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Chapter 1

Your Financial Checkup

Where did your childhood years go? Was it that long ago that you were concerned with what exams you had coming up, what you might be doing over your summer break, and what kind of job you were interested in and qualified to do?

As a young adult, you wonder where you are going to live, how much a decent apartment will cost, and how much you will actually have left over after taxes and those other pesky deductions that are taken from your paycheck. How much will it cost to buy a home that you'll really want? What are the best ways to save and invest your money?

And then life throws you a curveball like the COVID-19 government-mandated shutdowns, which turned plenty of young people's lives upside down in a way that few saw coming. Or perhaps an aging parent or other relative needs some help. How can you handle these situations personally and financially?

Those are some pretty big questions that even people 20 and 30 years older than you struggle to answer. You're wise to be thinking about these topics now. In this chapter, I help you start to answer those questions by showing you how to evaluate your net worth (addressing any debt, such as student loans, credit cards, or auto or other consumer loans). I also help you assess your savings rate, credit health, investment portfolio, and insurance coverage so you can develop and implement a winning plan tailored to your situation.

Calculating Your Financial Worth

Having a sense of what you own (your *assets*) and what you owe (your *liabilities*) is important because it provides some measure of your financial security and your ability to accomplish financial goals such as buying a desired car, buying a home, traveling, starting a business, or retiring someday.

In this section, I define net worth and then walk you through the relatively simple calculations of determining your own personal net worth.

Defining net worth

Your *net worth* is quite simply your *financial assets* (for example, checking, savings, and investment accounts) minus your *financial liabilities* (debts such as student loans and credit card debt).



REMEMBER

When I discuss your monetary *net worth*, I'm not talking about personal possessions. Your car, clothing, television, computer, and other personal items all have some value, of course. If you needed to sell them, you could get something for them. But the reality is that you're unlikely to accumulate personal items with the expectation of later selling them to finance such personal goals as buying a home, starting a business, retiring, and so forth. After all, personal property declines rapidly in value after purchase and use.

Figuring what you own: Financial assets

To calculate your financial assets, access your checking/savings and investment account records, including retirement accounts and any other documentation that can help you. You may have only one or two accounts, and that's fine. Add up all the values of these accounts to find out what you own.

It's common for most young adults to be in the early stages of accumulating assets. This book helps guide you through the best ways to do just that.

In addition to excluding personal property and possessions because folks don't generally sell those to accomplish their personal and financial goals, I would also probably exclude your home as an asset if you happen to own one. (You can include it if you expect to downsize or to rent in retirement and live off of some of your home's equity.) Include investment real estate — that is, real estate that you own and rent out.

VALUING SOCIAL SECURITY AND PENSIONS

Now or in the years ahead, you may accumulate some retirement benefits based on your years of work. You may do so through the federal government's Social Security program and/or through an employer's pension plan.

When you work and earn money, your employer (or you if you're self-employed) pays taxes into Social Security, which earns you future Social Security retirement income benefits. Under current laws, which of course may change, you're eligible to receive full Social Security benefits at age 67. (You may collect a benefit reduced by 30 percent if you begin receiving your Social Security payments at age 62.)

In surveys, most young adults say that they're more likely to believe in things like UFOs than in actually getting money out of Social Security! Although being skeptical and questioning things is useful, such deep cynicism about Social Security isn't well founded. Those who are eligible to receive benefits (generally, folks who've paid Social Security taxes above relatively low threshold amounts over at least ten years in total) should get them. As a young adult, it's important for you to also know that some Social Security benefits, such as disability and survivorship benefits for your children under 18, are a part of your Social Security insurance coverage.

Some employers provide a retirement benefit known as a pension that's paid to you in retirement based on your years of service (employment) with the organization. Your employer puts aside money above and beyond your salary compensation into a separate account to fund your future pension payments. Pension plans are more common in public-sector organizations (governments, schools, and so on) and larger companies, especially those with labor unions. Pension plans are generally insured/guaranteed by government agency entities.

