Andrew Hingston

The secret to **mastering your money** is …

You need to be able to …

1. **Explain the savings formula and the what influences each of the variables in the formula**
2. **Explain how saving to invest can create an investment income cycle**
3. **Explain the two types of saving (save to spend and invest)**
4. **Explain some typical reasons why people find it difficult to save money and some ways to overcome them**
5. **Explain why and how to track expenses**
6. **Explain why people get into credit card debt and how to break the credit card debt cycle**

Andrew Hingston

Understanding saving

Amount saved = Income – Expenses

Think and discuss

Out of all the people you know ... who do you think strikes the best balance between being a good saver and being stingy with their money?

Quote

A penny saved
… is a penny earned

Benjamin Franklin (1705 – 1790)
a Founding Father of the United States

Amount saved in one month

Amount saved = Income – Expenses

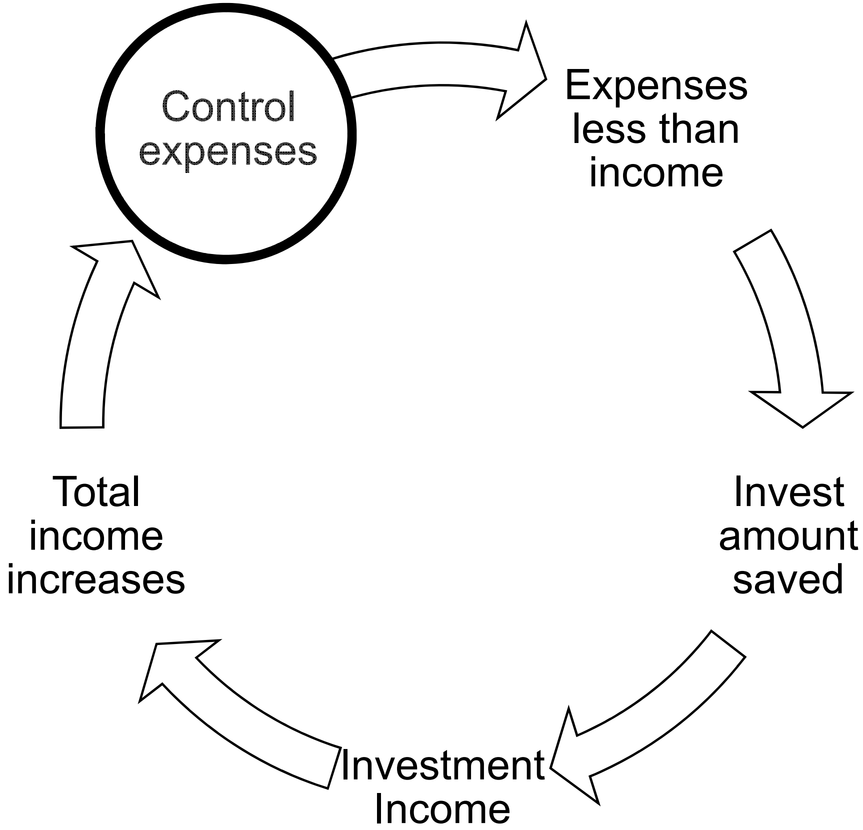
Income

- Personal income – salary and wages
- Investment income – interest, rent, dividends and distributions
- Gifts, pocket money, government payments, scholarships
- *Less* income tax

Expenses

- Fixed expenses – difficult to change within 1 year
- Variable expenses – increase with income

The investment income cycle



Most people never even start on this cycle

Q1: Understanding saving

a) Re-arrange the 'amount saved' formula to put Expenses on the left and all other terms on the right. Identify some practical implications.

b) You are with a good employer but get an offer with another company for slightly higher pay. Identify some possible pros and cons of changing jobs.

c) Identify two situations that will reduce your tax but may also reduce your wealth as well.

d) James and Sarah both have expenses of $40,000 per year. James earns a $50,000 personal income. Sarah earns $20,000 personal income and $25,000 investment income. Who is better off?

