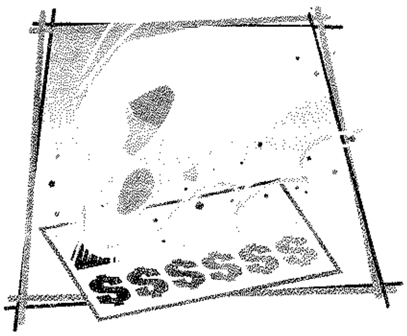
Set Yourself Up

Setting Financial Goals

Objective A

Who Wants to Be a Millionaire?

Everyone wants to have a lot of money, and it's fun to dream about ways to spend it: new clothes, a better car, maybe even a new home. What are *your* dreams, and how can you get the money you need to make them come true?



Unless you're certain to win the lottery (very, *very* unlikely), you have to *plan* to make your financial dreams come true. A good financial plan gives you a long-term focus that helps build your lifetime financial security. Instead of living only in the present, where fast food and CDs always seem like good ideas, you learn to live with an eye toward the future, where you will reap the rewards or pay the price for your lifestyle now. That's right—your day-to-day spending choices now have a huge impact on the money available to you in the future. Fortunately, you're in control; *you* are the one who determines your financial future.

How Do You Spend?

Naturally, you want to plan to have enough money for everything you need and for many of the things you want. By making a realistic plan and sticking to it, you'll be able to achieve much more than you would by existing day-to-day or paycheck-to-paycheck. Instead of thinking that the cash in your pocket is cash to be spent, you'll be thinking about setting aside some cash for use in the future, or even about investing some cash to let it grow. Remember, this isn't a method for wringing all the fun out of life. It's just a good way to realize what it takes to get the things you *really* want.

Every dollar you spend today is one less dollar you have to spend on something else. In economic terms, these are **opportunity costs**—the benefit that is lost when you choose one alternative over another. That $13 pizza? It actually "costs" you the opportunity to invest. In 20 years, with just average returns, that opportunity would have yielded $95. That's an expensive pizza![1] Knowing how you spend your money is the first step in creating a financial plan. If you're not already doing so, keep track of your purchases with a simple notebook or with inexpensive budgeting software. With this information, you can make better day-to-day spending choices and begin to control your financial future.

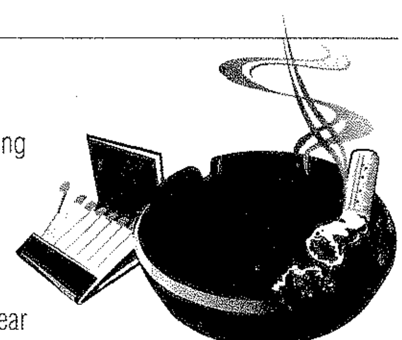
[1] In this example, the opportunity cost is actually $82: the future value of your investment minus the current value of the pizza.

Objectives:

A Describe the importance of financial planning.

B Demonstrate a process for setting financial goals.

Up in Smoke



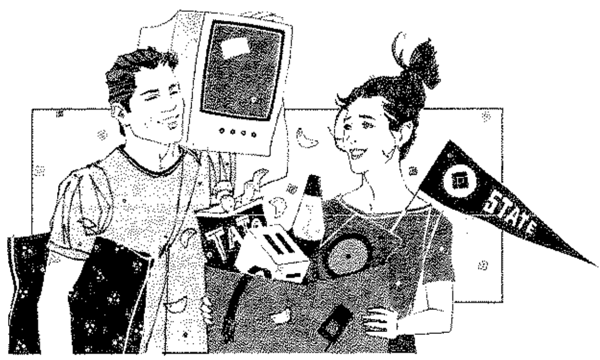
Smokers already know that smoking is bad for their health. Did you know it's equally devastating to their wallets? According to the smoking calculator, smoking a pack of cigarettes a day for one year costs just over $1,250, based on a low per-pack cost of $3.45. Investment author Andrew Tobias gives 18-year-old smokers a choice: One way, you put $1,250 a year into cigarettes and, at age 65, have cancer. The other way, you invest the money at 9% a year and, at age 65, have $1 million.

Are there other costs? You bet. Compared to nonsmokers, smokers also spend more on health care and insurance and are absent from work more often. Talk about opportunity costs!

A few people become so wrapped up in controlling spending that they are anxious about making any purchases at all. One way to avoid that kind of thinking is to realize that opportunity costs are only valid if they represent a *realistic* option. That is, if investing the $13 from the pizza isn't a realistic option for you, it's not an opportunity cost either. Furthermore, if you *do* forgo the pizza in order to invest, you have to follow through by actually investing. This is about purposeful use of your money, not about being afraid to spend.

