Ep62: Why You Shouldn't Budget!

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PATTI BRENNAN: Hi everybody, welcome back to the Patti Brennan show. Whether you have $20 or $20 million, this show is for those of you who want to protect, grow, and use your assets to live your very best lives.

Joining me today is Eric Fuhrman. Eric, you and I are going to be talking about that wonderful subject of budgeting, which, as you well know, having been with me for so many years, I just cannot stand the word budgets.

ERIC FUHRMAN: I know. Budgets, I think you say, are like diets. They are something that nobody ever wants to get in to or even think about.

PATTI: Yeah, it sounds constricting. It sounds like, "Oh gee, I'm not going to be able to do the things that I really want to do." It's this feeling of tightness and constriction, and that's not living your best life.

That's what we're all about. How do you live your best life? And yet we also have to be realistic that, "Hey, let's face it. You got to find a way to create cash flow, excess cash flow, to be able to save for the things that are really important to you." To me, that's what this financial planning is all about, financial navigation as we call it.

To really figure out, what's important to you, what you need to do between now and then in order to accumulate the assets that you need to accomplish that specific objective and how can you allocate it in a way that might help you to get there faster than you ever thought possible? Right?

ERIC: Right. Absolutely. I think what's so interesting from our perspective, or our vantage point, is that we get to see the ways that people track money, and those that are out there right now listening to the podcast, you'll probably find yourself falling into one of these buckets that we discuss.

Usually, when somebody comes in for a meeting to talk about their finances and their goals, usually there is a complete and total absence of a budget. There's the best guess approach, and then, there's the budget that somebody brings in, which is usually multiple tabs in an Excel spreadsheet with lots of pretty colors, and different things like that.

PATTI: I love the color coding. It is just classic.

ERIC: Oh, yeah. You can tell that somebody spends and hours and hours of their time going over and tracking every little expense and detail in penny.

PATTI: If that makes that person feel better, if that gives them a sense of control and comfort, then by all means, that is wonderful. The objective here is not to scrutinize how much you're spending, it is to be able to identify areas where we can increase the savings, right?

ERIC: Yep, absolutely. I think the common thread that we see and those different examples of how you might be budgeting your household finances, is that what those budgets merely provide is detail, or lack thereof.

They provide information of where the money is going, but the most critical element is that they are usually not attached to any kind of goal that bears any kind of resemblance to where somebody should be tracking in terms of wanting to retire early or something like that.

There's just no connection between the budget and a purposeful goal that is being followed on a regular basis.

PATTI: How often do we find, Eric, that if somebody doesn't have those objectives identified. Let's say that there's a liquidity event. Let's say that somebody exercises options, or gets an inheritance, or what have you. It sits in the checking account.

Because they don't have the disciplined approach, they don't have that thing that they want to accomplish at a particular date in the future, a lot of times that money just gets blown. It gets used in other areas just because it's there.

We had a situation last week where somebody had a significant amount of money that they had received a year and a half ago. It was literally six figures. Yet, by the time they came in, it was about $25,000 was left from it.

ERIC: It's a shame.

PATTI: When I ask them what they did, "Well, it went here, it went there. We actually built a pool." Things of that nature. That's great if that enhances the quality of life for them today. The problem is, is that they have three children. They don't have money saved for college.

ERIC: Exactly right. I think the common thing here that we see between somebody that has a budget, and somebody that has a successful plan is that there is either a behavior that's being followed, a savings behavior that has been part of how they've operated for a very long time, or there is very well-defined process that's automated to capture that savings and invest it on a regular basis. It's not just haphazard, in terms of how it's set up.

PATTI: Exactly. Let's you and I decide that we're going to do something right now. Let's just stop using that B word. From now on, for the rest of this podcast, you and I are just going to talk about defining what your monthly needs are. It's all about cash flow.

It is what it is. Ultimately, you're going to decide how you want to spend your money. It's OK as long as it's OK. If you don't want to save that money, is it OK that the kids are going to have to go out and borrow money for college? It's fine as long you're OK with it.

Is it OK that you're going to have to work until you're 75 years old? If you're not able to save a portion of what you earn today, that's the practical reality.

