Mind Your Money

Painting
New Car
Vacation
Holiday Home
Travel
Family
Financial Freedom
Happiness
Studying
Retire
Career
Spending
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Time Off
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$ $

How to Safely Improve Finances, Freedom, and Opportunities

Bech Nielsen

Samples from chapters

and

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2.3.2 Calculating Life Expectancy

The important question when considering retirement is what is your expected life length and thus, for how long should your money last? The expected life length will also affect which pensions you should choose.

Several calculators on the Internet can help you calculate life expectancy considering health, style of living, and ancestors. However, calculators can be too basic as well as politically biased; they want us to live in a certain way; avoid alcohol, smoking, or boost our pension savings, but there are decent ones too.[8] Try at least a couple of those with thorough questions covering lifestyle, health, and ancestors. I just tried two different calculators and they arrived at almost the same result; 93 and 95, even though I am 59, smoke, enjoy wine, and dining, but fortunately am in good health. One explanation is my ancestors all lived to their late eighties or more even though they did not live particular healthy.

However, the older you are the longer your life expectancy will be. This is because some die young due to disease, accidents, suicide, or the like. Therefore, the same calculation for you at age 20 and at age 60 will yield a different result. It may only be few years, but consider staying updated, it will help you remember what is important to do to achieve a long and healthy life.

Let us have a look at how life expectancy should influence your choice of pension.

2.3.6 Calculating Retirement Options

The following chapter presents models that can help you to estimate your retirement options, how much you will be able to withdraw depending on savings, retirement age, and expected life length.

Utilize the models for preparation and evaluation of options when approaching retirement or you can employ the models when you:

- Feel the need for checking up on status. What will the future bring if you stay on track?
- Want to figure out which adjustment will be necessary to achieve certain goals.
- Want to analyze negative or positive consequences when your life takes an unexpected turn for the better or for worse, divorce, a considerable change in income or cost of living, inheritances, or major changes in the value of your investments.
- Want to figure out what the consequences are when inflation or potential future return on investments changes considerably.

How do you calculate when to retire? Let us say you feel ready for retirement and want to assure you have enough means for a pleasant life.

First, estimate your life length as described under "Calculating Life Expectancy" so you have an idea of how long money is supposed to last. However, plan for a long run if you feel uncertain about life expectancy.

If you have a relatively simple economy, utilize one of the simple calculators for reverse amortization on the Internet, they allow you to enter number of years, your savings, and interest. Remember to use an interest rate after inflation and tax. The result should be how much you can spend each year.

Example: (4% interest - 25% tax (equals 3% after tax)) – 1.5% inflation = 1.5%

To be honest, with the current low interest rates, under a couple of percent, you could just add up all your means and expected income over time and divide by the number of years they are supposed to last.

For convenience, let us assume you are 66 and have a life expectancy of 85 and calculate in $1,000, so the spreadsheet will fit on the page, but you could just as well calculate from 43 to 90. Here is an example of such a calculation using thousands of $:

	Retirement budget in 1.000 $	Age																			
A	**Payouts / savings after tax in present value**	66	67	68	69	70	71	72	73	74	75	76	77	78	79	80	81	82	83	84	85
	Savings (nest egg)	175																			
	Downsize/rightsize house				257																
	Reverse amortization house																	34	34	34	34
	10 year rate pension											32	32	32	32	32	32	32	32	32	32
	Life annuity (yearly)		2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2	2
	State pension (yearly)		7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7	7
B	**Payouts per year**	**175**	**9**	**9**	**266**	**9**	**9**	**9**	**9**	**9**	**9**	**41**	**41**	**41**	**41**	**41**	**41**	**75**	**75**	**75**	**75**

C Sum of payouts for all years **1,059** **Number of years** 20 **Average per year** **53**

[A] Payouts: Enter payouts in the spreadsheet per year (use your age). Use amount after tax in current prices as the basis, for example, use the current free value in your house, your savings as-is. You can correct any future values as follows:

- Include future interest after tax and inflation, which you earn before payout.
- Expected appreciation of home value must also be after inflation. You should be safe if you assume zero appreciation.
- Ask your pension provider for the necessary pension details such as expected payouts.

[B] Sum up the **payouts per year**.