The Importance of Planning

Once you understand your spending habits, the planning process involves examining your values, setting goals, earning income, setting up a budget, and choosing to live within your means. Financial planning is vital because it gives you the ability to make informed decisions. Specifically, it is important because it can help you:



- **Meet needs *and* wants.** Making a financial plan doesn't mean living like a hermit. Quite the opposite. The idea is that by being more conscious of how you spend, you can plan for the big purchases that seem out of reach. Think you can't afford college? Think owning a home in 10 years is unrealistic? Want to start your own business? Financial planning can make it possible.

- **Influence the future.** One thing is for sure: No one cares about your financial future as much as you do. No one is going to come along, for example, and hand you income during retirement. (Social security, the safety net of your parents' generation, is no longer a sure thing.) You are the person with the power, and the responsibility, to influence your future.

- **Recognize the importance of income.** With a financial plan, you'll realize that every time you earn a dollar, you're being given an opportunity to spend, save, or invest. No income, no opportunities.

- **Prepare for emergencies that regular income can't cover.** Whether it's illness, job loss, or some other emergency, stuff happens. Financial planning that includes saving for emergencies can help you weather the storm.

- **Recognize the importance of investing.** No matter how hard you work, you cannot earn as much money as you can make with careful investing. **Investing** is about building wealth by using your money to make money. Without a plan for investing, you may as well plan to work the rest of your life, an option that could be downright scary for you 50 years from now. Instead, by investing for the next 50 years, you are likely to double your money nearly seven times! With an average market return of 10% (the historical average), a one-time investment of $100 turns into $11,739. Imagine if you invested $100 every month![2] Appreciating the value of investing, and actually doing it, is an important aspect of good financial planning.

Common Obstacles

No matter how well-intentioned our financial plans, most of us face some very common obstacles to meeting them at one time or another. Your awareness of these obstacles will help you understand just how important your spending habits are. Indeed, achieving your financial goals depends directly upon your ability to make wise spending decisions.

- **Impulsive spending** is a growing problem in our consumer-oriented culture. It's difficult to resist constant advertising and peer pressure. In addition, working teenagers who live at home have the privilege of ready cash but do not have the responsibility of major expenses. With no rent or mortgage to pay, no groceries to buy, and pressure to buy at every turn, it's easy to see how impulsive spending becomes a habit that's hard to break.

- **Easy access to credit cards** is also a growing problem. It's tempting to take advantage of the ability to borrow, especially because a credit card, *used responsibly*, can be a good idea. When you pay the entire balance each month, you are getting what amounts to a free loan. However, *not* paying the entire balance means you pay interest on the interest—kind of the flip side of using money to make money. Before too long, the balance spirals out of control. Worse still, you jeopardize your ability to meet necessary, future expenses.

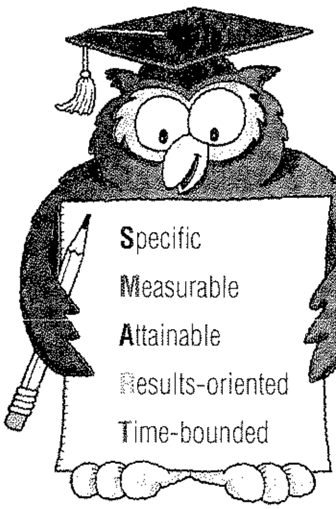
[2] If you begin investing $100 a month when you are 18, at age 68 you'll have an amazing $1,746,976.

Determining Your Financial Future

Once you've thought about your spending habits and the value of financial planning, you're ready to set some financial goals. Clear financial goals guide your spending decisions, helping you live in a way that supports them.

Set SMART Goals

Let's see . . . Save money for a car? Eat out less often? Earn a million dollars? What should your financial goals look like? Effective financial goals, like other kinds of goals, have what are called "smart" characteristics:



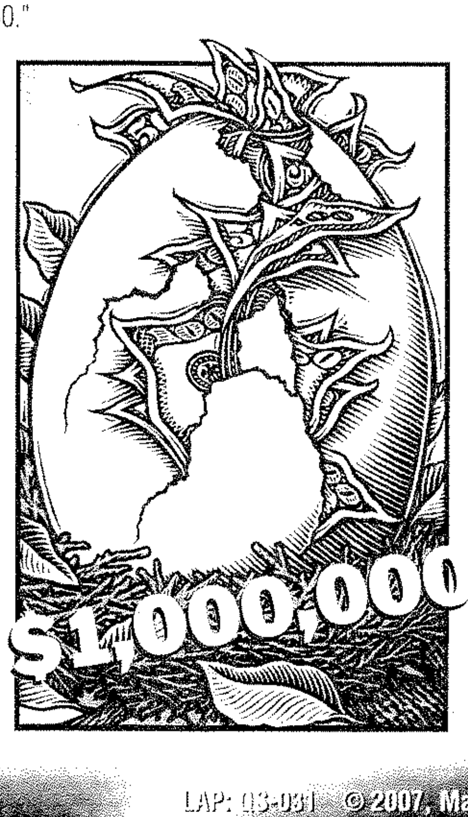
Specific. Instead of simply planning to "save money for a car," decide some of the specifics up front. Will it be new or used? Foreign or domestic? For commuting to work or for traveling the country? Setting a goal that states exactly what you need makes it real. It becomes a picture in your mind that motivates you.