Go to Answer

The purpose of saving

It is all about the *future*

Purpose 1: Save to spend

Save money to spend on future expense

This is really just 'deferred spending'

Examples:

1. **Saving for a $2,000 holiday at the end of the year**
2. **Saving for a $10,000 new car in 2 years**

6 reasons to save to spend

1. **Failing to do it becomes a life-long habit**
2. **Avoids expensive credit card debt and personal loans**
3. **Avoids missed opportunities due to lack of cash**
4. **Develops self-control through delayed gratification**
5. **Enjoy free happiness while anticipating the purchase**
6. **Interest on savings makes it easier to purchase**

Purpose 2: Save to invest

Save money to permanently increase wealth

This can either involve increasing assets or decreasing debts

It should also make it easier to save in the future

1. Increases future investment income; and/or
2. Decreases future fixed or variable expenses

You never plan to spend the ‘capital’ of your savings

The ‘capital’ amount is the amount you are saving now

You only plan to spend future savings generated by that capital

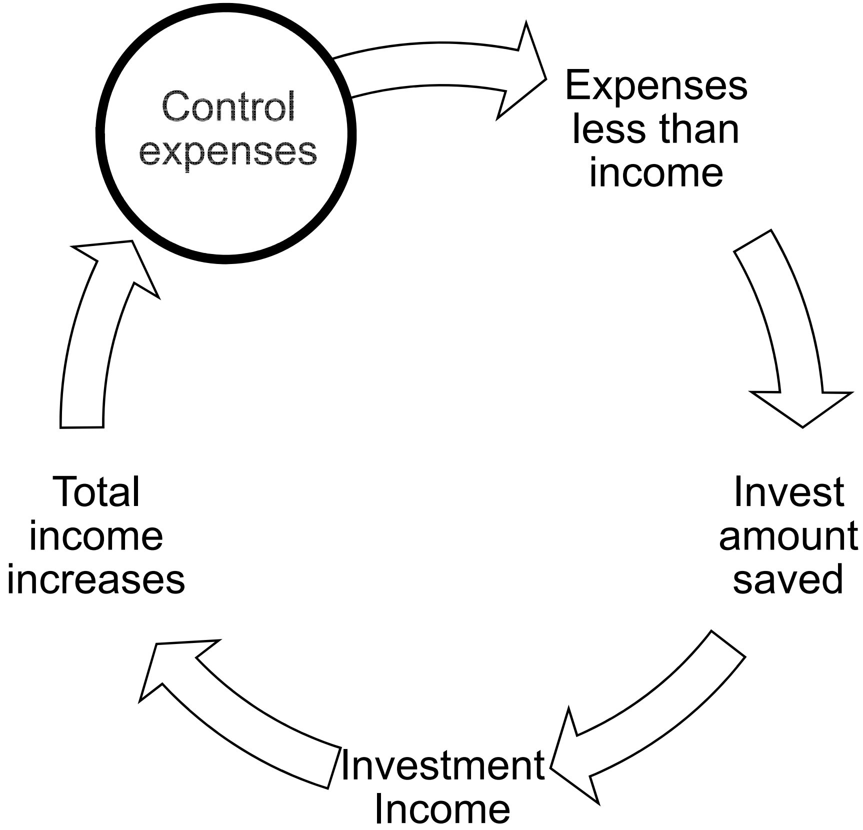
Examples:

Savings invested into a savings account to fund a deposit on a home

Savings used to pay off part of the principal of a home loan

Savings invested into a mutual fund that invests in shares

The investment income cycle



Most people never even start on this cycle

7 reasons to save to invest

1. **Doing it becomes a life-long habit**
2. **It makes it even easier to save in the future**
3. **Required for a deposit on a property**
4. **Essential for creating financial independence**
   This occurs when investment income fully pays all living expenses
5. **Starting at an early age makes it easier in long-term**
6. **Avoids missed opportunities from not enough capital**
7. **Develop investment experience and skill**
   … a key component of Money Intelligence (MIQ)

Q2: The purpose of saving

Identify if these situations are
1. Save to spend or 2. Save to invest or 3. Neither

	Situation	Type
A.	You put aside $100 a month to go on overseas holiday	
B.	You usually spend $100 less than you earn each month and you put that money into a savings account	
C.	You pay off your credit card balance of about $1000 at the end of each month	
D.	You have had a credit card balance of $5000 for a long time and you now reduce it to zero	
E.	You start a regular savings plan to buy a car in 2 years.	
F.	You start a regular savings plan for a deposit on a property.	