Now, I do have one exception to something that isn't generally thought of as a financial asset, which you may or may not want to include in this category. Some people have valuable collections of particular items, be they collectible coins, sports memorabilia, or whatever. You can count such collections as assets, but remember that they're only real assets if you'd be willing to sell them and use the proceeds toward one of your goals.

Determining what you owe: Financial liabilities

Most people accumulate debts and loans during periods in life when their expenditures exceed their income. I did that when I went through college. You may have

student loans, an auto loan, credit card debts, or a medical or pet debt. Access any statements that document your loans and debts and figure out the grand total of what you owe.

Netting the difference

After you total your financial assets and your financial liabilities, you can subtract the latter from the former to arrive at your *net worth*:

$$\text{financial assets} - \text{financial liabilities} = \text{net worth}$$

Don't worry if you have a small or negative net worth (where you have more debt than assets). There's no point wringing your hands over the results — you can't change history. And, it doesn't matter how you compare with your peers even if we can accurately define exactly who your peers are. *This isn't a competition or test.*

But you can change the direction of your finances in the future and boost your net worth surprisingly fast to work toward accomplishing your personal goals. First, you have to figure your savings rate and how to increase it, which I discuss next.

Grasping the Importance of Your Savings Rate

To accomplish important personal and financial goals such as building an emergency fund (the COVID-19 pandemic has proven the absolute need for emergency fund savings), buying a home, starting a business, traveling, and someday retiring, most folks need to save money. Some exceptions do exist, such as those folks who have trust funds or inherit significant-enough sums that they don't need to save money from their work earnings. But the vast majority of people must save in order to accomplish their goals.

You can't effectively save for a long-term goal if you don't know what your savings rate is. When I worked as a financial counselor and taught adult-education money-management courses (which I now do online), I was struck by how few people knew the rate at which they were saving money. Most people can tell you how much they earned from their work over the past year, but few folks really know what portion of their employment income they were able to save. That's because to have an accurate idea of this percentage, you really need to do some analysis and calculations. The math isn't that complicated, but it does require some time and effort, especially if you haven't been tracking your spending or net

worth over the past year. In the following sections, I explain a couple of different ways to calculate your savings rate over the past year.

Calculating your income and outgo

The first way to determine your savings rate is to tally your employment income and expenses over the past year. By subtracting your total expenses, including taxes, from the past year from your employment income, you can arrive at *net savings*.

The *employment income* part of the equation is simple for most folks — it's simply the total amount of your paychecks from work. (If you have work from side or gig jobs you do outside of your regular job, be sure to count that too.) But unless you systematically track your spending, that piece of the puzzle is a lot more work to figure. I walk you through how to compile your spending in Chapter 5.

Assessing the change in your net worth

If you don't want to be bothered with the time-consuming task of tabulating your spending over the past year, here's an alternative method for arriving at your savings rate that may be quicker for you. Follow these few easy steps, and fill in the blanks in Table 1-1.

1. Calculate your net worth.

Refer to the earlier section "Netting the difference" for an explanation of how to do so.

2. Calculate your net worth from one year ago.

You can determine your year-ago net worth by tallying your financial assets (savings and investments) from one year ago and subtracting your financial liabilities (loans and debts) from one year ago. Don't count your home as an asset or your mortgage as a liability. Your concern here is financial assets.

3. Correct for any changes in value of investments you owned the past year.

Suppose that your net worth today is \$15,000, whereas one year ago it was \$10,000. You might conclude from the change in your net worth that you've saved \$5,000 ($\$15,000 - \$10,000$), but that figure may not be correct, and here's why. A year ago when you had a net worth of \$10,000, you presumably had savings and investments, and those would have changed in value over the past year. Suppose you made some good investments and they produced \$1,000 in returns (from interest, dividends, appreciation, and so on) over the past 12 months. Though you're happy to have made \$1,000 on your investments, that money isn't new savings and shouldn't be counted in your savings-rate calculations. So you really saved \$4,000 ($\$5,000 - \$1,000$).