ERIC: What's so important about what you're highlighting there is it's all about trade-offs. The decision is not necessarily good or bad. It just involves a trade-off. What's so important is having an understanding of the domino effect of what those trade-offs can mean for later in life. It's important since we're no longer going to be using the B word anymore in this podcast. I'm going to try my best not to say it.

PATTI: It's a hard habit to break.

ERIC: It is.

PATTI: Believe me, I've broken about 20 years ago because I personally do not follow one.

ERIC: Absolutely, but I think what's important again a lot of people focus on the granular details of doing the B, right? What's more important is to think about the big picture things.

You have to be able to see the forest through the trees here. Those big picture things are things like housing. What decision did you make on housing? What decision are you making in terms of automobiles, meaning, how much do you spend on them and how often do you purchase them?

Oftentimes we hear these, in my opinion, these silly examples of not drinking Starbucks in a day and how much money you can save. Now Starbucks is not cheap. Three bucks for a cup of coffee is pretty expensive. It's about getting the big things right.

If you get the big decisions right in terms of getting into a house that you can afford and provides a lot of slack on savings and being smart about how you buy cars over your lifetime, you can drink as much Starbucks as you want. That's not going to make a difference. It's about getting the big things right first.

PATTI: Agreed. I think that for those of you who are listening today, I also think that it's OK if especially you're trying to teach these...give your children these tools because a lot of times the kids haven't been exposed to these ideas.

For them, going to Starbucks every day is a big thing for them. That's a big decision for them. To teach them about money and to teach them the concept of what we believe is saving money first and spending the rest.

If you identify what you need to do and how much you need to accumulate for these objectives and then you back into, "Well, gee in order to accomplish this, what do I need to save today?" Then you can just spend the rest. To teach your families, I think it's just...I'm going to get on my soapbox here guys.

I just really believe that this is a concept that is not taught enough whether it be in high schools or in colleges. How many people Eric come into us? These are highly powered, really powerful executives. Doctors, professionals and they just haven't been exposed to these concepts. It's really cost them a lot in terms of their own financial security.

ERIC: In terms of the opportunity because time is an asset that's probably the most valuable asset that anybody on this Earth has. It's making sure you're optimizing that and getting it working for you.

PATTI: There's nothing worse than having someone come in – and this happens so often – and they...How many times have we heard, "Gee Patty, gee Eric, I wish we had met you 20 years ago."

ERIC: More often than you would believe. All done.

PATTI: It's just amazing because there's that feeling of remorse or regret that, "Gee, if I had only known these simple ideas and these simple tools, just imagine where we'd be today."

ERIC: I want to go back to a point that you brought up earlier which is the concept of saving and paying yourself first. If we think about how our life operates, a lot of folks are used to a regular paycheck that comes in on a regular frequency.

The very first action, the very first thing you have control over in that process is saving. Not what you spend when that paycheck comes in you can make that decision saving first before you spend the money. That's what's so important is that's where you can really make the most impact is right there at that point in time.

PATTI: Eric and how many times have you and I run numbers for clients? Really bringing that concept home. I tell people all the time, "Good savings will be good investments every single time."

Yes, we manage a billion dollars, yes we do a great job of it, but we are really...We can be even more impactful by showing people that just by accumulating the assets in the first place that will go a long way to making their lives so much better later in life.

ERIC: You're absolutely right. There's often a lot of...People have probably heard the litany of examples about the powers of compound interest and how powerful it is but anybody has access to a spreadsheet wants to run those numbers. The power of compounding occurs in the very last few years of your savings when you've accumulated a significant base.

Unless you've done your part to accumulate that wealth and savor that period of time, that's where the power of compounding really kicks in is in those last 10 to 15 years of retirement or as you would say – I'm going to steal one your terms here – as the red zone. That's where the compounding really kicks in is at these points in time.

PATTI: Folks imagine it this way, it's a hockey stick. It doesn't feel like much when you're just starting out and it's you're saving a little bit, you're saving a little bit. It's $100 a month, becomes $400 a month, becomes $1,000 a month. Then you're doing the 401(k). All of a sudden, it just explodes.

