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Checking Your Personal Financial Ratios

When reviewing the financial health of a company, it's common to look at financial ratios, such as earnings per share, price/earnings ratios, book value, and total return. The reason financial ratios are so popular is they give you a means of evaluating financial information, while allowing you to track changes in a company's performance over time.

Consider using the same concept to assess and track your personal financial situation. At least annually, prepare a net worth statement and then calculate various financial ratios. Comparing those ratios over time will help you assess whether you are making progress toward your financial goals.

You should start by preparing a net worth statement, which lists all your assets and liabilities, with the excess representing your net worth.

All assets should be listed, including vested balances in retirement plans and 401(k) plans, personal property, jewelry, and household items. Assets should be valued at the price you would obtain if you sold them now, not the amount you paid for them. You'll also want to list your annual income, for ease in calculating some of the ratios.

Now, ask yourself the following questions about your finances:

✔ **Has your net worth grown by more than the inflation rate?** Calculate the percentage growth in your net worth over the past year and compare that to the inflation rate. To make progress toward achieving your financial goals, your net worth should increase by more than the inflation rate. If your net worth is not growing, determine the reasons.

✔ **What is your ratio of assets to liabilities?** A ratio of less than 1 indicates you have more liabilities than assets — a negative net worth. If that is the case, take active steps to reduce your liabilities. This ratio should increase over time, which would indicate you are reducing debt.

✔ **What is the trend in your liabilities?** Review the amounts and types of debt outstanding.

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Credit Card Debt

It's difficult to find anything good to say about credit card debt. Interest rates are typically high, and the interest is not tax deductible. If you only make the minimum payments on the balance, it can take years to pay off the debt. Your goal should be to pay off, as quickly as possible, all credit card debt. Some strategies to consider include:

✔ **Put your credit cards away until all your balances are paid in full.** If you are really committed to paying down those balances, you don't want to add to the problem by continuing to increase the balance.

✔ **Pay the balances in order of most expensive to least expensive.** Make a list of all your credit card balances and the interest rates charged on each. Add up your minimum payments and then determine how much more you can budget to help pay down those debts. Use these additional funds to pay off the debt with the highest nondeductible interest rate. Once that debt is paid in full, start paying the debt with the next highest interest rate.

✔ **Look for a lower interest rate credit card.** You may find an offer that contains a teaser rate, which can go as low as 0%, that is only available for a limited time. You can transfer balances from your high interest rate cards to the lower rate card and then pay off the balance as aggressively as possible.

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Financial Ratios

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Mortgages are typically used to purchase a house or other items that appreciate in value, so they are considered "good" debt. Credit card balances and auto loans are used to finance items that typically don't appreciate in value and should be kept to a minimum.

✔ **What percentages of your assets are liquid and nonliquid?** Nonliquid assets include items like your home, other real estate, jewelry, and works of art. Although they may increase in value over time, they can be difficult to sell quickly at full market value. Liquid assets, such as bank accounts and stocks, are more easily converted to cash. You want sufficient liquid assets to cover financial emergencies.

✔ **What is your savings to income ratio?** For this ratio, your savings equal all assets designated to help fund your retirement. It typically won't include your home, since you will probably live there after retirement. First, you need to decide what this ratio should equal at retirement. It is basically the amount of savings you want at retirement age, preferably determined after a careful analysis of all appropriate factors, divided by your annual income. For instance, if you want retirement assets equal to $2,000,000 when you retire and you currently earn $100,000, you would need a savings to income ratio of 20 when you retire. You might then develop benchmarks over your working years to help you gauge whether you are on track to achieving that goal.

✔ **What is your savings rate?** Calculate what percentage of your income you are saving on an annual basis. Typically, you'll want to save a minimum of 10% a year. This would include 401(k) contributions and individual retirement account contributions. If your employer matches your 401(k) contributions, you can include those contributions as part of your annual savings.

✔ **How have your investments performed?** Now may also be a good time to thoroughly analyze your portfolio's performance over the past year. Measure the performance of each investment, comparing it to an appropriate benchmark. This can help you identify portions of your portfolio that may need to be changed. Also calculate your overall rate of return and compare it to your targeted return. If your actual return is lower than the return you targeted when designing your investment program, you may need to increase your savings, select investments with higher return potential, or settle for less money in the future.