[C] Add up all cash payouts ($1,059,000) and divide by the number of years they are supposed to last (20 years). This will give you a rough estimate of **how much to spend per year** ($53,000).

If you are without enough pension savings to retire at the desired age, you can make the same calculation using your salary, savings, and state pension. The calculation will help you figure out when to retire or how much you need to work to make ends meet.

If your finances are complicated or you just need a more precise calculation, the next page will show you a more elaborate model. However, note how small the difference between the results are for these different calculation models by comparing how much you will be able to spend per year.

3.1 Create an Overview of Net Value

To attain a complete overview of your net value, calculate assets and liabilities, i.e. what you own and how you have financed it. The net value is the difference between assets and liabilities. Here is an example of how to lay it out; the numbers refer to the table.

Add first year in the column marked **[1]** separate current assets **[2]** and liabilities **[3]** as shown below in the same column.

The first year is your basis for making the plan for next year. Include the plan for the year to come in column **[4]**.

Each year you complete should consist of three columns per year: plan **[4]**, actual **[5]**, and difference **[6]** allowing you to follow up on progress.

After two years, the balance ends up as depicted in the table:

In $ / Year	Actual 2014 [1]	Plan for 2015 [4]	Actual 2015 [5]	Diffe-rence [6]	Plan for 2016
Assets [2]					
Cars [A]	11,429	10,571	7,143	-3,429	5,714
House [B]	214,286	217,857	235,714	17,857	240,429
Salary account	286	1,000	714	-286	286
Household budget account	143	571	714	143	286
Budget account (buffer)	1,429	1,429	2,000	571	2,000
Savings	7,143	10,286	11,714	1,429	7,714
Corporate bonds (ETF)					3,571
Non-cyclical stocks (ETF)					3,571
Net pension savings	57,143	60,000	60,286	286	63,429
Liabilities [3]					
Car loan	-12,857	-10,429	-10,429	0	-7,286
Mortgage / house	-142,857	-142,286	-142,286	0	-142,143
Credit card balance	-286	0	0	0	0
My net value	**135,857**	**149,000**	**165,571**	**16,571**	**177,571**

Some comments to the amounts in the example:

[A] The cars were estimated to lose around 20 % per year. However, in 2015, one car got some dents and a new improved model was released. My best guess was a substantial drop in value.[13]

[B] The house was expected to increase 2% in value; fortunately, the general housing prices increased 10%.

The idea is to give as precise an image of your net value as possible.

Consequently, by analyzing your net value and setting goals for the year to come, you should assure you and your partner:

- Have set and agreed on future financial goals.
- Accumulate enough savings for investments in home, transportation, emergencies, etc.
- Assure you are on the desired path to realizing your financial goals.

Here is a list of different assets and liabilities for your inspiration:

Assets – consider the following:

- Equity in your home, buildings, land as well as equity in vehicles and equipment.
- Cash, savings and other accounts, bonds, shares, funds, and other securities or notes.
- Valuable furniture, antiques, artwork, jewelry, etc.
- Retirement accounts (consider using the net value after tax).

Liabilities:

- Mortgages, loans, taxes, and unpaid bills.

After finalizing the first draft of your overview, start figuring out how to handle savings & loans, so you pay the banks as little as possible, reduce risk and assure any excess money multiply. Make these findings part of your plan.

You will find plenty of ideas for this journey in the following chapters.

3.5 How to Invest Your Savings

Assuming you have put considerable effort into saving, your main concern should be to avoid risking these savings, pay the bank as little as possible and at the same time receive a decent return. The next chapters will focus on these aspects. We will start by examining risk important to consider when investing.

