MANAGING MONEY 101: A PARADIGM & PRACTICES

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[1] The sections marked with an * are adapted from an unpublished manuscript tentatively entitled Finding My Island: Stories From My Life, 2011.

INTRODUCTION

Money and its management for most of us is complicated. We value it highly, wish we had more of it, believe if we did, we'd be happier. While often we get pleasure from spending it on a night out or on some purchase or on a gift, the actual management of it – budgeting, keeping track of it, investing it – is more often a source of frustration and anxiety than pleasure. That's true even if we're single, doubly true if we're married. (I read somewhere that finances is the area of greatest conflict in most marriages.)

When we look around us at others, we notice that in this area of finances, people otherwise intelligent, educated, good hearted, screw up much more frequently than you'd expect. Economist build their theories around the "rational decision" maker, but the results of most people's money management is often irrational.

It's my observation that just about everyone agrees …

- It's better to live within your means,
- That saving is important because Social Security will not be enough,
- That your budget should include contingencies, because crises like broken cars or medical emergencies happen regularly
- That education is more important than clothing and luxuries
- That having time with your family is more important than working two jobs to sustain a big house and multiple cars.
- It's better to generous than stingy,
- That money should support a good life – not be a major worry

Most would also go further and say that while money is important it should not rule your life. It's absurd …

- To marry for money or choose friends on that basis
- To work in a job you hate just because it pays more
- To let your self- worth get tied to "keeping up with the Jones"
- To think that "he who dies with the most toys, wins"

Yet the sad reality is that most Americans aren't living within their means, aren't saving enough, are often in jobs they would never do except for the money. They are less generous than they think. They spend most of their money in ways that do not reflect their values or give them much happiness.

This isn't because most people are compulsive spenders, awful investors, or mathematically handicapped. Most people are responsible, thoughtful, capable of arithmetic and capable of good decision making.

The problem, I submit, is that they are not clear on their values, what they want to accomplish, and haven't developed the tools to implement their intentions. Most of them

haven't learned to make good decisions across time or avoid fixed obligations that later preclude expenditures that are more important. The paradigm (or strategy) and practices which they are following, which they probably absorbed from their role models, are getting them into trouble.

My objective therefore is to share an alternative paradigm and spell out some practices useful in applying it to the real world. What I share comes from my own personal experience. It has worked well for me and it seems to have worked well for some of the people who have asked my assistance in getting their finances in order. It is congruent with what I've learned as a professor of finances in business schools and the best advice in books on personal finance which I have read.

I trace both the paradigm and practices to my parents. Though their situation was dramatically different from most Americans and their financial challenges extreme, they did a superior job and it's their example I've tried to translate into the paradigm and practices I recommend.

While I have been lucky to accumulate and manage more wealth than my parents ever had and while it is likely that my own children, nieces and nephews and their children will benefit and add to that wealth, it is my great hope that the philosophy we inherited will get passed down through future generations.

That's why I begin with "Ken and Elizabeth's Example", which describes their practices and philosophy.

The section which follows then describes two paradigms that are intuitively reasonable although they lead to significant differences of behavior. The "Optimize Spending" paradigm strikes me as the dominant, if largely unconscious, paradigm of most Americans. The "Net Producer" paradigm is the alternative paradigm I recommend, arguing it leads to a richer life, is ultimately more adaptive and satisfying.

In the section How To Live Within Your Means, we get into Practices, how to go about budgeting and managing spending so that you make smart decisions that help you achieve your objectives.

If you become a "net producer" you are forced to become an "investor", an investor both to grow your savings and a "social investor" to give to others in a constructive section. The final section suggests an principles and practices that have been useful.

Finally in the Appendix for those who want to see the practices of budgeting in action I have included a case study that illustrates them.

KEN AND ELIZABETH'S EXAMPLE*

Let me begin with my parent's example because I suspect their financial situation was significantly harder than 90% of the population. If their strategy worked under their difficult situation, it almost surely can work for the great majority who start with more resources.

Ken and Elizabeth Strachan both had graduate degrees, and the talent and leadership ability necessary to be very successful managers. However, they felt their calling was to serve as missionaries in Central America. For most of his life my father was General Director of the Latin America Mission, which grew to include a major hospital and clinics, day care centers, seminaries and schools, radio stations and publishing houses. The LAM, as the mission was known, also conducted evangelistic campaign throughout Latin America.

My mother while raising six children, taught an adult Sunday School, helped establish a K1through High School for poorer families, and wrote a number of books in between her mothering duties. After my father's death, she went back for a Masters in pre-kinder education, established a program to train kinder teachers in Costa Rica's leading university, lobbied for early education of children, and promoted a network of day care centers in the poorest areas of the city. Both my parents died in their 50's while their six children were still in school.

Though they were responsible for managing millions of dollars, their income was very low. In the LAM each missionary family, no matter its position in the hierarchy or tenure, received the same salary – one that depended on the number of people in the family. While I was growing up the salary, or living allowance as it was called, was $100/mo per adult and $25/month for each child. Our annual family income therefore in the 1950s was $4,200 a year. In 2010 dollars that might be equivalent to a yearly income of about $35,000 for a family of eight.

Our family lived on that – food, rent, clothing, education, vacations. Unexpected gifts which sometimes came at Christmas probably added another $200.

My folks' approach to finances was the following:

The first 10% of income was "tithe". Even though they were already giving their time to helping others, they believed the Bible teaches the first 10% belongs to the Lord. Some of this was given to the church, but most went to people with greater needs than ours.

The second 10% went into a "savings account" – put away for emergencies, for the kids' future education. When as the eldest I was given a scholarship for high school in the United States, my plane ticket up to the States used a significant portion of that savings.

The rest was divided into envelopes, my mother's way of budgeting:

- The food envelope was designed to make sure we always had plenty of milk (the "perfect food") even if at the end of the month, bananas growing in our back yard began to replace the meat servings,
- The envelope for rent and utilities was emptied at the beginning of the month to ensure we didn't fall behind on rent.
- The education envelope was next in priority, to cover school fees, books, uniforms if necessary.
- The clothing budget was minimal and supplemented by gifts of second clothing and hand-me-downs that rarely thrilled us.
- Most travel was by bus. Early in the 50's we used a car we were given but at one point had to sell it because we couldn't afford the insurance, gas and repairs.
- There was even an envelope for vacations and special events and every year generally had a vacation up in the mountains or down on the beach of Costa Rica.
- Each of us got to request one Christmas gift within a predetermined price range, around $10 dollars. Most of the other gifts that friends in the States sent, Mother persuaded us to use for gifts for poorer families in the Church. I have memories of helping her distribute these on Christmas Eve.

From earliest age we learned to wash dishes, set the table, sweep the floor, mow the lawn, clean rose beds and had regular chores around the house for which we received a very small allowance. In the summers and after school, we were encouraged to get paying part time jobs. From both our allowances and paychecks, we were taught to set aside 10% for others and at least 10% for savings. There was no question that college and higher education would follow high school and we'd have to get scholarships and work to pay for it.

Mother frequent told us "Neither a lender nor a borrower be." Debt was not an alternative for the family or in the Mission's finances. If we purchased anything it was because we already had the money. She didn't let us borrow from each other. If we had an obligation it was critical it be paid on time.

What was it like growing up in such a house? What philosophy regarding money did we imbibe in this atmosphere?

We were taught first of all that you don't make your decisions because of money. Your work, the focus of your efforts, should reflect your mission. Letting the love of money rule your life is evil, pursuing wealth is not the way to get into heaven or be happy.

We were taught that God always provides what is needed, but "to whom much is given much is required". God takes care of those "that take care of themselves and others." He counts on us to be his hands and feet on this earth, to be "good stewards" of what we're given. This idea mainly applied to how we spent our time and what we did with our talents, but it also covered any money that came our way. Learning to be a good steward of money was part of a good education.

