“Look to the future, because that is where you’ll spend the rest of your life.” — George Burns

What Is Covered in This Chapter:

- Ways to use saving as a tool to plan for the future
- Why compound interest can be a game changer
- Savings strategies for different timeframes
- Understanding retirement accounts
- Managing student loan debt

“Oops, I have saved too much money for all those things I’ve always hoped to do one day,” said no one, ever. Whether it’s 18 holes of golf, a trip around the world, a poolside mojito (complete with a mini umbrella), or quality time dedicated to a local non-profit, the possibilities for your own post 9-to-5 paradise are endless. The key to making your daydream a reality? Retire the notion that it is still too early to save, and start saving early so you will have the freedom to enjoy your future in style.
The Art of Saving

Take advantage of your twenties. You probably hear this a lot, but not necessarily in relation to your saving habits. The art of saving is more than simply putting money aside: It’s a practice, a philosophy, and a tool for accumulating wealth, reaching your goals, and most importantly, achieving financial freedom.

Saving is not just about retirement. It is about creating a plan to help finance your dreams—big ones like selling your home and retiring on a yacht in the South of France, but also shorter-term aspirations like adopting a pet or buying your first car. Saving can also make life cheaper. Living paycheck to paycheck may increase your probability of racking up credit card debt (which you will then pay interest on) or encountering additional costs associated with low account balances and bounced checks.

For most, life will gradually become more expensive as you take on additional responsibilities. More responsibilities mean more bills, and more bills mean less disposable income to stash away in your proverbial piggy bank. No more excuses—the time to start saving is now.

Americans today are living longer, healthier lives. Since 1965, the average American’s life expectancy has increased by almost 10 years; however, instead of saving more money to prepare for longer life expectancy, personal savings rates in the U.S. have dropped from around 12% during the 1970s to 5% in 2015. If people continue to retire at age 65, our savings may have to last us more than 30 years. Hoping that Uncle Sam will swoop in to make up the difference? Don’t “bank” on it.

Practicing sound saving habits can help provide you with the option to pursue more, experience more, and achieve more because you have the financial foundation and flexibility to do so.
It’s Never Too Early:  
The Magic of Compound Interest

Why is it so important to start saving early? Here’s the deal. Over time, your money can benefit significantly from something called “compound interest.” Compounding is the process of earning interest on your interest. For example, when you first open a savings account, your initial deposit grows by the percentage you earn in interest annually. The next year, however, you will earn interest on the original amount you put in as well as the interest you earned last year. It may not seem like much at first, but over time it adds up.
COMPOUND INTEREST AT WORK
Imagine 22-year-old Bob makes $60,000 a year and retires at 65. He contributes 10% of his pre-tax salary into his 401(k) retirement account and his employer matches up to 2% of that amount. Assuming a combined contribution (i.e., salary deferral contribution, plus employer match) of 12% ($600 a month) is consistently made to Bob’s retirement account and a 5% rate of return, he’ll end up with approximately $1,081,030 at retirement.

Sally is a late bloomer. She doesn’t start saving until age 45, but tries to make up for it by contributing $1,000 a month at the same rate of return. By the age of 65 she will only have approximately $458,294 in her retirement account—less than half of what Bob has saved. Witness the power of compound interest at work.

Now imagine that Bob can only afford to put away 4% a month due to his student loan debt and tight budget. Assuming the same rate of return over 43 years and a 2% employer match, he will have approximately $540,515 at retirement. Overall, Bob contributed $103,200 compared to Sally’s $240,000.

This example is for illustrative purposes only. Increase in inflation is not factored in. Individual’s results will vary.

DO THE MATH: 72 / interest rate = number of years it will take to double your money

The bottom line is that the earlier you start, the faster you can reach your saving goals.

TIP: Don’t be discouraged by a slow start. The true magic of compound interest might not kick in until you’ve been saving for a decade or more. Use the Rule of 72 to forecast the time it will take to double your money with the help of compound interest.
Step 1: 
**Save for the Basics**

It is always a good idea to keep at least a couple of month’s worth of living expenses available in your checking account for day-to-day transactions.

