Chapter 1

Exploring Money in Your Life

In This Chapter

- Understanding natural human biases and attitudes toward money
- Reflecting on your financial history
- Recognizing what obstacles stand in the way of your financial progress

Before you begin making concrete financial plans, you should understand how humans are wired regarding money, and you should explore your own personal financial history. What messages did you learn, consciously or unconsciously, about money when you were growing up? How have these messages affected the way you make money-management decisions now? If you're in a long-term relationship, what lessons did your spouse or partner learn, and how do your loved one's money biases and history affect your financial plans together? In this chapter, I help you delve into and analyze natural biases and financial histories.

Untangling Your Financial Hardwiring

Have you ever wondered why some of the most brilliant people seem to be really stupid with money? Why don't all Wall Street analysts have stellar portfolio returns? How come you may know exactly what you want to do with your money but you can't stay the course?

REMEMBER

Achieving your financial goals has much more to do with your mind-set than it does with math and markets. With that said, you can't just choose to change your mind. Human beings have some very common natural biases or tendencies — I call it *hardwiring* — toward money.

Take some time to think about the questions in Worksheet 1-1. Then read the following sections to gain a better understanding of the tricks your mind can play on you. After you have some insights into how you approach your financial life, you can increase the likelihood of altering seemingly irrational decisions in the way you spend, invest, save, and borrow money.

Worksheet 1-1 Reviewing Your Hardwiring

- ❑ Imagine you go to a casino with $100. You gamble and quickly get up to $1,000. Unfortunately, your luck turns and you leave with no money in your pocket. How much have you lost, $100 or $1,000?
- ❑ Would you find it easier to justify spending your tax refund, rather than spending money from your savings account, on the flat-screen TV that you've been wanting?
- ❑ Are you more tempted to buy last year's number-one-performing mutual fund, as touted in your favorite personal finance magazine, or another one with an extremely consistent but not stellar return?
- ❑ Do you tend to spend more — go shopping more freely — when using a credit card?
- ❑ Would you prefer a 10 percent raise with inflation at 12 percent or a 3 percent raise with inflation at 4 percent?

Analyzing what you think money is worth

In behavioral finance, the term *mental accounting* refers to the concept that you may place different values, or *worth,* on money depending on the circumstances. Your subconscious plays tricks, and you may begin to question your decision making.

For example, you may shop at a different location if you can buy a $25 item at 20 percent off and save $5. What if you were purchasing a $500 item that you can get for $495 (a 1 percent discount) at a different store? In percentage terms, one discount is 20 times more valuable than the other. However, in dollar terms, the savings are identical. Both examples save you $5.

Another significant disconnect that happens between your brain and your pocketbook is found money. Imagine that your miserly, old, great aunt Eunice passes away and leaves you an inheritance. You had no idea that you'd receive this windfall. If you're like the majority of Americans, you'll fall into the trap of reacting differently to this money than the money you bring home in your paycheck.

You may be prone to wasting money because you wrongly put different values on the same dollars. The source of the money shouldn't matter, whether it's from gambling winnings, a tax refund, your savings account, your great aunt Eunice, or hard-earned, after-tax income — a dollar is a dollar.

Illuminating the illusion of large numbers

You've probably heard stories of people who win the lottery and very quickly spend or give away all the money, or of the professional athlete who starts his career with a multimillion-dollar contract and later in life has no more money than the average American. You may have even thought to yourself that if only you had the opportunity to come into that kind of money, you'd never blow it. *You* wouldn't make the mistakes that so many people do in thinking that the money will last forever.

I think we need a warning label that states, "Objects — in this case a lump sum of money — appear larger than they really are." A classic example of this problem occurs when people have the opportunity upon retirement to take either a lump sum distribution from their pension plan or monthly payments for the rest of their lives.

