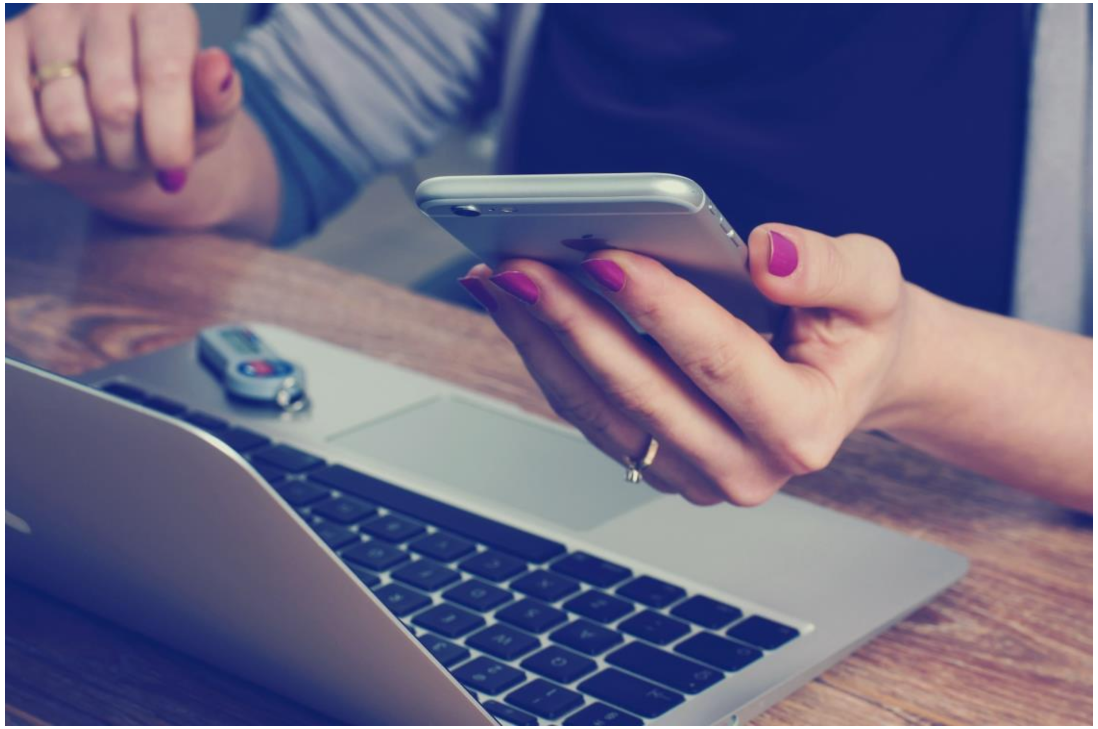
Financial Fitness

Personal Finance Basics

- Personal finance uses the process of personal financial planning to help you develop a spending plan around your lifestyle and financial goals
- It helps you set realistic goals and budget to meet them while managing your savings and investments



Setting Personal Financial Goals

If you do not know where you are going, how will you know when you get there?

- You need to set financial goals to help you make wise financial decisions—and also as a reward for your efforts
- Goals should be clear, concise, detailed, and written down
  - Unwritten goals are just wishes
- Those who set goals and fail often find they didn't set realistic goals to begin with
- The first step in setting any goal is determining what is realistic and what is not

Achieving Your Goals

- In order to achieve all your goals, you will need a plan
- You achieve your financial goals when you have the cash available to satisfy some immediate financial need, want, or desire
- The key is to be prepared to have the required cash when the time comes to achieve the goal

Making a Plan

- Each financial goal has its own price and time horizon (when you need the money)
- In order to achieve all your goals, you will need a plan
- Starting from what you already have available, you will need to determine how much more you need to accumulate and when you will need it

Making a Plan

- Don't neglect to consider that the price of your goal items might actually increase as well
- Depending on how you invest your savings over time, you might receive interest, dividends, or gains to help you along
- Also consider the effect of taxes on your savings

Determining Your Time Horizon

- Consider how important it is to achieve your goals on time
- Some goals are so important that not achieving them would not only be disappointing but also disastrous
- When a goal must be achieved by a specific date, you must plan conservatively, save more money, and take less investment risk to help ensure against loss
- However, if the timing isn’t as important or if you have discretionary assets and can take some investment risk, you might be able to invest more aggressively

