PT's 6 Key Takeaways of Personal Finance

Get Your Financial House in Order

After two years of writing consistently on the subject of money, I've come up with six things that I believe are the most important aspects of personal finance. They are:

This guide will walk you through each of the six takeaways in detail.

PT's 6 Key Takeaways of Personal Finance

Get Your Financial House in Order

I. Know Your Money

Below I'll share with you how to fully understand your financial situation, both now and in the future.

In my experience, knowing where you currently are is critical for determining how to get to where you want to be. Don't worry, I'm not going to make you do a budget. But there are two main things you need to do:

1. List Your Known Monthly Expenses

As a base line for your understanding, write down your monthly fixed expenses. Don't worry about variable spending (i.e. dining out, shopping, travel, etc.). We'll tackle those expenses in the next email.

To help you with this process of listing your expenses, I created a spreadsheet that you can use as a template. Download the spreadsheet.

If you prefer working with a much cooler, online calendar-based expense tracker, I encourage you to check out the online software, PocketSmith, and their free membership. Click to read my review of PocketSmith:

So what's the point? Why do this? Doing this will help you:

- Understand your minimum monthly expense needs and how they compares to your income.
- Project your future spending needs.
- Avoid late payments.
- Determine which expenses you could reduce or eliminate.

Now that you understand your monthly spending needs, you should review the balances in your banking, investing, and credit accounts.

2. View All of Your Accounts at the Same Time

In this new era of online financial account management, it's easy to lose track of all the various banking, investing, and credit accounts in your name. In order for you to understand your financial situation, you need to be able to see all of those account balances at once.

Just like the monthly tracker above, there is a manual and an online tool available to help you set this up. See this article where I discuss the free tool I built, the all-in-one financial dashboard.

Not only will that dashboard help you determine your personal net worth, it also has a place to store your online account IDs and passwords.

There are many good online tools (called "financial aggregators") that will also help you organize your accounts into one location. I prefer to use Quicken for this purpose. See my review of Quicken Online.

Does personal net worth matter? One of the benefits of seeing all your accounts at once is you get to determine your personal net worth (banking and investing balances minus your credit account balances). What makes this number important is not the number itself. You need to compare it over time.

What you want is a personal net worth that is trending in a positive direction. Calculate your current net worth, then revisit this exercise in a month and see how you've improved.

Final Thoughts

Alright, that should just about do it for takeaway #1. You've listed your known expenses and have seen all your account balances in one place. You should have a good understanding of your current financial situation. To ensure you maintain a good level of understanding, be sure to schedule some time each month to re-perform these exercises. Set yourself a reminder.

II. Optimize Your Spending

In this section I'll share with you how to spend your money a bit wiser so that you're able to meet more of your other goals (e.g. savings, debt reduction, security).

Just like in my previous email, there's no budget involved and there are only two main concepts you need to focus on:

1. Optimize Your Fixed Expenses

Remember the monthly fixed expense tracker I showed you last week? Break that out again. Now I want you to spend the next week doing the following:

- Only Pay for Things You are Actually Using -

Take a look at the list of your expenses and find any expenses for items that you aren't using, or that you wouldn't mind doing without. Cancel any unused or unwanted items.

For instance, if you don't use your cable TV service that much anymore because you're spending your nights using Facebook, then consider dropping your cable and watching TV using the over-the-air channels available. You could also consider watching TV using the Internet.

Another expense that people find they can actually do without is home land line service. If you have a cell phone, consider making that your only phone.

Those items are just suggestions. Only you know the expenses you could do without and still have the life you want. Don't worry if you can't find any items to cut. Check out my next point...

- Pay the Lowest Price You Can Get for the Things You Do Want -

Now take a look at the remaining items on your monthly expense list. Are you paying the best price available? For things like mortgage, car payment, you may not have a choice. But for monthly service items like Internet and cell phone, odd are you can negotiate a lower monthly rate.

Over the next couple of days, call each of these companies up and ask politely for a better monthly rate. Tell them you love their service, but to continue you'd need to pay less each month. If only a couple of these companies bite, you're going to save some money each month. If they don't go down on their price, look to a competitor for a quote. They will likely do what it takes to get your business. Trust me, this works. Read this example of when I lowered my TV bill.

The bottom line is to only have fixed expenses for the things you really want. And then pay the best price you can find for those things.

2. Consciously Spend the Rest

Now that you've optimized your fixed expenses, let's discuss the remainder of your spending: variable expenses. These are items like dining out, morning coffee, clothes, entertainment, household items, gifts, etc. These are the items that aren't necessarily needs, and you spend varying amounts on them from month-to-month. What I want you to do is:

- Focus Your Spending on Things That Bring You the Greatest Joy -

I'm not here to tell you what you should and should not spend your hard earned money on. But what I will do is urge you to only spend your money on those things that are truly bringing you joy.