Imagine that you're presented with the option of receiving a lump sum of $350,000 or a $1,500 monthly check for the rest of your life. What would you do? That sum of $350,000 is a lot of money. What will you choose to do with it? How will you invest it to generate the retirement income that you need? Is the $1,500 a month payout fair? Are you guaranteed to always receive this $1,500 a month? If you take the lump sum, you have control and the responsibility for managing the investment portfolio, paying taxes, and generating income. But the $1,500 per month may work out very well if you live long enough. But what if you need a chunk of money at one time?

There's a best answer for each situation, and it depends on individual circumstances. But you also need to have an appreciation of the mathematics and probabilities that go into this decision. Recognize that you're likely hardwired to view the lump sum as more valuable. This can help you focus on rationally analyzing the facts and circumstances and making the best decision for yourself.

In the last question in Worksheet 1-1, for example, I ask whether you'd prefer a 10 percent raise with inflation at 12 percent or a 3 percent raise with inflation at 4 percent. If you're under the spell of the illusion of large numbers, you'd be drawn toward the larger raise — 10 percent. However, the larger number in this case isn't the best choice. A 3 percent increase in your salary is only 1 percent less than the increase in your cost of living. With the larger raise, you'd actually fall behind the cost of living rate by 2 percent.

Understanding anchoring, overconfidence, and herding

The *anchoring bias* — putting too much stock in one piece of information or belief — may lead you to make important decisions based on the wrong information. A somewhat similar concept in behavioral finance is overconfidence.

Overconfidence is the price you pay for thinking you know more or have more control over things than you actually do. You may have more faith than you should in the reliability of your own judgment or experience.

And laypeople aren't the only ones affected by the anchoring bias and overconfidence. Wall Street analysts' recommendations regarding whether their clients should buy, sell, or hold a security are skewed by the human tendency to attach too much value to recent past experiences. For instance, an analyst may have recommended the sale of stock of the financial services giants just before the collapse of Lehman Brothers in 2008. Now, the same analyst may be overly confident in her ability to forecast the future. Wall Street analysts, financial advisors, and investors are all human and are all susceptible to falling into the same psychological traps.

Another trap is *herding*. What's the buzz on the street? Biofuels, gold, China? You don't want to miss out. How can *this* not be a good investment with so many of the "experts" recommending it? These are examples of following the herd. This tendency may cause you to rely too much on the opinions or actions of others. You may find it more painful to go against the crowd and potentially be correct than to go with the crowd and make an incorrect decision.

Balancing loss and risk

Behavioral finance has confirmed that human beings don't like to lose money. News flash, I'm sure! That's not the lesson here. Studies show that you're averse to loss but not necessarily to risk. You may be willing to take risk if it means avoiding a sure loss. For example, you loan your daughter and son-in-law $25,000 to start a business. If they're successful, they'll do very well and be able to repay your loan. But what happens if the company makes great progress but then goes through a rough patch? Your relatives need more money. Another $5,000 should get them through. If you don't loan them another $5,000, they'll have to shut down their business, and you're sure to lose your $25,000. So you lend them the additional $5,000. You're already down $25,000. If you risk another $5,000 you may get all your money back.

Exploring Your Attitudes about Money

I'm sure you've heard people say that they're "frugal" or "good savers." However, I find these statements to be less common than, "I'm not good at money management," "I don't know how to manage money," "It's too confusing," "I'll never get ahead," or "I'll have to work 'til I drop."

Try to maintain a spirit of open-mindedness when you think about your finances. For example, if you think you'll never get your credit card paid off or have adequate savings — let alone financial security — you may quit before you even start. However, if you remain open to making changes in your financial habits and you're gentle but persistent, you're likely to succeed. Which reality do you want? You have the opportunity now to make changes that affect your financial life forever.

REMEMBER

Your thoughts about money influence your actions. Positive thoughts lead to positive money-management behaviors. Negative thoughts can lead to financial ruin.

Everybody, at one time or another, has been majorly stressed out or felt stupid or frustrated about money. Exploring your current attitudes and beliefs about money is an important step in improving your financial education and situation.

