CHAPTER 1

The First Rule of Finance

The First Rule of Finance is to live within your means by spending no more than 80 percent of your take-home pay.

If you take home $100 per week, spend no more than $80. If you take home $1,000 per week, spend no more than $800. If you take home $10,000 per week, spend no more than $8,000 or, better yet, keep living as you did back when you made only $1,000 per week, because that's enough.

From this simple rule, all else falls into place. If you don't spend more than 80 percent of your income, you won't get into trouble. You won't allow house payments, car payments, insurance payments, and shopping charges to exceed your 80 percent threshold. You may not be Einstein, but you can manage this concept, right?

That's all we're talking about here. When you read that people were tricked by mean bankers, remember the First Rule of Finance and ask how anybody can be tricked into spending more than 80 percent of their income. How stupid are they?

Prove to yourself that humanity is up to the task of adding and subtracting. Test a son, daughter, nephew, niece, or neighbor kid. Give them ten bucks and tell them they can buy anything they want with it, but you want at least two dollars back then they're done. Drive them to a store and watch the magic. They look at prices, they look at their ten bucks, if they're really sharp they account for sales tax, and they find something for less than eight dollars. Bingo! A financial wizard is born.

It's really that simple.

Wealth springs from this First Rule of Finance. That's why it's first. Troubles begin the moment it's broken. The day you commit to spending less than 80 percent of your income is the day you start getting rich.

Killing Themselves for the Joneses

Ever look at what people spend their money on? I have relatives and friends chronically in debt, spending $12 for every $10 they earn instead of the $8 you know they should be spending. When I see them, they're proud of their new whatever. Cars are high on the list. Electronics, too. A few boats have shown up. Designer clothing is popular. "What do you think of my new truck?" asked one from the driver's seat. "Do you like my new shoes?" asked another on stiletto heels. "Check out my new big screen," said a third while holding the remote in his living room. We've all heard people fishing for compliments on their new toys.

Theirs?

The first guy didn't own the truck, the bank did—and eventually repossessed it. The woman didn't own the shoes, she made payments on them to the bank issuing one of her many credit cards and still pays on them today even though they've long since gone out of style. What did she do? Replaced them with new ones, of course—before she'd ever paid off the old ones. The third person didn't own the big-screen TV, he financed it with in-store credit that came interest-free for 90 days, then hit him with all the backed-up interest plus penalties if he was late in paying, which, of course, he was. These people don't own anything.

Every one of them was proud of what they'd financed. They seem to have bought it for the purpose of being proud, of showing off, of keeping up with the Joneses. Nice cars beget nicer cars, nice shoes beget nicer shoes, and big TVs beget bigger TVs. "Look at my new . . ." is everybody's favorite phrase, even when the object in question isn't theirs at all and won't be new when they've finally paid for it, if they ever do.

They're proud of being stupid. They think it's cool to drive the financed car, wear the financed shoes, and watch the financed TV, but to smart people, whose opinions are the only ones we should respect, these people look dumb as rocks.

The Joneses Are Broke

The following is an *Investopedia* article on conspicuous consumption, by Lisa Smith:

> It used to be that spending money on status symbols for the sake of flaunting your wealth was an activity reserved for celebrities and millionaires. That has all changed. Conspicuous consumption, what was once referred to as "keeping up with the Joneses," has brought the lifestyles of the rich and famous to suburbia.
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> Just as most people consider themselves to be above-average drivers, most people assume they aren't the ones doing all this needless spending. They aren't wearing ten pounds of gold chains or gowns created by famous designers. Four-hundred-dollar haircuts, sprawling mansions, Rolls-Royces, and private planes aren't in their budget, so they assume their spending is reasonable. However, a closer look at what you're spending might put your own lifestyle in a different light. . . .

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Many of the people driving around the suburbs in their giant SUVs while talking on their new cell phones are deeply in debt. If you ask them how they are doing, they will tell you that they are just barely getting by. According to a Federal Reserve Board study, 43 percent of American families spend more than they earn.

