



Common Money Management Mistakes and How to Avoid Them

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Q. We are newlyweds, just starting our financial journey together. What advice do you have to help us avoid financial pitfalls?

A. It is great that you're already talking about money and how to make the most of your financial situation. Whether you are just starting out on your financial journey or well along the path, the following tips and professional insights should help you avoid the mistakes that people most commonly make.

Top 12 Money Mistakes People Make

1. Not living within your means. We live in a consumer culture. Sometimes it seems as if everyone is buying new cars, taking expensive vacations, and dining out. If your credit card bills are painful, you already may know that you're living more lavishly than you should. Perhaps that's why you picked up this book. Or, even though things seem fine, you may have a hunch that you're not using your money as wisely as you could. This is a good time to ask yourself, "What are my long-term financial objectives?"

2. Failure to set goals. If you don't know where you're going, you may wind up somewhere unpleasant. That's as true on a road trip as on your financial journey. Whether you dream of long-term financial security, greater prosperity in the near future, sending the kids to Harvard, providing for elderly parents, or retiring to a tropical island, if you haven't identified and prioritized your goals, you haven't taken control of your financial future. Once those goals are established, you can make spending and investment decisions that will lead you in the right direction.

3. Not saving enough. Figuring out how much you need to save can be complicated, but chances are you need more than you think. Americans are living longer, so your retirement nest egg may need to last 25 to 35 years or more, providing an income adequate for your lifestyle while keeping up with inflation. Social Security benefits will be dismally inadequate for most people, so many professional financial planners don't even include them or reduce the estimated benefits drastically in retirement income projections. Even if you're just starting out and have little discretionary income to set aside, getting into the habit of saving is important. Take advantage of 401(k)s with company matching or other tax-advantaged investment vehicles such as IRAs and Roth IRAs. The power of tax-deferred investment returns that compound over your entire working life is tremendous.

4. Failure to create and stick to a budget. Few people create a budget and stick to it. Nonetheless, after you've set your financial goals and developed a budget, you need the discipline to stick to your plan and achieve your long-term goals. Often, people find that once they've taken control of their finances through goal setting, planning, and budgeting, the resulting sense of well-being far outweighs any disappointment they feel from not spending as much.

5. Too much debt. Ideally, a home mortgage is all the debt most people would have. It's considered "good debt," because your home has appreciation potential and mortgage interest is deductible. For most people, however, having mortgage debt alone just is not realistic. They need to borrow to buy automobiles and to make other major purchases. Here are three guidelines to help determine your maximum level of debt.

Monthly housing expenses (rent or mortgage payment plus real estate taxes and insurance) should be less than 28 percent of pretax income.

Total monthly debt payments should be less than 36 percent of pretax income.

Consumer debt payments should be less than 20 percent of after-tax income.

You are wise to stay below these limits if possible. And do try to pay down consumer debt as quickly as possible. Carrying credit card balances month to month (just paying the minimum) is an absolute no-no. If you can't pay your monthly credit card bills in full each and every month, then you're living beyond your means-period.

6. Failure to maintain sufficient (or having too large) cash reserves. Most people should keep the equivalent of three to six months' worth of expenses in liquid, accessible accounts. The lower amount may be appropriate for two-career couples or singles with a second source of income; the higher amount is better for one wage earner families or if your income is volatile. Unless you have special circumstances that warrant greater liquidity, keeping excess cash in low or noninterest-bearing accounts is undesirable, because inflation eats away your money's purchasing power over time. For example, with 4 percent annual inflation, over 10 years, a dollar loses roughly one-third of its purchasing power. Yikes.

7. Insufficient disability insurance coverage. Many people purchase life insurance but don't realize the importance of disability coverage. You are more likely to suffer loss of income due to prolonged illness or injury than you are to die prematurely. In addition, the financial consequences to your family from a disability can be disastrous-not only does income stop, but expenses can rise due to the costs of treatment, rehabilitation, or long-term care. If you're self-employed, purchase your own disability policy. If an employer offers group disability coverage, be aware that it may have some big loopholes. Read the policy carefully and consider replacing or supplementing it with additional coverage.

