Financially Fit in 40 Days Challenge

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Cashflow & Debt Fitness Exercise: Week 4

Creating a Plan to Keep You Financially Fit…For Life

"A goal without a plan is just a wish." Antoine de Saint-Exupéry

So you have a vision of where you want to be, by when, and what it's going to feel like when you get there. You're going to have a higher probability of making your vision a reality by becoming financially fit and staying that way. That is, what you want is not to get fit once and slip backwards into the condition you were in before; rather you need to get fit and stay that way. You need a plan to keep you fit for life.

In this exercise you're going to understand what that means and how to achieve it.

Let's start by asking the question: what does it mean to become fit financially?

Here's what it's NOT. It's not about earning high investment returns, being mega thrifty with your income, or having a self managed super fund. Your plan for financial fitness needs to be broader and deeper than that. Becoming financially fit for life is really about a process of diligently implementing a **comprehensive** action plan that addresses **all** areas of your finances.

So with that in mind this chapter isn't going to give you an education in property investment, share trading, insurance policies or tax schemes. Although your plan may include action items in each of these areas, the exercises in this chapter are going to help you build a foundation for your plan, scoping what it should consider: how broad and deep your plan needs to be to do its job.

To put this into perspective, let's consider the analogy of becoming **physically** fit …

Experts identify **five** main parts to physical fitness. They are:

- Cardiovascular exercise
- Strength training
- Flexibility conditioning
- Nutrition
- Rest

If your strategy to become physically fit is simply to run 5km a day then you are very likely to improve your cardiovascular fitness. But if you neglect your diet you won't lose any weight. If you fail to stretch or increase the strength in your joints you are likely to injure yourself. If you don't get enough sleep you'll soon become run down and get sick.

The quality of your fitness, then, is determined by your attention to each of the five building blocks of physical fitness. Becoming physically fit and staying that way means having a plan that pays attention to **all** the components of physical fitness.

Financial fitness is no different. There are 6 components to financial fitness and together they make a whole. Ignore any one of them and you threaten the quality of your fitness.

Consider a plan that only concentrates on investing, for example. If you have no strategy for money management you'll soon find yourself cannibalising your investments to fund daily cashflow needs. Similarly, your tax structures and thrift might be excellent but a neglected insurance program means that if something unexpected happens your savings and goals suffer.

By ignoring any one of the building blocks of financial fitness, not only do you place your goals in the hands of lady luck, it can have a toxic affect on your finances and utterly ruin your quality of life.

So what are the 6 components to financial fitness?

The 6 Building Blocks of Financial Fitness

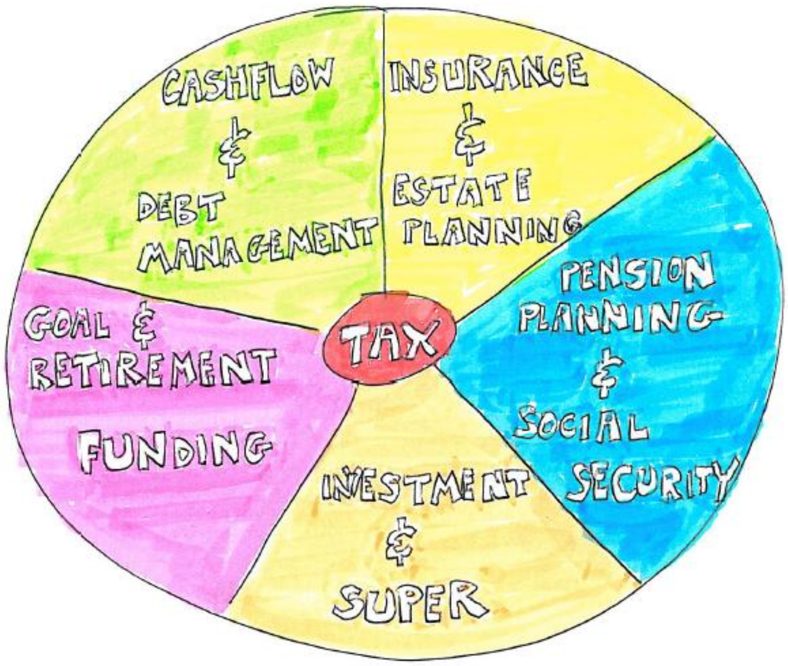
Think about money and how it works … You earn it, win it, borrow it. It's taxed and tithed. You bank it, accumulate it, invest it, spend it.