Money was scarce and we knew you had to be careful with it. Compared to most of our friends and relatives, we were poor, but compared to many others in the world, we were well off, could afford to be generous.

COMPETING PARADIGMS

Optomize Spending vs Net Producer

My guess is that most modern people if asked to describe a paradigm for managing money that makes for a happy life would come up with something similar to what I'm going to call the **"Optimize Spending"** paradigm. The challenge in life is to take the money you earn over the course of your life or have inherited and spend it in a way that maximizes your happiness.

Yes, you save enough for your retirement -- you don't want to end up homeless after your earning days are over. But if you knew the minute of your death and had no relatives you wanted to inherit, the smart thing would be to spend your money so that you spent your last dollar as your life expired. Money is to be used. As the saying goes "You can't take it with you."

Obviously if you have children, you invest in their education just as your parents invested in yours, and you hope they will pay it forward to their children, your grandchildren.

If you expect to get a raise and make more money down the road, you're willing to use credit cards in order to bring forward expenditures like a bigger house, nicer car, or vacations that will add to the quality of your life. It's important to take full advantage of the things money can buy while you're young and healthy enough to fully enjoy them.

If you are making more money than your grown children and have amassed some wealth, the smart thing is to subsidize their life style. Why wait to inherit them when they won't

need it? Make it possible for the grandchildren to have nice things even if their parents are not able to afford them.

This paradigm is logical and hard to argue against. However, I'd like to advocate an alternative I've labeled the **"Net Producer"** paradigm. Although it has taken me some time to get it clear in my own mind, I now realize that this is how I would translated my parent's paradigm into non-religious language. It's the paradigm I hope my children and grandchildren and great grandchildren will live by.

The focus of this paradigm is not on "consumption" but on "production or contribution". The objective is to be a "Net Producer" over the course of your life, to produce more than you consume, to solve the problem of over accumulation of savings by being a "net giver" to others and society.

As children we are all "net receivers" and in our retirement we will probably consume more than we produce. That means that during our productive years we need to "produce" more than we consume, enough to repay our childhood consumption, perhaps by paying it forward to our own children, and we must "save" enough for our retirement years so we are not a burden on them. At the end of life we want to be able to look back and say, "I was able to take care of myself and my family and give to others, I was a net contributor."

Being a "net producer" has five important derivative objectives. Let me list them and then describe them more fully:

- Become the most effective producer you can be.
- Become a smart and frugal consumer
- As a saver become a smart investor
- As a net giver become a smart philanthropist
- As a parent raise "net producers" in a society that emphasizes consumption.

Be an effective producer.

This means fully developing your skills and talents and your capacity for hard work. You follow a personal strategy to understand your talents, fully educate yourself, get the skills and habits that make you successful in jobs in a profession or business or non-profit roles, or in whatever arena you choose, be it mothering, or as an artist, musician or writer. You are not afraid of menial work or to experiment at new things, recognizing that that's the way you get to know yourself.

You pay attention to market feedback from others for clues as to what you're good at. Recognizing that what you become is more important than what you do, you are willing to change roles to cultivate under-developed parts of yourself.

Be a smart consumer.

Recognizing that the quickest way to ensure financial freedom and independence is to need little, you learn to be frugal. You also know that to live within your means requires making tradeoffs and delayed gratification, so you learn to manage yourself along those lines. That means cultivating enough self awareness that you understand the roots of your desires for certain purchases. You accept that your wants and needs are all legitimate feelings, facts of life, but you are smart enough to recognize that the things you want to buy may, in fact, not be the best way to deal with these desires. Feeling lonely is legitimate; believing a hot chocolate sundae is going to meet that need is dubious.

You accept that tradeoffs are real. If you're a missionary you live on a missionary's salary. If you're an artist you adjust your lifestyle to what you earn from your art, same for doctors, teachers, and business people. It doesn't mean you try to spend all you make, but it does mean you don't spend what you don't make.

Be a good saver and investor.

Since an important part of being a "net producer" is saving it also means you learn to be a wise investor, discriminating about likely returns and risks and probabilities. You learn to avoid paralyzing fears that keep you from investments where the risk return ratio is good. You learn that if an investment is too good to be true, there is a real chance you're being suckered into a scam. You learn not to get euphoric or despairing as the stock market goes up and down.

In a later section I'll share some stories of experiences with investments and what I've learned.

Be a good giver.

Giving is also a part of being a "net producer" so you learn to be a good social investor. Generally your giving is far more effective if accompanied by your own effort and time so you give not just of your money but also of your time and talents, which may also be more plentiful when you're young.

You learn to give in a way that preserves the dignity and bolsters the self esteem of the recipients, perhaps by some form of contribution from them to others. I've given all my nieces and nephews a partial scholarship for college but to get it they have to submit a plan each semester which covers not just the courses they'll be taking but their objectives re exercise, sports, extracurricular activities, social service and part time work. At the end of each semester I ask for a report. If they fail to meet minimum results based on

their capacity, the scholarship is suspended. If they exceed expectations in grades and accomplishments, they can earn a bonus.

Raising net producers.

Finally if you want your children to perpetuate the family's paradigm you have to learn to raise children as net producers. In the face of a dominant social paradigm that emphasizes consumption that's not easy.

The reality, of course, is that this means you have to lead by example. They will learn what you do not what you say. Talking frugality but practicing undisciplined spending teaches undisciplined spending.

However, kids also need to practice skills in order to develop them. Chores at an early age teach work habits. Increasing work and linking it to an allowance which they earn is a great way to start. You set them up for success not failure by limiting their first allowance to small purchases. Later it may cover clothing and school expenses and bigger purchases like a bike. If one of your child is a saver and the other a spendthrift, you don't let the spendthrift borrow from the saver but make him or her live the consequences of a poorly spent allowance.

You share with your kids family decisions regarding a new car or sound system or Jacuzzi or vacation and get them involved discussing the tradeoffs. You encourage them to save and help them invest alongside you.

When my kids were still in high school they began to managed their college savings under our supervision. I sat down with them and told them they should not count on an inheritance but that my objective was to save enough to cover their college education. I was saving in order to be financially independent at 50 so I could take a job for $1 / year for my "public service" and not be a burden to them or anyone else during my retirement years.

Furthermore, I was going to give it them their college money while they were still in high school and we'd invest it together. They would commit to pay all of their college expenses from these savings and not ask me for any money while in college. Anything they earned or saved from these monies was theirs for graduate school or as a down payment on a house after college. We did agree that we would adjust the amount of their college fund up or down depending on the expense of the college to which they were admitted. I didn't want finances to determine the school they attended as I wanted them to go to the best they could get into.

Both decided to invest most of their college fund alongside me in private equity with Bain Capital. They did well. When they went off to college each year they'd prepare

their budget for their needs and this was transferred from their savings into checking current accounts. We'd reinvested what was not needed for that year's expenses. They kept their side of the bargain, managed their finances well, and never asked me for extra money. They each graduated with a small nest egg of their own.

I don't plan to subsidize a higher life style than my children can afford from their own earnings even though I have begun to inherit them early for tax reasons. The principal reason I want my adult children to live on what they earn, not what they inherit, is that I believe it is very hard to raise children with good money values in a household where the parent's lifestyle exceeds what they are producing. Even when the parents can't be spoiled by too much money, their children can. There is something very healthy in being raised in a family where you realize that you can't have everything you want, where you have to work to get an allowance, where you participate in the struggle to live within the family's budget, where you have to work at outside jobs to buy things you want. The damage of trust funds often shows up, not in the children, but in the grandchildren.

Clarifications.

It may sound from the above that I think it is important to make a lot of money. That is very far from my opinion. I actually believe money should be a relatively minor determinant in the work you choose and do.

