

**THE
SAVAGE
TRUTH
ON
MONEY**

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C H A P T E R

THE SAVAGE
TRUTH ON
GETTING
RICH

Financial Security
Demands
Smart Choices

Everyone wants to know the secret of getting rich. And lately, people are wondering if it's even possible to "get rich"—or at least to live well and then retire confidently. America faces real challenges, given our country's burden of debt and our political infighting, not to mention the current economic situation. It's tempting to give up, to forget that this is not the first time America has surmounted challenges and gone on to prosperity.

So here's the Savage Truth: *The American Dream is not over.*

Achieving financial security will require a fresh start and a new approach. If you're willing to try, or try again, you can succeed. You need only to understand the basic Truths, which have not changed despite market volatility and economic uncertainty.

It's a tribute to America that there are many roads to wealth in this country, and they are open to all. Stories of young technology entrepreneurs abound, but age is no barrier. Michael Dell founded his computer company at the age of 19, and by age 34 his personal stock ownership in Dell Computer was valued at \$16 billion. Ray Kroc, on the other hand, didn't start McDonald's until he was in his mid-fifties. Great fortunes were started in the Depression years of the 1930s.

In case that seems like ancient history, consider the fortunes built in the last few years. Facebook made its founder, Mark Zuckerberg, a billionaire even after the tech bubble had collapsed. Groupon's founders tapped into the social-networking, bargain-hunting mentality of the recession to create a successful technology company with a value exceeding \$6 billion in 2011.

The Savage Truth: *Even in tough economic times, entrepreneurs with good ideas can build companies that defy the most pessimistic mood of the nation.*

There is no one template for success in America, but building a business does require an entrepreneurial spirit born of optimism. In America, age, race, and gender do not stand in the way of success—nor does the economic climate.

As entrepreneurs build businesses, they create opportunities for others—either by creating jobs or by selling shares to public investors. Groupon had just 50 employees in the summer of 2009, and more than 3,500 by year-end 2010. You don't have to create a new business to build financial security, but you do have to be aware of the growth opportunities around you. That's how success spreads, and an economy grows.

One of the fastest routes to financial success has always been through sales of a product or service. Today, technology allows start-up companies to compete without the investment capital that was traditionally needed to gain a foothold in markets. In other eras, real estate developers used borrowed money to amass wealth. All of these roads to success involve the risk of uncertain compensation. And not everyone has the desire or can afford to trade a regular paycheck for the potential riches of entrepreneurship.

It is also possible to become wealthy by investing in the business-building talents of others, but that requires patience, attention, and self-discipline. That's why the stock market exists. First, though, you need the capital to invest. That's a matter of simple mathematics.

You Can Get Rich on a Paycheck If You Don't Spend It All

There are two simple rules for amassing investment wealth:

1. Spend less than you make.
2. Invest the difference—both money and time—to maximum advantage.

Here are two stories that illustrate these truths:

RETIRED SECRETARY LEAVES \$18 MILLION TO HOSPITAL

CHICAGO *SUN-TIMES*—A secretary who made her fortune investing bonuses from her salary, which hit an estimated high of \$15,000 a year before she retired in 1969, left her fortune to Children’s Memorial Hospital. Few friends suspected that Gladys Holm, who lived in a modest two-bedroom apartment, was wealthy.

Holm’s boss, the company’s founder, had advised her to invest her yearly bonuses in the stock market, a longtime friend said. “If he bought a thousand shares of some company, Gladys would buy ten shares of the same thing. Nobody gave her that money; she earned it.”

NEW YORK UNIVERSITY TO GET ONE-FOURTH OF COUPLE’S \$800 MILLION ESTATE

ASSOCIATED PRESS—Professor Donald Othmer and his wife, Mildred, lived modestly in a Brooklyn townhouse and rode the subway. In the 1960s, they each invested \$25,000 with an old friend from Nebraska, Warren Buffett. In the early 1970s, they received shares in Berkshire Hathaway, then valued at \$42 a share. When the couple died recently at ages 90 and 91, the stock was worth \$77,200 a share—making their fortune worth an estimated \$800 million.

All of these successful investors lived modestly all their lives. At no point did they decide it was time for an expensive vacation, an impressive vacation home, or even a new car. Thus, they were able to accumulate, invest, and leave behind a huge fortune. Surely, there must be a happy medium between living daily on credit card debt and dying with a huge fortune. Most people I know would like to live in that middle ground.

There is one other similarity to note: Neither Gladys Holm nor the Othmers had children. Children may be nature’s way of making sure that we can’t possibly die with a fortune!

Most important—neither Gladys Holm nor Professor and Mrs. Othmer ever sold any of their stock. Think of the temptations. As their fortunes grew, there was surely the temptation to spend just a little of their profits. And at times of stock market crisis, surely there was a temptation to sell and cut their losses. But they stuck to their long-term plan.

Don't doubt that this kind of investment success can happen again in the coming decades. Think what a great leap of faith it was for these ordinary people to invest in an uncertain future. Their profits were built slowly, but were accelerated by the fact that they were investing when others were skeptical.

Today's true headline success stories are the current generation of technology entrepreneurs. They built businesses, and their wealth is scored by the value of the stock they sold to the investing public and the shares they still hold. But behind each "overnight" success story is the truth that they followed the two principles at the top of this chapter. They lived frugally—primarily because they were too involved in their businesses to spend time on recreation and consumption. They also invested their resources, mostly their time, in building their businesses.

Steven Jobs, who founded (and later rescued) Apple Computer, is renowned for starting the business in his garage. Only *after* his company proved itself did he share in the rewards. Bill Gates built his mansion after he built his company, Microsoft. And then he started giving his money away through strategic philanthropy. Facebook, which today has half a billion participants, including the Queen of England, was another college venture, but Facebook cofounder Mark Zuckerberg famously was not in it for the money!