Money flows like a river and through your efforts you divert some of the stream into your trough, using it to feed your crops and water your livestock, stockpiling it in case of a drought, and drinking some yourself.

Good plans for handling your money can make you financially fit over time whereas a poor plan – or no plan at all – leaves you hoping for rain so you can hold out your cup for a drink.

Directing the flow of money to achieve your goals requires six interrelated strategies, each with a checklist of action items which, when ticked off each year as part of your overall plan, builds your financial fitness, makes you less susceptible to droughts or cyclones, and gives your goals more likelihood of becoming a reality, regardless of external events that are beyond your control.

THE 6 PARTS TO FINANCIAL FITNESS



You can see that they are interdependent – they all relate to each other in some way. They are also all linked directly to tax. Each building block has an ideal result which, if you were financially fit in that area, it would deliver to you ideal outcomes.

- **Cashflow and Debt fitness**. You're living within your means and accumulating savings every time you receive money. You are paying the lowest interest appropriately available and have a sensible schedule for clearing all debt, with a higher priority on non-tax deductible debt.
- **Goal and Retirement Funding fitness.** You have considered and costed your goals and are on track for funding them. The cost of your retirement has been analysed and you are on track for funding it, too.
- **Investment and Superannuation fitness**. Rather than having a collection of investments you have a fat-free, globally diversified portfolio being managed according to an independently verifiable strategy that only takes risks bearing worthwhile rewards. Your super is fully funded and low-cost, with no valueless middle men.
- **Pension and Social Security fitness**. Your pension is structured effectively to minimize tax and maximize social security benefits. Your eligibility for Centrelink benefits has been assessed and all available benefits have been applied for.
- **Insurance and Estate Planning fitness.** You own comprehensive, low-cost financial protection which either has no commissions contained within the premium or the commissions are being rebated to you in cash. Your wills and powers of attorney are thoughtfully constructed, up to date, and are compatible with tax entities and your super.
- **Taxation fitness**. Your returns are up to date and tax bills paid. All available tax options have been considered and your tax structures minimize your tax and protect the assets you are building.

Financial fitness in each of these areas requires some understanding of the guiding principles coupled with some rules for you to follow. You're not going to get fit by owning a gym membership, it's the doing that gets results. More on that later. For now, it's time to school up: it's time to get your tuition.

It's not the intention of the ***Financially Fit in 40 Days Challenge*** to give you a degree in financial science or tax & accounting. The purpose is to get you implementing a real plan that's going to take you forward on your own path.

The first step is to put a strong foundation in place for your action plan. This starts by establishing the Wealth Habits that are going to get you fit and keep you that way. It starts with how you handle your money …