**WINNING PLAY to Prep Your Plastic:**

Consider setting up overdraft protection on your account to help avoid fees from accidentally spending more than you have available. If you have outstanding credit card debt, make it a priority to pay it off before focusing on additional savings.

Step 2: 
**Save for the Unexpected**

To make sure you’re prepared to deal with any and all unexpected costs that come your way, consider creating an emergency fund. These “emergencies” can include events such as losing your job and steady income stream, getting evicted from your home, or paying for care related to an urgent medical condition. As a general rule, your emergency fund should cover about three to six months of expenses.

Ensure your emergency fund is readily accessible by keeping the allocated money in a vehicle that is highly liquid, such as a savings account or money market account. A savings account helps protect your money from market swings and allows you to easily withdraw funds at any time.

**WINNING PLAY for Combined Accounts:**

Many banks will link accounts and give you credit for all assets you hold in combined accounts. It may be worth accepting a lower interest rate on savings if it qualifies you for free checking and other reduced fees.

Another option to consider is investing in a money market deposit account. Money market deposit accounts can offer the best of both worlds—they often pay higher interest rates than savings accounts while also allowing you to write checks. Similar to checking and savings accounts, your money is easily accessible; however, most money market deposit accounts require a minimum deposit to open the account.

**THE FDIC EXPLAINED**

When opening a bank account, choosing a chartered bank with FDIC insurance tends to be the safest move. The Federal Deposit Insurance Corporation (FDIC) is an independent agency of the United States government that protects depositors of insured banks against the loss of their deposits if any of the banks fail. FDIC insurance provides dollar for dollar coverage (up to $250,000 per depositor, per insured bank) for deposits in checking accounts, NOW accounts (“Negotiable Order of Withdrawal” accounts that are similar to interest-bearing checking accounts), savings accounts, money market deposit accounts, cashier’s checks, and money orders. The FDIC does not insure money invested in stocks, bonds, mutual funds, life insurance policies, annuities, or municipal securities even if these investments are purchased at an insured bank.³
Step 3: Save for the Future

In general, a good rule of thumb is to try and save at least 10-15% of your post-tax income. Once you have saved up enough money to cover your day-to-day expenses and any unexpected emergencies, you can start planning for your longer-term goals.

To encourage people to save for the future, the government created several tax-deferred accounts. This means that over the years, your contributions (the money you put in) can grow faster because the taxes are being deferred to a future date. (Think back to the value of compounding!) In general, you will only be taxed when you make a distribution (or withdraw money). Keep in mind that most tax-deferred accounts are structured to help you save for retirement and therefore you may be subject to a penalty tax if you withdraw assets before reaching age 59 1/2.

WINNING PLAY for Your 401(k):

Some companies will match their employees’ contributions up to a certain amount or percentage. If your employer offers matched 401(k) plans, consider contributing the maximum amount allowed in order to take full advantage of the opportunity.

403(b) plans are essentially 401(k) plans for employees of certain organizations such as 501(c)(3) organizations and public schools.

Traditional IRA

A traditional IRA is an “Individual Retirement Account.” Unlike a 401(k) or 403(b), a traditional IRA is not offered by employers, but by financial institutions. An IRA has a lower pre-tax contribution limit than a 401(k) and there is no employer-matching involved, but your IRA contributions may be tax-deductible. So if your annual salary is $60,000 and you contribute $5,500 to a traditional IRA, you may only need to pay income taxes on $54,500.

Roth IRA

If you earn below a certain income threshold, you may qualify for a Roth IRA. The difference between a traditional IRA and a Roth IRA is that contributions made to a Roth IRA are not income tax-deductible, meaning you don’t get a tax deduction on your federal income tax return for your contributions to a Roth IRA. However, distributions from a Roth IRA are not subject to federal income taxation if certain conditions are met. Unlike a traditional IRA, Roth IRAs do not force the Roth IRA owner to withdraw money by a certain age, but after the death of the Roth IRA owner, the beneficiaries are required to take distributions in accordance with the required minimum distribution rules. You can also contribute to a Roth IRA after age 70 1/2, as long as you continue to earn below the income limits. Talk to your own independent legal and tax advisors, along with a Financial Advisor, about what retirement account may be best suited for your long-term goals.

