Learn Reverse Psychology To Develop Ways Of Frugal Living, Understand Wealth Management Strategies, And Steps to Financial Freedom

The Psychology Of Money

A SIMPLE GUIDE - TO - FINANCIAL INTELLIGENCE

ADDISON BELL

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A Simple Guide to Financial Intelligence: Learn Reverse Psychology to Develop Ways of Frugal Living, Understand Wealth Management Strategies, and Steps to Financial Freedom

By
Addison Bell

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Table of Contents

Introduction

Money is often deemed a very taboo topic. Not a lot of people are always going to be so willing to discuss their finances with others. It's more likely that you would encounter someone who would be more inclined to discuss their sex life than they would their finances. Have you ever wondered why that is?

Well, if you are one of those people who are uncomfortable with talking about finances, then there's a good chance that you might not have a good relationship with your finances. If you want to get serious about mastering the art of money management and fiscal responsibility, then you need to start getting comfortable with talking about money in the first place. This entire book is dedicated to propagating a healthy conversation about your finances so that you can have a better relationship with your money.

A lot of people are under the impression that finances are all about numbers. The pluses and minuses. There is a popular myth that well-off people are just people who are good in math because math skills are the ones necessary to work on a balance sheet. Yes, there is some truth to that. Financial management does require some level of mathematical prowess. However, it is really just all about the basics. You don't need to familiarize yourself with complex mathematical equations to get good with money. That's the one truth that you need to learn as early as now. As you make your way through this book, you will discover that math plays just a tiny part relative to other aspects of the way that you conduct yourself.

If we are going to be specific about it, this book's contents will focus more on the *psychology* of money management. Haven't you ever wondered about how some people can come into large amounts of money and still find themselves in massive debt? Some people might earn a modest income and still be as financially secure as other people who make a significantly higher salary. This is because every person has a different psychological approach to handling money. Of course, it is good if you have a high-paying job that provides you with a steady monthly income. But all of that is moot if you don't have the right mindset to effectively manage your money. Earning lots of money from your work is only a small part of the battle. This book will help sharpen your mind so that you have the financial skills necessary to achieve the ultimate goal: financial security.

So, don't make the mistake of thinking that this book is only reserved for trust fund kids, rich tycoons, or billionaire heiresses. This book is designed for absolutely everyone and anyone interested in earning a living and making sure that their money is properly managed and cared for. In fact, you can be someone who is very deep in debt and who feels like there is no way out. The real truth is that as long as you are willing to work hard and stay disciplined, you will always manage to find your way out of any financial hole. You just have to be humble enough to admit that the way that you have been doing things so far is wrong and that you have to learn new habits and principles for yourself moving forward.

One of the more essential lessons you will learn in this book involves the importance of financial management. Obviously, before you can get to the whats, whens, and hows, it is important to know your *why*. You need to understand why reading this book is crucial to developing your understanding of finances and why you need to have a more wholesome relationship with your money. This book will also delve very deeply into the psychology of money and how a person's mindset can spell their own financial success or undoing. Even if you are not given a lot of money, to begin with, if you have the right psychological approaches in place, you are putting yourself in an excellent position to keep and grow your wealth. In contrast, you will also learn how certain mindsets and psychological approaches to money can be very detrimental to your bank account if left unchecked.

Aside from that, you will also be learning about the dos and don'ts of money. You must realize that the concept of financial management and responsibility has been studied and practiced since the dawn of trade and commerce. There are certainly some best practices (and not-so-best practices) prevalent throughout human history. This book will point out the simple habits that you need to incorporate into your daily life and the stuff you need to avoid at all costs. If you are in debt or in bad financial shape, this book will also provide some very concrete steps for you to get out of that hole and rebuild your life from scratch. Again, as long as you stay disciplined and determined, you certainly have what it takes to live in the green.

Most importantly, this book is going to teach you how to be a more financially independent individual. It does not matter if you are just fresh out of college with loads of student debt or if you already have millions in your bank account. All of the principles and ideas that will be discussed in this book will still apply to you. They are universal principles that are relevant regardless of your financial situation. It's not just about raking in the dough and staying frugal. It’s about knowing how you can make your money work for you.

The ultimate goal of this book is to inspire you and equip you with the skills and mindsets you need to earn, keep, and grow your money. Don’t be intimidated by complicated financial concepts, models, or theories. This book will provide you with all of the information you need in more digestible packets so that they become easier to understand and adopt for your lifestyle. Ultimately, there are many challenges involved in achieving financial security and independence. There are many obstacles that you will need to hurdle. However, there is no need for you to feel overly intimidated or scared. It is only a problem when there is no solution. Fortunately, this book will provide you with the tools that you need to solve any financial situation that will come your way.

Whenever people fall into financial despair, it can be so easy to look around and blame the environment around them. Instead of being accountable for your own actions, you try to find scapegoats so that you absolve yourself of any responsibility. That is not the winning way. That’s the kind of financial mindset that keeps people from achieving genuine wealth. Hopefully, this book will help open your eyes to the path forward—the path that will ultimately lead to you mastering the psychology of money.

Chapter 1:
The Importance of Financial Intelligence

Getting good with money is not just a matter of putting yourself through a crash course and then getting instantaneous results. Think of it as if you are trying to shed off some excess pounds and become healthier. You will not get bulging biceps, sculpted abs, or a powerhouse cardiovascular system after just one workout and a salad. It's going to take a series of concerted efforts done consistently enough so that the sheer volume of your work and commitment will translate into real results. You need to work out five days a week and have a strict diet in place before you can really see the benefits of your hard work. Sometimes, it can take weeks, months, or even years for you to reach that goal.

It is exactly the same as trying to become more financially intelligent. You are not going to earn your first million after just reading this book. It is a process. It is a very long and tedious process. And sometimes, you can get lost and discouraged as you are in the midst of that process. This is the reason why so many people who set out to become healthier end up abandoning their goals midway. They become discouraged whenever the work gets too complicated or if they don't see results right away. They are too focused on the desired outcome that they end up forgetting why the process is so important, to begin with. It is the same with money. Sure, it is nice to be goal-oriented and to always dream of getting better with your finances. However, it is just as important for you to understand the reason why you are doing these things in the first place.

Motivation can be a very powerful tool when it comes to achieving your goals. Sometimes, there will be certain days when you will be tempted to stray away from the path toward financial security. During those days, you need to bank on your motivation. You need to rely on your *why*. Sometimes, people can be extrinsically motivated to get their finances straight. Maybe you have a family that is counting on you. Other times, people are intrinsically motivated by their own dreams and ambitions. Perhaps you just think that you are truly capable of improving the state of your finances on your own. Whatever the case, discovering your motivation can go a long way in helping you stay the course. However, that is a feat that is a lot easier said than done. It is not always easy finding (and keeping) one's motivations. This is precisely what this chapter is going to help you out with.

In formal schooling, you learn a lot of things. You are taught about history, science, mathematics, language, arts, and a bunch of other disciplines. However, unless you are taking specialized interests in finance, it is unlikely that you will get any formal education on that front. This can be a real problem for a lot of people. Finances are important in sustaining life. That's the way of the world. You might know the theoretical principles that you need to learn to be a professional engineer. However, if you don't understand the basics of financial management, you will put your career in jeopardy.

Whether you realize it or not, finances will play a significant role in your life. This chapter will help open your eyes to the many ways that having good (or bad) finances can affect you and the way you live. Moreover, this chapter will also delve deeper into what it means to be a financially intelligent and mature individual. Like any other discipline, there are many skills and traits that you need to develop over time for you to be good at handling your money. This chapter will help you figure out what those skills are and what you need to do to get better at them.

More than anything, what this chapter aims to do is help you figure out your *why*. It's important to note that your reason for achieving financial intelligence and maturity shouldn't have to be limited to just one. In fact, it is advisable for you to have many motivators, both internal and external ones. Think of them as tiny pockets of fuel that you can use to help you stay on the path of achieving financial intelligence. By the end of this chapter, you should have a good idea of just how dire the state of finances can be in many people's lives. More importantly, it would help if you also had a good idea of how much better off people can be as long as they make an effort to be more conscious of their financial habits.

The State of Financial Intelligence in America

In the age of social media, it can be so easy to get lost in your Facebook and Instagram feeds. You see the people in your social circle living their lives happily and lavishly. You might see a friend who has gone on vacation with their family. Maybe an old college classmate is posting about an expensive bag that she has just purchased. You look at these people and the expensive lifestyles they lead. This makes you think that everyone has money and that many people are okay with their finances.

Well, first of all, you have to remember that social media feeds are only designed for users to show you what they want to show you. Very few people are going to post about how they are struggling to pay rent or if they are suffocating under piles of debt. Sure, a few people open up about these struggles every so often, but they seem like a rarity. However, little do you know about the financial struggles that people within your circle go through. So, there's no shame in admitting that you find yourself in the occasional financial bind as well. If you are struggling to get out of debt or if you just can't seem to make ends meet, that's fine. You are not a special case. Many people have been where you are now and have managed to tread these troubled waters effectively. It should be no different to you.

To start this chapter, we will be discussing just how rampant financial troubles can be in the lives of people all over the world. You must realize that this is not a problem that you are tackling on your own. It might help your confidence to know that this burden is not yours alone. Of course, you have to brace yourself as well. A lot of the data and information you are about to read can be very jarring. The truth is that there is a serious financial literacy problem in the modern world. These issues only become further exasperated in the face of global crises and issues like pandemics, recessions, and various struggles with income inequality. But the bright side here is that, given a choice, it is likely that people would always opt to make smarter financial decisions. You are living proof of that testament right now by reading a book such as this.

No Emergency Savings

The *New York Times* published an article about how two in every three American families don't have emergency savings (Carns, 2019). The article was based on a report that was published by JPMorgan Chase, the second-largest commercial bank in the world as of this moment of writing. The report recommended that families keep around six weeks' worth of income to use as an emergency fund. This recommendation can vary depending on who you ask. Others will say that your emergency fund's value should be around three to six months' worth of expenses. However, even if we go with the easier and more accessible standard set by JPMorgan in its report, two-thirds of American families don't have six weeks' worth of income set aside in case of emergency. This fact can be very problematic for unexpected problems like emergency home repairs, illnesses, or layoffs.

Living Paycheck to Paycheck

Another alarming number is that, in 2017, around 78% of adults were surveyed to be living paycheck to paycheck (Friedman, 2019). That meant that a vast majority of Americans were spending most (if not all) of their income in 2017. These people were practically incapable of having any substantial amount of money left over for savings or investments. This kind of financial lifestyle is a serious problem because it inhibits financial growth. Without having extra money, one wouldn't have the wiggle room to experiment in investments for growth. Another bad thing about living paycheck to paycheck is that it leads someone into debt whenever unexpected expenses arise as a result of emergencies or rainy days. Lastly, living paycheck to paycheck would render a person incapable of saving for retirement. This means that they would practically have to keep on working in order to sustain themselves.

Failed Budgeting (or Lack Thereof)

Based on a survey conducted in 2019, three out of five adults admitted to not sticking to any kind of budget for themselves (National Foundation for Credit Counseling, 2020). This is problematic because it establishes the erratic and wayward financial lifestyles of a lot of people. Failing to implement any kind of budgetary system is likely to lead to reckless spending and debt acquisition. Being able to stick to a budget is a very basic principle of financial intelligence. However, an alarming number of people freely admit to not doing so. A budgetary system allows you the chance to put a cap on the number of things that you spend or invest your money in.

Drowning in Loans and Debts

Another Forbes article revealed that student loan debt in the United States had risen to an all-time high of $1.56 trillion (Friedman, 2020). Not only are these exorbitant student loans making it almost impossible for everyday Americans to build their savings, but it is also diminishing their confidence and views on financial intelligence. More and more people feel like they are financial failures because of their challenges involving student loans. Fresh graduates are growing more and more concerned about their place in the workforce because of their student loans. Instead of getting excited about building their careers by taking risks and venturing into the workforce, these fresh grads are left anxious and worried about finding ways to pay back their loans.

But the debt problem in America is not just about student loans. Credit card debt is also a very real problem for most people. Just like student loan debt, credit card debt also ballooned to an all-time high of $1 trillion in 2020 (Arnold, 2020). Credit card debts can be just as deadly because most people are duped into just making the very low minimum payments without realizing the rising interest rates that are keeping them in debt. It was found that almost two out of every five Americans carried their credit card debt over every month. This kind of practice leads to unnecessary expenses as a result of interest rates and late fee penalties.

Rising Financial Worry

In a survey that the National Foundation for Credit Counseling conducted in 2019, they found that less than 20% of adults were confident about their finances. Now, of course, many factors go into this kind of statistic. A lot of it may have to do with issues like debt and unemployment. However, whether they realize it or not, a lot of it also has to do with financial illiteracy. There are just way too many people who don’t follow basic financial intelligence principles simply because they are unaware of these things. This kind of uncertainty and illiteracy in handling finances can indeed contribute to one’s shaking confidence in the matter. As useful and as valuable as a skill that financial intelligence is, not many people work at developing it.

What Does It Mean to Be Financially Intelligent?

It can be very difficult to work yourself toward becoming financially intelligent if you don't know what financial intelligence looks like. It would be a lot like firing an arrow without knowing what the target is. So, what does it really mean to be financially intelligent? Does it mean having a large income? Does it mean driving expensive cars and living in luxurious houses? Does it mean having the money to go off on lavish vacations without a worry? We're going to break down what financial intelligence is to have a clearer picture of the kind of lifestyle you need to strive for.

To be a financially intelligent person means developing a consciousness of your finances to a point wherein you cultivate an environment of financial safety and insurance for yourself. Being financially intelligent does not necessarily mean knowing where to find money. A lot of people seem to be under the false impression that financial intelligence is purely a matter of being able to rake in a large amount of cash. However, you should know that it is a lot easier to bring in money than to keep and grow it. A financially intelligent person is someone who knows how to do the latter. It's important that you can distinguish between someone who is and is not a financially intelligent person.

Signs of a Financially Intelligent Person

Someone Who Pays Their Bills on Time

Many people seem to think that it is okay to not pay bills or miss deadlines on credit card payments whenever their finances are tight. They might do so thinking that they should hold on to their cash to stay as liquid as possible when stuck in a financial bind. However, this is a big mistake. People who are financially intelligent know that they must always pay their bills on time. They do this because they know that if they go into debt by not paying bills on time, the charges and penalties will make it much more difficult for them to stay afloat in the long run. Also, financially intelligent people live within their means. They know that if they don't have enough cash to pay for a Spotify subscription or a credit card purchase, then they have to refrain from availing of these things, to begin with.

Someone Who Doesn't Accrue Bad Debt

Later on, you will learn about debt and how there are good debt and bad debt. Not all debt is created equal, and we will go deeper into that in the latter stages of this book. However, you should know that a financially intelligent individual understands the difference between good and bad debts. Moreover, the financially intelligent person would never accrue any bad debt. They understand the nuances of debt and how it can either make or break a person's financial standing.

Someone Who Has a Solid Budgeting System

The financially intelligent person does not just spend money on a whim. A lot of people get the wrong impression that financially intelligent people are rich. So, since they are rich, they have the luxury of squandering their money without dealing with the repercussions. However, that's not how it works. Financially intelligent people, whether they are rich or not, always stay conscious of their cash flow. They always develop certain mindfulness over their spending and saving habits. The amount of attention and focus they put into their budgeting will give them better control over how their finances will grow and prosper.

Someone Who Has Short-Term and Long-Term Financial Plans

Again, gaining financial intelligence and achieving financial security are not just two instantaneous things. They don't happen just once, and then you never have to worry about them ever again. It's a process. You are continually working on yourself and the state of your finances by setting, pursuing, and achieving goals. A financially intelligent person sets short-term and long-term financial plans for themselves so that they always have a north star. These plans will help dictate what kind of habits and systems they might have in place to make sure that they always stay on the path. Financially intelligent people don't just earn money for the sake of earning. They think about how they can utilize their earnings and income to improve their financial status in the future.

Someone Who Seeks Financial Knowledge and Advice

As it is with any other kind of discipline, true and complete knowledge can never be achieved. That's why scientists continue to work and do their research even as they advance in their old age. This is why educators still try to expand their knowledge in an effort to add to the wisdom they already have. It's the same with financially intelligent people. They definitely know more about finances than the regular Joe. But that does not mean that they are content with the knowledge that they already have. They will always try to learn more about how to improve their own personal habits and mechanisms in securing their finances.

Someone Who Is Strategic in Spending Money

Lastly, a financially intelligent person is someone who knows how to spend money wisely. Some people might think that frugality is the key to achieving true financial independence and security. To a certain extent, there is some truth to that. However, there is no escaping the fact that certain expenses are necessary to sustain life. More than that, some certain purchases or expenses just make good sense. Examples of such expenses are investments, necessities, and basic utilities. Financially intelligent people know when to keep their money and when it is a good idea to shell out their cash.

Signs of a Financially Irresponsible Person

Someone Who Always Acquires Liabilities

Sometimes, there is no getting around the acquisition of certain liabilities in life. In fact, it might even be useful to take on some debt to stabilize your finances. Again, this is a topic that will be reserved for the latter stages of this book. For now, all you need to know is that a financially irresponsible person wouldn't even know the difference between good debt and bad debt. They would willingly take on liabilities without knowing that they are digging very deep financial holes for themselves that are quite difficult to escape.

Someone Who Doesn't Have Any Savings

Savings are very important. Financially irresponsible people are those who are content with merely living paycheck to paycheck. Even though they might argue that they don't have any debt, these people should still try to build a sizable savings fund. Savings are important, and financially intelligent people understand how savings can help them become more financially secure in the future. Financially intelligent people use savings for emergencies, rainy days, and high-yield investments. Without having any savings, people wouldn't have the luxury of shelling out cash for such things. Also, financially irresponsible people tend to be more reckless in their spending. They enjoy the emotional highs of buying things and experiences that they don’t secure themselves for the future.

Someone Who Doesn’t Have Any Financial Plans or Systems

Very few people achieve financial security or independence by accident. Sure, some people luck into wealth through a chance inheritance or a winning lottery ticket. But these are very rare instances. For the most part, people achieve financial security through concrete financial plans and systems. Financially reckless and immature individuals would be more cavalier about their cash flow. They don’t have a reliable system in place that would accurately track the money going in and out of their bank accounts. This whimsical approach to financial planning is not a winning strategy and is very common for the financially immature.

Someone Who Doesn’t Seek to Learn About Finance

You might think that there is a higher room for growth for financially illiterate or immature people. However, often, an aversion to learning is what proves to be detrimental in most cases. Financially immature, irresponsible people tend to think that they are above learning. They think that they don’t need to take the time to learn financial management and develop good money habits. There’s a certain sense of pride there that inhibits them from acquiring knowledge. As a result, even though they should have a lot of room for growth, they don’t open themselves up to the opportunities afforded to them.

Someone Who Easily Gives into Peer Pressure and Lifestyle Inflation

Lastly, a financially irresponsible individual is someone who tends to want to *keep up with the Joneses*. They see their peers purchasing luxurious houses, so they pressure themselves to do the same even though they don’t have the means. For example, someone gets hired as an investment banker at a prominent firm. They look around the office and see that everyone wears a Rolex. So, they think that for them to belong, they need to purchase a Rolex for themselves, too. While there’s nothing inherently wrong in splurging on a luxury item, it would definitely be wrong to do so just because everyone else is doing it. Financially intelligent people are more intentional with their purchases, and they never buy anything just because they think it is what other people expect of them.

What Do You Gain from Financial Intelligence and Responsibility?

By now, you should probably have a fairly good idea of what it means to be a financially intelligent and responsible individual. You now know that you need to develop certain skills, traits, values, and principles for you to be a financially stable and mature individual. However, you might still not really have a full grasp over why all of this is necessary, to begin with. You might have a vague idea of why it is better to have money. However, unless you have given considerable thought to it, you might not really understand why financial intelligence is not just something that you treat as if it were a hobby or casual interest. In a world powered by the circulation of money, you need to take better control of your finances to ensure your comfort and stability in society. Here are a few ways that developing your financial intelligence can impact your life:

You Stimulate Growth in Your Income

Financial intelligence will allow you to have better consciousness and control over your income. You will be able to monitor properly just how much money is coming into your life. But more than that, financial intelligence will open up new doors of income as well. You will come to learn more about how you can make your money work for you. You will also learn various tricks and hacks in finance that will allow you to grow the amount of money you are getting. Obviously, the first step in building your wealth is finding out how to bring money into your life. Financial intelligence will offer you a broader view of how money circulates in the world and how you can better earn from it.

You Nurture Your Cash Flow

This particular benefit of financial intelligence is in connection with the previous entry. Once you are able to stimulate growth in your income, you can then effectively nurture your cash flow. Financial intelligence enables you to plan for both your day-to-day expenses and your long-term financial goals. However, there is a much bigger emphasis on the nitty-gritty when it comes to monitoring your cash flow. Ultimately, it is the little transactions that take place in a single day that ultimately lead up to the bigger financial milestones. Financial intelligence grants you the ability to better analyze your spending and budgeting patterns. This means that you would be in a much better position to optimize your budgeting habits to maximize your income while minimizing your expenses. Ultimately, the goal is to keep more money coming in while reducing the amount of money going out.

You Provide Security for Yourself and Your Loved Ones

Financial security is just another added benefit of gaining financial intelligence. Financial security means that your finances are in such good shape that you will not have to worry about sustaining yourself regardless of whatever happens in your life. Of course, the idea of financial security is relative for most people. However, at its core, financial security merely means that you will not have to think about where to get money to acquire your basic needs and essentials. You will not have to worry about where your next meal will come from or whether you will be able to pay rent. More than that, financial security also means that you are prepared for unexpected circumstances and emergencies. For example, if you are financially secure and you get fired from your job tomorrow, then you will have enough money in the bank to sustain yourself for a while as you try to look for alternative sources of income.

Another example is if someone in your family gets sick and you end up with a massive hospital bill. Financial security means you have the money to finance these medical treatments without having to go into debt. This can also apply to other unexpected disasters like car accidents, pandemics, and natural calamities.

You Learn How to Make Your Money Work for You Through Investments

If you work toward being more financially intelligent, you will also learn more about the concept of investments. Financial intelligence will enable you to plan your finances so thoroughly to the point wherein you can start making your money work for you. Most people will have their money sitting in banks. More prehistoric people will stuff their money into their mattresses. However, financially intelligent people know how to invest their money in such a way that they're not losing value over time. Instead, the money grows and works for them with just a certain level of oversight. All of these investments can serve as financial assets that are useful for the future.

You Gain a Better Understanding of Assets and Liabilities

The word *asset* has been thrown around a few times already in this book, and there's a reason for that. A lot of finance has to do with balancing assets and liabilities. As much as possible, you want to build your assets while minimizing your liabilities. That's the essential gist of financial responsibility. And when you are a financially intelligent person, you become a lot more adept at making distinctions between these two concepts. Moreover, financial intelligence will also allow you to figure out the mechanisms involved in building your assets while fending off your liabilities. The whole point of securing these assets is that they add to your overall bed of wealth and allow you to have a more secure and comfortable future.

You Grow Along With Inflation

Not a lot of people realize that the hundred dollars that you have in your wallet right now is not going to be worth the same in five years. Sure, you might think that you are saving your money by keeping that bill in your wallet. However, what is actually happening is that you are losing money because of inflation. Inflation is essentially the gradual and systematic increase in the price of goods and services. To put it simply, things and experiences become a lot more expensive over time. This is why a single dollar might have been enough to cover a whole meal for you back in the 1900s, but it would be barely enough to cover just your drinks in this age. Financial intelligence will help you grow along with inflation so that your spending power and net worth don't diminish over time.

You Develop Your Sense of Discipline

By now, you should probably already know that discipline is one of the most valuable skills that you could ever develop in life. Discipline is often what many successful people will attribute their own personal achievements to. It can be very difficult to achieve anything remarkable or outstanding in life without sheer discipline. Discipline will enable you to stay on a diet whenever you are trying to lose weight. Discipline will help you work hard on lifting your struggling business off the ground. Discipline will force you to delay your gratification, knowing that it eventually culminates in you getting everything that you want in life. Financial discipline is crucial because it prevents you from accruing any unnecessary debt or partaking in useless expenses. It's what will help you stick to whatever savings plans you might have to ensure your financial security in the future. Simply put, discipline is what will prevent you from splurging on an unnecessarily luxurious car now so that you can invest that money into the stock market and watch it grow and work wonders for you.