To guide you in your exploration, I include Worksheet 1-2. To use this worksheet, determine how often the statements fit you — frequently, sometimes, or never. In the blank provided, write *F* for frequently, *S* for sometimes, and *N* for never. Don't spend a lot of time mulling over the answer, no more than a few seconds on each question. Because your attitudes can and do change, respond to these questions as you feel right now and go with your gut.

Worksheet 1-2 Attitudes about Money Quiz

_____ I hate to open the mail because all I ever receive are bills.

_____ I'll never have enough money.

_____ When I'm feeling down or bored, I go shopping.

_____ My spouse/partner/kids spend money faster than I can bring it in.

_____ I don't want my kids to go without things they want, like I had to when I was growing up.

_____ If I have cash in my wallet or purse, I'll spend it.

_____ How can I save for retirement when I can barely make ends meet now?

_____ I can't or won't be able to help my kids pay for college.

_____ In the event of a financial emergency, I don't know how I could come up with the money.

_____ My employer has a retirement plan, but I can't afford to participate.

_____ If I want something, I buy it, more easily with credit than cash.

_____ I'm not out of money until I'm out of credit.

_____ I'll postpone making a purchase if I don't have the cash right now.

_____ I use a list when I shop and only buy those items on my list.

_____ My family will be financially okay if something happens to me.

_____ I expect to pay off credit card debt in the very near future.

_____ I feel stressed when I think about my financial commitments.

_____ I'm ashamed of my wardrobe, car, and/or home.

_____ I know how much money is in my checking account.

_____ My parents had to do without. I will not.

_____ My income has increased steadily for years, and there's no limit to my earning potential.

_____ My lack of money makes me feel inadequate.

_____ I'm the one my friends/family turn to when they need money.

_____ I've lied about money to people I care about.

_____ I'm tired of not having *enough* money all the time.

_____ I've been financially burned before (ex-spouse, financial advisor, deadbeat friend, or family member), and I won't let it happen again.

_____ I feel knowledgeable about my ability to manage money.

_____ I make only minimum monthly payments on my credit card debt.

_____ I've taken money out of IRAs or retirement plans before I should have.

_____ I tend to be good about spending large amounts of money wisely, but I fritter away money on a lot of small purchases.

After completing Worksheet 1-2, you should have a pretty good picture of your attitude and feelings toward money. But to take it a step further, spend a few minutes writing about your current attitudes and feelings about money; see Worksheet 1-3 as an example and use the space provided in Worksheet 1-4. This exercise can help you become more aware of how your thoughts and attitudes toward money may have evolved and how those attitudes and beliefs are affecting your financial life today.

Worksheet 1-3 **Reflection**

I don't know much about money management. I feel like I ought to know, but I don't. We save a little each month, and we pay extra toward our credit-card balances each month. And I'm very happy to say that the balances are finally starting to go down. Unfortunately, I feel like I am nagging my family every time I turn around. They think I'm becoming a miser. My dad was a miser and didn't live long enough to enjoy it. My mother and I would have loved to have had a few niceties like clothes that were in fashion, a newer car, and a larger house. But my dad said we couldn't afford it. When it came to money, Dad's only communication was "No."

I don't want to turn into my dad, but I do want our family to be financially secure.

Worksheet 1-4 **My Reflections**

Taking Stock of Your Financial History

Your financial history consists of your natural biases and the lessons and messages you heard about money while growing up. Much of what you are today you owe to your upbringing, whether good or bad. So it makes sense to reflect on the messages you received and how they may be affecting your money-management decisions today.

Your parents or primary caregivers may have been somewhat or very secretive about their personal financial situation; however, what they said and how they acted can reveal a lot.

Worksheet 1-5 helps you reveal your financial history. Check off each statement that you heard (or anything darn close to it) from a parent or primary caregiver growing up.