Please call if you'd like help reviewing your personal financial ratios or assessing whether you are on track in pursuing your financial goals. ❍❍❍

Financial Tips for Your Children

As a parent, you often wish you could impart wisdom gained over the years so your children don't have to make the same mistakes you did. What are the most important financial tips you should pass on to your children? Try these:

✔ **Graduate from college.** Even if your children are interested in pursuing careers that don't require a college education, encourage them to obtain a college degree first. It is much easier to go to college straight out of high school, before getting married or taking on other responsibilities. And financially, college graduates on average have higher earnings than nongraduates.

✔ **Develop written financial goals.** This will help your children think about their future and how to achieve their goals. As part of the process, encourage your children to get a money management system in place to track expenditures and organize information about assets and investments.

✔ **Live well within their means.** As your children start lives of their own, help them make some fundamental decisions about how to live. Make sure they realize that the only way to save for future goals is not to spend all their current income. So, before your children decide where to live or what kind of car to drive, help them prepare a budget.

✔ **Utilize all retirement vehicles available.** As soon as your children are eligible, they should start contributing to a 401(k) plan at work. If their employer doesn't offer a 401(k) plan, teach your children the benefits of individual retirement accounts (IRAs), both traditional deductible and Roth.

✔ **Use debt sparingly.** If your children get into too much debt early in life, they can spend the rest of their lives struggling to get out of debt. Stress to your children that it is best to only use credit cards if they can pay the balance in full every month. Other debt, like car loans and mortgages, should only be taken on after a careful analysis of whether your children can afford the payments and whether the purchase fits in with their financial goals. ❍❍❍

Use a Budget to Control Spending

First, keep this in mind — almost no one enjoys the process of analyzing and budgeting expenditures. But inefficient and wasted expenditures can be major impediments to accomplishing your financial goals. It is difficult to manage your money if you don't know how much you have or where it is going. Consider these steps when developing your budget:

1 Identify how you are spending your income. You should review an annual period so you identify regular monthly expenses as well as irregular, periodic expenses, such as insurance premiums, tuition, and gifts. Much of the information can be found by examining canceled checks, credit card receipts, and tax returns. Total expenses in categories that make sense for your lifestyle. If you can't account for more than 5% of your income, take a closer look at your cash purchases. Keep a journal tracking every penny you spend for at least a month.

2 Evaluate your expenditures. If you're having trouble finding money to save, critically review your expenditures. Consider these tips:

✔ Find ways to save at least 10% of your income. Almost all expenditure categories offer potential for savings. With essential expenses with fixed amounts, such as your mortgage, taxes, and insurance, you may be able to refinance your mortgage, find strategies to help reduce taxes, or comparison shop your insurance to reduce premiums. Essential expenses that vary in amount, such as food, medical care, and utilities, can usually be reduced by altering your spending or living habits. Discretionary expenses, such as entertainment, dining out, clothing, travel, and charitable contributions, typically offer the most potential for spending reductions. Dining out four times a week? Reduce it to two, go to less expensive restaurants, and save the difference.

✔ Limit the use of your credit cards, especially if you're not paying the balance in full every month. Not only do credit card balances carry high interest charges, but credit cards tend to encourage impulse spending. Use cash or a debit card, which automatically deducts purchases from your bank account.

✔ Resolve not to purchase impulse items or items over a certain dollar amount on your first shopping trip. Go home, think about it for a week, and then go back to purchase the item. Often, you'll decide you don't really need it.

✔ Delay the purchase of large items. For example, instead of purchasing a new car every two or three years, keep your car for four or five years.

✔ If you're really serious about reducing expenses, consider moving to a less expensive home. Not only will you reduce your mortgage payment, but you will save on other costs, such as property taxes, insurance, and utilities.

3 Prepare a budget to guide future spending. You may want to start by setting a budget for a couple of months, tracking your expenses closely over that time. You can then fine-tune your budget for an annual period. Some tips to consider when preparing your budget include:

✔ Don't include income in your budget that is uncertain, such as year-end bonuses, tax refunds, or gains on investments. When you receive that money, just put it aside for saving.

✔ Set up enough expenditure categories to give you a good feel for your spending patterns, but not so many that it becomes difficult and time consuming to monitor your progress.

✔ Make your budget flexible enough to handle unforeseen expenditures. Nothing goes exactly as planned, and your budget should be able to deal with emergencies. Be sure to include large, periodic expenditures, such as insurance premiums or tuition.

