# 3 STEPS
## To Financial Freedom

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# 1. Introduction

I've been a financial planner for nearly 17 years at the point of writing this little eBook. In that time I have learned lots of technical things about money, obviously, and I've gained experience in applying that information to the real-life circumstances of my clients.

But surprisingly (to me at least), I have found that I have learned as much from my clients as they have from me. Over the years I have observed the habits that they have adopted in order to get to where they are now. Most of them are financially free, by which I mean, they no longer need to work to pay for their lifestyle. They have amassed enough money to be comfortable for the rest of their lives and to enjoy giving to their children or their favourite charities.

I'm not there yet; far from it. Regular listeners to the podcast will know that I struggle sometimes with the discipline needed to be financially successful. But I am getting there, and striving to be better each day.

So this little book is not a sermon aimed at you. Instead it is an aide memoir of the things I need to remember as I journey through my own financial plan. Hopefully they'll be of use to you too. These three steps are the distillation of all I have learned about the necessary elements of financial success. They are bullet points, that's all, but I will put some flesh on the bones as I go along. If you and I can get these three things right consistently over a period of years, I can guarantee financial success will follow, as sure as night follows day.

# 2. Simple is best

If there is one thing that the financial services industry excels at across the world, it is over-complicating things.

Insurance companies, investment houses and financial advisers have all done their best over the centuries to use technical jargon and lengthy terms and conditions to confuse all but the most analytical of minds. I sometimes wonder how and why this has happened. I'm fairly sure the only people this smoke-and-mirrors approach really serves are the industry insiders themselves, who can hide behind the lengthy Ts and Cs when the time comes to pay out a claim.

But perhaps I am being cynical. Financial Services is a heavily regulated industry, and rightly so. But this regulation does bring with it a burden of compliance which can sometimes do an excellent job of hiding the wood amongst the tightly-worded trees.

If something is going to be memorable and easily applicable, simple is best. It's the reason mnemonics are so powerful in helping us remember things. I bet you can remember plenty of things you learned at school using daft memory tricks. For example, I can remember that Some Old Harvesters Can Always Have Tankards Of Ale - SOHCAHTOA. That helps me remember that Sine is Opposite over Hypotenuse, Cosine is Adjacent over Hypotenuse and Tangent is Opposite over Adjacent. Which is handy, because I have never had to measure Sin, Cos or Tan since leaving school.

Reducing things to simple principles makes them easy to remember, but provides a springboard from which to jump into as much detail as you want or need. My three steps are the raw basics of financial planning. They encompass everything you need to know and everything you need to do, but without the level of detail that can get in the way sometimes. These three steps are all you need, really, but I will put on a bit of detail as we go along.

So let me introduce you to my three bullet point steps, for which I have created a little logo which you'll find throughout this book. Here it is:

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Make sense? I like it, and you'll be seeing it quite a lot on the website, in video and in lots of other things over the coming months. Exciting!

But enough self-congratulation - let's look at the three steps now.

NEXT: Step One - Budget

# Budget: Spend Less Than You Earn

The first of our three steps is easy to say, but not so easy to do. That's true of many things in life, wouldn't you say? I know I should eat fewer carbs and exercise more, but there is often a disconnect between speaking the truth and doing it.

Spending less than we earn is a discipline. In order to do it, we have to be intentional about what we spend our money on, or more truthfully, what we don't spend it on. There are plenty of shiny things vying for their share of our wallet, and plenty of human necessities too. Those of us fortunate enough to have so-called disposable income are used to stopping off for an overpriced coffee from CostaBucks, or getting takeaways when we could cook something for a tenth of the cost.

And life is for living, don't get me wrong. Being a puritan when it comes to spending doesn't turn me on. I do like to enjoy things, but when we need to get into debt to enjoy those things we have a problem.

When I was a student, I used to close my eyes whenever I went to take out money from a cash machine, simply because I had no idea whether it would give me any money or not! I never tracked my bank balance or kept an eye on what I spent. My friend Dave, on the other hand, wrote down every penny he spent and ended his first year at university with enough money to buy a complete set of cymbals. He was the drummer in our college band, the awesome 2nd Nature. My wife bought a 14" portable TV with money she didn't spend while at university. That TV was a fixture in our lounge for the first few years we were married!

I had no cymbals or TV. I had debt with nothing much to show for it.

We must be intentional if we are to spend less than we earn. The name of this process is a verb that strikes fear and boredom into many that hear it: budgeting.

