Introduction - Don’t be Afraid

Money has a lot of connotations and emotions attached to it. We all know we need money to survive. The process of obtaining and managing money can be a stressful or burdensome activity but it doesn’t have to be. It can be both enjoyable and rewarding. To generalize “money is bad” is missing the point entirely. Money is simply an exchange medium to get the things we require to live and to provide for ourselves and our loved ones. As a young person embarking on a responsible life it’s an activity that will become very much a part of your reality.

Generally the biggest obstacle to effectively managing your money is the fear you’ll do a poor job or make mistakes. This is a common and somewhat expected reaction. Over many years working with students I find the most common fears are: Will I make enough money to live on my own? How will I ever pay back all these student loans? Will I be able to invest wisely? When might I feel financially secure? I am scared I’ll have to live with my parents after college? All of these and many more are valid and real concerns. However, there is absolutely no reason you have to play the fear game.

Fear is an illusion created in our minds. Notice when we succumb to our fears they tend to expand and take up more and more of our thoughts to the point where we might not sleep or we can’t concentrate on anything else. This can be terribly debilitating. Hopefully the chapters that follow will help you realize you don’t need to be afraid – with some diligence and a willingness to learn it will all become second nature to you.

The very best way to fight fear is with action. You will make mistakes – it’s inevitable. Learn from them and move on. Managing your financial life doesn’t have to be a big stress. I identify fear as an illusion to help myself realize I’m the only one that can allay my own concerns. Therefore, taking constructive action is a first step in developing the confidence to be financially independent. As you develop simple and effective systems you may even find some enjoyment in building wealth for yourself and your family.

The Foundation

Budgeting

When you build a house it always begins with a solid foundation. The foundation is made of very strong material, solidly assembled in order to support the walls, ceilings, roof and the rest of the important elements of the structure. The foundation to being financially successful is getting a handle on your budget and spending. These two items are what create the foundation for success in all financial matters. The true value of a budget is it allows you to segregate monies for specific obligations as well as to begin to save on a regular basis. It takes some practice and you need to pay very close attention as you are establishing your foundation. Over time, this process will become second nature. I also find when you are budgeting you are much less likely to spend on items you really don’t need. In order to build your financial foundation you need a source of income. For most people this is some kind of employment. Getting work is beyond the scope of this book but again, the key point is you must secure a regular income. Once you have established a source of income you can begin the process of developing a budget.
A basic budget is made up of ‘Take Home Income’ and ‘Monthly Expenses’. I have included a budget worksheet for your use although you can use whatever method works for you (See Appendix A). There is no real magic formula to budgeting. It is easy to determine your take home income. Simply add up the money you receive for work rendered and from all other sources. To get a handle on monthly expenses, monitor and record your expenses for several months. There are ‘fixed’ expenses such as rent, car payments, student loan payments, etc…(any recurring payment that is the same amount every month) and ‘variable’ expenses such as electric, phone, gas, entertainment, etc…(payment amounts that fluctuate each month). Start a log with your fixed expenses then begin to estimate and monitor closely your variable ones.

If you hope to have a balanced budget controlling ‘variable’ expenses is essential to your success. Sure the electric bill will be higher in the winter but I’m talking more about expenses where you have a choice. For instance, if you purchase a gourmet coffee everyday that’s about $3 a day times 30 days and a $90 monthly estimated expense. If you like to go out to dinner and/or have a drink once a week that might amount to $20-$25 dollars per week. $25 times four weeks equals a monthly estimated expense of $100. Monitor all of your expenses every day for two months and you’ll have a good idea of what your total monthly expenses might be. The question is: do you make enough to support that lifestyle?

I said there was no magic with budgeting and there isn’t. As you monitor and record your monthly expenses you may find that you don’t make enough or just barely make enough to pay your bills. This is when you should take a more critical look at how you’re spending your money. If you could keep that special coffee to three days a week that’s twelve days a month times $3 which equals $36 thus saving $54 when compared to daily coffees ($90 minus $36 = $54). This leaves that money for something else.

The primary idea with budgeting is to have enough to pay your critical bills yet live and save the way you like. A budget is also a very efficient method to save for specific expenditures sometime in the future. For example, let’s say you need a new car but can wait another two years to replace the one you have. The new car you want costs $15,000. To buy a new car you might consider putting 5,000 as a down payment and get a loan for the remaining balance. Two years is twenty-four months, $5,000 divided by 24 equals, approximately $208 a month. In your budget you will set aside $208 for your new car fund. Hopefully you get the idea here. Make your best estimates and begin to form the foundation for You, Inc.

**On-line Budget Programs**

There are several very good on-line budget programs you can use and many you can get started for no cost. Most will integrate your personal finances and help you to budget your money. Many provide reports that also help you to save more and spend less. These are quick and simple to get started and I highly recommend you give them a try. The ones I list below have data security levels comparable to major financial institutions like banks and brokerage firms.

One of the most popular choices is mint.com. They are supported by advertising so there is no cost to use their program. They have received very good reviews from reputable reviewers such as PC Magazine, NY Times, etc… To integrate your bank or other financial institutions you’ll need to
give them your account numbers and passwords for those accounts. This allows them to
download your information very quickly and provide you budgeting reports etc…

For those of you who really want or need something very simple then check out
budgetsimple.com. This also gets very high marks and does not require you to download bank or
password information to start with. As you get more comfortable with the program you can add
that later on.

The point here is to **DO SOMETHING** that helps you to track and record your expenses and
savings. By automating this process it takes away much of the hassle and diligence needed to
stay on track. Remember this is the foundation of your entire financial process so do whatever it
takes to get established.