As one successful entrepreneur remarked to me on the occasion of a new accomplishment: "After a certain point, it's not the money. It could be lollipops. It's just the way you keep score!"

For most of us, it *is* the money. We need it to take care of our families, to put our children through college, to plan for retirement. But we can take lessons from these success stories. And even if we may not reach that pinnacle of great wealth, we can participate.

There's no question that their inherent brains and timing (sometimes referred to as luck) helped make these entrepreneurs rich. Their success stories are notable because they took a relatively short time to build dramatic wealth. But they followed the basic principles: They invested their time and money *before* they reaped the rewards. Yes, they dreamed, but they didn't buy lotto tickets or create extravagant lifestyles before they were financially successful. They worked to turn their dreams into reality instead of living as if their dreams had already come true. And they didn't quit when things got tough. Many of those tech multimillionaires (even billionaires) saw their paper fortunes melt away in 2001. Others lived through the decline and went on to amass even greater wealth.

It's a Savage Truth: *Persistence pays!*

So, how can the Savage Truths in this book get you on track—or back on track—to financial security? Life doesn't come with guarantees, but it does come with opportunities.

The secret of getting rich is to make choices that help your money work *for* you and stop working against you. If your money works at least as hard as you do, and if you have a sensible plan you can stick to, over time you'll come out a winner. And that's the Savage Truth.

THE SAVAGE TRUTH ON YOUR RELATIONSHIP WITH MONEY

Money Is Power

Before you make any investment or saving decision, before you set financial goals or choose a career, you must come face to face with the power of money in your life. Your relationship with money must be reevaluated as you reach different stages in life. Only by facing money issues directly can you become comfortable with so many other personal decisions that confront you.

A decade ago it might have been possible to coast along, expecting pay increases and a comfortable lifestyle that would lead to retirement. Now we've all seen a compelling demonstration of the importance of financial security, and the importance of financial planning. This generation will be forever changed by the longest recession since the Great Depression. Today's children will never take money for granted the way their parents might have done. And out of these experiences comes a new respect for the power of money.

Recognizing the power of money can be exhilarating or intimidating. If other people have money, and therefore a degree of power over your life, you may react negatively. If your boss holds the power of the paycheck, you may feel forced to work certain hours or perform unpleasant tasks. If your parents hold the power of the purse, you may feel coerced into making concessions about your lifestyle.

However, if *you* have the money, you are empowered to choose how you spend your time as well as your cash. You may choose to work even harder, to enjoy more leisure, to become philanthropic or artistic, or to devote more time to making your fortune grow. Money certainly isn't the only powerful force in your life, but having money can empower you to take greater control over your lifestyle.

Saver or Spender?

You know who you are, when it comes to your money personality. Are you a *saver* or a *spender*? I'm not quite sure where our money personality is created. It could be from the experiences you had as a child. But, then, how do you explain two children, growing up in the same household, who have completely different money personalities? Give each an allowance, and one hoards every penny while the other can't wait to go to the store!

Whether it's determined by heredity or environment, by this stage of your life your money personality is firmly ingrained. If you realize how hard it is to change yourself, you'll know how impossible it is to change your spouse or partner. So the entire concept of money management is to set up systems to deal with your inner self—your fears, your compulsions, and your desires. If you can channel all that energy into a disciplined plan, you can be successful financially no matter what your basic personality traits.

The Most Powerful Money Emotions Are *Fear* and *Greed*

Decisions about money unleash these two powerful emotions, which are frequently the cause of financial downfall. Noticing the symptoms and gaining the courage to surmount these emotions is the first task in managing money. Lack of emotional control will negate all the benefits of good advice and good planning.

Greed is understandably dangerous because it is the emotion that makes us take risks we cannot afford. Greed convinces us that we “need” instead of simply *want* to make that purchase. Greed urges us to spend for today instead of investing for tomorrow. It can distort investment decisions and blind us to long-term consequences and risks.

Fear can be equally dangerous. Fear keeps us from taking appropriate risks or making changes to improve our lives. It paralyzes us and blinds us to opportunity. Indeed, this paralysis can be an actual physical reaction to making money decisions. It's as difficult to conquer a fear of money as it is to rein in overwhelming greed.

These emotions may be triggered by our childhood conditioning about money, by cultural expectations, or by recent experiences with money decisions. There's no doubt that people have money personalities. By nature or nurture, they become savers or spenders.

Inside each of us is a small persuasive voice that dictates how we respond to fear and greed.

Those twin emotions assault even the wisest investors and smartest traders. Taking control of your financial life requires not only knowledge of money, but also the self-discipline to use your knowledge to conquer fear and greed. What good is a financial plan if you don't have the self-discipline to stick with your decisions?

Self-Discipline Is the Essence of All Decision Making

Self-discipline should not be confused with self-denial. Self-discipline means making knowledgeable decisions based on a rational assessment of likely results and then sticking to your decisions in the face of emotional upheaval. That principle applies to every financial decision—from buying a car or a dress to investing in a stock or mutual fund. People recognize the importance of discipline when they turn to financial advisors for help—not only in determining the appropriate investment, but in sticking to that decision in the face of market reversals. It's human nature to seek advice, reassurance, and counsel about when to alter a decision based on new realities.

Can you do it alone? Most people are capable of managing their own finances, given the knowledge and tools that are now easily available. You'll learn how to use Quicken or Mint to gain control over your everyday spending and to plan for the future.

However, I know that many people who write to me or post questions on my blog at **TerrySavage.com** are overwhelmed by their relationships with money. Just as all the desire in the world cannot help alcoholics or gamblers to overcome their compulsions, all the investment books and rules cannot make the fearful bold, or the greedy self-controlled.

