Truepoint
WEALTH COUNSEL

Five Guiding Principles for Young Adults Transitioning to Financial Independence

College degree, check. New job, check. Respectable salary, check. Congratulations! You have begun your journey toward financial independence. And while this is a great start, you stand to face even greater challenges than your parents if good financial habits are not formed early. Following are five guiding principles to aid you along the way:

#1: Pay yourself first - always! If you are just getting started as a professional out of college, saving may seem impossible – you have rent, car payments, groceries and maybe student loans. The problem is you are “saving” from what is left over, versus making saving the priority. There is no better argument for starting to save and invest early than the power of compounding. The following chart represents two individuals. The first invested a total of $27,000 over 9 years from age 22 to age 30, and then stopped investing. The second started investing at age 35, and contributed a total of $78,000 to his/her portfolio over 26 years. The difference in their totals at age 65 is due solely to when they started-- and it is quite a big difference!

Scenario #1						Scenario #2					
Age	Payment	Year-end	Age	Payment	Year-end	Age	Payment	Year-end	Age	Payment	Year-end
20			43		$ 110,035	20			43	$ 3,000	$ 40,460
21			44		$ 118,838	21			44	$ 3,000	$ 46,937
22	$ 3,000	$ 3,240	45		$ 128,345	22			45	$ 3,000	$ 53,931
23	$ 3,000	$ 6,739	46		$ 138,613	23			46	$ 3,000	$ 61,486
24	$ 3,000	$ 10,518	47		$ 149,702	24			47	$ 3,000	$ 69,645
25	$ 3,000	$ 14,600	48		$ 161,678	25			48	$ 3,000	$ 78,456
26	$ 3,000	$ 19,008	49		$ 174,612	26			49	$ 3,000	$ 87,973
27	$ 3,000	$ 23,768	50		$ 188,581	27			50	$ 3,000	$ 98,251
28	$ 3,000	$ 28,910	51		$ 203,668	28			51	$ 3,000	$ 109,351
29	$ 3,000	$ 34,463	52		$ 219,961	29			52	$ 3,000	$ 121,339
30	$ 3,000	$ 40,460	53		$ 237,558	30			53	$ 3,000	$ 134,286
31		$ 43,697	54		$ 256,563	31			54	$ 3,000	$ 148,269
32		$ 47,192	55		$ 277,088	32			55	$ 3,000	$ 163,370
33		$ 50,968	56		$ 299,255	33			56	$ 3,000	$ 179,680
34		$ 55,045	57		$ 323,195	34			57	$ 3,000	$ 197,295
35		$ 59,449	58		$ 349,051	35	$ 3,000	$ 3,240	58	$ 3,000	$ 216,318
36		$ 64,205	59		$ 376,975	36	$ 3,000	$ 6,739	59	$ 3,000	$ 236,864
37		$ 69,341	60		$ 407,133	37	$ 3,000	$ 10,518	60	$ 3,000	$ 259,053
38		$ 74,888	61		$ 439,704	38	$ 3,000	$ 14,600	61		$ 279,777
39		$ 80,879	62		$ 474,880	39	$ 3,000	$ 19,008	62		$ 302,159
40		$ 87,350	63		$ 512,870	40	$ 3,000	$ 23,768	63		$ 326,332
41		$ 94,338	64		$ 553,900	41	$ 3,000	$ 28,910	64		$ 352,438
42		$ 101,885	65		$ 598,212	42	$ 3,000	$ 34,463	65		$ 380,633

$27,000 invested @ 8% for a grand total of $598,212

$78,000 invested @ 8% for a grand total of $380,633

Ways to pay yourself first:

- Create an **emergency fund**. It is important to be prepared for the "just in case" aspects of life. We recommend creating a savings account that accrues for an unexpected expense such as a car or home repair, or a needed medical expense for you, your child or pet. This account may also be needed if you are faced with being laid off. Instead of racking up credit card bills, it is important to have money set aside to cover your living expenses. We recommend having enough to hold you over for at least 6-12 months.
- If you think it is too early to be putting aside for retirement – think again. As company pensions and Social Security are becoming less of a certainty, the bulk of retirement savings will be your responsibility. **Contributing to your company's <u>401(k)</u> and starting a <u>ROTH IRA</u> are two of the smartest moves a young adult can make**. These accounts allow your investments to grow tax-deferred and tax-free, respectively -- and again, with the power of compounding, can lead to sizeable future wealth.
- Make the process of saving as painless as possible by setting up automatic deductions from your paycheck. If you don't see in your paycheck to begin with, it is much easier to live without it.

