

FIVE WORDS YOU NEED TO KNOW ABOUT PERSONAL FINANCE

BY EUGENE YIGA



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“LIFE IS REALLY SIMPLE, BUT WE INSIST ON MAKING IT COMPLICATED.”

- CONFUCIUS

When it comes to financial education, a lot of us are totally clueless. It's just not the kind of thing that was taught in school. And none of this is helped by the fact that we're bombarded by people talking gibberish on TV.

If you ignore the issues and live day to day, or leave money matters to a partner who might know even less, that has to stop. Financial education isn't for those born gifted or lucky enough to know the tricks of the trade; everyone can and must learn.

After reading many books on money, I've come to realise that personal finance is nowhere near as complicated as we make it out to be. In fact, it can all be summed up in a quote from a character in David Copperfield by Charles Dickens:

“Annual income twenty pounds, annual expenditure nineteen nineteen and six [£19.95], result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six [£20.05], result misery.”

Breaking that down even more, we can sum up everything you need to know in just five words:

SPEND LESS THAN YOU EARN

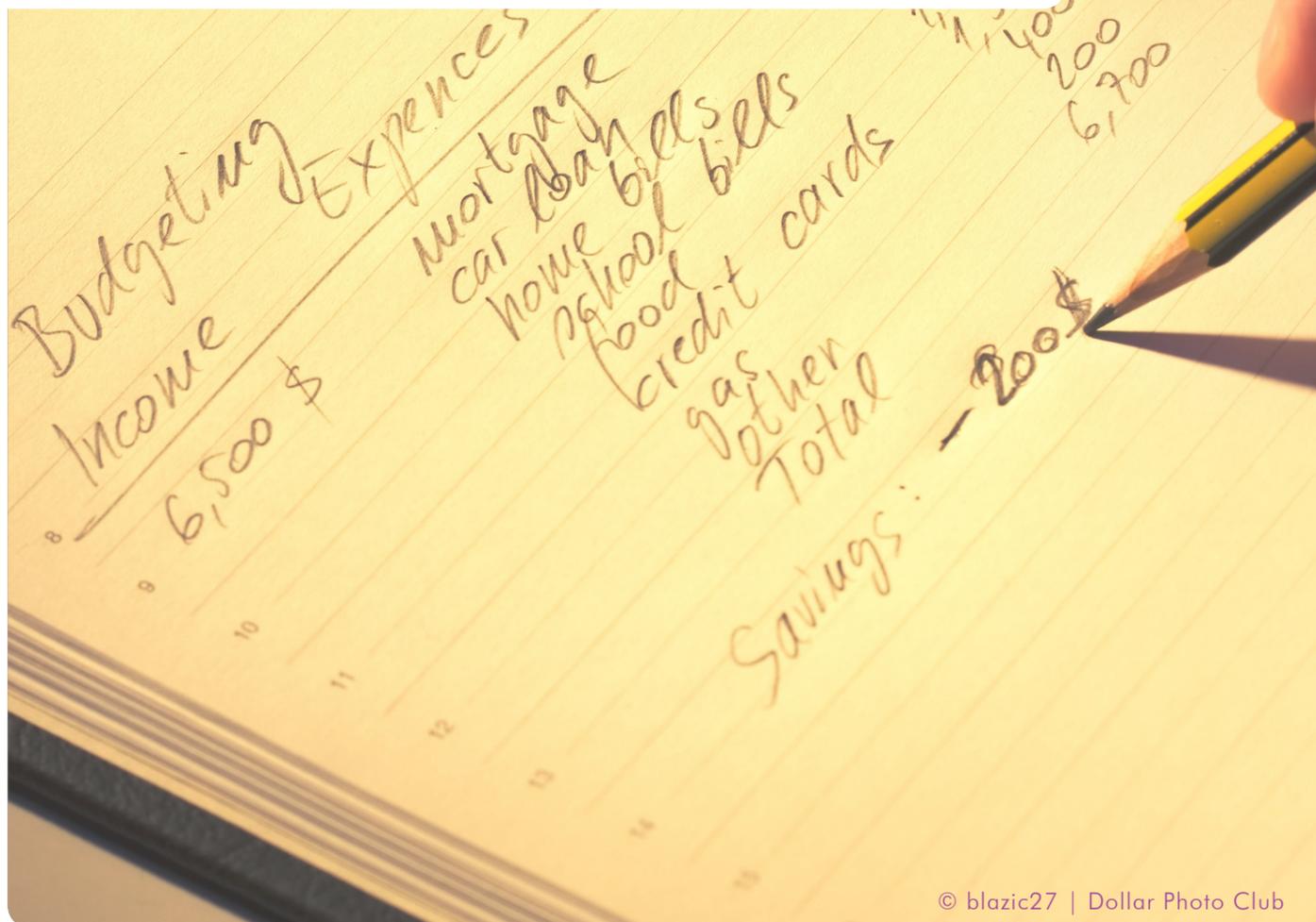
Spending more than you earn means you have to borrow and go into debt. As this continues to happen and the debt continues to grow, you're left in a deep and miserable hole.

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But spending less than you earn means you can save and invest. As this continues to happen and the assets continue to grow, you'll reach a point where the passive income (i.e. income you don't have to actively work for at a job) will cover your monthly expenses. Then you can retire financially free because, as Rich Dad writer Robert Kiyosaki says, your money will be working for you instead of you working for it.

So, just like a business, the goal is to create a profit every month. Then it's a case of investing that profit wisely so that it grows. That's all there is to it!

It's important to note that the phrase is "spend less than you earn" and NOT "earn more than you spend". More money often means more problems because we're more likely to increase our spending instead of saving more.

"If thou wilt make a man happy, add not unto his riches but take away from his desires." ~ Epicurus

The first step to improving your finances is to know exactly how bad they are. This means you need to draw up a financial statement so that you can take a long hard look at where you are right now.

1 WORK OUT YOUR MONTHLY PROFIT OR LOSS.

"My problem lies in reconciling my gross habits with my net income."
~ Errol Flynn

Just like a real business, start with your total income and then subtract your total expenses. (Include the details for your partner if you want to look at this from a household perspective.)

2 CALCULATE YOUR NET WORTH.

"Facts do not cease to exist because they are ignored." ~ Aldous Huxley

Just like a real business, start with your total assets (using the current market value for things like your car, your house, and so on) and then subtract your total liabilities (debts).

3 THINK ABOUT WHAT ALL THIS MEANS FOR YOU.

"The truth will set you free. But first, it will piss you off." ~ Gloria Steinem

What you see might shock you. Perhaps you aren't making as much money as you thought (income is low) or perhaps most of it is paying for frivolous things (expenses are high). Or perhaps you're making a profit every month but all your cash is sitting in a bank account earning you no interest (assets are low) or being used to pay off a growing pile of debts (liabilities are high).

No matter what your situation, you should be glad that you've taken the time to know where you are. You're already way ahead of most people who still have absolutely no clue! And now you're ready to start setting some goals to make things better.