Cashflow and Debt Fitness

"The mint makes it first, it is up to you to make it last." Evan Esar

Guiding principles

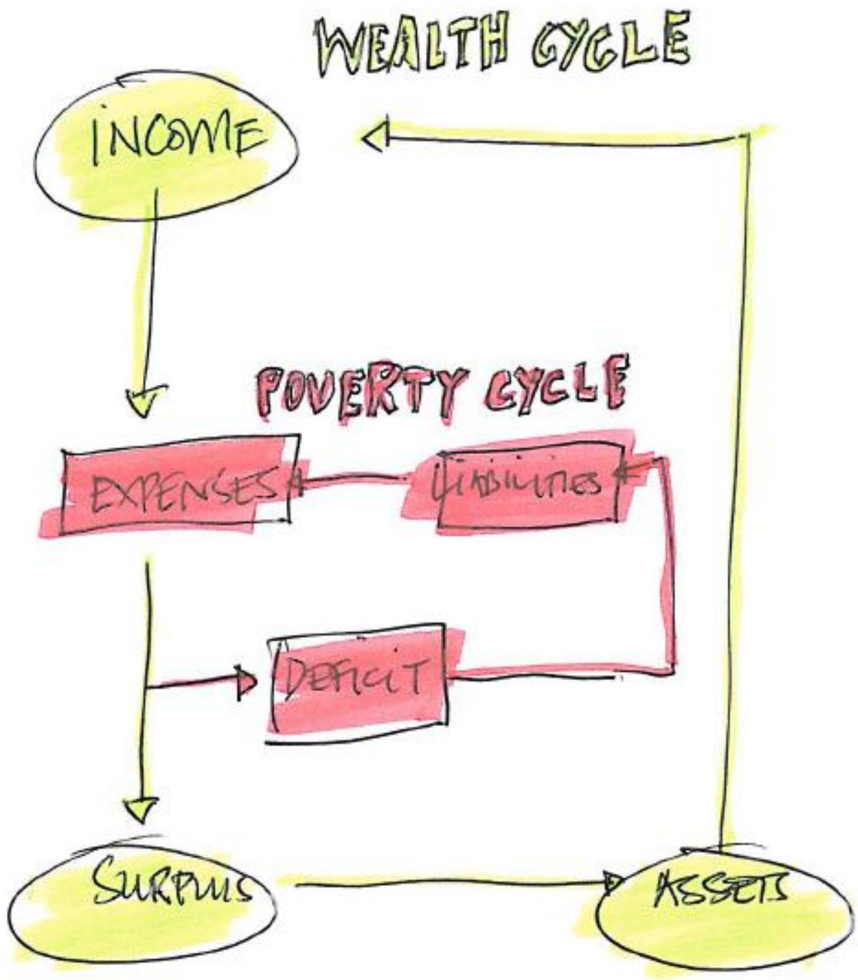
Recall that there are 6 components to financial fitness. The ideal outcome of Cashflow and Debt fitness is that you're managing your income so that you …

a) you are living within your means by spending less than you earn,
b) the surplus builds a cash reserve that ensures you are financially secure,
c) your goals continue to be funded through saving,
d) you minimize the need to borrow 'expensive' money,
e) you eventually end up without any debt, and
f) ultimately your wealth grows until you become financially independent.

To achieve this level of financial fitness as it relates to cashflow management you need to have an understanding of just how important money handling habits are. Then there are some simple exercises you can do to improve your fitness in this area.

Force of Habit: the wealth and poverty cycles

If your income is greater than your expenses then you can spend your surplus or use it to grow your savings. You make the choice to do this it until it becomes the habitual thing to do, like brushing your teeth. This habit leads to wealth and the lack of it leads to poverty. It's as simple as that.