**Conscious Spending – Need versus Want**

As you go through your day today I’d like you to begin to think about why you buy certain things.
As Americans we are the greatest spenders on earth . . . by far. Why is that? There are a lot of
factors of course but most of it is our perceived feeling that we ‘need’ something. What are the
material items you absolutely need? The truth of the matter is what we “want” overwhelms what
we really ‘need’. Our minds have a remarkable way of creating a need from a want. I really
want the new iPhone but do I need it? Probably not. However, as those around me get the new
model iPhone I begin to think of it as a need. I want to fit in with others and I want to feel good like
all of them. However, if you are willing to be more purposeful and conscious in achieving your
financial goals it’s easier to make good choices that allow you to live within your means.

When we buy things we want it makes us feel good…temporarily. These positive emotions are
created every time we buy something we want – in some ways it’s like a drug addiction. The
problem is the good feelings don’t last. We bounce from one material item to the next. In the short
term it feeds our desires to ‘keep up’ or ‘belong’. Ultimately this is simply about our ego taking
control of our emotions and buying decisions. After the new sweater gets worn a few times its
newness fades and so does its value in feeding our ego. Shortly it just becomes part of the unused
wardrobe waiting for the next trip to Goodwill.

Our ego has a curious way of being satisfied but it is not without hope. As we establish financial
goals which encompass things like, a house to live in and providing for our families, it becomes
easier to resist that ego banging on the door of our conscious
mind. We no longer dread opening
that credit card bill knowing we do not have the money to cover the expense.

Recently I attended a meeting of people where we were sharing some of our life experiences.
One participant related how he had landed a wonderful job just out of college and had rapidly
advanced within his chosen field. He became the administrator of a large medical facility and all
was well with the world. He married, had a couple of wonderful children, bought a big house,
added a sports car and other expensive items as his income rose. He was living the dream and
enjoying the perceived comforts of life. One day, out of the blue, he was fired. It was a financial
decision made by his employer. He was a casualty.

Over the course of the next twelve months he was unable to find sustained employment and
began the painful process of downsizing his excesses. He sold the sports car, cancelled the deluxe
cable TV package, sold unneeded items and basically cut back the family’s budget by reducing
costs wherever he could. An amazing thing happened as he worked through this process. He, and his family, felt happy. They spent more time together and everyone pitched in wherever they could to ‘save’ the family. They found their interactions were rich and special. As time went by they realized they didn’t miss all that ‘stuff’ they had once had.

Fortunately after this one year period he was able to find another good job. His situation stabilized and he began to rebuild the family savings. In addition the family decided that all those material items really didn’t add to their quality of life. To this day they have not replaced many of the items that were purchased out of emotion. They found happiness by living within their means and were all taught a very valuable lesson.

The point here is to become keenly aware of where your money goes so you can make positive choices, based on your financial reality, rather than letting emotions control the day. It’s okay to have wants – make a list. When you feel you are financially protected fulfill your desires.

The reality is we need to include some ‘wants’ in our budget. As humans we really do require some things that just make us feel good. If you like that $3 coffee every day then so be it – just make sure it fits in your budget. The objective is to have money left over every month to save. This starts with having a clear picture of what income you take home, what your critical expenses are and what expenses you can do without. Awareness of what you spend goes a long ways towards living within your means and creating wealth over time. Write a budget every month, or use any of the excellent online resources mentioned previously, and begin to refine your personal budget as time goes on. Soon you’ll be getting what you want as well as managing your money efficiently.

**Action Items**

- Create a monthly budget
- Keep a record of your spending every day for at least 2 months – write down everything or better yet enlist an online budgeting system
- Be consciously aware of need versus want and how it impacts your budget
- Begin to make choices according to your personal financial goals
- Like any good habit it takes practice practice practice to develop

**Debt Management**

**Good Debt**

A debt is nothing more than money you owe to someone else. Generally this is in the form of a loan from a bank or other lending institution. Because you are using the bank’s money the loan comes with an interest charge associated with borrowing that money. Let’s say you buy a $15,000 car. Your down payment is $3,000. The lending institution loans you the additional $12,000 and charges you 8% for the privilege of using their money. The institution computes a monthly payment
and you drive away in your new car. This becomes one of your fixed expenses—a monthly bill. Good debt is characterized as debt that improves your life and something required for you to live. The two primary good debts would be a house loan and a student loan. Both of these debts provide significant benefits. A house is something you can live in, usually it appreciates in value over time, and there is some tax advantage associated with home ownership. A student loan allows you to get a significant education which can lead to reasonable paid employment. It is in essence, an investment in you. I will also include car loans here as most of us need a car to live life.

One thing to remember about vehicles: from a financial point of view, they are almost always worth less the day you drive them off the lot. In general, they are not a good investment but they are necessary.

**Bad Debt**

**Credit Cards**

A primary source of bad debt is credit cards. Bad debt can devastate the foundation of You, Inc. if you’re not careful. One of the reasons we are such great spenders is the willingness of institutions to extend credit to us. They do not give credit from the goodness of their hearts. Consumer credit is an extremely profitable business. Too many people buy items on their credit card to achieve that ‘good feeling.’ However, when the statement comes, they are surprised at the amount they have spent. It is very easy to over spend when using a credit card. On the flip side, it’s totally okay to use a credit card as long as you pay the entire balance each month.

