



**BERNSTEIN**



YEARS OF INVESTMENT MANAGEMENT & RESEARCH



# **PERSONAL FINANCE:** Making Sense of It








# KEY COMPONENTS

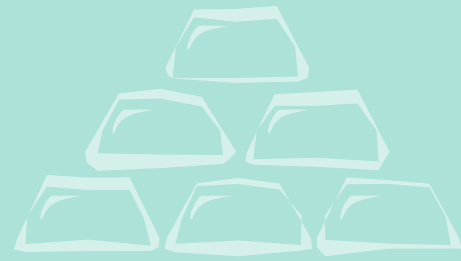
How much do you know about personal finance?

This brief guide aims to help you make responsible financial decisions and achieve your financial goals—to help you make money meaningful.

Each section offers basic information and a checklist to get you started:

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***Bernstein does not provide tax, legal, or accounting advice. In considering this material, you should discuss your individual circumstances with professionals in those areas before making any decisions.***



## FINANCIALLY RESPONSIBLE (adj.):

- *Living within your means, regardless of your income or assets*
- *Servicing your debt with timely payments of interest and repaying principal*
- *Planning for your future financial needs and goals with savings and investments*





# CREATING A BUDGET

How do you decide what to spend today, this month, or this year? A budget can help (**Display 1**, next page). Rather than make a series of ad hoc decisions, you weigh all your needs and desires against the money you earn—and set priorities. Creating a budget can also help you to save for bigger-ticket items, like a new car, a vacation, or a wedding, or to pay down debt.

## THE BOTTOM LINE

Budgeting is simply balancing what you earn and what you spend. If these two categories don't balance and your expenses exceed your income, you could run out of money before the next check comes in, run through your savings (if any), or start accumulating debt.

Check out these budgeting apps:\*



[mint.com](https://mint.com)

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DID YOU KNOW ?

Rent should not exceed 25% to 35% of your monthly income.

THE BIG IDEA



It's important to strike a balance between spending and saving. A budget can help you to do so.

\*Bernstein has no affiliation with these applications and makes no endorsement of them.

# CHECKLIST: Creating Your Budget

- ☐ **List all of your expenses and sources of income each month.** Review your bank statement, credit card bills, and receipts; remember to account for items that you paid cash for.
- ☐ **Identify your *fixed* expenses**, such as rent or a mortgage, car or student loan payments, and insurance premiums.
- ☐ **Identify your *variable* expenses** and divide them into must-haves (utilities, transportation, food, and clothes) and nice-to-haves (eating out, entertainment, travel, and more clothes).
- ☐ **Set a spending target for each category**, so that the sum of all categories is less than your after-tax income. If you have to cut back, variable expenses are a good place to start; you may have to manage fixed expenses, too. Could you move to a cheaper apartment, get a roommate, or lease a less expensive car?
- ☐ **Monitor your spending** for a couple of months and revise your budget as needed. Chances are, you'll find that you forgot some expenses and that you need to adjust some spending across categories.

DISPLAY 1: A SAMPLE BUDGET

	Income	Expenses	Savings/Investments
Automatic Monthly Contribution to 401(k)			\$500
Take-Home Pay	\$3,100		
<b>Fixed Expenses</b>			
Rent		-\$1,400	
Utilities		-67	
Debt/Student Loan Repayment		-250	
Car/Transportation		-200	
Car Insurance		-120	
Renters Insurance		-15	
Gym/Yoga		-100	
Netflix		-8	
Cell Phone		-100	
<b>Variable Expenses</b>			
Food		-350	
Taxi/Uber/Subway		-50	
Entertainment		-150	
Misc. (Clothing/Home Goods/Gifts)		-100	
Yearly Vacation (Savings Account)			75
Down Payment for Home (Investment Account)			115
<b>Total</b>	<b>\$3,100</b>	<b>-\$2,910</b>	<b>\$690</b>

Source: Bernstein



# BUILDING CREDIT, MANAGING DEBT

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Have you accumulated student loan or credit card debt? What about a car loan or a mortgage?

Borrowing isn't necessarily bad. It's often the only way to pay for costly things, like an education, or a car, or a home. And if you've never borrowed, you may find it hard to start: Banks want to know that you've paid back other debt before they give you a credit card, let alone a mortgage.

