

# PLANNING STEPS TOWARD SUCCESS



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## Sustaining positive cash flow: One-Quarter please

by Chia-Li Chien

Do you remember your first school field trip? I clearly remember mine – actually – I can still taste it.

My mom, Kinuko, was a 6th-grade teacher when I was kindergarten age. Most schoolteachers did not make much money, so I always tagged along to my mother's classroom in order for her to not have to pay for a babysitter. My first field trip was actually with her 6th grade class to a beautiful state mountain park north of Taipei Taiwan.

One of the big deals about a grammar school field trip was the picnic box mothers would prepare for their children to take on the trip. In Taiwan, you could buy a picnic box at any bakery store. It was full of delicious truffle cakes, Western cookies, a variety of candies, and fresh juice. Children dreamed of taking a picnic box with them when they went on a field trip.

At lunchtime, as my mother settled her restless 6th graders on top of the mountain park, I watched one of the students open her picnic box. Her face lit up, filled with joy and pride for what her mother had had packed for her. As I drooled over her delights, she stared at me to remind me to get my own box.

Suddenly it dawned on me, "Oh my gosh! Mom forgot about my picnic box."

I did not have a picnic box with me. How could my mom ever forget about the picnic box – what every child looked forward to when going on a field trip; what every child dreamed about? My eyes turned red with envy over the 6th grade girl's picnic box. But my mother showed up right before I started to panic.

She reached down to me and gave me a loaf of bread and said, "Honey, eat your bread. That's your lunch."

Wow, I certainly had not expected plain bread instead of a picnic box. I pulled out one piece of bread – there was no butter, no peanut butter, or jelly – just a slice of white bread. I slowly bit on it and it took a long time to swallow just that one bite. As a matter of fact, it tasted awful. It was the taste of embarrassment that I still remember to this day. That taste of embarrassment then still serves as a reminder to me that I don't ever want to be in that kind of situation again. I want to be able to afford whatever I want.

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As I was growing up, it became apparent that there was no way my mother could go to work on time and still prepare breakfast and lunch for myself and my three siblings. From the moment we entered middle school, she gave 25¢ a week to each of us. It was then our job to make sure we could feed ourselves breakfast and lunch six days a week with a quarter in 1979. (Back then; we went to school five and a half-days a week in Taiwan).

Since I could still taste the embarrassment of the plain bread from that first field trip when I was such a little girl, I became determined to save my quarter each week by eating whatever I could scrounge up in the house for my breakfasts and lunches. Little did I know that saving that quarter every week would turn into the effective **one-quarter rule** that I've used ever since that time in my life.

Today, I cannot thank my mom, Kinuko, enough for this one-quarter rule that she inadvertently taught me. It laid the foundation for everything I do now – whether it's teaching my daughter or helping my clients with financial questions and dilemmas.

Lately, I've become even more convinced of the wisdom of the one-quarter rule. Here's why:

Ever since the last part of 2008, we've heard from the media and read the headlines about an impending economic slowdown. However, I don't really see a slow down in spending in the Charlotte area. Even though North Carolina had one of the highest unemployment rates in the U.S. during the first three months of 2009, every mall and shopping center that I frequently visit are full of people who are still buying.

Even when we take a road trip or go hiking, we always see lots of people still out and about, enjoying their lives. It appears to me that everyone is still spending – and spending a lot – regardless of the economy. Some people are most likely even dipping into their savings just for the things they want to buy now instead of waiting until their cash flow improves.

My point goes beyond the many “how-to-budget” books and workshops out there that can teach you how to live within your means. I think budgeting is a great tool – but only if you have the discipline to follow it.

By understanding my **one-quarter rule**, you get a better sense of how to manage your finances. Yes, you still need to have a budgeting tool to help you stay on track. But, the one-quarter rule simplifies how to stay in your budget, putting you in a strategically better position than with a good budgeting practice alone. I've worked with many clients – from families with millions of dollars and multiple assets to families with no assets and very little money.

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But, no matter how much you make or own, this one-quarter rule applies to everyone.

The **One Quarter Rule** of cash flow sequence:

1. One quarter goes to **you** – pay yourself first.
- 2 One quarter goes to the **twin uncles** –Federal and State IRS.
3. One quarter is necessary for your mortgage or rent, or any other debt.
4. One quarter is for other living expenses.

#### ***Pay yourself first.***

One quarter of your income should go to YOU. Yes, you. Three quarters of your income goes to other people. If you don't keep a portion for yourself, it's not really worth working five days or more a week, is it? For most people, this one-quarter might represent your 401(k) or 403(b) retirement plan contributions at work. Many well-disciplined families pay themselves beyond the traditional retirement plan at work. They direct a portion of this quarter to a structured savings plan for a reserve, life event purpose, or just to have a nice stash.

#### ***Like it or not.***

One quarter of your income goes to what I like to call the twin uncles – Federal and State income tax paid to the IRS (Internal Revenue Service). For those whose family makes more than a combined \$80,000 a year, it will be more than one quarter. But, let's just use one-quarter, or 25% to illustrate this rule. You see, the twin uncles know best. They don't want to wait until tax time to ask you pay the 25% of the income tax you owe to them. They take it out of each paycheck before you even see it. When it's already taken out of your paycheck, and not put into your checking account, you can't spend it, ensuring they will get their portion of your income.