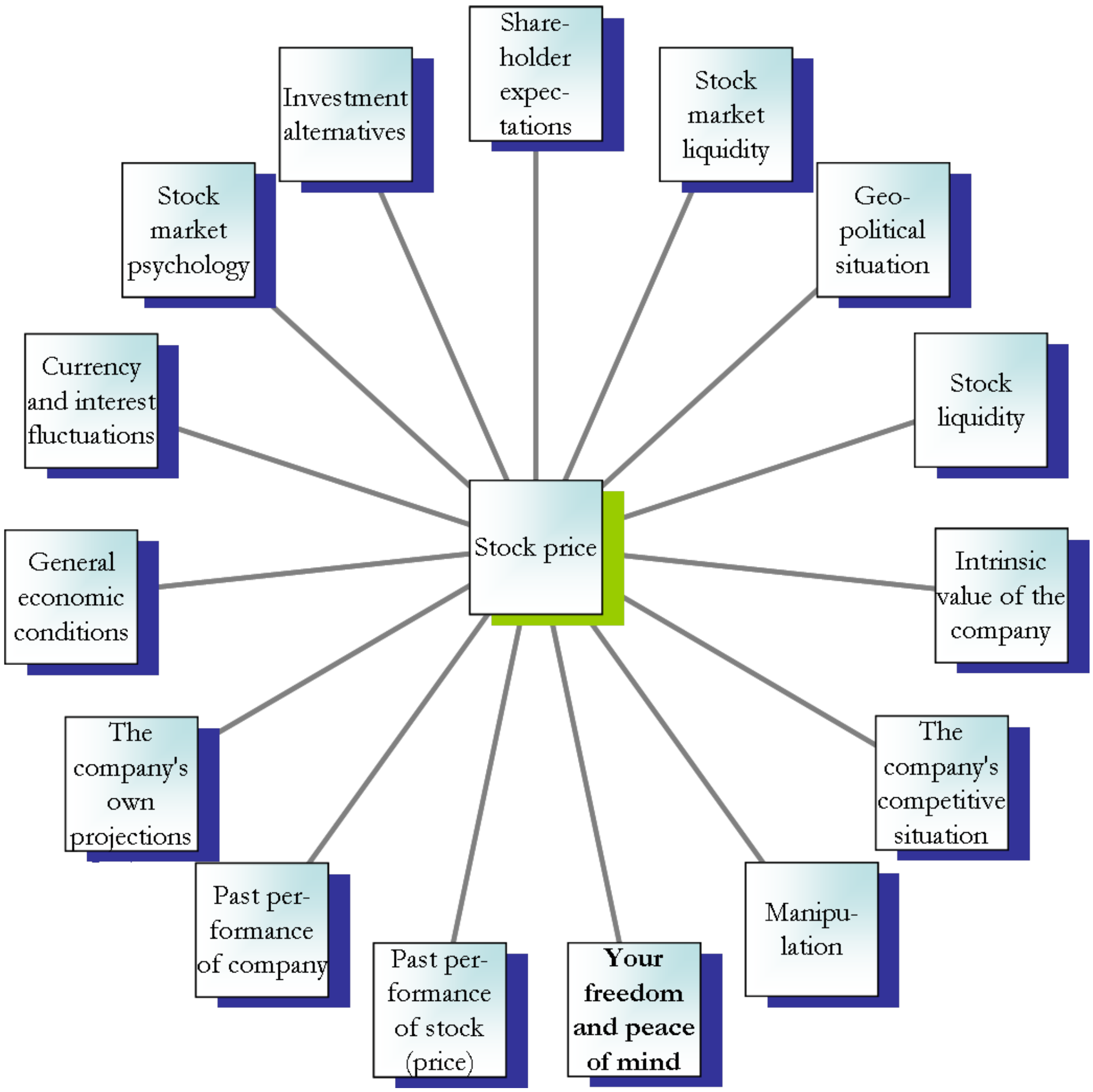
Maybe you do not feel you have the means to consider investing. However, this is exactly the point in time where some might be tempted to try shortcuts. We will dig into the dangers of these shortcuts whereof many will promise you fantastic returns without warning you of the potential risks.

> The surest way to lose a friend is to borrow him money.
>
> Danish saying

3.5.2.3 Do You Have the Time to Invest and the Stomach?

Let us assume you master one or preferably more of these previously mentioned strategies and intend to employ them. First, you need to perform the necessary analyses and buy your best choices. In addition, you need to follow the investment on a regular basis and redo the calculations periodically to assure your analyses and assumptions still holds.

The partial overview below depicts factors influencing stock prices and gives an impression of the complexity you must relate to.



Also, consider if your psyche is up for it; are you able to execute when an investment is going in the wrong direction?

It is painless to sell when making a profit. It is harder to sell when facing a loss. In addition, we tend to fall in love with our own decisions and have trouble changing direction, even when we are wrong.