But too much debt can overwhelm your budget, especially if you borrow at a high interest rate. And not staying current on interest payments can destroy your credit score, which makes it hard to borrow if you need to. A credit score shows how creditworthy lenders deem you to be. It takes into account your total and types of current debt, how long you've had it, and your payment history (**Display 2**, next page).

## THE BOTTOM LINE

Building good credit takes time. Start early and be responsible: Even if you just take out a credit card with a \$500 credit limit and use that card to pay one fixed expense, such as an \$8/month Netflix account, you can begin to build a credit history. Be aware of due dates, payment amounts, and interest rates, and always pay your bills on time.

**Do:** Pay your bills on time; pay monthly balances in full; regularly check your credit score.

**Don't:** Fail to make minimum monthly payments; exceed your credit limit; apply for excessive loans.

## DID YOU KNOW ?

72% of college students in a 2016 survey said they pay off their credit card balances each month. That's good!<sup>1</sup>

## THE BIG IDEA

You're entitled to one free credit report a year from each of the three major credit agencies.

<sup>1</sup>2016 Equifax College Student Survey, <http://investor.equifax.com/releasedetail.cfm?ReleaseID=985450>

# CHECKLIST: Managing Your Debt

- ☐ **List** all your outstanding loan balances, due dates, interest rates, and interest-rate reset dates, if any.
- ☐ **Pay off your highest-cost debt first.** Often, credit card debt is most expensive, followed by student loans, and then car loans and mortgage loans. Interest on mortgage debt is tax-deductible if you itemize, which lowers its effective cost.
- ☐ **Consolidate or refinance your debt** to lower your interest cost, avoid extending the loan term, and avoid paying pricey consolidation fees.
- ☐ **See if you can get a federal (not private) student loan.** The interest rate on a federal loan is fixed and typically lower; you don't start paying it off until after graduation; a credit check and cosigner are usually not needed; and you can consolidate the loan into a direct consolidation loan, if necessary.

DISPLAY 2: CREDIT SCORES

	FICO Credit Score		% of People
Exceptional	800–850	Applicants with scores in this range are at the top of the list for the best rates from lenders.	20
Very Good	740–799	Applicants with scores here are likely to receive better-than-average rates from lenders.	18
Good	670–739	Only 8% of applicants in this score range are likely to become seriously delinquent.	22
Fair	580–669	Applicants with scores in this range are considered to be subprime borrowers.	20
Very Poor	300–579	Applicants may have to pay a fee or deposit, and may not be approved for credit at all.	17

Source: [www.experian.com](http://www.experian.com), <http://www.experian.com/blogs/ask-experian/credit-education/score-basics/what-is-a-good-credit-score/>





# SAVING FOR YOUR GOALS

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Do you want to buy a car or a home, get married, have children—or retire someday? Unless someone else is going to pony up for those big expenses (or at least make the down payments), you have to learn to save—to put aside money you’re not spending this month or this year for future spending.

## THE BOTTOM LINE

Savings should be a monthly budget item. Build your emergency cash reserves first, and then begin saving for other goals. You’ll need to identify your goals and set a timeline for reaching them (*Display 3*, next page).

## DID YOU KNOW ?

Only 52% of employees ages 25 to 34 have saved for retirement.<sup>2</sup>

## THE BIG IDEA

Emergencies happen. Try to keep three to six months of living expenses in the bank in case of emergency.

<sup>2</sup>2017 Retirement Confidence Survey Fact Sheet #4, Employee Benefit Research Institute, [https://www.ebri.org/pdf/surveys/rcs/2017/RCS\\_17.FS-4\\_Age.Final.pdf](https://www.ebri.org/pdf/surveys/rcs/2017/RCS_17.FS-4_Age.Final.pdf)

# CHECKLIST: Creating a Savings Plan

- ☐ **Establish an emergency cash fund.** A good rule of thumb for its size is three to six months of expenses.
- ☐ **Identify additional goals.** You may not be able to save for everything at once.
- ☐ **Include saving in your budget.** Figure out how much you can save each month or year, given your basic spending needs.
- ☐ **Stick to your plan.** Sign up for automatic transfers into personal savings, investment, or retirement accounts to make it easier. Your bank and your employer's payroll department may offer this. Many providers make it easy to do online.