Here’s how credit debt works. You buy an item using your credit card. When you receive your bill you’ll notice there is a ‘minimum payment’ required. This number is generally significantly less than the total amount you owe. Many unsuspecting people think paying the minimum payment is all they have to do. This is certainly true but it becomes highway robbery after that. Most credit card companies will charge 12 to 24% on outstanding balances. They require a minimum payment to stay current but then charge exorbitant interest rates on your overall balance.

If you’re paying the minimum payment you are NOT getting ahead of the game. Some red flags to pay attention to that indicate you may have a problem with credit card debt:

- You cannot make the minimum payments,
- You realize you’ve been borrowing money from family and friends to cover payments
- You’ve gone to a lender you wouldn’t normally go to (payday loans, etc.)

**Action Items**

- Monitor very closely what you charge on a credit card
- Do your best to pay the full balance each month
- Call the credit card company to determine what interest they charge on unpaid
Managing your Credit Score

FICO stands for the Fair Isaac Corporation. FICO developed the evaluation system that has become the industry standard for consumer credit. The formula clearly establishes what is needed to have a good credit score. The higher your credit score the lower the interest rate you will pay for credit products such as credit cards, car loans, and mortgages.

A good credit score can save you literally thousands of dollars on lower interest loans. When one considers the savings over a period of 20-30 years on a big item such as a house, the savings can be staggering—in a good way. The primary means to boost one’s credit score is essentially using credit wisely and responsibly. The formula evaluates your credit usage history for evidence you are actively managing your credit and using it in a responsible manner.

Your score is weighted as such:

- 35% of your score determined by payment history
- 30% determined by the amount you owe
- 15% determined by length of credit history
- 10% determined by any new credit established
- 10% determined by types of credit you have

One vital way to maintain a high credit score is to make payments on time. There is no reason to make payments too early but make sure they arrive at the issuing company a couple of days before they are due. Late payments can kill a credit score so avoid that at all costs. If you’ve had a problem with late payments there is a possible solution. If you go twelve months without a late payment many companies will ‘re-age’ your account and remove previous delinquencies. You must call the company where you have credit to request this. Late and skipped payments, even if you only do it once, can knock your credit score into the basement. Multiple serious delinquencies (payments late by over 90 days) will damage your credit score extensively. Remember the primary criterion they are evaluating is responsible credit use. Do your best to maintain your credit balance at 30% or less of your available credit—10% is even better. The formula does NOT like those who are using ALL of their available credit. Do NOT max out your cards or exceed your credit limits. In addition, resist the urge to close accounts. The amount of credit considered is based on the amount of available credit that has been issued to you; closing an account decreases that amount. It is important to remember here to keep your credit balances at 30% or less of available credit. As an example: If your borrowing limit is $10,000 then don’t borrow more than $3,000.

The formula will penalize you for having too many inactive accounts. They consider a large number of inactive accounts red flag. One strategy would be to keep your oldest and largest
credit cards active by charging something on them once a month. These are the accounts that help your score the most so you want to keep them active. Finally, consider paying your balances in full every month; this will save you tons of money and keep your finance charges down.

Review Your Free Annual Credit Report

Diligent and timely monitoring of your credit report is essential to a good credit score. Be sure to review your credit report at least once a year.
The three main reporting companies are: TransUnion, Equifax, and Experian. They are required to provide one free report to you every twelve months. The easiest way to get your report from these companies is via the web at: www.annualcreditreport.com
This web site is sponsored by these credit reporting companies. You have the option of filling out your request online, by phone or by mail. You may have your information sent electronically or have a hard copy mailed to you. When you receive the report it should be examined very closely for:

- incorrect entries
- late payments
- credit incidents that are a case of mistaken identity
- credit events that should have been dropped off your report
- any signs of identity theft (identity theft generally involves the opening of a new account in your name but with a different address)

You should dispute any serious errors, such as accounts that are not yours. Additionally, any negative information more than seven years old can be disputed and removed from the report.

One interesting feature of this service is you are entitled to a free annual report from each separate company. If you wanted to you could stagger your requests over the course of a year and essentially receive continual updates of your credit status.

A note of warning with this process: although the Credit Report is free these companies ‘enroll’ you in a monthly credit review service. The one I looked at ran $14.95 a month. This is not something you necessarily need so I would suggest you consider cancelling this service after you print off your report. In general, you have nine days to cancel.

Evaluate Your Credit Situation

Once you have your report in hand it’s now time to consider the state of your credit situation. Credit scores will be lower if your credit card balances are consistently near the maximum balance allowed. It is far better to do your best to keep your credit balances at or below 30% of your available credit. If you use several cards and one has a lower interest rate, you should resist taking that card up to its credit limit. Having one card consistently near its credit limit will lower your credit score. If you have older higher interest rate cards you should NOT stop using them but rather use
them for an amount you can pay off each month. This improves your credit score by showing a low credit usage to credit available ratio and gives you a longer credit history.

Remember the FICO formula is looking for: timely payments, length of credit history, amount of one’s total debt, and borrowing ratio of used to available credit. These are the critical pieces of your credit score. In essence, the primary driver to a good credit score is to use credit responsibly. A high credit score will literally save you thousands and thousands of dollars over your life time.

**Action Items**

- Make your payments on time
- Never skip a payment
- Make payments before the due date
- Consider setting up automatic payments for your credit card accounts
- Carefully monitor your credit report each year and clear up issues quickly
- Manage open credit properly (don’t max out any cards)

**Save Every Month**

Once you get a good handle on budgeting and spending it’s time to think about investing your funds for better returns on your money. One of your budget items should be a monthly savings amount. I like to think of savings as a way to pay myself. Of course you’ve got to have money above and beyond your expenses to create savings. Once you do there are various ways you can save every month.