Source: Lisa Smith, "Stop Keeping Up With The Joneses—They're Broke," *Investopedia,* http://www.investopedia.com/articles/pf/07/conspicuous_consumption.asp.

The Joneses, nine times out of ten, are financially stupid. That's why they have all that stuff, on borrowed money. Why try to copy them? Worse, why try to impress them? Copy and impress smart people, the ones who own their stuff. If you want to impress smart people, debt is the last way to go about it. Trying to impress a money-smart person by going into debt is like trying to impress Olympic swimming champion Michael Phelps by drowning in a pool, or golf pro Tiger Woods by driving your ball through the windshield of a parked car. Michael Phelps is impressed by good swimming, Tiger Woods by good golfing, and a money-smart person by good money management.

First Save, Then Buy

If you ever want to know how predictably stupid most people are and how smart people are onto them, attend a product-and-marketing meeting. Companies that make and sell shiny objects know what they're doing, and they consider the average consumer to be a complete dope. I once joined a meeting at an electronics manufacturer where a manager asked if people would really buy a big-screen TV model as big and expensive as the one discussed that day. "Sure," said an executive, "just show a celebrity using it and break the price into 60 monthly payments that don't begin for six months, and they'll buy anything." Everybody laughed and nodded, because he was right. The same meetings happen at car companies, clothing companies, furniture companies, and jewelry companies. Most consumers are just walking debt dopes. Companies know that and have learned the language and images that trick the dopes into piling on more debt.

"I deserve this," says one debt dope.

"It fits my lifestyle," says another.

"In today's world, your car is your home away from home," regurgitates a third.

O First Rule of Finance, First Rule of Finance! Where art thou, First Rule of Finance?

Here's a little secret: most of the joy of buying is anticipation. Dreaming and saving for the car of your dreams is the best part. Once you buy it, it's just your car. Same with a pair of designer stilettos. Same with a big-screen TV. Life is long. When you buy everything you want immediately, there's nothing to look forward to anymore.

Instead, get your life on the First Rule of Finance, save a foundation of money, and make purchases from it. If you see a big-screen TV you want that costs $5,000, break it down into 24 monthly payments of $210 into your own savings account *before you buy*, and enjoy counting the months and watching the cash pile up. On top of the joy you'll get anticipating the day you walk in and slap cash on the counter, four fringe benefits will emerge:

1. The money you save will generate interest until the day you use it. Keep that for yourself instead of paying it to bankers and corporate tycoons. You'll read later how the Federal Reserve sometimes destroys this benefit by lowering interest rates to encourage spending, but for now just know that saving puts whatever interest is available into *your* pocket, instead of a corporation's.

2. By the time you've saved enough for the object of your desire, there will probably be a newer and better model available for the same price or less.
3. You will own free and clear the object in its most pristine state when it's brand spanking new. Debt dopes never own anything, or by the time they do own things they're old and in need of replacement—with further debt.
4. You will never suffer buyer's remorse because your purchases will be carefully planned. You won't jump into anything lame and then suffer paying it off for years.

First save, then buy.

By saving and then buying, you pace your purchases, enjoy them much more, and never get into debt. Most people do just the opposite. They buy everything they want the moment they see it, rack up a mountain of debt, and add to the mountain when they buy new things.

That's the debt cycle, and the economy is built on it. During the credit crisis, the government said repeatedly that it needed to get banks lending again and people shopping again, even though it was excessive borrowing and shopping that created the crisis. "Holy smokes!" Washington exclaimed. "We have to *stimulate* banks into lending so people and businesses borrow and spend, so we can get right back to the debt-based economy that got us into this mess. Hurry!"

At the time, I remarked to my smart friends that if everybody lived the way we do, there could be no debt economy. Companies can't force us to buy things. Buying is voluntary. If people restricted themselves to buying what they could pay for with cash, companies would adjust by offering only reasonably priced goods. Companies will never stop making shiny objects that are too expensive as long as debt dopes line up to buy them on credit. If enough people wise up, though, companies will change their ways and surround us with affordable goods.