Conversely, if your net worth was reduced over the past year by declines in the value of your investments, you should add back that figure when determining your savings rate. If your investments declined by \$1,500 in value over the past year, you really saved \$6,500 (\$5,000 + \$1,500). Table 1-1 walks you through this part of the analysis.

TABLE 1-1 **Your Savings Rate over the Past Year**

Calculate your net worth now and one year ago	
Today	One Year Ago
Savings & investments \$ _____	Savings & investments \$ _____
– Loans & debts \$ _____	– Loans & debts \$ _____
= Net worth today \$ _____	= Net worth a year ago \$ _____
Correct for changes in value of investments you owned the past year	
Net worth today	\$ _____
– Net worth a year ago	\$ _____
– Appreciation of investments (over past year)	\$ _____
+ Depreciation of investments (over past year)	\$ _____
= Savings amount	\$ _____
Annual gross income	\$ _____
Savings rate (savings amount divided by your annual gross income)	_____ %



REMEMBER

If you have debt that you’ve been paying down over the past year, you can count the principal payment reduction on that debt as savings. For example, suppose a year ago you owed \$5,000 on an auto loan. Now, a year later, you owe just \$4,500. You can count that \$500 reduction in what you owe as new savings.

Considering FIRE: Rapid savings to retire early

A “movement” that has gained more attention in recent years, is known as FIRE, which stands for Financial Independence Retire Early. Followers seek to save large portions of their annual earnings typically with hard work and spartan spending. On social media platforms, you may hear from devotees bragging about “retiring” in their 40s, for example.

Striving to retire “early,” before the traditional age of 65–67 when Social Security benefits kick in, isn’t new — plenty of people dream about doing so and some accomplish it. I would point out, however, that most people find purpose in doing (some) work and many younger retirees who cease work completely are unprepared for and not as happy as they thought they would be with all the free time on their hands. How much binge watching can you do on your favorite streaming services?

Having worked and interacted with many adults of all ages as a financial counselor, instructor, and writer, my best advice here is to seek balance in your life and always value the here and now. Endlessly sacrificing and preparing for an amorphous future goal can lead to missed opportunities and regrets today and along the way.

Understanding and Improving Your Credit Score

If you expect to someday apply for a loan of any type and get a competitively low interest rate, you should understand your credit report and credit score and how to improve each. A *credit report* is basically your credit history, while a *credit score* is a three-digit score based on the information in your personal credit report. This section highlights what you need to know about your credit score and reports, including how to obtain and improve them. Chapter 4 provides more insight into managing your credit report and credit score.

Deciphering how lenders use credit reports and scores

Most people borrow money at various times in their life, whether it’s to buy a home (or other real estate), to finance a small business, pay for educational

expenses, or for other purposes. When you want to borrow money, lenders examine your credit report and your credit score(s) to determine how responsible you've been with credit and to help them decide whether they should lend you money (and if so, how much to charge you based on your creditworthiness habits).

Specifically, lenders examine your history of credit usage in your credit report. This information tells the lender when each of your accounts was opened, what the recent balance is, your track record of making payments on time, and whether you've defaulted on any loans. A credit report also tells a prospective lender where else you've been applying for credit most recently.

Lenders use your credit score to help them predict the likelihood that you'll default on repaying your borrowings. The higher your credit score the better, because a high credit score means that you have a lower likelihood of defaulting on a loan. Thus, more lenders will be willing to extend you credit and charge you lower rates for that credit. It's important for you to know your credit score because a high credit score puts you in a negotiating position to ask for better rates.

The most widely used credit score is the FICO score, which was developed by the FICO company (formerly known as Fair, Isaac and Company). FICO scores range from a low of 300 to a high of 850. Most scores fall in the 600s and 700s, and the median is around 720. You generally qualify for the best lending rates if your credit score is in the mid-700s or higher.