You Put Yourself in a Better Position to Pursue Your Dreams

Of course, financial intelligence is also going to help put you in a better position to pursue your dreams. Again, the reality of the world is that everything costs money. There are some people out there who are lucky enough to have their passions be of a certain value to a substantial number of people. Hence, they have the luxury of making a career out of the things they are passionate about. However, this is not something that is always afforded to everyone. You can't always pursue your dream of being a successful entrepreneur if you are not booking any gigs and you need some stream of income to pay the rent and utilities. Sometimes, your dreams have to take a backseat to your more practical pursuits. If you are more pragmatic and intelligent in handling your money to the point that you attain financial security, it will be a lot easier for you to take those risks and pursue the dreams that you really want to achieve in life.

You Won't Stress About Retirement

Careers are good. They offer you a sense of purpose and structure in your life. They give you something to build upon and continuously work on. However, a lot of people merely use careers as tools to sustain their lifestyles. And there's nothing wrong with that. In fact, the vast majority of people in the world only keep their jobs as a means of self-sustenance. It only really becomes a problem if you are not financially responsible or intelligent enough to prepare for retirement. You have to realize that you are eventually going to grow old and you will not have the kind of energy that your youth affords you. When that happens, you should still have enough assets, investments, and financial capital saved up to sustain your lifestyle even when you lessen (or completely eliminate) your income from work. Financial intelligence will grant you the ability to prepare for your retirement responsibly so that you will not end up having to work yourself to death.

Quick Run-Through of How to Be More Financially Responsible

To conclude this chapter, we are going to do a quick run-through of some specific tips and lessons that you need to learn for you to be more financially intelligent and responsible. Again, this is not just a matter of swallowing a large amount of knowledge whole and then immediately yielding the results. It's a very slow and gradual process of learning that involves trial and error. You will find that your intuition for fiscal management will sharpen a lot more through practice and experience. Of course, it helps if you enforce good habits into your daily life in order for you to yield good results efficiently. As you make your way through this book, you will be exposed to a sizable number of different concepts, lessons, and habits that will help you become a more financially intelligent person. However, in the interest of whetting your appetite just a little bit, here are a few concrete tips and principles that you need to take to heart if you are going to improve your financial intelligence. The items listed here will be discussed briefly, but a lot of these concepts will be expounded further in succeeding chapters.

Set SMART Goals for Yourself

The first thing that you really want to do when it comes to increasing your financial intelligence is to develop SMART goals for yourself. SMART stands for *specific*, *measurable*, *attainable*, *relevant*, and *time-bound*. We will go into further details about intelligent financial goal-setting later on. However, for now, all you need to know is that goal-setting is critical because it gives you a target to aim for. Again, motivation can be tough to come by when you are partaking in an endeavor such as working toward financial security. However, if you break the process down into more digestible goals, it will become easier for you to motivate yourself and stay on track.

Develop a Strong Financial Plan

Of course, goals are nothing when you don't have a solid set of plans to get you from point A to point B. Goal-setting is only the first step. Once you already have a clear idea of your destination, the next step is to determine the route you need to take to get there. This is where the planning process comes in. The plan that you set in place significantly decides whether or not you will reach your goal successfully. A good financial plan should be detail-oriented and pragmatic. Every aspect of a financial plan should serve a purpose, and they must all be in service to the greater overall goal.

Build and Adapt Your Plan Over Time

Sometimes, the plans you start out with are not necessarily going to be applicable somewhere down the line. This can happen because of several different reasons. Maybe you discover along the way that you have different goals after all and that you need to change your course somewhat. You might find that you want or need other things, after all. Perhaps, conditions in your life may have changed and have rendered certain plans irrelevant or counterproductive. Whenever that happens, it is more important to be adaptive than to be resilient. Use your best judgment whenever deciding on whether or not to change course. Sometimes, starting a new path from scratch is a lot better than sticking to a failing plan.

Learn the Difference Between Good Debt and Bad Debt

In an ideal and perfect world, you would never want to be in debt. From the outside looking in, you would think that the best way to get rich would be to just save all your money, limit your expenses, and eliminate your liabilities. To a certain extent, that's true. However, not all debts are created equal. Sometimes, going into debt will put you in a better financial position. It's all a matter of learning how to distinguish between good debt and bad debt. Again, this is a topic that will be discussed more comprehensively in a later chapter. For now, you just have to understand that while you never want to stay in debt, you don't always have to fear it either. You just have to be smarter about the kind of debt you take on.

Distinguish Wants and Needs

There's no denying that a lot of people can muddle up their wants and their needs when it comes to budgeting. This can become particularly tricky if you are someone who has a penchant for luxury and status. For example, you might convince yourself that you need a car to help you get to and from work every day. That seems like a perfectly reasonable justification for buying a car. In this case, you consider the car a need. After all, it is going to bring you to your office, where you will be earning your money to pay off all your expenses. In that sense, a car is a reasonable expense. However, it can get really tricky when you start thinking about what car model you are going to buy. Since you have convinced yourself that you need a car, there's a chance that you will have convinced yourself that you need an expensive luxury car even when you really don't. Just because you need to buy a car for work does not mean that it has to be a Porsche, does it? This is what it means to distinguish between wants and needs.

Build Your Savings

The most important person that you need to pay in your life is yourself. It's not your parents. It's not your company. It's not your school. And it certainly is not your favorite clothing brand. If you are so willing to liberally funnel your money into the pockets and bank accounts of other people and institutions, then you should be just as willing to pay yourself that amount as well. This is the very idea of savings. Sure, it can feel nice to use your money to pay for something that you know you'd enjoy. However, if done excessively, you will end up putting yourself in a very precarious and compromising position. Pay yourself first before you pay for anything else. Your savings are important because they will serve as a comfortable lifeline for you should your sources of income ever become depleted.

Build Your Emergency Fund

No matter how precisely you will plan out your life, there's no getting around the unexpected. Life is bound to throw a few curveballs your way, and you are not always going to like them. These curveballs manifest in the form of a blown tire or a house fire. Sometimes, you might get laid off from your job or contract a severe illness. You don't plan for these things to happen, but that does not mean that they can't happen all the same. So, the best way for you to handle these unexpected occurrences is to prepare for them beforehand. That's what an emergency fund is all about. Your emergency fund should be independent of your savings and the money that you use to sustain yourself. An emergency fund is a war chest that you set aside and never touch unless an emergency arises. This way, whenever a curveball is thrown at you, you would be in a much better position to handle the situation better.

Stick to Your Own Standard of Living

Lastly, it is very important that you stick to your own personal standard of living. People tend to get so lost in the rat race of life that they lose sight of their sense of self. You might see that your neighbor has just gotten a new LED TV, and you think that you also deserve the same. When you are at work, you see that your officemate has just gotten a new Rolex, so you assume that you need one as well. In your family, you found out that your brother has gone on a trip to Rome with his wife and kids, so you book a flight for your family too. What ends up happening here is that you are spending your money to fund the standards of living of other people. You might not have known that your neighbor had just gotten a raise, and that's why they bought a new TV. Maybe your officemate's new Rolex was a gift from his parents. Perhaps your brother's wife was the one who paid for their trip to Rome. Whatever the case, you are not always so familiar with other people's financial situations. As such, it is important for you to adopt only a lifestyle that fits within the scheme of your own financial status.

Chapter 2:
The Role of Psychology in Financial Management

There seems to be this prevailing idea in mainstream dialogue that money is all about mathematics. After all, money is typically assigned numerical values. So when you deal with numbers, it always has to do with mathematics, right? Well, not necessarily. A lot of people tend to use this idea as a copout. They refuse to pay attention to their finances because they say that they're "bad with math" or they're "hopeless with numbers." They decide to just wing the management of their finances. These are the kinds of people who tend to be very reckless with their money because they don't pay attention to the details. On top of that, they willfully do so.

However, what not a lot of people realize is that mathematics has very little to do with financial management. Any dummy can make use of a calculator. It's not a mathematical issue at all. Financial management has more to do with psychology than it does with anything else. Sure, you need to do your pluses and minuses every now and then. However, that comprises a very small part of managing your money. Your psychological approach to handling your finances is a lot more influential than your cognitive abilities.

This is the message that this chapter is going to try to drill into your brain. You need to develop the kind of mindset that is willing to take on the challenge of really managing your finances more purposefully. A lot of people seem to be under the impression that wealth just happens by accident. They think that as long as they have a job that gives them a steady income, they are in good shape. However, financial management is a lot more nuanced than that. There are plenty of people who have jobs and still find themselves in financially compromising or humbling positions.

By the end of this chapter, you should have more than just a whimsical approach to handling the money that comes your way and goes out of your pocket. You will discover more about how your mental mindset plays a huge role in how your finances are going to look like.

Money as a Tool to Meet Basic Needs

To understand and tweak your behavior toward money, it is imperative that you take the time to think about what role money plays in your life first. For some people, money is used as a tool to manifest their loftiest dreams into reality. You might envision yourself becoming a big-time lawyer. Then you need money to help pay for law school. Perhaps you dream of having an amazing wedding with the person you love most in the world. Then you will need money to book venues, hire caterers and performers, send invitations, and more. Or maybe you want to be a business owner. You will definitely need money as startup capital for whatever business you want to establish. Essentially, this is how money can help manifest your dreams into reality.

So, it begs to ask the question. Does not having money equate to you being unable to achieve your dreams? And if so, does “not having money” mean that you will be subjected to a life without any sense of purpose or fulfillment? If you derive purpose and meaning from achieving your dreams, then not having money will make it nearly impossible for you to find fulfillment. In some weird way, if you think that your dreams help define your legacy, does that also mean that money defines who you are?

A lot of people will tie their sense of self-worth to their money precisely because of this reason. If that’s the case with you, then this is the first lesson that you need to learn from this book. Your money does not define you, nor will it ever change who you are. Ultimately, it is still your actions, behavior, and motivations that will define you as a person. In this sense, money may not necessarily define you. However, the way that you handle the money that comes into your life speaks loads about who you are and what kind of mindset you have.

If you are reading this, then you have probably found yourself in financially compromising positions in the past. Heck, you might even consider yourself to be in a financial bind right now. At the very least, you will be familiar with anyone's story about having certain challenges and setbacks when it comes to finance. Perhaps, it is a time in your life when you were facing eviction because you couldn't pay for rent. Maybe you needed to drop out of school because you couldn't afford tuition anymore. Maybe you had dreams of starting a business, but you didn't have the money to cover capital expenses. Whatever the story is, try to think back on it and reflect. Ponder on everything that you were feeling in that moment. Were you scared? Were you anxious? Were you excited? Were you sad? Were you angry? It's important that you think about these feelings because they will give you better insight into your personality and your relationship with money. Your emotions can be very revealing about your true character.

Next, think about what you did next when you were faced with these challenges. Did you develop a game plan for yourself to try to find a way to make rent? Did you plan to save up and go back to school once you had enough money? Did you reach out to friends and potential investors to help you get started on your business? Or did you merely just give up and resign yourself to the situation that you are in?

See. That's the difference. The answers to these questions are what define you. It's not about the amount of money that you have in the bank or in your wallet. It's what you do within these financial situations that really reveal your true self. Your responses to these situations will show what money means to you and what kind of power you give it. Moreover, it will reveal whether you are someone who takes control of money or if you merely let money (or the lack thereof) take control of you.

Ultimately, the way that most people see money is as a tool to satisfy certain needs. However, that idea in itself is not so cut and dried. It's so much deeper than it seems. Many people will define or perceive these needs in different ways. And in order to determine how money is used to address these needs, we will call into reference Maslow's hierarchy of needs.

Physiological Needs

At the base of Maslow's pyramid are a person's physiological needs. These are essentially all of the basic things that a person needs in order to survive, such as food, water, shelter, and clothing. As you may already know, very few things in life are free. In this modern world, even basic commodities, like water and breathable air, are commercialized and sold off as products. This is even truer for other more finite commodities, like food, shelter, and clothing. Naturally, you need money to buy groceries for yourself and your family every month. You need money to build a house or pay rent so that you always have a roof over your head. You need to pay for clothes and basic utilities, like running water, electricity, and internet connectivity. All of these basic needs require some kind of funding.

Safety and Security

The second level of Maslow's hierarchy of needs is safety and security. It all has to do with establishing a sense of certainty in one's life. They say that the only thing that remains constant in life is change. That means that you must always expect the unexpected. You are just bound to encounter a few snags in the road that you would never have expected. Of course, variety is fun. It adds to the spark of life. However, on the other hand, uncertainty can bring about a lot of anxiety and insecurity. Keep in mind that there are varying kinds and degrees of uncertainty. You might say that it is fun to book a random trip to a destination that you have never been to before. But that’s a different kind of uncertainty from not knowing how you are going to pay rent or where you will be getting your next meal. Money provides a certain layer of security for people in this regard. There’s really a different kind of comfort that comes from knowing that you have a job that will provide you with a steady income to address your needs. Money can pay for health and life insurance whenever you get sick unexpectedly. Money will give you a chance to prepare for your retirement fund so that you don’t have to keep on working for the rest of your life. This is the kind of safety and security that money can provide you with.

Love and Belonging

This particular need can be tricky since most people would believe that you can’t buy love with money. You can’t pay people to be your family. Sure, you can provide people with a salary to work as a team around you. But that’s a different kind of companionship. That’s not what we’re talking about here. This particular need speaks of the sense of community and belongingness that can’t be bought with money. Every human on earth has this innate need to feel like they belong. We all crave for relationships. It’s just how we’re wired. Our psychology compels us to pursue attachments with others. However, these attachments can’t be purchased with cash. So, how does money factor into this exactly?

Well, while it is true that money can't make people fall in love with you, it is definitely true that money can help create an atmosphere that makes falling and staying in love a lot easier. For example, there are marriages and families all over the world that get broken up as a result of stress brought about by financial strain. Many couples who go through financial struggles will often find themselves in environments that are filled with stress and anxiety. These kinds of environments can make it very difficult for a sense of love and belongingness to prosper.

But more than just that, money also provides people a chance to be of service to others. You would be in a much better position to contribute to society if you have money. Again, it is innate for humans to desire to belong to a larger community of people. Embedded within that instinct is also the desire to be of service to the people within that community, whether it be through philanthropy or casual emotional support. Money gives you the chance to set up businesses that can provide employment to others. Money affords you the opportunity to donate goods to underprivileged and marginalized communities. And these are just some of the ways in which money can cultivate a sense of love and belonging within a person.

Self-Esteem

Next, there is the matter of self-esteem. Whether you like it or not, there are just some people out there who tie their sense of self-worth to how much money they have. Most of the time, this obsession with status and esteem when it comes to finances might even be impractical. It no longer becomes just about being able to provide for essential needs like food or clothing. It's more about subscribing to the status that is associated with accumulated wealth. Maslow postulated that humans always want to feel confident about themselves. They will grasp at anything that makes them feel special or unique. Money can be used as a very powerful tool in simulating that kind of experience for people. There are loads of individuals who will pay a serious amount of money for exclusive memberships to clubs or luxury fashion pieces just to feel like they are a part of a special or elite group. It does not even matter if you think that they are justified in thinking this or not. It happens all too often.

This is not to say that people without money are incapable of being confident. It's also not always the case that rich people are without their insecurities automatically. The point here is that money *can* be used as a tool to boost one's self-esteem. It's the same kind of ego boost that you get when you wear nice clothes that make you feel good inside. These clothes are bought with money. It can boost your confidence to know that you have graduated from a school like Harvard. That Harvard tuition does not come cheap. These are just some of the ways in which money can directly impact your sense of self-esteem.

Self-Actualization

Lastly, at the very top of Maslow's hierarchy of needs is self-actualization. More than anything, human beings desire to make something of themselves. According to Maslow (1943), "What a man can be, he must be."

Of course, the thing about self-actualization is that it can mean many things to many different people. It all depends on how ambitious you are and what particular talents or skillsets you have. Essentially, it is an innate need within all of us to maximize our potential and the time that we have in this world. We all understand that the time afforded to us is finite. It is a limited resource that we can't buy, extend, or bargain for. Whatever time we get is the time that we get. So, Maslow argued that since we all have a fundamental understanding that we don't have unlimited time, we need to make do with whatever we can get. It's through self-actualization wherein people can derive a sense of meaning and fulfillment in their lives. While the other needs such as safety, security, and physiological utilities are crucial to survival, it can be argued that self-actualization is what makes life worth living.

Now, how does money factor into self-actualization? Again, whether you agree with it or not, many people will tie their sense of selves to how much money they have. In essence, money is no longer just a tool for survival. Rather, it is the goal. Earning money in itself becomes the endgame. Of course, some people will use money to fund their dreams of self-actualization, like running for public office or starting a business. Regardless, there are many people all over the world who will factor money into their need for self-actualization.

Developing Your Financial Self-Awareness

Financial self-awareness is a very important aspect of financial intelligence. Essentially, financial self-awareness is a gauge of how familiar you are with your own personal financial situation. Most of the time, people don't fall into debt out of the blue. Sure, some people go into debt as a result of one-off expenses, like medical emergencies or student loans. But there is a huge chunk of people out there who get into credit card debt as a result of a series of systematically poor financial choices. It's a lack of awareness of the ill effects of these decisions that leads to them committing the same mistakes over and over again.

Self-awareness is a powerful tool in helping to combat the systematic takedown of one's own finances. In a nutshell, financial self-awareness can be measured by how well you know your financial assets, liabilities, and spending habits.

Why Is Self-Awareness Important?

Now, you still might not be sold on why we're talking about financial self-awareness here. Sure, this book promised you all of the psychological secrets and hacks to getting you to handle your money better. However, what you might not realize is that developing your self-awareness serves as a foundational requirement to any of those hacks. To further compel you, here are four concrete ways in which financial self-awareness can contribute to you achieving whatever financial goal you set for yourself.

It Develops Your Financial Confidence

Firstly, financial self-awareness contributes to your confidence and self-efficacy. Confidence is key whenever you are partaking in any particular task or endeavor. It is crucial that you believe in your capacity to achieve your goals in order for you to find success. If you are not confident in yourself, it is probably because you know that you are not up for the task. If you develop self-awareness over your finances, then you are eliminating any blind spots in your life. Most of the time, confidence can waver as a result of uncertainty. But working on your self-awareness can literally appease any uncertainty you might have about your financial situation.

It Is Associated With Financial Discipline

Next, developing your financial awareness is closely associated with developing your discipline. It does not matter whatever you are trying to achieve in life. If you don't have discipline, then you will not get very far. Discipline is what helps you stay on track even when you are distracted or demotivated. It's what helps you make the right decisions consistently so that they eventually become instinctive to you. Self-awareness can impact your discipline because it gives you more insight into what your habits are. When you have financial self-awareness, you know exactly what kind of habits to keep and which ones to eliminate. This can help develop your financial instincts to the point wherein making the right decision almost becomes second nature to you.

It Leads to Better Financial Satisfaction

Your financial self-awareness is also closely tied to how satisfied you will be with your financial situation. You might not think much of developing a sense of satisfaction over your finances, but it is actually crucial to your success. Feeling satisfied or fulfilled over the state of your finances is an emotional response that signifies that you are on the right track. Of course, this emotional response can only be validated by your own self-awareness.

If you are perfectly aware of everything that’s going on with your finances and you are still happy, then that’s a sign that you are on the right track. Some people out there have a false satisfaction over the state of their finances. They might think that since they’re staying afloat and are free of debt, then they are in good financial shape. However, if they don’t have the kind of financial self-awareness that will help them realize that they don’t have emergency savings or a retirement fund, then it is a false kind of satisfaction.

It Contributes to the Effectiveness of Financial Intelligence

Lastly, financial self-awareness contributes to the overall effectiveness of one’s financial intelligence. Ultimately, your knowledge and intelligence over your finances can only be as good as your awareness of it. You wouldn’t be able to capitalize on any of the hacks or secrets that will be listed here when you don’t have a good grasp of your own financial situation.

For example, how would you know how much to save for an emergency fund if you are not aware of what your total monthly expenses amount to? How would you be able to establish a sense of safety and security if you don’t know what kind of coverage your insurance provides you?

Essentially, financial self-awareness provides you with all of the necessary data that you need to establish a game plan for your financial goals. If all of the wisdom and advice listed in this book will serve as the vehicle for you to achieve financial freedom, then your financial awareness is the gasoline that will get that car to move forward.

How to Develop Financial Self-Awareness

Ultimately, the way to gain better control of your finances is to find a way to train your mind to be more intentional in its approach to using money in service of your needs. You have already learned a lot about the motivations that drive people's money-making decisions. You have learned that a lot of it has to do with addressing basic needs, like food and shelter. But a lot also has to do with servicing one's desire to belong to a community or to fulfill certain goals and aspirations. It's always going to be a different case for every person. But the people who tend to be the most successful at managing their money are those who develop a good sense of self-awareness over how they think and behave.

So, while you might already be eager to figure out all of the psychological tips and tricks that are involved in helping you get better with your money, we must hold off on the specifics for a bit. All of the more detailed tidbits of wisdom and knowledge will be sprinkled out in generous doses all throughout the book. This is not a process that we can rush as if it were just some sort of crash course. Changing one's mindset is a lot more difficult than you might imagine. You can't expect to just simply get better and become a master by reading a quick article about how you can handle your money better. There are some specific steps that you need to take before you can get to where you need to be. For now, the current step you need to take is for you to understand your personal relationship with money and how you use it to service your needs. Strip it all down to the bare essentials.

If your memory permits, do a quick recall of all the expenses that you have made over the last week or for as long a time period as possible. List down every single thing that you have paid money for and how much you spent on it. This can include parking fees, gas, clothes, groceries, movie tickets, electricity bills, and whatnot. List as many of them down as you possibly can. Then, when you are done listing them all, try categorizing them into each level of Maslow's hierarchy. For example, if you pay for groceries, then that might be considered as a service to your physiological needs. If you paid for insurance recently, that might be a part of safety and security. If you gave your kids their allowance, then that's a part of love and belonging. If you bought yourself a nice pair of shoes as retail therapy, then that's a part of building your self-esteem. If you put more money into building your business, then that might be in service to your need for self-actualization. During this process, it is important to be honest with yourself with regard to your approach to your expenses. This is the very first step to developing the kind of mindset that is befitting of a financially intelligent individual.

Then, once you have successfully categorized these expenses, it is time to total them up. See how much money you are spending on each level of the hierarchy. Now, bear in mind that this process might come as a shock to you. You might not realize just how much you are spending on trying to build your self-esteem and how little you are spending on padding your safety and security. Again, it is important that you stay honest with yourself here, no matter how uncomfortable the numbers might make you. Once you have those rough totals, it is time for you to think about whether you are using your money wisely.

If you are spending $1,000 a year on shopping to make you feel good about yourself and just $200 in that same span on health insurance, do you feel like that's a smart way of spending your money? There is no right or wrong answer here. It all depends on you. What this activity forces you to do is come to terms with how you are prioritizing your expenses. It reveals to you the kind of monetary value that you attach to certain needs you have in your life. Ultimately, as you try to save money, you will be forced to make certain cuts and compromises with regard to your spending. That will be a lot easier to do when you have a good understanding of what your priorities are and what your bad spending habits might be.

Again, the whole purpose of this exercise is not to tell you that you should only be spending all of your money on physiological needs and that it is foolish for you to spend money on your loved ones or your community. Rather, the point of this activity is to provide you with a more systematic approach to analyzing the way that you deal with your finances. By doing this, you are giving yourself more insight into what your current spending habits are and where you could possibly spot potential areas of improvement. This is the very essence of financial self-awareness.

Chapter 3:
Knowing Your Net Worth

You might already be familiar with the concept of net worth with your exposure to articles from media outlets like *Forbes* magazine. You may read all about the net worth of powerful people like Elon Musk, Bill Gates, Jay-Z, Michael Jordan, Dwayne Johnson, and Oprah Winfrey. However, what you may not know is that the concept of net worth is not exclusive to the financial elite. You, whether you realize it or not, have a net worth as well. You may not understand why yet, but knowing your net worth is crucial to you developing your financial intelligence.

This entire chapter is going to help you through the process of figuring out your net worth. First of all, you will be briefed on what net worth is so that you can gain a deeper understanding and appreciation for the concept. Then, you will learn why it is important and how it contributes to your eventual financial success. Moreover, you will learn the many terminologies and facets that are associated with the concept of net worth and how these all play into your financial situation. And to conclude this chapter, you will be taught how you can compute your own personal net worth moving forward.

What Is Net Worth?

