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Ten personal finance principles

"I quickly convinced myself that the true key to material happiness lay in a modest standard of living which could be achieved with little difficulty under almost all economic conditions" - Benjamin Graham[1]

In the process of accumulating financial wealth, an investment program is useless without a solid financial foundation. The formation of such a financial foundation is a unique process for everyone, however we believe that there are some universal principles related to personal finance which can be used as a starting point for the majority of individuals, families, households, and small businesses who are interested in accumulating and growing their wealth. These principles are summarized below. Keep in mind that this is not financial, legal or tax advice and that you need to do your own research and/or consult with a financial, tax or legal adviser as necessary.

1) **Be frugal:** Live well below your means, and save as much as possible, but save at least 15% of your pre-tax income. This the "margin of safety" of personal finance. Avoid impulse purchases. This is the easiest principle to understand in theory but the hardest principle to implement in practice. It comes easily to some but not so easily to others. All else being equal, someone with low career satisfaction and high career risk should save more than someone with high career satisfaction and low career risk.
2) **Use debt wisely:** Use debt as little as possible, but if you do use debt, match the assets and liabilities. For example, if you expect a car to last three years then don't take out a car loan with a longer duration (five years, for example). Unsecured debt, such as credit cards, should be used with caution.
3) **Have an emergency fund:** Allocate the first portion of the savings from part (1) above to an emergency fund. The emergency fund should consist of between three and twelve months of living expenses, depending on the stability of your income. For example, the emergency fund of a self-employed person with unpredictable income should have closer to twelve months of living expenses, while the emergency fund of someone collecting a government pension should have closer to three months of living expenses. Place the emergency fund money in a high-yield savings account. Do not "overstuff" the emergency fund, as having more assets in cash/liquid savings than is needed could result in the erosion of the purchasing power of those excess assets over time.
4) **Build financial statements:** Keep your income and expenses organized. Build a cash flow/income statement and balance sheet for your household (and business if applicable) and update monthly or quarterly so you know the details of every dollar moving in and out of your household. Run a household

[1] Graham, Benjamin and Dodd, David, *Security Analysis*, from Introduction to the Sixth Edition by James Grant, 2009, and Graham, Benjamin, *Memoirs of the Dean of Wall Street*, 1996

and/or small business that is as lean as possible. Constantly scrutinize each financial transaction and ask yourself whether or not it is necessary.

5) **<u>Protect your human capital and protect against potential losses:</u>** If there is a high-wage earner upon whom the family is dependent then that person's human capital (i.e., salary, earnings, etc.) should be protected against catastrophic loss (death or disability). Similarly, you need to be aware of potential liabilities (legal, etc.), losses (flood, fire, other property destruction, such as via an accident, etc.), and potential medical expenses and protect yourself against these as necessary. A licensed insurance agent can help you to evaluate these risks and recommend appropriate solutions.
6) **<u>Understand tax laws:</u>** Know the basics of the tax laws (federal, state, local, property) so that you can be proactive in your financial life. All else being equal, the larger the size of a financial transaction, the larger the potential for tax consequences and you should make sure that you are aware of what those are *before* engaging in the transaction. Take advantage of tax-avoidant and tax-deferral vehicles such as employer-sponsored retirement plans, IRAs, etc. (But remember that tax-avoidance is legal while tax-evasion is illegal.)
7) **<u>Your home is not an investment:</u>** Home ownership, financed via a fixed-rate mortgage, is an excellent way to lock in a portion of your periodic housing costs (principal and interest) and provide a hedge against inflation (rents tend to rise with the price of all other goods and services while the principal and interest component of a fixed-rate mortgage will remain fixed over time). However, we believe that home ownership, and by this we mean owner-occupied home ownership and not the ownership and operation of rental real estate, is primarily consumption, not investment.
8) **<u>Have an estate plan:</u>** At the very least, appropriate beneficiaries should be specified wherever possible, such as on retirement accounts and on life insurance policies, and in many cases a will should be drafted. In some cases, a more elaborate estate plan, such as one involving trusts, is needed. A licensed attorney can assist you in determining what is needed if you are unsure.
9) **<u>Define and quantify your goals:</u>** *Define*, *quantify*, and *prioritize* your long-term financial goals and risks and specify *time horizons* for each of them. Any financial goals with time frames of longer than five years are candidates for an investment program.
10) **<u>Design and implement an investment program:</u>** Investment programs should typically be used for larger, longer-term goals (five years or longer), such as retirement funding and education funding. You must feel comfortable with your investment program for it to produce satisfactory results. All else being equal, a simple, consistent investment plan is more likely to produce satisfactory results than a complex, inconsistent investment plan. Broad market timing is unlikely to produce good results over the long term. Short-term investment portfolio performance tends to be based on luck and long-term investment performance tends to be based on skill, soundness of judgment and the quality of the investment strategy. A licensed financial adviser can assist you with designing and implementing an investment program which is appropriate for you.

<u>Postscript: help is available.</u> If you don't want to go it alone, hire a financial adviser. A high-quality financial adviser can help you with basic financial planning (Items (1) – (10) above). And, lastly, if you would like to speak with us, feel free to set up an introductory phone call at https://atherean.com/contact/ . We would be happy to speak with you.