Obtaining your credit reports and fixing errors

You want to get your hands on your credit report so you know what lenders are reviewing. You're entitled to receive a free copy of your credit report (which does *not* contain your credit score) every 12 months from each of the three credit bureaus — Equifax, Experian, and TransUnion. If you visit www.annualcreditreport.com, you can view and print copies of your credit report from each of the three credit agencies. (Alternatively, you can call 877-322-8228 and request that your reports be mailed to you.) You could also order your credit report from a different bureau every four months.

When you obtain your reports, inspect them for possible mistakes. Credit-reporting bureaus and the creditors who report credit information to these bureaus make plenty of errors.

If your problems are fixable, there's no need to hire someone to do so for you — you can fix them yourself, but you will likely have to make some phone calls or submit a dispute online via email or by writing a letter or two.

Some credit-report errors arise from other people's negative information getting on your credit report. This can happen if you have a common name, have moved a lot, or for other reasons. If the problematic information on your report appears not to be yours, tell that particular credit bureau and explain that you need more information because you don't recognize the creditor.

Creditors are the source of some reporting mistakes as well. For example, perhaps a bill you paid off is still incorrectly being reported as a balance you owe. If that's the case with your report, write or call the creditor to get the incorrect information fixed. Phoning first usually works best. (The credit bureau should be able to tell you how to reach the creditor if you don't know how.) If necessary, follow up with an email (preferred because it leaves a trail) or letter. You can also dispute errors online directly with the credit reporting agency.



TIP

Whether you speak with a credit bureau or an actual lender, make notes of your conversations. If representatives say that they can fix the problem, retain their contact information, and follow up with them if they don't deliver the promised results. If you're ensnared in bureaucratic red tape, escalate the situation by speaking with a department manager. By law, bureaus are required to respond to a request to fix a credit error within 30 days. And if you file a dispute and the creditor doesn't respond, the credit bureau must then remove the derogatory item.



TIP

You and a creditor may not see eye to eye on a problem, and the creditor may refuse to budge. If that's the case, credit bureaus are required by law to allow you to add a 100-word explanation to your credit file. Just remember that if you go this route, be factual in your write-up and steer clear of broad attacks on the creditor (such as "their customer service sucks"). You'll find sample 100-word statements online and a place to enter your statement on each bureau's website. Or, you can mail your statement to the bureau.



WARNING

Avoid "credit-repair" firms that claim to be able to fix your credit report problems. In the worst cases I've seen, these firms charge outrageous amounts of money and don't come close to fulfilling their marketing hype. If you have legitimate glitches on your credit report, credit-repair firms can't make the glitches disappear. As I explain earlier in this section and in Chapter 4, you can easily fix errors on your own without the charge.

Getting your credit score

Many folks are disappointed to find that their credit reports lack their credit score. The reason for this is quite simple: The 2003 law mandating that the three credit agencies provide a free credit report annually to each U.S. citizen who requests a copy did *not* mandate that they provide the credit score. Thus, if you want to obtain your credit score, it's generally going to cost you.

One circumstance allows you to get one of your credit scores for free, but unfortunately, you can only do so when you're turned down for a loan. Current law allows you to obtain a free copy of the credit score a lender used in making a negative decision regarding your desired loan.

For recommended websites to use to obtain your credit score as well as those to avoid, please see Chapter 4.

Improving your credit reports and score

Take an interest in improving your credit standing and score rather than throwing money away to buy your credit score or paying for some ongoing monitoring service to which you may not pay attention. Working to boost your credit rating is especially worthwhile if you know that your credit report contains detrimental information or if your score is lower than 740.