Help is available in many forms. As you'll see in Chapter 3, there are several national, nonprofit consumer credit and spending counseling services. Your local community college may offer classes or help in setting up a budget and managing your money. Later in this chapter I'll show you how to find a qualified and certified personal financial planner. Automatic monthly investment plans can create the structure to override your emotions and build an investment program, just as automatic deductions can be used to cope with debt repayment.

Keep in mind that knowledge is one ingredient of your relationship with money, but conquering your emotions is quite another

aspect of financial success. Smart people do fail, but failures can always be overcome. Impulsive and irrational people rarely find financial success.

Bulls, Bears . . . and Chickens—Your Relationship with Money Is Unique

No matter how smart your advisor, or how sophisticated your investments, your personal relationship with money is unique, and it affects the decisions you make. No one else has quite as much insight into your desires, anxieties, and tolerance for risk. The most difficult task is to step back from your emotions and calculate the risk it is appropriate for you to take.

This is a process of self-discovery that I have long referred to as “sorting out the bulls, the bears, and the chickens.” In any financial market, the *bulls* invest believing that prices will move higher, while the *bears* sell out in fear that prices will drop. But the *chickens* stay on the sidelines, unwilling or unable to risk their capital. There’s a little bit of chicken in all of us, and it’s nothing to be embarrassed about. In fact, those who had adequate savings were cushioned from the impact of the recession and job loss.

Sometimes it’s wise to be chicken because you have a very short time horizon. If college tuition is due next fall, or if you’re saving for a down payment, you don’t want to risk investing in the stock market. Short-term losses could jeopardize your important long-term goals. It’s important to sort out the portion of your finances that can, and should, be exposed to the opportunities that risk provides. But it also takes discipline to set aside a portion of your assets and keep them safe from risk.

Sometimes you’re forced to be a chicken because this is the only money you have. While it’s tempting to risk doubling your resources in some exciting investment, you can’t afford to lose even a portion of your capital. There’s an old saying in the markets: “Desperate money never makes money.” The world is littered with losing tickets from racetracks and lotteries. Long-shots and jackpots make news when they pay off because it’s so rare. Those huge lottery pools are created by all the people who buy losing tickets.

Risk and reward are two sides of the same coin, but unlike a coin toss, on which the odds are always 50–50, risk and reward are not always equally balanced. The science of money management is understanding your own tolerance for risk and acting when the rewards can objectively be considered to outbalance the risks. Unfortunately, this is not a subject for intuition.

At the top of the market, an investment seems least risky and most enticing. At market bottoms, it appears most risky to invest your cash—but hindsight shows that's just when you should have taken the risk. The big money is made—and lost—at the extremes. But an ongoing and disciplined program can keep you from being wrong at those turning points. And some “chicken money” sitting on the sidelines can give you courage to follow your plan.

Never be chicken out of ignorance. There are objective ways to balance risk and reward. Nobel Prize-winning economists created the concept of *beta*, a way of measuring inherent risk and volatility in individual investments. And computers can theoretically measure and limit portfolio risk, when markets run true to form. But no one has yet developed a way to measure the risk inherent in human emotions. So let's just set aside some “chicken money” and follow the old market saying: “Sell down to the sleeping point.” If it keeps you awake at night, it isn't worth the risk.

THE SAVAGE TRUTH ON THE CONSEQUENCES OF CHOICES

Little Choices Have Big Consequences

In the midst of life's turbulence, you're reminded of the consequences of the big choices you made over the years: the choice of a college, a marriage partner, or a career, or a decision about having children. These turning points stand out as defining moments that changed the direction of your life. But small decisions, compounded over time, can have an equally significant impact on how your life turns out—especially when it comes to money.

Your money can work *for* you or *against* you. It all depends on the choices you make. If you make the correct choices, even a small amount of money can grow to become a powerful ally. If you make the wrong choices, your money will leverage its power against your own best interests. One thing to keep in mind: It's never too late to change course for the future.

Every day we're faced with money choices: *Spend or save, buy or sell*. They may appear to be decisions of the moment, but today's choices can have long-lasting consequences. That's because the consequences of our financial decisions are magnified over time.

Think of the problems NASA has in sending a rocket to Mars. Sure, the planet is a huge target. But if the navigation calculations are off

by just a fraction of a degree at the launch, the rocket will miss Mars by millions of miles. Small errors, magnified by distance or time, can take you very far off course.

This advice, given a decade ago, reached too few people. By mid-2005, the U.S. savings rate went negative, as people borrowed on their home equity and financed their lifestyles on their credit cards. It's no surprise, then, that the impact of the housing market collapse was so devastating to so many.

Even as we move into the second decade of this century, Americans now have nearly a trillion dollars revolving on their credit card bills, many making only minimum monthly payments. The recession forced millions of consumers into bankruptcy. And, despite a 24 percent decline in the number of credit cards outstanding, there were still 378 million cards being used at year-end 2010. The debt habit—and the burden of carrying debt—are hard to shake.

American families remain burdened with debt taken on during the boom years. They purchased things they wanted or needed *now*, without regard to the long-term consequences of those choices. Then, during the recession, they were forced to incur debt, simply to purchase basic necessities. With no savings, Americans have been digging a deeper hole, despite write-offs of balances in bankruptcy.

My favorite story about choices shows the long-term effect of time on money when it comes to spending decisions. Suppose you charge \$2,000 on your credit card this month and make only the required minimum monthly payments on your bill. At an annual finance charge of 19.8 percent and a \$40 annual fee,

It will take you 31 years and 2 months to pay off that \$2,000!

Along the way, you could pay an additional

\$8,202 in finance charges.

If you had made a different decision, the results would have been equally dramatic and far more pleasing. If you had *invested* that same \$2,000 in a stock market mutual fund that returned the historical average of 10 percent and placed your investment inside a tax-sheltered individual retirement account (IRA), in 31 years—about when you'd be paying off your final credit card bill—

Your IRA would be worth \$38,389.