One of the reasons I favor the "net producer" over the "optimize spending" paradigm is that I happen to believe that material things contribute relatively little to our happiness and growth. Owning things generates much less happiness, in my experience, than cultivating relations, being active, reading, and living in simplicity. The pressure of having to make more and more money is that it gets in the way of the activities that help foster this personal growth. One of the main benefits of a simple life style and frugality is that it makes it less likely that you'll end up a slave to work or to taking care of things and thus have time for the other important things in life.

The clutter of so much stuff in our life is one of the big negatives of American materialism. Everything you own has a cost and a benefit. Very quickly the cost of multiple shoes, suits, shirts, appliances and other things begins to exceed the contributions they make to your happiness. At one point we sold our 10,000 sq foot three story palatial home filled with huge amounts of furniture, velvet curtains and twenty years of accumulations and I moved for several months into a sparsely furnished small apartment in Costa Rica with only two suitcases of clothing, personal effects and books. I found the simplicity and lack of clutter wonderfully spacious and freeing. I enjoyed the few things I owned, developing for some of them a real sense of affection.

Having emphasized that the money you earn should not be the determinant in your decisions, I do not subscribe to the romantic idea that it should be ignored. I believe in

market feedback. It helps you focus on things of value to others. If no one buys your art or reads what your write or wants to fund your nonprofit ideas, that is as relevant as if no one wants to buy products you are manufacturing or your services.

Why the net producer paradigm is superior?

While the "optimize consumption" paradigm is reasonable and is held by a number of friends who are smart and whom I respect, I'd like to make a strong, very strong, argument in favor of your adopting the "net producer" paradigm for yourself. Why?

First, your role as a "producer" will help you realize yourself and live a much happier life. Although it sounds grandiose, each of us has a unique set of talents, a unique set of life experiences, lives in a unique place and time and therefore has a unique opportunity to make a contribution. We each, in Covey's language, have a mission. I'm convinced that one is happiest and most fulfilled if one can realize that mission. It's a work that stretches us but also reflects our passion. It's a work that helps us develop our full potential. And very often it's a work that because it is so valuable to others, earns us resources that permit a comfortable life.

Second, the work required to be a net producer, is an important part of a superior education. Work should start early in a child's life with chores around the house. It should include jobs for pay during the summer and perhaps even part-time work during their school and college years where workplace skill and discipline are learned. It means getting an education that fully develops talents and skills of all sorts so that we get good at the career or job we choose.

The pressure of having to work forces us to do things we would not voluntarily have chosen to do and we discover afterward how much we learned and grew as a result. Waiting tables, washing dishes, and painting houses during high school and college, selling during the summer, teaching extra classes in the Army, managing finances for the Harvard Development Services during my doctoral program, were not things I would have done if I hadn't needed the money, but they were as valuable as what I learned in the classroom. If I'd been a "trust fund baby" I'd probably not done them and as a result would have been a much less complete person. I used to envy kids from wealthy families who had plenty of money to spend and no pressure to work. Now I realize they should have envied me all the experience and skills I gained working. I don't think it's a bad thing for children to be under to pressure to make money.

Third, work not only teaches skills, it turns out that in the work environment is where you get some of the most valuable feedback on your weaknesses and mistakes, what you need to change in order to be more effective. The formal and informal feedback I got in selling, teaching and consulting and in all my jobs forced me to confront weaknesses and

recognize mistakes I could have otherwise ignored. The workplace is much more likely to sand your rough edges than other parts of your life.

Fourth , having to live within your means is also a great source of leadership skills. You have to learn to anticipate the future, make tradeoffs, evaluate the value/cost of options, become a smart buyer and negotiator. It forces you to develop skills that are absolutely critical in any leadership position. If you can't manage your own finances or are never forced to deny yourself things you want, my impression is that you are probably never going to learn the skills required of an effective leader in a world of scarcity.

Fifth, being "productive" and "living within your means" builds your sense of security and independence, your self esteem. You know you can take care of yourself even in tough situations. You learn that you are not dependent on material things for either status or your happiness. These lessons create the real freedom to follow your vision and to be generous. I work with many of the wealthiest families in Central America and in these families there are a number of non-productive relatives and children who live on inherited wealth. Almost without exception these non-productive relatives are underdeveloped as people, less happy, have a lower self esteem, and are less respected by those around them, than the family members who are producing, who are generating the wealth.

Finally, I believe children who are earning more than they consume tend to have a much healthier relation with their parents. If as a parent I value frugality and "good use of money," I am likely to feel resentful if my child takes my money and spends it on things I deny myself. They may define "good things" and frugality very differently from me and consequently feel I am trying to manipulate their choices by my attitude. So long as my money is subsidizing their living above their earnings, they are going to feel dependent on me and at some level, resentful of it. If my kids make what they spend, there is much less of a chance that money will contaminate our relationship. They spend according to their values. I spend according to mine. We both feel aligned with our values and can love and give to each other without resentment.

Guideline not commandment.

In advocating for the paradigm of "net producer" I know I can sound dogmatic and moralistic. Nowhere in the Bible, or any other religious book I know of, is there a commandment that says "Be Ye a Net Producer." I believe it's a good guideline, but I also recognize that reasonable people can disagree with me on its application.

I have many good friends, whom I respect a lot, who feel that if you have wealth you should subsidize your children's lifestyle even if they can't afford it from their own income. They argue "Harry, if on my death my kids are going to inherit money, why not

let them enjoy it much sooner than my death. Doesn't money exist to be spent on good things?"

I understand their arguments but paradoxical as it may sound, I believe that the payoff from my children living under the pressure of making what they spend is better for them and for my grandchildren than what they suffer from not having the "good things they miss".

I don't apply this principle rigidly and make exceptions for "investments" especially of an educational nature, or in the down-payment of a house whose mortgage they can afford, or on vacations we take together that I pay for, but I try to make these exceptions really exceptional and not a regular subsidy to a higher lifestyle than they can afford on their own.

HOW TO LIVE WITHIN YOUR MEANS

Being a net producer is another way of saying try to spend less over your lifetime than you make while at the same time being smart about your spending so it reflects your real values and desires. This means at a minimum at least "living within your means", something just about everyone agrees is wise advice.

How to do that probably isn't as easy as it sounds but also not as difficult as many people believe. It does require skill and tools for making two types of tradeoff. It is going to require you to make **tradeoffs in time** (spending now for example versus spending in the future, a new car now versus the children's college education later) and **tradeoff between different types of expenditures** (housing for example versus vacations, nicer clothing versus meals out).

I'm going to recommend a simple model for thinking about tradeoffs over time that help you estimate what you can afford by way of a standard of living now. Then I'll talk about a way of preparing a simple annual budget that will help you get the biggest bang out of whatever your net income permits.

Tradeoffs Over Time

Let's start with an assumption that you want to be able to maintain a standard of living, that it is unpleasant to have to cut back spending, give up things you have become accustomed to. If you make more money than expected, you want to increase your spending in a smooth sustainable way that permits you to enjoy each increase. (An personal example. When I returned to the United States as a professor we could afford a Toyota Corolla. When I became a Bain consultant and was suddenly earning considerably more than I had as a professor, I could make my saving targets and still

afford a much nicer car, even a Mercedes had I wanted it. Figuring I get more pleasure from regular upgrades than one big jump, I planned instead over a fifteen year period on going from my Toyota first to a Nissan Maxima then a Lexus Sedan and finally the Mercedes. Each new car every three or four years gave me a sense of significant upgrade and more pleasure than had I jumped immediately to a Mercedes.)

Planning your finances over the course of your life sounds impossible but a rough picture which can be tweaked over time is better than no picture at all and quite feasible. Let's assume (to match the specific example in the Appendix A) that you are a recent graduate starting out on your career. You have a girl friend you hope to marry and you've already discussed having kids whom you hope to send to college. Both of you have careers in mind. Say one of you is an executive working in a large corporation with expected significant pay increases over the first fifteen years and then a leveling out until retirement while the other is in a nonprofit environment where cost of living adjustments are likely but where you'll reach your steady state salary within five years.