Determining Your Time Horizon

- Goals should be grouped as short-term (3 years or fewer), intermediate-term (3-7 years), and long-term (more than 7 years)
- Generally, the longer the time horizon to achieving a goal, the more aggressive you can be in your investment approach
- However, you should never exceed your risk tolerance (the amount of risk you can take without abandoning your goal)
- If you approach setting financial goals in this way, you will make better financial decisions about setting goals and ways to invest to potentially achieve them

Measuring Your Progress

- You should always monitor your goals to ensure they are on track
- Set up a way to measure your progress
- If you see you are lagging behind, you may need to make an adjustment in the amount or way you are investing
- If you are way ahead, you may want to be more conservative, shorten your time horizon, or add a new goal

Building a Financial Action Plan

- Goals tend to fail when they are not specific
- To really work, goals should specify three things:
    1. What the goal is
    2. How much money is needed for it
    3. When the goal is to be achieved
- A working financial action plan should consist of a specific, measurable goal and specific actions to achieve that goal
- You should monitor your financial action plan monthly to make sure it is on track and revise it as necessary

Example Financial Action Plan

- ***Goal: Create an emergency fund of $5,000 in 24 months***
    - ***Task 1:*** *Reduce the phone bill, cable bill, dining out expenses, and other expenditures by $208 per month*
    - ***Task 2:*** *Divert the amount of money saved into a separate account, such as a savings account*

Savings and Investments

- Personal finance helps you make better savings and investment decisions because it focuses on your goals
- Your budget (spending plan) should be built around your day-to-day expenses, including your short-term lifestyle and financial goals
- These may include your goals for your family's well-being, shelter, food, clothing, and recreation, and it should also provide for future personal lifestyle and financial goals

Savings and Investments

- Savings and investments should be used to match your short-, intermediate-, and long-term financial goals
- You save and invest for a purpose, not just to accumulate great wealth
- How you save and invest depend upon the purpose
- To make these decisions, you need to understand the relationship among investment risk, time horizon, and investment reward

Reward for Risk

- Investors are rewarded for taking investment risk
- To encourage investors to take higher risks, the potential rewards must be higher for those higher-risk investments
- You can spread investment risk over many different investments—this is called diversification
- However, keep in mind there is no guarantee that a diversified portfolio will protect against loss, enhance overall returns, or outperform a non-diversified portfolio
- You can use this relationship in making savings and investment decisions—lower risk for short-term goals and higher risk for longer-term goals

Small Changes Can Add Up to Big Savings

- Building wealth can seem like a daunting task, but even putting aside small amounts can add up to something big
- Small, periodic expenses on discretionary items like coffee, candy, and fast food (and the sales taxes on them) can add up to a lot
- If those expenses were saved and put into an account that earns interest, dividends, or capital gains, the results over time could be substantial

Small Changes Can Add Up to Big Savings

- You do not need to completely deprive yourself of the little things in life
- Look closely at your spending, see where you are leaking money needlessly, and make changes accordingly
  - A good way to find out where you can make changes is to track your expenses for a month
  - Record every single penny spent and check any online bank accounts to see if withdrawals are being made that you are unaware of
- The next step is diverting these small amounts into savings or investments where they can grow in value or earn interest, capital gains, or dividends—with compounding, the earnings can add up even faster
- Saving small amounts here and there is not what investing is about; rather, saving small amounts here and there is one starting point for gaining the discipline to control your spending
- The drive to save is much stronger when you first establish a goal that you want to work for—retirement, a house, a small business, a hobby item, etc.

Small Changes Can Add Up to Big Savings

How much can you save by making small changes to your spending?

- So-called "latte factor calculators" that you can find online let you plug in the numbers
- For example, spending $3 every other day over the course of 10 years could instead become over $7,200 if put into an account earning 6% interest (compounded annually)
  - This figure includes over $1,700 worth of interest alone!
- You can still splurge on your favorite things (more so once you have built up a good savings), but you may need to scale it back or cut out other expenses
- Going cold turkey could backfire and prompt you to binge-spend at inopportune moments

Practical Ideas to Start With Today

- List your financial goals, the date you want to accomplish each goal, and the dollar amount of each goal
- Match each of your short-, intermediate-, and long-term financial goals with a specific portion of your savings or investments
- Determine how much you should save to meet your goals
- Enroll in the Caterpillar Financial Fitness ACADEMY™!

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Open 24/7, 100s of easy ways to muscle up

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Available through September 2018