The process of budgeting isn't fun necessarily, but neither does it have to be tedious or terrifying. Essentially it comes down to two things:

- Starting each month or each week by deciding where each pound is going to be spent that month
- Tracking progress to make sure reality matches the intention.

For years I thought I was budgeting when in fact, all I was doing was tracking where my money **had gone** - past tense. This was far less useful than planning where it was **to go** - future tense. I could tell you to the penny what we had spent on fuel or food, but we never set out with a plan for what those figures should be.

Budgeting should be forward-looking. This might not sound like a revelation, but it was a light-bulb, forehead-slapping moment for me. So now we (that's Jo and I) sit down at the top of the month and plan the month ahead. What birthdays are coming up and how much will we spend? Do we have any nights out planned? If so, what will they cost? What about jobs that need doing round the house? Do we have to buy paint or sandpaper or doorhandles?

Our bills are allowed for first, usually paid by direct debit and are paid out of a different bank account from our spending money. This makes things tidy and easy to manage. There's no sense in budgeting a value which is the same each month, like an electricity direct debit payment or house insurance. So we just budget of rate variable items like food, fuel, kids' expenses, nights out (rare), birthdays and Christmas, things like that.

Annual bills are budgeted for monthly, so the cost is divided by 12 and that amount saved each month into yet another account. To get ahead on this, divide the figure by ten instead.

As we go though the month, we sit down for ten minutes each week and see how we're doing against the plan. If something unexpected has happened, like some maintenance on the car, then we may have to adjust the budget. We don't go outside the agreed budget without consulting with each other first. This puts in place a check against rash, impulse purchases, and keeps us accountable to each other. If you're on your own, try to stick to a 'sleep on it' rule, rather than blowing the budget on an impulse buy.

The last thing to say about budgeting at this point is that we try to pay ourselves first. That means that before we allow for bills, and before we allow for our monthly variable expenditure, we put in an amount we would like to save. It doesn't always happen. Sometimes those unexpected things mean we can't save in one given month, but again, it is all about being intentional. If you have debt (other than a mortgage which is a bill, rather than a debt) then this should be the first priority.

Spending less than you earn, then, can be distilled to these steps:

- Plan the month in advance
- Pay yourself first (savings or debt repayments)
- Pay standing orders and direct debits next
- Budget what is left, to the last penny
- Keep track of your actual spending throughout the month

Once you're in a rhythm of doing this, it takes half an hour at the top of the month and then 10 minutes a week to stay on top of it. The benefits are significant though. You will never, ever be rich if you spend more than is coming in every month. But if you can master this most basic of financial planning skills, the future is bright indeed.

NEXT: Step Two - Protect

# Protect: Insure Against Disaster

There's a bible story about the wise man building his house upon rock. When the storms came, his house stood firm. The foolish man, by contrast, built his house on sand and when the storms came, his house was washed away. I'm fairly sure that Jesus wasn't relating his story to architectural principles, and neither was he talking about financial planning, but I'll exercise some licence here and apply this principle to your financial well-being.

We all like to dream about maybe one day being rich. Very few of us will inherit a fortune or win the lottery, but with careful planning and diligent discipline, we can all be financially free.

This is all predicated on our plans panning out as we dream them, and too often those plans are derailed by some event that we can do nothing about - the storms arrive.

Think about it: Your ability to save into pensions, ISAs and savings accounts is entirely dependent on you earning an income and saving some of that money. But what if that income is taken away? What if you or the main breadwinner in the house is killed or disabled by accident or injury?

Your health and ability to earn an income is the firm foundation on which your future wealth is built. And that foundation needs to be reinforced against the storms, and for that, you need insurance.

Insurance is a funny thing. We pay it, hoping we never need it. Sometimes we gripe about the price of it, but when we need to claim, we are very glad we have it.

Insurance is designed to get us back into something like the position we were in before the insured event happened.

Obviously, **Life Insurance** doesn't have the power to resuscitate us if we're dead, but it can go some way towards replacing the money we won't be earning when we're six feet under.

**Critical Illness Insurance** pays out if we're diagnosed with something nasty. These are life-changing illnesses like cancer, heart attack, stroke, Motor Neurone Disease or Multiple Sclerosis. Often these things won't kill us, but they will likely mean an extended period off work. Sometimes our house may need alteration for wheelchair access after an accident. Critical Illness is more likely to pay out than life insurance, which makes it more expensive, but it should be considered an essential, particularly if you have a large debt like a mortgage.

The final major type of protection that concerns us now is **Income Protection Insurance**, sometimes called permanent health insurance. This is designed to replace most of your income if you can no longer earn it. So even if your illness isn't critical, if you can't work, an income protection policy will pay a regular tax-free payment into your bank account until you are able to return work or until the end of the policy, whichever comes first.