If you made that same spending-versus-investing decision every year and set aside \$2,000 in your IRA for 31 years at the same rate of return,

Your IRA would be worth \$364,000.

Special attention to twenty-somethings: If you started your annual \$2,000 IRA contribution *now* and averaged a 10 percent annual return, in 50 years

Your IRA would be worth nearly \$2.5 million!

This is a classic example of how small choices, leveraged over time, can change your life. You may not remember every small spending or saving decision as you look back over your life. They may not compare with the major life-changing choices you agonize over. But these small decisions reveal one of the greatest money secrets: the power of time in compounding money. Money makes money.

The CARD Act of 2009 offered some protections against many credit card practices, including requiring higher minimum monthly payments. Still, the average rate being charged on outstanding balances is nearly 16 percent, and many consumers who have missed payments or charged over the limits are paying rates over 30 percent.

Despite your skepticism about stock market returns, the average long-term annual rate of return, including dividends, on large-company stocks remains 9.9 percent at year-end 2010, according to Ibbotson, the market historians.

The basic Savage Truth is more valid than ever: *Debt will destroy you.* If you'd invested that money in stocks—over the long run—you would have come out far ahead, despite the scary setbacks in the market. Sadly, too many people learned the lesson about the dangers of debt the hard way. Fortunately, America does not have debtors' prisons. Bankruptcy—a last resort—allows you to start over. But this time, learn the lessons and do things differently to get different results.

Here's an important Savage Truth: *The lessons that cost the most teach the most!*

It's Easier to Find Money than It Is to Find Time

I've often told this story of how you could easily turn a \$2,000 IRA into a million dollars or more by investing conservatively in a mutual fund that just matched the performance of the stock market averages. (For details on getting started, jump to Chapter 6.) But some people who come to my seminars are buried in debt, wondering whether to take the bankruptcy route or continue to struggle with bills. Where

would they ever find the money to make a monthly investment in the American Dream?

That's the problem with big numbers like "a million dollars." They're so overwhelming. So let's make it more realistic. Just in case you were intimidated about finding that \$2,000 a year to set aside in your individual retirement account, let me point out that

\$2,000 a year is only \$38.46 a week!

Surely, you can adjust your spending—or your earnings—to find an extra \$38.46 a week.

If you're already buried in debt, then an extra \$38.46 a week will pay down \$2,000 of your debt within one year, to say nothing of the interest payments you'll save. Perhaps finding that weekly sum will require working in a restaurant instead of dining out. A weekend or part-time job may bring in more money if you can't possibly cut back your spending. In recent years, even these temporary jobs have been hard to find. But don't give up, because it's always easier to earn more than to cut back.

Do you still think you can't afford to get out of debt and start investing for your future? Take a quick look at your paycheck. For sure, there's a deduction for Social Security taxes that's much larger than your \$38.46 weekly target. You get along fine without that money—and you're not likely to see much, if any, of it at retirement. Doesn't it make sense to put an equal amount away every paycheck in a savings and investment plan that will pay off in the future?

A \$2,000 debt seems relatively insignificant now, in an era when families routinely find themselves \$20,000 in debt, and students graduate from college with an average debt burden of \$25,000. But the principle remains the same: Break it down into monthly and then weekly chunks and attack the problem one step at a time.

In Chapter 3, you'll find specific resources for dealing with debt—from counseling you can trust, to bankruptcy procedures, to recognizing and avoiding scams such as debt "negotiation" offers. And even if bankruptcy is your only way out, you'll want to do things differently next time, so read on.

Time Is Money

You may have heard the story about the boy who was asked whether he'd rather have \$5 million in 31 days—or 1 penny doubled every day for 31 days (see Figure 1.1). The boy chose wisely.

Day	Dollar Amount
1	\$ 0.01
2	\$ 0.02
3	\$ 0.04
4	\$ 0.08
5	\$ 0.16
6	\$ 0.32
7	\$ 0.64
8	\$ 1.28
9	\$ 2.56
10	\$ 5.12
11	\$ 10.24
12	\$ 20.48
13	\$ 40.96
14	\$ 81.92
15	\$ 163.84
16	\$ 327.68
17	\$ 655.36
18	\$ 1,310.72
19	\$ 2,621.44
20	\$ 5,242.88
21	\$ 10,485.76
22	\$ 20,971.52
23	\$ 41,943.04
24	\$ 83,886.08
25	\$ 167,772.16
26	\$ 335,544.32
27	\$ 671,088.64
28	\$ 1,342,177.28
29	\$ 2,684,354.56
30	\$ 5,368,709.12
31	\$10,737,418.24

Figure 1.1 Growth of a Penny Doubled Daily

**One penny, doubled every day for a month,
will grow to \$10,737,418.24.**

That’s certainly a huge consequence from a small choice. Although this book won’t show you how to double your money every day, you will certainly learn how to invest very small amounts regularly to create dramatic long-term growth.

Taxes Impact Tomorrow More than Today

No one likes to see the bite that taxes take out of a paycheck or to compute the amount owed to the government every April. And if you think the overall burden of taxes is rising, it’s not your imagination.

In 2000, federal tax receipts were 20.6 percent of the economy (gross domestic product)—the highest since 1944, during World War II. It is projected that government spending as a percent of GDP will rise to 25 percent by 2030. And as our population ages, more of this annual spending becomes nondiscretionary.