To try to put it simply, net worth is a monetary value that is assigned to a person. Your net worth amounts to your total assets minus your liabilities. To make it even simpler, your net worth is essentially everything that you own minus whatever debts you have. It's really as simple as that. If you have assets that have a higher value than your liabilities, then you are considered to have a positive net worth. If the reverse is true, then you have a negative net worth.

Now, it is important to preface this entire chapter by saying that your net worth does not define you as a person. You shouldn't consider yourself less of a human just because you don't have a higher net worth than the people around you. This is especially true for people who have a negative net worth. However, what net worth does provide you with is a quantitative value of your financial situation. Think of your net worth as the balance sheet for your life. The ultimate goal of this book is to help build your net worth as much as possible so that you always come out ahead. By attributing a concrete number to your net worth, you have a better way of measuring your progress as you move forward.

To shed further light on the concept of one's net worth, we need to further break down the definitions of assets and liabilities.

Assets

An asset is anything within your scope of ownership that provides current or future monetary value. Essentially, you should think of your assets as anything that can be converted into cash or just plain cash itself. Some of the most common assets that people have include the money they have on-hand, money in their bank account, stock market investments, company shares, retirement funds, jewelry, vehicles, and collectible items (such as valuable paintings and luxury fashion items). Real estate can also be considered as an asset so as long as you have paid for it in full and own it outright. If you have taken a mortgage or a loan on your property, then the net worth of that piece of real estate is the market value of that item minus whatever amount you owe.

Depending on who you ask, assets can be classified in many different ways. However, there’s no need to overcomplicate things. It just so happens that many people have many different ideas and perspectives when it comes to how they perceive assets. You will grow to have your own personal philosophy in this matter the more you practice finance as well. For now, you just have to learn the four essential asset classes: (1) equities, (2) fixed income, (3) money market and cash, and (4) alternative assets and investments.

Equities

Equity is just a technical term in finances that is used to denote ownership or a stake in a company. If you have any kind of investment (whether financial or industrial) in a company, then you should be compensated with some kind of equity. For example, Company X started out with a valuation of $100,000. Out of that $100,000, you invested $25,000 for 25% stake. That is your equity in the company. If you keep that equity and the company’s value rises over time, the value of your equity also increases. Hypothetically, if Company X grows to become worth $1,000,000, then your initial equity will now be worth $250,000. This is an example of an asset that can grow over time.

Fixed Income

Just because you don’t have your cash on hand does not mean that it is not an asset. Bonds are an example of a fixed income asset. By investing in bonds, you are essentially lending institutions money with a set interest rate. These institutions will take your money and try to grow it through other investment opportunities. Then, once they are successful in growing that money, they will periodically pay you back along with your set interest fee. This way, you end up earning a profit. The profits that you earn from these loans are also considered assets. The length of a term of payouts and the amount of interest is all dependent on the terms of the bond agreement.

Money Market and Cash

The most common and most accessible type of asset that anyone can have is cold hard cash. This can be cash that you have stored in a savings account that you can access through an ATM or a bank withdrawal. It can also be cash that you keep in your wallet, home safe, or piggy bank. Another form of this kind of asset is money market holdings. They are typically considered liquid investments that can be converted into cash relatively quickly as compared to other kinds of assets. Also, they have a fixed market rate that does not fluctuate.

Alternative Assets and Investments

The final asset class is where things can get very diverse and creative. This is where assets like real estate properties, gold, jewelry, livestock, art, antiquities, and other special investments come into play. When done correctly, these kinds of investments typically grow in value along with inflation.

Liabilities

A liability is anything within your scope of ownership that you owe to someone else, whether it be a person or an institution like a bank. One of the most common examples of a liability is credit card debt. You may be amassing certain *assets* when you buy things with your credit card, but the amount that you end up owing the banks is still considered a liability. Other examples of liabilities include mortgages, student loans, car loans, and any personal loans you might have with friends and family.

Just like assets, a liability can also come in different shapes and forms. Also, like assets, different people can have different definitions of what financial liabilities are. However, for the purposes of uniformity, these are the two main types of liabilities that you should be concerning yourself with: current and non-current liabilities.

Current

As its name implies, current liabilities are essentially those that require your immediate attention due to the short-term nature of their dues. Think of the credit card bills that you need to pay at the end of the month. Those are examples of current liabilities because they fall within the standard length of one year. Anything that you owe to another person or entity that is payable within that span can be considered a current liability.

Non-Current

Non-current liabilities are essentially any payables that you have that exceed the length of a year. Maybe you are either financing a car, a mortgage, or student loans. Typically, these kinds of debts take years before they are paid off. These are all examples of non-current liabilities.

Now, in order for you to calculate your net worth, it is just a matter of taking all of your assets and subtracting the worth of your liabilities from them. While that may seem like an easy feat, it is a lot more complicated than it seems. We will go back to how you can calculate your own personal net worth in the latter portions of this chapter.

Why Is It Important to Know Your Net Worth?

It Gives You a Good Idea of Where to Start

Unfortunately, one of the sad truths about finance is that not everyone is going to have the same starting line. Keep in mind that there is such a thing as "privilege." Some people are just dealt a better hand than you. Whether that is fair or not is irrelevant. There is very little to be gained from saying that other people have it better off than you. What is more important is that you know what you need to do to keep moving forward. This is why establishing your net worth is very important. It gives you a good idea of where to start. If knowing your net worth reveals to you that you need to focus first on getting out of debt, then you need to do that. If your net worth says that you have a little wiggle room to take risks with your investments, then work on that information.

It Helps You Develop Short-Term and Long-Term Goals Better

One byproduct of knowing where you are with your finances through calculating your self-worth is that you end up in a better position to set goals for yourself. Later on in this book, you will be briefed on how you can set financial goals relative to your personal financial situation. Not all people are going to have the same goals when it comes to their finances. It all depends on a number of factors, and one such factor is net worth. Part of developing your financial goals is making sure that they are realistic and attainable. Knowing your net worth can give you a better idea of what goals are achievable and which ones are not.

It Helps You Make Better Financial Decisions

Knowledge of your net worth will lead to you making better financial decisions. At the end of the day, you always want to make sure that you enforce good financial habits by making consistently good choices. This means that if you ever have to spend money on anything, make sure that it is within your budget and that it serves a purpose. If you are more aware of your net worth, then you also have a good grasp of how flexible or tight you have to be with your money. For example, you might be considering buying a car. If you know that your assets don't really outnumber your liabilities as much, then perhaps you can settle for a modest car that will not break your bank. If you have a negative net worth, then you might consider foregoing a car purchase until you manage to put yourself in the green. Essentially, knowing your net worth will help you avoid reckless spending.

It Helps You Secure Necessary Loans

Lastly, knowledge of your net worth will help you secure loans. Right now, you might be apprehensive about loans because of the fact that they're liabilities. That's true. They are liabilities. However, in a later chapter, we will be talking about how not all debt is bad. In fact, debt can be used as a powerful tool to uplift your current financial situation as long as you are smart about it. Even the richest people in the world take out loans consistently as a means to expand a business or invest in real estate. Whatever the case, most creditors will want to know your net worth as a way to measure your financial strength.

How to Calculate Your Net Worth

One of the biggest challenges involved in calculating your net worth is valuing your assets. Actually, most people will not have a problem assigning a certain value to their assets. The real problem lies in whether those values are accurate or not. It's just that a lot of people will have a tendency to inflate the valuations of their assets. Whenever you assign values to your assets, it is important that you provide conservative estimates. This way, you don't have an unrealistic or overblown view of your actual wealth. It's much better to be conservative in this regard rather than to be liberal.

For example, you may have invested a sizable amount of money into a luxury wristwatch. By purchasing this timepiece, you know that you have a valuable asset that you can call your own. However, if the watch model you purchase is not necessarily short in supply, it is likely that its value will only go down the moment you walk out of the store. Of course, there are certain outliers, such as luxury timepieces from brands like Rolex and Patek Philippe, whose products not only retain value but end up increasing over time. But for the most part, the value of items like these really go down.

When calculating your net worth, you shouldn't be valuing your watch at the price that you bought it for. Rather, you should be valuing it at the lowest possible market price. This means that if you were to sell your watch today, what is the lowest reasonable amount that you could possibly sell it for? This is the kind of approach that you should take with other assets you have, like cars.

Things get a little tricky when it comes to determining an accurate value for a piece of real estate like your home. Still, if you are going to ascertain a value for your house, it is still important that you stay conservative in your approach. Try to research recent listings or transactions for similar houses within your neighborhood in order for you to gain a better idea of what the market price for your house truly is. If you feel like you can't do this on your own, you can always get your house appraised by a certified professional. However, it is not as simple as that. Even finance experts are divided on whether you should consider a home an asset, to begin with.

On one side, there is a group of people who say that whatever equity you have in your home should be considered an asset because of the inherent market value of that home. Since your home has a market value, it means that it can be converted into cash when it is sold. With that reasoning alone, it should be enough to justify a home as an asset.

However, there is also another group of people who say that this is a false belief. They say this because whatever cash you get from the sale of a home immediately goes into the purchase or rental of another home or living space. In essence, the cash that you receive from the sale ends up being converted into a liability. From profit, it transforms into the cost of replacement housing. In this case, if the previous home is flipped at a profit and ends up having a higher value than the replacement housing, then the value of the previous home can be considered an asset. Whether you subscribe to one particular way of seeing the matter or another is up to you.

Once you are done assigning an honest and accurate value to your assets, then the rest of the process of determining your net worth is a lot easier. You just simply have to follow this formula:

Net Worth = Assets – Liabilities

It's basic mathematics really. See? At the start of this book, you were promised that you wouldn't have to do any complex mathematics. If you are still iffy on how the calculation process should look like, then here is a hypothetical example below.

Assets	**Liabilities**
Home market value: $350,000 Cash in savings: $10,000 Stock market investments: $15,000 401k = $17,000 Jewelry market = $13,000 Car market value = $18,000 ***Total assets = $423,000***	Outstanding mortgage = $240,000 Credit card debt = $2,500 Outstanding car loan debt = $8,000 Personal loan debt = $10,000 ***Total liabilities = $260,500***

Given these values, it is just a matter of applying them to the formula.

Net Worth **=** 423,000 – 260,500 **= $162,500**

It's that simple.

What Do You Do With Your Net Worth?

Okay, to get the obvious out of the way, the first thing your net worth will tell you is whether you are in debt or not. If your net worth is a negative number, it means that you have more liabilities than assets and that you are likely in debt. However, it is important to emphasize once more that your net worth does not necessarily define you as a person. It just so happens that if you have a negative net worth, your finances are not in the most ideal state. That does not make you a bad human being.

Keep in mind that your net worth is never a set monetary value. It can fluctuate with every passing day just like the stock market. Sometimes, your net worth can go down ever so slightly, and it might shoot up dramatically. It all depends on the financial choices you make in life, and a little luck can factor into the equation as well.

Ultimately, you should treat your net worth as you would a stock. You might not be familiar with stock trading, but the general principle is that you want to invest in companies that consistently increase their value over time. Sure, there are red days (negatives) and green days (positives) in the stock market. But ultimately, if the trend shows that the stock keeps going up over time, then it is a safe stock to invest in. That's what your goal for your net worth should be as well.

Over time, as you age, your net worth should keep on increasing even if your day-to-day values keep going up and down. The trend should always shoot upward. At some point in your life, you may find yourself dipping into your savings and retirement fund a lot more often when you retire. You may not have the same kind of income that you would have if you were still working. That's fine. It's normal for the net worth of people to dwindle after retirement. However, the ultimate goal is to have a net worth value that is so high that you continuously stay in the green even after retirement up until death. This way, you never find yourself in debt.

Chapter 4:
Your Income Defines Your Outcome

It all starts with your income. Any financial move or decision you make in life should depend on the amount of money that's coming in. Ultimately, your income defines your outcome. There's no way that you can save, invest, or grow your money if you don't have it in the first place. This is why it is important for you to focus on growing your income as much as possible. Most people will be under the impression that you can only generate income from your job. They think that you have to go to the office and stay there from nine to five so that they're entitled to their paychecks at the end of the month. This is how most people will earn their income, and by limiting themselves to such a system, they also stymie their capacity to grow.

The problem with just depending on your day job for all of your income is that you are always at the mercy of your employers. Sure, it is great if you are one of the rare few who are able to ascend the ranks quickly (whether through luck or hard work) and have a high-paying position that would leave you set for life. But even then, your job can be taken away from you without any prior notice, and you would then be left without any more income streams. This chapter is going to try to open your eyes to how your income does not always have to come from your nine-to-five. In all actuality, your income can come in many different shapes, forms, and sizes. It's all just a matter of you being open-minded enough to explore alternative forms of income than what you are used to.

There’s really no need to overcomplicate this chapter for now. The first part of the chapter will talk about the different faces and forms of income. You will be taught about the many ways you can earn money without having to rely on an office job. The latter parts of the chapter will give you some concrete tips, tricks, and hacks that financially intelligent people use to grow their income and maximize their financial potential. Again, your income defines your outcome. This is where it all starts. If you want the luxury of being able to play around with your money through saving and investing, then you need to have a solid income.

Active vs. Passive

Any failure to set a steady stream of income will result in financial ruin. That's the first truth that you need to know when it comes to talking about income. Whether you are talking about a business or even just your own personal finances, you would never be able to sustain yourself without generating income. Money that is not coming in is money that you can't spend on utilities and life pleasures. Generally speaking, there are two main types of income that you need to be familiar with. These two main categories will be broken down further into the many specific types of income. But it is important that you get a good grasp on these two main forms prior to tackling the specifics.

Active Income

For the most part, this is the kind of income that people tend to be familiar with. Active income is the kind of income that you get as a result of any labor or time that you put into a particular project. For example, you take the time to source materials for a shoe. Then, you construct it yourself and go through different prototypes. Once you have settled on a product you are confident with, you decide to take the shoe to market. Whatever money you get from selling those shoes is active income. This is because you were actively involved in the process of conceptualizing, producing, and selling this product.

But active income is not just about manufacturing products. It can also be about the kind of services you render. For example, when you show up to your office for your nine-to-five, you are essentially providing your company of employment with your professional services. As such, you are entitled to your compensation, which is a form of active income. Your daily wages from your job are considered as active income as well. Essentially, with active income, you have to perform a substantial amount of work in order for you to earn money.

Passive Income

Passive income is a type of income that tends to be less popular than its active counterpart. You might think that if active income is money that is earned as a direct result of hard work and effort, then passive income is money earned with minimal effort. However, that's not the case. Any reliable and steady source of passive income will still be the result of a substantial amount of hard work. However, the difference here is that the intensity and volume of labor for a passive income project are not as sustained as active income. You might do a lot of work at the beginning. But eventually, you can just dial your efforts back down and have that income stream work for you with not as much effort or investment as when you started.

Here is a classic example of this kind of income. Imagine a bank teller named Stacy. She works for a big bank for her day job, and she earns a fair amount of money. As a result, she has a lot of cash left over in her savings, and she decides to invest it in a passive source of income. So, she buys an apartment unit to be rented out. At the start, she has to invest a lot of her money into buying the unit itself. Aside from that, she also has to do a lot of work in decorating the unit and marketing out to potential renters. That process requires a lot of time, money, and effort. However, once she is able to secure a long-term lease with someone, her income just begins to flow gradually with minimal intervention on her part. Essentially, the apartment unit that she has put a lot of her resources into is now doing the work for her. Even if she now spends practically all of her time and effort on her day job at the bank, she still earns a separate source of income from the apartment unit.

Different Types of Income

There is an enormous group of people out there who are content with having just one source of income. Plumbers will go to different houses and work on their plumbing fixtures all day. Then, after a day of doing just that, they go home and think that the work is done. A bank teller will show up at the bank during their mandated office hours and do their job to the best of their abilities. Then, when they clock out, their income streams stop as well. These are all classic examples of people who are not financially intelligent.

A financially intelligent plumber, aside from going house to house for gigs, would be investing money on the side into a plumbing company that he can own and have work for him. A financially intelligent bank teller would take whatever extra money she has and invest it in an apartment unit that she can lease out to monthly renters, as we learned through Stacy's case earlier. When they do this, they are taking the money that they have from their day jobs and investing it right back in another potential stream of income. These are just two simple examples of people who know how to diversify their income streams.

You can be just like these people as well. It's totally possible for anyone to have multiple income streams. You don't even have to limit yourself to just two sources of income. If you have the time, patience, and resilience, you can have as many income streams as you wish. It all starts with you making yourself aware of what your true potential is and what your opportunities are. Most of the time, people think that they can't diversify their income because they believe that they don't have the opportunities to do so. Well, by acquainting yourself with the many different types of income, you also effectively open yourself up to as many opportunities to earn money as possible.

Earned Income

The first type of income is the one that most people are familiar with. It's the kind of income that comes from a direct transaction, whether through goods or services. For example, we already talked about the cases of the plumber and the bank teller. Whatever effort they put into their jobs will result in income that they earn. When it comes to earned income, it can also come in many different types. There are full-time earners and part-time earners. There are people who earn income through a day job and others who earn income through hobbies and side hustles.

The first key to maximizing your earned income is finding a job that pays well. To do this, you need to invest in developing certain skill sets that are of value to other people. These days, it often means developing skills in sales, technology, data analysis, and others. Another key to maximizing earned income is to have multiple sources of it. A lot of people will want to just limit their workday to their nine-to-fives. That's fine. But some people are also capable of working a second job to supplement their earned income. Of course, there are those who will say that this is not an efficient use of their time, but it is still a means of supplementing one's earned income.

Profit Income

Profit income is any kind of revenue that you can get as the result of selling something at a higher price than what it cost you to make or provide. In simpler terms, profit income is the kind of money that you earn from starting a business. This is the second most common type of income, next to earned income. Essentially, the money you earn from a business does not exclusively rely on your time and effort alone. This is especially true if you have a business with numerous employees who are working on your behalf. Also, take note that your business can earn an income either from a service or a product. In some cases, businesses are able to offer both. It all depends on the nature of the company.

Running a business can be very rewarding, both financially and emotionally. However, it can also be very risky. A business is not always going to be as secure as a job that you have with another big company. For a lot of people, the potential returns vastly outweigh the risks. If you are one of those people, just make sure that you do your due diligence prior. Do all of the necessary research and calculations that you need to make sure that your business will survive in a volatile and unforgiving market.

Interest Income

Interest income is any money you earn from loans or deposits. You might not realize this, but when you put money into a savings account at a commercial bank, your money is actually earning interest. This is because the bank takes that money that you deposit with them and they invest it elsewhere to grow their business and repay their investors. With every investment the bank earns, you are entitled to a cut of those earnings as an account holder. Essentially, think of it as you loaning the bank some money to invest in other ventures. Each bank will pay you back a certain interest set at the start of your deposit. And they will continue to pay you back so as long as your bank account satisfies the set minimum balance. However, interest income does not always have to come from banks. You can also earn interest income from loans for friends or family.

Interest income will not yield the highest returns in the quickest amount of time, but it is one of the safest and most consistent forms of income you could ever have. When you start a business, there's always a risk that your business will fail and you end up losing your investment. However, if you invest in government bonds or in high-interest commercial banks, your money is working for you without you having to do anything. And the best part is that there is no risk. You are always guaranteed a return on your investment. But we will dive deeper into investments in a later chapter. For now, just know that you need to do your research when it comes to selecting where you want to put your money for interest income.

Dividend Income

Dividend income is a lot like interest income in the sense that you get a certain amount of money over time just because you invested a principal amount to start. You can get dividend income by becoming a shareholder of a company. There are many ways that you can choose to go about this. But the general gist of the process is that these companies will use your capital investment as a tool to grow their value and net worth. Then, once they've grown their wealth as a result of your investment, they will repay you in the form of dividends.

For example, you might start a new tech company with three of your friends. You all agree that you each own 25% of shares of the company. After around a year of operation, you found that your company has a net profit of $1,000,000. Upon seeing that, as shareholders, you agree that you will dedicate $100,000 of that amount to dividends while you invest the rest of the money back into the business. Given the way that your shares are set up, you are each entitled to $25,000 as shareholders because of your 25% stake.

Dividend rules can vary from company to company. Some companies will dole out dividends once or twice a year, while other companies can do it more frequently. Dollar amounts of dividends will also vary depending on the decisions of the shareholders.

If you are not an entrepreneur and are still interested in earning dividends, there is a way for you to do so. Most commonly, people will invest in the stock market. Through the stock market, any adult has the opportunity to invest in publicly listed companies. They buy a certain amount of shares, and if the company hands out dividends to shareholders, they would be entitled to a cut because of their investment.

Rental Income

Rental income should be pretty self-explanatory. Essentially, the idea is that you earn money by renting out a commodity that you own. It's one of the most reliable and appealing types of income that a person can have. However, the key is in having a rentable commodity that is attractive to the market. Most of the time, you need to invest a lot of initial capital into the acquisition of such an asset. A classic example is real estate. Whether you own a commercial or residential property, it can be very easy to earn an income from rent as long as you are in a desirable location with reasonable amenities.

There is another downside to rental income aside from having to shell out huge capital investment. Most of the time, it can take quite a while before you can recuperate what you spent on acquiring that asset in the first place. So, if you are looking for immediate returns on investment, this might not be the way to go. But if you are looking for an opportunity that will provide you a steady stream of income in the long term, then investing in property is always a great choice.

Capital Gains Income

Capital gains income is essentially the art of buying and selling. You buy something at a certain price and then resell it when its market value becomes higher. Whatever difference you net from your initial purchase to your selling price is your income. This is an active form of income because it requires you to participate in the procurement of certain commodities. On top of that, you also have to stay on top of market trends and values. Lastly, you also have to initiate the selling of the commodity. There are a lot of people who turn this kind of income stream into a business model for a legitimate company.

The most common kind of capital gains income comes through the buying and selling of stocks on the stock market. We touched on the stock market earlier when we talked about dividend income. However, not all companies are so liberal in the handing out of dividends to shareholders. This is why the most common way to earn money through the stock market is by buying stocks at a certain price and then selling them off when their values get higher. But it is not just stocks. You can earn capital gains from buying and flipping other commodities as well, like property, rare vintage cars, luxury watches, designer fashion pieces, antiquities, and so on.

Royalty Income

Then, there is royalty income. This is when you are able to generate income as the result of any concept, product, idea, or artwork that you can claim ownership over. Royalty income is considered passive income because it only requires a lot of time and effort at the start. Once you have finalized the production or conceptualization of an idea, you have to establish legal ownership over it. Then, when you are done with that, you are free to sell that commodity repeatedly as many times as you want within the legal bounds of your ownership. For example, you are a songwriter. You have managed to write a very popular song and have secured your rights to it as well. Then, you find out that movies and TV shows want to use your song for their productions. They will have to pay you for the rights to use the song, and the money you earn from that is called royalties. Another example of royalty income is when you are a writer who has written a novel. Publishers will pay for the rights to publish and distribute your book. The money they pay you for the rights to publish is your royalty income.

Another very common form of royalty income is the franchising of fast-food chains. Take McDonald's as an example. Whenever an entrepreneur wants to open up a new McDonald's store in a given location, they must pay certain franchising fees for the licenses and the rights to do so. McDonald's as a company earns royalty income through these franchising fees.

The Value of Diversification

It does not matter how long you have been working for a company. You could even be the CEO of a large conglomerate. Your job is never going to be 100% secure. There is always a chance that you could be replaced by someone else. Sometimes, certain things might happen in your life that will render you incapable of carrying out any of your duties, and your company will have no choice but to let you go. Just because you have full-time employment does not always mean that things are going to stay that way. This is why it is absolutely crucial to protect yourself in a financial capacity by diversifying your income streams.

You already know that there are many different types of income, and it is not just about the salary you earn from working for a company. There are many opportunities for you to supplement your earnings by partaking in multiple types of income streams. If you really want to ensure your financial security, you should diversify your income as much as possible. To diversify your income means to generate multiple sources of income so that you don’t end up totally reliant on just one.

When investing, there is such a thing as diversifying one’s portfolio. Investors do this so that they are always protecting their overall investments if one aspect fails. For instance, a responsible investor would have investments in real estate, technology, finance, entertainment, and food and beverage services. If a pandemic takes place and restaurants are forced to shut down, then it is likely that a person’s investments in food and beverages will also tank. However, since that individual has stacked his investments against other sectors as well, he still comes out on top. In essence, his diversity protects him whenever one part fails.