**Emergency Savings**

As you begin to make a life for yourself one of your first financial objectives should be to establish an emergency savings account. The amount set aside will vary according to your situation but should be somewhere between $2,000 to $5,000. If you have a family, and debt obligations, this number may need to be even greater. This money should sit in a low risk, interest bearing account. Examples are a savings account or a money market fund. By definition these monies are very accessible (i.e. “liquid”) with little or no cost and earn a nominal amount of interest. The purpose here is to have funds readily available if an unexpected expense arises (which they always do). As you begin investing for long term growth you’ll want to do your best not to touch those investments and allow them the time to create wealth for you. Having an emergency savings account helps mitigate the need for short term money thus leaving your long term investments intact.

**Action Items**

- Save as much as you can monthly to reach your emergency savings goal
- Keep these monies in a low-risk interest bearing account (e.g. money market fund
Dollar Cost Averaging

An excellent long term investment strategy is called dollar cost averaging. This is a systematic method to invest for the long term. I’m assuming you’ve created your budget, have your spending to a level that you are saving every month and have created your emergency savings account. Now you can begin to invest for the long term. In simple terms dollar cost averaging is a long term investment strategy that promotes regular, periodic investing of a fixed amount over time. Most often the period will be dependent on when you receive your paycheck. The contribution amount will be a direct result of the budget you have created but can be done for as little as $100 a month. An appropriate investment vehicle to begin with would be a growth mutual fund. Mutual funds are set up as a diversified and professionally managed portfolio of investments. As the word implies (mutual) your money is pooled with lots of other individuals and institutions. The manager of the mutual fund decides where and when to invest the funds. Your money is segregated into your own personal account and as you buy every month you accumulate shares of the fund. Shares are your evidence of ownership. Each month as you dollar cost average you buy more shares.

Whether the markets are up or down you consistently and UNEMOTIONALLY invest your monthly amount. This provides a great benefit over time. As a young adult you likely have 30 to 40 years to accumulate wealth using this method. This extended period of time, your “investment horizon”, is your best friend at your age. You have a number of years to put money away the result of which, will hopefully be, a substantial total that you can enjoy in your later years. Additionally you have reduced the stress of investing in the market by taking the emotion out of investing. You simply plug away with your regular investing routine and let the market do the work of making money for you. Take the 2008 stock market as an example. The market collapsed largely because of failures in the real estate market and the banks that issued real estate loans. It was a time of great fear and turmoil. Investors were paralyzed. However, if you were dollar cost averaging (investing in more shares every month regardless of price) you were purchasing shares at bargain prices and accumulating more and more shares for your money. As the markets improved in 2009 you began to see the advantage of staying the course with your investments. Not only did those ‘cheap’ shares increase in value but you had more of them because you had purchased them at depressed prices. It’s easy to get scared and not participate in the markets when they are down but, as a young person, with time on your side, you should consider these lower prices an enormous gift. Focus on accumulating as many shares as possible and stick with your plan!

Alternatively there will be times when the market is high and you will not get as many shares for your money. That’s fine. Just remember the ‘average’ in dollar cost averaging. There will be high times and low times but dollar cost averaging spreads your cost over many years reducing your overall risk of investing at the inopportune time and helping to protect you from fluctuating market prices.
Retirement Plans

If you happen to be employed by an organization that offers a retirement plan this sweetens the dollar cost averaging deal. Retirement plans, by definition, are long term in nature. Most company plans offer a variety of investment choices with which to invest. Most of these investment options are mutual funds. You determine how much is taken from your check each period to invest in your retirement account. Identify and invest in appropriate mutual funds from your investment choices and you’re off and running on your retirement goals. An added advantage of investing through a retirement plan is earnings on your investments are not taxed until you begin to withdraw the money many years from now. The beauty is once you’ve established a periodic investment amount and selected suitable mutual funds (focus on the growth funds) it becomes automatic. You don’t miss the money because it isn’t available for you to spend. Over time you will be amazed at how much you accumulate during good times and bad.

Mutual Funds

I have mentioned mutual funds several times and I want to explain how they work. Mutual funds are by definition a diversified portfolio of investments chosen by professional money managers. The word mutual means there are a lot of people, just like you and me, that place money into these investments. The mutual fund collects these monies and hires professional money managers to decide where to invest the capital. In general, a growth mutual fund could have as many as 200-300 different companies within its portfolio. The advantage of a mutual fund is, for a small amount of money, you receive a range of diversification you would otherwise not be able to attain as an individual investor. Diversification simply means that your money is spread over a variety of investment categories – commonly known as Asset Classes. Examples might be Large Cap Growth Stocks, International Stocks, Government Bonds, Real Estate, etc…

An additional advantage of mutual funds is investment professionals make the buy and sell decisions for you. They have research teams which visit companies and do extensive analysis to determine what they believe to be the best companies to own within the mutual fund. Most company retirement plans offer a variety of mutual fund choices where you may invest your retirement money. For most people mutual funds are an excellent way to create wealth over time with less risk and less headache.

Action Items

- Invest monthly – whether on your own and/or within your company retirement plan
- Invest during good times and bad – when the markets are down, you accumulate more shares at inexpensive prices
- Focus on growth mutual funds as you have lots of time to let the money work
- Invest for the long term
Creating Wealth

Long Term Investing

Life goes by very quickly and it’s easy to defer investing until you feel more knowledgeable or have more money. However, I strongly encourage you to get started as soon as you can. You find good employment, you create a workable budget that builds in monthly savings and you participate in any company retirement plan available to begin your investment process.