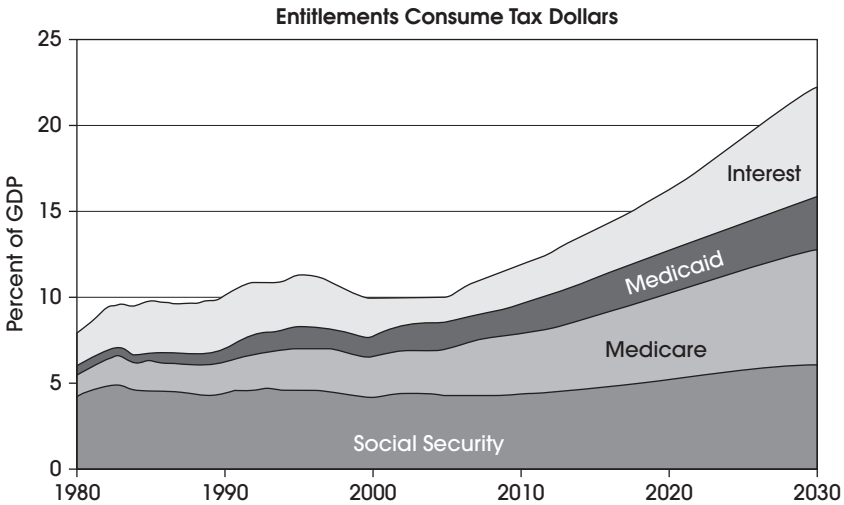


Figure 1.2 What's Left?

Within 20 years, government spending on mandated programs and promises such as Social Security, Medicare, Medicaid—and interest on the national debt—will consume every penny of this 25 percent tax levy on the economy. That will leave nothing for national defense, roads, education, or any of the other programs we'd like government to provide. Figure 1.2 shows this graphically.

We confront some devastating choices as a nation. While income tax *cuts* would help our economy grow out of its problems, the political reality is that Congress is likely to increase taxes in your lifetime. Or they will push the Federal Reserve System to create more money, devaluing the dollars you've saved for retirement.

That turns some standard investment advice on its head! You'll want to plan ahead for the potential impact of inflation on your retirement savings. Since we save and spend in dollars, it will become very important to consider what those dollars will buy in 20 years or more.

When it comes to tax decisions, you'll also have to reconsider your historic plans. Traditionally, the idea was to invest in tax-deferred programs such as an IRA, because you assumed you'd be in a lower tax bracket at retirement when the money is withdrawn.

But if you believe income tax rates will rise in the future, you'd want to pay taxes now, and invest your money for tax-free growth, in a Roth IRA, for example. At the very least, you might want to split some of your retirement savings into before- and after-tax types of plans.

Whether you save pre-tax or after-tax, the most important thing is to *save*. Set some money aside from every dollar you make. Later in this book, you'll learn how to hedge your bets on the buying power of those dollars in the future.

THE SAVAGE TRUTH ON GOALS AND CHOICES

Your Goals Are Your Most Important Choices

Now that you know financial independence is within your reach—if you make the correct choices—it's time to set some personal financial goals. These are your most important choices because they create the framework for all your other investment and lifestyle decisions. These are the beacons to keep you on target; they are the guardrails that keep you from taking emotional wrong turns. Your goals are your most personal financial decision.

Whether your goal is getting rich or having financial security, it's important to define that goal on your own terms. Take a moment to think about your own definition of being secure enough to not worry about money on a daily basis.

For some people, financial security is defined by being out of debt; others total up the amount of their investments to get a perspective on their current and future situation. Some people define financial security as being able to live for six months to a year without a job; others define it as having their money last as long as they do—a secure retirement income.

Some may put a specific dollar figure on their target; others recognize that the possibility of inflation or changing health needs requires a flexible financial cushion. For some, getting rich implies having enough money to do whatever they want—and they have an extravagant list of “wants.” Still, most multimillionaires will tell you that money can't buy freedom from problems.

The best—and worst—thing about setting goals is reaching them. That means you have to set new, higher goals. Keep in mind when setting goals that you're posting both a target and a direction. You may reach milestones along the way to your ultimate goal of financial freedom. The day you've paid down all your debt will certainly be an exhilarating one. Now you can travel further down that same road, using the money you set aside to pay bills to start investing. I never

heard anyone complain about retiring with too much money! I hope your biggest problem is that you've reached all of your financial goals.

Set No Goal You Can't Control

The key in setting goals is to set targets you can control. If your goal is to set aside a certain amount of money every month to pay extra on bills or to start investing, don't count on a pay raise to make it happen. A raise is up to your boss. But you could reach your goal by spending less on dining out each month. That's a decision under your control.

Since the whole idea of goal setting is to motivate yourself, you'll need some financial targets that you can reach in a far shorter period of time than it will take to hit more distant targets such as retirement. Start by listing your short- and long-term financial goals.

Your short-term goals might include paying off all your credit card bills or student loans. You might set a goal of saving enough money for a car or a down payment on a first home. Short-term goals might take anywhere from six months to five years.

At the same time, you should also be setting longer-term goals such as college for your children or retirement savings. Those numbers may seem larger, and more intimidating—but you have the advantage of time on your side if you start working toward those long-term goals now.

Tape your list of goals to your mirror, where you'll notice it every morning and evening. Your goals should be motivating, not intimidating. Be realistic about your expectations, and set goals in manageable increments. Your short-term goal of paying off your credit cards might start with paying off the highest-rate card, or the largest balance, first. Then move on to the next objective.

Remember: No matter what the time horizon or size of your financial goals, you'll never reach them if you don't get started. The first two letters of the word *goal* are "go."

A Goal without a Plan Is Just a Dream

Only in fairy tales do castles get built without a plan. In real life, you have to hire an architect to create a drawing and then engage the services of a builder to help you achieve your dream home. Then you have to have a reasonable financial plan to make your mortgage payments, consider rising property taxes, and have savings to pay for

repairs. And as millions of Americans have now learned, you can't plan for rising home prices to automatically take care of these needs.

A financial plan is not engraved in stone; it can always be adjusted to fit your circumstances. But having a plan is the only way to put the odds of achievement on your side.

Life doesn't come with guarantees. When you define financial security for yourself, you'll need to make some assumptions. How long will you live? How much money will you need to maintain your lifestyle? How much will your investments grow? How much will inflation erode your savings?