TIP

Here are the most important actions that you can take to boost your attractiveness to lenders:

- » **Check your credit reports for accuracy.** Correct any errors, and be especially sure to get accounts removed if they aren't yours and they show late payments or have gone to collection. Refer to the earlier section "Obtaining your credit reports and fixing errors" for more information.
- » **Pay all your bills on time.** To ensure on-time payments, sign up for automatic bill payment, which most companies encourage customers to use. This enables companies to automatically deduct (typically monthly) what you owe from your checking account or to charge that amount to your credit card so you don't have to remember to pay the bill. (This also prevents you from being charged interest or late fees when you make a payment after the due date.) On-time payments carry the most weight when calculating your credit score.
- » **Be loyal if it doesn't cost you.** The older the age of loan accounts you have open, the better for your credit rating. Closing old accounts and opening a bunch of new ones generally lowers your credit score, so don't jump at a new credit-card offer unless it's really going to save you money. Examples would include if you're carrying credit card debt at a high interest rate and want to transfer that balance to a lower-rate card or a card that provides you with rewards/benefits greatly in excess of any costs. Ask your current credit card provider to match a lower rate you find elsewhere.
- » **Limit your total debt and number of debt accounts.** The more loans, especially consumer loans (credit cards, auto loans, and so on), that you hold and the higher the balances, the lower your credit score will be. Work to pay down consumer revolving debt, such as on an auto loan and credit cards. See Chapter 5 for more information.

Comprehending Your Investment Options

If you're like most folks in their 20s or 30s, you may not have saved as much as you would have liked during your early working years. That's fine for now, because together, we address that in this book. Regardless of how much (or how little) you have invested in banks, mutual funds, or other types of accounts, you want to invest your money in the wisest way possible and have it grow over time without exposing it to extraordinary risks.

In this section, I provide some background to help you understand how to best focus your efforts to become a more knowledgeable and successful investor. (In Part 3, I delve into all the important details of investing.)

» **Investment options:** Making the best investments without understanding your range of options and the strengths and weaknesses of each is difficult. Do you understand the investments that you currently own, including their potential returns and risks? If you invest in or plan to invest in individual stocks, do you understand how to evaluate a stock, including reviewing the company's balance sheet, income statement, competitive position, price-earnings ratio versus its peer group, and so on?

Last but not least are issues that come up if you work with a financial advisor for investment advice. Do you understand what that person is recommending that you do, are you comfortable with those actions and that advisor, and is that person compensated in a way that minimizes potential conflicts of interest in the strategies and investments they recommend? See Chapter 18 for advice on hiring professionals.

» **Tax considerations:** For many working people, taxes are either the number-one or -two largest expense categories. For starters, do you know what marginal income tax bracket (combined federal and state) you're in, and do you factor that in when selecting investments? For money outside of retirement accounts, do you understand how these investments produce income and gains and whether these types of investments make the most sense given your tax situation?

» **Short-term money:** *Short-term money* includes money you'd use in an emergency or for a major purchase within the next few years. Do you have enough money set aside for short-term emergencies, and is that money in an investment where it doesn't fluctuate in value? Is the money that you're going to need for a major expenditure in the next few years invested in a conservative, low-volatility investment? See Chapter 9 for more on keeping an emergency fund.

» **Long-term money:** *Long-term money* includes money set aside for longer-term use such as for retirement. Do you have your money in different, diversified investments that aren't dependent on one or a few securities or one type of investment (that is, bonds, stocks, real estate, and so on)? Is the money that you've earmarked for longer-term purposes (more than five years) invested to produce returns that are greater than the rate of inflation? See Part 3 for long-term investing information.

Examining Insurance Coverage

Just about everyone dislikes spending money on insurance. Who enjoys thinking about risks and possible catastrophes (fires, floods, tornadoes, hurricanes, and so on) and then shopping for insurance that you hope will pay some of the bills should said catastrophes strike? Therein lie some major reasons why most people don't have all the coverage they really need and don't get the best value when they do buy insurance. But folks who've suffered a major loss understand the security provided by a good policy.