For instance, let's say you'd love to travel more, but you find yourself blowing all your money on clothes you never wear that much or trips to fast food joints that don't satisfy. Why not wait to spend for the life you really want?

Be conscious enough to skip the shopping spree (buy classic styles that last longer) and eat just 50% more at home where you don't have to spend as much. Now you have more room in your budget to do some traveling with.

Again, my point isn't to tell you what to spend on. Heck, you may get the biggest thrill out of new clothes and burger joints, while hating to travel.

That's okay. Just make sure you're spending your money intentionally.

- Take Just a Moment to Find the Best Price -

The second part of conscious spending is taking a few moments to find the best price. This doesn't have to be a long, drawn out thing (although my wife says that I sometimes make it so). You just need to take a brief moment once you decide you're going to purchase something to think about the best place to buy the thing.

Do you have a coupon? Can you find one? Is it better to buy online? Would a used version be just as nice? If you're not asking these questions, you're spending unconsciously, and over time you're wasting money.

There are a couple of great online services that give you cash back when shopping online: Upromise and ebates. Check out my review of Upromise and ebates and consider their service next time you're looking to optimize your online spending:

Read my review of Ebates. Read my Upromise review.

- Know When to Go High Dollar -

Lastly, I'll add in a quick word about quality. I'm not an advocate of always buying the cheapest item. Sometimes it makes sense to spend more money on a higher-quality, longer lasting version of the product or service. To be a conscious spender, you sometimes need to pay more.

Final Thoughts

I hope you enjoyed this second part of the series. Hopefully you're able to trim your budget down to only those fixed items that you truly want, and then spend consciously on the rest. My challenge to you is to take control. Find a way to design your spending around the life you truly want.

III. Build Up Short-Term Savings

In this section I'll share with you how and why you should build up your short-term savings.

Saving is the life blood of any good financial plan. Your ability to save has the biggest impact on your ability to get ahead financially and have success down the road.

If you can master this one thing (saving) then you're going to be in a better position that most people, regardless of the other financial moves you make. This is truly the most important takeaway. Let me give you 3 reasons why it's important to save:

3 Reasons to Save More

1. Life's Emergencies

Unless you have some sort of magical insurance policy that covers everything, you're going to run into the occasional emergency, or at least an unexpected expense that you can't pay for with your regular monthly income. Short-term savings can act as an emergency fund against life's unexpected turns.

For instance, you might experience a job loss, and your primary source of income is temporarily suspended. If you had a bit of savings built up, you could meet your monthly expenses and at least temporarily weather the storm. Read more about how to save for emergencies.

2. Your Major Planned Expenses

But there doesn't have to be an emergency to justify the need for short-term savings. Think of a vacation you've been wanting to take, or maybe an upgrade to your home you've been wanting to make. How are you going to pay for these bigger expenses?

The best way is to save up the money for these expenses over time, prior to when you actually need the money.

Instead of saving first though, we often decide to finance the planned expenses on debt. That leads me to my last reason saving it so important.

3. Avoiding Debt

Without savings, we typically turn to debt to get us by when the unexpected happens. Financing an emergency or a major expense on credit can be costly. Interest charges alone can quickly turn a moderate purchase into a big mistake. Debt is a poor substitute for a fully funded short-term savings account.

How to Save More: Separation and Automation

I know you want to save more. That's why I'm going to tell you exactly how to make it happen. These are the two specific steps you need to take to actually save more of your money:

1. Separate your savings account from your spending account
2. Automate direct deposits into the savings account

You may recognize this concept from the free guide I offered you a couple of weeks ago, PT's Quick Guide to Truly Saving More. Download the guide again.

I encourage you to read through that guide if you haven't already. The concept there is truly the "golden ticket" of personal finance. It's the best thing I have to offer you.

High Interest Savings

Lastly, I'll just add a quick note about the best place to stash your short-term savings. It's no secret that I'm a huge fan of the online savings accounts, like ING DIRECT, FNBO Direct, and even SmartyPig.

These are all great savings products that will help you on your way to increased savings. I use them personally and could not recommend a better financial product.

To learn more about your options with online savings accounts, see my review of high-yield savings accounts.

Final Thoughts

By using the strategy I describe above, you'll begin to build up your short-term savings. And in doing so, you'll be:

- Better prepared for life's emergencies
- Able to do more of the things you want
- Able to avoid debt

Sounds like a limit-less financial life to me.

IV. Save for Your Retirement (Plus, Saving for College)

In this section I'll share why and how you should begin investing money for your retirement. Plus, I'll share a link to find out more about college savings.