Deciding how much insurance you need is a bit like deciding on the length of a piece of string. You should make sure any debts can be paid off if you were to die. If you have a major debt, like a mortgage, you should ideally have that paid off in the event of a critical illness. At the very least, you should think about insuring yourself for three, four or five years' worth of mortgage payments, to give yourself a breathing space if the unthinkable happens.

Depending on your sick benefits from work, you should consider income protection too, an try to build up emergency fund to cushion yourself against the immediate effects of disaster.

Every situation is different. Someone with large debts and a young family needs more life insurance than a singleton with no debts or responsibility, who probably doesn't need any. But that singleton should ask how he or she would cope if they were unable to work for an extended period of time and consider income protection.

Insurance is a firm foundation on which to build a future worth getting excited about. It is like a very sturdy nail, securing the proverbial rug to the floorboards, so it can't be pulled from under you. It can seem like money for nothing, but can be worth its weight when the worst happens.

NEXT: Step Three - Invest Wisely

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# Invest Wisely

Having mastered budgeting and insured ourselves against disaster, we can turn our attention to the future and begin to build that future for ourselves. Those two words, “invest wisely” are so simple, but cover a huge array of choices of investments, tax wrappers, providers, costs, asset classes and methods of investing .

For most of us, the good news is that our investment regime should be very simple. Essentially it comes down to three things:

- Spread your money around
- Keep costs (including tax) to a minimum
- Keep an eye on things

## Spread your money around

Your granny always told you not to keep all your eggs in one basket. Then you reminded her that no-one keeps eggs in baskets anymore, instead they use those cardboard boxes that double as soundproofing. She clipped you round the ear and told you not to be such a smart-alec. What? Oh, just me then...

Eggs, money, whatever. The point is that if you spread money around, the impact of one thing going wrong won’t massively impact your whole financial plan. I’ll resort to a pre-school-level analogy here if I may.

If you invest all your money in umbrella shares and we have a boiling hot summer, your money won't do very well because no one is buying umbrellas. If the weather is wet, then you'll do well. If on the other hand you invest all your money in ice-cream shares and the weather is sunny, you'll do well; but if it is wet, not so much. Invest half your money in each, then you should make some money whatever the weather.

The same goes for banks, asset classes like shares and bonds, and areas of the world. You should spread your money widely to avoid the risk of putting too much in one place that performs poorly.

How much you should put where is the subject of thousands of pages of research over many decades, and depends very much on your tolerance for risk, your timescale and about a million other variables.

### Keep costs (including tax) to a minimum

One of the biggest miracles of life is the miracle of compound interest. Every pound or dollar or yen that is created by an investment portfolio and which is ploughed back in is working for you again. It will create more pounds or dollars or yen which are themselves put back in, and begin creating their own pounds or dollars or yen. Phew. This creates a snowball of money that grows and grows - excellent news.

Conversely, every pound, dollar or yen which is spent in charges is NOT compounding in this way. Needless to say then, that you should keep costs to an absolute minimum.

This includes tax. Every pound, dollar or yen (I'm going to stop this now) is instead working for the government, and compounding for them rather than you. I'm guessing you don't like the idea of this any more than I do, so you should use all the available tax reliefs, wrappers and allowances to reduce your tax burden to a minimum.

These are always changing and keeping on top of them can be a pain. It's the job of a professional adviser to do just that of course, but for those of you who want to do this yourself, keep an eye on MeaningfulMoney to keep abreast of changes as they happen.

### Keep an eye on things

Speaking of keeping an eye on things, that goes for all aspects of your investing. It's been fairly well proven, at least anecdotally and in my own experience, that any portfolio set up and then left to its own devices will underperform an equivalent portfolio which is reviewed and updated regularly.

Think about this. Let's say you set up a portfolio of £200 which is half invested in shares and the other half in bonds. If shares double in value and bonds halve in value, you have a portfolio of £250. Not a bad return, I know. But now you have a portfolio which is heavily skewed in favour of shares. 80% of it is now held in shares, so instead of a balanced portfolio, you have ended up with an adventurous one.

That's only a theoretical problem until shares go south and bonds do well. Now you're heavily exposed to the weaker performing asset and don't have enough of the balancing asset.

If instead you had kept the balance of your portfolio at roughly 50:50 as you had gone along, taking profits from the shares and buying more bonds as their price fell, you would have maintained the balance nicely, and been better placed when bonds rose.