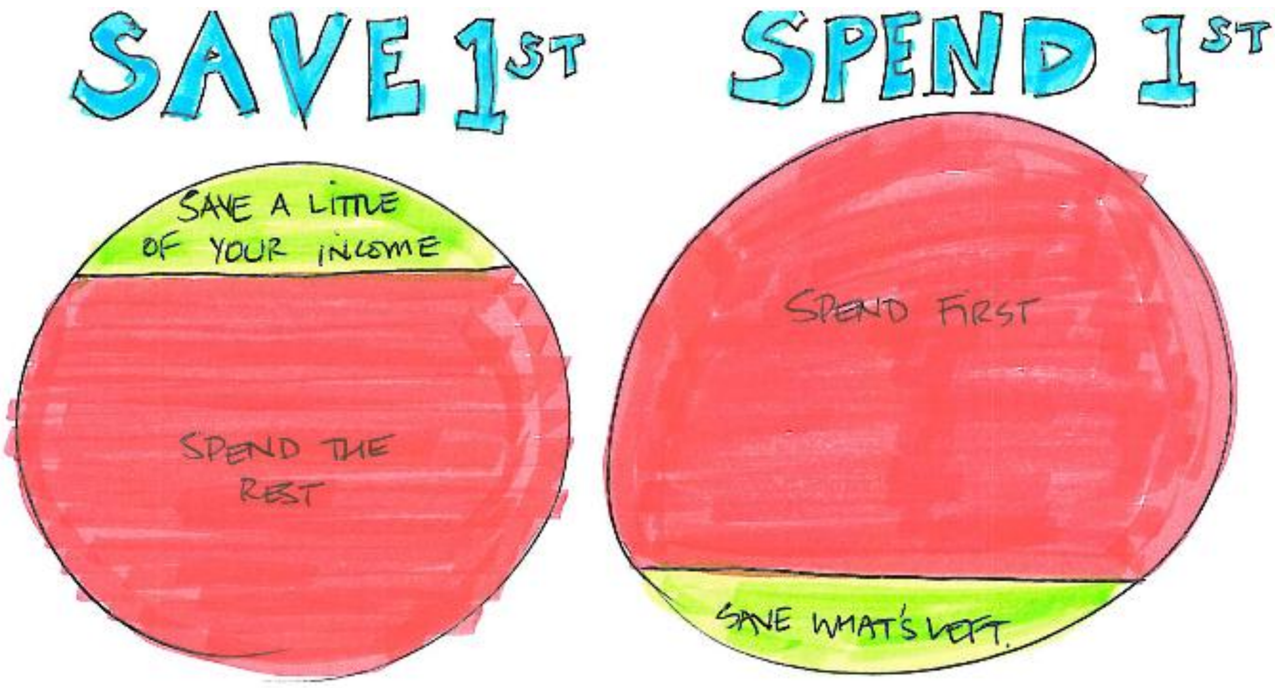


The savings habit works most effectively when you have a goal you're working towards. Your ultimate goal is to become financially independent, via the stepping stones of debt free and financially secure. There are three phases to implementing the wealth strategy that pave the way for achieving these goals of becoming secure, debt free and financially independent.

But first, you need a way of organizing how you handle your money so that you create a higher likelihood of building momentum for a Wealth Cycle.

Your wealth strategy: 70/20/10

Which is more likely to produce a positive result: save a set amount every paycheck and spend what's left? … or do the spending first and save anything that's left over?



It’s not rocket science but it makes all the difference: part of what you earn should be yours to keep. The proven way to make this happen is to set aside some of what you earn every time you earn it, and have no intention of spending it. Ever. This accumulating pot of savings is one day going to replace the income you need to work for. Just how much should you save?

The formula is 70/30 and here’s how it works …

1. **Seventy percent** of everything you earn must be sufficient for you to provide yourself food, clothing, shelter and entertainment. No more.
2. **Twenty percent** of your earnings is going to accelerate the repayment of your debts.
3. **Ten percent** of everything you earn in the hand is to be set aside for savings. Get used to it accumulating, you’re never going to spend it. Ever.

It’s not complicated. It doesn’t need to be. Simple works just fine. The end result is that you’re living within your means, your debts are repaid, and your wealth grows, slowly at first but picking up speed with time. In due course the income generated by your growing wealth is sufficient to cover your living expenses which means work is now optional for you.

“My problem lies in reconciling my gross habits with my net income.” Errol Flynn

If living on 70% of your income isn’t something you’re used to, it will feel uncomfortable at first. Anything you try for the first time is. But be assured: there are NO other options that give you a higher probability of success. This is it. So commit to it. Keep at it even though it might be difficult for a few months, and you’ll never look back.