Just as there is a life cycle curve to your earnings, there is an expected curve to your spending if you want to keep it constant. Having graduated from school, no longer a poor student in the dorm supported by your parents, you're on your own, earning a good salary, living in your own apartment. You can afford a standard of living we'll label S. You marry and there are now there are two of you. As you move into a bigger apartment find you need two cars you discover that two cannot life as cheaply as one, just to maintain the same standard of living both of you together now need 2.0S. Fortunately since both of you are working you income has also doubled.

Some time down the road you want three children and you find as they come along that each adds .5S to the family needs and the overall budget during their childhood jumps to 3.5S. One of the important decisions you make is whether one of you is going to stay home full or part time to invest in raising the children a tradeoff that reduces income but may be more important to you. You also know in advance that you want them to go to private schools in which case they cost 1.0S and college 1.5S. Fortunately they'll graduate, no longer part of the family budget and you and your wife can return to the 2.0S level of expenditures, perhaps at the same time as both of you work your final full time years.

In retirement you hope to be able to maintain your standard of living, shifting how you spend your money to permit more travel and leisure activities but now having to live from your savings and social security.

On a simple spreadsheet we can model out both your likely annual income over time in constant dollars and your likely needs in constant dollars to maintain your standard of living. Making assumptions about the net return after inflation on savings we can project your savings and then calculate the standard of living (S) you can afford.

Tradeoff Over Expenditures

Let's focus now on how you spend whatever is the Standard of Living (S) you can afford.

One way of calculating that is the model described above, but that can have a large margin of error so it's not a bad idea to assume as a rough rule of thumb that the income now we have to spend is what we are earning now after at least saving 10%. This is a good rule of thumb that has worked well for many people.

The budgeting process I'm going to suggest is the following:

Step #1 Calculate your "net income" accurately

Most people have a "gross income" from which taxes are deducted so that there "net income" is close to the amount of money they see in their "take home paycheck". However if you're self employed or in a job where you have to cover all your work related expenses and taxes, then to calculate your "net income" you need to subtract from your "Gross income" the amount you need for income taxes, social security contributions and work related expenses like agent fees, office or car expenses related to your job. If both of you are working and that requires daycare expenses for the children, this also should be subtracted to determine "net income."

Step #2: Allocate the first 20% of net income to "Savings" and "Others". Set up an automatic deduction, if this is possible, and have the 20% sent directly to your Savings account in the Bank and an account for Others where they start earning interest. The Savings is for your retirement, for down payments on your house when you buy one, for unexpected needs and contingencies, not for your living expenses. "Others" covers your contributions to charity, gifts you want to make to others, help you want to give those in need. Some religious people call this "Tithe" and give 10% to the church in obedience to their faith.

Quite apart from any divine commandment and even if non-religious, I would argue to allocate part of what you earn whether it's 5% or 10% for the United Way, or for your alma mater, or for worthy charities is an enriching habit, even more enriching if you set aside a part of your time for the same purpose. This is a habit you want to get into early, even when you feel you hardly earn enough for yourself. It's also something I'd encourage you to make a part of your children's experience with their allowances and pay checks.

Step #3. In preparation for budgeting decisions collect estimates of your spending needs.

The remaining 80% is your "standard of living budget". To allocate it wisely you need to understand what you are currently spending, the minimum you need, and what would measurably improve the quality of your life. Then these amounts need to be organized into categories that can be related to spending decisions.

In the example of a budgeting exercise we present in Appendix A the expenditures were organized into the following nine categories: Housing, which included rent or mortgage payment, condo fees, utilities; Car and Transportation, car payments, gas, tolls, car insurance, repairs; Medical, health insurance, doctors, dentists and medicines; Food and Supplies for the house which tend to be purchased at the supermarket; Entertainment and Food Out; Personal spending, clothing, communications and professional expenses for cell phones, computers and other expenses associated with their work; Vacations and Gifts; and finally Contingencies , for all the unexpected.

1. **Current spending.** If possible collect real data on what you are spending using your checkbook and credit card stubs for the past year. Most people underestimate what they are really spending if they don't do this.

2. **Minimal Budget** If you are in a financial crunch, I suggest you go through the drastic exercise of calculating the minimal amount you really need. What if you were only earning one third of what you actually earn, how would you spend it? This exercise may strike you as so unrealistic that it's a waste of time, but it will actually give you a good sense of what you really need. It will show you that you have much more freedom of choice than you may think. A home that you own is not a necessity, much less a second vacation home. If your income was close to the poverty line, what is the minimum you'd need for housing – rental of a room in a house, or a small apartment in the least expensive but safe part of town near public transportation. Think through what it would cost if you ate simple foods, prepared at home, wore clothing bought from Good Will. A car is for most people not a necessity -- what would it cost if you used public transportation and a bike? What is the cost of public schooling for your kids or the cheapest daycare available? Add it up and you'll probably see that with good management you can live on much less than you are currently spending. Everything which costs more, then, is really a discretionary decision on your part, an allocation or tradeoff you're choosing freely. These are the choices you want to make in a way that enhances your life and reflects your values.

3. **Desired budget**. Now go through an exercise of imagining what it would cost to have the housing you really want, the clothing, money for eating out, private schooling, or any of the other things that you think would add measurably to the quality of your life. This is not a day dream exercise of what you'd do with a million dollars but rather an attempt to visualize the cost of improvements in your life that you know would make you happier.

Step #4: Prepare a budget for 80% of net income that will maximize the quality of your life and reflect your values.

Let me suggest that in your budget you think about two types of expenditures. **Close to the Skin Expenditures** are rarely the biggest but they are generally discretionary, can be turned on and off, and often give the most pleasure. **Locked In Expenditures** are generally the biggest and once you make them they are very hard to change. They are mainly housing, cars, private schooling and tend to set your Standard of Living. They are the ones which, in my experience, can get people into trouble.

Start with the discretionary **Close to the Skin Expenditures**. Before you focus on your car and housing take an amount of money that permits you to have dinners out, go to shows with friends, buy books, buy some nice clothes, have cable TV, talk with friends on the phone, and take a regular vacation each year. These are rarely the big items in the budget but they are the ones that enhance the quality of your life.

Budget these first because they are also the easiest to turn on and off, to give up if they stop giving you pleasure, or if you suffer a setback in your income. If two of you share the same budget don't forget to budget some amount for spending money that doesn't have to be accounted for, that each can spend as they like without feeling guilt. However if you do this, it is important that both of you agree to keep expenditures within that amount.

Once you have calculated the incremental cost of these smaller expenditures that add a lot of quality to your life, then you can estimate what is left over for the big fixed expenses like housing, cars, second homes, private schooling, etc. These are your most important budget decisions. These choices can add wonderfully to your life, but they are also the ones that trap you into "living beyond your means."

I call these big fixed expenses **dangerous** for two reasons: First, because once you have made them, you've locked yourself into a set of ongoing expenditures which are very hard to reduce or eliminate without significant loss. Second, they are dangerous because the cost of these decisions is often greater than what appears on the surface.

Housing. It is easy to think that you can afford to buy a house if the mortgage payment is only slightly more than what you would otherwise be paying for rent. In a recent case, a young couple, decided to buy a house because the husband had a new job with a raise and the mortgage payment was only 40% higher than the rent they were paying. Part of their increased payment they believed could be justified as an "investment". To their surprise, almost immediately the new house put them under financial stress. They were no longer living comfortably within their means. It turned out that when they added in the taxes on the home, insurance, their utilities and heating bill (previously covered by

the rent), and the maintenance on house and lawn, they had in fact doubled their "housing consumption" even accounting for the "investment" portion of their expenditures.