I have mentioned several times to invest for long term growth. When you are young you can afford to be more aggressive in your investments, especially within a retirement plan. Remember too that the markets inevitably go down from time to time and this becomes a bonus for you as you continue to systematically and unemotionally invest even when prices are low. This strategy alone can create great wealth over time. One thing I have learned in my years of investing is that no one, not one person, has ever been able to consistently predict the future of the stock market. I know that the companies in the stock market are made up of people just like you and me. Those companies must run their business to make a profit and thrive over time or they will not survive. This is where the growth in your investment comes. Mutual fund managers are constantly on the lookout for the next Apple Computer or Starbucks Coffee. Companies like them have rewarded their shareholders very handsomely over many many years. There is no reason for you to stay on the sidelines and miss participating in that growth.

If I were to identify the greatest barrier to creating wealth over time it would be the emotion of fear. When we get scared we are often afraid or unable to take action of any kind. This paralysis certainly translates to the investment world and can be a serious detriment to your financial future. The flip side of fear is greed – this too can have a devastating impact on your long term financial well-being.

In 1999 technology companies were soaring in the stock market. The prevailing feeling was technology was going to be more and more a part of our lives (which was true) and one couldn’t lose by owning these types of investments. Greed caused people to flock to technology investments like lemmings marching mindlessly toward the precipice. In early 2000 the tables turned. Within a very short period of time the value of many of these companies decreased significantly. The prediction of ‘can’t lose with this’ was terribly wrong.

In 2006 the same mindset was demonstrated in the real estate markets. Low interest rates and lots of ‘eligible’ borrowers made the real estate market soar. Everyone wanted in just like the technology lemmings of 1999. The result of this ‘can’t lose’ mentality in the real estate markets mirrored that of the technology crash. Many people found their investments worthless or substantially reduced to the point they were ruined.

It gets back to our own psychology – we want in on the action but are compelled by our emotions to make terrible decisions. Each one of these periods of wealth decimation was followed by extreme fear and a ‘get me out at any price’ mentality. Recognize the greed to fear cycle and avoid it.
Investing for the long term takes away these emotional mistakes we all can make. Remember with dollar cost averaging we invest every month without regard to what the markets are doing today. We have our emergency fund set up, we budget closely, and we invest for the long term. Creating wealth is easy in many ways as long as you keep your emotions under control. Don’t do what everyone else is doing. Sure, buying tech stocks in 1999 provided a lot of short term ‘good feelings’ but in a very short period of time it was taken away. People who paid exorbitant prices for real estate in 2006 are now left holding properties that are well underwater in value. Smart investors did not change their process. In fact, a smart investor might even raise the level of investment as prices came under the siege of mass fear. Today, in 2013, real estate is now a much better value because of reduced prices.

One of the smartest investors of all time, Warren Buffett, is famous for investing in out of favor industries when everyone else is running for the door. This takes great courage and faith but is absolutely the best way to create wealth over time. The fact is no one knows the future. What is obvious though is when prices are cheap and when they are expensive. When everyone is flocking to a particular investment gains are usually limited and those investments are typically well advanced in price creating a much higher chance of loss. You see, we are built psychologically to want in on things that are working now – we love short term gratification. However, this can be terribly damaging to your financial well-being. Warren has made a fortune buying when no one else is willing and does not get caught up in ‘can’t lose’ fads.

Don’t Be Too Conservative

I find one of the greatest mistakes individuals make when investing is being too conservative. Again, in this case, our natural instincts for safety are something we have to fight. I’m not suggesting you speculate or even get too aggressive but most investors need growth of capital over time. There is this phenomenon called inflation which is truly the biggest enemy to any financial asset. Inflation is nothing more than seeing the prices of the goods we buy every day increase a bit every year. The long term average inflation rate is around 3% but at certain economic moments it’s been a lot more. All that means is that carton of milk you buy every week next year will cost 3% more than it does today if that is the current rate. For the past 5 years the inflation rate has been around 2%.

So let’s do the math. Let’s say you’re a very conservative investor and do not want to take any risk of capital. Your money is invested in things like CD’s (Certificates of Deposit, sometimes called Time Certificates) which are insured against loss by the U.S. Government. Unfortunately, there is a price you pay for this safety. Currently [2013] if you buy a CD that matures in one year it pays about 0.50% annually. If inflation is running 2% you are not keeping up. I like to use the phrase: ‘you are safely losing money every year.’ In this example you are actually going backwards by 1.50%, however, it is “safe”. (Inflation 2% - what you’re earning on the CD 0.50% = 1.50%)

Realistically most investors will need to earn between 7-9% to not only keep up with inflation but also grow their money. Retirement accounts in particular are an investment where you can afford to be more growth oriented. In addition, a home is an investment that has surpassed inflation fairly consistently. The point is playing it too safe can be harmful to your long term financial picture. Remember, stocks and real estate vary in price literally every day – their value depends on the current market for that investment. Both have had great long term returns for those investors with
patience and a willingness to invest regularly.

