CHAPTER 1
Getting Your Financial Act Together and Eliminating Indentured Servitude

When I was a Superior Court Judge, I presided over many trials involving residential burglary. The burglars did what burglars do—they stole money, jewelry, and other personal property. Sometimes they took property that had no street value, like photo albums. If the homeowner had insurance, most of their losses were compensated.

A lot of the victims were middle class families barely getting by financially. There was an excellent chance that the victims also had substantial credit card debt that charged interest at a compounded rate of 18%. Did these victims realize that getting behind the eight ball with credit card debt was actually worse than being burglarized? The residential burglar only robbed them once. The card companies robbed them every month. These middle class families had become long-term indentured servants to the credit card companies.

One of the major obstacles to financial freedom is the inordinate card debt owed by the average U.S. household. Estimates vary from $2,000 to $8,000 debt per person (depending on which survey you accept). I will show you how you can become a *saver* rather than a *spender*, and turn a negative situation into a positive situation. If you follow my approach, you can save 1 to 5% of your gross income, or more.

If you are a person who has excessive credit card debt, you need to admit that you cannot distinguish *wants* from *needs*.

Later in the Chapter, you will see a sample household budget. The budget has two columns—the first is for your *actual* income and expenses, and the second is for your *revised* budget that cuts spending and provides savings.

Wants are items you purchase that are generated by slick advertising, and your inability to fight off the "sheep" mentality that infects our society. *Needs* are the basic necessities of life such as food, shelter and medical care.

Getting Started

1. Take 3 to 4 weeks to gather all the information. This is one of the most important decisions you will ever make. It's important that you have an *accurate* picture of your financial condition. Your budget should be revised annually.
2. There is no magic formula to distinguish wants from needs. The entire family, including children, needs to be involved in the decision-making.
3. After all the facts are gathered and a discussion has taken place, establish a *game plan* for the future. Be realistic and try to maintain flexibility.
4. If you have excessive utility bills (needs), you could save by properly insulating your home.
5. Can we generate more income? Can someone baby-sit, or pet-sit, cut lawns, or perform other services? At Christmas time, some people will pay you to string lights on their house.
6. Can money be raised by selling personal property that is never used? This could include a boat or camper.
7. If you need to buy clothes, furniture, or appliances, go to your local thrift store. Groups such as the Salvation Army, Goodwill Industries, St. Vincent de Paul, and the Disabled American Veterans sell quality merchandise at rock bottom prices.
8. <u>*Credit Card and Installment Contract Debt*</u>. Installment

Income and Expenses (Budget)

Income	**Actual**	**Revised**
1. Gross Paycheck		
2. Net Paycheck		
3. Income from other sources – Investment or Rental Income, Child Support, Spousal Support		
4. Add 2 + 3 to get actual net income		
5. Total Net Income		

Expenses	**Actual**	**Revised**
1. Rent/Mortgage		
2. Groceries		
3. Homeowners/Renters Insurance		
4. Taxes: Income, Real property & Sales		
5. Telephone (including cell phone)		
6. Utilities		
Electric		
Gas/Heating Oil		
Water		
7. Cable TV		
8. Internet Access		
9. Medical Expenses, including health insurance		
10. Transportation		
(a) Gasoline		
(b) Car insurance		
(c) Car payment		
(d) Car repairs and maintenance		
(e) Public transportation		
11. Insurance		
(a) Disability		
(b) Life		
(c) Long-Term Care		
(d) Other		
12. Entertainment/Recreation		
(a) Meals away from home		
(b) Vacation, other out-of-town trips		
(c) Health club, gym, golf, tennis, etc.		
13. Work related expenses, lunch		
14. Education expenses, grades 1-12, college, including costs of books and supplies, tuition, etc.		
15. Personal		
(a) Clothes		
(b) Grooming		
(c) Other		
16. Miscellaneous		
(a) Charitable Gifts		
(b) Gifts		
(c) Gifts or loans to friends or family		
(d) Child support		
17. Interest on credit cards and personal property, other than cars, e.g., furniture or TV, boat or camper, recreation		
18. Total Expenses		

19. Surplus or Deficit

Photocopy at 120% for use at home.

Contract Debt is an important drain on your budget. It involves purchases of personal property such as furniture, appliances, beds, boats, campers, RVs and an automobile that never gets used. In some cases your interest rate is 18%. Too many people make only a minimum payment, perhaps 3% of the unpaid balance, so they dig themselves into a hole.

Figure out a way to totally eliminate this debt in 12 to 24 months.

