Financial Planning 101 for Millennials

Over the years our firm has had the opportunity to speak with many college students and young adults seeking some basic financial advice as they get ready to start their own journey through life. This early stage of adult life is an important time to establish a disciplined foundation that will lead to a successful financial future. With that being said, I would like to offer a couple guiding principles.

Live Within Your Means

Living within one's means may be the most important factor in achieving financial success. The ability to spend less than you earn and save on a regular basis is far more important than picking the hottest stock on the Robinhood app. The perception of wealth in our culture is deceitful. Whether it's the most popular television show or social media site, the image of excess is constantly promoted as a means to happiness and fulfillment. What's not often shown is the debt and stress that comes with this type of lifestyle.

Most people don't have a clear idea about their cash flow, which is understood as the income they bring home less expenses. I would recommend preparing a basic budget. This doesn't have to be a tedious accounting exercise, perhaps just a brief review of the last couple months of bank account and credit card statements. Once you have established a rough budget all you need to do is perform a quick review of your expenses each month to confirm that you're still on track. This can be an eye opener and many people are surprised to learn where they are spending money.

Credit cards are a convenient way to purchase goods and are almost mandatory right now during the current Covid-19 pandemic. However, it's often very easy to forget that payment is due the following month, which is a major reason millions of Americans overspend. Credit cards typically charge high interest rates, often double digits, if you carry a monthly balance. At these rates you don't need to have a PhD in Finance to understand that the amount of interest is going to snowball in short time with carrying a balance.

Carefully Consider Big Decisions

One of the most significant decisions a young adult will make is choosing their education or vocation path. These decisions made at an early age will impact the trajectory of the next several decades. There's much more to consider than just future income potential, but it is prudent to pursue a career that will provide the necessary income to achieve financial goals.

Save Early, Save Often

Once you have established a budget and understand your cash flow, it's time to organize short, intermediate, and long-term goals. An example of a short-term goal could include saving for an upcoming vacation, intermediate-term goal saving for a down payment on a house in 5 years, and long-term goals will likely prioritize retirement or financial independence.

Most employers offer a company sponsored 401(k) or 403(b) retirement plan. Over the past several decades these type of defined contribution plans have grown in popularity as they've replaced traditional pensions. A 401(k) is a great vehicle for retirement savings and a benefit that you will want to participate in. Your contributions are automatically deducted through payroll and deposited into the plan. A good savings target is 10% to 15%, but don't worry if you can't start at that level. Save what your cash flow permits and plan to increase your savings rate over time. If your employer provides a match on your contributions, you will definitely want to try and save at least the minimum to receive the full match, since this is basically free money. If your employer matches fifty cents on the dollar, this is like getting a 50% return on your contribution.

If you have extra funds available after participating in a company retirement plan, a Roth IRA would be another option to consider. A Roth IRA is a retirement savings account that is funded with after-tax money, grows tax free, and provides tax-free distributions in retirement. A Roth can provide significant leverage to a young person with tax-free growth over the coming decades. A single tax filer can make up to the maximum Roth contribution ($6,000 in 2020) if they have earned income and their Adjusted Gross Income is below $124,000 (a partial contribution is allowed if income is between $124,000 and $139,000).

Next is the million dollar question, how should I invest my retirement accounts? For most in their 20's or 30's, a diversified growth strategy consisting of about 80% stocks would be appropriate for meeting long-term retirement goals. With a time horizon of 40+ years until retirement, an individual will need to have enough exposure to a diversified portfolio of stocks to provide the necessary long-term growth.

Live Generously

The last principle is to have a healthy perspective of money and view it as a means to an end versus an end in and of itself. Achieving financial independence will provide the flexibility to help those you love and contribute to meaningful causes. Having a sense of gratitude for our blessings and abundance is more likely to lead to satisfaction than getting caught up in the culture of affluenza.

Please visit our website, www.hfinancialmanagement.com, for more information about H Financial Management's investment philosophy.

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