That's what we're talking about here. You want to focus on saving first and spending the rest. If you get the discipline down early in life, it's terrific. Eric, is it too late if somebody's listening to this podcast when they're in their 50s?

ERIC: It's never too late. As long as you're living and breathing, you always have an opportunity to get focused and start saving. Any kind of 10, 15-year, 20-year increment of time, you have to expect it.

Even if you're in your 50s, there's probably a very strong likelihood that you'll be alive, at least, roughly 30 years from now, 35 years from now. You still have a lot of time to be able to make course corrections that will make a big difference.

PATTI: You are probably in your peak earning years as well. For some of you, not me, because I still have young children, one in college, if you're like a lot of people, the kids are educated, they're out of the house, those cash flow needs have diminished.

Your excess cash flow or what might be left over might be greater, and that's important to keep in mind. I also think it's important to understand what you want your life to look at in retirement. That's where understanding the goal, in the first place, is important.

This is all very achievable. Anybody can do this. It's just having that heart-to-heart talk to say, "What does our life look like? Are we going to be in this house? Are we going to be moving to a different location? How much cash flow do we actually need coming in per month when we are retired?"

ERIC: Absolutely, right. This is a perfect segue into the goal formation and savings process that we're going to talk about. You're absolutely right. The mathematics here are not that difficult.

When you think about this and sit down, you have to plan that whenever that retirement period is going to be, you generally probably have to plan for a 20 to 30-year period of time that you're going to be retired.

Knowing that, then you can go back in, and reverse engineer, not only the retirement number that you need to target, but what kind of savings rate is going to be needed in order to achieve that objective.

PATTI: Here's a simple fact, folks, that will help to bring this home for you. If you decide or if you choose that you're going to spend a thousand dollars less per month in retirement, I got good news for you.

What that means is that you need $300,000 less accumulated by the time you retire just because you've made that proactive decision that, "Hey, you know what? We're going to downsize. We probably can cut our expenses by a thousand dollars a month."

Eric and I get to tell you, "Hey, you don't need that extra $300,000 now because you made the choice that you're going to be living in a different way." Not budgeting. Not feeling that sense of lack.

You're just choosing to use your money differently both in retirement and today, because that reduces the stress that you have today on having to save as much as you possibly can. It's quality of life. It's living your best life today as well as in the future.

ERIC: What you're highlighting is an important consideration. It's that glide path of how your expenses are going to change as you age. For example, the mortgage could be paid off, you could always make the decision to downsize.

You have four kids at home. I imagine the adjustment and expenditure will be different by the time the last one...

PATTI: I'm hoping so. It's working already, but you do have the boomerang kid that comes back and lives at home.

ERIC: What about these?

PATTI: Yes, it is…That's a practical reality that we all have to keep in mind. It's a navigating process. Things are going to happen. Kids are going to need maybe some help, or you might want to give them some help.

Wouldn't it be wonderful if you're in a position where you've made certain life choices, and you were able to set aside even more money, and it accumulated to even more than what you will need to accomplish your objectives?

It puts you in a position to be able to do things for the people that you love and get them to experience it, and you get to enjoy it along with them.

ERIC: Exactly. What do you think about maybe going through a quick rudimentary process? Just to give people a guide to how you would go back in and say, "How much do I need to save? What's important?"

Maybe just give them a couple of steps and say, "Here are the pertinent questions that you need to answer." That will go a long way to helping you along this road to determine what you need to start saving to meet your goal.

PATTI: Love it. Let's go for it. It's all about actionable steps that they can take. We can all make it relatable so that you can use this information.

ERIC: The first thing is that life expectancy is getting longer for everybody. That's been a long-established trend that's been changing over time.

You have to understand, if we're thinking about a household, husband and wife, that there's roughly about a 74 percent chance that one of you will still be alive at 85 years old, and roughly a 48 percent chance that one of the individuals will still be alive at 90.

When we're thinking about how long do we have to plan for we're thinking 20 to potentially upwards of 30 years based on the likelihood that at least one of the spouses will be alive that long.

PATTI: Eric, this is a good segue to highlight another podcast that we just finished called, 8,000 days. Roughly speaking, people are going to be retired for 8,000 days. That's a long period of time, and there are different seasons of that retirement. Let's keep that in mind as well in terms of what cash flow might look like.