DISPLAY 3: MAPPING THE TIMING AND HIERARCHY OF YOUR GOALS



Source: Bernstein



# INVESTING FOR YOUR FUTURE

Investing can be overwhelming. The wide array of choices and technical jargon paralyze some investors; the memory of the 2008 credit crisis and stock market crash scares off others. It's easy to avoid taking the time to learn how to invest. Still, doing nothing can be harmful.

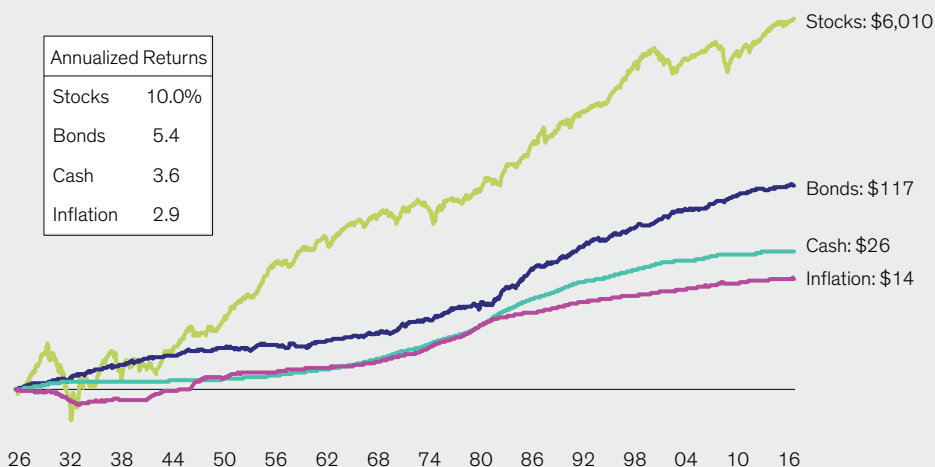
Stocks (ownership interests in companies) have grown most in value over the past 90 years and fluctuated most in value along the way (**Display 4**). High-quality bonds (US government and company debt) and short-term cash instruments grew much less with fewer fluctuations. So stocks pose more market risk, but bonds and cash pose more shortfall risk: not earning enough to fund your goals. Bonds and cash also pose more risk of losing value relative to inflation.

## THE BOTTOM LINE

You can't afford **not** to learn about investing.

**DISPLAY 4: BONDS AND CASH PROVIDE STABILITY; STOCKS PROVIDE GROWTH**  
Growth of \$1

Annualized Returns	
Stocks	10.0%
Bonds	5.4
Cash	3.6
Inflation	2.9



Through December 31, 2016

US stocks are represented by the S&P 500 Index; bonds are represented by US long-term government bonds from 1926 to January 1962, US five-year Treasuries from February 1962 to 1975, and the Barclays US Aggregate Index in 1976 and thereafter; cash is represented by three-month Treasury bills; and inflation is represented by the Consumer Price Index. **Past performance is not necessarily indicative of future results.**

Source: Barclays; Bureau of Labor Statistics; Center for Research in Security Prices; Compustat; Roger G. Ibbotson and Rex A. Sinquefeld, "Stocks, Bonds, Bills, and Inflation: Year-by-Year Historical Returns," University of Chicago Press *Journal of Business* (January 1976); Standard & Poor's; and Bernstein

## DID YOU KNOW ?

The S&P 500 Index of US stocks regained all its losses in the 2008/2009 drop in just four years and kept setting new highs over the next four years.