If market turmoil arises, you may need to react. Furthermore, such events can happen when you least expect it or at a time where you do not have the time or opportunity to do anything about it. Will you panic and sell at the worst possible time? As some professionals say, the bottom of the market is reached when the last fool has sold.

Hence, consider if you want to let the stock market rule your life: vacations, important events, your precious spare time, and risk losing your savings due to lack of knowledge. State your decision in your plan.

Before proceeding to safer ways to invest, let us examine if Private Banking is the right choice, are too expensive, or could lead you off in a wrong direction.

3.5.4.1 Handling Risk in Your Investments

Handling risk is not complicated, decide when you need the money back, what is safe to invest in according to your timeframe, and decide how to weight your investment according to this risk. Why is it important? If, for example, you need to sell shares after just a couple of years you risk losing money.

Let us look at a simplified example of how to create an overview table for analyzing risk. A piece of paper will do fine:

	Weight of investments in each risk group						
Horizon in years and purpose	Bank accounts	Bonds matching investment horizon	Non-cyclical domestic shares	Cyclical domestic shares	Foreign shares Developed countries	Foreign shares 3. World	*Overall risk profile*
0-1 Buffer	10.000	-	-	-	-	-	*No risk*
1-4 New car	10.000	20.000	-	-	-	-	*No risk*
4-8 Down payment	-	40.000	40.000	-	-	-	*Low risk*
8-10 Pension	-	-	70.000	60.000	50.000	40.000	*Low risk*
Short term risk	*Low risk*	*Low risk*	*Medium risk*	*Medium to high risk*	*High risk*	*Very high risk*	

The first column with time horizons in the left side of the table deserves explanation:

- **0-1 year - Buffer**: Savings for unforeseen expenses are safest placed in a bank account. Keep this buffer readily available in an account. Who knows when you need the money for a car repair, a new refrigerator, a new mobile, a broken tooth, maintenance, job loss, or what other unforeseen expense come your way. Long-term investments do not fit this purpose, no one knows if the stock market is up or down when you need cash.

- **1-4 years - New car**: Savings for a new car would be safe placed in short bonds matching this time horizon or placing the money in a bank account. Moreover, it is normally possible to achieve a reasonable interest rate on a bank account if placing a large amount for a set period, so check possibilities with your local banks.

- **4-8 years - Down payment**: If you are saving for buying a home in 4-8 years it is unwise to invest too much in shares. In most cases, non-cyclical shares will be safer, but remember to consider the cycles in the stock market. However, bonds matching the time horizon will be safe.

- **8-10 years - Pension**: If part of your savings are for a pension more than 8-10 years away it will be relatively safe to invest in shares. However, pay attention to the cycles in the stock market and expectations concerning future interest rates.

Assumptions in the above example are:

- Funds are utilized for long-term investing, if not, the risk may be considerable higher unless you spread the risk over several companies.
- Interest is assumed to rise in the future, which could reduce the value of long bonds.
- Risk on stock investments will depend on type of companies, countries, geographic locations, the geopolitical situation, business climate, leadership, and more, so developed world versus 3rd World is too simple. In addition, I would personally choose 6-8 ETFs preferable investing in different areas just to spread my risk. Therefore, I would include 2-4 more columns in the table.

Some claim your age should decide investment profile and if you are young, risky investments make sense. This is in my opinion, pure nonsense; the important part is your time horizon i.e. when you need your money. Moreover, it makes sense to take more care of your money the less means you have, and in addition, who wants to start their investment career with failure. It also makes perfect sense to have part of your investment in shares (funds) even though you are 70, if you need the money in say 8+ years and the trend in the stock market is moving in the right direction.

However, if you decide to invest in shares, consider starting with a small amount and carefully monitor your progress as compared to your other investments.

The riskier the investment - the smaller the investment should be.

When determining risk research is important, if you use Morningstar[25] to find interesting funds, note Morningstar has a risk rating for each fund.

In addition, you also need to assess interest risk on any loans or mortgages, especially variable interest loans: consider the cost for you if interest payment increases and the probability of such an event.