There are several types of retirement accounts to consider. Different types of accounts have different rules about who is eligible, how much you can contribute, when the money is taxed, and at what age you can access the funds. The following is a non-exhaustive list of tax-qualified arrangements that may be available to you.

1 401(k) Plan

401(k) plans are employer-sponsored plans that allow employees to make pre-tax contributions into a tax-qualified account. If your employer offers a 401(k) plan, you can choose to automatically deposit a portion of your pre-tax salary into your 401(k). This can be a good option for those who have trouble staying disciplined when it comes to saving.

2 403(b)

CERTIFICATES OF DEPOSIT (CD)

Purchasing a certificate of deposit (CD) can be a useful saving tool because CDs pay a set interest rate for a pre-defined period of time ranging from 3 months to over 10 years. Generally, the longer you are willing to lock up your money, the higher the rate will be, so CDs may be an option to consider for predictable longer-term expenses such as buying a home.

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“Carpe per diem—seize the check.”

ROBIN WILLIAMS
WINNING PLAY for Retirement Plans:

You may be eligible to participate in multiple retirement plans simultaneously, such as an employer-sponsored 401(k) and an IRA. Take time to understand the tax advantages, eligibility requirements and contribution limits of various accounts before mixing and matching. Talk to your legal and/or tax advisor, along with a Financial Advisor, to help determine the most effective way to put your retirement strategy into practice.

“I’m currently saving to travel with my fiancée. We’ve been to Rome, Paris, and the Dominican Republic, but we have a lot of countries on our “must-see” list. I’m also saving to ultimately own an apartment in New York City. At the end of the day, I just want to have enough money to live freely and comfortably.”

AMILCAR JAVIER — ASSOCIATE SOFTWARE DEVELOPER, MORGAN STANLEY INSTITUTIONAL & CORPORATE TECH

SEP IRA

A SEP (Simplified Employee Pension) IRA allows employers to make tax-deductible contributions on behalf of eligible employees, including self-employed individuals. Employers can contribute up to a certain percentage of compensation, or the annual SEP IRA contribution limit, whichever is lower.

529 Plan

Instead of helping you save for retirement, a 529 plan helps you save for your future child’s college expenses. Also known as “qualified tuition plans,” these are offered by your state, state agencies, or educational institutions.

PRO TIP

“While it is never too early to start saving for your kids’ education, it’s important to make sure you are adequately prepared for other long-term milestones first. There are a lot of ways to pay for education, but very few alternatives when it comes to saving for retirement.”

ROSE PALAZZO, MANAGING DIRECTOR, HEAD OF FINANCIAL PLANNING, MORGAN STANLEY WEALTH MANAGEMENT

SAVING FOR SHORT-TERM GOALS

There are probably countless other milestones you’ll want to save for before you even think about leaving the workforce. So let’s look at how to approach one of these shorter-term goals, such as saving for a share in a summer home rental.

As with saving for anything, it starts with a plan. Figure out your total expected costs upfront and work backward from there. How much do you need to put away each month to foot the bill? Then determine the necessary sacrifices in your day-to-day spending that you may need to make to start saving that money.

Keep in mind that you may encounter unexpected costs that you did not budget for. For instance, when it comes to a share house, you typically will be charged a security deposit upfront (10-20% of the total rental price), and some landlords may even ask for a utilities or services deposit to cover things like fuel, cable, internet access, lawn and pool maintenance, garbage removal, and house cleaning.

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WINNING PLAYS for Smart Savers:

Start early.
Take advantage of compound interest so that you can enjoy the fruits of your labor in the future.

Set clear goals.
It’s a lot easier to save when you know what you’re saving for. Get specific about your goals as well as any upcoming expenses or life milestones and calculate how much you will need to save within what time horizon.