It is true that houses appreciate in value and the mortgage payments have tax advantages and that the payment of principal is a form of savings. But the reality is that houses appreciate much less than people think and the lost investment income on the down payment is generally greater than that appreciation. What often happens is that when people move out of rented quarters into their own homes they unwittingly increase their "housing consumption". If this is not a conscious allocation of discretionary income that greatly increases the quality of their lives, it can be a mistake hard to correct. A good rule of thumb is that if your total housing is more than 30% or 40% of your net income, you may be making allocations that don't add enough to the quality of your life.

Automobiles. The real cost of a car is even more hidden that that of a house. Why? Because it includes the "depreciation" each year in the value of the car, the "lost earning" on the money tied up in the car, and the expenditures in taxes, insurance, parking and repairs. Gas may only take $ 50/month out of the budget but when you add in all the other costs, you can easily be spending over $500 to $1000 a month on a car. If you live in a city like New York with public transportation and taxis, it is probably cheaper to use these forms of transportation and rent a car on the weekend when you need to go out of town than to own your own car.

Step #5: Be conservative in your assumptions but reward yourself if you beat your budget. My mother had a phrase "Don't muzzle the ox that treads the corn." If your income exceeds what you were counting on or you under-spent your budget, reward yourself. Learn how to splurge responsibly, spend joyously. Each year when my kids were young, we'd plan a "reward" for ourselves if I got a good bonus, perhaps a Jacuzzi or new sound system or special vacation. The important thing, though, is make sure before you spend it, you have earned and saved it.

I have a wealthy friend who has found an ingenious way to both enjoy his money and at the same ensure that he shares his good fortune with others. As his income has gone way beyond his budget, he has learned to give himself luxuries (a beach house, first class tickets and now a private plane.) But for every luxury he buys himself and his family, they set aside an equivalent amount to add to their budget for Others. Recently he began to give away triple his luxuries. He is still careful to get value for his money, still values frugality, but he is also learning to really enjoy the abundance he has earned and at the same time share it with others.

Keeping Track of Your Money

It's my experience that many people swing between two extremes when it comes to keeping track of their expenditures and finances. Often they keep no records, and as a

result have no idea where their money is going. While it's in their pocket or checking account, they feel free to spend it, and when they have to start paying down their credit cards, they suddenly realize they have exceeded their means and are in trouble. But they have little sense of why or where they overspent. This will often lead to the other extreme, people feeling they have to keep track of every single cent spent, which quickly becomes such a hard job, with so many mistakes, that they get discouraged and give up.

One of the reasons I like to set my standard of living comfortably within my means is that I don't want to have to spend a lot of time thinking about or managing money. I want to use my time on things that are more productive and more fun. I don't even want to have to keep the running balance of my checking account up to date if I don't need to. Over the years the cost/efficient systems for me have been the following.

I invest time in putting together a budget that is within my means and make sure that I am spending my money where it is most aligned with what I value and adds to the quality of life of my family.

I make full use of automatic deductions and transfers from my paychecks and the account into which it is deposited to cover regular expenses. At the beginning of the month savings and others, car payments, rent or mortgage payments are automatically taken out and paid. What's left in the checking account is that part of my budget whose monthly total I know. My bank generally demands or I choose to keep a certain amount in the checking account. I try to use checks or credit cards that leave a written record of the big expenditures should I need to know where the money is going. ATM withdrawls generally correspond to the sum for discretionary amounts.

When the bank statement comes, once a month, I take the time to make sure that the checks are mine, haven't been forged and that all my deposits have been recorded. I look over the expenditures to make sure nothing unusual is happening. If my checking account balance is roughly in line with what it should be given the budget, then I don't feel it's necessary to do a detailed reconciliation of my actual to budget expenses.

Only when something is out-of-whack do I set up a spread sheet and analyze where I exceeded the budget and try to isolate the problem. In other words, I manage by exception and only worry when I'm exceeding my budget and need to pay more attention.

The Envelope Solution

If your net income is such that it is tough to stay in budget or if you have trouble controlling your propensity to spend when you have money in your checking account or room on your credit card, then I suggest "the envelope solution".

Close down your credit card. Take the budget for your regular out-of-pocket expenditures in cash and put them into physical labeled envelopes that reflect the monthly budget. Take money from the appropriate envelope as required. When you've run out of money for that item, you'll know right away.

Friends, a young couple jointly making $400,000 / year, recognized that in spite of their very high income they were spending virtually everything they made, not saving for the time when the wife might want to cut back on work and start a family, not paying down the mortgage on a lovely home they had brought, not frankly much happier than they had been as poor graduate students in school spending less than a tenth of what they now earned.

Neither was good at resisting temptation for impulse buying, so they set up their budget with envelopes, shut down their credit cards and became prodigious savers and at the same time increased the expenditures that really gave them satisfaction. They are now saving more than half their income and within a relatively short period of time will be free, if they want to, to cut back on their intensive work schedule and have a family or spend time on personal projects.

INVESTMENT STRATEGY

Let me begin this section sharing some stories from my own experience that taught me valuable lessons.

Head and Soulders Investing*

In the doctoral program I played tennis with a classmate who later became Dean of one of Canada's leading business schools. At the beginning of almost each game he would tell me how much money he had made on the stock market that week. He had about $30,000 and was in and out of the market in what today would be called "day trades." He was a "technical" investor making his moves without knowing much of what the company did or its performance. He worked off of charts of recent stock market prices and volumes. He was paying his way through the doctoral program with his earnings from the stock market.

I was intrigued, but did not understand how the different "formations" on which he based his decisions could possibly predict future stock prices. After a semester of his considerable success, though, I asked him to give me a tip for $500 of hard earned savings. "When you have something sure, let me know."

The next time we played he told me "I have something sure – Diamond Shamrock – it's just completed a "head and shoulders" formation. Within six months it will probably have doubled."

"What's a head and shoulders?" I asked and he explained. Though it made no sense I went out and purchased the stock at something like $21 / share. Within several weeks the stock was selling at $13 / share. I held it for many years during which it bounced between $5 and $13 / share. I finally sold it about 10 years later for less than half of what I had invested.

So long as I had this stock in my portfolio it was a powerful reminder of a lesson that was easily worth the money I lost – "Don't invest in businesses that make no sense to you!" I promised myself I would not invest in "tips" where I could not see a good reason for appreciation.

Year later friends urged me during the dot com boom to invest in companies valued at multiples of their revenue even though these companies were losing money and not projected to make money for some years. I avoided these investments because no theory of valuation I understood suggested these stocks were worth what the market was paying. As a result when the dot.com bubble burst I was saved significant losses.

There is a saying on Wall St that "Bulls can make money, Bears can money, but Pigs generally lose money." Get rich schemes almost always will lose you money. If it's too good to be true, it generally "ain't true".

Asset classes for Investments*

Early in my career as a consultant a client came to Bain asked us to help him figure out how to invest the half a billion dollars he'd received from his family in a split up. He wanted to know how wealthy families had done this in the past and the best investment vehicles in which to hold wealth. I was asked to oversee the project.

We decided on two studies. Part of the team went back to business magazines in the 1920s and 1930s that had published articles on the wealthiest families of that time, and compiled a list of about 35 wealthy families, like the Rockefellers and Fords. We created a record of what had happened to that wealth across time, how it had been invested and what it was now worth. Since these fortunes had been split among heirs or placed in foundations that wasn't always easy. The discouraging results from this first study was that less than one third of the families had managed to maintain or grow their wealth in real terms (after inflation) and there was no single pattern of investing among the more successful. Making wealth grow isn't easy.

The other part of the team took historic data from 1920 to 1980 on the various assets in which wealth can be invested and held: equity stocks, bonds, bank saving accounts, commercial and residential real estate, gold, art, etc. This team divided the data on each asset class into twelve five-year periods. For each period we calculated the "nominal return" on that asset class, dividends plus appreciation minus holding costs and fees. We then estimated taxes and calculated the "after tax returns" since certain assets groups paid higher taxes than others. Finally we deflated these return by the effect of inflation calculating the "after tax return in constant dollar."