Worksheet 1-5 Figuring Out Your Financial History

- ❑ Money burns a hole in my pocket.
- ❑ Live for today. You never know what tomorrow will bring.
- ❑ Don’t carry cash. You’ll either spend it or someone will clunk you over the head and take it.
- ❑ If you want something, you have to work very hard to get it.
- ❑ You’ll never amount to anything.
- ❑ It’s easier for a camel to pass through the eye of a needle than for a rich man to enter the kingdom of heaven.
- ❑ If you want something, you must be willing to sacrifice.
- ❑ You don’t appreciate how hard I work to put food on the table.
- ❑ If you can’t afford to pay cash for something, you shouldn’t buy it.
- ❑ Neither a lender nor a borrower be.
- ❑ You can accomplish anything you desire in life.
- ❑ Women don’t make as much money as men.
- ❑ Invest in yourself.
- ❑ Diamonds are a girl’s best friend.
- ❑ Your mother or father can’t manage money.
- ❑ Your mother or father lies about spending money.
- ❑ The rich get richer on the backs of working-class people like us.
- ❑ I can’t afford to pursue the career of my dreams.
- ❑ If we would have only waited longer before having kids . . .
- ❑ Save it for a rainy day.
- ❑ A penny saved is a penny earned.

Read through the statements that you checked off in Worksheet 1-5 and spend a few minutes reflecting on the messages you heard as a child and how those messages may have affected your current attitudes and feelings about money. Ask yourself the following questions about each of your parents or primary caregivers and write your reflections in Worksheet 1-7. (You can use Worksheet 1-6 as an example if you get stuck.)

- Were they spenders or savers? Do you know?
- Did they talk about money around you?
- Did they fight about money?
- What lessons did you learn about money from them?

Many of the messages listed in Worksheet 1-5 are somewhat or very negative belief statements. Of those that you checked, which do you find potentially negative, and what effect do you feel those messages may have had on you growing up?

Some people are hoarders, and others are overspenders. Being extreme — on either end of the spectrum — isn't healthy. Balance is key. You can't spend everything today or you won't have anything for tomorrow. You also shouldn't put off everything you'd like to do until tomorrow because tomorrow may never come. Finding the appropriate balance with your time, energy, and money leads to the best outcome.

Worksheet 1-6 Reflections on Financial Origins

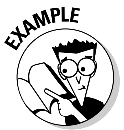
Example #1:
My father was a good provider — financially speaking. Unfortunately, he wasn't home as much as I would have liked him to be because he was constantly working. I regret not having more time with him while I was growing up. I don't know whether he worked to better provide for his family, or because he felt he had to, or maybe he was just a workaholic. He grew up in a very poor family. He never felt we were saving enough.

Example #2:
My mother would like to spend more money than she does. However, my father keeps a tight grip on the purse strings in our family. I remember a few occasions when my mother bought a new dress or pair of shoes, and she hid them from my father in the back of their closet. She'd tell me, "By the time I wear them, Dad won't realize that they are new." And my father may have been too much of a hoarder. When he was growing up, his family was broke. I know he didn't want that for us.

Worksheet 1-7 Reflections on My Financial Origins

Identifying What or Who May Be Holding You Back

What irrational beliefs or unhealthy behaviors do you feel you may have picked up from your parents or primary caregivers growing up? What tricks may your subconscious be playing on you? Using Worksheet 1-9, reflect on these biases and ways of thinking and how these beliefs may be affecting you now. (If you'd like to see an example of this type of reflection, you can check out Worksheet 1-8.) For example, do you find that you follow in your tightwad father's footsteps or do you resent the fact that you weren't allowed to buy things that you wanted when you were younger and have made up for it — in spades — in your adulthood?



Worksheet 1-8 Unhealthy Behaviors Learned When Growing Up

My father felt very strongly that if you want to achieve financial security you have to be willing to sacrifice time with family. He felt his job was to make money and be a good provider. I got the feeling that money was more valuable than his family. I missed my father. I wanted more time with him when I was growing up. You can't replace that with any amount of money. I will never let that happen to my kids.