The banks issuing credit cards have enormous power over your well-being. The *fine print* in the contract allows the bank to raise the interest rate you pay for *any reason*. Many people get hooked with a low introductory rate. If you are late on a home mortgage payment, or other installment contract debt, a credit card company can raise your card rate even if you have paid them like clockwork. A late payment may affect your FICO score, a credit rating system set up by credit bureaus. A high FICO score means you are a better credit risk, and a low score means you are a poor credit risk. A low scorer pays higher interest rates on all loans.

If you pay lower interest rates, you can save more money. Use the money for savings.

9. If you lack the self-discipline to dig yourself out of a hole, consider using a Credit Counselor. This business has a spotty track record. Some companies are rip-off artists but others can provide a useful service. For more information contact the National Foundation of Credit Counseling at 1-800 388-2227, or try www.debtorsanonymous.org, a self-help group.
10. If you are a two-wage earner family, your budget should be arranged so that the most important items in your budget are the responsibility of the larger earner. If you are a homeowner with a mortgage, you should purchase a term life insurance policy on the life of the largest earner.

Ideally, it should cover the unpaid amount of the mortgage. Shop around for the best insurance rate. You can usually find a term rate lower than one offered by the bank that holds the mortgage.

11. Give serious consideration to canceling all your credit cards. That way you pay for items by cash or check. This is a great weapon against impulse buying because you know how much money is available. Many thrift stores do not accept credit cards. Purchasing items at thrift stores is an excellent way to satisfy both wants and needs.
12. *Gifts*. The purchase of gifts causes a serious drain on the family budget. The entire family, including the children, should be brought into the loop on this issue. Children need to be educated about the value of savings. Open savings accounts for them.
13. *Medical Bills.* If you have unpaid medical bills, some doctors and hospitals will negotiate with you about cutting their bills. The medical providers often turn unpaid accounts over to a collection agency. The agency recovers 50% for themselves and the provider gets 50%.

    If you can convince the medical provider that you can pay cash on an agreed reduced amount of the debt, and pay within 30 days, you will get a bigger reduction. You should do this even if you have to borrow the money from family or friends.
14. Canceling credit cards does not mean that you will be unable to establish future credit. If you pay your bills and mortgage on time, you will be able to obtain future credit.
15. If the family needs to replace their present automobile(s), *do not* buy a new car. Purchase a late model used care from an automobile dealer with a warranty insurance policy. The insurance policy covers you for most future repairs or breakdowns. It does not cover normal maintenance like replacing a battery. Before purchasing the

insurance policy, read the fine print to see which items are not covered.

The reason you buy a used car rather than a new one is because a new car loses value the minute it's driven off the dealer's lot. Your car payments will be dramatically lower.

When you decide to buy, purchase a car that gets the best gas mileage possible and has a history of good maintenance. If you end up making a wise purchase, you can prolong the life of the vehicle by changing the oil frequently, and performing other types of preventive maintenance. Also, a car with good appearance on both the inside and outside maintains its value. It is not unknown for people to own cars that have over 200,000 miles on the odometer.

16. Even if you show a deficit in your actual budget, it is not impossible to get the financial monkey off your back if you *develop a game plan and stick with it*.

    After you have established a revised budget, note the date. Your budget should be revised every 12 months to determine if revisions are necessary. These revisions may range from minor to major (such as paying off a car loan).

    Even though many of us think of ourselves as being heavily taxed, the perception is incorrect. In California, which is a relatively high tax state, a family of four earning $75,000 per year, has *spendable/savable* income of $59,250 (79%). A single person earning $100,000 per year has *spendable/savable* income of $63,800 (63.8%).

    It is very difficult for me to believe that one can't turn a negative into a positive with these percentages.
17. Once you have established a goal, you need to divide your savings into two groups—savings for emergencies and unforeseen problems, and retirement savings.
18. If you are employed, and your employer has a 401-K plan,

this is one of the best sources of found money in America. If you earn $50,000 per year, your company will match your contributions *dollar for dollar* up to 6% of your total income. That means $3,000 per year of *found* income. Assume you are an ultraconservative investor who keeps his money in a money market fund that yields 4.5%. At the end of one year, the balance in your account is $6,270. You contributed $3,000. Your return is 109%. Tragically, only a small percentage of Americans take advantage of this opportunity.