**Action Items**

- Invest long term by investing monthly – this reduces the chance for errors based on emotion
- Rejoice when particular markets are down in price – this becomes your opportunity to buy at excellent prices
- When everyone is doing something in the investment world do the opposite

**Power of Compounding**

I believe compound interest is the 8th Wonder of the World. This simple process has created a great deal of wealth over the years for many people. Essentially the concept is whatever interest or returns you create from an investment, your earnings, also begin to earn interest and returns. It’s a self-feeding process. A basic example: let’s say you have a $1,000 invested in an account that earns 5% interest annually. Over the course of one year you will have earned $50 in interest. The following year you start the year at $1,050 and earn another 5% on that money. At the end of the year you would have then earned $52.50 on the investment. Your money begins to compound or multiply on its own (multiplier effect). As time goes on this makes a larger and larger impact and is a primary factor in creating great wealth over the long term.

**Compound Interest Table**

Investors who are able to leave their initial investment alone (or add to it) over long periods of time can benefit greatly from compounding. The $1,000 investment mentioned above, if left untouched in a 5% interest bearing account, will be worth over $7,000 at the end of 40 years.

This next table shows the future value of a $1,000 investment over 20 and 40 years at various interest rates from 4% to 10%.

As you can see from the table the multiplier effect makes a significant and positive impact on your wealth over time.

**Action Items**

- Investing long term allows your money to compound on itself
- Keep your money invested to take advantage of this power

**Mastering Key Emotions for Financial Well Being**
Patience

Having grown up with microwaves, faster and faster computers and the convenience of cell phones, I, like most, have come to expect quick results from my actions. Whether it’s a quick drive-thru meal or fast internet speed this obsession with immediate satisfaction is engrained in our culture. Unfortunately this is a death knell in the investment world. Patience truly is a virtue and something I continue to struggle with all the time. I understand patience and its benefits but putting it into practice in real life can be problematic. Fortunately, one area of life where I have learned to have patience is investing. If you take one little bit of wisdom from this book, it needs to be this one. Building significant wealth happens over time and requires a great deal of patience. Every single day we are bombarded with news on the economy and the investing markets. We can receive investment news twenty-four hours a day and a multitude of opinions on what to do with our money. Remember this: building wealth is not a short term proposition. If you are going to be successful, you will need patience and persistence.

Rule of 72 and Your Investment

The Rule of 72 works like this: divide seventy-two by the annual rate of return (72/8=9). This determines how long it takes money to double at a particular rate of return or interest. Recent research covering the past 30 years shows the stock market has returned approximately 8% per year compounded. Using the Rule of 72, that means your money will double every 9 years with a 8% compounded rate of return. This is the interesting part. Research shows the average investor over that same 30 years has earned only about 3% compounded. Rule of 72 math tells us it will take 24 years of compounding at 3% to double your money!! Yikes!! Why would the average investor only earn 3% versus what the markets did? The answer is surprisingly simple. The average investor got impatient and scared when the economy and markets took a dip. The average investor did not view a down market as an opportunity to purchase a greater number of shares at exceptional prices. The average investor allowed the talking heads on TV and mass media to influence their emotions and thus their investment strategy. The average investor got out of the market at the worst possible time, when prices were low. In addition, they didn’t get back into the market until it was significantly higher. It’s easy to fall into this trap.

The Crash of 2008

Let me refer to recent history and review 2008 (some refer to it as ‘the crash of ’08’) as an example of poor investor behavior. The real estate market became severely overpriced because of low interest rates and relaxed borrowing standards. Lending institutions were giving out loans to just about anyone to buy homes, cars, boats, etc. Many of these borrowers simply could not afford to pay their loans (and never should have qualified for them in the first place) and it began a vicious cycle which eventually impacted all of us. In a matter of two months, the stock market fell over 50% in value as real estate prices plummeted.

The easy and emotional reaction was to get scared (impatient but mostly scared) and sell out of their investments related to the stock market. The market ‘felt’ way too risky and the average
investor sold out at ‘garage sale prices.’ This not only locked in their loss but also took them out of the market. When I say ‘locked in’ I mean when you sell your investments at whatever the current price is to you ‘lock in’ that price. If the price is low that’s what you get. If you invested $1,000 and that investment is now worth $500 when you sell you have ‘locked in’ a loss of $500. An investor who sells out has to be right on two decisions – when to sell and when to buy back in. I would say most of the time you will get one of these decisions wrong.

You really haven’t lost anything until you have sold. It’s all on paper. Given a young person’s long investment horizon why would you sell in the short term? There is no good reason. Why take the chance? Learn to be patient and take positive actions. Positive action could include actually adding to your investments when the prices are down. Psychologically this is very difficult because it will ‘feel’ like the absolute worst thing to do. Force yourself – have faith in the future and learn to do what others are not. This is the pathway to great wealth.

When you see events like this happen, and they will, you need to train yourself, not only to be patient, but to take advantage of the ‘50% off sale’. If a desired cell phone went on sale for 50% off wouldn’t you consider buying one? You should have the same approach when investing in the markets.

There are times when fear and gloom overtake the national psyche and it’s easy to get sucked into that mentality. However, if you truly want to build wealth, these situations create incredible opportunities. Imagine buying stock in companies like NIKE, Pepsi or Google at 50% off prices. Professional money managers have learned to divorce themselves from the fear emotion and do some ‘bargain hunting’ in down markets. If you saw an item that was grossly underpriced at a garage sale wouldn’t you seriously consider the purchase because it was such a good value? The truly successful investor increases their investments when the markets are down. Sometimes those markets are down for two or three years. We may feel stupid because we’re not making any money . . . yet. But, when everyone loves the stock market again you will have positioned yourself advantageously because you have consistently bought shares at excellent prices during the down periods. Good values are always worthwhile if you’re patient.

