Financial Survival Pocket Guide

There's more free financial advice on the internet than you could read *in a lifetime*. When there's innumerable voices all clamoring for your attention, the only way to stand out from the crowd is to provide excellent content in a succinct package. Quality > Quantity.

That's why I've created this pocket guide to provide a solid baseline for money management skills. Sure there's always more tips, subtleties, and minor details to any subject, but this covers the major stuff. Of course I also encourage you to learn from as many different sources as possible, so I've recommended some of my favorites at the end.

These are the steps to follow to optimize your finances:

1. **Avoid Big Mistakes:** *Your financial situation is the result of lots of tiny decisions and a few big ones. Don't be careless with the big ones. Accept that 100% optimization of the tiny decisions is impossible because financial and lifestyle choices are inherently intertwined.*

    1.1. Wealth eroding habits like gambling, drugs, excessive partying, and smoking have massive long term costs both direct and indirect associated with them. Is it really worth it?

    1.2. Never lease a car or buy a brand new car. Avoid the depreciation hit and high transaction costs of switching cars by buying a slightly used car and keeping it for a long time.

    1.3. Never buy a home unless you intend to live there for at least 3 years. Purchasing property comes with huge transaction costs and lots of hidden expenses. You can consult a buy vs rent calculator to help figure out the details. But ultimately buying a house is a personal lifestyle decision *more than anything else*, so no calculator or dumb set of rules can make the decision for you.

    1.4. Don't lend your friends any significant amount of money. Better to lose a 'friend' over not helping them than to lose a friend *and* your money because you did. *Your* situation is *not* different.

    1.5. *It's much easier to turn money into stuff than it is to turn stuff into money*. Tying your money up in stupid consumer purchases comes with the opportunity cost of being able to invest it elsewhere. Almost every time you purchase something at retail cost, value is lost in the transaction. Stop buying things you don't need.

    1.6. Small spending/saving actions can have a large cumulative effect over time, but it's not worth doing if it becomes a major source of stress. Don't sweat the small stuff if doing so distracts you to the extent that you make big mistakes elsewhere. Go ahead if you enjoy it though! (.)

2. **Create an Emergency fund:** *An emergency fund is not an investment, but rather insurance. It is ultimately a debt avoidance mechanism.*

    2.1. Do a quick bit of math to estimate how much money you need to live and set aside a few months worth of expenses in an accessible bank account. This money will earn squat for interest but it is the best insurance you will ever buy because it saves you from having to deal with consumer debt or selling off your other investments at inopportune times. It will be there when you need it.

2.2. Bad things inevitably happen in life and you don't want to rely on credit cards to bail you out. The opportunity cost of investing a few thousand dollars as a safety net is minimal compared to the inconvenience of not having those assets be liquid when you need them.

2.3. Even if you are in debt it is necessary to first build an emergency fund before you can climb your way out.

3. **Pay off your debts:** *Having high interest rates working against you will undermine all other financial efforts.*

3.1. Take care your credit score because it will have a huge impact when you want to buy a home. It can even impact your ability to get certain types of jobs (banking for one). Interestingly, a person's credit score is the single best indicator of the likelihood that they will file a car insurance claim. Monitor your score for free using www.creditkarma.com. Also see my list of tips for establishing good credit here.

3.2. *Should you pay off low interest debt or invest?* Student loans and mortgages are special because the interest rates are so low. This can make it hard for people to choose whether to pay off the debt quickly or to use their extra assets to invest. Here is the general rule of thumb for deciding with a long term perspective in mind. If the debt interest rate is:

- <4%, then invest
- 5-6%, then it's a tossup. Let your personal risk tolerance decide.
- 7+% then pay off your debt.

4. **Invest for the future:** *For all practical purposes the stock market fluctuates completely at random. No amount of graphical analysis or research is going to give you a leg up on other investors, especially if you are trying to do it in your free time.*

For this reason the optimal investing strategy is to focus on what you can control: Removing the element of human error and minimizing expenses/transaction costs. Sticking with a diversified portfolio of low cost broad-based index funds is the least risky way to invest.