Go to Answer

Why is it so hard to save?

Our bank balance
is like the thermostat
of an air conditioner

It is rational to be consistent ...

Fixed expenses of $25,000

Spend $0.50 of each dollar of income

$25,000 and 0.50 do <u>not</u> change with income

... but it doesn't work that way!

It is rational to plan for the future …

	Budget
Saved	**10,000**
Income	**45,000**
Personal income	44,000
Investment income	1,000
Expenses	**35,000**
Home (mortgage interest, bills etc)	12,000
Food and drink	8,000
Vehicle (including 2,000 depreciation)	5,000
Leisure	1,000
Education	3,000
Clothes	1,000
Other	5,000

It is rational to be self controlled …

	Budget	Actual
Saved	**10,000**	**10,100**
Income	**45,000**	**45,050**
Personal income	44,000	44,000
Investment income	1,000	1,050
Expenses	**35,000**	**34,950**
Home (mortgage interest, bills etc)	12,000	12,100
Food and drink	8,000	7,900
Vehicle (including 2,000 depreciation)	5,000	5,100
Leisure	1,000	900
Education	3,000	3,100
Clothes	1,000	900
Other	5,000	4,950

... but we are not rational

We are not consistent

We do not plan

We are not self controlled

A behavioural view of saving

We have a target balance

Spend less if balance < target

Spend more if balance > target

Our bank balance
is like the thermostat
of an air conditioner

Tip 1: Be consistent

Plan to save 10% of every dollar of income

This keeps fixed and variable expenses under control

Be regular … save a little amount often

Move savings out of bank account … into investments

Tip 2: Plan for the future

Prepare a budget as part of this course

Use a recurring reminder to update once per year

Review the mix of expenses to satisfy more needs

Consider big expenses over the next few years

Calculate a savings plan for expenses (save to spend)

Plan to save 10% of income to invest (save to invest)

Tip 3: Practice self-control

Regularly track expenses

Keep an eye on daily/weekly/monthly amount saved

Tracking expenses changes behaviour (observer effect)

Compare expenses against budget

Practice being frugal

- **"I cannot afford this right now … and I am okay with that"**

Practice contentment

- **"I can be happy and content with what I already have"**

Avoid hobbies that are known to weaken self-control

- **Shopping, gambling, drinking, smoking, gaming, over-indulgent eating**

Q3: Why is it so hard to save?

Identify 3 ways that you could reduce your overall expenses without significantly decreasing happiness

Hint: this might involve spending less on one thing and more on something else!

No answer provided

Tracking expenses

Information is

POWER

Think and discuss

What insights or shocks do you expect to experience from tracking your personal expenses?

9 reasons to track expenses

1. **Increases accountability**
2. **Tracking expenses can decreases them (observer effect)**
3. **Provides detailed information**
4. **Answers questions**
5. **Identifies areas to improve**
6. **Make better decisions**
7. **It signals to others you are good with money**
8. **It becomes fun after a while!**
9. **Every company does it … why not households?**

4 methods of tracking expenses

1. **Extreme tracking**
   Track every dollar in software
   Most information and control but many don't have the discipline to do it
2. **Electronic tracking**
   Track only electronic records and track cash spending in total
   Good information and control but miss a lot of detail in cash transactions
3. **Audit tracking**
   Track every dollar for two months per year
   Okay information and control but difficult if your numbers vary a lot
4. **Fixed savings tracking**
   Put $X per month into savings account then spend the rest
   Good for saving but focuses on cash flow and not much information