#2: Set goals – Whether you are dealing with an existing situation such as paying off student debt, or aspiring toward something in the future like buying a home, get in the habit of setting goals. Goals are the fundamental building blocks of success -- not only in finance, but every area of life. Setting and working toward goals will help you maintain control over your destiny. Here are some suggestions:

- **Manage your debt –** Whether it is student loans or excessive credit card bills, set a goal of paying these debts off as soon as possible. Consider how the power of compounding works *for* you in #1, and think about how it works *against* you when it comes to paying interest on debt. If you have a $1,000 credit card bill charging 18% in interest and you decide to pay only the minimum payment, guess how long it will take you to pay it off? Twenty years! In addition, you will end up paying the credit card company over three times the amount of the original purchase! Debt is not inherently bad. In fact, we all need to take on some form of debt to build a credit history. The key is to not pay unnecessary interest and fees. A few rules of thumb:
  - Only buy things with a credit card that you can afford to pay back by month's end
  - Pay your bills! And on time! A poor credit rating can negatively impact not only your ability to qualify for loans, credit cards, or even a job, but can also result in higher interest rates since you will be perceived to be a higher risk – and that will add to your costs
  - Stick to one or two major credit cards with no annual fees and a reward program that aligns with your goals/lifestyle (cash back, miles, travel, etc.)
- **Practice the art of conscious spending** – You are in what is called the "accumulation phase" of your financial journey, which means you are building wealth with your hard-earned income. This is an important time to evaluate every purchase -- from an impulse buy at the mall, to large items like computers or a car. Conscious spending simply means you are actively choosing to spend on some things and not on others. Always be willing to ask the following questions as you contemplate a purchase:
  - Is this a "want" or a "need"?
  - Can I wait to buy this? Try curbing the impulse for immediate gratification and wait 30 days to see if it is still important to you.

  - o If I charge this now, will I be able to pay my credit card bill in full this month? If not, then it would be prudent to save until you can.
  - o Is this the best price? Can I wait until it goes on sale or even borrow it?
  - o Is this part of my bigger plan? Given my financial situation, is it more important to keep my eye on a bigger goal, such as buying a car?
- **Create a budget** – While this may be the last thing you want to do, it is all about getting into a habit and can be accomplished in a number of ways:
  - o The **Balanced Money Formula** -- proposed by Elizabeth Warren and Amelia Tyagi in their book *All Your Worth: The Ultimate Lifetime Money Plan* -- is based on net income (**after** deductions for taxes, health insurance premiums, and participation in company-sponsored retirement plans) and calls for spending no more than 50% of your paycheck on "needs." (Keeping the total spent on "needs" below 35% is even better!) Of the remaining amount, at least 20% should be devoted to savings, while up to 30% can be spent on "wants." If you are just starting out, these percentages may not seem realistic (especially if you have student debt to pay down or are saving for a house) -- but they should always be the goal and something you work toward sooner rather than later.
  - o With today's technology, it is easier than ever to create a budget. Websites such as www.ynab.com, www.smartypig.com and www.levelmoney.com help you set goals and create a savings schedule, while providing a simple, real time picture of how you are doing to stay in the black. More importantly, you can see how your everyday decisions tie into achieving your long term goals!
  - o Limit the amount of cash in your wallet and checking account so you are less likely to spend it. Use a debit card which will help you keep track of what you are spending on.
- **Behavior and lifestyle are part of the equation, too!** – While the power of compounding interest and investment gains are wonderful things, remember success (professional as well as monetary) still comes from work and discipline. Be strategic in your career, realistic in your expectations (salary versus standard of living) and plan it out (including contingencies).

No matter what your financial circumstances are, take time to set both short term and long term goals that: 1) are attainable, 2) are specific, and 3) have a deadline.

#3: Educate yourself and be vigilant – Life is an on-going learning journey. Your career will give you "hands on" experience, and hopefully you will find a mentor. Likewise, from a personal standpoint, to be financially successful, you should learn more about how other people have achieved their financial goals. Read, seek advice and take action, because it will not happen by chance. Investing and budgeting may not be your passions, but you owe it to yourself to have a base level of knowledge around these disciplines.

- Suggested reading:
  - o *The Automatic Millionaire*, by David Bach
  - o *A New Purpose: Redefining Money, Family, Work, Retirement and Success,* by Dan Kadlec
  - o *Lean in: Women, Work and the Will to Lead*, by Sheryl Sandberg
- Helpful websites:
  - o http://www.getrichslowly.org/blog/
  - o http://msmoney.com/

- Be vigilant – It is not how much you *make* but how much you *keep* that matters! Pay attention to the following to ensure you don't leave money on the table!
  - **401(k)/HSA/FSA:** Once you begin a new job, you may find your company offers to match some part of what you invest for your retirement. If you don't opt in to a 401(k) plan with a matching provision, you are essentially turning down a raise from your company. Let's say that you make $50,000/year and your company provides a match on the first 5% of pay contributed. That means that if you are investing 5% of your income for retirement, your company will also contribute 5% -- basically giving you a $2,500/year bonus, or in other words, essentially a 5% raise.