This process is called rebalancing and is part of the discipline of investing. The detail of this is more than we have space for here, but the point is that unless you keep an eye on your portfolio at regular intervals, you may suddenly find yourself with money which behaves erratically.

Circumstances, and not just market movements can make it necessary to review things too. A job change, a sudden illness, an inheritance - any one of a thousand different life events can mean a change of tack for your investments. Stay on your toes, hang loose and keep an eye on things.

To be sure, "Invest Wisely" is a very short phrase to cover a lot of depth of information and practice.

NEXT: Getting Started

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# Getting Started

So then: three little steps, that's all.

Obviously that isn't all, not really. Each of the three steps involves more or less detail depending on your own circumstances. But we can't do it all at once, so how do you and I get started on this journey of financial self-determination?

The three steps are in order. You need to master spending less than you earn first. With that, comes the money to put in place an insurance foundation on which you can begin building your future with your disposable income. Budget. Protect. Invest. In that order.

There is no sense in investing first, and then having your hard work wiped out by a sudden and catastrophic illness. And you won't get anywhere without the money free every month to put aside in any case.

Budget. Protect. Invest. In that order. Have I said that already?

If you have already mastered budgeting and have all the insurance you need, then yes, you can begin investing and saving in earnest. We're all at different points in the journey. You need to master all three to succeed over the long term, but you have to begin where you are!

In the next and final section, I'll put some links to other MeaningfulMoney resources to enable you to get going on each of the three steps. I plan to build further on the three steps throughout 2015 both in the podcast, in video and in lots of other ways, so stay tuned.

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# Resources & Links

Over the past five years of making videos and podcasts for Meaningful Money, I've covered each of the three steps in some detail, as you can imagine. Below I have collated some useful resources to add some meat to the bones of what is contained in this little eBook.

**Step One: Budget**

**Videos:**

Episode 187 - Essential Cashflow

Episode 189 - Cashflow II: Budgeting Tips

Episode 235 - How To Budget: The Key To Financial Success

Episode 236 - A Budget Example

**Podcasts:**

Session 3 - How To Budget

Session 4 - Five steps to get out of debt

**Resources:**

My budget spreadsheet

Course: LearnHowToBudget.com

Software: YouNeedABudget

Book: The Total Money Makeover

## Step Two: Protect

**Videos:**

Episode 255 - What could possibly go wrong?

Episode 256 - Types of Life Assurance

Episode 261 - Types of Term Assurance

Episode 262 - How Whole of Life Assurance Works

Episode 265 - How Much Life Assurance Do You Need?

Episode 266 - How Critical Illness Insurance Works

Episode 267 - How Income Protection Works

Episode 268 - Building a Protection Portfolio

Episode 269 - Life Insurance In Trust

**Podcasts:**

Session 7 - Protecting Your Future

Session 22 - All About Trusts

## Step Three: Invest

**Videos:**

Episode 247 - The Miracle of Compound Interest

Episode 205 - Succesful Investing Intro

Episode 207 - Asset Allocation explained

Episode 208 - Strategic Asset Allocation

Episode 209 - Tactical Asset Allocation

Episode 210 - Investor Mistakes

**Podcasts:**

Session 6 - An Introduction to Investing

Session 10 - Asset Classes, or things you can invest in

Session 11 - Platforms, Wrappers and Funds

Session 16 - Risk

Session 41 - Building an investment portfolio

Session 47 - Investing for Income

Session 54 - Investing in Shares

[Session 61 - The Three T's of Intelligent Investing]

[Session 64 - Investment Terms Explained]

**Resources:**

[Monevator Blog]

Hopefully  those are enough to keep you going for now! Like most things in life, it is better to learn by doing.

Remember, if I or my colleagues at Jacksons can help you with any of this, then do let me know by sending me an email to pete@jacksonswealth.com.

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# Conclusion - Over to you

I'm thinking that if you found MeaningfulMoney and have got this far, you're serious about getting your finances in order and securing your financial future. That's good, because no-one is going to do it for you. I can arm you with as much information as possible, and I'm committed to doing so, but only you can implement it in your situation.

You'll need to stick at it when you don't feel like it. You'll need to forego that little frivolous expenditure for the sake of the greater future. You'll need to choose not to have that monthly meal out in favour of getting the life insurance in place. All the good stuff will come, and not only in the distant future. You'll get to have some fun and luxury along the way, don't worry.

So, more power to you on this exciting journey. I'll be developing the whole BPI theme in the months and years to come, so stick with me and I'll do all I can to help.

Good luck!

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Soli Deo Gloria