Choose method that best fits your personality

Depreciation … the invisible expense

Depreciation measures fall in value of an asset over time

Doesn’t affect your bank account directly

So most people don’t take it into account

Recording depreciation helps you save to replace asset

Depreciating a car

Most vehicles halve in value every 3.5 years

Simplest way is to depreciate to zero over 7 years

If car is currently worth $8,400 then …

- **Depreciation is $1,200 per year or $100 per month**

In your smartphone app …

- **Enter the current value of your car … and spread it over 7 years**

If sell for more than zero in 7 years then it is a bonus

If sell before 7 years then make manual adjustment

Depreciating a notebook computer

Most notebook computers halve in value every 2 years

Simplest way is to depreciate to zero over 4 years

If notebook computer is currently worth $2,400 then …

- **Depreciation is $600 per year or $50 per month**

In your smartphone app …

- **Enter the current value of your computer … and spread it over 4 years**

If sell for more than zero in 4 years then it is a bonus

If sell before 4 years then make manual adjustment

For anything else
… think about the 'useful life' of the asset

8 tips for extreme tracking

1. **Enter transactions into smartphone immediately**
2. **Ask for receipts**
3. **Check all receipts once a week**
4. **Use payment methods that give an electronic record**
5. **Use recurring transactions for regular expenses**
6. **Avoid buying small things**
7. **Add $X a week for any small things you missed**
8. **Don’t forget depreciation**

Q4: Tracking expenses

1. **What questions do you have about tracking expenses for the Money Assignment?**
2. **What questions do you have about expenses that are paid by your parents on your behalf?**
3. **Which categories are missing?**
4. **Have you worked out how to use recurring transactions?**

No answer provided

Andrew Hingston

Credit card debt

Think and discuss

Do you know anyone who has significant problems with their credit cards?

Without mentioning their name … what affect has it had on their lives?

What is credit card debt?

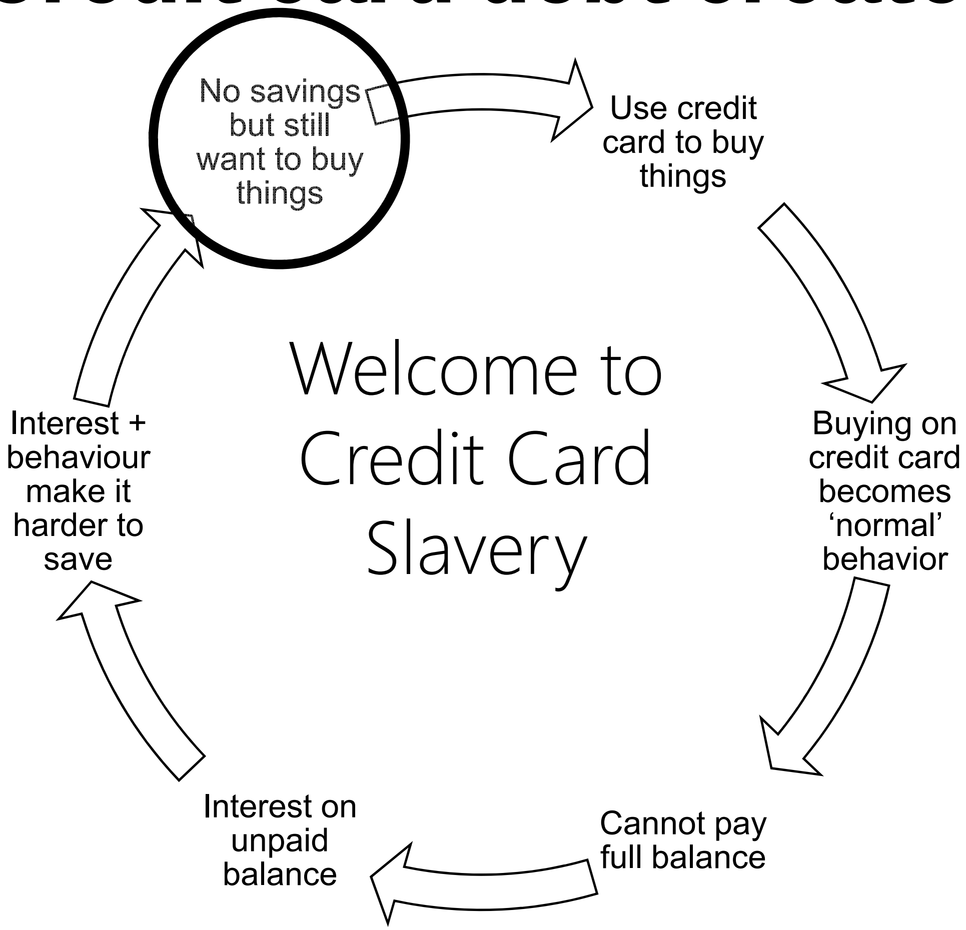
You buy things on credit card during the month