Pay off your debts.
While you should never compromise your ability to cover day-to-day expenses, debt is expensive and has a way of overstaying its welcome. Focus on eliminating high-interest debt first, which is typically comprised of credit card or store card debt. While it is important to pay off lower-interest debt, such as student loans, don’t sacrifice building up personal savings in case of an emergency.

Automate your savings.
People have a tendency to spend what they have. Treat your savings as an additional expense and set up an automatic deposit to transfer a percentage of your income to your savings account each month. Some employers allow you to do this through payroll, but you can easily set this up via your online banking account or a mobile app like Digit or Acorns.

Take advantage of tax-deferred savings accounts.
If your employer offers a 401(k), consider it as an opportunity to build long-term wealth. If this option is not available to you, consider one of the other types of accounts covered earlier in this chapter.

Master the art of saying “no.”
One of the biggest obstacles to overcome when trying to remain disciplined about your saving strategy is FOMO or “Fear Of Missing Out.” This doesn’t just apply to exotic trips and dinners with friends, but can also relate to saying “not right now” to that pair of shoes you’ve had in your virtual shopping cart for the past two weeks. If you find yourself feeling tempted, turn to your savings goals for inspiration.

Don’t forget to treat yourself.
When it comes to saving, recognize what small expenses give you the most pleasure and allow yourself to enjoy these in moderation. These occasional rewards can help keep you motivated as you build healthy money habits.

Save on taxes.
Make sure you educate yourself about any tax deductions you may be eligible for. If you’re in grad school, you may be eligible for an education credit or certain deductions. Similarly, if you are self-employed, you can deduct expenses related to transportation, health insurance, a home office, and any client-related activities.
“Get into the habit of saving a little bit of money each and every paycheck. You won’t miss it if you never got used to having it in the first place and it’s surprising how quickly that small monthly amount begins to add up to a nice rainy-day fund.”

TOKS AFOLABI-AJAYI — VICE PRESIDENT, MORGAN STANLEY INVESTMENT BANKING
Questions to Ask Your Financial Advisor

1. When looking at my income, can you help me determine how much should be allocated toward any outstanding debt and how much I should save?

2. What are some ways that I can save for nearer-term expenses such as a big trip, wedding, or grad school without jeopardizing my retirement savings?

3. What lifestyle factors should I consider when calculating the amount I will need to retire, and should I be thinking about this now?

4. Should I have different saving strategies for different milestones like buying a house or having children? What can I do now to start preparing?

5. Given my upcoming milestones, what savings vehicles are most appropriate in relation to my goals, risk tolerance, and time horizon? Are there alternate types of accounts that provide more compelling interest rates when it comes to saving money for medium-term goals?

6. What are some strategies to accelerate my student loan payments without compromising my other saving goals?
Must Reads

MONEY Master the Game: 7 Steps to Financial Freedom
AUTHOR: TONY ROBBINS
This book shares the wisdom of 50 leading investors in a 7-step blueprint for achieving financial success.

The Index Card: Why Personal Finance Doesn’t Have to Be Complicated
AUTHORS: HELAINE OLEN & HAROLD POLLACK
Inspired by an idea that everything you need to know about money fits on a 4 x 6 index card, this book shares simple rules and how-tos for taking control of your finances.

Get a Financial Life: Personal Finance In Your Twenties and Thirties
AUTHOR: BETH KOBLINER
This book is a comprehensive, practical guide to financial basics and managing your money in the real world.

The Total Money Makeover
AUTHOR: DAVE RAMSEY
Focused on the idea that “winning at money is 80% behavior and 20% head knowledge,” this bestseller provides a results-driven plan for developing the right money habits.

CITATIONS:
[4] CDs are insured by the FDIC, an independent agency of the U.S. Government, up to a maximum amount of $250,000 (including principal and accrued interest) for all deposits held in the same insurable capacity (e.g. individual account, joint account, IRA etc.) per CD depository. Investors are responsible for monitoring the total amount held with each CD depository. All deposits at a single depository held in the same insurable capacity will be aggregated for purposes of the applicable FDIC insurance limit, including deposits (such as bank accounts) maintained directly with the depository and CDs of the depository.

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