The same kind of philosophy can also be applied when diversifying your income streams. It does not matter whether you are working a full-time job or not. As a financially intelligent individual, you should always try to diversify your income as much as possible. This can especially help you in the long run as you near retirement and you will be out of a job soon. Having diverse streams of income will definitely add a sense of financial stability and security to your life in a world that is filled with so much uncertainty. You could get fired from your job today. You may get sick in the future. Maybe you will get into a disagreement with your boss that will end up in your dismissal. The point here is that you never know. But with a diversified set of income streams, at least you always know that you have money coming in. More than that, having different sources of income will aid in increasing your wealth and your potential to grow your finances.

In an ideal world, you would want to be earning money from each of the seven types of income that have been listed here. However, in truth, that would be quite impractical and nearly impossible for most people. Even some of the richest and most financially secure people in the world will only have as many as three types of income streams. But that’s fine. You just need to make the most out of any opportunities that are afforded you. The more that you can do, the better off you will be because of it.

Take Bill Gates as an example. He is undoubtedly one of the richest men in the history of the world. However, as of right now, he does not even have an earned income since he is not technically employed by the companies in his portfolio. Rather, he has income dividend and capital gains income streams from his shares of Microsoft. He also earns royalty income from his

Windows products. The point here is that you should find an income scheme that works best for you, given the opportunities and resources that are afforded to you.

However, there are also certain drawbacks to this method of building your wealth. The truth is that you only have so much time and energy to devote to building these income streams. If you want to add to your earned income by taking a second job, then you would be compromising time that you could spend with family and loved ones or even on hobbies and interests. Also, if diversifying your income means having to give up your day job, then it might not be practical. You need that earned income for your survival, and it may take a while for the other income streams to yield you any practical returns. It's important that if you are working a full-time job, your other pursuits for income don't affect your job performance or your mental health. You might be doing yourself more harm than good otherwise.

Another thing you need to stay wary of is risky investments. If you consider yourself a novice in the area of real estate or stock investments, then it is best to consult the expertise of a trusted professional first. You don't want to be reckless in your approach to diversifying your income, either. Remember that not all investments are sure to yield positive results. You can spend all your savings on starting a business for an added income stream, and it is possible that the business could fail.

At the end of the day, the one thing you need to realize is that there is no shortcut to earning a large amount of money (unless you win the lottery). You really need to be smart and methodical in your approach to building your wealth. Be practical. Understand where you can improve and boost your income, but also acknowledge what your limitations are so that you don’t spread yourself out too thinly. You need to stay patient and delay your gratification as much as possible. Nurture your multiple streams of income at the start, and eventually, all of your hard work and resilience will pay off big time. Having a diverse set of solid and steady streams of income will be one of the greatest tools you can use to achieve financial independence.

How to Increase Your Income

This section of the book is probably one that most readers would most be interested in. At the end of the day, it is really about bringing in more money. Sure, you can use all of the tricks in the book to make sure that money works for you and that you don't end up going on unnecessary spending sprees. However, you can't work with what you don't have. The first tangible step toward becoming a rich and financially intelligent person is earning money and increasing your income. And no, your day job is not enough. Even the top executives of the biggest companies in the world will not rely on just their salaries as their income. To conclude this chapter on income, we will highlight some simple tips and ideas to supplement the money you are raking in.

For the most part, it is really about making the most out of your time. You only have so many hours in a day to work at finding money. This is why there is often a need to get creative with your approach to increasing your income. If you are not blessed with the creativity gene, don't worry. There are many approaches that you can take to growing your income. You don't have to take up too much of your time trying to figure out what will work for you and what won't.

It can be so easy to get duped into these get-rich-quick schemes that you see on the internet all the time. Sure, the appeal seems really tempting, and you might even make a buck or two at first. But most of the time, these kinds of schemes are not sustainable, especially when you don't have the network and the know-how to keep them going.

At the end of the day, there are a myriad of ways in which you can supplement your income. You might even become paralyzed by the endless choices at your disposal. However, not all of them will always be an efficient use of your time and a good way to maximize your potential. Whether you are in a financial bind and you are in desperate need to increase your earnings or you are just looking for more ways to grow your money, here are a few tips that can help you rake in the cash more efficiently and effectively:

Condition Yourself to Work Harder and Smarter

In the past, people always used to be about working harder. People from older generations will always preach about the value of hard work and devoting all of their days and nights to putting in the effort. However, over time, the narrative has changed from working harder to working smarter. It's especially evident in people who practically work themselves to death while still living paycheck to paycheck and struggling to make ends meet. So, people are now looking for ways to work smarter in their approach to earning money. This has resulted in the proliferation of get-rich-quick schemes to earn as much money with as little effort as possible. Unfortunately, as mentioned, these kinds of schemes are rarely ever sustainable and don't always provide a steady flow of income.

The real truth of the matter is that increasing your income requires you to work harder and smarter. You need to condition your mind into believing that you have to devote a lot of your time and effort to growing your income. However, more than that, you also have to train yourself to be smart about it. It's all about learning how to utilize your time well. Think of your time as a commodity you can spend to earn money in return. Look for opportunities that will provide you with as much return on your investment as possible. However, that does not mean that you don’t work hard anymore. At the end of the day, the amount of time you put into something will directly translate to what you get out of it.

Learn High-Value Skills

When you were young, you were probably always told that people like doctors, lawyers, engineers, or accountants were the people who made the most money. Of course, there is some truth in that. These people tend to make a decent buck through a steady income. They also typically have better job security than a bunch of other professions. But these kinds of careers or professions also require a lot of investment when it comes to education. You must have undergone formal schooling in order for you to become a competent and competitive professional in these fields. What do you do if you don’t have a background in medicine or engineering? Well, here’s the good news: you can still earn a decent living and supplement your income by developing other skills.

The truth is that people will only be willing to pay you for your proficiency and mastery of valuable skills. The real key here is knowing which skills are valuable so that you can dedicate a certain amount of time and effort to mastering them without having to go through formal schooling. These days, there are all sorts of skills that you can develop on your own so that you can increase your value to the global market. Since this is a very comprehensive topic on its own, we will devote more content and insights on this matter to another segment of this book.

Devote Time to Side Hustles

Wouldn’t it be great if you could turn your hobbies and passions into something that can earn you some money? Too often, people will set their passions aside in favor of their safer and more secure day jobs. However, there is not any rule out there that is barring you from earning a living outside your nine-to-five. In fact, if you really want to be financially intelligent, then you need to maximize whatever time you can get. Devote your extra time to finding ways to earn money. There’s nothing wrong with supplementing your income by finding another job.

This is also where your high-value skills come into play. For example, if you are a skilled writer, then you can turn that skill into a side hustle. Many companies and websites out there are looking for writers to add content to their online platforms. Even if you just devote one or two hours of your time every day to writing, that can do a lot for supplementing your income. Even if you are just earning small amounts (relative to what you get in your day job), it is still added income that you should welcome.

Invest Your Income

Later in this book, you are going to learn more about investments and how you can make your money work for you. Whenever you have more money coming in, it might get to the point wherein you have a lot of extra cash just lying around. While it is good to have that kind of security blanket that’s readily available, it might also be good to put that money to good use. One of the best ways that you can make use of your income is by investing it into alternative streams of income. This method of supplementing your income is not always going to be so clear cut. There are safer investments out there that will yield relatively conservative results. Some riskier investments will not always pay off for you in the long run if things don’t go well. This is why this is another topic that will have to be discussed more thoroughly in a later chapter.

Sell Items You Don't Need

Lastly, sell items that you no longer need. Do you still keep that electric guitar from when you had a huge rock-and-roll phase lying around in your basement? You might have told yourself that you would eventually start playing guitar again when you find the time. But if you have been telling yourself that for one or two years, then you are unlikely to ever pick that guitar up again. Take an inventory of all the stuff you have in your possession and sell everything you don't need. As the old cliché goes, one man's trash is another man's treasure. You would be surprised at how much you could earn from selling off old clothes, unused gadgets, and random knick-knacks around your house. Also, in the age of the internet, it is so easy to get in touch with potential buyers anywhere and everywhere. It's never been more convenient to sell your unwanted items as it is now.

The Last Word on Income

There are endless ways to earn an income. There are even more ways to supplement and grow it even further. However, the truth of the matter is that not all sources of income are going to yield the same results. Some conservative income streams will provide you with some decent cash padding. There are also some key investments you could make that will deal you some serious coin. You could dedicate more time to sharpening high-value skills, or you could just be smart about investing your money in high-yield mechanisms. Whatever you choose to do, you must own up to your decision.

You're not going to have a lot of free time. That's something you need to accept as early as now. However, that does not mean that you can no longer have fun. In fact, if you are smart about it, you can turn the things that bring you fun into another income stream. For example, you might be a runner who enjoys going on long runs and joining races as a way to de-stress and let off some steam. There are probably some people out there who want to get into running as well but don't know how to. By coaching these people, you could turn something that's fun for you into a potential source of income. Supplementing your income can really be something as simple as that.

It's just important to remind yourself that every situation is different. There's very little to be gained from looking at other people's riches and feeling jealous about it. Rather, observe these individuals and see what they're doing right. If possible, ask them for some advice and try to adopt these lessons into your own life. But also, acknowledge that the method that works for them is not always going to work for you. Again, this is your own financial path that you need to figure out on your own.

Chapter 5:
The Art of Saving and Budgeting

Hopefully, the previous chapter has provided you with the foundational framework for how you can start increasing the numbers in your savings account. But of course, increasing your income is only just the start of the battle. One very huge aspect of financial intelligence and fiscal planning is knowing how to save and budget your money. If you ask financial experts and money-conscious individuals, they are bound to tell you that at the very base level of financial intelligence is knowing how to budget. It’s not enough that you know how to bring in the money. It’s just as important that you know what to do with the money that you have.

This entire chapter is going to be dedicated to the art of budgeting. Think of a budget as a tool that you can use to direct the movement of your money. Having good savings and a budget plan in place is going to help you make sure that your hard-earned money stays with you and keep track of where your dollars might be going. At its core, a budget plan is a tangible reference point for how much money is coming into your life, how it is moving around, and how you are spending it.

It’s imperative that you take the time to sit down and develop a solid budget plan for yourself if you want to become financially independent and secure. By reading this chapter, you will learn how budgeting can help put you in better positions to make sound decisions on what to do with your money. Essentially, a budget will help keep you from being reckless in the management of your finances. A budget will drive you to be more intentional in your approach to spending money because it forces you to stop and think about every transaction. You will be compelled to weigh the merits of every expenditure against whatever budgetary scheme you are imposing on yourself.

Earlier, we talked about the value of financial self-awareness and how this skill is crucial to developing your financial intelligence. A budget is essentially the best way for you to maintain awareness of the state of your finances at all times. It forces you to take a look at your habits (whether good or bad) so that you always know what role your decisions play in the development of your finances. This chapter will teach you everything you need to know about developing a budget and sticking to it. After all, a budget is only ever going to be as good as how you choose to implement it in your own life.

More than that, a budget is also going to amplify your capacity for saving money. Too often, people fall into the trap of wanting to make use of whatever money they earn right away. They turn their income into experiences (e.g., trips, meals, and entertainment) or objects (e.g., clothes, jewelry, and gadgets). However, what ends up happening is that they don't have enough money left over for savings after all their expenditures. This chapter will also delve deeper into saving, why it is important, and how sticking to a budget can help you build your savings for the future.

When you look at a financially intelligent person, you won't always see them decked out in luxurious items or driving fancy cars. They are not always going on lavish vacations or partaking in exorbitant feasts. Sure, they have the capacity to do so. But more than anything, financially intelligent people understand the value of saving and why it is important for them not to be reckless with their money.

A Brief Explanation on Why You Should Budget

Having a solid budget plan will afford you a structured and methodical approach to managing your money. Think of a budget plan as a financial tool that you can use to oversee how you spend and save after the end of a set period. Typically, it is recommended that you develop a weekly or a monthly budget plan (to coincide with a monthly salary). This is the best way for you to see how your financial behavior is dependent on a structured and intentional framework.

Granted, budgeting is not the sexiest or most exciting thing in the world. You would rarely ever hear people bragging about how they're sticking to a strict budget plan. However, there's just no denying that a budget plan is one of the most important tools that you can use to keep your finances in order. This is especially true when you are managing a budget of a household that involves multiple people with varying levels of income and differing needs.

In all its purity, budgeting really centers on the principle of balance. You already know by now that you don't have an infinite amount of money. Sure, you have already learned how you can supplement your income. However, you are never going to have unlimited resources. Given that, you need to stay on top of how you are spending your income. Keep in mind that assigning your funds toward a certain item will take away from your capacity to spend on another item. For example, if you like to devote a little more money to your monthly groceries, that might mean you having to cut back on eating out with your family. If you have a tendency to splurge on shopping sprees, that might take away from your capacity to save money for your kids' college tuition.

Consequently, a budget will help you figure out how to achieve that optimal financial balance that will put you in the best position to succeed and find financial fulfillment. Of course, it shouldn't always just be about saving for the sake of saving, but it shouldn't be about being reckless with your finances either. You need to strike that perfect balance. This is what it means to be purposeful in your approach to earning and spending your money.

How to Create a Budget Plan

There is no single methodology for creating a budget plan. It's a lot like using a diet as a tool for weight loss. There are all sorts of diet plans out there that people use as a way to manage their weight. Some people are more fond of low-carb diets, while others tend to adapt better to a well-balanced approach to dieting. It's the same with budget plans as well. As you do your research, you will find many different approaches to budgeting and saving. That's actually a good thing. This way, if a certain budgeting philosophy does not work for you, there are others at your disposal.

With that said, there are certain principles that you want to keep in mind when it comes to developing your own budget plan. If you want to develop one from scratch but you are unsure of how to go about doing so, then don't fret. This section of the chapter will provide you with a step-by-step process on how you can build your own personal budget plan. This way, you will not have to go into it blindly. It can be difficult having to navigate your way through financial responsibility when you don't know where to start. But with the right guiding principles in place, you will find that it is a lot easier than you think.

Prepare All Your Financial Documents

The first thing you need to do when developing a budget plan is gathering the evidence. Put your best detective hat on and gather all the financial documents that you can possibly get your hands on. This is crucial because these documents will give you a clear insight into the money that's coming in and going out of your wallet. What documents, in particular, should you be looking for? Well, basically anything that has any kind of monetary amount indicated on it. Here are a few examples:

- payslips
- bank statements
- investment accounts
- credit card bills
- utility bills
- receipts
- loan statements

You probably get the picture. If you find any document that serves as proof of any agreement or transaction that you have made that deals with money, then you should keep it ready. Again, it is a crucial first step, and you mustn't skip it. Of course, it is possible that you will not be able to get a hold of some receipts or utility bills from previous weeks or months. That's fine. Just gather as much as you can. The more you can dig up, the more accurate your financial information will be.

Calculate Your Monthly Income

Next, you must compute your monthly income. If you were able to apply everything that you learned in the previous chapter, then you would have multiple sources of income. This can make it difficult for you to track how much money is coming into your life and where exactly it is coming from. However, if you keep track of it all through your bank statements and receipts, then it should be a fairly easy process. The key here is to find out what your average monthly income is. Again, if you have alternative sources of income besides your day job, it is possible that the amount of money coming in will fluctuate from month to month. That's fine. You don't need an exact number. What you need is an average monthly income that can serve as a reliable benchmark for you to build the rest of your budget plan around. Every other succeeding step in building your budget plan revolves around the amount of money you have to work with on a monthly basis.

Importance notes:

- If you are receiving welfare from Social Security or child support, then you can count that as income.
- If your earnings from certain side hustles are too random and volatile on a month-to-month basis, then take your lowest-earning month and use that as a benchmark. This way, you are taking a more conservative approach to building your budget plan.

Itemize Your Monthly Expenses

Then, after figuring out what your monthly income is, it is now time to itemize your monthly expenses. When doing so, make sure to list everything down. If you left a little extra tip for a waiter when you ate out that one time, then take note of it. If you paid for a small parking fee, then that’s an expense too. Most of the time, people will only focus on their biggest expenses, like bills and such. However, the little things do add up over time as well. This is why it is essential for you to itemize *all* of your expenses, no matter how big or small they are.

If you are having trouble with recalling what you have been spending your money on, then that’s what all the receipts and billing statements are for. If you are fond of online shopping, you will find all of your transactions on those sites or in your email as well. Make sure to leave no stone unturned so that you have a good idea of how much you are spending every single month. Here are a few things to look out for:

- debt/mortgage payments
- insurance premiums
- groceries
- meals out
- travel expenses
- parking fees
- personal maintenance expenses (doctor's fees, haircuts, etc.)
- transportation costs (gasoline, train tickets, etc.)
- utility bills

Categorize Your Fixed and Variable Expenses

You now have a fairly good idea of where your income is going after listing down all of your expenses. It's time for you to categorize them into either fixed or variable expenses. Essentially, fixed expenses are those that you make routinely, and they stay the same amount every single time. Examples of fixed expenses are phone bills, mortgage payments, rent payments, school tuition, and subscription services. These kinds of expenses are the easiest to track because they happen routinely, and they stay the same every single time you make payments.

Then, you need to categorize variable expenses whose amounts can vary depending on the month or season. For example, during the holidays, you might be spending more on Christmas gifts for loved ones. During the summer months, your electricity bill might shoot up because of air-conditioning. From month to month, your general maintenance needs (e.g., groceries, gasoline, and entertainment) can fluctuate as well. These are all some examples of variable expenses. Try to find what your average monthly expense would be for this category.

Understandably, this step of creating the budget plan might prove to be the most complicated one. For that reason, there will be another section within this chapter that is wholly dedicated to helping you categorize your expenses.

Add Up Your Income and Expenses

The next part might be the scariest, depending on your spending habits. You need to add up all your monthly income and expenses. If you find that you are earning more money than you are spending, then that's a good sign. But we can still improve on that. We now have to find ways on how we can structure your budget in a way that you are maximizing your capacity to pay for expenses while also saving.

On the other hand, if your expenses are totaling more than your income, then there is a lot of work to do. You have to brace yourself for a serious lifestyle change. However, don't be down in the dumps if you find that you do spend more than you earn. A lot of people are guilty of doing that. It's just a matter of eliminating bad habits and reinforcing good ones so that you eventually end up on the green side of the balance sheet.

Set Goals Accordingly

The first step to allocating budgets for specific expenses is to focus on your debts and your savings. Essentially, those are the first two things that you should devote your income to, regardless of whether or not you have been spending more than you are earning.

This particular step of the budget plan is two-fold because how you execute it totally depends on your current financial situation. Your budgeting goals can be broken down into two more specific steps: paying off debts and paying yourself. If you don't have any outstanding debts or loans, then you can proceed to the step of paying yourself.

Pay Your Debts First

The very first expense that you need to focus on is your debts. Debts can be very tricky. They are so important in financial planning and management that we have even dedicated a whole chapter of this book to trying to get out of debt. If you are not careful, failing to adopt a system to get rid of your debts might lead you toward financial ruin. This is why the very first thing that you need to budget for is your debt. You will learn more about how you can manage and eliminate your debt in the next chapter. But for now, try to dedicate as much of your income as possible to minimizing the harmful effects of interest rates and late payments as a result of your loans.

Pay Yourself Next

If you are smart about it, then you should still have a substantial amount of money left over after paying off your debts. If you are lucky, then you will not have any debts to deal with at all. Whatever the case, the very next thing that you need to do is to allot money for yourself. Again, saving is very important because by paying yourself, you are better at securing your future. Now, the question is, how much should you be saving monthly? Some experts say that if you are debt-free, you should be saving as much as

20% to 30% of your income. Of course, this can vary on a case-to-case basis. We will delve deeper into the art of saving later on.

Add Caps to Your Variable Expenses

Now, it is time to add a cap to your variable expenses. Essentially, you need to limit your spending on the items that you don't have an expected budget for. It can be easy to control your spending for fixed expenses because they're the same every month. But with variable expenses, due to these payments' volatile nature, it can be very difficult to stay within reason if you are not mindful about it. Take all of the totaled expenses that you have had for each subcategory and find a conservative average for it. Then, based on that average, assign a cap or limit to that expense. Be reasonable. Take the most conservative approach to capping your expenses. You want to allocate just enough of a cap to make sure that you cover all your basic needs, but you don't want to be so generous to the point that you are eating away at your spending capacity in a substantial manner. Again, be reasonable.

Allot Funds for Fun and Leisure

After that, you should also allot a little chunk of your income for some fun and leisure. Again, the goal here is not just to save for the sake of saving. The goal is to put your money to good and practical use so that you can enjoy your hard-earned income without compromising the security of your future. Again, as it was with the previous step, it is important for you to be reasonable here. Don't go overboard with treating yourself. Allot just enough of your budget to get you excited and happy about spending your money, but still be mindful of your budget's limitations. At the end of the day, you should still be looking to earn and save more than you are spending.

When it comes to these kinds of expenses, it does not always have to be just one item. Perhaps you can allocate a monthly budget to saving up for a vacation with a loved one. Maybe you are eyeing a nice luxury watch that you can save up for over the span of a year or two. Whatever the case, just make sure that you are spending within reason and that you are not taking away from the other necessities in your life.

Provide a Buffer

Next, you need to provide a buffer. It does not matter how well you plan for your budget. Sometimes, life will throw certain things at you that will force you to pay for something that you didn't initially plan on. For example, you might need to go for a surprise doctor's visit because of a medical emergency. Maybe your car got a flat tire and it needs to be replaced. Maybe a pipe in your house requires replacement as it has suddenly burst. It's important that you allocate a certain budget to serve as a buffer for unexpected expenses. Even as little as 2% to 5% of your monthly income is good for this.

However, if you already have a solid emergency savings fund in place, then you are probably safe. You don't really need to allot as much of your money to build a buffer for these unexpected expenses. But it is still good if you do because you never want to touch your emergency savings unless you are forced to do so.

Trim the Fat

Now, it is time to trim the fat. Take a look at all of the caps that you put on your expenses, both fixed and variable. Take note of what funds you allotted for your fun and leisurely purchases. If all of your expenses add up to an amount that still fits within your budget after you pay off your debts and add to your savings account, then you are good. However, if that is not the case, then you need to trim off some fat.

When it comes to using your income, there are only two non-negotiables: your debts and your savings. These are the two things that you constantly have to pour a set amount of your income into. Everything else is fair game. Any kind of expense that does not involve paying off debts or adding to your savings can be eliminated. So, think about what your true essentials are in life. If you feel like you can scrimp a little more by downgrading your internet or mobile plan, then do it. If you see that you can find a way to keep everyone in your household fed even if you lower your grocery budget, that's good. If you can commit to eating out less or refraining from shopping more just so you can devote more money to other necessities, then do so. Again, budgeting is all about balance. Take away from one aspect of the budget so that you can feed it into the other. This process of trimming the fat will force you to think about what your priorities are and how you can better allocate your spending money.

Save Whatever Gets Left

If you did everything right, it is likely that there will be a few months wherein you still have some money left over. Maybe you chose not to spend whatever budget you allocated for your fun and leisurely expenses. Perhaps you were fortunate enough not to encounter any emergencies and you didn't have to make use of your buffer. Maybe you were very frugal and you didn't even meet the cap of certain expenses. Whatever the case, if you have some money left behind at the end of every month, pour that money back into your savings. These deficits shouldn't carry over into the next month. This way, you know that you are starting every month off with a clean slate.

Review and Improve Your Budget Plan Whenever Necessary

Lastly, it is important that you review and improve your budget plan whenever necessary. Again, just like it is with diets, a budget plan that works for one is not always going to work for everyone else. This is why it is important for you to stay constantly mindful of how your budget plan is working for you and whether or not there's room for improvement. If things are not working out, don't be afraid to start again and build a budget plan from scratch. If you feel like you are not saving enough money at the end of each month, then make those little tweaks as you go. If your income has experienced a rapid change, whether positive or negative, then you should definitely take a look at how this will impact your expenses. Fluidity and adaptability are key here. The plan that you start with is never going to be the same plan that you stick with for the rest of your life. Over time, your finances will get better (hopefully), and this will lead to you evolving your financial goals in the future. As a result, you will have to tweak your budget plans in order to accommodate these new goals. Don't be afraid to embrace change, especially if it gives you the opportunity to grow and become more financially intelligent.

Another Way to Categorize Your Expenses

Don't worry if you feel stressed or confused during the process of categorizing all your expenses. This is not a struggle that you alone have. In fact, a vast majority of people who are just beginning to figure out their finances will have substantial difficulty in categorizing their expenses systematically. However, there's no denying that being able to categorize your expenses efficiently can have a huge pay-off with regard to keeping your budget and savings game in check. With that said, we can break down your expenses into the following categories: non-negotiables, essentials, and non-essentials.

Non-Negotiables

If you have been paying attention, then there are only two non-negotiables when it comes to your expenses: debts and savings. We already talked about this earlier, so there's no need to belabor the point any further.