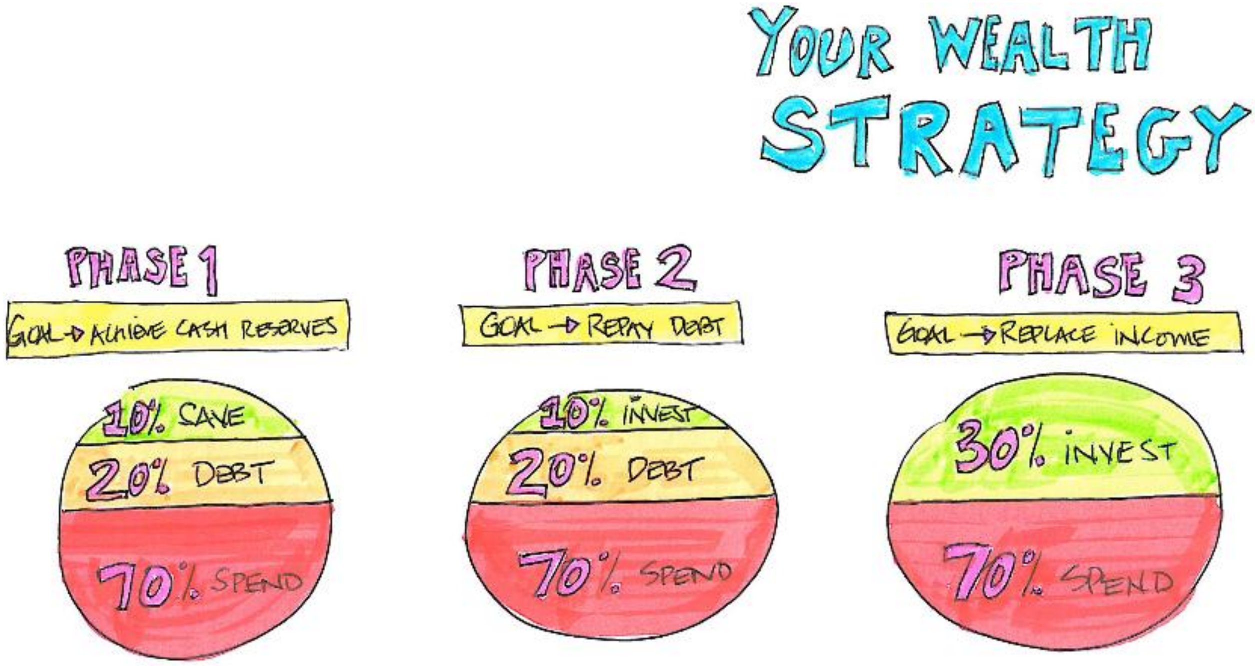
Implementing your 70/20/10 wealth strategy

The savings habit works most effectively when it’s goal-driven so there are three phases to achieving a 70/20/10 …

Phase 1. The most practical way to measure your financial security is by how long you could continue your current lifestyle if you weren't earning any. So the goal of phase one is to accumulate sufficient cash reserves to make you financially secure, and in the process you get used to living on less than you earn. Once you have accomplished this goal and are financially secure you will continue to set aside 10% but instead of building your cash reserves, it will be directed into more hard working investments to increase your wealth (more on that later).

Phase 2. Now that you're financially secure and have the thrift habit working for you, your next goal is to get out of debt. All the while you've been directing 20% of your net income into debt repayments and that continues during this phase. The goal is accomplished when you are debt free and it will be time to move into the last phase.

Phase 3. You're now financially secure and debt free; the goal of this last phase is to rapidly grow your wealth so as to make work optional for you. You achieve this by adding the 20% debt repayments to the 10% savings so that you are now adding 30% of your income to your wealth.



Living on 70%

Few people observe the laws of thrift naturally; most of us struggle with them.

New cars, iPads, and expensive holidays are temptations that we justify to ourselves … to our detriment. "I work hard so why not" … "I might be dead tomorrow" … "It's tax deductible" … "In my business it's important I look successful."

"It is the sign of a weak mind to be unable to bear wealth." Seneca

To a seasoned financial professional these excuses are the telltale signs of someone who lacks an awareness of what's important to them and has no boundaries or rules to follow about how they handle their money. Without a strong desire for financial independence so that your time is free to pursue those qualities on your values chain plus the wealth rules for you to follow, you are destined to be struggling financially your whole life.

In my experience the vast majority of Australians are great bill payers but poor savers. Most folks are financially insecure, are in debt they'll only ever pay off by selling their lifestyle assets (for a tiny fraction of what they paid for them), and never really achieve financial independence. This is true regardless of the postcode they live in and the toys they show off to their friends. If they were honest, "quietly desperate" is how they might describe their financial situation; it's certainly how they'd be described by a professional.

Exercise: setting your wealth strategy

The key thing to remember here is that if you lose sight of your goals while you're building the Wealth Habit your chances of success drop. That's why the exercise starts with your goals.