4.1. How much money do I need to quit working? After you have enough money in the market the income from your passive investments will eventually be enough to cover your living expenses. This is known as financial independence. The widely accepted amount that you can safely withdrawal from your investments indefinitely is 4% per year. This means you need a nest egg at least 25 times your annual expenses.

4.2. What's a reasonable rate of return to expect for various investments? This chart (from A Random Walk Down Wall Street) should provide a frame of reference for understanding the tradeoff of risk vs return. The author puts the amount of risk into perspective by describing how an investment might affect your ability to sleep at night.

"The sleeping scale of major investments"

Sleeping Point	TYPE OF ASSET *Risk Level*	*2010 Expected Rate of Return before Income Taxes (%)*	*Length of Time Investment Must Be Held to Get Expected Rate of Return*
Semicomatose state;	BANK ACCOUNTS *Risk Level:* No risk of losing what you put in. Deposits up to $100,000 guaranteed by an agency of the federal government. An almost sure loser with high inflation, however.	0–1	No specific investment period required. Many thrift institutions calculate interest from day of deposit to day of withdrawal.
Sound night's sleep	MONEY-MARKET FUNDS *Risk Level:* Very little risk because most funds are invested in government securities and bank certificates. Not usually guaranteed. Rates vary with expected inflation.	0–2	No specific investment period required. Most funds provide check-writing privileges.
	SPECIAL SIX-MONTH CERTIFICATES *Risk Level:* Early withdrawals subject to penalty. Rates geared to expected inflation and will vary.	1–3	Money must be left on deposit for the entire six months to take advantage of higher rate.
	TREASURY INFLATION-PROTECTION SECURITIES (TIPS) *Risk Level:* Prices can vary if sold before maturity.	2+	These are long-term securities maturing in five years or longer. Base rates vary with maturity.
An occasional dream or two, some possibly unpleasant	HIGH-QUALITY CORPORATE BONDS (PRIME-QUALITY PUBLIC UTILITIES) *Risk Level:* Very little risk if held to maturity. Moderate to substantial fluctuations can be expected in realized return if bonds are sold before maturity. Rate geared to expected long-run inflation rate. "Junk bonds" promise much higher returns but with much higher risk.	5–6½	Investments must be held until maturity (20–30 years) to be assured of the stated rate. (The bonds also need to be protected against redemption.) The bonds may be sold at any time, but market prices vary with interest rates.
Some tossing and turning before you doze, and vivid dreams before awakening	DIVERSIFIED PORTFOLIOS OF BLUE-CHIP U.S. OR DEVELOPED FOREIGN COUNTRY COMMON STOCKS *Risk Level:* Moderate to substantial risk. In any one year, the actual return could in fact be negative. Diversified portfolios have at times lost 25% or more of their actual value. Contrary to some opinions, a good inflation hedge over the long run.	7–8½	No specific investment period required and stocks may be sold at any time. The average expected return assumes a fairly long investment period and can only be treated as a rough guide based on current conditions.
	REAL ESTATE *Risk Level:* Same as above but REITs are good diversifiers and can be a good inflation hedge.	Similar to common stock	Same as for common stocks in general if purchase is made through REITs.
Nightmares not uncommon but, over the long run, well rested	DIVERSIFIED PORTFOLIOS OF RELATIVELY RISKY STOCKS OF SMALLER GROWTH COMPANIES *Risk Level:* Substantial risk. In any one year the actual return could be negative. Diversified portfolios of very risky stocks have at times lost 50% or more of their value. Good inflation hedge.	8–9	Same as above. The average expected return assumes a fairly long investment period and can only be treated as a rough guide based on current conditions.
Vivid dreams and occasional nightmares	DIVERSIFIED PORTFOLIOS OF EMERGING-MARKET STOCKS *Risk Level:* Fluctuations up or down of 50% to 75% in a single year are not uncommon but have diversification benefits.	8–11	Plan to hold for at least 10 years. Projected returns impossible to quantify precisely.
Bouts of Insomnia	GOLD *Risk Level:* Substantial risk. Believed to be a hedge against doomsday and hyperinflation. Can play a useful role in balancing a diversified portfolio, however.	Impossible to predict	High returns could be earned in any new speculative craze as long as there are greater fools to be found.

