Mark Donovan

SESSION 3: Practical Application

I. Budgeting Review

A. All of the 7-step programs presume living on a written budget.

i. Budget a target amount in each spending category. Give every dollar a job or mission.

ii. Track your actual spending and compare that to what you budgeted. Software can be very helpful and makes the record keeping manageable.

iii. Make adjustments each month. Don’t be surprised if you are spending more than you think initially. Be patient.

B. There is an abundance of resources at daveramsey.com; crown.org; compass1.org. (Spending guides, forms, worksheets, calculators, etc.)

II. Baby Step 1 - $1,000 in a beginner emergency fund

A. Protection against the unexpected.

B. Separate bank account, but easy to access.

C. Untouchable except for a true emergency that would cause you to incur more debt. (Car repair, emergency room visit, home appliance replacement.)

III. Baby Step 2 – Debt Snowball

A. Make the minimum payments on all your debts.

B. With all the extra income you can free up based on your budget, make extra debt payments.

C. To free up money to increase your debt repayment or saving, etc. there are only two options, right? Earn more, spend less.

D. Start with the smallest balance. When the first one is paid, take all the extra money and apply it to the next smallest balance, and so on.

E. Extra income like a bonus or tax refund should also be applied to the debt snowball for more acceleration.

F. The idea is focus, intensity, and momentum. It's motivating, and fun!

IV. Baby Step 3 – Increase the Emergency Fund to 3 to 6 months' of expenses

A. If you are self-employed, or work a job that is not secure, or work on commission, aim for 6 months or more.

B. These are necessary expenses, a survival mode standard of living.

C. Separate bank account, but easy to access. A return on investment is not the goal with the emergency fund.

V. Baby Step 4 – Invest 15% of your income in retirement

A. Time Value of Money - the cumulative effect of compounding interest. Another kind of snowball. It works for you when you invest but against you when you borrow.

B. Example: if a person at age 30 makes a $1,000 deposit each year for 35 years and earns an average of 8% each year, they will have saved:

Interest Rate	After 5 years	After 10 years	After 15 years	After 20 years	After 25 years	After 30 years	After 35 years	After 40 years
4%	5,416	12,006	20,024	29,778	41,646	56,085	73,652	65,026
6%	5,637	13,181	23,276	36,786	54,865	79,058	111,435	154,762
8%	5,867	14,487	27,152	45,762	73,106	113,283	**172,317→**	**259,027**
10%	6,105	15,937	31,772	57,275	98,347	164,494	271,024	442,593
12%	6,353	17,549	37,280	72,052	133,334	241,333	431,663	767,091

C. By starting 5 years earlier at age 25, the amount jumps to $259,027, an extra $87,000 in growth for only a $5,000 extra investment.

D. The S&P 500, an index of the stock of 500 major companies, has averaged 10% growth over the last 90 years, and even 10% over the last 10 years which included a recession.

E. Two Ways to Invest

iv. As an owner – stocks, known as equity securities; generally more aggressive and riskier.

v. As a lender – bonds known as debt securities or fixed income; generally more conservative and safer.

vi. The standard advice for a long-term investment strategy like retirement, is to have more stocks or equities while you are young, and gradually add more bonds or fixed income as you age until your portfolio is 50/50 at retirement.

vii. What is a mutual fund?

- A mutual fund is an investment made up of a pool of money collected from many investors, for the purpose of investing in many different securities, usually stocks and bonds.
- Choose mutual funds with no fees or commissions and low expenses. Vanguard is a good mutual fund company, as is Fidelity, Schwab and others.