Personal Finances (Maxims Part II)

This essay was written in 1992 in response to questions posed to Ron by his nephew about personal finance. The essay lays out a simple, step-by-step plan to pay off high-interest-rate debts and to shift assets to high-return investments.

Dear Nephew:

Here are some additional notes and things I didn't cover in "Basic Financial Maxims I Want My Kids to Know."

1. There are books available that go into great detail (maybe too much) on a whole shopping list of items relevant to spending and saving money. Two that I think you will find useful are *Making the Most of Your Money* by Jane Bryant Quinn and *Wealth Without Risk* by Charles Givens. Both are probably available at your local library. (Givens is also willing to sell you a whole program of videos, audios, and workbooks for $900, but that seems to defeat its own purpose.) Their sections on spending and savings are quite good, while their sections on investing are less so—partly because investing must change as the financial climate changes.

   To this end, *The New York Times Book of Personal Finance* by Leonard Sloane gives good descriptions of financial instruments all the way from CDs to stocks and annuities. The descriptions are concise and factual, and they focus on the inherent nature of the instrument, both pros and cons. In 10 minutes on any one topic, you will understand more about it than 95% of the salesmen who are trying to sell it to you. To determine which investment climate we are in, and therefore which instruments are not appropriate, your best bet is to ask me.

2. Make a list of your assets and debts and their relevant returns or interest rates. It may look like this:

Figure 5.9 Personal Assets and Debts

ASSET	VALUE	RATE
Savings Account – CD	$10,000	4%
Emergency Fund	$10,000	2%
Personal Goods	$20,000	Depreciating
Car #1	$10,000	Depreciating
Car #2	$5,000	Depreciating
House	$150,000	Inflation
Mutual Fund	$10,000	12-13%
IRA Stock Account	$20,000	12-13% and Tax Deferred
Pension or 401K	$30,000	Tax Deferred

DEBT	AMOUNT	RATE
Charge Card	$1500	-18%
Auto Loan	$6,000	-13%
Mortgage	$120,000	-9%

Then work to move your assets toward the areas where returns are high and pay off debts where the costs are high. In this case, I would keep the emergency fund intact but would use the savings account to pay off the charge card debt and part of the auto loan or fund the individual retirement account (IRA). I would continue to fund my IRA (rate 12%–13% and tax-deferred) or pay off my auto loan (saving 13% interest) with money I had been depositing into my savings account or CD that earned only 4% interest.

3. To make your savings plan seem more of a reality, keep a notebook and enter each prepayment just as you did in the savings account. When you want to feel like you are getting ahead, take a look at your notebook. It will read:

3/14/1992—Paid off Charge Card $1500 at 18%
3/14/1992—Deposited into IRA $500 at 12%
4/14/1992—Deposited into IRA $200 at 12%
5/15/1992—Extra Payment on Auto Loan $200 at 13%

You should be more satisfied seeing that you have been saving money at 12% to 18% instead of 5%.

4. Be aware that when you go to the bank for a mortgage or for any other purpose, the bank will ask you to fill out a statement similar to the one above. They will look at all of your assets and liabilities. They will be more impressed by your prepaying or not having high-cost debt than they will be by your having a savings account while carrying the high cost of debt. When you get to the point that the bulk of your assets are high return and your debts are low cost, your financial position will improve rapidly.

   If you really want to impress your banker that you're a good credit risk, put together the above statements, jot down your plans for paying off debt, and set up your prepayment notebook. Then make an appointment with the bank president and ask his advice on what you've done. He will be impressed with your plan and will think you're very smart for asking his advice. He will also remember you when you apply for a mortgage. Of course, all of this can turn negative if you don't actually follow through on the plan. Note that one of the best ways to impress people with your intelligence is to ask for their advice. (Parents and uncles are absolute pushovers for this!)

Good luck,
Uncle Ron