Essentials

The first major category we can lump your different groups of expenses into is the *essentials*. These are virtually all the expenses you have that are necessary to sustain life on a fundamental level. Here are a few subcategories that you can take note of:

Housing: Usually, a huge chunk of people's expenses will go into housing. Also, contrary to what many might believe, housing expenses are not just rent or mortgage payments. There are other aspects of homeownership that require spending as well. This might include property taxes, HOA dues, and general maintenance or renovation expenses. Of course, a bulk of housing expenses are usually those that come from mortgage loans. This is why loans in particular are considered non-negotiable expenses. They need to be paid off first.

Transportation: Then, there are transportation expenses. Just like houses, people rarely ever buy their cars with cold hard cash. Either they take out a car loan, or they lease. Again, just like mortgages, car loans need to be paid off first because they are non-negotiables. However, that's not the only expense that you need to worry about when it comes to transportation. You also have to think of general care maintenance expenses, like oil changes and engine tune-ups. Then there are expenses for gasoline, parking fees, tire changes, registration fees, and whatnot.

Food: Then, of course, there is food. However, it is very important to make a clear distinction here with food expenses. A lot of people will lump the money that they pay at restaurants into this category. That shouldn't be the case. When we talk about food as an essential expense, we're only talking about food that you buy at markets and take home with you to prepare on your own. Any food that is purchased from a restaurant, whether through takeaway, delivery, or dine-in, is considered a luxury and therefore non-essential. Food is undoubtedly necessary to sustain life. But that does not mean that you need to keep on having frequent visits to the Olive Garden for sustenance.

Utilities: Then, there are utilities. These are essentially the bills that you need to pay in order to literally keep the water running. So, expenses that fall under this category include bills for electricity, communications (phone and internet), sewage, waste disposal, and running water. However, when it comes to communications, an argument can be made that they can be considered luxuries as well. It's undeniable that people need a phone and internet connection to be a functional member of modern society. But that does not mean that you should be splurging on the most expensive phone and internet plans on the market. Doing so would be an example of communication costs that are more luxurious than essential.

Healthcare: Healthcare is also considered an essential expense because you must always make it a point to invest in the quality of your health. No one should ever tell you that it would be dumb for you to invest money into taking care of yourself. First of all, it is true when they say that prevention is better than cure. So, investing in consistent checkups even when you are not sick is still an essential expense. All expenses that you can lump into this category include doctor's fees, medicines, nutrition supplements, laboratory tests, and others.

Insurance: Insurance is also something that you want to devote your income to. If we go back to what we talked about earlier regarding Maslow's hierarchy of needs, one thing that human beings always crave is security. This is exactly what insurance is able to provide you. Of course, you can also lump your health insurance under the *medical* category or the car insurance under the *transportation* category. That's fine as well. You can also lump your home insurance into your *housing* category if you are going to follow this trend. It's entirely up to you. Again, insurance is a necessary expense because it helps protect you from the unseeable and unknowable.

Childcare expenses: Now, this is a category that might not apply to everyone. This is just an essential expense for parents. If you have kids, they would typically be incapable of earning an income for themselves. As parents, it is your responsibility to cater to their needs out of your own pocket. This means that you need to allot a generous chunk of your income for their food, shelter, clothing, education, and other essential needs.

Non-Essentials

When it comes to trimming down the fat, your non-essential expenses are where you would typically have the most flexibility. These can either be fixed or variable expenses. However, for the most part, it is possible for you to limit your spending on these items or even eliminate them altogether.

Personal grooming and wellness: This might be controversial to some because grooming is something that is directly tied to health. Obviously, expenses that are concerned with health are considered essential expenses. That’s true, and that’s a perfectly valid point to have. However, there are also aspects of personal grooming that can be considered as non-essential. Some examples of non-essential personal grooming expenses include manicures, facials, hair or beard trims, waxes, gym memberships, sports apparel, and the like. These are still technically considered expenses that can fall under the personal grooming and wellness category. But it would be a stretch to refer to them as essentials too.

Fashion: This is another controversial item that is labeled as a non-essential expense. We all know that clothing is considered an essential expense. It’s a need. There’s no denying that. However, it would be farfetched to say that you need those $700 sneakers or that $500 overcoat. Those are not essentials. Those kinds of items are obviously manifestations of luxury. This is why fashion is typically considered a non-essential expense. This is not to say that you shouldn't be spending on nice quality clothes. It's just that you don't necessarily need to be spending too much on these fashion pieces.

Entertainment: Essentially, any kind of expense that you don't need but consider to be fun and fulfilling is an entertainment expense. This could be you spending money on books, movies, theater plays, vacations, and meals out at restaurants. These are essentially forms of recreation that make you happy and satisfied. However, they are also things that you could do without and you would still survive.

Miscellaneous: Lastly, there are miscellaneous expenses. These are essentially any expenses that you don't typically need but still exist anyway, and they don't necessarily fall under any of the other non-essential categories. So, these kinds of expenses include gifts that you give to friends, donations to charity, tips to service staff, and the like.

Budgeting With a Partner

If you think that dealing with your own finances can be really complicated, then you are in for a big surprise when you start budgeting with a partner for a family. Think about it for a second. There are so many people all over the world who struggle with dealing with their own finances. Complications will only intensify when you are taking the needs and financial goals of another person into consideration.

Even though any conversations involving budgeting and finance between couples can be really awkward and uncomfortable, they must still be had. There are many perfectly healthy relationships all over the world that end up crumbling because of the stress of financial challenges. Many married couples will give up on their marriages because of financial constraints. This is why it is imperative that couples in long-term relationships be more concerted in their efforts to manage their finances.

Discuss Your Individual Financial Goals and Philosophies

The very first thing that you need to do is discuss your individual financial goals and philosophies with each other. It’s the same as when couples talk about religion, politics, ethics, or morality. You’re essentially getting to know each other to see if you would be a good fit. Talking about your financial styles will give you a good sense of what kind of person you are getting into a relationship with. During this phase, it is not about trying to outdo each other to see who is better with their finances. Rather, it is an opportunity for you to learn from each other and really understand what your individual financial philosophies are. This phase is crucial in ensuring that everything else will be smooth-sailing for the two of you as you move forward with your finances.

Should You Combine Your Finances?

If you have asked yourself or your partner this question before, know that you are not alone. This is not really a question that people tend to think about until they're in the actual relationship itself. Only when they see that things are starting to get serious with someone will they start to ponder on how they should manage their finances together. Now, just to get it out of the way, the truth is that there is no one correct answer. Many couples have found success in combining all of their finances together, while others have found success in maintaining individual accounts as well. What this should tell us is that no one methodology reigns supreme. At the end of the day, it is mostly dependent on the personalities and goals of the people involved. Given that, there are a number of different approaches you could take to managing your finances as a couple. Here are three of the main ways:

1. *Combined:* The first approach that you could take is to combine all of your finances. This means that you and your partner take all of your individual income and pour it into a single pool. This approach also means the two of you taking on each other's expenses and liabilities. You take from the shared pool of your income to finance whatever expenses you may incur both as a couple and as individuals. With this approach, you are essentially functioning as one entity with a single financial plan that the two of you share. This is an easier approach for those couples who want to avoid the hassles of accounting for separate individual needs and shared needs.

2. *Individual:* Then, there is the approach wherein couples split everything down the middle. With this kind of approach, both people

in the relationship will maintain their individual financial portfolios. This is the ideal kind of approach for people in relationships who want to maintain their autonomy and financial independence. For items or expenses that are conjugal in nature, such as groceries, rent payments, and transportation costs, these kinds of couples will typically split the expenses right down the line. This is also the kind of approach that will allow individuals to make purchases or investments freely on their own without needing permission from their partners.

3. *Hybrid:* The last approach to managing finances as a couple functions as a hybrid of the previous two. With this approach, both people in the relationship still maintain their individual bank accounts and finances. However, aside from that, they also devote a certain amount of their income to a shared pool that the two of them can utilize for shared expenses. This kind of approach maintains personal autonomy while also capitalizing on the spending power of having shared finances.

Itemize Your Shared Expenses

Once you have figured out what your ideal financial philosophy is moving forward, it is now time to put everything into action. Itemize all of the expenses that you have both as individuals and as a couple. List everything down so that the two of you can get a clear picture of what your expenses will look like from month to month. If you need help with this, just refer to the previous segment of this chapter about expense categories. The same principles should apply when you are itemizing expenses as a couple.

Plot Your Goals and Develop Your Plans

This is the phase where things might start to get tricky if the two of you don't see eye to eye when it comes to your expectations. One of you might be incredibly ambitious with finances, while the other might just be looking to get by. It's important that the two of you really manage your expectations well and be more open-minded as you discuss these things with each other. Discuss what your long-term goals are, such as which debts you need to pay off and what investments you need to make. It's important that the two of you both reach a consensus on what your shared financial goals are going to be.

Then, once all of that is done, you can talk about the plans that you need to implement for yourselves in order to reach your goals. Here are some concrete plans that you can try out for yourselves:

1. Pay down your debts to make sure that your income does not just end up going to paying off interest rates and late fees. More people tend to find success by addressing the highest-value debts first and working their way down the list.
2. Establish a clear savings plan for the two of you. Plot milestones in your savings and investment plan so that you are both actively working toward securing your finances in the future. Settling down with someone can be expensive, especially when you are looking to buy a home and raise children. Having a savings plan in place will help prepare you for such milestones.

Discuss Individual Needs

After you have talked about all the shared finances and expenses that you need to tackle, it is now time for you to discuss your individual needs. This is where you can really go into detail about the stuff that you want to spend your money on—new gadgets, home renovations, gym memberships, luxury pieces, haircuts, spa treatments, and whatever. These are things that you can allot yourselves an allowance for so that you constantly stay within reason when it comes to your budget.

It's important that you discuss these things with your partner so that neither of you will have the right to make the other feel bad about a particular purchase. It's this kind of openness that can really alleviate a lot of the tension and prevent unnecessary drama in a relationship.

Monitor Your Spending

The very last thing that you need to do is to track your spending. The two of you need to put some kind of system in place that will allow you to track your spending methodically. This is an important step in helping the two of you stay on track with your financial goals. You can take some time at least once a month to sit down and review your finances to see if everything is still going according to plan. If you really want to take a more hands-on approach to handling your finances as a couple, you could even have meetings as frequently as once a week.

It might be very stressful having to deal with finances as a couple. The important thing for the two of you to remember is to stay calm and always stick to the plan. Having a good financial plan and budgeting system in place will help the two of you stay accountable.

Tips on Sticking to Your Budget

A budget plan is only as good as your ability to stick to it. However, sticking to a budget requires a great deal of discipline, and this is not something that most people tend to be in abundance of. In fact, most people take a more nonchalant approach to sticking to a budget. Over time, you will eventually reach a point wherein maintaining your budget will almost be second nature to you. This is a natural byproduct of developing your financial intelligence. However, if you are just starting out as a novice, you really need to take a more detail-oriented approach to sticking to your budget.

If you are not mindful of how much you are spending relative to how much you are earning, this could spell disaster for your finances without you even realizing it. Even the littlest of expenses can add up to become a sizable amount. Ultimately, sticking to your budget is really a matter of you taking the time to keep track of every single transaction in your life. Here are a few tips on how you can make that happen:

Use a Tracking Device or Ledger

If you want to take a more traditional approach to tracking your expenses, you can always make use of a ledger. This is what accountants and financial managers in major companies use to keep track of business transactions. You can always make use of a ledger in real life as well to monitor all your expenses. Make sure to keep a ledger small and mobile so that you have it with you wherever you go. Whenever you buy or pay for something, jot it down on your ledger along with the corresponding expense. It does not matter how small the expense is. You must list it down and categorize it accordingly.

If you want to make use of technology that's better suited for the 21st century, you can always utilize budget tracking apps on your smartphones. There are all sorts of different budget trackers out there (some paid and some free) that are designed to help you keep track of your expenses while on the go. The best part about these apps is that they perform all the totals for you. The only thing you need to do is list the expenses down and categorize them accordingly.

Regardless of how you want to document your expenses, whether it be written or digital, it is important that you stay honest and accurate. Make it a habit. If it helps, set a daily alarm for yourself every night before your sleep reminding you to list your expenses for that day.

Always Keep Receipts

Receipts are important because they serve as proof and documentation of your spending habits. It's good if you religiously document and track all of your expenses as they happen. However, there might come a time when you will not be able to track these transactions in real-time. This is where the receipts can really come in handy. Just make it a habit to keep receipts of any transaction within the previous three months in a box or envelope that you can access at home or in the office. This way, you have an additional source of reference for your spending habits.

Never Exceed Your Spending Caps

This tip should probably go without saying, but you would be surprised at how many people tend to be overly generous with themselves. Whenever you set a cap or a limit on a certain expense category, make sure that you never exceed it. Sure, it is okay for you to have a deficit wherein you don't meet the cap. That's actually a good thing. It means you will have some savings left over. What is not okay is you going over that cap. This often happens when people underspend in one category and make up for it in another. For instance, just because you spent less money on groceries this month does not mean that you get to pour that money into your shopping allowance. It shouldn't work like that. Adhering to a spending limit is a huge part of building your financial discipline.

Only Use Credit Cards for Payments That Are Within Budget

Credit cards are not evil. When used properly, they can be great tools for building your finances. Sure, we talked earlier about how so many people fall into credit card debt. However, credit cards in themselves are not bad. It's usually just how people use them that causes them to fall into financial ruin. Ultimately, as long as you are able to make full payments at the end of every month, credit card transactions are fine. In fact, later on, you will learn more about how you can use a credit card to improve your credit score. This will help you secure loans from banks a lot easier to fund future investments. But we can talk more about that later. For now, just remember that you should only use credit cards for purchases that you can pay off with cash at the end of every month.

Plan Your Meals and Groceries Ahead

Don't go into a grocery store without a plan. Most of the time, people will go to the market without any kind of shopping list and just randomly pluck items off shelves. What ends up happening is that they experience bill shock when they reach the check-out counter. This is a very reckless approach to shopping, and you want to avoid doing this. Before you visit the market, list down everything you need in the house. Set a budget for each item and stick to that budget. This way, you will not end up picking out anything that is not essential, and you will avoid overreaching on your allowance.

Cut Down What You Can Cut Down On

Just because you set a certain spending limit on yourself every month does not mean that you have to hit that limit every single time. If, after a while, you notice that you are not really reaching a certain limit on a particular expense category, then cut that budget down and devote more of your money toward savings or paying off debts. Frugality might not have a lot of sex appeal, but it can go a long way in rehabilitating your finances, especially when they're in a shamble. There is absolutely nothing wrong with wanting to live a modest lifestyle.

Make Adjustments to Your Budget Whenever Necessary

This is a concept that's already been touched on earlier, so there's no need to belabor this point. Just remind yourself that budget plans are great only as long as they're effective. If, over time, you see that your plans are not helping you achieve whatever goals you set for yourself, then don't be afraid to shake things up. Financial intelligence is a constant evolution that requires consistent growth and development.

The Importance of Saving

In a nutshell, the whole purpose of budgeting your money is to help you maximize your savings by limiting your spending. That's the whole point of sticking to a budget in the first place. But we still haven't covered why saving is so important, to begin with. Sure, you might have a faint idea of why having a lot of savings is a good thing. But you might not really be sure about the specific ways that having savings can be good for you. We already talked earlier about why motivations are important in sticking to a plan. If you really want to commit yourself to budgeting and saving more money, then we need to discuss why it is important to do so. This way, you stay motivated.

You Get to Build Your Emergency Fund

We touched upon the concept of an emergency fund briefly in an earlier chapter. But it is now time to delve deeper into what it is, why it is important, and how you can build it up. One thing you have to know about building an emergency fund is that, aside from paying off debts, it is the first thing that you should invest your income into. Essentially, you are lessening your likelihood of getting into debt by building an emergency fund that you can reliably fall back on whenever an unexpected expense takes place.

As you already know by now, life is filled with a lot of uncertainty. However, just because you fail to plan for these uncertainties does not mean that you shouldn't prepare for them. That's precisely what an emergency fund is. It's your preparation against the unexpected things that life will throw your way. Not only will an emergency fund keep you from getting into debt, but it could also potentially save your life. An emergency fund is so much more than just being practical with your finances. It's also about being responsible.

What is an emergency fund?

An emergency fund is essentially money that you set aside for the sole purpose of sustaining yourself in times of an emergency. It's important that this emergency fund is easily accessible (ideally, in a savings account) and is only ever really accessed in actual times of emergency.

How much should you save?

The ideal amount of your emergency fund can depend on your lifestyle and your needs. However, a good amount to start with is $500. Find a high-yield savings account that you can pour that money into and just work from there. Again, you want your money to be as accessible as possible since emergencies can strike anywhere at any given moment.

Experts say that you should have a conservative amount of around three to six months' worth of living expenses sitting in this fund. If you are someone whose job security is rather volatile, then you might want to consider setting aside even more. Essentially, an emergency fund should be sizable enough to keep you afloat for around half a year or so even if you don't have any cash coming in. Again, it is okay to start small, but you should work your way toward building that fund as big as you can.

How do you build and manage your emergency fund?

The first thing you need to do when building your emergency fund is to determine what your target amount is. This is where calculating your monthly expenses comes into play. Since you have already done that step, then you have a solid number to work with. If you don't know your monthly expenses yet, then just shoot for $500 in the meantime as you get your financial affairs in order.

Then, check your cash flow. Try to allocate a certain amount of your budget to building your emergency fund every month. When plotting your budget, dedicate a certain amount to building your emergency fund on a monthly basis. Do this until you are able to cover at least six months' worth of expenses. Once you have done that, you can dedicate whatever extra money you have to other forms of investment. Never touch your emergency fund unless you find yourself in an actual emergency.

You Get to Prepare for Retirement

Too many people focus a lot of their energy on work but not on retirement. If you have a job that pays you well and you enjoy what you do, then that's good. But for the vast majority of people in the world who work their day jobs purely as a way of sustaining themselves, your job should only serve as a means to an end. It's not the end itself. Your job is a tool that you use to build up your financial security. You shouldn't be working for the sake of working. Rather, you should be working with the purpose of retiring as early as you can without having to compromise the quality of your life. If you dedicate a huge chunk of your income to saving, then you will be in a better position when the time comes for you to retire from your job.

You can save for your retirement by systematically setting a certain amount of money aside to be used as a retirement fund. However, there are also alternative investment options available for you to prepare for your retirement. We will cover these investment options in a later chapter.

You Increase Your Spending Power

The more money you have, the more things you can buy. It's that simple. This is why saving when you are young is crucial. The earlier you save, the more money you will have saved up for the big purchases in your life. As you grow and mature, you will find that the things you want and need in life will become a lot more expensive. You will have to start thinking about setting down payments on houses or cars. You will need to find money to fund weddings and honeymoons. You will need cash to help sustain your family, especially if you will have kids in the future. Essentially, by saving early, you are increasing your capacity to spend on all of these things without a worry.

You Get More Financial Flexibility

Having a sizable savings fund will also grant you a certain amount of flexibility. When you ask people about what it means to be rich, you are probably going to be greeted with a variety of different answers. But one likely answer that you are going to receive is financial flexibility. This means that you get the luxury of getting more options available to you with regard to how you want to live your life. Essentially, money gives you certain freedoms that not all people will have.

Think about it. Hypothetically, if you get to a point in the future wherein you are feeling sad and unfulfilled with your job, what would you do? If you have enough money saved up, then you would have the option to take a step back and see what's out there. You can explore other forms of livelihood without worrying too much to sustain yourself. You have that option because you have enough money to keep you afloat. However, if you are living paycheck to paycheck and you don’t have savings, then that’s a luxury that you don’t have access to. You are forced to stick to your job that does not make you feel happy or fulfilled because you don’t have any other choice. You need that income in order to sustain yourself.

It’s not just that either. Financial flexibility gives you the freedom to go on random trips, invest in businesses, partake in impulse purchases, etc. Living paycheck to paycheck will not even give you a chance to think about where else you could devote your money because your bank account is being emptied every single month.

You Can Let Your Money Work for You

One of the greatest advantages of having a formidable savings account is being able to invest your money into mechanisms that will grow them even bigger. A lot of us will devote hundreds of days every single year to trying to earn as much money as we can. But not a lot of us are aware that we can stash our funds in certain places wherein they actually work for us. Of course, not many people are aware of this because many don’t have savings that they can play around with. You will learn more about investments and making your money work for you later on. Just know that this is another added benefit of having savings.

You Get Better Peace of Mind

The last and possibly the best benefit that you can gain from having savings is that you get better peace of mind. There are very few things in life that feel better than going to sleep at night knowing that you are set for the next five, ten, or fifteen years. You could quit your job tomorrow, and you wouldn’t worry about how to make rent or buy groceries. There’s a certain anxiety that is attached to living paycheck to paycheck. If one thing goes wrong, then you are screwed. Your whole life would be thrust into a world of uncertainty and uphill battles. But if you have a comfortable bed of savings that you can lie on, then things will not be so bad.

Chapter 6:
Dealing with Debt

Getting into good financial shape is not easy—far from it. In fact, for a lot of people, it can almost seem downright impossible. This is especially true for people who find themselves drowning under mountains of debt. More than any other time in history, Americans are struggling to lift themselves out of the debt hole. It's no longer just adult Americans either. Even people who have yet to enter the workforce are already bombarded with loads of debt as a result of student loans.

To paint a clearer picture, an average student will graduate from college with more than $30,000 in student loans. They also average as much as $4,000 in credit card debt. Another alarming number is that 30% of students graduate with a credit card debt amounting to $10,000 (Financial Literacy 101, 2020). Imagine getting out of college and not knowing where your source of income is going to come from. However, you are already bombarded with all of these financial statements telling you that you are in debt and that you need to make payments immediately. The worst part is that these numbers don't even show you the students who failed to graduate as a result of financial constraints.

People can get into debt for a variety of possible reasons. Sometimes, it is something that can creep up on you like an unexpected medical emergency, or it can also be because of habitual behavior like chronic gambling. For the most part, a lot of controlling debt has to do with financial habits in the day-to-day life of an average individual. If you are talking about getting into debt because of a medical emergency, this could have easily been avoided (or alleviated, at the very least) by building an emergency fund. If it is habitual behavior like constant gambling or shopping, then you know that you could have chosen to quit at any time to keep yourself from getting into debt. You might think that the world does not want this for you and that no one should ever wish this even on their worst enemies. But that's not the case.

The truth is that a lot of financial institutions develop marketing campaigns and mechanisms that are designed not just to get you in debt but also to keep you there as well. As unethical as it might seem, there is no denying that these financial institutions, like banks and private lenders, make a living off other people's poor financial choices. Lenders will never discourage you from making late payments if it means that they get to add to your debt by charging you for penalties. Any media that you consume on a daily basis is bombarded with subliminal messaging that is designed for you to open your wallet and spend. Whether or not you give in to this messaging is all up to your willpower.

If you are already in debt, there is no use in crying over spilled milk. Pining over being buried in debt and regretting your financial choices will do nothing to improve your situation. However, just because you are stuck in a hole of debt does not mean that you have to stay there. This entire chapter will be dedicated to opening your eyes to all of the dangers of debt and why you should avoid it at all costs. Moreover, you will also be taught about the red flags that you might be making some financial decisions that could potentially lead you into debt. As you make your way through this chapter, you will also learn all about the system of debt so that you gain a better understanding of how you can work your way out of it.

Debt is the one target that you need to tackle before you can make any other significant movements when it comes to your finance. Set aside investing and growing your wealth for a second. Focus on just paying off your debts for now. If you are not struggling with debt, you shouldn’t skip this chapter either. There are still certain tidbits of information in this chapter that can help you out. Contrary to popular belief, not all debt is bad. In fact, you can use debt to your advantage to build your financial portfolio and become richer. Also, it will help you to learn more about the things that you must and mustn’t do when it comes to debt just so you can protect yourself in the future.

What Is Debt and Why Should You Avoid It?

The quickest way to define "debt" would be any money that you owe another person or institution. It's that simple, and there is no need to overcomplicate things. Sure, we can get into the nitty-gritty details of debt later on. But for now, that's all you need to know. At first, you might think that a little debt will not hurt. You borrow two dollars from a friend to pay for parking. You loan a hundred bucks from your aunt to pay for a car repair. You ask for a small loan from the bank to fund a potential business. All of this seems so innocent, right? Yes, if you look at each individual loan, it does not look too bad. However, it is only when you start looking at the collective that you will truly realize just how bad things really are.