## THE BIG IDEA

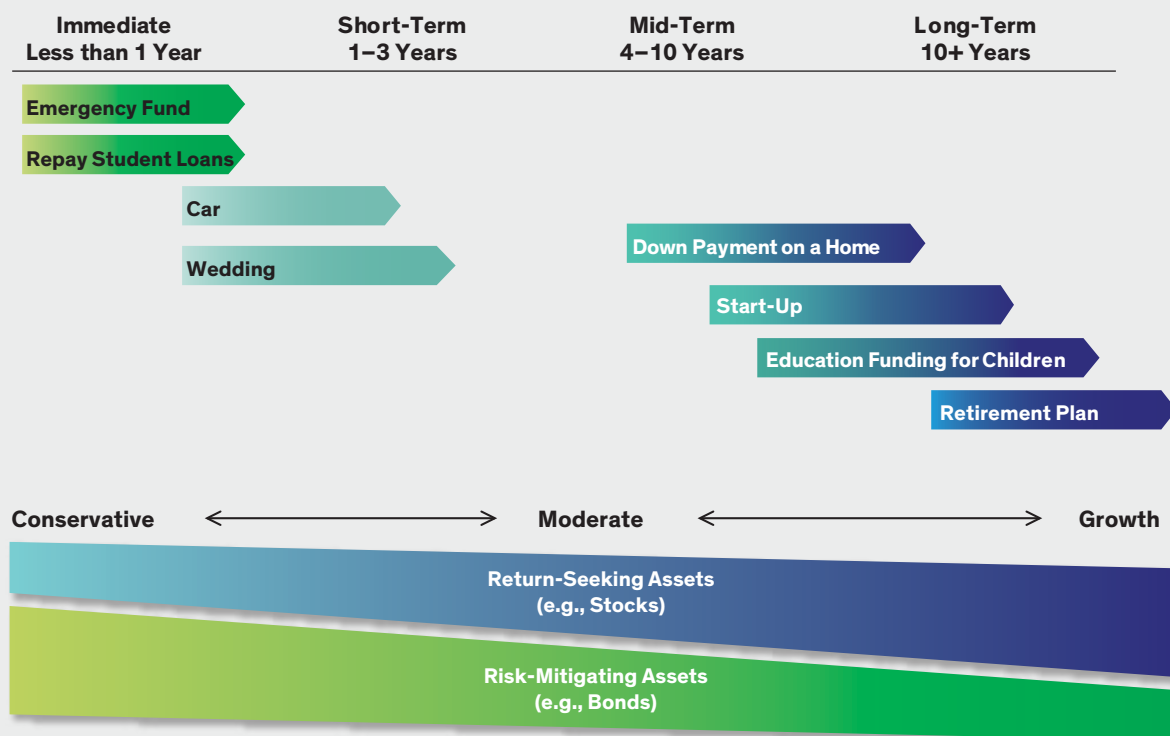


Market risk and return go hand in hand. Market risk is the size of short-term price changes, and the odds of a large short-term loss.

# CHECKLIST: Creating Your Investment Plan

- ☐ **Align time horizon and asset allocation** (*Display 5*).
  - » **For emergency cash and spending within two years**, set up a bank savings account or a money market fund. Cash instruments like these are best when you'll need the money soon.
  - » **To fund spending in two to five years**, invest mostly in risk-mitigating assets, such as high-quality bonds. Include some return-seeking assets, such as stocks, to add return. Stocks also diversify your exposure to a potential rise in inflation or interest rates, which hurts bonds more.
  - » **For longer-term goals, invest more in stocks.** You don't have to worry about short-term losses if you're not going to take the money out for a very long time, and history suggests that the returns are likely to be higher. Maintain some exposure to bonds for income, stability, and diversification.
- ☐ **Diversify your investments** by issuer, economic sector, and country. Diversification reduces risk, because different types of investments rise and fall at different times (they are weakly correlated).
- ☐ **Avoid unnecessary short-term trading.** It can lead to unnecessary transaction fees, lower returns, and higher income tax due.
- ☐ **Consider active management strategies.** They can add return and avoid the concentrated risks that passive index strategies can be prone to.

DISPLAY 5: IDENTIFYING THE TIME HORIZON FOR FINANCIAL GOALS



Source: Bernstein



# BUILDING LONG-TERM WEALTH

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The money and assets you own—minus your debt—constitute your wealth, or net worth. You can inherit wealth or accumulate it by saving from your income (or both). You can grow your wealth by investing in your own business or in assets that grow over time.