Those projections will change as you redefine financial security and as the economy changes. You may have lifetime goals but be forced to revise your plan because of current events. Always keep your actions on track to meet your goals.

In Chapter 3, you'll find links to programs that can help you plan for the impact of inflation, or changing tax rates or investment returns, to help you decide how much you should be saving now.

Your financial plan is a framework that needs to be adjusted—but not entirely replaced—as circumstances change. If you are self-disciplined and willing to invest the time to stay current, you can certainly do this yourself. But you are likely to decide that you need professional help, if only to mitigate the emotion that can overwhelm you in both bull and bear markets, in good economic times and bad.

Finding the Right Planner Is the Most Important Part of Your Plan

Financial planning is an art as well as a science. When hiring a financial planner, it's important to discuss the scope of the plan and have mutually agreeable expectations about the outcome.

Before you start your search, you need to consider what type of advice you need. Do you only want investment advice for your IRA rollover? Or do you need a more complete projection of whether you're on track to reach your goals, be it the first home, or college for your children, or retirement? Have you considered the impact of estate and life insurance planning?

It will be important to find an advisor to cover all your questions, although you may continue to work with your own lawyer and accountant. But if you're just getting started, don't think you have to wait until you accumulate a huge pile of assets to need a planner. In fact, setting up an annual consultation with a planner can help you

accumulate those assets and avoid making mistakes at the beginning that could derail your future.

Financial planning is important for *everyone*—young or old, rich or poor. The most basic spending and saving plan doesn't have to cost you a thing. In Chapter 3, you'll see how to reach the nearest office of the National Foundation for Consumer Credit. They'll work with you to create a spending/saving plan (okay, a budget!) and it won't cost you anything.

But if you have goals, or want to set goals, you'll be better off working with a *certified financial planner*. Don't be led astray by salespeople who call themselves "planners." Here's how to find the real thing:

- There are several good sources of referrals to financial planners. The Certified Financial Planner Board of Standards created the registered mark *CFP*. It designates licensed planners who have taken a rigorous examination covering not only the financial planning process, but also insurance, investments, tax planning, retirement planning, employee benefits, and estate planning. The board also investigates candidate backgrounds and requires adherence to a code of ethics. To search for certified financial planners near you, go to www.cfp.net.
- Some planners work only for a fee and do not accept commissions on the investment and insurance products they recommend. Fee-only planners belong to the National Association of Personal Financial Advisors (NAPFA). Check in at www.napfa.org or www.feeonly.org for a list of fee-only planners in your state.
- Many banks, insurance companies, and mutual fund companies also employ certified financial planners to offer advice, either on investments only, or on a wider range of topics. Look for the CFP designation, because these planners are held to a higher standard of responsibility. They must disclose any conflicts of interest, and they are required to put their clients' interests ahead of their own. Stockbrokers, financial consultants, and others who may sell financial services are not bound by these fiduciary obligations, although that type of regulation is being considered.
- It's important to know how your financial advisor is compensated, and it is imperative that you ask whether she or he is bound by the CFP fiduciary standard. Many brokers or salespeople have a high degree of integrity and set their own high standards in their relationships with clients. But you should be aware of the differences between the two categories.

- To check on a *broker's* disciplinary history, go to **FINRA.org** and click on the “Broker Check” tool. To check on disciplinary history of an *investment advisor*, go to **AdviserInfo.sec.gov**. Go to **CFP.net/search** to check out *financial planners*.

The Outcome of Your Plan Is Only as Good as Your Input

Just as you'd choose an architect for your dream home based on references and examples of his or her building style, you'll have to do some interviewing and investigating before you settle on a financial planner. References, preferably from someone you know and trust, are a must. And you'll have to determine if you feel comfortable after an initial meeting or two. Don't be afraid to ask questions about the planner's fees and style. Equally important are the questions the planner should be asking of you. He or she should be willing to listen to your hopes and fears and to your short- and long-term goals.

Just as you accept responsibility for determining your own goals and seek help in reaching them, you must accept ultimate responsibility for the financial plan you mutually agree upon. A special note to couples: It's unlikely that you have exactly the same money styles or personalities, but it's important that both of you feel comfortable with the plan and the planner you choose.

No matter how much each member of the family contributes financially, this plan will affect your current and future lifestyle equally. Just as an architect might meld styles to suit the eclectic tastes of clients, the planner must create a product that encompasses the personal traits of the individuals. If you don't speak up during the initial meetings, the planner will not have the information to build upon.

Plans Change

Whatever dollar amount you put on financial security, your goals will inevitably change as your personal circumstances change. Flexibility in planning is not to be confused with an emotional reaction to changing life events. A plan exists to provide context for change, yet nothing changes circumstances like a change in the economy. That's why you need to understand some basic truths about the economy and politics—and how they affect your financial plans.

THE SAVAGE TRUTH: NO PLAN IS AN ISLAND

No man's fortune is safe while Congress is in session.

—Mark Twain

No one has said it better than this eminent observer of our society and its politics. Although the words were written generations ago, they ring true in our economy even today.

All the goals you set and the plans you make are affected by the general state of the economy. And that is determined by two separate sources of economic power. The legislative and executive branches have the power to tax and spend, while the independent Federal Reserve System governs banks and sets monetary policy by controlling the supply of credit and its price (interest rates). That's why it's so important to keep an eye on Washington and how actions there are affecting your future wealth.

As a result of the global financial crisis in 2008, both the Fed and the government have assumed new, greater economic powers justified by the need to “resecure” our financial system. The government “bought” one of America's largest companies—General Motors—as part of its rescue plan. Then the government “sold” part of its holdings, when the company became profitable again, retaining a large interest. Had I written of this possibility 10 years ago, you would be astounded, but now we take government intrusion into the financial markets as a “necessity.”