If there was one word that could be used to describe debt, you could come up with a number of different possibilities. But for the most part, it is this: dangerous. If you are not smart about handling your debt, you could be in for a world of trouble. You think nothing of applying for that credit card from a nearby bank that offered you some great promos and deals. After all, you assumed that you had the necessary willpower to keep you from overstretching your budget. But you should know that many people who are buried by debt were in the same exact position as you. Eventually, one small bad decision after another, they find themselves in these precarious positions as they desperately try to claw themselves out.

If you still don't take debt seriously, hopefully, this chapter will have you singing a different tune by the time you finish reading. Here are a few reasons why you should definitely be scared of debt.

Debt Diminishes Your Net Worth

We already talked about net worth early on and why it is important to keep it high. If you are in debt, then that means you have a negative net worth, and that will result in various consequences. For one, you would have more difficulty getting approved for loans in the future. Another problem with having a negative net worth is that you are restricting your own financial flexibility. There really is not much room for growth when you are starting with a number that's lower than zero. Increasing your debt will only result in you increasing your liabilities. This will make it harder for you to come out on top with a positive net worth.

Debt Encourages You to Spend Beyond Your Means

Keep in mind that a bulk of finance is about psychology and not just about mathematics. There is just a psychological aspect to debt that induces people to spend more than they are capable of paying. There is a reason for that. Put yourself in the shoes of a child whose parents are taking you to a toy store. You're young. You're naive. You have no idea what money is or what value it holds. You just know that you want toys and that the store has loads of them that are available for you to bring home. You list down every single toy that you want, and your parents buy it for you. After that, you go home, and you enjoy your toys without any other care in the world.

You know why it was so easy for you to just ask for so many toys? It's because you didn't need to shell out any cash to purchase them. They were readily available because your parents made it so. It's the same with credit cards as well. Somehow, these magical devices have the ability to make you think that you can afford something even though you really can't. It's the instant gratification that people thrive off when getting into debt. They acquire something that they want immediately without having to deal with the stresses of paying it off until later on.

It's a Lot Easier to Get into Debt Than to Get Out of It

Think about how easy it is to walk by a jewelry store and buy that gorgeous diamond ring with just a single swipe of the credit card. If you are quick about it, you can be in and out of the store in just a matter of minutes. You could literally accrue thousands of dollars' worth of liabilities in just a few seconds. Now, think about how many hours you have to devote to working hard and earning money in order for you to pay that debt off. It's not the same, is it? That's what it means when we say that "it is so easy to get into debt but hard to get out of it."

Being in Debt Is Expensive

It costs a lot more to be in debt than it does to have no liabilities whatsoever. This may not seem obvious to you now, but things get exponentially cheaper the higher your net worth grows. The opposite is also true for whenever your net worth diminishes. Everything just becomes a lot more expensive the deeper you get into debt. This is because you always end up having to spend more money in order to cover interest rates or penalty fees. More than that, people tend to save more money when buying utilities or necessities in bulk. However, if you are in debt, you are likely not to have that kind of spending power. Thus, you are relegated to more expensive alternatives instead.

Debt Diminishes the Spending Power of Your Future Self

Whenever you go into debt, at face value, you might think that you are borrowing money from a bank or from another person. But that's not the whole truth. If you really think about it, you are not just borrowing money from someone else, but you are also stealing money from your future self. You are already assigning whatever future income you will earn to something you want to acquire in the present. Sure, you might be able to get that fancy dress now, but that also means that you are depriving your future self of the ability to pay rent or to supplement the emergency funds. It can be easy to think that you are getting something for free by swiping your credit card. However, you are essentially just delaying the process of making that painful payment to a later date, and your future self will suffer for it.

Interest Rates Do More Damage Than You Think

Credit card companies will try to dupe you into making these ultra-low minimum payments every month to make it seem like you are actually making payments on time. However, what you might not realize is that making just the minimum payments every month is actually forcing you to spend more money than you initially thought. One thing that you have to learn about people who are financially intelligent is that they know how to use the interest to make themselves richer. However, being late on your payments and subjecting yourself to the interest rates of others is going to make you poorer and poorer the longer you stay in debt.

You might think that it is a good idea to invest in that gorgeous surround sound system for your living room. So, you spend $2,000 at a 10% interest rate on your credit card to make it happen. If you pay just the minimum payment every month, you are going to end up spending a lot more money by the time you finish paying everything off. It would be more prudent to set aside some cash and just buy the device once you have all the money in hand.

Debt Is Bad for Your Mental Health

Just ask anyone who has ever experienced being stuck under a huge pile of debt. It’s stressful and anxiety-inducing. A lot of people will have trouble going to sleep at night thinking about where to get the money to pay off their debts. There are loads of people who have even decided to take their own lives because of their financial situations. Ultimately, if being financially secure offers you peace of mind, being in debt offers you the opposite. The mental anguish of knowing that you need to climb out of a debt hole can be very excruciating.

Debt Makes Budgeting More Difficult

It can be very difficult to keep track of how much money you really have to spend and account for if you are managing a lot of debt. One of the worst things about debt is that it can come from anywhere. You might have debts with your banks, friends, coworkers, and family. With all of those different liabilities in play, it can be hard to find a way to allocate a certain amount of your income to pay them off. More than that, it can be challenging to develop a budget plan if your income is prematurely accounted for because of the debts you need to pay off. Debts are essentially predetermined expenses that you can’t opt out of.

Debt Hurts Your Credit Score

You might not think much about your credit score, but you should know that it matters and that debt can have a significant impact on it. The higher your debt, the lower your credit score is going to be. And a credit score is crucial in helping you secure credit cards, mortgage loans, and auto loans. But it is also so much more than that. Having a high credit score will save you a lot of money on insurance premiums. If you have a lower credit score, you will have to pay more out of pocket. This is another way in which debt can make life more expensive for you.

Debt Keeps You From Achieving Your Financial Goals

Lastly, debt can keep you from achieving your financial goals. You will not be able to build your emergency fund. Debt will keep you from saving up for retirement. Your liabilities will continue to diminish your net worth. Debt will deprive you of the opportunity to invest in safe money-making ventures and mechanisms. Ultimately, you would be crippling yourself in a financial capacity if you don’t find a way to get out of debt. There’s very little you can do with your income if most of it is going toward paying off loans and penalties.

How to Know if You Have a Debt Problem

Financial health is a lot like physical health in the sense that prevention is always better than cure. It would serve you a lot better in the long run if you manage to stop yourself from incurring debt as opposed to dealing with debt when it is already there. Most of the time, pride will get in the way of letting us see what we're supposed to see. We already see how debt can destroy the lives of the people around us, but we never really think that it could happen to us. That's a lie. That's just your pride talking. The truth is that if you are not careful, you could find yourself in deep financial trouble without you realizing it until it is too late.

Again, the best way to deal with debt is to avoid having that problem in the first place. This means that you devote most of your money to savings and investments. More importantly, you should have a solid emergency fund to help cushion the fall for any unexpected expenses that may present themselves in life. Still, despite that, it helps for you to know what really goes on in the mind of someone who engages in *chronic debt*. This way, you get a better understanding of how they allow themselves to get into such compromising financial positions, to begin with.

Stages of Debt

Yes, a lot of people fall into debt as the result of one-time occurrences, like medical emergencies or losing a job. But for most people, it is really a series of poor choices and decisions that can lead to someone getting into debt. In fact, a person's fall from grace into the pit of debt can be summarized in three distinct stages: surprise, denial, and rock bottom.

1. *Surprise:* The first stage of debt is when people just realize that they're spending more money than they know they can afford. It's that moment when you open a credit card bill and you see that the number at the bottom of the page is larger than the amount of cash that you have on hand. This is essentially your first taste of the perils of debt. You're being introduced to that initial anxiety of trying to figure out how you can pay for something that you can't afford. During this stage, you might try to double-check your bill to see if you have been wrongly charged for anything. But if everything is accurate, then it is true that you have been overspending. Usually, this is the stage at which it is easiest to go into a financial remission. It's really just a matter of correcting some bad habits and sticking to a solid financial game plan. You are not in too deep yet to the point where it feels impossible to solve your problems.

2. *Denial:* The second stage of a debt problem is denial. This is when you just bypass the initial stage of surprise and you carry on with your ways without a care for what it is doing to your finances. Somehow, you convince yourself that things are going to get better over time and that you don't really have a problem yet. However, you are not doing anything to correct your poor financial behavior, and you are just falling deeper and deeper into debt. It can be very hard to shake yourself from this stage because you are in deep, but you don't even acknowledge that there is a problem, to begin with. You've essentially acclimated yourself to the wrongness of your ways.

3. *Rock bottom:* Then, there is rock bottom. This is when the problem has ballooned so big that it is no longer insignificant enough for you

to ignore. This is when other people are really being hard on you to pay them back for what you owe them. Maybe at this point, your accounts are getting frozen. No one is offering you any loans anymore. Your landlord is probably going to evict you soon. This is the time that you feel like there is no one else to turn to with your finances. At this stage, it is too late for you to employ any quick fixes to solve your problem. You're going to need a major financial overhaul to get things back to normal and establish a semblance of stability in your life.

Signs of Financial Trouble

In case you have an inordinate amount of pride that blinds you to all the signs of financial woe, then here are a few red flags that you should consciously keep an eye out for. If even just one of these entries applies to you, then you should take that as a serious warning for you to correct any poor financial behavior.

- When filling in your budget tracker, you find that your expenses are always more than your income every month.
- You consistently get penalties for late payments on your credit cards or other loans.
- You get a lot of calls and nudges from lenders and collection agents.
- You are compelled to find alternative lines of credit because your current lines of credit have been frozen.
- You have to go into debt in order to pay for things that you should already have a budget for (household essentials, food, utilities, etc.)
- You don't have a plan to pay off your debts.
- You purposefully avoid reading your billing statements.

- You don’t have an emergency fund to help you out.

If you ever find yourself experiencing financial stress, then take that as a sign for you to make a change in the way that you approach money. It’s important that you have a healthy and wholesome relationship with your finances. It does not matter whether you are in the first stage of debt or you have been dealing with financial woes for years on end. There is always going to be a way out. There is always something for you to do to improve your situation. As cliché as it sounds, no financial situation is completely hopeless. You can always refer to books like this for help and guidance on how you can improve the state of your finances. If possible, ask the help of financial advisors. They can aid you in steering your finances in the right direction. In the age of information, all of the knowledge is out there and ready for you to consume. It’s just a matter of you taking the time to seek this knowledge out and apply it to your own life so that you can benefit from it moving forward.

Basic Debt Terminology

As you may know, a basic understanding of language and terms is an essential aspect of developing your financial literacy. Keep in mind that a lot of banks and financial institutions will deliberately use confusing jargon in an effort to mislead you in a way that benefits them. Of course, in the long run, the only person who ends up losing is you. So, before we move on with this chapter, it is important that we get some of the basic terminologies surrounding debt out of the way. In this manner, it will be a lot easier for you to understand what we are talking about as we go along.

Principal

A principal of any debt is essentially the original amount that you borrow and/or the remaining amount (without interest) that you owe at any point during the period of the loan. For example, you take a loan out of the bank for $30,000 to fund your business payable over the course of five years with an interest rate of 10% per annum. That initial $30,000 serves as your principal amount without interest. Then, before your first billing, if you are able to pay off $5,000 of that loan prior to the interest kicking in, your new principal becomes $25,000. It’s important to note that every monthly payment you make toward a loan is inclusive of interest, so you are not paying that total amount toward just your principal.

Interest Rate

An interest rate is a debt that you acquire on top of the principal amount that you owe. Usually, an interest rate is expressed in the form of a percentage of the principal. In our previous example, the initial principal loan is listed at $30,000. The set interest rate is 10% per annum. Now, the value and nature of an interest rate can really depend on the terms of an agreement. Typically, an interest rate can come in one of two forms: fixed and variable. A fixed interest rate stays the same all throughout the tenure of a loan. A variable interest rate changes, given various conditions throughout a loan term.

Collateral

You might have heard of the term “collateral” from people who try to take out huge loans. This is essentially any item that can serve as a piece of insurance in the event that the borrower is unable to pay back the debt given the agreed-upon terms. Let’s go back to our example of the man who borrowed $30,000 to use as startup capital for a business. The bank told him that he needed to put up collateral for them to approve his loan. So, the man decides to list his car as collateral. If the bank sees that his car is economically valuable enough to compensate in the event that the man fails to pay back his debt, then they will approve his loan. If the man does end up failing to pay the bank back for the loan, then they will have the right to take possession of his car.

Loan Term

A loan term is essentially the agreed-upon time duration for which a debt is to be paid back. If we go back to the previous example wherein the debt of $30,000 is to be paid back in full over five years, then the loan term for that particular agreement is five years. However, usually, loan terms are set in monthly units.

Amortization

Most big loans go through something that is referred to as amortization. This is essentially the spreading out of payments for a loan over a regular interval or installment. So, again, with the previous example, the principal amount of $30,000 does not have to be paid back all at once in its entirety. Most borrowers will resort to amortization, which will allow them to pay down the debt in a series of monthly installments (including interest, taxes, and fees).

Credit Score

Then, there is a credit score or credit rating. Essentially, based on your financial history, you will be assigned a certain credit score. This score is crucial for banks and lenders to determine how viable you are for certain loans. The higher your credit score, the more qualified you are for bigger and more complicated loans.

Types of Debt

As you learn more about finances and money management, you will discover that not all debt is created equal. Some debt can be beneficial, while a lot of debt can be downright damaging to your finances. The key here is in being able to determine what kind of debt can serve you best and what wouldn't. Again, there are all sorts of different groups and classifications for debt. However, just to cover the basics of your financial knowledge, here are the first two types of debt that you need to orient yourself with.

Secured Debt

A secured debt is essentially any debt that you inherit with the intents of purchasing an item that can serve as its own collateral. This is most common with home or auto loans. For example, you borrow $100,000 from the bank in order to finance an apartment that you want to purchase. The bank will grant you that loan with the condition that the apartment will serve as collateral in the event that you fail to make payments. If, by any chance, you do fail to pay your debt, the bank will have the right to seize control of the apartment and will assume ownership of it.

Unsecured Debt

If a secured debt is any kind of debt that you inherit involving collateral, then an unsecured debt is the exact opposite of that. The most common example of unsecured debt is credit card debt. Whenever you swipe your credit card to purchase something at the store, it is not like you need to put up some kind of collateral first to serve as insurance in case you can't make payments. You are essentially granted limited access to a certain amount of money that you can use however you like. However, the problem with not having collaterals is that these kinds of debts tend to have higher interest rates to compensate. There is a higher risk for banks to lend you money without collateral. They must compensate with the high-interest rates in order to protect themselves in case you can’t make payments.

Good Debt vs. Bad Debt

After going through this chapter so far, the very idea of debt must be traumatizing to you. You could even make the argument that you would never want to take on any kind of debt for the rest of your life. But there is also no getting around the fact that most people will have to accrue debt in order to afford some heavy purchases, like homes or cars. How do you balance that line between taking on the right amount of debt and making sure that it does not lead to a downward spiral for your finances?

Generally speaking, taking on debt might not make you feel good inside. However, you have to learn that not all debts are created equal. There are certain debts that are truly bad and need to be avoided at all costs. But there are also various ways in which you can use debt to build your net worth and work your way toward financial independence and freedom. Sure, this chapter might have demonized debt in a way that has made you fear it. But that shouldn't be the case. You need to keep an open mind and judge every possible transaction on its own merits. Not all debts are inherently bad. You can't let your emotions play a trick on you by telling you how to assess your financial decisions. You need to let your mind and rationality do the work. This segment of the chapter is going to help you figure out the difference between good debt and bad debt.

Good Debt

You are already probably familiar with the saying "It takes money to make money." That is essentially the principle behind good debt. Sometimes, debt can be used and manipulated in such a way that you are able to put yourself in a much better financial position than you would be without it. This may seem counterintuitive given that debts are typically liabilities. But there are nuances to this. If you do things right, your debts might even count as potential investments for you. Essentially, you are taking on debt now because you know that it will help you come out ahead in the long run by increasing your future net worth and financial health. Ideas of *good debt* will change depending on who you ask, but here are some general examples that you can work with:

Mortgages

You might be skeptical now. We have referenced mortgages a lot of times in this book, and we have even talked about how a lot of people are struggling to pay their mortgage loans. But don't let any of that talk deter you. A mortgage loan is a good debt to have. Why? It's an investment. When you buy a home using borrowed money, you are essentially taking current finances to pay for something that will increase in value over time. You might just see a home as a structure in which you can live and grow with your family. But financially, a home is also a great investment. Real estate is always one of the safest investments that you can make with your money as its value continually rises over time. What you pay for a home in 2021 will be significantly much cheaper than when you pay for it in 2031. This is why it makes sense to borrow money and buy a home now instead of saving up for years to buy a home in the future. Even with the interest rates on home loans, you still come out ahead if you compare it to you saving money to buy a house with cash. You will still end up paying cheaper.

However, a mortgage loan, while being an example of good debt, still has its caveats. Just because it makes sense to purchase a multi-million dollar mansion while it is cheaper because it will grow in value in the future does not mean that you should do it. At the end of the day, you are still going to have to find a way to pay off your mortgages. This is where your budget plan comes in. Analyze your income properly and see if your cash flow is healthy enough to sustain payments for your home throughout the loan term. You still need to be a responsible buyer even though mortgages tend to be good debts to have.

Student Loans

This might stir up controversy. There are bound to be some people out there who will say that you don't need to go to college to get rich and earn a living. Sure, that might be true for a select group of people. But in order to stay relevant in this increasingly competitive workforce, having a college degree can go a long way. Essentially, student loans can be scary because you are not investing in anything tangible, like a house or a car. If you can't afford to pay your student loans, it is not like you can just opt to sell it off, like a car that you can no longer afford. A student loan is an investment in yourself. This is precisely why it is considered good debt.

Earlier, we talked about the importance of having healthy cash flow, and all of that starts with being able to generate a modest income. According to the U.S. Department of Education, college graduates are expected to earn $1 million more than high school graduates (2020). This is no longer just a belief. These are actual statistics. Yes, you can believe yourself to be an outlier and that you don't need a college education to be just as rich as everyone else. But if you want to play on the safe side, it would be better to invest in a college education. This would put you in the optimal position to maximize your earning potential in the future.

Small Business Loans

Ask any entrepreneur, and they will tell you that the only way you could ever get rich in life is to start your own business and be your own boss. By working for another company, it is still possible for you to get rich. You will have to compete with other people in the workspace as you try to jostle and claw your way up to the top. Even then, you are not always assured of job security. In fact, an argument can be made that the higher up you go, the more insecure your position in a company becomes since so many people are gunning for your spot. Regardless of where you stand on that matter, taking out business loans is still considered by many to be an example of good debt.

Of course, you always read a lot about how businesses fail and how people go into financial ruin because they funnel too much of their money into these failing companies. That’s just a matter of poor execution. In principle, every business has the chance to succeed and make it big. If all entrepreneurs were too conservative and decided not to take on debt in order to fund their businesses, the world economy would collapse.

A lot of people have found substantial success by taking on debt in order to fund a small business. If you are feeling entrepreneurial, you can definitely do the same. You just have to make sure that you do all your due diligence first. Come up with a good product or service, research your market, and hire the right people. This book will not go into detail on how to make a business succeed; you can go to other sources for that. However, in principle, you should know that investing in a business with a solid platform for growth and development is always a good idea.

Bad Debt

You have already learned about how debt has the potential to increase your net worth and build your future wealth. Now, it is time to discuss how debt can do the reverse and destroy your finances if you are not careful. In a nutshell, debt is good only if you are using the money to invest in an asset whose value will appreciate in the long run. Given that, debt is bad if you are investing in something that is just bound to keep on depreciating or losing money. To put it simply, if you are not investing in something that will help make you money in the future, then you shouldn't go into debt to purchase it. Here are a few concrete examples of bad debt that you need to avoid as much as possible.

Credit Card Debt

That innocent little plastic device in your wallet is not as innocent as it seems. It can ruin lives if you are not careful. The truth is that figuring out credit cards can be a really daunting task. These credit card companies make their language on credit cards so alluring and confusing at the same time. And they do it on purpose too. They don't want you to realize just how bad of a financial decision you are making, for example, when you just settle on paying the minimum for monthly dues.

Stores will have you thinking that using your credit cards for layaway plans to purchase expensive TVs or high-end jewelry is a good idea. But then you will be surprised to find the interest rates of these transactions. And by then, it is already too late. You've already been drawn in with fancy marketing, and you have no choice but to make these payments.

Payday Loans

If you think credit cards are bad, then you should know that payday loans are worse. Much worse. Think like ten times worse. Resorting to payday loans can seem like such a convenient way to gain access to cash whenever you are in a bind. Essentially, you would be tricking your mind into believing that you have instant access to cash that you could just easily pay off. But that’s not how payday loans work. It’s true that they make it easy for you to get that money in the first place, but they make it really hard for you to pay that cash back. You could be paying as much as $30 in fees for every $100 that you borrow. That’s a whopping $30! If you borrowed $1,000, then you would have to end up paying an additional $300 when the due date comes. If you are already in a financial bind, then $300 is certainly not an insignificant amount of money.

Luxury Loans

The last (and arguably the worst) kind of loan that you could take on is one that funds luxury items or experiences. The very idea of luxury has always been very polarizing. It’s something that we all aspire to, but it is only reserved for the rich and wealthy. However, a lot of people give in to these aspirations even though they don’t have the means to do so. You would be surprised at how many people will go into debt to buy cars or watches that they can’t afford. People will throw big and lavish parties, like weddings or quinceañeras, in order to have a good time, but they will need to go into debt to do so. Obviously, by definition, these luxury items and experiences are only reserved for people who have money because these things don’t make much financial sense to invest in. They certainly are not for people who are going through financial struggles and are having a difficult time coping with debts.

Wild Card Debt (Gray Area)

As it is with life, debts in themselves can't always be classified as either good or bad. Again, depending on who you ask, you are going to get a bunch of different answers on what kinds of debt can be beneficial or not. This is why it is essential to highlight the debt transactions that fall under the gray area. A lot of financial maneuvers can only be judged when placed in the proper context. For example, an investment in a yacht might be a good idea for billionaires, but it wouldn't make sense for an office worker. Context is everything. This is why some debts make good sense in certain situations while also being completely bonkers in others. Here are some *wild card debts* that can either be good or bad, depending on how you use them.

Auto Loans

Auto loans are really tricky. This is another one of those debts that can either be considered good or bad, depending on who you ask. There are those on one side who will argue that cars are luxuries and not necessities. More than that, cars tend to depreciate and lose value over time. So, you end up losing money in the long run if you take on debt to invest in a car. If you look at things from that perspective, then a car really is a bad investment. On top of that, there are maintenance costs that you need to consider in order to keep the car running, like gas and repairs.

However, there is also a camp of people who will say that auto loans are good debts because their cars are crucial aspects of their daily productivity. For example, for some people, it would make more financial sense to have a car in order for them to get to and from work every day. After all, their performance at work is what generates income for them in the long run. In that sense, then maybe a car is not as bad an investment as you think. Ultimately, it all boils down to a person's lifestyle and what kind of deal you are getting on a car.

Leveraging

Leveraging is a technique that people use in finance in order to earn money after getting into debt. Essentially, you would borrow money at a low-interest rate and then invest that money into a high-interest-earning account. By using this technique, you are essentially moving money around that is not yours in order for you to profit. In theory, a lot of people have made quite some coin through this technique. However, if you don't have a lot of experience or mastery in such a financial scheme, then it would be very dangerous for you to try it out. This is why it is considered a good debt practice for people who are savvy with investments. But it might not be for everyone.

Debt Consolidation

Debt consolidation is the act of going into debt in order to pay off another debt. As we have learned so far, debts in themselves are not bad as long as you can pay them off. However, one crucial aspect of debt that will make it difficult for certain people to make payments is the interest. In order to circumvent this problem, some people will resort to borrowing money from other lenders with low interest rates in order to pay off other debts that have high interest rates. Again, in theory, this makes good financial sense. However, it is not always going to pay off for you if you don't know what you are doing.

Credit Card Rewards

One of the biggest selling points of a lot of credit card transactions is the rewards that come along with every purchase. Some credit card companies will attach rewards or points for every transaction that will translate to discounted meals, freebies, or even airline credit. In a certain sense, this can act as a double-edged sword. If that credit card purchase is absolutely necessary (like paying for groceries or electricity), then it makes sense to use a credit card to capitalize on the rewards. However, if you are just forcing a purchase on something unnecessary with your credit card so that you can earn rewards, then it does not make much financial sense. Most importantly, regardless of whether these purchases are necessary or not, you should only be making them if you know that you have the cash to pay them off at the end of the month in order to avoid penalties.