The conclusions from this study were more interesting, but also discouraging. There were five-year periods in which every class of assets had generated attractive returns, but very rarely did the best performing asset of one period do well in the period which followed. It also appeared that "intermediaries", the brokers and dealers managed to take significant portion of any gains in the underlying assets in the form of fees or "carry". Owners of real estate, for example, did significantly less well than the developers of real estate. Owners of hotels did significantly less well than the franchisors managing the hotels.

Our study showed that **real estate** had a high carrying costs and was a much less attractive long term investment than conventional wisdom suggested. The average net after tax returns in constant dollars for the twelve periods was very close to 1% per year.

Buying your own home so long as its cost is roughly equivalent to what you'd be paying in rent can be a wise investment. It has good tax treatment, it often provides psychic income, and it is forced savings for people who have trouble being disciplined about setting money aside. However second homes, time sharing condos, are almost always expensive consumption and not savings.

A particularly prevalent misconception for many people is the average appreciation in real estate market. People see home prices rising by about 5% to 10% above inflation for a four or five year period and think that is the average appreciation and stampede into buying houses or real estate before it goes up. In fact studies show that most appreciation in real estate is during relatively short periods followed by relatively long periods of stagnation or even dropping prices. If the real estate market has been having high growth in prices over the last five years, and you are feeling desperate to get into it to take advantage of the future appreciation, I can almost guarantee you that you're making a mistake. You are probably buying in at the top of the market. Wait until the market is down or stagnant, until rentals are over 5% of the value of the real estate. That's the time to get in.

In the arena of publicly available asset classes, **equity stocks** are probably your best bet for holding wealth over the long run, better than bonds or savings accounts. In our study the best performing asset class over the entire period was equity stocks. However even

for this class the returns averaged less than 2% per year in constant after-taxes dollars. **Bank saving accounts** and **bonds** were close to 1% per year.

The average returns on art and gold were actually negative in part because of their high carrying costs. **Art**, unless you are skilled art dealer, is consumption, not investment. Stay away from **gold** except in very exceptional circumstances.

The combination of taxes (always figured on nominal income) and inflation made it very difficult to earn real money on savings. Our study suggested you were lucky if you earned enough to preserve the money's original value. The average person with only access to public vehicles in which to hold savings has to save virtually 100% of what he hopes to consume in his or her retirement.

These studies had a great personal impact on me. They convinced me that the best investments were ones in the **private equity of well-managed businesses**. It lead me to invest with others of my partners in a "private equity fund", Bain Capital, where we had the capacity to influence the performance of the companies and focus them on things we thought would create real value.

Bain Capital in its criteria for investing looked:

1) A superior management team
2) An industry cycle working in our favor
3) A superior strategy for gaining and using dominant market share.
4) Changes in operations that could result in immediate cost savings and operating improvements
5) Financial leverage and good exit strategies.

Bain Capital's approach made a lot of sense to me. I had seen the effect of these things in the performance of our clients. But this approach also seemed more aligned with my philosophy and values. It is a lot easier to make money if you creating wealth not just speculating. And in those cases where perhaps you lose money you at least have the satisfaction of knowing that your investment created jobs and wealth or knowledge for others. At that age I knew I could afford to take the higher risks since I could always continue working and have enough to live on.

If you have a hobby or talent that gives you great pleasure and in addition might make you money, then I'd encourage you to put part of your savings into that. It might well be your best "investment".

I know a scholar who had a real knack for finding and buying rare books in odd places. He turned it into a profitable side business by finding, collecting, and then reselling these books. He made his hobby pay.

Another couple with regular paying jobs loved fixing up their home, doing carpentry, landscaping and redecorating. They'd buy an old house in a good neighborhood that needed a lot of work, fix it up during their evenings and weekends. Two years later they'd sell the house for a very nice profit, then take their money and invest it in another house to fix up. Their returns on their real estate projects was higher than on any of their other investments because they really enjoyed what they were doing and were good at it.

My grandmother Walker, a teacher, knew very little about business or financial analysis. But when she came across a product she really liked, she would investigate the company that made it, often one that was just starting out. If she thought the people running the company were honorable and competent she would buy stock in it and hold on to it for her retirement. In this way she built a portfolio of stocks that did very well. In her retirement she sold much of the stock to buy a big house in a college town, which she then subdivided into rooms she could rent out to students, which generated more income than she needed.

APPENDIX A: LEE AND NORA'S BUDGET

Let me apply my budgeting advice to an actual case of a young couple about to get married who recently came to me for advice on the purchase of a condo.

Lee and Nora are both in their mid 20s, out of college, starting on their careers. They come from middle class families where their parents have nice incomes and homes and they have become used to a standard of living that is comfortably middle class. He and she each have wealthier relatives who have promised them a small inheritance and are giving them about $25,000 in gifts for the wedding and honeymoon.

He is starting out in business with a B.A. in economics and earns after taxes $2,200 / month which he expects will increase next year to $2,500. At some point in the future he would like to get an MBA. His dream is to go to a top school away from home.

She has a degree in child counseling and a job with a non-profit that gives her an after tax income of $1,800 month. They plan to wait to start a family for two years while they cement their own relation. Ultimately they want two or three children and she would like to be a full time mother during their children's pre-school years but then go back to her career part time.

They showed me the budget they had prepared along with the information they collected for their decision:

1. **Housing.** They have been offered a condo for $160,000 that was selling for over $180,000 before the recent downturn in the real estate market. They can get a mortgage on it of $140,000 at around 8% all fees included. They estimate they need an additional $10,000 to fill it with appliance and furniture. The real estate taxes are relatively modest at $360 / year although there is a new tax law that could double them soon. The condo fee is $200/month, utilities another $120. Since they both work they have budgeted $150/month for a cleaning service. The mortgage payment which includes insurance comes to $1,200/month. Their research suggests that equivalent rentals would be in the range of $1,000 to $1200 / month but not build any savings. Apartments of the same size in not so nice condition or location are available for as low as $500 / month. Everyone in their families is encouraging them to buy the Condo which is similar to ones their best friends have received as wedding gifts.

2. **Car.** They figure they need one car and a relative in the car business has offered Lee a new high end car at cost which results in a lease payment (interest, principal and insurance) of $620 month. Car taxes are $1200 / year, and repairs per year will probably be another $480. Gasoline and tolls are around $160 / month,.

Since the first year's depreciation is roughly equivalent to the discount on the purchase price Lee believes he can probably recoup the value of the car if he sells it after one year and maybe even make a profit.

3. **Medical Insurance and medicines**: $330 month.

4. **Clothing, Communications and Professional**. Neither feels the need of buying much new clothing though both have to dress professionally for their work. They believe $1,000 a year should be enough. Their two cellular phones which they use at work but have to pay for themselves are $90/month; professional fees are another $10/ month.

5. **Food**. From the supermarket they should be able to purchase food for about $300/ month.

6. **Entertainment & Cable.** They have budgeted $125/ month for food out and events out with friends. TV Cable is another $75/ month. There is no personal money in their budget.

7. **Vacations and gifts** They don't plan any big vacations in the next two years. If they take them they will be near home where they will have the have the use of family condo on the beach. They both come from large families with many birthday gifts to buy so have budgeted a total of $200/ month for both vacations and gifts.

8. **School Debts.** Nora has a $300 / month school debt to pay off which is a form of forced savings. Since both are religious they like the idea of tithing their net income.