Retirement may seem very far away, but it's not too soon to start saving for the day you're ready to retire. Tax-deferred retirement accounts are particularly valuable ways to build wealth over time, because they let you garner investment growth on dollars that would have otherwise been paid in taxes. There are limits on how much you can invest in these vehicles each year. The sooner you start, the better.

## THE BOTTOM LINE

Time is on the younger investor's side. You have more time to benefit from compounding (earning a return on a return). It's also easier to weather market upsets if you're not withdrawing money for spending, which forces you to realize losses. Thus, younger people investing for the distant future, such as retirement, can generally take more investment risk than people near to or in retirement.

## DID YOU KNOW ?

As of 2015, the most popular employer match is dollar for dollar, up to 6% of salary. That's a lot of free money!<sup>3</sup>

## THE BIG IDEA

Your largest asset today may be your future earnings, or human capital. Your goal is to convert your human capital into financial capital.

<sup>3</sup>Source: Aon Hewitt, <http://www.aon.com/attachments/human-capital-consulting/2015-trends-experience-dc-plans-highlights.pdf>

# CHECKLIST: Building Your Wealth

- ☐ **Find out** what retirement vehicles are available to you, and study their terms. If your employer offers a 401(k) or 403(b) retirement plan, you should generally take advantage of it. Not only will it give you easy access to tax-deferred investing, but your employer may match your contributions and help you save with automatic salary deductions. **Display 6** gives basic facts on the main categories of retirement funds.
- ☐ **Time frame matters.** You can take more risk when investing for the long term (such as retirement) than when saving and investing for the shorter term (perhaps to make a down payment on a home).
- ☐ **Stock-heavy allocations** tend to have greater potential return and risk than bond-heavy allocations.
- ☐ **Diversify investments** by security, asset class, and geography, so you're not vulnerable to a big loss in one area.

DISPLAY 6: THE VARIETIES OF RETIREMENT SAVINGS PLANS

	COMMON EMPLOYER-SPONSORED DEFINED CONTRIBUTION PLANS		SELF-EMPLOYED OR EMPLOYER PLAN	COMMON INDIVIDUAL RETIREMENT ACCOUNTS	
	Traditional 401(k)/403(b)	Roth 401(k)/403(b)	SEP IRA	Traditional IRA	Roth IRA
Earnings grow tax-deferred?	Yes	Yes, and possibly can be withdrawn tax-free	Yes	Yes	Yes, and possibly can be withdrawn tax-free
Contributions reduce taxable income or are deductible?	Yes	No	Yes	Maybe*	No
Taxes to pay upon withdrawal? <sup>†</sup>	Yes, as ordinary income	Yes, if owner < 59½ or Roth held less than five years	Yes, as ordinary income	Yes, as ordinary income	Yes, if owner < 59½ or Roth held less than five years
Maximum annual contribution for people < 50 <sup>‡</sup>	Lesser of \$18,000 or total earned income	Lesser of \$18,000 or total earned income	Lesser of 25% of compensation or \$53,000	Lesser of \$5,500 or total earned income	Lesser of \$5,500 or total earned income
Age when required minimum distributions (RMDs) start	70½ unless still working; for a 5%-or-more owner, at 70½	70½ unless still working; for a 5%-or-more owner, at 70½	At 70½	At 70½	None during owner's life

\*Depends on your household income and whether you or your spouse is covered by an employer plan. See Internal Revenue Service Publication 590-A: <https://www.irs.gov/pub/irs-pdf/p590a.pdf>

<sup>†</sup>With few exceptions, retirement account withdrawals taken before age 59½ will incur a 10% additional penalty tax.

<sup>‡</sup>Maximum contribution amounts adjust with inflation and are announced by the IRS each year. For participants age 50 and older, defined contribution plans allow a "catch-up" contribution of \$6,000 per year, and traditional and Roth IRAs allow a "catch-up" contribution of \$1,000 per year.

Source: Internal Revenue Service and Bernstein

# STILL HAVE QUESTIONS?

For more information on financial planning for younger investors, check out *[Live Once, Plan Often](#)* on Bernstein.com.

*[Bernstein.com](#)* and *[CONTEXT: The AB Blog on Investing](#)* also offer a wealth of information on financial planning and investing.



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