ERIC: Absolutely. Then from that day, you also…There's different people have different opinions on this but the factor in that there's going to be some other non-portfolio related sources of income. Social Security would be a big one. Perhaps you're lucky enough to still have a private pension that might help add in there.

When you think about these sources of income, you have to figure out what that will be part of your retirement income stream. What portion do you need to finance through private savings?

PATTI: Exactly. It's all about filling the gap. If based on these examples, we put together some examples of somebody who is living on or has an income of $100,000 per year, and then we've got another example, someone who is living on $250,000 a year. That is, today, you might make different decisions and different choices in retirement, but let's just start with those two examples.

ERIC: If you're in a household that was basically making $100,000 a year…This is from a study called, The Guide to Retirement, from JP Morgan, which is a great study that you can go through. They estimate that if your household income was $100,000 a year, you need roughly 41 percent of that to be financed through private savings.

If you are in a higher income household of 250,000 a year, you're going to need roughly 58 percent of that to basically replace your income through private savings.

PATTI: That becomes a pretty big nut. Depending on where you are today, and how much you've accumulated so far, that can be, for some people, feel insurmountable.

You and I, you know me very well, Eric. There is always hope. There is always a solution. It's just a matter of figuring out what we can tweak here and there to make all of these things realistic and achievable.

ERIC: As long as you're getting out of bed every day, you have an opportunity to change the course of the future.

PATTI: Absolutely.

ERIC: Going back to that example, a lot of people have heard about the four percent rule. Just keep in mind, this is a rule of thumb. There are lots of caveats to consider with this. If you think about the rule of four percent, basically what it means is this is what we consider to be, in a lot of cases, a safe withdrawal rate.

As long as you can live on four percent of your private capital that you've accumulated over your lifetime, it's associated with a fairly high likelihood that you will not run out of money over a 25 to 30 year period of time.

PATTI: Now again, Eric, let's talk about what this is. First of all, I'm going to tell you that I have a bias against rules of thumb like this because every family is very different. Also, understand it's four percent of the initial value of that working capital.

When you retire, you pretty much have whatever you're going to have. Then it is just a matter of how that spends out for the rest of your life.

The four percent rule basically says if you've got a million dollars, you can take $40,000 a year increasing by inflation. There is a relatively low probability of running out of money over 25 years. There is tons of caveats that assumes a well-balanced portfolio, well-allocated, diversified, yada, yada, yada. It's a general rule of thumb.

Many people, myself included, are much, much more comfortable with three percent, especially in this low-interest rate environment. We're not getting the rate of return on bonds that we did just 10 years ago.

ERIC: Right. Well, that study was first basically unveiled, I think, in roughly the mid-'90s. It was based using bond returns from the '80s and '90s when interest rates were far higher than where they are today. That's a shortcoming.

The other thing, too, is that it doesn't consider the possibility of a long-term care event. If you're in a household that doesn't have long-term care insurance, for example, that could be something that could definitely make the four percent rule completely irrelevant.

PATTI: Absolutely. Let's talk about the income replacement or the rule of 25. I think that's an interesting one for people. If you're trying to do this on your own and you want to have a goal, you want to just have a number. The rule of 25 basically takes the income that you're currently earning, and it does a factor of 25 against that.

For example, if you're a $100,000 household, you're going to need a million dollars by the time that you are retiring.

ERIC: Retirement age, right.

PATTI: If you have an income need or you want to replace $250,000, you're going to need $3.6 million accumulated by the time you choose to retire. It gives you those goals and those numbers to work with your own financial planning, if you will.

ERIC: Yeah, I mean, basically, the rule of 25 is just the inverse of the four percent rule. If you take 1 divided by 0.04, gives you 25. That's the idea, is that, whatever that income need that you have to supplement that's not covered by state pension or Social Security, whatever you solve that to be, simply multiply that by 25.

Then that gives you a good guideline for the kind of capital you're going to need to accumulate.