8. Failure to keep an up-to-date Will. It's surprising how many people don't bother with a proper Will. They mistakenly believe that if they don't have a large estate, it's not necessary. But if you die intestate (without a Will), the state will determine how your assets are distributed. Estate planning is critical if your assets are more than \$1 million, including life insurance and equity in your home. To avoid having your hard-earned assets eaten up by unnecessary taxes, you should explore tax minimization strategies with a qualified attorney.

Don't overlook the fact that, if parents die without a Will, minor children become wards of the state, with the state ultimately choosing their guardians. If you have children (or plan to in the future), your

Will should identify guardians in the event of your death. Note also that if you move to a different state, you may need to get a new Will. Estate planning is not just for the wealthy. Don't put off to tomorrow what you could be doing today.

9. Failure to diversify. Simply stated, diversification means not putting all your eggs in one basket. Remember the Enron scandal and those employees and retirees with all their retirement assets invested in company stock? They lost everything when the company went bankrupt. Had they been properly diversified, the scandal might not have been as financially disastrous. Diversification means spreading your assets among several different types of investments-like stocks, bonds, cash, and real assets. Diversification among different asset classes can lead to higher returns and lower risk over time. Asset allocation takes diversification one step further (see Chapter 7 on investing).

10. Too much focus on short-term investment results. Investors often think that they should try to time the market-buy stocks before the next big market rally or sell before the next downturn. That's just not possible over any meaningful period of time. Instead, your asset allocation and investing strategy should be based on your age, life circumstances, and when you need the money. For example, a 25-year-old might have a portfolio weighted heavily toward growth stocks, because a person just beginning their career can tolerate near-term volatility in exchange for the superior long-term growth that the stock market historically has delivered. On the flip side, a retiree who needs a stable cash flow should probably have a greater proportion of fixed-income investments.

11. Failure to get advice from an expert when needed. Most people never seek professional financial advice. Unfortunately, it is easy to understand why. The prevalence of financial advisors who sell products can be a real turnoff. Because their compensation is directly affected by the recommendations a client implements with them, their advice may not always be in their clients' best interests. Fortunately, though, a growing number of fee-only financial planners will address your concerns by working with you on an hourly, as-needed basis without account minimums, long-term contracts, or commission-based bias.

While a planner can help with virtually any aspect of personal financial management, at a minimum you should get professional help with certain issues:

How much will you need for retirement?

How much will you need for your children's education, and what are the best ways to fund it?

How much should you save on a systematic basis to achieve those goals?

How can you best allocate your portfolio between different asset classes?

What are the best options when approaching a transition point in life such as a new job, marriage, home purchase, having children, or retirement?

The cost of professional financial advice is small compared with the potential costs of not getting professional help.

12. Not being an educated investor. Have you seen the bumper sticker, "Ignore your teeth and they will go away?" The same can be said for your money. If you don't take care of it, it may not last long. Managing your money is a lifetime project, so continue to work diligently and become better informed.

Reading this book as well as credible magazine and newspaper articles and listening to reliable experts are all great ways to get started. Just watch for hidden agendas and biases, and don't listen too closely to the daily news and stock market talk. Remember, financial news shows need to garner audiences, too, and because personal finance is not usually a racy, exciting topic, sometimes the "news" gets overly sensationalized or exaggerated.

Also, educating the client is a major objective of a good financial planner, so if you opt to work with a planner, make sure they are willing and able to explain things clearly. If you have a life partner, both of you should be involved. Too many people rely on their spouses or partners to make all the household financial decisions, ending up woefully unprepared to handle the finances when the unthinkable happens.

End Note\$

You work hard for your money. By educating yourself on personal financial matters and becoming a better-informed consumer, you can make smarter decisions about money and enjoy greater peace of mind now, while building for a more secure financial future.

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