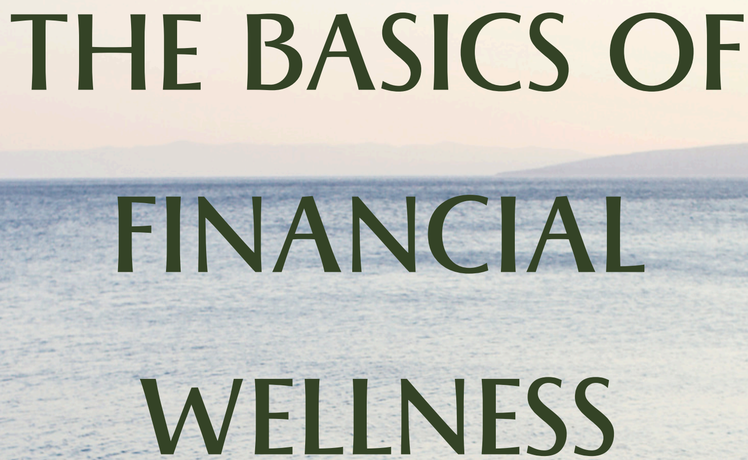
THE BASICS OF FINANCIAL WELLNESS



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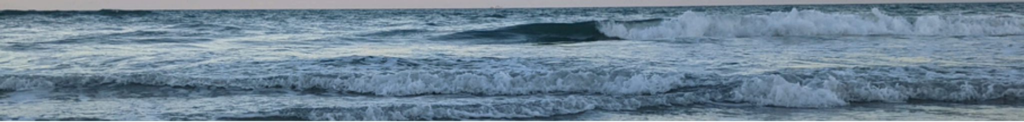
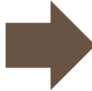


Let me help you …

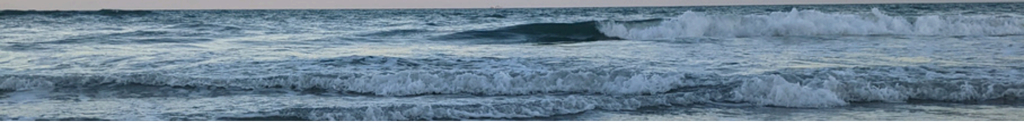


Intro

There are many ways to define Financial Wellness or Well-being, but the essence of most of them is that ***you are on track to meet your short-term and long-term financial goals*** **but also *feel financially secure*** and don't worry about money all the time.

The last point is maybe the most important one regarding overall wellness:
You can have very little money and still feel secure and content but you can also have more money than you can ever reasonably spend and still feel anxious about your financial situation.

Nevertheless, being on track regarding your financial goals is more often than not a prerequisite for feeling financially secure, reduces anxiety and stress and is beneficial for your overall Well-being.



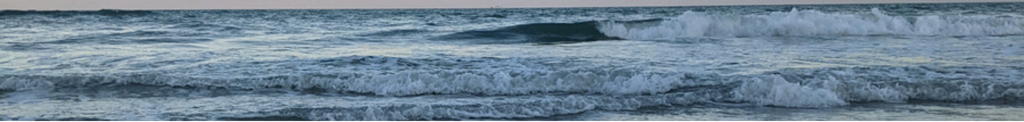
Short-term Goals

Your basic short-term financial goal should be to earn enough money to **pay for all your current expenses and have an emergency fund to cover 6-12 months of living expenses** in case you loose your job or face other unforeseen events.
For this to happen, your current income should be at least slightly greater than your expenses.

If you feel you need work on this, you have basically two ways to do so:

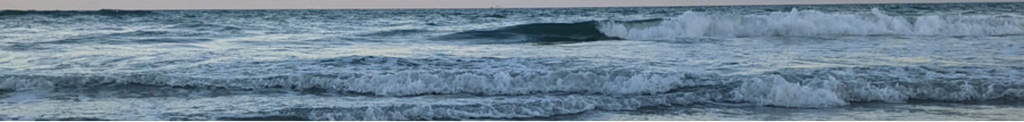
1.) Increase your income:

- Look for ways to increase your salary in your current job by taking on more responsibility or working harder/smarter
- Find a better paying job which may require getting additional qualifications or moving to another location



2.) Reduce your Expenses

- Move to a smaller house:
  - Do you really need all this space?
  - Is a lot of the space just used to store things you rarely need or use?
- Move closer to work and save on commuting costs:
  - Commuting costs are not only the gas your car uses: Maintenance and depreciation for example are also driven up by usage
  - According to conservative IRS guidelines driving a car costs you around 65 cents/mile
- Reduce the number of cars you own
  - Do you really need 2+ cars or could you coordinate and share?
  - Could you bike or use public transportation instead?