PATTI: Again, folks, those of you who are listening, remember these are rules of thumb and the caveats we said before. To me, someone earning $100,000 having a million dollars saved for retirement, that feels a little light to me. I'm going to be honest with you. Again, take these rules of thumb, add a couple hundred thousand dollars. You'll probably be fine.

ERIC: Yep. Well, hey, and we are all about being conservative here like Patti said. If you want to take a more conservative approach and say the three percent rule, then just multiply it by 33. Then that's the factor you need to save for rather than 25.

PATTI: Also, Eric, I think it's really important to point out that people's needs during retirement actually do change. We're focused on retirement. We're also focused on life in general. You're not going to need exactly the same amount of money rising by the rate of inflation every single year for the rest of your life.

In the initial stages, you might want a little bit more coming in. Then you've traveled to the places you want to travel. Your cash flow needs will go down, and then they might go back up depending on health and things of that nature.

ERIC: Right. Excellent.

PATTI: Let's go back to this concept of, "OK, fine. You're talking about retirement. You're talking about college and all those things. You don't believe in the word budget."

How do we get from here to there? What practical steps can we share with our listeners to help them accomplish the things? Where are they going to come up with the money?

Where are they going to come up with the cash flow, I should say, to be able to steer into savings and investments to accumulate $3.6 million? That's a lot of money.

ERIC: Yeah, it absolutely sure is. I guess you would start first with your employer retirement plan. Just think of it this way, if you're getting, say, a 4 percent match in your employer retirement plan, and then you also put in 10 percent, you've got 14 percent right there. That's you're saving. That's the first place you would start.

Ideally, you want to try and put in as much as you can to that retirement plan. Then really have a systematic process setup that can be linked directly through your payroll provider, or, maybe, through your bank account where you're just simply taking out a certain amount of money, an automated process that coincides with whenever your payment is.

If your bi-weekly payroll, every two weeks, a certain amount of money is getting pulled out of that paycheck and put into an investment account.

PATTI: Eric, I tell people all the time. Here's the deal, if you really want to make this simple and actually work, automate your savings, pay your bills the old fashioned way. You're going to be making choices as it relates to how your money is being allocated. If it's, or if you're doing automatic bill pay, it's great. It saves you time, but you don't really control it.

It's not necessarily empowering you to make those decisions. It's like, happening after the fact. If you can actually slow down that process, again, we're not talking about budgeting per se, but just create an awareness of where the cash flows actually going.

ERIC: Absolutely.

PATTI: I think that, when you think about this whole thing, it doesn't have to be crazy, complicated, or overwhelming. It's just a matter of making good choices.

ERIC: Yeah, absolutely. Like we said, it's all about adopting the right behaviors. More importantly, a process to just safe on a regular basis.

PATTI: There are for those of you who want to look at different ideas on ways to increase your savings, which might mean cutting down on your expenses, there's a really neat site, or an article by Marion called, thebalance.com, Ways To Save Money Today.

She's got different ideas in terms of 20 ways to save on food, 20 ways to save on your monthly bills, 20 ways to save on entertainment costs. We are not talking about micro-managing your day-to-day activities. Yet at the same point, if there's something that could save $50 on a cable bill, then by all means, why not know about it?

The one that I think is really important that I just want to point out is this concept of retail therapy. I will tell you that time and time again, when people are going through different times, etc, that it's not unusual to just go out to the mall and just engage in a little bit of retail therapy.

If you're looking at where you can come up with that extra hundred dollars per month, this may not be for you who are listening, it might be more for your kids. When it comes to anything that's over $100, wait 24 hours before you do it. If you're stressed out or upset, just do not go to the mall. I mean, that's just practical. Just don't go there.

When you're planning for those big purchases, really, talk about it. It's fun to just banner about if you're married with your spouse. Wouldn't it be cool if, fill in the blank. What can we do together so that we can accomplish that?

ERIC: Do you have any solutions for Amazon therapy? I don't know about you, but boxes continually show up at my house. I don't even know who're these things or where they come from.

PATTI: It is definitely, I mean, I'm bringing in the B word, that is a budget buster. If I ever heard one, it's just too easy. It does, it definitely can interfere with people being able to set aside that money every month.