3.5.4.6 Other Investments

Alternative areas to invest in can also be jewelry, art, fine furniture, etc. However, these investments may at best keep their value and part of the return would be enjoying them in your everyday life, but, if the timing is right, you may also be able to find interesting opportunities in these areas.

> When the wind of change blows, some seek shelter others build windmills.
>
> Ancient Chinese proverb

At times, real estate presents interesting opportunities, for example at one point in the depressed real estate market, a friend found, that summer cottages had become so cheap, you could own them free of charge, if renting them out. Consequently, he bought a tremendous summer cottage directly to the sea with a fantastic view, and it actually cost him close to nothing; the guests pay for the amortization, and he can stay there at no cost. In addition, his investment has been serving as a lottery coupon with a nice profit chance if the real estate market picked up steam again.

An example of his initial calculation corrected with actual rent after tax[28] and the actual sales price is included below:

	In 1.000 $	Year				
		2012	2013	2014	2015	2016
	Value of cottage	170.0				300.0
	Own initial investment (furniture etc.)	14.3				
	Net interest ex inflation	2%				
	Cost & income					
	Interest on loans (fully financed)	-3.4	-3.4	-3.4	-3.4	-3.4
	Insurance	-0.4	-0.4	-0.4	-0.4	-0.4
	Maintenance	-0.1	-0.1	-0.1	-0.9	-0.1
	taxes and renovation	-1.6	-1.6	-1.6	-1.6	-1.6
	Water and electricity	-0.9	-0.9	-0.9	-0.9	-0.9
	Furnishing, artwork, plants,garden tools etc	-14.3				10.0
	Earned rent after taxation	***4.7***	***5.1***	***6.3***	***8.9***	***8.9***
	Sales profit after sales costs					***130.0***
A	***Net profit***	***-16.0***	***-1.3***	***-0.1***	***1.7***	***142.5***

B **Net present value of investment (2012)** 113.7

C **Interest per year on investment** 72%

Status after 4 years is his lottery coupon seems to pay off much faster than expected; there has been a 76% price increase on the cottage, where he initially expected a few percent:

[A] Net profit: The last line in the table, it is the sum of all expenses and income for each year.

[B] Net present value:[29] This is the value of all payments in the row “Net profit,” but adjusted for interest. It represents his profit on the investment in 2012 prices.

[C] Internal interest:[30] In effect, his investment (the negative **net profit** for the 3 first years) of $17,400 increased to $113,700 equaling **a return of 72% per year after tax**. This phenomenal return was achieved, with a small initial investment and minimal risk.

Worth noting, the initial calculation only required him to:

- Use the costs (except furnishing) from the sales material from the realtor.
- Contact a rental bureau for their best estimate on rental profit after tax.
- Ask the bank for interest cost (after tax).
- Estimate the total cost per year.

For inspiration on how to spot a bottom in the real estate market, read the chapters under "Surfing the Waves of the Economy".

You should be able to make some tremendous deals in almost all areas when the economy is depressed. Other interesting areas to invest in could be furniture, antiques, artwork, jewelry, stocks, vintage cars etc.

If you have decided on an investment strategy, now is the time to state this in your plan.

4. Optimize Your Budget

A Gallup survey in the USA revealed only around 30% of all households has a long-term budget.[31] When people were asked why they did not prepare a budget, they responded they spend everything anyhow. At the same time, around half of all Americans claim they cannot afford a major purchase or a major repair.

> Wherever you go, go with all your heart.
>
> Confucius

However, any household should be able to achieve substantial savings on their expenses; all it takes is a little work. Opportunities and possibilities for saving will be revealed later, after a closer look at budgeting

5.2.2 Maintaining Financial Autonomy

Financial independence among couples is an issue that many couples are discussing. It can be a wise step if you remain financially independent, and when properly implemented, this means freedom and autonomy while simultaneously assuring stability to the family's finances. The following section presents one way to reach autonomy when it comes to finances.

Financial autonomy is possible if you as a couple keep your finances separate and only negotiate how to use the budget accounts you have together. This allows the freedom and independence to make decisions on your own; in turn, financial autonomy assures that:

- Each accepts responsibility for their actions and decisions.
- There will be less disagreement.
- You avoid guilt (e.g., "you always and I never…")
- You decide your own actions and priorities; for example, more work and fun or less work and more freedom, etc.