Measurable. Measurable goals can be counted or assessed in a way that shows clear progress. Financial goals are usually measured in terms of dollars, but also might include a time element. A measurable version of saving for a car becomes, "I want to save $2,000 for a car," or even better, "I want to save $25 each week for a car."

Attainable. Attainable goals are ones that are realistic and within reach. Be careful, though. At this early stage of the financial planning process, it is easy to become discouraged. How can you possibly set high goals if you're earning minimum wage or, worse yet, if you don't have a steady income at all? In this case it helps to focus on performance. Perhaps instead of saving a specific dollar amount, your goal should be to save half of whatever income comes your way. Saving half of your cash from gifts and lunch money? Reasonable. Saving $200 a week so that in 10 weeks you'll be able to buy a car? Not so much.

Results-oriented. Goals that are results-oriented focus on getting something done, an approach that helps you to consider the big picture as well as your day-to-day activities. After all, you want your efforts to get you somewhere, right? You know when you've achieved a results-oriented goal—it doesn't leave room for excuses or half-hearted attempts. Save money for a car? Okay, but your overall goal is to actually *buy* a car.

Time-bounded. A time-bounded goal has a time limit with a target date that helps you focus on what needs to be done when, and then gives you milestones by which to gauge your progress. In financial planning, time limits are particularly significant. If you plan early, time works for you, allowing your investments to grow with little effort on your part. A goal that is unrealistic with a two-year time horizon—"Have a net worth of $1 million by age 20"—is perfectly reasonable restated with a different time horizon—"Have a net worth of $1 million by age 50."



A Process for Setting Goals

There is evidence that people who have *written* goals accomplish 50 to 100 times more than people who do not. You can increase your chances of success simply by putting your goals in writing. You also have a better chance of meeting your goals if they are truly yours, not from a book, not from your parents, nor from some vague notion of what they ought to be. Take a few moments now to clear your head and focus on *you*—where do you see yourself in five or 10 years? How about in 30? How about in one?

Now, take out a pencil and paper, or turn on the computer, and follow this process:

1. **Write your financial goals** based on your needs and wants. What do you *have* to do in order to take care of yourself? What are the experiences and material things you would *like* to do and have? Both are important, and both can be achieved with a good plan.

2. **Break down each goal into smaller parts.** What are the things you'll have to do in order to make the larger goal happen? Do you have to earn a certain amount? Save a certain amount? Find out some information?

3. **Identify the time horizon for each financial goal.** Generally speaking, short-term financial goals are those with a time horizon of less than three months. Intermediate financial goals are from three months to three years. Long-term financial goals are over three years.

4. **Prioritize your goals.** Take a good, long look at your list and assign each goal to a category. Identify all of the ones in the must-do-this-or-else category with a #1. Use #2 for all of the important-but-not-critical goals. And finally, use #3 to identify the remaining goals. Watch out for these pitfalls:

   - Ranking every goal in numerical order. At this point, you don't want to stress over the details, so assigning each goal to a category is enough. You can fine-tune the rankings within each category later. At least now you have some idea of where to begin.

   - Ranking everything as #1. This is where the rubber meets the road, so to speak, and you have to make difficult choices. Try ranking your goals in terms of *relative* importance. How do they rank *compared* to one another? What's more important? Setting aside some money for retirement, fixing the dent on your car's bumper, or buying a new interview suit? There's no one, right answer. Your rankings reflect your unique situation and personality.

   - Ranking all short-term goals as #1 because they have to be done soon. This is what happens to people who don't set goals—they spend their time meeting their immediate needs, without having time for the larger, longer-term goals. As you prioritize, temporarily put each goal's time horizon out of your mind. You may have to defer things that would be nice now for the things you really want later.

5. **Make plans to support your goals.** Realistically, you can work on only two or three goals at a time. Take a closer look at the must-do-this-or-else category, and select a few on which to focus. Review each goal to make sure it meets the SMART criteria, identify the resources you will need, and break down each goal into specific steps.

No matter what you focus on, the single most important aspect of making a financial plan and setting goals is getting started *now*. Once you've set goals, revisit them regularly to check your progress. Achieving your financial goals takes motivation, commitment, and discipline, but now that you've begun the process, you can move forward with confidence.