The Federal Reserve System became more intimately involved in the economy than its historic role of dual responsibilities of keeping inflation low and employment high. During the financial crisis of 2008, the Fed expanded its mission beyond buying only Treasury securities. The Fed bought many “assets”—including mortgages guaranteed by Fannie Mae and Freddie Mac, and commercial paper from money market funds—in its effort to keep the U.S. financial system from collapse. As for Congress, after helping to create the housing bubble by requiring Fannie Mae and Freddie Mac to buy lower-quality mortgages to provide home ownership to those who could least afford it, Congress went on to “reform” the financial system. In one of the great ironies of American history, the financial reform bill—Dodd/Frank—was named after two members of Congress who did the most to facilitate the disaster in the first place!

The past few years have given you even more reason to keep an eye on the politics of Washington, if you're trying to plan for your own future! While you don't have to be an economic forecaster, you should understand the basic forces that will impact your investments and retirement plans.

Sound Money Is the Key to Creating Wealth

The Federal Reserve has the power to create more money and put it into circulation. It's a little more complicated than running the printing presses, but easily understandable if you've ever played Monopoly. Suppose the game is moving slowly, so the banker decides to change the rules and give everyone an extra \$500. Whenever someone lands on a property like Boardwalk or Ventnor Avenue, an auction is held and the highest bidder gets the property.

Suddenly, with more money in the game, property prices rise as extra cash goes into purchases. The value of the old money you saved—just in case you landed on Park Place—declines. With more money in circulation, your savings have less buying power. Prices go up, even though the illusion of wealth had been created only because the banker distributed more money.

That's the phenomenon of *inflation*: money creation pushing prices higher. Thirty years ago, the United States had a taste of how inflation can destroy a country. Given the amount of money the Fed has created in the wake of the financial crisis of 2008, we may get another close-up look at what happens when too much money or credit is created. We should learn from past experience.

Inflation was rampant in the early 1980s, rising to double digits and causing people to trade their cash for real assets that would hold their value. Everything from soybeans to houses to gold coins increased in value as more dollars purchased fewer goods. People were fearful that money held for the future would continue to lose value.

It took a decade of total discipline, along with a deep recession and high interest rates, to regain people's faith in the future value of their money. Under Fed Chairman Paul Volcker, people came to trust the future value of the dollar. Proof of that was the fact that savers demanded less interest on the money they loaned to the government and to corporations—believing that the money would still be worth nearly its current value when their loans were repaid.

Truly, a belief in the future value of the currency is the key ingredient in real economic growth. Even a small amount of inflation can have devastating long-term consequences, as seen in Table 1.1.

If you think you need \$100,000 today to maintain your lifestyle, take a look at the long-term impact of even a relatively small amount of annual inflation—3 percent. In 10 years, you'd need nearly \$135,000 to match today's spending power. In 20 years, the number jumps to over \$180,000. That's why you must make plans that include the impact of inflation on your retirement, on your life insurance benefits, and on the cost of anything you will need to purchase in the future.

A belief in the future value of the currency is still a key ingredient in real growth. But after several years of concern about the long-lasting recession, and jobless recovery, the Fed started to act like that banker in the Monopoly game—throwing more money on the table in an effort to get things moving. They called it *stimulus* or *TARP* or *quantitative easing*—all terms for creating money and credit out of thin air. The Fed simply buys government securities or other assets, and pays for them with newly created credit on the books of the banks.

As of this writing the jury is still out on whether this latest round of money creation will keep the economy from falling deeper into

Table 1.1 Effects of Inflation

How Inflation Impacts \$100,000 Over Time (Amount required to equal today's spending power)		
Years	Inflation Rate	
	3%	5%
1	103,000	105,000
2	106,090	110,250
3	109,273	115,763
4	112,550	121,551
5	115,927	127,628
6	119,405	134,010
7	122,987	140,710
8	126,677	147,746
9	130,477	155,133
10	134,392	162,889
15	155,797	207,893
20	180,611	265,330
25	209,378	338,635
30	242,726	432,194

recession or stimulate recovery. Ultimately, there is little doubt that down the road the value of the dollar will fall, as it looks more and more like “Monopoly money.” That is the very definition of inflation, which can devastate all your financial planning.

The Inflation–Deflation Debate

For a generation, Americans worried about inflation, the declining purchasing power of their dollars. Then, the growing spread of global *deflation* created new concerns. Deflation is reflected in falling prices for assets, typically as buyers are fearful of spending money. But deflation is not always a negative force.

Sometimes deflation is caused by innovation, as when technology led the way to change. The economy reaped the benefits of ever-lower prices for chips and other computer components. As prices fall, new inventions are easier for everyone to afford. And those new technologies create new and better jobs for those who are prepared to take advantage of them. That was Henry Ford’s philosophy when he started manufacturing automobiles on his assembly lines, and as a general principle it holds true today.

However, deflation can also be a dangerous negative force in the economy. Deflation is a tremendous burden to those who must repay debt. While inflation makes debt easier to repay in cheaper dollars, deflation makes dollars more valuable and harder to come by. As an economy slows and workers are laid off, people find it harder to repay their mortgages and their credit card debt. That leads to bankruptcies and write-offs. Money literally “disappears” down the black hole of lower asset values and loan write-offs.

Perhaps the most negative aspect of the deflationary process is falling prices on those assets, such as homes being sold after foreclosure. Everyone figures prices will continue to fall, so they wait to buy—leading to a downward spiral in prices, and in attitudes. Fear rules as people worry about losing jobs, so they stop buying in spite of lower prices. Deflation is a dangerous downward spiral, and the Federal Reserve is quite aware of that fact.

So if you picture the economy as a giant see-saw in a child’s playground, you can see the effort it takes to balance out the forces of inflation and deflation. That’s the job of the Fed, using its monetary tools of credit creation. And it’s also the job of the government, using its fiscal tools: government spending and taxation policies.