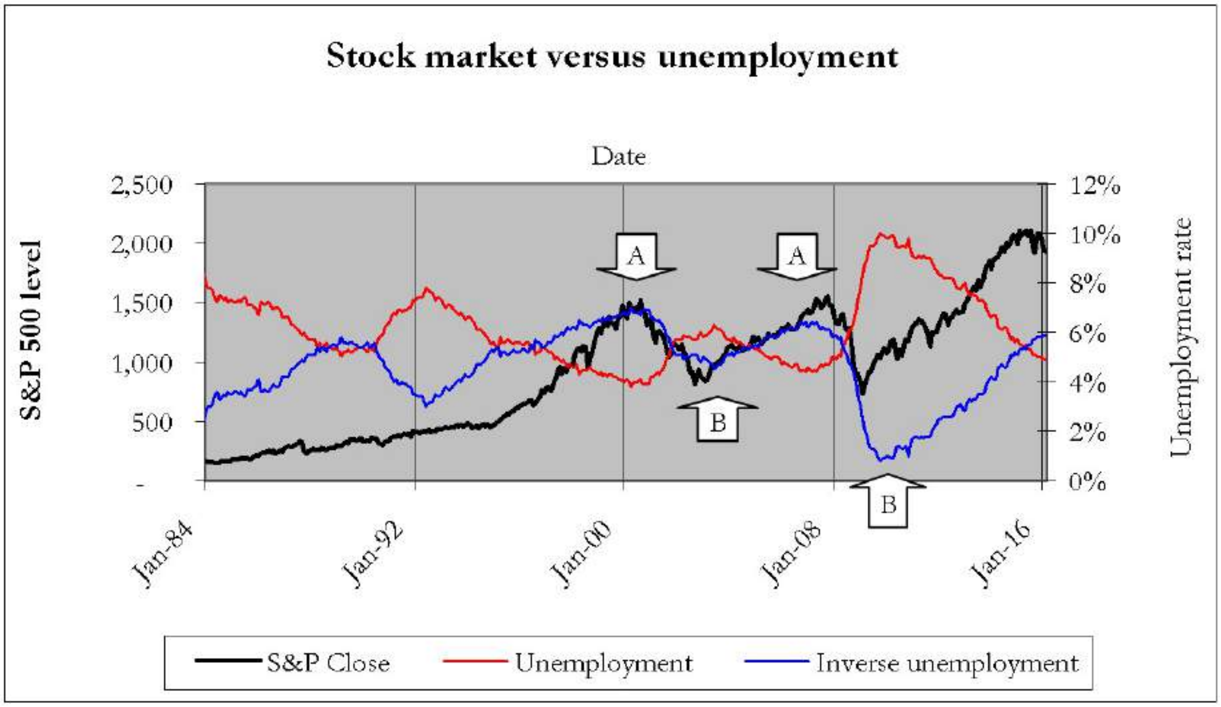
Moreover, if you do not earn approximately the same, you can regulate differences by one contributing more to the common household.

Some of my friends have practiced financial autonomy for years. The result has been fewer quarrels, more responsibility, and they are wealthy.

6.1.2 The Stock Market Points the Direction

Development in the stock indexes is a leading indicator of the general economy. Why is this interesting and why is it not the unemployment rate?

The example of changes in S&P 500 depicts how the unemployment rate[78] shifts direction later than the stock market at least at the bottom of the stock market; the inverse (flipped) unemployment line spells this out:



[A] If you observe rising unemployment around a stock market top, consider this **an early warning** of serious trouble. The consequence of falling employment as well as falling stock prices may be seriously lower consumption that will influence all areas of the economy negatively.

[B] Companies are not prone to hire before they are certain the economy is improving or visa versa (hiring and firing can be costly) consequently employment starts rising **after** a stock market bottom. The rise in employment is confirmation of better times and increased consumption which benefits all areas of the economy.

Realize that the stock market will give you invaluable information, which you may benefit from on other investments, when the stock market plummets: it gives an early warning that problems will hit other areas. On the other hand, when the stock market picks up steam, you may benefit from this in other areas, for example real estate, job opportunities, etc.

However, a serious downturn in the real-estate market has an even larger influence as revealed in the following.