Their own calculations below suggest that with wedding gifts and loans of $25,000 from relatives they should be able to afford the Condo and furnish it. They believe it will be a good investment for them when housing prices bounce back. (See below Lee and Nora's Original Budget)

Lee & Nora's Budget (HWS format)		
	Original	
	Mo	*Year*
Income		
Lee's Salary after tax	2500	
Nora's Salary after tax	1800	
Committed Parental Gifts	300	
Total	4600	55200
Savings & Others		
Debt Repayment Nora's Schoolin	300	
Others / Tithe on Earnings	430	
Total	730	8760
Expenses	*Month*	*Year*
Housing	1700	
Car	920	
Medical	330	
Food & Supplies	300	
Food Out, Entertainment & Cable	175	
Clothing, Personal, Cellular & Pro	175	
Gifts, Vacations,	200	
Contingencies		
Total	3800	45600
Extra Savings/(Deficit)	70	840

Further Analysis of the Budget

Nora's eyes shone when she talked about the condo so we began by asking a series of questions to try at get what about the condo was so emotionally important. Her answers revealed that the three couples they considered their closest friends had been given by their parents a similar condo when they got married and everyone said it was a good investment. However, they did not feel they would lose status in their friends or family's eye in rented quarters as everyone knew that their parents were not going to give them a house.

Nesting considerations more than anything else, were what were so attractive to her. She thought she'd enjoy decorating and fixing up her own home. Most important, though, was the relief she would feel on having one less item on her crowded pre-marriage list of tasks – she was really feeling stressed by the logistics of getting married.

A review of their budget in greater detail suggested they might have under-budgeted certain items. They planned to have a weekly dinner date at least once a week to cement their relation, and then perhaps on the weekend go to a restaurant or bar with friends. $300 for entertainment and food out was probably closer to what they really wanted than the $200 in the budget. Their food budget hadn't covered supplies for the house and other likely expenditures at the supermarket or any money for wine and beer so that budget was raised from $300 to $400. Each also needed some pocket money at least $50/ month each for incidentals. Suits and professional clothes might also require at least a budget of $600 for each of them. They also wanted to be able to travel to a cousin's weddings and the vacation budget really didn't provide anything for that. They also had not set aside anything for contingencies and decided they'd feel more comfortable with $200/ month for that given their lack of good data for budgeting. With these adjustments it was clear they were no longer living within their means and either had to give up their "tithe" and some other expenses. (See below Lee and Nora's Corrected Budget.)

Lee & Nora's Budget (HWS format)				
	Original		**Corrected**	
	Mo	*Year*	*Mo*	*Year*
Income				
Lee's Salary after tax	2500		2500	
Nora's Salary after tax	1800		1800	
Committed Parental Gifts	300		300	
Total	4600	55200	4600	55200
Savings & Others				
Debt Repayment Nora's Schoolin	300		300	
Others / Tithe on Earnings	430		430	
Total	730	8760	730	8760
Expenses	*Month*	*Year*	*Month*	*Year*
Housing	1700		1700	
Car	920		920	
Medical	330		330	
Food & Supplies	300		400	
Food Out, Entertainment & Cable	175		300	
Clothing, Personal, Cellular & Pro	175		300	
Gifts, Vacations,	200		300	
Contingencies			200	
Total	3800	45600	4450	53400
Extra Savings/(Deficit)	70	840	-580	-6960

But they had a much bigger shortfall if they wanted to achieve certain goals they had set for the future, specifically Lee's MBA and for Nora the freedom to be a stay-at-home mom. These were much more important to them than living in the Condo and having the new car To figure out what they had to do to meet their more ambitious goals required a different sort of analysis across time.

Adjusting The Budget To the Life Cycle

So they began to visualize different stages of their life and the implications of each for income and expenses. Building a plausible scenario of their life was easier than they imagined it might be. Their life divided natural into the following stages:

- Several early married years before the kids came
- An MBA and the start of a family
- Having two children and buying a nice house in a safe neighborhood
- School years in which their children could attend the school of their choice
- College years for their kids
- Empty nest years where both continued to work and earn
- Freedom to retire at 60 with enough savings for travel yet maintain their life style.

If their current budget reflected a life style for two adults, say 2.0, they estimated that each little child would probably add about .5 of expenses to the budget. When this child started private school each would cost 1.0. When he or she went off to college it would probably require 1.5.

While the kids were in school Nora could go back to part time work and probably earn half her salary and when they went away to college go back to work full time but so long as she worked for a non-profit organization her income in real terms probably wouldn't increase much.

Lee's hoped his company would be able to contribute half his income during the MBA and when he returned from his MBA that his salary would grow nicely. He estimated conservatively his salary might grow by $400/ mo each year until it leveled off at $6000/ month take home pay.

An excel spreadsheet permitted them to calculate the implications of these stages of life on their budget and income and savings. To simplify things they used a model of expenditures in constant dollars and reduced the yields Lee expected he could make on his savings by the rate of inflation.

The model made it immediately clear that if they brought the Condo and spent their original budget and tried to implement their plan, they would be in a hole of increasing debt for the rest of their lives. They would not have the savings for the MBA or for Nora

to give up her work and be a stay-at-home Mom. At that time they'd either both have to continue working or take a drastic reduction in their standard of living.

Lee & Nora's Estimated Budget Over Time									
Inflation in Expense		0%	simulation in constant $						
Return on Savings		4%	above rate of inflation						
Lee's Increase Earn		$4,800	per yr once he gets his MBA in 2012						
Until Reaches		$72,000							
Nora's Income		$21,600	p.a. before children, none as little kids, .5 in school, 1.0 college until retirement						
Tithe		10%							
Fam Budget=1		$ 23,000	Budget of $46,000 /2						
Family Equivalent			Baby =.5, child in private school & college = 1, child in college 2.0, left home 0						
	Age	*Family*	*Lee*	*Nora*	*Gifts*	*Ohers*	*Budget*	*Savings*	*Net Worth*
2010	27	2	$30,000	$21,600	3000	$5,160	46000	$3,440	$3,440
2011	28	2	$34,800	$21,600	3000	$5,640	46000	$7,760	$11,338
2012	29	2	$18,000	$21,600	3000	$3,960	46000	($7,360)	$4,431
2013	30	2.5	$34,800	0	3000	$3,480	57500	($23,180)	($18,572)
2014	31	2.5	$39,600	0	3000	$3,960	57500	($18,860)	($38,175)
2015	32	3	$44,400	0	3000	$4,440	69000	($26,040)	($65,741)
2016	33	3	$49,200	0	3000	$4,920	69000	($21,720)	($90,091)
2017	34	3	$54,000	0	100000	$5,400	69000	$79,600	($14,095)
2018	35	3	$58,800	0		$5,880	69000	($16,080)	($30,739)
2019	36	3.5	$63,600	0		$6,360	80500	($23,260)	($55,228)
2020	37	3.5	$68,400	0		$6,840	80500	($18,940)	($76,377)
2021	38	4	$72,000	$10,800		$8,280	92000	($17,480)	($96,912)
2022	39	4	$72,000	$10,800		$8,280	92000	($17,480)	($118,269)
2023	40	4	$72,000	$10,800		$8,280	92000	($17,480)	($140,480)
2024	41	4	$72,000	$10,800		$8,280	92000	($17,480)	($163,579)
2025	42	4	$72,000	$10,800		$8,280	92000	($17,480)	($187,602)
2026	43	4	$72,000	$10,800		$8,280	92000	($17,480)	($212,586)
2027	44	4	$72,000	$10,800		$8,280	92000	($17,480)	($238,569)
2028	45	4	$72,000	$10,800		$8,280	92000	($17,480)	($265,592)
2029	46	4	$72,000	$10,800		$8,280	92000	($17,480)	($293,696)
2030	47	4	$72,000	$10,800		$8,280	92000	($17,480)	($322,924)
2031	48	4.5	$72,000	$10,800		$8,280	103500	($28,980)	($364,821)
2032	49	4.5	$72,000	$10,800		$8,280	103500	($28,980)	($408,394)
2033	50	5	$72,000	$21,600		$9,360	115000	($30,760)	($455,489)
2034	51	5	$72,000	$21,600		$9,360	115000	($30,760)	($504,469)
2035	52	3.5	$72,000	$21,600		$9,360	80500	$3,740	($520,908)
2036	53	3.5	$72,000	$21,600		$9,360	80500	$3,740	($538,004)
2037	54	2	$72,000	$21,600		$9,360	46000	$38,240	($521,284)
2038	55	2	$72,000	$21,600		$9,360	46000	$38,240	($503,895)
2039	56	2	$72,000	$21,600		$9,360	46000	$38,240	($485,811)
2040	57	2	$72,000	$21,600		$9,360	46000	$38,240	($467,004)
2041	58	2	$72,000	$21,600		$9,360	46000	$38,240	($447,444)
2042	59	2	$72,000	$21,600		$9,360	46000	$38,240	($427,102)
2043	60	2	$72,000	$21,600		$9,360	46000	$38,240	($405,946)
2044	61	2	$72,000	$21,600		$9,360	46000	$38,240	($383,943)
2045	62	2	$72,000	$21,600		$9,360	46000	$38,240	($361,061)
2046	63	2	0	0		$0	46000	($46,000)	($421,504)
2047	64	2	0	0		$0	46000	($46,000)	($484,364)
2048	65	2	0	0		$0	46000	($46,000)	($549,738)
2049	66	2	0	0		$0	46000	($46,000)	($617,728)
2050	67	2	0	0		$0	46000	($46,000)	($688,437)
2051	68	2	0	0		$0	46000	($46,000)	($761,975)
2052	69	2	0	0		$0	46000	($46,000)	($838,454)
2053	70	2	0	0		$0	46000	($46,000)	($917,992)