It is 2013 as I write this. From March 2009 to November of 2013 the stock market is up approximately 136%. Those who panicked and sold out missed out on this significant return. Those who stayed the course, increased their investments when prices were low, have regained their value plus some. Patience is a virtue worth learning with investing. Whenever you are tempted to drastically change your course make sure you determine whether it’s fear or logic supporting your rationale. Making choices based on the emotion of fear rarely results in a positive outcome.

**Fear**

Fear is often in opposition to patience. The typical investor’s greatest fear is losing money. It’s nice to have money but money brings its own challenges and demons to confront. Think about when you have felt fearful and what kinds of thoughts run through your mind. You might think of dire
consequences, consider harmful outcomes or have an inability to take action.

In the stock market you can determine your share values on any given day. If you own real estate it’s more difficult to determine value as it’s truly worth what someone else would pay. This obsession with daily pricing can cause many people to make awful decisions. As we listen to the negative news it’s difficult to hear the voices that make one feel confident and courageous. It’s hard to invest when you feel this way. You become paralyzed (a sure signal you’re reacting out of fear). The fear emotion tells you to flee, to get out now yet that response works directly against your long term investment strategy. Again let’s use the ‘Crash of 2008’ as an example.

Your best friend had $100,000 invested in the stock market when the markets tanked and lost 50% of its value. They allowed fear to rule their mind and sold out at this level. Now they have $50,000 in locked in losses. They invest the money in a money market account paying 0.1% (that’s right less than 1% return). They have calmed their fears by placing their money in an ultraconservative, ‘safe’ investment. The markets thrash around for about five months and in March of 2009 reach a crescendo of pessimistic news. The news made one feel like all the banks were going to fail, there would be massive unemployment, and most of us won’t be able to pay our mortgages, etc.

You, on the other hand, remember that when the markets go way down it creates opportunities. Other’s fear is actually your new best friend. You cautiously add money monthly and in March as you ‘see’ the fear reaching a peak you invest a bit more. You have successfully bought additional shares at garage sale prices. From March 2009 to February 2010 the market goes up 70%. Let’s see how everyone did:

Your Best Friend - $50,000 * 0.1% = $50,005

Patient Investor - $50,000 * 70% = $85,000

Granted you are not back to your original $100,000 but you are well on the way to recovery. By the way, did you really lose that money if you never sold out of the market? Your spreadsheet or Quicken account took a beating but in the real world what did you lose? Your best friend beats himself up for being ruled by fear and vows to get back in but remains fearful the market will come back down. He reinvests after the market makes a meaningful move up, a pattern typical of scared investors. The result? He gets the ‘benefit’ of buying shares at higher prices with less money to invest because of his locked in losses. Let patience, not fear, rule your decision making. Simply put, make your money work over the long term.

Diligence

Diligence is nothing more than becoming responsible for your financial life. It’s a willingness to learn what you don’t know and to seek help if you need it. Diligence translates into specific financial goals which then drive the investment decisions you make. Once you develop a system that works for you it’s a matter of adapting as life changes. Be diligent in sticking to your long term plan. With a good system in place you take a lot of the worry about money out of the life equation so you can concentrate on your true passions in life.

Mitigating Risk
There are several ways to make your journey through the financial maze more pleasant. First, know this; all investments have risk of loss. Still, most do not create a TOTAL loss. Win or lose propositions are not good investments. Your likelihood of success with these types of investments is similar to playing the slot machines. Trusting your investment to speculation and chance are risky at best and downright foolish at worst. I’ve seen so many people blow up their life because they speculated and lost. My advice...stay away from win or lose propositions.

I like to think of risk as volatility in prices. In other words, most every investment fluctuates in value every day. This volatility in price is what causes us to consider selling at the wrong times and plays into the fear emotion. As a knowledgeable investor you can protect yourself in several ways. I want to make clear these ideas do not cure short term panics such as we saw in 2008 but, if you adhere to them, you’ll recover and thrive sooner.

1. Have your emergency fund in place. One of the main advantages of this is you do not have to sell investments prematurely to cover any unexpected expenses thus avoiding potential capital loss in your portfolio.

2. When you invest be as diversified as possible. Diversification smoothes out market volatility. Mutual funds, in general, are very diversified. In a growth mutual fund the dollars might be invested in over 200 companies within that mutual fund portfolio. As a shareholder you own just a small percentage of that mutual fund and an even smaller share of any one company. The risk of 200 companies all performing poorly is much less than the risk of any single company performing poorly. To be properly diversified you’ll probably want to seek some basic asset allocation counsel. This can be a local Financial Advisor or someone within Human Resources at your place of employment. You might pay a little for this service but it would be well worth your while.

Asset allocation allows you to place money into several different investment areas appropriate to your life situation. For example you might have a growth mutual fund, an international mutual fund and a bond mutual fund. As a young person you might consider an allocation of 80/20. This means 80% in growth investments, 20% in conservative investments. In my example above the bond fund would be the conservative investment. Asset allocation strategies change over time particularly as one gets older. This is where the advice of a trusted advisor or professional can be invaluable.

3. Invest for the long term and attempt to invest more when the markets are down.

4. Add money regularly, preferably at least monthly. If you can participate in a company retirement plan this is a great way to build wealth. You can ask your company to withdraw a certain dollar amount each pay period to invest within the plan. You can also have investments outside of retirement as well. Investing on a set schedule, making investing part of your financial routine, takes the emotion out of participating in the market. Down markets are a gift to you only IF
you take advantage of them.

