plan to travel extensively, must pay for health insurance, and carry significant debt, you may find that 100% of your preretirement income is not enough. You need to look closely at your current expenses and planned retirement activities to come up with a reasonable estimate.
- **Underestimating how long you'll live.** Today, the average life expectancy is 76 years for a 65-year-old man and 81 years for a 65-year-old woman. But don't just use those figures without further analysis. Average life expectancy means a woman has a 50% chance of dying before age 81 and a 50% chance of living past age 81. Since you can't be sure which will apply to you, you should probably assume you'll live at least a few years beyond your life expectancy. When deciding how many years to add, consider your health and how long other family members have lived.
- **Overestimating how much you can withdraw annually from your retirement savings.** With a retirement that could span decades, it's important to withdraw a reasonable amount so you don't deplete those savings too soon. A number of factors can make that a difficult number to calculate. First, as noted above, you can't be sure how long you'll be making withdrawals. Live significantly beyond your average life expectancy, and you could find yourself with little in the way of savings. Second, inflation over such a long period means you'll have to withdraw increasing amounts just to maintain the same purchasing power. Third, your rate of return on your investments will significantly affect how much you can withdraw annually. When withdrawals are being made, down markets can have a devastating effect on your savings. Not only will your investment value go down, but you will be withdrawing the same amount from a smaller balance. Thus, when the market rebounds, you'll have less capital available to participate in that rebound. Especially if a major market downturn occurs early in your retirement, withdrawing an amount that may have been reasonable during an up market may quickly deplete your assets. Thus, it's generally prudent to keep your withdrawal percentage as low as possible, perhaps 3% or 4% of your balance. With that level of withdrawal, your funds should last for decades. ❍❍❍

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Did You Know?

The difference in average annual full-time earnings between young adults ages 25 to 32 with a college degree and those in the same age group with only a high school diploma is $17,500 (Source: *Time*, April 28, 2014).

The average length of retirement for those turning 65 in 2014 is 19 years. The average 401(k) balance at the end of 2013 was $89,300, up 16% from 2012 (Source: *Money*, May 2014).

In 2013, more than 13 million U.S. adults fell victim to identity fraud. Approximately one in three consumers who received a data breach notification letter became a victim of identity fraud. Research shows that the average identity theft case costs the victim $631 and takes an average of 500 hours to repair the damage (Source: Javelin Strategy & Research, 2014).

Approximately 55% of individuals with a household income under $100,000 say they are living paycheck to paycheck, while 37% of those with a household income over $100,000 indicate they are living paycheck to paycheck. This financial stress impacts relationships, with money being the top source of marital stress and the source of couples' most serious arguments — 41% of respondents indicated that they argued about money at least once a month (Source: *Money*, April 2014). ❍❍❍