ERIC: Well, I think in this day and age, with technology the way it is, retailers had made it so easy to make the purchases via your cell phone. Having, basically all your credit card information. Everything loaded and preloaded. You can just literally make it so easy to make a transaction on the phone.

That's, definitely, something that's going to be hard to manage if you want to meet your savings goals as well.

PATTI: Here's the idea, Eric, in terms of this Amazon issue. What I would say is, I would connect the debit card. I know debit cards are not theoretically as safe as credit cards.

There is nothing that is less safe than running out of money. Just for whatever that's worth. Connected to the debit card. My point there is, if we can apply that 50/30/20 rule.

What that means is, based on your net paycheck, reserve 50 percent of your net paycheck for essentials like housing and food, 30 percent for discretionary spending, and 20 percent for savings. everybody listening today, if you are not retired, should be setting aside 20 percent. I'm sorry, it's tough information. It's not easy for everybody.

As Eric said, we don't have pensions anymore. It is incumbent on you to save this money for your own future. 20 percent is really what you're probably going to have to set aside.

If you know that that's the goal, if you know what your next paycheck is, you know what that 20 percent is, you set that aside first. Your 401(k) would be one area, then your monthly, yank it out of your checking account would be the other area, whether you're investing in mutual funds or ETFs, etc., and then you get to spend the rest.

50/30/20, you're saving 20 percent of your income to the things that are most important to you.

ERIC: You got it.

PATTI: Let's pull this together in terms of helping more listeners accomplish the things that are most important to them, to live their best life. The thing that you started out with, Eric, was so very important. If it makes you happy to track your set spending, if it makes you happy doing the spreadsheets, terrific.

I find most people don't like doing that. It feels punitive. Let's go back and do the opposite way. Let's figure out what your 20 percent is, choose where you're going to be saving that money, and then you get to spend the rest. Keep it simple, right?

ERIC: Absolutely. The most important thing you can do is that very first step, which is, when you get paid, that's where you have to save the money. It has to happen there.

PATTI: Second thing is identify what is important to you. Figure out your timeline. Come up with the number that you're going to need to have at that point in time, and then you reverse engineer it. Figure out what you need to do today to accomplish that objective.

Again, it makes the savings part feel like you're working towards something that you've identified as important. It is. It feels good. It's really fun when the money really starts to add up, and you see the account balances. You say, "Oh my goodness, this is actually working," because guess what, folks? It does. It does work.

Again, we've pulled it together. We're not micromanaging. We're figuring out how much you want to save. You're doing it every month. You're watching your money grow.

You're accomplishing the things that are important to you.

Guess what? It's not all about the future. By doing this, you are living your very best life today. If I can say, as a mother of four children, you're also setting an amazing example for your family.

ERIC: Absolutely.

PATTI: For those of you who are interested in learning more about this, again, we are not talking the budget word. We are talking about cash flow. What are your cash flow needs today? What are they going to be in the future? What can you do to make all the things that you want to have happen in your life achievable?

It's so incredibly empowering. It's so wonderful to know that, if you just do A, B, and C, you're pretty much there. All of a sudden, going to work takes on new meaning. It doesn't feel like you're slaving, etc., because you know you're working towards something that you've identified as really important.

Again, that's what gives people that sense of well being and happiness. Again, not just when you're 65 or 85, etc., that's not what it's all about all the time.

Yes, it's important. I would be remiss. I wouldn't be doing my job if I didn't put you in a position to accomplish those things. Let's also make sure you're doing the things that you want to do today as well. Have that fine balance.

If you want to learn more about how to do that from a practical perspective, go to our website. Give us a call. I'm happy to talk with anyone and give you these ideas that are much more personalized that apply to your particular situation.

Really, if you like what you heard today, and you want to share it with anybody, share it with those people that you also think might benefit. Share it with your financial advisor. I'm all about making everybody in America financially secure, financially confident.

If we can get even more advisors talking about these issues that really make the big difference, then we're all going to be better. What do you think?

Eric, thank you so much for joining me today.

ERIC: Thank you for having me, Patti. I look forward to the next one.

PATTI: Very dry subject, I love doing these with you. You really pop it up for me. Thank you all for joining me. I am Patti Brennan, and I will see in the next episode. Have a great day.