… then get the statement at end of month

… and <u>cannot</u> pay the full balance

Balance incurs interest at 15%+ per year (or more)

Credit card debt creates a cycle …



7 reasons why people get into credit card debt

1. **Impulsive behaviour disorder**
2. **Bad habits**
3. **High fixed and variable expenses relative to income**
4. **Poor planning (Save to spend)**
5. **Lack of personal discipline to stick to a budget**
6. **Sometimes a valid choice for short-term financing**

   Be careful playing games with honeymoon rates … it may backfire!
7. **Bad luck … bad stuff happens despite good planning!**

7 signs you have a problem with credit card debt

1. **You couldn't pay full balance for 2 months is a row**
2. **You juggle purchases between 2 or more cards**
3. **You have already wondered "do I have a problem?"**
4. **Your family/friends have asked if you have a problem**
5. **Your credit card solves "I don't have enough money"**
6. **Your credit limit feels like "One of my bank accounts"**
7. **You regularly worry about your credit card debt**

6 steps to get out of credit card debt

1. **Acknowledge that you have a problem**
2. **Seek counselling from a professional psychologist**
   Identify any underlying issues otherwise it will re-occur
3. **Freeze your credit cards**
   Suspend with bank … or cut them up … or freeze in a block of ice
4. **Talk to your bank about consolidating debt**
   Consider rollover to honeymoon rate only if you freeze the new card
   Consolidate all credit card debt into personal loan with repayments
5. **Start tracking expenses using smartphone app**
6. **Change behaviour to save 10% of every dollar earned**

You need to be able to ...

1. **Explain the savings formula and the what influences each of the variables in the formula**
2. **Explain how saving to invest can create an investment income cycle**
3. **Explain the two types of saving (save to spend and invest)**
4. **Explain some typical reasons why people find it difficult to save money and some ways to overcome them**
5. **Explain why and how to track expenses**
6. **Explain why people get into credit card debt and how to break the credit card debt cycle**

A1: Understanding saving

a) **Expenses = Income – Amount saved**
Expenses are residual amount after making planned savings

b) **Pros: Higher personal income, plus different experiences.**
Cons: Foregone promotion opportunities, risk new employer will be bad and perceived as disloyal.

c) **Earning less income may reduce your wealth (if expenses exceed income) but would likely also reduce tax. Reducing your tax by $10,000 while also paying $11,000 in advisory fees may also reduce your wealth and tax at the same time.**

d) **James can save more but he relies on his personal income. Sarah is probably better off as she has a large investment portfolio to generate that income and it will probably be easier for her to grow both personal and investment income.**

Go to Question

A2: The purpose of saving

Identify if these situations are 1. Save to spend or 2. Save to invest or Neither

	Situation	**Type**
A.	You put aside $100 a month to go on overseas holiday	1
B.	You usually spend $100 less than you earn each month and you put that money into a savings account	2
C.	You pay off your credit card balance of about $1000 at the end of each month	Neither
D.	You have had a credit card balance of $5000 for a long time and you now reduce it to zero	2
E.	You start a regular savings plan to buy a car in 2 years.	1
F.	You start a regular savings plan for a deposit on a property.	2

Go to Question