- Buy less:
  - Do you really *need* the new sweater, iPad, TV etc?
  - How much is true “need” and how much is “want” and what is really the cause for the “want”: Boredom? Impress other people?
  - **A good rule is to wait a month before buying something you want but not immediately need**
  - **Before buying things you think you need, see if there are other ways to get it** (Borrow, buy used etc.)

A large percentage of our expenses are driven by "wants" which are created by peer pressure, advertising, social media etc.

We are social beings after all and are hardwired to take all these outside influences into consideration but we also have to realize that in the end the decision to buy something is ours alone and is always a trade off: Time/Money for Goods.

My advise:
Before buying anything ask yourself if this purchase will make your life better in the long run.

Long-term Goals

Long-term financial goals could be saving for a down-payment on a house, a college fund for your kids or retirement just to name a few.

All long-term goals have a simple fact in common:

- Your current expenses reduce your potential savings in two ways:
    - The money you spend now is not going towards your savings
    - **The money you spend now can not accumulate interest**

The last sub-point is huge and very often overlooked!

If you spend for example **1,000$** on a new TV now, your savings over the next 10 years will be potentially reduced by **2,000$**:
The 1,000$ you paid for the new TV and an additional 1,000$ in potential returns/interest you could have earned on the original 1,000$ you spent.

Compound interest is a very powerful ally when it comes to reaching long-term financial goals.

Let's have a closer look at how it works by using the ultimate long-term financial goal as an example: Saving for retirement.

For most people, retirement means to have to live off the money you saved while you were working.
The idea that you have enough savings to live the rest of your life off your money is called "Financial Independence".

The question now is how much money exactly do I have to save for this and how long would that take?
Of course the detailed answer to this question depends on your unique situation and the particular economic environment but I want to give you a general idea about the concept by using my fictional friend Peter as an example.

Peter is 30 years old and curious when he would be able to retire by being financially independent. His financial numbers are:

- Annual Income: 100,000$ after taxes
- Annual Spending: 70,000$
- How long would retirement last: 40 years (he expects to retire at 50 and live to 90)

Peter figures he would need
70,000$ x 40 years = 2.8 million dollars to make his plans work.
That is already assuming he holds his retirement savings in high-yield savings accounts or CD’s (Certificate of Deposit) where the interest payments would cover the rate of inflation.

At his current savings rate, that would take him 93 years!

The next morning, during breakfast, Peter thought about his parents and how they have their retirement money invested in stocks and bonds.

He finds out that the broader US stock market (via the SP500 Index) has an average “interest rate” or return of more than 10% per year over the last 100 years. That would be a 7% return per year even after adjusting for inflation!

Peter calculated if he invested all his savings in the stock market (via an SP500 Index fund) and the stock market would keep performing in average like it did the last 100 years, it would only take him around 30 years to be able to retire.

But now he is thinking: What if I keep my money invested in the stock market even after retirement? Would that make a difference?

After talking to his Financial Advisor, he learns that when you keep your money invested in volatile assets like stocks, you can not calculate how long your money lasts by using the average (inflation adjusted) return rate of 7% for stocks but a significantly lower rate, called the “Safe Withdrawal Rate” (SWR). The reason for that is something called “Sequence Risk”: Basically you have to allow for the fact that when you keep taking money out of your retirement savings every year, that you might take so much money out during a loosing streak of the stock market, that there is not enough money left to make up for the loss during a subsequent upturn.
He also tells Peter that the exact SWR depends on a lot of factors but if you invest in stocks and bonds properly, you can expect it to be around 3.3%.

With that new information Peter calculates that he would not need 2.8 million dollars but only 2.1 million dollars to have 70,000$ per year available in retirement and it would take him an average of 27 years to get there.

That puts Peter at a retirement age of 57; not too shabby but maybe there is a way to reduce that even further:
Peter calculates that **for every 10,000$ less per year he needs in retirement, he needs to save 300,000$ less before retiring.**

Or in other words:
For every 10,000$ he reduces his annual expenses, he can retire around 5 years earlier!

That is why it is so important to avoid lifestyle creep:
Keeping your lifestyle reasonable before retirement does not only allow you to save more while you work but also sets you up to need less in retirement.

Of course the question what lifestyle is reasonable or not is very subjective and also strongly influenced by your upbringing and cultural background.

Everybody has to decide for themselves what they are willing to live with or without.

At the end it always comes down to one question:
“Is the juice worth the squeeze?”

Thank you for staying with me til the end of this little eBook.
I hope I gave you some food for thought and maybe some inspiration to re-evaluate your lifestyle choices.

If you want to learn more or need support to achieve your financial goals, write me an email at olafmoves@gmail.com or check out my website at olafmoves.com

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