In Part 4, I discuss everything you need to know about insurance, including what policies you do and don't need. Here are the major points to consider as you review your insurance knowledge:

- » **Smart shopping:** Do you know when it makes sense to buy insurance through companies that sell directly to the public (bypassing agents) — and when it doesn't? Do you shop around for the best price on your insurance policies at least every couple of years? Do you know whether your insurance companies have good track records when it comes to paying claims and keeping customers satisfied?
- » **Coverage understanding:** Do you understand the individual coverages, protection types, and amounts of each insurance policy you have? Does your current insurance protection make sense given your current personal and financial situation (as opposed to your situation when you bought the policies)?
- » **Income protection:** If you wouldn't be able to make it financially without your employment income, do you have adequate long-term disability insurance coverage? If you have family members who are dependent on your continued working income, do you have adequate life-insurance coverage to replace your income should you die?
- » **Liability protection:** Do you carry enough liability insurance on your home, car (including umbrella/excess liability), and business to protect all your assets?

Identifying Common Financial Mistakes Young Adults Make

Your financial checkup is complete if you've been working along with me since the beginning of this chapter. The results should help you best understand where you can get the biggest return on your time invested elsewhere in the book.

One motivation for reading the rest of the book is to reduce your chances of making common mistakes. Your 20s and 30s are decades where lack of financial knowledge is exposed and reflected in the beginning of costly money mistakes such as

- » **Spending excessively and accumulating consumer debt:** Too many young adults leave home being experts in spending without having learned much about living within their means and saving and investing. Many things may tempt you — the never-ending stream of gadgets and electronics, cars, restaurants, bars, nightclubs, new clothing, concerts, sporting events, and so on. Check out Chapter 5 for information about reducing your spending on items you don't need.
- » **Defaulting on student loans or other debts:** This problem is often the consequence of the preceding problem of spending too much and accumulating too much debt. Being overwhelmed with debt, which may be exacerbated by a job loss or unexpected expenses, can cause folks to fall behind on their student loan or other debt payments. Given the ridiculously high cost of college these days, the amount of student debt that some young graduates have accumulated is also ridiculously large! See Chapter 3 for information on paying down debts.
- » **Experiencing failed relationships that damage your credit rating and financial health:** You know what they say about love being blind sometimes, right? Well, one of the things many 20- and 30-somethings don't think about when in a relationship is how the things they're doing are going to work out or not work out should the relationship fail. Sharing bank accounts and bill paying may not present glaring problems when everything is going well, but you can quickly end up with a tarnished credit report should your love boat run aground. See Chapter 8 for info about relationships and money.
- » **Falling behind on tax payments and violating tax laws:** Filing your annual tax return and making quarterly tax payments if you're self-employed aren't enjoyable tasks. In fact, you may find these chores downright intimidating and stressful. But if you fail to complete them correctly, or complete them at all, you could get socked with hefty interest and penalty charges and possibly do some jail time in the worst cases. Check out Chapter 6 for a complete discussion of paying taxes.

- » **Making poor investments:** You work hard to earn money and then to save it. So you should do your homework to ensure that you invest it well. Don't rush into making an investment you don't understand, because you have a lot to lose. There are plenty of slick-talking salesmen who will sell you an investment that helps to line their pockets but not yours. You also don't want your money sitting around for years on end in a low-interest bank account, which is what often happens to folks who don't know how to invest. Go to Chapter 10 for more in-depth information about investing your money.
- » **Neglecting to secure proper insurance coverage:** Most young people don't spend a lot of time thinking about risks. After all, most young adults are healthy and energetic. So things like health insurance or disability insurance seem unnecessary and for older folks. The good news is that insurance costs less when you're younger because you're less likely to suffer a major illness or disability than someone decades older than you. See the chapters in Part 4 for all the details about insurance.
- » **Being taken and duped by biased and/or shoddy advice:** Many companies and people have something to sell. Some of what they're selling is good stuff, much is mediocre, and some is downright awful. You don't need to pay high commissions or end up in the wrong type of investments or insurance. Check out Chapter 18 for what you need to know about dealing with professionals.