✔ Don't be so rigid that your family is afraid to spend any money. Everyone in the family should have a reasonable allowance that can be spent without accounting for it.

✔ Find ways to make the savings component of your budget happen automatically. Get the money out of your bank account and into an investment account before you have a chance to spend it.

The money you have available for saving is a direct result of your spending habits. Use a budget to control your spending so you can maximize your savings. Please call if you need help with this process. ❍❍❍

Debt

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Before getting the new card, make sure to review all details. The low rate may only apply to new purchases or to transferred balances. You're looking for a card that will apply the low rate to transferred balances. Also check if there are any balance transfer fees. Once the teaser rate is over, either find another low rate card or call the company to request a lower rate on that card.

✔ **Consider using a home-equity loan to pay off your consumer debts.** Home-equity loans typically carry lower interest rates than other consumer debt, and as long as the balance does not exceed $100,000, interest paid on home-equity loans is deductible on your tax return as an itemized deduction. Keep in mind that you are taking equity out of your home when you do this. This may be a good tradeoff if you use the funds to reduce higher cost debt. However, if you just run your credit card balances up again, you will still have the consumer debt plus less equity in your home.

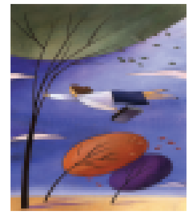
Student Loans

Paying for a college education is no small task, with the average annual cost of a four-year public college at $15,566 and of a four-year private college at $31,916 for the 2005-06 school year (Source: *Trends in College Pricing*, 2005). You may not want to count on financial aid, especially since approximately 47% of all financial aid awards are loans (Source: *Trends in Student Aid*, 2005). Even if you have been diligent about saving and qualify for some financial aid, you may need student loans to get through college. To keep student loans under control, consider these strategies:

✔ **Consider consolidating student loans.** Student loan borrowers have a one-time opportunity to consolidate all student loans and lock in an interest rate for the loan's term. Students who are just graduating have a six-month grace period before repayments must begin. However, if those loans are consolidated during that period, the interest rate will be discounted by .6%.

✔ **Shop around before consolidating.** While the interest rate for Stafford and PLUS loans won't vary by lender, lenders do offer different incentives for a good repayment history. Allowing the lender to automatically deduct the loan payment from a bank account will often result in a .25% interest rate reduction. Make every payment on time for four or five years, and the lender will often reduce the interest rate by 1% for the remainder of the loan's term.

If you'd like help getting your debt under control, please call. ❍❍❍



Dealing with a Spouse's Credit Issues

When you apply jointly for credit, both your credit histories will be evaluated. Thus, if you or your spouse has an outstanding credit history and the other has credit problems, it can affect the approval process and the cost of your debt. Consider these tips in that situation:

✔ **Don't apply for joint credit.** If your spouse's credit history is very bad, it may pay to leave him/her off the credit application. However, that means your spouse's income won't be considered.

✔ **Ask a parent or relative to cosign a major loan, such as a mortgage.** Before asking, keep in mind that you are asking that person to take responsibility for the entire loan. If you default, the lender can come after your cosigner.

✔ **Instead of applying for joint credit cards, list your spouse as an authorized user of your cards.** While an authorized user can charge on your credit card, you are responsible for paying the bills. ❍❍❍

Financial Thoughts

In 2005, 69% of workers saved for retirement, compared to 74% of workers in 2000. Approximately 39% of workers age 55 have saved less than $25,000 for retirement, while 19% have saved more than $250,000 (Source: *Retirement Confidence Survey*, 2005).

Approximately 81% of senior citizens plan to stay in their homes as they age (Source: *Journal of Financial Planning*, January 2006).

Workers under age 35 have a 33% chance of becoming disabled for at least six months while in the work force and a 50% chance of disability before age 65. Working women face a 54% chance of becoming disabled during their working years, compared with a 43% risk for men. In addition, 46% of mortgage foreclosures are a result of lost income attributable to a disability. Despite these odds, approximately 110 million Americans do not have long-term disability insurance (Source: PlanSponsor.com, 2006).

While small-business owners age 50 and older tend to work longer hours than other workers, they also have more learning opportunities, more control, more flexibility, and make more money. In 2002, the average small-business owner earned $114,000 compared to $52,600 for a salaried worker (Source: Families and Work Institute, 2005). ❍❍❍