4.3. DO NOT waste money trying to 'time the market', buy 'hot' stocks, or use leverage to make investments. You are not going to be become the next Warren Buffet *in your free time*. Do you think you can pick a stock better than a computer or one of the thousands of highly intelligent full time stock analyst teams who have access to resources you don't even know exist?

4.4. DO invest in low cost passively managed broad based index funds. If it seems like there are an overwhelming number of choices out there then you're looking too hard. My choice of online brokerage is the investor-owned Vanguard. An example of well diversified investment portfolio might consist of the following funds, the amount of each allocated appropriately for your risk tolerance.

VTSAX stocks (for growth)
VBMFX bonds (as a deflation hedge)
VGSIX REITS & VIPSX TIPS (as an inflation hedge)
VFWIX international stocks (as U.S. currency hedge)

4.5. DO allocate your resources appropriately for your age. A rule of thumb is to hold a percentage of stocks equal to 110 minus your age. If keeping up with the allocations is too much work then buy a life-cycle fund (target retirement fund), which *automatically* adjusts your investments to balance risk as you age. In either case start investing young to take advantage of compound interest, (investments grow exponentially over time, The sooner you start the better!)

4.6. DO NOT make buying or selling decisions out of fear or greed. Keep a long term perspective and make regular (monthly) contributions and ignore day to day market fluctuations.

4.7. DO take advantage of special tax advantaged opportunities such as 401k's with matching (always meet the match % at minimum), IRA's, ROTH IRA's, etc.

4.8. DO NOT let your lack of finances keep you from investing. Many people are simply unable to save very much money and so they are too discouraged or otherwise unable to afford the minimum fund buy in. To these folks I recommend using betterment, which is a super easy way to get your nest egg started when you don't have a lot left over at the end of the month.

4.9. Other types of investments:

4.9.1. DO NOT invest in niche physical assets unless you are an expert in that niche. I don't mess around with precious metals, guns, antiques, artwork, or even real estate because I don't know enough about those topics.

4.9.2. DO invest in higher education. Getting an education up to a bachelor's degree is always a great deal for careers in STEM fields. According to Freakonomics Radio, every extra year of education you get will translate into an 8 percent increase in earnings over your lifetime, in addition to a decreased unemployment rate.

Going for an advanced degree is financially worth the investment too. Although the payback period depends hugely on your career field, who's paying for it, and whether it requires you to stop working to return to school. For instance, don't bother with an MBA if you already have the engineering degree.

I ran some calculations for investing in an engineering master's degree based on realistic expectations and averages from the internet. The results show an ROI of 10.6 years, which is probably a worst case scenario. It would pay back significantly sooner if you got the degree on the side while employed or if your employer/school helped pay for it!

Summary: The overall idea is to avoid big financial mistakes, maximize your income, minimize expenses, then save and invest the difference.

That concludes my financial advice. I'm not rich yet but everything discussed is based on lots of research and I practice what I preach myself. I still advise you to draw your own conclusions based on research from *multiple* sources. Below are a few that I recommend:

Recommended Reading #1: Jim Collins Stock Investing Series, Blog

Don't be intimidated by the large number of posts here (26), each one of them was a joy to read and is packed with solid experience based advice.

Recommended Reading #2: I Will Teach You to Be Rich, Book

Entertaining book on personal finance and frugality written specifically for people in their teens and twenties.

Recommended Reading #3: Mr. Money Mustache, Blog

A lifestyle blog written by a badass bike riding mustache wearing guy from Longmont, Colorado. Mr. Money reached financial independence in his thirties and learned that he was *more* happy living a life of frugality.

Recommended Reading #4: A Random Walk Down Wall Street, Book
Written for intellectual adults, this book is split into two sections: Part 1 is a massive piece on why it's impossible to time the market and how low cost broad based index funds are the choice. Part 2 is about choosing a brokerage, index funds, allocations, and otherwise general personal finance advice.

Final Note & Disclaimer: I am not a financial adviser and I am not responsible for any financial decisions *you* choose to make!

It's good to have money and the things that money can buy, but it's good, too, to check up once in a while and make sure you haven't lost the things that money can't buy.

~ George Horace Latimer