    Also, if you have the opportunity to put aside money in a Health Savings Account (HSA) or a health care Flexible Spending Account (FSA), be sure to take advantage of it. The money you place in one of these accounts is taken from your paycheck before taxes and can be used to pay your medical expenses. Imagine you spend $1,000 a year on health care expenses and your average tax rate is 20%. You would be saving yourself $200 per year. Importantly, HSAs do not have an expiration date, so you can continue to allow these funds to grow tax-free over your career. Think of it as a ROTH IRA dedicated to help cover any medical expenses you may face in retirement. An FSA, on the other hand, also allows pre-tax funds to be set aside for medical needs, but you must use them within a specified period of time, or lose them – making it important to come up with a good estimate of what your medical expenses will be during that period.
  - **Banking fees/finance charges/credit card interest:** Use *your* bank's ATM machine. Other banks may charge you a fee to use their machine, and you may even be charged by your bank, as well. Withdrawing $20 and getting hit with $6 in fees makes little sense. Watch out for minimum balances, overdraft fees and other finance charges -- like a fee for an incoming wire -- in your checking account. And pay bills on time to avoid wasteful late charges.
  - **Bundle services (insurance/cable):** One way to save money on insurance and cable services is to package most of your coverage (home, auto, valuables) under one carrier and bundle cable/phone/internet services. But remember, cable/internet should be considered a "want" versus a "need"!
  - **Review, review, review – and don't be afraid to ask for discounts:** Every year, make it a point to review your financial situation (insurance, memberships, and agreements). Are there things you are paying for that are no longer necessary? Did you have an "introductory offer" that has expired? Have interest rates fallen? Don't be afraid to ask for discounts on rent, insurance, cable bills. Or, if you incur a late fee after many months of on-time payments, call and ask (nicely!) if they might be willing to waive the charge. All they can do is say no. Also, make sure your "savings" are being invested. It does not help to funnel the money into an account if it is not going to earn money for you.

#4: Manage your risks – Protect your personal assets -- and your reputation – by being aware of the risks around each and taking the proper precautions.

- **Assets** – Car and health insurance are MUST HAVES. Make sure you have enough coverage and the appropriate deductibles. If you are renting, think about content insurance.
- **Estate documents** – As an adult, you should have the following planning documents:

- Will – directs where you want your assets to go should you pass away
- Living will – defines your wishes should you be medically incapable of making decisions on your own
- Financial power of attorney – designates a person who would make financial decisions on your behalf if you were unable to do so
- Health care power of attorney – names the person who would be deemed the decision maker on your health care needs
- Here's a link to fillable forms for the state of Ohio: https://www.ohiobar.org/Advance%20Directives/practiceaids/advancedirectives/Advance%20Directives_Fillable_10-22-12MAY.pdf

- **Identity** – Protecting yourself against identity theft is always easier than having to clear your name and credit record after the fact. Always monitor your bank statements and credit card statements, shred documents with confidential information, and protect your technology with strong passwords.
  Helpful websites:
  - www.annualcreditreport.com
  - www.creditkarma.com
- **Reputation** – Thanks to technology and social networking, any person in a position to review your reputation for the purposes of employment, volunteering or other public interface can find out a great deal about you and your past. Be smart about your online social media accounts by writing consistent profiles with productive information that you would like to be acknowledged for. Watch spelling and grammar -- and think before you click!

#5: Stand on your own

You will never know your true cost of living if the *Bank of Mom and Dad* continues to subsidize your lifestyle. For instance, if your parents are paying your health insurance premiums while you are still on their policy, it may be surprising to learn that the cost to see your doctor is considerably more than the $20 co-pay, but actually includes the hundreds of dollars of premiums your parents and their employer are paying for your health insurance. Remember, your parents are also saving for their own retirement and may have spent a significant amount of money on your college education. Now is the time for them to focus on *their* future needs -- which will likely include higher taxes, increasing medical costs and greater uncertainty around Social Security.

Conclusion:

The road to achieving financial success will not always be easy. According to the JumpStart Coalition, 18-24 year olds are one of the fastest growing age groups filing for bankruptcy. It is very tempting to live beyond your income, but the consequences can negatively impact your life for years to come. Be smart about your spending, have patience and save for the things you want, invest for your long-term future and be careful in taking on debt.

Follow these principles, stay on course and you will reach your destination.