Finding that Balance

Using debt when building your wealth requires a balanced approach. Of course, in theory, you would never want to be in debt. However, there are proven practices out there that are designed to put more cash into your pocket. Certain risks are involved when it comes to playing with debt. This is why you need to be safe about it. Sure, you can read up and learn as much as you can about how you can use debt to your advantage. However, you should also make it a point to be careful so that your debt will not end up swallowing you whole. Even certain examples of good debt can leave you in really bad financial shape if you are not careful. It is all about moderation and balance.

Simple Strategies to Prevent a Debt Problem

We have said it over and over again, but it is still worth mentioning. Prevention is a lot better than cure. If you are not in debt, then you better make sure that things stay that way. Again, it is a lot harder to get out of debt than it is to just accidentally fall into it. One thing that you have to realize about debt is that it is rarely something that happens beyond your control. Given that, there are certain strategies and tips that you can employ in life to serve as a safety net for you. This way, you are essentially protecting yourself from falling into debt so that you can always stay on the green.

Build Your Emergency Fund

This is already something that we have discussed earlier, so we don't have to spend too much time talking about this again. But you should already know by now that having an emergency fund is one of the biggest tools that you can use to protect yourself from incurring any unwanted debt.

Only Buy What You Can Afford

Credit cards don't give you free money. They don't provide you with any real spending power. What they do, however, is offer you a free lane toward the land of debt. Whenever you are pondering a purchase, it is okay to use a credit card. We have already talked about how credit cards can help you improve your credit score. However, it is important that you know that you have the money to pay for this purchase by the time your billing statement comes around. As a rule of thumb, make it a point to set aside the appropriate amount of cash every time you make a credit card purchase. This way, you already consider it as cash that has been spent.

Pay Off Your Balance in Full and on Time

Avoid falling into the trap of only paying the minimum amount every month. That's not the way to go. You are only going to end up having to pay so much more money than you plan on because of the interest rates. This is why it is crucial that you only swipe your card for purchases that you know you have the actual cash on hand for. If you know that you can't afford to pay your balance in full at the end of a monthly cycle, then just hold off. Try to find ways to get around not making that purchase. This kind of behavior can go a long way in helping you stay out of debt.

Be Aware of the Signs of Credit Card Debt

We already talked about the signs and stages of chronic debt earlier in this chapter. Again, it is important that you stay mindful of these stages. Look out for these red flags in your life. They are not always going to be so obvious to you. This is why a lot of people experience a sensation that is referred to as *bill shock*. They get surprised at how much they have been spending when they read through their bills at the end of the month. In order to prevent bill shock on your end, you must always stay mindful of your spending habits. If anything about your spending feels uncomfortable or stressful, then you should take that as a sign to reassess your financial behavior.

Don't Do Cash Advances on Your Credit Card

Earlier, we talked about how you shouldn't see a credit card as money that you own and can spend. Purchasing items with a credit card is you spending money that you don't have. You shouldn't think that you can work around that process by doing cash advances with your credit card either. That's not how credit cards should work. First of all, these cash advances have exorbitant interest rates. If you can’t pay them back in time, the penalties are going to have you losing money that you couldn’t afford to lose in the first place. When it comes to earning money, as a general rule, if it seems too convenient, then there’s probably a catch.

Limit Your Credit Cards

How many credit cards do you really need? And how high of a spending limit should you really have? Ideally, you should only have two credit cards at most. One is a credit card with a high spending limit that you set aside purely for emergency purposes. You shouldn’t use this credit card unless you really need to. Then, you should have another credit card that you can use for your usual expenses. The spending limit for this credit card should only be barely enough to cover your usual monthly purchases, like groceries and utility bills. Most importantly, you should always have enough cash saved up to cover the spending limits of both these credit cards.

Don’t Engage in Lifestyle Inflation

One common way that a lot of people fall into debt is through something that is called lifestyle inflation. It happens way too often with people who find success in their careers. As a result of all the hard work that they pour into their professional lives, a lot of people will see immediate returns in terms of their compensation.

For example, a hotshot college athlete is offered a chance to become an NBA player the moment he becomes eligible. A young lawyer who’s just passed the bar is ready to work as an associate at a large firm. At first, these are people who haven't had a taste of success yet. They still have a solid platform of humility to stand on.

However, when the dollars start coming in and they see what money can do for their lives, there's a chance that they get carried away. The NBA player sees that his teammate just bought a multi-million mansion in Beverly Hills, so he decides to do the same. The lawyer sees that everyone at the firm wears a Patek Philippe watch, so he buys one for himself too. Essentially, these people are inflating their lifestyles regardless of the impact it might have on their bank accounts. They see that just because they are earning more money now, they can probably afford to splurge a little more as well. Of course, some people are able to keep their lifestyle inflation in control. They take a moderate approach to it. However, there are also people who get too carried away and end up spending way beyond their means.

If you start to find more financial success in life, it is okay to reward yourself. However, it is important that you don't adjust your lifestyle too much to the point wherein you end up compromising your good financial habits in the long run.

Always Stick to the Budget

This last piece of advice is also probably going to be the most effective that you will ever receive. The absolute best way to stay out of debt is to stick to a budget. We have already talked exhaustively about the importance of a budget plan and how you can build one for yourself. There's a reason why we have continually emphasized the importance of sticking to a budget in this book. The exact function of a budget is to make sure that your finances are always well managed so that you will never go into debt. Even if you ignore every other tip on this list so far and you just stick to a solid budget plan, it is unlikely that you would ever go into debt.

Getting Out of Debt

As has been mentioned, getting out of debt certainly is not going to be as easy as getting into debt. In fact, to a lot of people, it might seem near impossible. All it really needs is for one or two really bad transactions for you to get into deep debt, and it will take you months or maybe even years to pay these debts back. With that said, paying off debts is not an impossible feat. It can definitely be done. You shouldn’t lose hope in yourself or your finances. There are numerous examples of people who are able to lift themselves out of debt and back into a healthy financial state. Why shouldn’t you be able to do the same?

If you feel like you are lost and you don’t have a way out, don’t worry. Here are some pieces of advice that can help you think of a game plan to pull yourself out of debt.

Stop Taking in More Debt

The very first thing you need to do is to stop taking in more debt. This shouldn’t come as a surprise to you now. Obviously, you need to stop doing the things that put you into this whole mess, to begin with. Of course, this tip will not necessarily help you get out of debt, but it is going to make the entire process a lot easier than if you just continually added to it. One of the best ways to stop yourself from creating more debt is to cut off any sources of debt as much as possible. Getting rid of credit cards is the most common example.

Organize Your Debt

Next, you want to be systematic in your approach to tackling your debt. This is where you really need to put all of your organization skills into play.

Before you can develop any kind of strategy to pay down all of your debts, you need to know exactly what you are up against. Organize and gather all your current bills and loans. Go through every single one of them. Check what your principal amounts are and take note of what the accommodating interest rates are as well. Write them all down and put them side by side with all of your necessary living expenses. This way, you have a good idea of how much money you need to be setting aside from your monthly income to go toward paying your debts.

The Debt Snowball

One of the most common ways that people go about eliminating their debt without succumbing to the dangers of high interest rates is by using the debt snowball method. This is where the psychological aspect of debt resolution comes in. A lot of people tend to feel overwhelmed whenever they know that they have multiple debts to pay. There are auto loans, credit card bills, medical debts, and mortgage loans. No wonder people can feel really defeated when trying to pay everything off. This is why a debt snowball method can be a very rewarding and systematic way of tackling your debt.

Currently, you might be stuck just trying to stretch out your budget as you devote a certain amount of your money to each particular debt. You might be able to find some progress with this method in the long run, but it can be a very deflating and long-winded process. By doing a debt snowball, you are essentially taking as much financial power as you can and dedicating most of it toward resolving one debt. Ideally, you would choose one particular debt, the one that seems easiest to solve, and pour most of your money there. Settle for making minimum payments toward the other debts. You will be able to resolve one debt a lot faster, and it will make you feel good about seeing actual progress with your efforts. Then, it is just a matter of moving on to the next debt that would be quickest to resolve. Repeat the process over and over until you are able to pay everything off.

The debt snowball method is great for morale as you are able to experience tangible progress every time you conquer a debt. That morale can serve as momentum and inspiration for you to keep on moving forward as you eliminate all debt from your life. However, there are a few situations wherein this method of debt elimination might not be ideal. If you have debts that have unreasonably high interest rates, like payday loans or title loans, then you should address them first, regardless of how low or high they are. These are the debts that need to be paid off as quickly as you possibly can. If not possible, consider refinancing that debt, which you will learn about in the next entry.

Refinance Your Debt

One effective way to manage your debt is to refinance them. Again, we talked about how a huge bulk of the stress that comes with dealing with debt is because it comes from so many different directions. You are getting calls from the bank about your credit card debt. Maybe a lending company is trying to collect payment for a mortgage loan. Then, you have to deal with the small business loan that you took from someone in your family. It can all get so overwhelming. On top of that, you might have certain debts with exorbitant interest rates that are making it difficult for you to make ends meet. This is where refinancing can come to the rescue.

There are a number of different ways that you can do this, but debt consolidation is by far the most popular and most efficient method. Earlier, we talked about how you needed to organize all of your debt so that you are aware of what you are up against. You need to know how much money you really owe. If you want to go about refinancing your debt, you will need a bank or lender that is willing to let you borrow money at a low interest rate so that you can pay off all of your debts. Essentially, you are paying off all of your individual loans so that you can combine them all into just one big loan that you can focus on. This is especially useful if you manage to strike a loan with someone who is offering you an interest rate that is lower than those that are found in your current debts.

The benefits of debt consolidation are two-fold. For one, you are streamlining your debt payment process by consolidating all of your debts into a single entity. Another is that you have the possibility of negotiating for a lower interest rate than the one that you are already dealing with.

Commit Extra Money to Debts

Life shouldn't be so hard on you, right? If you have been dealt with a bunch of bad cards, then the universe is bound to throw you a bone every once in a while. The law of averages says that you will eventually be given some breaks every now and then. Whenever that happens and you come into some unexpected money, whether through a raise, company bonus, tax refund, or a gamble paying off, then all of those earnings should go immediately to paying off your debts. Now is not the time for you to be treating yourself. Don't go rewarding yourself when you know that you still owe money to other people.

Negotiate Debt Settlements

Consider this a Hail Mary play that you run when you feel like you have no other options left. Try going to your lenders and ask if they're willing to renegotiate the terms of your debts. You would be surprised at how receptive they would be. First of all, you should remember that lenders and banks, for the most part, want you to be able to pay them back. If you default on your debt, then your lender ends up losing the money that they lent you without any chance of getting it back. This is especially true for unsecured debts, where no collaterals were put up. This is why they would definitely be open to you looking for ways to renegotiate the terms of your debt. Maybe you can ask them to lower interest rates to make it easier for you to pay your debts back in full.

Sometimes, if lenders are feeling generous, they might even be willing to negotiate for you to pay your debt back at a lower rate, especially if you have already invested in a lot of interest payments toward paying down your principal. Again, you might feel like this is a shot in the dark, but there's really nothing to lose here. You have everything to gain by just asking.

Chapter 7:
Make Your Money Work for You

We are nearing the end of the book here, and if you have effectively followed every piece of advice here so far, then you should already be at a point where you are comfortable with playing with the money that you have to your name. You have probably encountered the idea of making your money work for you before. It's fairly common, and it is probably considered to be a cliché in the finance industry. But do you know what it really means? Essentially, this phrase embodies the idea of how it is much easier for rich people to get richer. The more money you have, the easier it will be for you to multiply that money through investing.

Money is so much more than just a safety net for you. It's much more than just a device that you can use to satisfy certain needs that you have in your life. Money is not just something that defines your wealth and security. It's also a tool that you can use to amplify your wealth even further. This chapter will focus on the idea of investing and how you can use your money to make yourself even richer. The financially intelligent person understands that money is not just the destination. It can also be used as a part of the process toward achieving true financial independence and freedom.

This chapter will cover basic definitions and concepts that are associated with investing so that you can gain a better understanding of what it means to make your money work for you. Moreover, this chapter will also teach you about why investing is important and why you shouldn't shy away from it, especially if you are looking to achieve financial independence. Of course, investing can be very scary and risky, particularly for people who are inexperienced in the field. This is why this chapter will also walk you through the process of investing and what the best practices are when it comes to growing your money and building your wealth.

Most importantly, this chapter will open your eyes to the fact that investing is not just a rich person's game. It's not an activity that is only reserved for the ultra-wealthy. You don't have to be a CEO or a yacht owner in order for you to be eligible for investing. You can be a regular working Joe or Jane, and you can partake in various investment strategies to grow your money. The thing about investing is that there's always going to be the right investment strategy for you. It's just a matter of you studying up and learning more about who you are as an investor and what your best options are.

What Is Investing?

The basic definition of investing is the act of committing a certain amount of money toward a venture with the expectation that the value of that money will grow or appreciate over time. Contrary to popular belief, anyone is capable of investing as long as they are in relatively good and stable financial health. While this is a method of building wealth, it is not an activity that is only reserved for the wealthy. Rather, it is an activity for the wealthy-minded. There are all sorts of investment strategies and vehicles out there that can accommodate people of different backgrounds and economic classes. Everyone has an opportunity to grow their wealth through investing.

Most people typically get into investing as a means to accomplish certain financial goals. However, investing can also be considered as a safety net for the future in case of any financial emergencies that may arise. There are many ways in which a person's net worth can grow as a result of investing. Sometimes, it can come in the form of earnings or profits. It can also vary in terms of how much time and effort it demands. Some forms of investing will require constant management and oversight, like day trading. There are other forms of investing that are more passive in nature. While the ultimate goal of investing is to turn current financial assets into something more valuable in the future, there are many approaches that one can take to achieve this. There are certain levels of risk that are involved in investing, and one can find success through a variety of different platforms.

The Importance of Investing

If you are really interested in building your wealth, you need to learn how to invest your money wisely. Any failure on your part to capitalize on investment opportunities would be an awful waste of your financial potential. Of course, investments are risks. So, there's always a chance that you could lose money as a result of poor investments. That's why you always need to be smart about your investments. Regardless of the risk, the opportunity to earn money through smart investing makes it all worth it. If you need more incentives on why you should be investing, here they are:

You Create More Wealth

Why wouldn't you want to take an opportunity to grow your wealth? We have already talked about the benefits of increasing your income. You get better flexibility when you have a higher income. By investing your money, you are essentially creating more streams of income for yourself. This can be even more beneficial when you gain more knowledge about what your investment style is like and what your strengths are. As you develop your intuition and instincts for investments, it will be a lot easier for you to find additional sources of income.

You Grow Along With Inflation

We have already tackled the idea of inflation earlier in this book. If you keep a hundred dollars in your wallet for five years, it is not going to have the same spending power in the end as it originally did. There's a reason why you can't buy a quality meal for yourself at 50 cents anymore. It's because money inherently loses value over time. This is the entire idea behind inflation. So, instead of keeping that hundred dollars in your wallet, invest it. That way, the value of your money will keep on growing along with inflation. Even if you are scared of investing because of the risks involved, there are many low-risk strategies that are much better than just keeping your cash on hand.

You Secure Your Retirement

There are people who spend their entire lives working because they love what they do, and that's fine. If you genuinely enjoy your career, then you should pursue it for as long as you want. However, there are also people who work their entire lives, not out of desire but by sheer necessity. These are the kinds of people who, if they stop working, would be incapable of sustaining themselves and their lifestyles. Even though they might want to just retire and rest, they don't have that luxury. They need to keep on working in order to pay bills and put food on the table. Investing is a great way to protect yourself from ever being in that situation. There are various retirement funds and investment options that you could pour your money into for the sole purpose of retirement. If you invest your money in these areas, they will keep on growing more in value so that the money will be ready to serve you when you are ready to retire.

You Maximize the Potential of Your Money

A recurring theme that we have emphasized over and over again in this book is the idea of money being used as a tool. For most people, money is a tool that is used to satisfy certain needs, such as physiological needs, safety, security, and self-esteem. However, financially intelligent people know that money is not just a tool that's used for spending for the sake of acquiring things or partaking in experiences. Money can also be used as a tool to grow one's wealth and income. Any money that you earn always carries with it a certain potential. As a financially intelligent person, you should know that investing your money is one of the best ways to maximize its potential. If you spend your money on certain things, that’s fine. But you can’t expect to earn your money back if you indulge in a nice luxury bag or a sports car. On the other hand, if you invest your money, not only will you get it back, but you will have grown it substantially.

Risk Tolerance

The very first thing you need to do before you make any investments with your hard-earned money is to figure out your risk tolerance. Not all investments can guarantee returns. In fact, very few investments can guarantee high returns. Even fewer than that can guarantee high returns in short periods of time. There is always going to be a certain level of risk that is involved when it comes to investing your money. Given that, it is important that you figure out what kind of risk tolerance that you have so that you can develop an investment plan that is better suited to your goals and your personality.

Knowledge of your risk tolerance is crucial in you figuring out what your investment ideology is. One of the best things that you can do with investing is to stay consistent, especially when you have a solid game plan in place. Sometimes, deviating from a set plan will cause you to lose certain gains or slow the process of your financial growth. This is why knowledge of your risk tolerance is important. It helps you figure out your intuition and instincts when it comes to investing so that you are better able to make consistently sound decisions every time.

Factors That Influence Your Risk Tolerance

To put it simply, risk tolerance is a way to gauge how much an investor is willing to lose on any given investment. There are a number of different factors that can influence what kind of risk tolerance you have. You can always take tests online or seek the advice of seasoned professionals in trying to determine your own risk tolerance. But for the purposes of introspection, these factors will help you assess your own risk tolerance in a more systematic manner.

Investment Timeline

The first thing that you need to consider when assessing your risk tolerance is your investment timeline. When planning your investments, you have to decide how long you are going to want to keep investing and when you plan to reap the returns. For example, if you are in it for the long haul and you can afford to wait 20 years before getting your money back, then you have a little more wiggle room when it comes to risk. However, if you are looking to take back your investment after just five or ten years, then you have a smaller margin for error. Thus, it will be more difficult for you to take on riskier investments.

Financial Goals

Contrary to what most people may think, not all people are interested in investing just for the sake of earning money nonsensically. Sure, there are those who just want to find ways to grow their money without any particular target in mind. However, there are also those people who just want to invest their money, hit a certain number, and then get their investments back. Given people's financial aspirations, they can choose to either be aggressive or conservative with their investments, depending on which one would serve their goals better.

Liquidity

Then, there is the matter of liquidity. Some people are not as liquid enough as others when it comes to investing. Staying liquid means having as much access to immediate cash as possible. However, by investing cash into various opportunities, you are also diminishing your capacity to stay liquid. It might take a while before you can see returns on that cash, and in some cases, you might not even be able to get that money back at all. This is why liquidity is such an important factor. Usually, the more liquid you are, the higher your tolerance for risk.

Portfolio Size

Your risk tolerance for investing should also depend on the size of your portfolio. To put it simply, the smaller your portfolio, the lower your risk tolerance should be. If you are still starting to build your portfolio from scratch, it would be best to stick to safe and conservative investments that are practically guaranteed to yield positive results. Once you have a sizable portfolio, then you would have the luxury of being able to take more risks with your investments because you have more assets to play around with. This is not to say that beginner investors shouldn't be aggressive right at the start. It's just that it would be a lot safer to only be aggressive once you have built up a solid investment portfolio.

Comfort Level

Lastly, a lot of it has to do with your personality. At the end of the day, you are the one who will be making decisions since it is your money that's being put out there. If you have a strong and aggressive personality type and you have managed to find success in life so far because of the way that you are, you need to stay true to that. Your investment portfolio should essentially be an extension of your personality and your financial philosophy. If you are uncomfortable with certain investment decisions, it is unlikely that you will develop the consistency that you will need to master the market as you learn more about it.

Types of Risk Tolerance

Risk tolerance can be measured through a spectrum of different levels and ideologies. However, they can generally be boiled down to three categories: aggressive, moderate, and conservative.

Aggressive

An aggressive investor is someone who wants to establish a lot of control over the way that their investments move. They take a lot of time and energy out of their day to study market trends and understand how investments might flow up and down. These are also people who tend to have a deeper and more profound understanding of how stocks behave in a volatile market. This means that they are in a much better position to make precise trades and investments that will yield high returns in a relatively short amount of time. They understand that their moves in the market carry great risk, but they weigh that against their expertise and their capacity to yield high rewards.

Moderate

A moderate investor is someone who also likes to take an active role in studying the market, but they wouldn’t take as much time as the aggressive investor. They also tend to be people who are interested in expecting returns on their investments in the medium term (five to ten years). They also tend to be the types of investors who really like to balance out risky investments with safer and more secure ones. A typical approach of a moderate investor is to invest 50% of their investment capital into more aggressive funds and have another 50% in less risky securities.

Conservative

The conservative investor, as you may have already guessed, is someone who wants as minimal risk as possible with their investments. They might not care that they will not get to see maximal returns on their investments in a short period of time. They are more interested in just parking their investment capital in certain spots wherein they know that their funds are kept safe and secure at all times. They might opt for investing their money in money markets, bank certificates, and bonds.

Difference Between Risk Tolerance and Risk Capacity

Now, it is important to make a distinction between the ideas of risk tolerance and risk capacity. Essentially, risk tolerance has more to deal with your own personality and your philosophy toward investing. It's a measure of how much risk you are willing to take in order to execute a particular investment. However, there is also such a thing as risk capacity. If risk tolerance is a measure of how much risk you are willing to take, then risk capacity is a measure of how much risk you are actually capable of taking.

For instance, you might have aggressive risk tolerance. This means that you are willing to take on risky investments for the possibility of high returns. However, given your current financial situation, you have discovered that you are not very liquid and that it wouldn't be wise for you to make such risky bets in your investments. Hence, you will be forced to do something that goes against your risk tolerance just because it makes better sense to do so. It's important that you understand your risk capacity as well because it will force you to be wiser when implementing your risk tolerance. It also works the other way. If your risk capacity shows that you really do have some wiggle room for riskier investments, then you will have more confidence and conviction in taking these risks.

Common Investment Options

Get used to hearing advice about the diversification of your investments because this is a point that's going to be emphasized over and over again. You don't just want to pour all of your investment capital into one particular investment. You want to spread it across different investment instruments so that you minimize your risk in the long term. The manner in which you spread these funds depends entirely on you. Now, it is time to orient yourself on the different investment options that are available for you out there.

Equity or Stocks

You might already be familiar with the stock market at this point. But do you really have any idea of how stocks work and why a lot of investors seem to be so fond of it as an investment option? First, you have to be oriented on the stock market. Think of a stock market like any farmer's market that you would visit with your family during the weekends. At the market, you will find all sorts of food items, like fruits, vegetables, jams, bread, and others. The stock market is a lot like that, except that instead of shopping for food items, you are shopping for shares in companies.

Big companies will reach a point in their life cycle wherein they will require additional investments in order to scale and grow their businesses the way that they want. They can do this by having a round of investments for any potential investors in a private setting. Investors will pour their money into the company in exchange for a stake or share. This share will entitle them to a certain level of ownership over the company. The more money they invest, the higher their shares will be. However, when they feel like they've exhausted all private investment options, they can make the decision to have their companies publicly listed. Publicly listed companies will then be presented on the stock market for the general public to invest in. This means that anyone with adequate investment funds can buy a certain number of shares from these companies. When a company does well on the stock market, the value of shares from investors rises. There are certain companies on the stock market called *blue chips*, which have shown a proven and reliable history of growth. They are essentially the safest stocks to invest in because they are likely to sustain their growth over time.

However, it is also important to note that the stock market will experience occasional dips, and shares can also lose their value. This is especially true for companies that don’t have a proven track record in terms of their stock performance. This is where an investor’s risk tolerance comes in when determining which stocks to invest in and how much they would be willing to invest.

Mutual Funds

Mutual funds serve as a great investment option for those who don’t want to think too much about how to spread out their investment capital. A mutual fund is essentially a pool of funds from a number of different investors that’s professionally handled by a money manager. The money manager will essentially take these funds (the accumulation of investments from people like you and other investors) to invest in securities like stocks, bonds, and other financial market instruments. To put it simply, you and a bunch of other people are giving your money to one person so that they can decide on your behalf on how to invest this money and maximize its growth. Typically, these fund managers are incredibly smart and reliable when it comes to maximizing investments. This is a perfect investment option for those who are risk-averse and who don’t want to take the time to study the investment market for themselves.