From my mother, I learned that if she wanted something but ought not to buy it, she could so long as Dad didn't know about it. She definitely wouldn't endorse lying, but that is exactly what I learned when it came to her relationship with my dad and money. "What he doesn't know won't hurt him," she used to say. I'd like to have a more understanding, collaborative partnership with my spouse, rather than it being so one-sided as it was with my parents.

Throughout my childhood, it became apparent to me that people judge you by how much money they think you have. I care about what others think of me. But I have to really try not to spend my money on things that will impress "them."

Worksheet 1-9 Unhealthy Behaviors Learned When Growing Up

You may hold a grudge, feel taken advantage of, or have animosity toward people in your financial life. You may also have regrets about decisions you've made. Bad decisions are frequently the result of your subconscious disconnect between the value of one dollar and another. So in addition to the messages you received growing up, what other people or beliefs/biases do you feel may be keeping you from realizing your full potential financially? Use Worksheet 1-10 as a guide to get you thinking (and writing) about what or who may be holding you back from your financial goals.

Thus far, you've been focusing on your hardwiring and the messages you learned growing up. In Worksheet 1-10, I'd like you to focus for a moment on other people in your life and how your relationship with them may be affected by money.

Worksheet 1-10 Who or What Is Holding You Back?

Spouse/partner (if so, how?):

____

____

____

____

Children and family responsibilities (if so, how?):

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____

____

Education and/or career, health, or other issues (if so, how?):

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____

Your natural biases toward money (if so, how?):

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____

By becoming more aware of your beliefs and attitudes and recognizing how those beliefs influence your relationship with money, you can discover what or who may be holding you back. The first step is awareness.

Dealing with the Subject of Money

Sharing your financial goals, objectives, quirks, and hang-ups about money with the people in your life is the best way to overcome perceived or real issues impeding your financial success.

However, money is the last taboo subject for most people, and you likely don't talk about your personal finances with others. Worksheet 1-12 is designed to help stimulate healthy and meaningful dialogue with your spouse/partner, kids, parents, friends, and employer. See Worksheet 1-11 for some examples to jump-start your thinking. Focus on positive, healthy interactions that you've had in the past. How can you benefit from having these types of conversations now?

Worksheet 1-11 Meaningful Money Discussion

My daughter recently started her first "real" job. She asked me for advice regarding whether she should sign up for her retirement plan at work. I don't know much about investing or retirement plans. However, I do know that I regret not participating in my employer's retirement plan when I first started working. Because I didn't, I have not saved anywhere near the amount of money I should have by now. So I encouraged my daughter to start saving now. The biggest regret I have about my financial decisions is that I didn't start saving a lot sooner. Hopefully, I have helped my daughter avoid the same mistake I made, by being open and honest with her about my mistakes and regrets. Heck, if you can learn from your mistakes and that knowledge helps someone else, all is not lost.

Worksheet 1-12 My Reflections on Meaningful Money Discussions

With your spouse or partner:

With your children:

With your parents:

With your friends, employer, others:

Many people would prefer to avoid talking about money. Why is the topic of money off-limits, like politics and religion? Burying your head in the sand leaves your backside wide open. And trouble brews when couples or families ignore the topic. You should discuss matters, such as your desires about what to do with your annual bonus. Your spouse or partner may have very different ideas about using this money. Communication and compromise are required. Remember, you're in a financial partnership with your spouse. Collaborate on your financial plans together.

You and your spouse/partner are not only romantic and domestic partners; you're also financial partners.

Using Worksheet 1-13, determine some financial discussions you may need to have, perhaps with your loved ones or even your employer. Be specific about what you need to address and why.

Worksheet 1-13 Financial Discussions You Need to Have

With your spouse or partner:

With your children:

With your parents:

With your friends:

With your employer:

With others:

Now that you've identified some key conversations that need to take place, consider how and when you should bring up these discussions. Address any critical issues as soon as possible. The longer you wait, the more resentment and animosity can fester. Nip potential problems in the bud.

Open the conversation. Be persistent and patient. Change takes time, but the results are worth it.