One word of caution about 401-K plans sponsored by small employers—Companies with fewer than 100 employees are not subject to U.S. Department of Labor audits, so employees are vulnerable to employer theft. Kathy Kristoff of the *L.A. Times* wrote an excellent article about some employees who were victimized by their employer. Federal law requires that an employer need only post a bond of 10% of the value of the employees retirement account. My instinct is that the vast majority of employers are honest, so requiring a larger bond would probably be too expensive and might discourage employers from setting up 401-K plans. The employee should be vigilant about tracking the funds in the 401-K account.

19. Throughout this book, I will expose you to a variety of savings and retirement plans. You will be given a choice. The ultra-conservative plans are money market funds and U.S. Treasury obligations. At the other end of the spectrum you will find dividend stocks that pay 8%, and stock mutual funds that have higher yields.

There is absolutely no excuse for not becoming a saver rather than a spender. All I ask is that you use 1 to 5% of your gross income for this purpose. If you do this, it won't take long to obtain financial freedom.

Determining Your Net Worth

Determining your approximate net worth is important if you want to accurately plan your financial future. *Assets Minus Liabilities = Net Worth.*

Assets
1 The value of your home.
2 The value of other real estate.
3 The value of interest in limited partnership.
4 Amount of savings, C.D.s, etc.
5 Average balance of checking account.
6 Value of Brokerage Account.
7 Values of Retirement Accounts, IRAs, 401(k)s, etc.
8 Cash value of life insurance policies.
9 Value of automobiles.
10 Total Assets.

Liabilities
1 The unpaid balance on your home mortgage.
2 Unpaid balance on other real estate mortgages.
3 Unpaid balances on credit cards.
4 Unpaid balance on auto loans.
5 Unpaid balance on loans on furniture, TVs, etc.
6 Amount of loan on life insurance policy.
7 Total liabilities.

Net Worth = No. 10 minus No. 7

Calculating your net worth in most instances involves adding and subtracting figures. However, there may be some exceptions.

Your home or other real estate. If you don't have a recent appraisal from a mortgage lender, contact a realtor. Tell them you are thinking about selling your home and ask them for a brief appraisal that shows recent home sales in your area. A realtor's appraisal should be based on actual property sales. The real property value set by the taxing authorities is not always accurate so don't rely on it. There are a number of online appraisals available on the internet.

Zillow.com gives a good estimate of your house value. To get a more accurate value, compare the value of the comparable sales they list in support of their own opinion.

Interest in a limited partnership: For the value of your limited partner's interest, contact the general partner of the partnership.

Whole Life Insurance Policies have cash values. The insurance company usually provides an annual statement.

The value of your auto. Cars depreciate rapidly. The balance on your auto loan may exceed the value of your car. If you think you have some equity in the auto, consult the Kelly Blue Book to learn its value.

Whether you end up with a positive or negative net worth, *remember that you have promised to save 1 to 5% of your income, or more.*

If a family of four is able to distinguish wants from needs, they should take the following approach: Save 1% of their income ($750) annually, the first year; 2% ($1,500) the second year; 3% ($2,250) the third year; 4% ($3,000) the fourth year; and 5% ($3,750) the fifth year.

If that family, who earns $75,000 annually, follows my plan and purchases a dividend paying stock that pays 7%, *and reinvests dividends* quarterly, it will have a nest egg of *$13,278* at the end of five years.

Since reinvestment of dividends illustrates the miracle of *compound interest*, their actual yield will be about 7.2%.

Indentured Servant Credit Card Addiction

This table shows the folly of making only the required minimum 3% payment on a $500 purchase. After 12 months, you still owe $417.62.

Month	Balance
0	500.00
1	492.55
2	485.22
3	477.99
4	470.88
5	463.87
6	456.96
7	450.15
8	443.45
9	436.85
10	430.34
11	423.93
12	417.62

Notes: 18% APR; assumes credit card applies interest immediately after purchase; payment applies at end of month; months are all 30.42 days long, and year is 365 days.

Understanding Your Old "Mental Handbook"

The *No BS Handbook* provides valuable information that will enable you to become a successful investor. However, the information I have written will be of little use to you unless you take stock of the fact that your behavior is ultimately governed by your own set of rules. Most people *already* have a "mental handbook" containing rules about money and investing. These rules are not written, but were formed in your subconscious by several factors. Some rules about money may have been learned from relatives. Slick advertising that urged you to buy the latest fad may have formed other rules. Also, the mainstream financial news media exacerbates the problem by either scaring or confusing an investor with false or useless information.

We all bring along our own set of old feelings, attitudes, and rules about money when we begin reading a new finance book. *The No BS Handbook's* purpose is to help the reader *replace or modify* old BS-based rules that don't work in the real world, and keep and use the old ones that actually do work.