First though, let me give you two good reasons why you need to save for retirement:

Why You Need to Save for Retirement

1. Because You Can Only Count On You

You're the only one who can ensure you're ready for retirement. You certainly can't count on the Government. Are you going to ask your friends and family to support you? Are you going to be able to take out a loan?

No. You need to be prepared yourself. No one is going to save up all that money for you. And you don't want to be relying on the charity of others to help you get by. Imagine how many trips or golfing green fees they'll want to fund for you.

2. Because There's Usually Free Money to be Had

There are rewards to be had for those who save for their retirement. The Government and your employer both are giving away free money in tax savings and matching contributions for those who take part. Are you getting your share?

How Much Do You Need in Retirement?

A lot of people will tell you to you need to find a specific number to shoot for in retirement. At some point this may be true, and there are some great retirement calculators to help you determine this.

But initially, you just need to get started. As with most financial issues, it's the starting that makes the biggest difference. Knowing a number and fully understanding all the issues are secondary to just starting. But, if you just have to have a number, here's some percentages for you.

In general, if you're in your 20s, 10% of your income will likely get you to a very comfortable retirement. For those in their 30s, 20% contributions might be necessary if you're just getting started. If you're in your 40s or 50s and just starting to save for retirement, you'll likely need to start saving around 50% of your income.

I'm in my mid 30s and I saved around 25% of my income towards retirement this last year.

How to Save for Retirement

Okay, let's get down to action. Here's how to actually start saving:

Saving for retirement has never been easier. I'm a huge fan of using tax advantaged retirement accounts. These types of accounts are really all I use to save for my own retirement. Here's more of what I'm talking about:

1. Save with the Company Plan: The 401(k)

Do you have access to a 401(k) or 403(b) account? These accounts let you save pre-tax dollars (effectively reducing your annual taxes) towards retirement.

Some companies match a portion of your your contributions to these funds. The first thing you should be doing is contributing enough to get your employer match every month.

I currently contribute around 17% to my company 401(k). I have it invested in a simple target date fund, which gets more conservative as I age.

2. Next Step: An IRA

If you don't have a company retirement savings account, or if you want to take your savings to the next level, you should consider an IRA. There are 2 main types: the Roth IRA and the Traditional IRA. Both have tax advantages that save you money in the long-run.

Read more information about the Roth IRA.

3. Go for the Maximum: Max Out Your Annual Limits

Finally, you should strive to max out your annual contribution limits every year. Doing so will allow you to achieve your retirement savings goals quicker and allow you to pay less in taxes every year. Keep in mind the IRS changes these guidelines often. Here's a blog post I did about the contribution limits: IRA Contribution Limits.

College Savings

I wanted to provide some basic information in case you wanted to start saving for your kid's college education. I don't recommend doing this before you take care of your own retirement needs though. Here's some information I shared a while back about college savings: 5 Ways to Save for College.

V. Use Credit Wisely

In this section I'll share how to handle debt. I'll tackle two overall themes: (1) understanding different types of debt and (2) how to get rid of unwanted debt.

Understanding Debt

- *Bad Debt vs. Good Debt* -

While I generally believe that we should try to avoid any debt in our lives, I also believe that some debts are worse than others. Generally, good debt refers to those debts that incur a low interest rate, can help to create income (e.g. student loans), or are used to purchase appreciating assets (e.g. mortgages). Bad debts would be the opposite: debts that incur a high interest rate, don't create income, and are used to purchase depreciating assets. The point of those definitions is to help you evaluate your choice before getting into more debt and to help you prioritize your debts when paying them off.

- *Please Avoid High-Interest Consumer Debt* -

One of the worst, and most common types of debt we get into is high-interest consumer debt. An example would be using a credit card to pay for a vacation and paying off the balance over several years. If you can simply avoid this type of debt in your life, you'll be light years ahead of your peers and you'll be able to do a great deal more with your money.

- *Use Credit Wisely* -

At a minimum, you should shoot to avoid carrying a balance on any revolving credit (e.g. credit cards) from month to month. Doing so will cause you to incur interest charges. You'll end up paying more for the things you buy. A great deal more.

Get Rid of Unwanted Debt

Now that we have a clearer picture of the types of debts to avoid, let's discuss how you can go about getting rid of that debt. But first let me discuss the benefits of paying down your unwanted debt.

- Benefits of Less Debt -

There are plenty of good reasons to get rid of your unwanted debt. Here are a few:

Avoiding the Hassle - If you didn't have all those debt payments to worry about each month, you'd free up your mind and time to do other things. Less stressful things.

No More Interest Charges or Late Fees - Paying interest charges and the occasional late fee stinks. It's costing you much much more to finance this stuff than had you just paid for it all upfront. If you paid off this debt, the interest payments and potential late fees would go with it.