#### ***Don't become a slave to your dream house.***

The third quarter of your income should go to your mortgage or rent. And congratulations if you have a place to stay and no need to pay for it. If that is the case, then invest this extra quarter of your income into YOU. But for most, the third quarter portion of your paycheck will go to pay for a roof over your head.

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Your bank would probably love to lend you money for just that purpose, and there is nothing wrong with that. And since they're in the business for profit, they may tell you a common rule of thumb is that you can comfortably borrow three times your annual salary for your home. But think about it – that roughly equates to one-third of your income per month.

In my opinion those who followed the financial industry rule of thumb are unfortunately in foreclosure today. Not knowing about the one-quarter rule, they most likely simply borrowed too much.

And don't forget – many people make a lot of money and live in huge house, only to realize later that they have become slaves to their dream home. Because their mortgage payment is such a cash drain on their income, they can't afford to save anything. Yes, yes, they're building equity, but would you want to do it so painfully?

### ***The rest is all you can spend.***

There is not much left, right? Only one-quarter remains for your living expenses. This includes utilities, groceries, eating out, cable TV and Internet, cell phones, your children's sports equipment, piano lessons, vacations, holiday gifts, entertainment, etc. If you want to buy those gorgeous shoes at Macy's that you can't afford, that cost will have to go on your credit card and your debt will continue to pile up until there is no end. Is it only because you can't really be seen in a bargain wardrobe while living in a luxury home? Ouch. It's a trap, and that hurts.

Now that you know my secret one-quarter-rule, set your own one-quarter-rule goal. You will stress less about the economy and find creative ways to save money both at work and in your family life. When you strive for the one-quarter goal, you begin to clearly see how to allocate your income and satisfy everyone. If you're disciplined enough, over time, you will have larger portions for YOU. Yes, the ultimate goal is for the largest portion to go to **YOU**.

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And as you move forward in effectively reaching the one-quarter-rule goal, here are five mistakes you must avoid, in order to begin keeping more for **YOU**:

1. ***Not making a profit.***
2. ***Keeping a debt amount greater than savings.***
3. ***Having little or no routine for saving.***
4. ***Not finding ways to save on taxes.***
5. ***Focusing on investment opportunities before you meet other financial priorities.***

## ***1. Not making a profit –***

Let's stick with a very simple rule:

$$\text{Income (I)} - \text{Expense (E)} = \text{P (Profit)}$$

Your take home income minus all expenses should show a profit, or positive cash flow. If this is not the case, you're probably using credit cards or borrowing money. When a company is not making enough profit, ultimately it will go out of business. You work so hard – why not be diligent about making a profit for YOU? Yes, life is too short, but it could be too long for you as well. A healthy profit will serve you well for the long haul.

## ***2. Keeping a debt amount greater than savings –***

Be conservative! If your debt burden is more than what you have saved, focus on reducing your total debt. You will not earn enough interest on your savings to equal the interest you will pay on any credit cards or line of credit. If you're five to ten years from retirement, consider paying off your mortgage.

## ***3. Having little or no routine for saving –***

To keep more for YOU, get in the habit of automatically transferring a portion of your income to a separate savings account. If you can't see it in your checking account, you are less likely to spend it. By the way, if you can't pay for it with cash, please do yourself a favor – don't buy it!

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#### **4. Not finding ways to save on taxes –**

Your favorite twin uncles, Federal and State income taxes, actually make special provisions for almost everyone. There are many tax-saving programs to help you. Have you discussed the possibilities with your CPA? You can also discuss these questions with a CERTIFIED FINANCIAL PLANNER™ who can coordinate with your CPA to determine ways to decrease your tax bill in the current tax year as well as in the coming years.

#### **5. Focusing on investment opportunities before you meet other financial priorities.**

If you're still struggling paying off your credit debt or line of credit, your first priority is to pay off your unsecured debt. After that, you need to have a minimum three months reserve for living expenses in case of any emergency like health issue or job loss. Once you achieve these goals, then you can start taking appropriate step toward investing.

#### **Out of small savings –**

Even though I could not imagine what I was saving my quarters for in middle school, I see now, and I cannot thank my mom enough for the one-quarter rule. By saving the quarter she gave me each week, I had saved enough money to transfer to the U.S. by my senior year of college. From all those quarters, I even had travel funds and three months living expenses when I arrived in the U.S. in 1988.

#### **Retire early –**

This same one-quarter rule has also served my own family well. My husband, TC and I have consistently saved more than 25% of our monthly income for the past eighteen years. Yes, there have been a lot of sacrifices such as no cable TV, no vacations for the first seven years of our marriage, living in a multi-family home for seven years before we bought our first single-family home, as well as other things we did without. But we have been rewarded for our discipline because TC and I retired early in 2003, and now we both are doing something we really enjoy today. You too can do this!! Stick with the one-quarter rule. It will serve you and your family well.

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