Usually, people who are just starting out as investors can use mutual funds as a way to get their feet wet. By investing in mutual funds, you are already adhering to the principle of diversifying your portfolio by having the money managers invest your cash into stocks, bonds, and other securities. They are also relatively safer investments as long as you put your money in fund managers who have a proven track record and solid reputations in the industry.

Bonds

Bonds is also one of the safest investments that you could possibly make with your money. When you invest your money in bonds, you are essentially loaning that money out to corporations, government agencies, or any other type of organization under set terms that are designed to pay you off generously in the long run. Typically, these terms are structured in such a way that you get to earn interest payments regularly over a specified loan term along with the repayment of the principal bond. By investing in bonds, you are virtually acting as a lender. However, bonds tend to have a longer payoff time, and you shouldn’t be willing to invest in them if you want immediate returns on your money. Make sure that whatever you invest into your bonds is money that you are willing to part with and not see back for a long time. Bonds are still relatively on the safer side of the investment spectrum, and they are a great place to start for most novice investors.

Real Estate

Real estate is as good an investment as you could possibly ever make. If there's one thing that's for certain in the world of investment, it is that real estate will more than likely grow in value over the years. This is why, if you are capable, it would always be wise to invest your money in real estate assets, like apartments, houses, or lots. Of course, the obvious downside of investing in real estate is that it requires a sizable investment capital. Not everyone will have immediate access to cash to acquire a condo unit or a large piece of land.

There is a common tactic that some investors will try wherein they will attempt to secure a loan from a bank with the lowest interest rates possible in order to buy a house or a condo. They will then lease that condo out to prospective renters and have their rent profits fund the repayment of the initial loan to buy the house. If everything goes right, they will have bought the property without funding it themselves. However, many factors that go into this must be satisfied in order for the investment to pay off. But for the most part, investing in real estate is always a good option if you ever have the opportunity to do so.

Commodities

If you are familiar with pop culture, you would likely be aware of the economics surrounding hype culture. Manufacturers and brands will put out a limited number of products on the market in order to generate hype and demand around them. Due to the limited quantities, the hype surrounding these items cause their inherent values to spike up in the secondary markets. For example, a brand like Rolex will only be able to manufacture so many watches in the span of a year. Certain watch models that Rolex manufactures are considered to be hype models because of market demand.

Unfortunately, there is very little supply due to the manufacturing process of the Rolex brand. As a result, a watch that gets sold by Rolex at $10,000 will end up selling for as much as $25,000 on the secondary market. So, a person who invests $10,000 in a Rolex watch will be able to gain a $15,000 profit from selling it off to another person. This is all consistent with the principles of supply and demand. This is also the principle behind the idea of investing in commodities.

It is not just about luxury watches either. Investing in commodities like luxury designer pieces, art, sneakers, coins, stamps, vintage sports cars, and the like is a great way to turn a profit. Of course, there is a high amount of risk involved when it comes to the volatility of certain markets. There is a tendency for certain items to lose their hype and value over time. Also, usually, the purchasing of such items will require a substantial capital investment.

The Types of Stock Market Investment Styles

Again, there are many different approaches you can take to investing. There is not really any one-size-fits-all approach to investing. There are many factors to consider when it comes to choosing your investment style, such as your financial knowledge, goals, liquidity, and more. Just because a particular investment style works for you does not necessarily mean that it is going to work for others as well. As you navigate your way through the world of investments, you will come to develop a style of your own that might be a mix and match of many different styles. But for now, it might be a good idea for you to see the typical investment styles of people in finance.

Active Investing

The active style of investing is perfect for people who have a higher risk tolerance than others. Take note that all investments are risks, but there are certainly some investments that are a lot riskier than their alternatives. Also, it is important to note that you should only ever consider being an active investor if you have a lot of liquidity to play with. You should make sure that you are not in debt, and you should be okay with parting with the money that you use to invest. Due to the high-risk nature of these investments, you shouldn't be using money that is supposed to be for paying off debts, utilities, or other essentials. Also, active investing is going to require a lot of time and focus. You will have to spend a copious amount of time studying market trends so that you can make the right investments at the ideal time. Also, with active investments, you are not as focused on the long-term gains as you are on the short-term profits.

Passive Investing

Passive investing is for people who just want to play it safe when it comes to investing their money. Also, if you don't fancy staring at computer screens all day as you study market trends, then this is definitely the type of investment style for you. Typically, you would just be funneling your desired investment funds into various assets at a regular rate in the hopes that the values will grow in the long term. Also, with passive investing, you should be using money that is only purposefully allocated for long-term growth. Due to the low-risk nature of these investments, you shouldn't be expecting high returns immediately. It's going to take substantial time for these kinds of investments to grow.

Buy and Hold

When it comes to the stock market, there are two usual types of passive investing. The first is the buy-and-hold method. This is essentially when you buy blue-chip stocks and hold on to them for as long as you can. Blue chips are essentially companies that have proven to perform well in the stock market. They are the best-performing companies and the safest investments you can make. A person who engages in this method of investing will rarely ever sell off any of their equity because they know that it will just continue to grow in the long term.

Indexing

Another kind of passive investing in the stock market is indexing. This is when an investor develops a stock portfolio that is designed to mirror the stock index. A stock index is a financial market that is used to measure the performance of a particular stock market. Essentially, it displays all the prominent stocks of a certain market from varying industries in order to give a general idea of the performance of the market as a whole. People who use indexing as a way to invest are generally those who don’t want to spend too much time researching individual stocks. So, they defer to the expertise of the index to guide them through their investments.

Growth

Like the active investor, a growth investor is someone who keeps an eye on companies that are trending in terms of their growing valuations. Every so often, due to a number of different reasons, certain stocks will outperform others and show some serious promise in terms of growth. For example, in a time of a pandemic where everyone is forced to stay at home in quarantine, there is a high demand for video messaging platforms. So, companies that do well in providing such a service will also likely experience a rise in their stock. A growth investor will try to spot these developing trends and invest immediately. They ride that wave of growth even when the company has shown little to no prior history of sustaining such growth.

Value

On the other hand, there is the value investor, who does not ride hype trains when it comes to investments. Growth investors rely on hype in order for certain companies’ stock prices to skyrocket in an extraordinary way. However, the value investor has a more savvy eye toward companies that are proven to deliver great results in the stock market but are somehow currently undervalued. Sometimes, certain companies will underperform in the stock market for a number of different reasons. However, these same companies have shown a solid track record of always increasing their value over time. Value traders will seek these companies out and buy them when their prices are at the lowest in anticipation of when they begin to rise again.

Market Capitalization

Market capitalization is a style of investing that is influenced purely by the size of any given company. One would be able to compute the market capitalization (or *market cap*) of a company by multiplying its number of shares outstanding by the value of earnings per share. There are typically three different cap categories that carry different levels of risks and potential rewards.

Small-cap companies have a market cap of around $300 million to $2 billion. They are generally the riskier type of investment due to the volatile nature of their stocks. However, since their stock performances are so volatile, there is also a chance that you can score big with their returns.

Mid-cap companies have a market cap of $2 billion to $10 billion and are relatively safer than small-cap companies. But they are still prone to the occasional spell of high losses or returns.

The safest investment you could make based on market caps are the big-cap companies. They are those that have a market cap of more than $10 billion and tend to perform well almost every single time. However, they also yield the lowest returns out of the three.

Diversification

The last stock investment style is diversification. Think of yourself as a business owner who has a ton of money to play with. So, you decide to invest in a restaurant, flower shop, construction company, real estate brokerage, tech company, shipping company, events planning agency, and a manufacturing firm. Then, suddenly, the housing bubble bursts, and people are struggling to make payments for homes. Given that economic trend, it is likely that your construction company and real estate brokerage will not be doing so well. However, since you have such a diverse investment portfolio, you still have other businesses that are performing relatively well and are still supplying you with a modest income. That's essentially what diversification is in the stock market as well. You would invest in as diverse a pool of stocks as possible. This way, any underperforming stock is likely to be compensated by another stock in another industry that's doing much better. Essentially, this is the stock market equivalent of not putting all of your eggs in one basket.

Things to Keep in Mind When Investing

Diving into the world of investments can be a very exciting and exhilarating period in your financial life. It will feel as if new doors of opportunity are presenting themselves to you every day in the form of potential investments. Given that, it can be so easy to get swept up in the hysteria of all that potential to the point that you might be prone to making decisions that are not financially sound. This chapter has taught you the basic principles and vehicles through which you can make your investments. However, what this chapter can't do is make those actual investments for you.

Whether you are just starting out with your investment portfolio or you need a quick refresher on basic principles, this chapter will help reinforce certain tips that you need to keep at the back of your mind at all times when investing. You must always put yourself in the best position to make an informed decision with any investment that you partake in.

Develop a Plan and Stick to It

Always invest with a purpose. Never go about investing nonsensically or whimsically. Before you even make your first investment, you need to develop a financial roadmap for yourself. Know what your goals are, what your timeline is, and what resources you have to work with. From there, you can start to plot the steps toward eventually achieving your goals. Developing a plan will also help you in times when you will be forced to make hard decisions with your investments. It will be a lot easier to know what to do if you already have the desired outcome in mind as a result of your planning and preparation.

Evaluate Your Risk Tolerance

Think of your risk tolerance as an integral aspect of your investment personality. When making certain investments, you have to set reasonable expectations relative to the risks that are involved. You can't expect some low-risk investments to yield high returns in a short amount of time. At the same time, you can't expect high-risk investments to always work out the way that you want them to. Evaluating your risk tolerance will help you set more realistic expectations and better align your investing decisions with your overall financial plans.

Don't Put All Your Eggs in One Basket

Diversify your investments. Protect yourself against potential losses by investing in different categories that could move up or down at any given time. There's no way that you could ever predict the future performance of your investments. Some of them may experience some steep climbs, while others can also go through some heavy declines. The best way you can protect yourself from the damage of an underperforming investment is to have other investments in the works that can compensate. So, even though one particular investment is not doing so well, you are still coming out ahead because of strategic diversification.

Make Sure You Always Stay Liquid While Investing

Here's a general tip that you want to keep in mind whenever you are investing: consider any money that you invest as money lost. Make sure that whatever cash you devote to certain investments—no matter how safe or low-risk they might be—is cash that you will not need in the immediate future. Invest this money with the knowledge that it will take you years or maybe even decades before you will see that money again. This is why it is always best to build a sizable emergency fund for yourself before you start investing. This way, you always have access to a modest amount of cash to keep you afloat in case you ever need it.

Try Dollar Cost Averaging

Dollar-cost averaging is a popular investment plan, especially among those who don't want to spend too much time looking at the market and studying trends. To do dollar-cost averaging, an investor would have to specify a certain investment amount that is paid in regular intervals to specific and targeted assets. The principle behind this method is that the constant influx of investment will be enough to reduce the impact of a volatile market where an asset's value can go up and down in drastic ways. This method of investing is most suited toward long-term investors who are looking more for capital gains over a long period of time as opposed to those who want short-term returns. This is also the safest way to protect your investment over time.

Don't Give in to Fraudulent Investments

If it seems too good to be true, then it is. There are loads of different scam artists out there who are willing to prey on those who don't know any better. It is always best that you protect yourself from people who make you lofty promises with seemingly minimal risk. Earning money is not supposed to be easy. And if it is too easy, then it is probably cheating. If you do end up getting scammed, at best, you will have just lost some money. At worst, you could end up being an accessory to a crime and might be subject to certain legal repercussions.

Chapter 8: Crucial Money Mistakes

Throughout this book, we have talked a lot about things you should be doing regarding your finances. You have learned about the importance of developing your financial intelligence and what kind of role your mindset and psychology will play in determining the health of your finances. You have learned about the value of knowing your net worth and figuring out what your financial goals for the future might be. You have also been dealt with a lot of knowledge on how you can supplement your income and how you can set yourself up for eventual financial security through saving and budgeting. We have also talked about how it is possible to come back from being stuck under piles of debt and how we can better utilize our money through wise investments. You have learned so much about everything that you should do with your finances. Now, it is time to talk about the things that you shouldn't be doing.

A lot of the content in this chapter will be lessons that we have already tackled so far in this book. However, even the most financially savvy people in the world are still prone to making money mistakes, especially when they are not mindful of them. This chapter will highlight the essential mistakes you need to keep an eye out for. At the end of the day, no one is going to be able to police you with regard to your finances. This is something that you are going to have to do on your own. It is not always easy maintaining the discipline required to achieve financial freedom and security. Sometimes, you just need a good old reminder of the things that you should look to avoid as you navigate your finances.

Here are some reminders of crucial mistakes that a financially intelligent person would never commit:

You Don't Have an Emergency Fund

An emergency fund is essentially the first step to being a financially responsible adult. Failing to establish an emergency fund would be the biggest mistake you could ever make in finance. An emergency fund is there to serve as a safety net for you if you ever go through rough patches or hard times. An emergency fund will offer you peace of mind, along with the safety and security to venture out and grow your finances on your own. A lot of people will be so eager to invest the money that they earn out of sheer excitement. That's fine, but you shouldn't forget to invest in an emergency fund first.

You Ignore Debt Problems

Debt can kill your finances if you are not careful. It does not matter how savvy you are with your investments or how skilled you are at upping your income. If you ignore paying off your debts, you will never find yourself in good financial health. A lot of people will make the mistake of ignoring their debt problems in the hopes that they will resolve themselves on their own. Unfortunately, that’s just not how debt works. Don’t make the mistake of thinking that a miracle is going to fall into your lap and eliminate all debt for you. You must establish a game plan to pay off your debts and work at achieving it.

You Don’t Stick to a Budget

Budget plans are crucial to determining your financial success. They serve as the little blueprints to whether or not you will achieve your goals. Ultimately, failure to adhere to a budget plan would render any goals or aspirations that you have moot. They would be practically irrelevant. Remember that the only way you can manifest your dreams into reality is if you make things happen. If you don’t stick to your budget, you are making it harder on yourself to turn those dreams into reality.

You Don’t Invest in Insurance

A lot of people will think of insurance as an unnecessary expense. But if you ask anyone who has ever been in a car accident or has had their home catch fire on whether they want insurance or not, the answer would always be a quick yes. It’s true that insurance payments can be heavy on the pocket. But you have to look at it through another lens. Insurance is essentially self-protection. It’s another form of emergency savings. You’re going to end up paying so much more money if a disaster strikes and you are not insured for it. Worst-case scenario, if something bad happens to you and you don’t have life insurance, your loved ones will have to bear that financial burden of your loss. Try to find insurance plans that have an investment aspect to them. That way, you still know that your money is growing and working for you.

You Don’t Have a Savings Plan

Having a savings plan in place is crucial for two reasons. First, you need to have savings in order to pay off expenses. These are necessary expenses that are a natural part of your life. You need to have money saved up to pay for housing, transportation, education, groceries, utilities, and whatnot. If you don’t have a savings plan in place for such expenses, then you might find yourself surprised at not being able to pay for them when the time comes. Savings are also crucial for retirement. You can’t expect to keep on working forever. You need a saving plan in place that can fuel your investments for your retirement from work.

You Partake in Lifestyle Inflation

Just because things start getting better with your finances does not mean that you should also be upgrading your lifestyle along with it. Of course, you want to put your money to use by investing it in things that bring you joy and happiness. However, you still have to do so responsibly. You don't want to earn a lot of money and put yourself in good financial shape just to end up losing it all by doing the things that you are not supposed to be doing, to begin with. It's okay to upgrade your lifestyle in moderation and within reason, but for the most part, you should try to live modestly so that you don't become susceptible to losing all of your money on senseless things and experiences.

You Don’t Talk About Finances With a Partner

Many couples refrain from talking about their finances because they think that it is some kind of taboo topic. People get really touchy and uncomfortable when discussing income, savings, and other financial matters. That’s fine if you are engaged in a casual relationship with someone. That shouldn’t really matter. But if you are going to get into an intimate and committed relationship with someone, then you really need to discuss your finances. This is crucial not just to the individual state of your finances but also to your relationship as a whole. You should always be free to discuss money with each other if you are in an intimate relationship.

You Settle for Only One Source of Income

Relying merely on your day job for all of your income would be a waste of your earning potential. More than that, there is an added layer of insecurity in knowing that you practically lose all of your income if you lose your job. By diversifying your income streams, you wouldn't just be increasing your capacity to earn, but you would also be protecting yourself in the event that one of those income streams happens to go bust. You don't have to pressure yourself to establish income streams in all ways possible. Even having just two or three can prove to be quite beneficial.

You Partake in Impulse Purchases

Regardless of whether you have a lot of money or not, you need to avoid partaking in impulse purchases as much as possible. There will be times when you will come across something at the mall or in a store and think that you need it. It could be something small like a nice pair of shoes or something more expensive like a shiny pair of diamond earrings. Whatever the case, these are items that you never intend on purchasing but they just happen to catch your attention. You must stay disciplined and avoid purchasing them on the spot. Wait it out a couple of days. If possible, wait for a couple of weeks. If you still want it after that time period, then check your finances to see if you can afford it.

Chapter 9:
The Ultimate Steps to Financial Independence

We have finally reached the end of the line—the ultimate chapter of the book. You might be feeling overwhelmed with everything that you have learned so far. Granted, money is not necessarily something that you can learn all about in a day, and it can take a lifetime to master it. Fortunately, this book will always be there for you should you ever need a quick refresher or two about certain financial concepts. Also, feel free to indulge in other resources for any supplementary information or alternative points of view. After all, this book can only cover so much without it dragging on and on endlessly.

The final chapter of this book will be a basic rehashing of all the major principles discussed here so far. Essentially, these are all the major steps that you need to take as you work your way toward achieving true financial freedom. This is a goal that many people set for themselves for a number of different reasons. When you achieve financial freedom, it can bring a certain sense of peace and calmness, not just with your current state but also with the state of your future. While too many people do fail to achieve financial freedom in their lifetimes, that does not have to be your fate. Below are the ultimate steps that you need to take in order for you to achieve financial freedom.

Know Where You Are and Where You Want to Go

The very first step you need to take to achieve financial freedom is to know where you are and where you want to go. Knowing where you are means familiarizing yourself with your current financial situation and philosophy. You have to know what tools you have to work with and what financial state you might currently be in. Then, you have to figure out where you want to go financially. How rich do you want to become? At what age do you want to retire? By when do you want to eliminate your debt? What earliest possible age can you start investing? These are some questions that you should answer to help determine your best path forward.

Invest in Learning High-Income Skills

You can’t let your money work for you unless you have money to play with. You can’t pay off any of your debts unless you have money coming in. This is why it is crucial that you always find ways to increase your income. We already talked about how it is essential for you to diversify your income streams. However, that wouldn’t really be possible if you don’t have any skills that would give you the capacity to do so. You should take some time and other resources you have to invest in your learning and development of high-income skills. The more skilled you are, the bigger your potential to earn. Here are some examples of high-income skills:

- Writing
- Content creation
- Marketing
- Graphic design
- Coding/programming
- Web design and development
- Social media marketing
- Financial management
- Stock trading

If possible, don’t limit yourself to just one skill, either. If you diversify your skillset, it will become easier for you to diversify your income streams as well.

Commit to Living Within Your Means

In other words, stick to the budget plan. If you did the first two steps correctly, then you would already know the state of your finances. Moreover, you would also know what your financial goals are and what steps you need to take in order to achieve them. Lastly, you would also be equipped with the skills that are necessary to earn you a decent income. Now, it is just a matter of committing yourself to a lifestyle of frugality and practicality. If you are still struggling to build your wealth, then you don’t have the luxury of being luxurious. Live a frugal lifestyle by always acting as if you could lose your money at any given moment. A budget plan is set in place to make sure that you never go spending beyond your means. Commit to that plan and trust that it will all pay off for you in the end.

Pay Your Debts and Then Pay Yourself

If you have any debts, pay them. Make sure that you get them out of the way so that you don’t get bogged down by interest rates and penalty fees. These are little nuisances that will keep you from achieving your financial goals quickly and efficiently. However, if you have a little wiggle room, it is also important that you pay yourself by pouring money into a savings account. You need to keep a modest savings fund to help you pay off expenses and future investments. You can’t grow money that you don’t have. By committing to not living paycheck to paycheck, you are putting yourself in a much better position to achieve financial success.

Keep Track of Your Spending

Always track your spending. Don't make the mistake of thinking that just because you have money, you now have the luxury of being lackadaisical with your finances. Even the biggest companies in the world will pay top-tier money to hire the best people to manage their finances for them. It's this kind of attention to detail that will help you not just attain your wealth but also retain it for the long haul. Regardless of whether you use a classic financial diary or some kind of budgeting app on your smartphone, it is imperative that you always find ways to stay on top of your spending habits.

Develop a Strong Investment Plan

You shouldn't be wasting too much time before you start investing. Once you are financially capable of doing so, you need to develop a strong investment plan and stick to it. Of course, if you are still dealing with getting out of debt, then that's fine. You should put all of your focus and energy toward paying off your debt and rebuilding your emergency fund. However, once you have gotten your debts and emergency fund out of the way, don't waste any time before investing. The sooner you invest, the higher the value of your money will end up becoming in the long run. When it comes to money, you are competing with time and inflation. You can beat these things by investing your money in high-interest or high-return investment instruments.

Seek the Help and Advice of Financial Experts

If possible, learn the secrets of the trade from the people around you. There are plenty of financial advisors out there who would be more than willing to help you grow your money. If you don't want to resort to paying for financial advice, then you can always go to trusted friends and colleagues who can give you casual advice on how to manage your money. At the end of the day, you can only learn so much on your own. There is a lot more to be learned from the experiences and trials of others. You just need to take the time to seek them out and learn more about their insights so that you get an added dose of perspective to your life. In fact, if you can find yourself a trusted mentor who can help guide you throughout the entire process, then that would be ideal.

Never Stop Learning

In connection with the previously listed step, you should never stop learning. Again, finance is always going to be a learning process. Just because you have read this book does not mean that you already know all that there is to know about the world of finance, saving, and investing. In this age of information, knowledge is as accessible as ever before. You can learn so many more insights and perspectives on financial intelligence from other sources. Yes, this book is a great place to start, but it shouldn’t be where it ends either. When it comes to developing your financial intelligence, it is important that you adopt a learner’s mindset. This will enable you to keep on learning and expanding your knowledge as you develop your financial instincts.

Conclusion

There you have it. That's the psychology of money. If you didn't trust that money was more about mindset than it was about mathematics when you first started this book, then hopefully, you are singing a different tune now. But more importantly, you should have a much better relationship with your finances at this point. It does not matter whether you are in great financial shape or you are struggling to pay off your debts. The principles highlighted in this book are designed to help you improve your finances, regardless of your situation.

Money is a tricky matter because it is such a polarizing subject for a lot of people. Some don't want to discuss money because they don't want to be seen as materialistic or shallow. Then, there are also those people who don't want to discuss finances because they literally don't know much about it. It's high time that people have more wholesome views of how important finances are in people's lives. Everyone should learn to be more comfortable talking about money so that they all get an opportunity to learn about the best practices from one another.

Hopefully, this book will have served as a valuable asset and addition to that global conversation surrounding finances. Even if this book manages to get you to talk to at least one other person about money so that you can learn from each other, then this book has done its job. Of course, this author also hopes that you will have improved the state of the finances in your life as a result of the ideas and concepts discussed in this book. Ultimately, that's the whole point of reading books like these in the first place. It's so you can gather perspective and knowledge on a topic that you may know nothing about and come out on the other end with newfound confidence and authority in the matter.

Again, it was mentioned earlier that you should never stop having that learner’s mindset. This book shouldn’t be where your journey ends. Go out and put to practice everything that you have learned so far. Figure out your investing style. Learn about your risk appetite and tolerance. Work on your skills to turn yourself into a more valuable member of the workforce. Increase your income and diversify your investment portfolio. Build your emergency fund and start saving up for retirement. But most of all, put your money to good use. Money in itself has no real value unless you put it to good use. So, invest in things and experiences that bring you joy and fulfillment. Put your money in places where you know it can help you live a fuller and happier life in the future. Use that money to enrich yourself and all of the people around you. Your money is only as good as how you intend to use it.

This book may have equipped you with the know-how on earning, protecting, and growing your money. But only you can define whatever purpose you want to assign your money to. One can only hope that you use that money for noble and life-enriching purposes. At the end of the day, while money is important, many other things in life are much more valuable.

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