Debt Payments Could Be "Savings Payments" - If you got rid of your monthly debt payments, you could begin saving that same amount in your retirement account or short-term savings account.

Read more on the benefits of less debt. You should also check out 10 Reasons Why You'd be Happier if You Were Debt Free.

- How to Pay Off Debt -

If after all of this debt talk you find yourself wanting to get rid of your debts, you're in good company. Over the past couple of years I've been able to get rid of a lot of unwanted debt. I blogged about my journey at ptmoney.com. Here are some of the more memorable posts:

- Our Original Debt Reduction Goals
- First Checkup On Our Debt Reduction Goals
- When We Paid Off the Car
- When We Paid Off our Student Loans

I share those with you not to brag, but to give you some motivation to pay down your own debt.

Paying off debt is challenging. It doesn't happen over night. And it usually doesn't just happen for those that really really want to do it. It takes a plan, and consistent hard work. Here's my best advice for paying down debt:

> *"Know your debts, prioritize the debts, establish a payment plan, automate the payments, create accountability, and reward yourself."*

For more specifics on this, see these blog posts:

- How to Prioritize Your Debts for Payoff
- A Plan to Be Debt Free
- 10 Tips to Help Reduce Credit Card Debt

That should give you plenty of motivation and strategy for getting rid of your unwanted debt. Best of luck to you in your efforts.

VI. Protect What You Value

In this last section I'll share how to protect what you value: your family's financial future. I'll focus on the why and how of getting term life insurance.

The reason I'm focusing only on life insurance is two fold: most other forms of insurance are required (e.g. home owner's insurance if you have a mortgage, auto insurance) and life insurance is something a lot of people need, but just haven't taken the time to purchase.

I realize I could also devote another whole email to spending less on other forms of insurance. That is important. But not as important, I believe, as getting those without life insurance, who need it, signed up with a policy.

What is Life Insurance?

Life insurance is a contract between the policy owner (you) and the insurer, where the insurer agrees to pay a designated beneficiary a sum of money upon the occurrence of the insured individual's or individuals' death or other event, such as terminal illness or critical illness. In return, the policy owner agrees to pay a stipulated amount called a premium at regular intervals or in lump sums.

What Life Insurance is Not

Life insurance is not an investment opportunity. I'm of the opinion that investing and life insurance are two separate things. Why the heck did investing and life insurance ever get involved? Insurance products that promise investing returns are just an expensive waste. Keep investing simple, inexpensive, and separate from your insurance goals.

Life insurance is not a waste of money. You aren't just throwing money away. Therefore, cheap isn't always better. Make sure you get the proper amount, type, and quality of life insurance.

Term Life Insurance Is Best for Most

For most people, a simple term life insurance policy will do. Term life insurance ends after a specific period (or term). This makes it less expensive than other forms of life insurance and it also matches the specific needs of most people. Most people have dependent people (kids, stay at home spouse, etc.) in their life for around 20 to 30 years. After the kids have left, and you've built up retirement savings, there's not much need for more life insurance.

When to Get Life Insurance

I'm of the opinion that life insurance isn't needed until there is a dependent relationship established. Once you have someone in your life that relies on your income and is unable to produce that income by themselves if needed, then you need to look into life insurance. For most people, this means when they get married and/or have children.

How Much Life Insurance Do You Need?

This is probably the most personal decision you'll need to make when getting life insurance. It really depends on several factors: your current and expected monthly expenses, your current and expected savings funds, your current and expected debts, your spouses ability to work full-time even without you, etc. The list could go on. Luckily, there are plenty of calculators out there that will help you come up with an amount that's right for you. Also, the cost difference between $500,000 and $1M in term life insurance isn't that great, so it won't hurt to over insure by a little.

Read how I personally came up with my own life insurance amount.

Where to Get Life Insurance

There are lots of places to get life insurance. You can check with your employer, the company that insures your auto or home insurance, your bank, or at a life insurance broker, like Zander Insurance. The key is to shop around, get quotes, look for discounts, and make sure you use a highly rated company. Check ratings at www.insure.com.

A while back I polled some members of the personal finance blogging community and got the scoop on where they got their life insurance. Read their responses.

I personally ended up getting my 20 year term life insurance plan with ReliaStar (a company under the ING name). You can see their rates at www.ingforlife.com.

Get Started Now

Don't put off this need any longer. It takes some time to get set up with life insurance, so it's important to get started early. Here's a post I shared a while back about going through the process of buying life insurance.

For even more reading on life insurance see:

- Further Thoughts on Life Insurance
- Do You Need Term Life Insurance

Series Wrap-Up

That wraps up this series covering my 6 Key Takeaways of Personal Finance. I hope you enjoyed it and can use the information to create a better financial life for you and your family.

If you have any questions, you can email me at pt@ptmoney.com.