



THE FINANCIAL PLANNING ASSOCIATION

of San Diego

HOME

PLANNER RESOURCES

8 KEYS TO BECOMING FINANCIALLY INDEPENDENT

Most people aspire to become financially independent, but few actually think about or take the actions necessary to reach independence.

Financial independence means having sufficient financial resources to comfortably choose whether to work or not work, or perhaps work in a highly desirable job that otherwise couldn't support your standard of living. It means being able to withstand the inevitable financial storms along the way. But what key steps does it take to achieve that financial independence short of just hoping you'll win the lottery?

1. Set specific goals. Goals define what financial independence will look like for each of us. Equally important, goals—particularly specific goals written out with timetables—can motivate us to initiate and stick with the other keys to financial independence.
2. Consistently spend less than you earn. Yes, your mother probably taught you this when you were receiving an allowance as a youngster, but how so many of us forget. Unless you spend less than you earn, it's impossible to become financially independent—short of winning that lottery. Consistent saving is even more important than what investment rate you might earn with that savings. Aim for saving ten percent or even more of your pre-tax income, but even a smaller percentage helps, especially if you start saving while you're younger and can let the power of compounding work for you.
3. Create a spending plan. The key to spending less than you earn is to create and follow a spending plan: earnings minus expenses equals savings. Better yet, treat savings as an expense item and put it at the top of your budget—have the money taken out at work and put into your savings and investments so you won't miss it and won't spend it. You can help your efforts to spend less than you earn by eliminating frivolous expenses, buying smart and cutting taxes.
4. Invest. To build financial independence, you'll need to earn a reasonable return on your savings. A savings account alone won't cut it. That means investing in stocks, bonds, perhaps real estate and other assets that involve an acceptable level of risk. Yes, there's the risk of some loss of principal, as the last three years have painfully illustrated. But understand that investing is for long-term goals (at least five and preferably more years away). When goals get closer, shift the invested funds into those lower-earning but less risky savings accounts and money markets.
5. Stay invested. One of the big mistakes many investors make is waiting until the market is really hot to invest and then bailing out when it sinks—in short, they buy high, sell low. Get in and stay in, though make adjustments if necessary. Keep in mind that the bulk of the returns of a bull market tend to come

early in the upswing, and people often miss out on them because they're waiting for the market to turn "hot."

6. Diversify. As the recent markets have also shown, it's key to diversify your assets. Overloading on company stock, on stock in the industry in which you work or on other higher-risk investments is an open invitation to trouble. By spreading your investment money among several asset categories, you minimize the impact of the downturns of a particular segment. For example, while stocks tumbled the last three years, bonds and real estate did well.

7. Use tax-favored accounts. One in four eligible workers didn't participate in their employer's 401(k) plan in 2002, according to Buck Consultants. Yet retirement plans and individual retirement accounts is the most efficient way to build toward financial independence because you get more bang for each invested buck, especially if your employer matches your contributions.

8. Bulletproof your independence. As you accumulate money for financial independence, you need to protect it. The primary way is insurance—not just life, health, auto and homeowner's insurance, but often overlooked disability and liability coverage. Disability insurance helps offset the loss of income if you can no longer work due to a disability, and liability coverage is a cushion against lawsuits. Another form of insurance is a cash-reserve emergency fund where dollars are kept in a savings or money market account to see you through emergencies such as major car repairs or a stretch of unemployment so you don't have to dip into retirement accounts or other investments.

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