Phase one goal: become financially secure. Go back to your financial snapshot and work out how much is six months' living expenses, excluding your debt repayments. That's your cash reserves objective, accomplishing it signifies the successful completion of phase one.

Goal: Phase One	
Total annual living expenses	
Less annual debt repayments	
Equals	
Divide in half = Phase One Goal	

Phase two goal: become debt-free. Go back to your financial snapshot and list all your debts in order of interest rate; this tells you which debts are most expensive. The 20% of your income needs to be allocated among all your debts so that the minimum repayments are met, but what's left of your 20% is directed to the most expensive debts first. Once the most expensive debt is repaid, the amount which was going to that is all directed to the next most expensive, and so on, until it's all repaid. When it's all done, you've completed phase two.

Goal: Phase Two		
Debt	**Interest Rate**	**Priority**

Phase three goal: become financially independent. You will have accomplished phase three when the income produced by your investments is equal to the 70% you have been living on. How much income has your wealth produced for you in the last twelve months? What does it need to be to cover your living expenses? The answers below will give you the direction you need.

The rules of your wealth strategy

Now you've set your goals, it's time to confirm the rules of your Wealth Strategy.

Your Wealth Strategy Rules		
Net Income		This is all there is
X70%		This is to live on
X20%		This is to repay debts
X10%		This is to save

Control thy spending. Your first task is to work out what you get paid in the hand. Now calculate 70% of that figure because this is how much you've got to make last until your next payday. Make it stretch – it needs to cover all the bills between now and next payday PLUS you need to set sufficient money aside for the bills that come in less frequently – e.g. rates, car rego, insurance, etc. Work out what these are and set aside money to pay those bills when they arrive. What's left must stretch to cover the rest of your bills till next payday.

Most people only have a few weeks' cash stashed somewhere; they are financially insecure. Having six months' living expenses in cash reserves is the goal. The reality is that being in that position tends to improve dramatically the quality of your financial decisions. That's why it's the first step.

Don't get caught up in the minutiae of whether you should use an offset account or a cash account to capture your savings; it's not the account that will get you to the end of phase one. Don't try and jump the gun on investing before you've achieved your savings goal; it's not the interest rate that makes this work. Don't kid yourself by adding the 10% to your home loan. It's what you learn during phase one that will make the rest of the program work for you.

Repay thy debts. Calculate what 20% of your net income is. That is to go into your debts – principle and interest combined.

We're talking about personal debts here, rather than your investment debts that are funding investment assets. Although the subject of borrowing to invest is an important one to understand, it's not relevant here. For now, understand that your 20% has to cover your personal debts. Beware, though: if that figure isn't sufficient to cover the minimum repayments of your personal debts then it's time to get professional advice, and I mean right now. You don't have a moment to lose and you've got everything to gain.

Provide for thy prosperity. Calculate what 10% of your net income is. That is never going to be spent, ever ever ever. If you never spend it then one day it's going to replace your income and continue to rise every year. Won't that be hard to take!

You probably have money being taken out of your gross pay (if you are an employee, or you are making contributions to super as the employer yourself). Take those into consideration as part of your 10%; what's left needs to go into savings to build your cash reserves. If you are already contributing more than 10% to super then that's fine PROVIDED you have already completed phase one and are ready for phase 2. Otherwise you're going to have to reduce your super contributions until you have completed phase one, then you can increase your super contributions again.

Recommended reading

You have set your goals and your rules. That's the easy part. The hard work is yet in front of you. Be consoled: the hard work is only hard while you're struggling with it. Accept this as the way it is from now on and it feels much, much easier. And it gets easier again when the Wealth Habit is installed which takes only a few months.

To help your motivation and understanding, drench yourself in this plan. Make your goals visible by writing them on small laminated cards and put them in your pocket, stick them to your bathroom mirror, place them on your bedside table. The other thing to place on your bedside table is a book: go pick yourself up a copy of ***The Richest Man in Babylon***, by George S Clason. This is probably the most valuable thing you can do today to turbo charge your financial fitness.

I won't wish you good luck because that's the last thing you need. I wish you happy follow through. Remember: acceptance, not struggle. In 90 days you won't recognize yourself. ☺