5. Continually educate yourself. The world of finance is really quite interesting but you don’t have to be a genius to be a good investor. Take some classes at the local community college and look for other educational opportunities. There are a wealth of educational opportunities online. As you become more comfortable investing you will be more confident in following an independent path to creating your own wealth and also wise enough to capture opportunities as they present themselves.

6. Hire a Trusted Advisor. This will sound self serving but I really do think most people would benefit from having an honest and intelligent Financial Advisor. A Financial Advisor is especially helpful when the markets turn sour and you need to talk with someone who has greater depth of knowledge on the subject. A Financial Advisor can help you develop a plan, monitor the plan on a regular basis and help calm you when the world seems like it’s falling apart. Lastly, they can develop an appropriate asset allocation model for you to accomplish your goals which include specific strategies and investments.

7. Talk with your parents or get a couple of referrals from them on an older person with whom to talk. Perhaps you might speak with their Financial Advisor. Experience is a great teacher. Most adults would be honored to share their wisdom and their mistakes. Developing a conversational relationship with these experienced and knowledgeable people is invaluable when building the foundation of your financial future.

**Giving Back**

One of the great joys of creating wealth for yourself is the opportunity you have to financially support those organizations or causes that mean something to you. Giving back to your university or to a favorite charity is a wonderful way to disprove that the love of money is the root of all evil. There is a great sense of happiness, peace and contentment when you give of yourself and your money. Our lives are enriched when we contribute.

Although you might not be in a position to give back right now I believe it is an interesting and valuable exercise to write down who you’d give money to if you had the money to give. Keep this list. If you practice a financial and investment strategy based on reason over emotion, are diligent in your efforts and have patience, one day you will find you have the resources to live as you’d like and be able to support the causes, organizations and ideas that are important to you.

**Hugo**
As a ten-year old child I was thrilled every year when summer would roll around. Not only was there no school but my cousin and I had the privilege to work (i.e. accompany) for our Grandfather who was a Tom’s Candy Distributor. To us he was Pa Pa but most everyone else knew him by his given name: Hugo.

Hugo was an amazing spirit. He always had a smile and laugh at the tip of his lips. His candy route took us on a 100 mile radius around Jefferson City, Missouri. It’s beautiful country which includes the Lake of the Ozarks. Our job was to carry the candy boxes into whatever establishment he was serving that day. Most customers ran bars or taverns. We were fortunate laws back then regarding kids and places that served alcohol were a lot more lenient then they are today. The one thing I noted was wherever we went patrons and business owners alike were delighted to see Hugo. People seemed to love him. I’m not sure if it was his gentle nature or just a feeling that this was someone you could trust and believe in. By the end of the ‘workday’ we’d probably put more candy in our mouths than put in work.

When we arrived home after ‘work’ Grandma would have a nice meal prepared for us. After dinner Hugo would make his way to his desk to count the money brought in that day. We always enjoyed watching Hugo count the money. He’d dump out all the change and bills onto his desk and begin to sort them. The quarters were stacked four high, nickels five high and dimes ten high. We’d watch from desktop level as he deftly moved the money around. Once it was all organized he’d add up the totals and write them down. This was always a moment of great anticipation. Once totals were complete it was time for us to get paid.

If we’d been good, as in not too much trouble, we’d each receive one quarter. He’d hand us the quarter and say, “If you save this it will grow”. Frankly, we had no idea what he meant at the time and most of those quarters were immediately spent on baseball cards or more candy. However, I could see even then, he and Grandma were very careful about how they spent their money.

I share this story because Pa Pa and Grandma never had much of anything yet they were able to own a house, a car and take care of us kids. Much of my own personality and spirit emanate from Hugo. He saved every time he was paid. It wasn’t much but over 40 years it added up. “If you save it will grow.” In many respects that concept is what this book is all about.

Diligent savings, unemotional investing, and careful spending can make anyone wealthy. I wish you all the best of luck.

About the Author

James Schupp (Scoop) has worked as a Registered Financial Advisor for over 30 years with a National Brokerage firm in Corvallis, Oregon. As a Courtesy Faculty at Oregon State University he has had the pleasure of assisting countless students in all aspects of personal finance and other life issues for many years. James lives with his wife, Karen, dog Verdell, and cat Daisy, in Corvallis, Oregon.
Appendix A - Monthly Budget Worksheet

Monthly Income

- Job Income (take home pay) $ 
- Interest and Dividends $ 
- Rental Income $ 
- Other Income 1 (e.g. parents) $ 
- Other Income 2 $ 
- Total Income $ 

Monthly Fixed Expenses
(same amount each period)

- Mortgage/Rent $ 
- Loan Payments $ 
- Car $ 
- Student Loans $ 
- Other Loan 1 $ 
- Other Loan 2 $ 
- Cable/Internet Services $ 
- Insurance (car, medical, life, etc.) $ 
- Other Fixed Expense 1 $ 
- Other Fixed Expense 2 $ 
- Total Fixed Expenses $ 

Monthly Variable Expenses
(amount varies each period)

- Entertainment (dining out, movies, travel, etc.) $ 
- Food $ 
- Transportation (gasoline, bus fare, taxis, etc.) $ 
- Consumer Credit (credit cards, etc.) $ 
- Other Utility 1 $ 
- Other Utility 2 $ 
- Other Variable Expense 1 $ 
- Other Variable Expense 2 $ 
- Total Variable Expenses $ 

Total Income – Total Fixed Expenses – Total Variable Expenses = $ ____________ Surplus/(Deficit)