Running the model with different budgets suggested that if they reduced their living budget to about $36,000 /year they had a good chance of achieving both the MBA and their other objectives.

A Budget Lee & Nora Can Afford Over Time									
Inflation in Expense		0%	simulation in constant $						
Return on Savings		4%	above rate of inflation						
Lee's Increase Earn		$4,800	per yr once he gets his MBA in 2012						
Until Reaches		$72,000							
Nora's Income		$20,000	p.a. before children, none as little kids, .5 in school, 1.0 college until retirement						
Tithe		10%							
Fam Budget=1		18,000	Budget of $36,000 /2						
Family Equivalent			Baby =.5, child in private school & college = 1, child in college 1.5, left home 0						
	Age	Family	Lee	Nora	Gifts	Ohers	Budget	Savings	Net Worth
2010	27	2	$26,400	20000	3000	$4,640	36000	$8,760	$8,760
2011	28	2	$31,200	20000	3000	$5,120	36000	$13,080	$22,190
2012	29	2	$18,000	20000	3000	$3,800	36000	$1,200	$24,278
2013	30	2.5	$36,000	0	3000	$3,600	45000	($9,600)	$15,649
2014	31	2.5	$40,800	0	3000	$4,080	45000	($5,280)	$10,995
2015	32	3	$45,600	0	3000	$4,560	54000	($9,960)	$1,475
2016	33	3	$50,400	0	3000	$5,040	54000	($5,640)	($4,106)
2017	34	3	$55,200	0	100000	$5,520	54000	$95,680	$91,410
2018	35	3	$60,000	0		$6,000	54000	$0	$95,066
2019	36	3.5	$64,800	0		$6,480	63000	($4,680)	$94,189
2020	37	3.5	$69,600	0		$6,960	63000	($360)	$97,596
2021	38	4	$72,000	$10,000		$8,200	72000	$1,800	$103,300
2022	39	4	$72,000	$10,000		$8,200	72000	$1,800	$109,232
2023	40	4	$72,000	$10,000		$8,200	72000	$1,800	$115,401
2024	41	4	$72,000	$10,000		$8,200	72000	$1,800	$121,817
2025	42	4	$72,000	$10,000		$8,200	72000	$1,800	$128,490
2026	43	4	$72,000	$10,000		$8,200	72000	$1,800	$135,430
2027	44	4	$72,000	$10,000		$8,200	72000	$1,800	$142,647
2028	45	4	$72,000	$10,000		$8,200	72000	$1,800	$150,153
2029	46	4	$72,000	$10,000		$8,200	72000	$1,800	$157,959
2030	47	4	$72,000	$10,000		$8,200	72000	$1,800	$166,077
2031	48	4.5	$72,000	$10,000		$8,200	81000	($7,200)	$165,520
2032	49	4.5	$72,000	$10,000		$8,200	81000	($7,200)	$164,941
2033	50	5	$72,000	$20,000		$9,200	90000	($7,200)	$164,339
2034	51	5	$72,000	$20,000		$9,200	90000	($7,200)	$163,712
2035	52	3.5	$72,000	$20,000		$9,200	63000	$19,800	$190,061
2036	53	3.5	$72,000	$20,000		$9,200	63000	$19,800	$217,463
2037	54	2	$72,000	$20,000		$9,200	36000	$46,800	$272,962
2038	55	2	$72,000	$20,000		$9,200	36000	$46,800	$330,680
2039	56	2	$72,000	$20,000		$9,200	36000	$46,800	$390,708
2040	57	2	$72,000	$20,000		$9,200	36000	$46,800	$453,136
2041	58	2	$72,000	$20,000		$9,200	36000	$46,800	$518,061
2042	59	2	$72,000	$20,000		$9,200	36000	$46,800	$585,584
2043	60	2	$72,000	$20,000		$9,200	36000	$46,800	$655,807
2044	61	2	$72,000	$20,000		$9,200	36000	$46,800	$728,839
2045	62	2	$72,000	$20,000		$9,200	36000	$46,800	$804,793
2046	63	2	0	0		$0	36000	($36,000)	$800,985
2047	64	2	0	0		$0	36000	($36,000)	$797,024
2048	65	2	0	0		$0	36000	($36,000)	$792,905
2049	66	2	0	0		$0	36000	($36,000)	$788,621
2050	67	2	0	0		$0	36000	($36,000)	$784,166
2051	68	2	0	0		$0	36000	($36,000)	$779,533
2052	69	2	0	0		$0	36000	($36,000)	$774,714
2053	70	2	0	0		$0	36000	($36,000)	$769,703

As they discussed their options Lee and Nora realized that what was most important to them was Lee's MBA and Nora's ability to stay at home while the children were young. They also wanted to be able once they had children to buy a nice house with a yard and garden in a secure neighborhood.

They therefore decided in their first two years of marriage to save as much as they could. They gave themselves a comfortable budget for the expenses closest to their skin, decided not to buy the condo but rent an apartment for $500/month and buy a second hand car instead of the new one. The result was a budget of $36,000 / year that permitted them to save about $1,000/month as well as pay Nora's school debts while they both worked. This they felt would put them in a good position to realize their longer term dreams. (See below the Austere Budget.)

Lee & Nora's Budget (HWS format)						
	Original		**Corrected**		**Austere**	
	Mo	*Year*	*Mo*	*Year*	*Mo*	*Year*
Income						
Lee's Salary	2500		2500		2500	
Nora's Salary	1800		1800		1800	
Committed Parental Gifts	300		300		300	
Total	4600	55200	4600	55200	4600	55200
Savings & Others						
Debt Repayment Nora's Schoolin	300		300		300	
Others / Tithe	460		460		460	
Total	760	9120	760	9120	760	9120
Expenses	*Month*	*Year*	*Month*	*Year*	*Month*	*Year*
Housing	1730		1730		695	
Car	920		920		560	
Medical	330		330		330	
Food & Supplies	300		500		400	
Entertainment	200		300		350	
Clothing & Professional & Cellular	180		250		200	
Gifts, Vacations,	200		300		300	
Contingencies			200		0	
Total	3860	46320	4530	54360	2835	34020
Extra Savings/(Deficit)	-20	-240	-690	-8280	1005	12060