



# Simple Steps to Financial Security

By Blythe J. McGarvie

## THE FISO FACTOR & FINANCES

**D**uring the past year as I described leaders who meet the “Fit In Stand Out” criteria including financial acuity, it struck me that questions and answers about personal financial security continue to interest readers of all ages. The three most important concepts for personal financial security can not be found in one book. First, the sooner you take advantage of the magic of compounding interest, the more secure your financial future will be. But, where should you invest your money? The second critical concept is to have a clear asset allocation policy. Finally, when you are tempted to change your asset allocation or ignore your disciplines, don’t.

### Start Now

When I was beginning my career in the late 1970s, paying off student loans and wanting to spend money on nice things, I had an epiphany. A friend told me he saved \$250 per week. I knew we were earning about the same salary and had similar lifestyles. Yet, my goal was to save \$100 per week. After our conversation, I thought to myself, if he can save that amount, so should I. That is when I started to increase my saving level and writing the first check out of each paycheck to a savings account, then spending the rest on living expenses and any discretionary items, if I had the funds. Although this may seem to be a ridiculously low amount of savings, you have to start some-

where. Plus, my dream was to buy a little house as I felt apartment rent and mortgage payments had the same cash outflow, but very different affects on wealth accumulation. Saving helped build funds for a down payment.

As I saved for most of my down payment I did not invest in any equities, as I had a short term horizon. I found money market funds worked for me. Some of my friends invested in CDs (Certificates of Deposits). In retrospect, budgeting and watching interest accumulate was the first step to financial security. The secret is to ignore the money you put in an interest bearing account. The magic comes from having your interest income continue to earn interest.

*Compounding interest* means that you earn interest on your interest. The sooner you start, the quicker your funds grow. To help you plan and give you encouragement, use the same principles Warren Buffet and many investing websites extol: The Rule of 72. This rule allows you to approximate how quickly your money will double. For example, say your funds will earn 5% annually. Divide that into 72 to discover that your money will double in 14.4 years (72 divided by 5). Knowing how quickly funds will grow at different interest rates will help you determine how much risk you will tolerate with your savings that, in turn, can help identify the types of investments that will be appropriate for you.

### Determine Asset Allocation

Once you have the beginning of a nest egg, then it is time to decide how to allocate your funds based on your investment time horizon and risk tolerance. Allocating your funds between US equities (companies with

small market capitalization or large market capitalization), non-US equities, bonds, cash and other types of assets is more important in determining your investment returns than selecting specific stocks because few investors can outsmart and consistently achieve returns greater than the market. One of the most compelling books that explains this concept in less than 100 pages is *Investment Policy, How to Win the Loser’s Game* by Charles D. Ellis, a veteran investor. It is worth reading if you want proof. My copy was written in 1985, updated in 1993. The author recently expanded the book in 2002 and renamed it to “Winning the Loser’s Game”.

No one can predict stock market returns or inflation rates, but we each have our own assessment of the future based on reading, thinking and assessing what we see and know. Once you consider your own goals in the context of your vision of the market, you will want to plan how to accumulate the funds you need and desire. A quick way to determine how your current asset allocation compares to your desired allocation to reach your goals with financial security can be found at <http://www.smartmoney.com/oneasset>.

### Gain confidence

Finally, if it were so easy, why doesn’t everyone have financial security? The analogous question is if we know how to avoid getting fat and sick, why doesn’t everyone stay thin and healthy? Discipline to stick with your asset allocation and not gamble your future is the third simple step. This is easy to say, hard to do. As we start 2007, take an inventory of your current assets and liabilities. Decide how much of your income will be used for immediate gratification or longer term financial security. You can have a little bit of both, but only after you know how much volatility you can tolerate in your investment returns. By keeping to your plan and eventually reaching your goals, you will stand out and have some comfort in your lifestyle and have confidence in the future. With this confidence, others will want to follow your example. ■