Adding to the problem is the fact that these tools work with a lag. Injecting new credit into the economy may take a while before it creates growth. And if the deflationary fears are too great, the money may sit on the books of the banks and corporations because they're too worried to lend or invest for future growth that might not come.

Then add politics! Politicians on both sides of the aisle are afraid to offend their constituents by cutting spending or raising taxes. Compromise is hard to reach—and when it comes it often makes for the worst kind of irrational legislation. And, in that context, you have to make some important financial plans for your future!

It's a Small World, After All

Walt Disney may have created that refrain to demonstrate how interconnected we are with the rest of the world, but the past decades gave an economic demonstration of its truth. When you're making financial plans and investment decisions, you must look beyond America's borders.

Technology has created a globally interdependent financial system. With the click of a computer key, vast amounts of money can rush into a country to purchase its stocks or to invest in its real estate or industry. Similarly, money can be transferred out easily when prices move too high for economic reality.

Overvalued currencies in mismanaged economies are sold by investors and speculators who transfer their assets to a currency that will preserve its value. Loans are defaulted, and banks fail. Interest rates are raised to lure speculators to hold on to the weakening currency. One positive side effect emerges when a country devalues its currency: Its exports appear cheaper to the rest of the world.

For many years, the dollar's strong buying power meant lower-cost imports for Americans, keeping a lid on domestic price inflation. But those cheap imports provided competition for domestic manufacturers of the same goods. As business slowed, domestic manufacturers were forced to lay off workers. The jobs went overseas, destroying much of our traditional industry.

Fear of global competition raises the issue of restrictions on imports—something that hurts both U.S. consumers and foreign producers. A decline in world trade because of protective tariffs has the potential to create a global depression. The financial crisis of recent years has been a very frightening demonstration of how small and interrelated the global financial system has become.

The Danger of America's Debt

The ongoing financial crisis that was ignited in 2008 has created a new Savage Truth: *You have to think beyond the dollar.*

That's because the United States is so much in debt, and because so much of that debt is held by foreign central banks. China and Japan each hold nearly a trillion dollars of our IOUs. How did that happen? Well, actually, you helped the process along every time you went shopping.

Those low-cost imports, so much in demand by U.S. consumers, eventually caused a great economic imbalance. We buy "stuff" from China and send them dollars to pay for our purchases. Chinese exports to the United States rose from \$100 billion in 2000 to \$365 billion in 2010, while their imports from the United States rose only from \$16 billion to \$92 billion.

Chinese companies deposited those dollars in their bank, in exchange for the local currency, which they used to pay their workers. Then the Chinese central bank used the dollars it held to buy U.S. government securities: Treasury bills, notes, and bonds. In effect, China has been financing the U.S. budget deficit.

By the end of 2010, it was estimated that the Chinese central bank held more than \$850 billion of U.S. government debt, slightly more than Japan's holdings. The two countries hold more than 44 percent of our foreign-owned debt.

In effect, the Chinese, Japanese, and other foreign central banks that hold dollar debt have become a potentially powerful force in the U.S. economy. They could demand higher interest rates if they saw that the Fed was creating too much new money—*inflation*. And higher interest rates could devastate the U.S. economy.

The United States has become the world's largest debtor. Since the U.S. dollar is the world's "reserve currency," the entire world is watching. Many countries have their own debt problems. The U.S. economy is still the largest in the world, but China is now running second. Europe, which united to compete with both economic superpowers, is now in the midst of its own financial crisis. Even as the United States copes with its growing budget deficits, several European countries are being forced into austerity, much to the anger of their citizenry.

Those who do not learn from history are destined to repeat it.

—George Santayana

We are often so caught up in our current economic circumstances that we forget to take a step back and gain perspective. Unfortunately, history never repeats itself in exactly the same way. We know from nature that there are regular cycles. Spring inevitably follows winter—no matter how long winter drags on. Many historians and market technicians perceive long- and short-term cycles in the economy and the stock market, which serve as a guide to the future.

Others refuse to acknowledge any patterns of repetition. Over the centuries, there have been many claims to a “new era”—whether it was discovering the riches of the New World, the promise of the Industrial Revolution, or the potential of technology. Indeed, these discoveries changed the direction of the future. But were they a “new paradigm” or just part of the continuing upward spiral of human progress? And can economic progress overcome human nature?

Those are the challenges faced by optimists who believe in the future, who believe that intelligent planning can build on lessons from the past, instead of repeating past disasters.

Paradigms Change, but People Don't

There's no question that scientific knowledge and technological developments have the power to create and redistribute both power and wealth. But one factor that remains constant over history is human nature.

Those two basic forces—fear and greed—always rise to the surface when it comes to making money decisions. How else to explain the extremes to which markets always swing? When human nature gets involved in the decision-making process, all the rules of behavior are set aside along with all of the facts and statistics that determine where markets “should” go.

Market technicians use charts that smooth out the variations in behavior caused by emotional extremes. Historic averages blend in the highs and lows of price and emotion. But when you are living through one of those extreme periods, it is difficult to resist joining the crowd in either buying or selling at exactly the wrong time. After all, it's only human nature!

So that is your challenge today—to develop perspective both historical and global to withstand human nature and make sensible plans for your future. One thing is sure: The future will come. Will you be ready?

TERRY'S TO-DO LIST

- 1.** Examine your attitudes toward money: power, fear, and greed.
- 2.** Set three realistic financial goals—some short-term and some longer-term targets.
- 3.** Think about whom you should consult for good financial advice—a financial planner, broker, banker, accountant, lawyer, rich uncle—and start asking for advice. Then consider that advice carefully in terms of your own financial personality and goals.
- 4.** Pay attention to what's going on in the economy, politics, and the financial markets. All will affect your best-laid plans!

