The 7-Day Turnaround

One Week to Change Your Family's Financial Destiny

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Introduction

Welcome to "The 7-Day Turnaround:

The current state of our collective finances finds most of us saddled with large amounts of debt and very little savings. Unfortunately, our public school system has done little to prepare young people for the onslaught of advertising from credit card companies and other media sources aimed at normalizing a culture of debt. To turn the tide we must do a better job of educating future generations on the importance of living a frugal lifestyle. With all the resources and opportunities available today there is no reason why anyone should not retire with enough wealth to impact generations to come.

As I finished out my 20's I certainly wasn't headed in that direction. I had accumulated too much debt after spending the better part of a decade living above my means. Turning 30 was a wake up call for me, and I set out to learn all I could on the subject of personal finances, frugality and beating debt. I found many resources, but most were written in a highly technical tone, extolling the benefits of 15 year mortgages over 30 year mortgages. What I really needed was a simple plan for turning around my finances – something I could implement in a week. I needed something drastic. The week after I turned 30 I implemented all the steps below (it took a while to actually start the latter steps, but the plans were in place in that first week). It's my hope that this simple guide will lead you to financial independence. If you are reading this you have already taken the first step to educate yourself on the subject of finances.

Day 1: Take an Inventory of Your Finances

Before beginning a plan to overhaul any aspect of your life the first step is to develop a baseline from which you can measure future success. Dieters may visit the doctor or a gym to get the latest measurements and internal health samplings such as blood pressure readings or a calculation of body fat percentage. Consider this first step of your financial turnaround a financial checkup. Many people go through the day-to-day motions of earning money, paying bills and spending the remainder without ever knowing where they stand. Though painful, without facing reality and establishing these baselines, you will not be able to measure future successes.

Get the tough part out of the way first; take an inventory of all your liabilities. This could be as simple as grabbing a legal pad and pen, or as technical as designing your own spreadsheet on a computer. The means by which you list this inventory isn't nearly as important as the activity itself. Like any good hiker would tell you, when lost you must first try to determine where you stand before deciding on which direction to set out.

Armed with your simply-designed legal pad, or ornate spreadsheet, dump all credit cards, bills and financial statements out on the table and begin to get organized. **Get current balances on all your debts by calling the companies individually, pulling a copy of your credit report, or accessing your information online.** Add up the balances and record your total outstanding liabilities, the negative side of your personal balance sheet. Don't forget medical bills, family loans and any other non-recurring bills outstanding.

Now list the value of all your assets. Beginning with the most liquid assets, cash outside of retirement accounts, list the current value of all the things you own. Even if the bank technically owns it (your home or your car), you need to list the current value to offset some of the liability recorded in Step 1. Visit sites such as Kelley Blue Book to obtain a current valuation on your vehicle, using the private-sale amount quoted. At this point, it is not necessary to pay for an appraisal on your home. Record your best estimate on the value of your home by comparing it to similar homes that have sold in your neighborhood, or peruse real estate listings and compare listing prices. Be sure to record all savings, investments, and retirement accounts on this positive side of your personal balance sheet.

Subtract your liabilities from your assets and you have just calculated your personal net worth. For most people this is a sobering point in their financial turnaround. The realization that you owe more than you own is depressing. The fact that you have not saved enough toward retirement, or another major financial milestone (kid's college, new home, etc.) is also enough to bring you down. However, no matter how bad the situation looks it can only improve with the implementation of the six remaining steps. Turn the television off at night and work on just one step each day. Who gets the most votes on American Idol, or who gets voted off the island, means nothing to your bottom line. You simply cannot afford to go any longer without a game plan.

Day 2: Build an Emergency Fund, Quickly

Experts argue over the first step of a money makeover. However, anyone who has ever been close to the edge, or hanging over the edge, will agree that there is no feeling like having a financial cushion. I heard someone sum it up that there is no softer pillow than money in the bank. So true. Instead of sitting up at night fretting over the next bill, or counting the days until your next paycheck, take actions now to put some distance between you and the edge.

Take drastic actions to immediately begin an emergency fund. Of all the steps in the 7-Day Turnaround, this one may be the most important, and one you simply cannot afford to delay. Carrying debt creates a vicious cycle. Your available cash is spent making large minimum payments to service your debt. When the hot water heater breaks, or the transmission goes out, you have no cash reserve and reach for a credit card. This is like trying to climb an escalator with the stairs moving in reverse. The faster you run, the faster the stairs move, but when climbing out of a hole of debt, the stairs are always moving just a little faster thanks to fees and interest. This means you are constantly losing ground. The only way to break this cycle is to implement an emergency fund, a place to turn for those untimely breakdowns and other household emergencies.

An emergency fund is not an investment vehicle. Forget about interest rates and investment options. The only thing you are concerned with is liquidity - how easily you can access your money. Ideally, your emergency fund should be parked in a bank or credit union savings account linked to your checking account for easy access. If the savings account comes with ATM access, even better. Murphy tends to visit on the weekends and late at night, making traditional banking access impossible. Many online banks offer a fantastic rate on savings products and allow electronic access to your money. Beware, sometimes the electronic transfers can take up to three days to process, so opt for a product with an ATM card or check writing privileges for faster access to your cash.

I recommend keeping a minimum of three months of living expenses in your emergency fund. Notice I didn't say income. Three months of ***living expenses*** should cover mortgage payments, car payments, insurance premiums, household utilities and food. Credit card payments, luxury purchases and gym memberships could all be skipped in a real emergency such as a job layoff, serious illness or injury. For most families, $10,000 is a good, round figure covering roughly three months of household expenses.

If you are like most people you probably don't have much disposable income to put towards an emergency fund. This is where the drastic measures come in. Round up books, DVDs and other small items that can be easily shipped and list them on eBay. For larger items, consider listing them in a local credit union or bank bulletin, or on Craigslist.com. Furniture, fitness equipment, and kids toys tend to generate a lot of interest in local advertisements. Things that don't sell online can be collected for a yard sale. Schedule a yard sale around the first of the following month – these sales tend to do best because most people have just received a paycheck.

Sign up for legitimate, online money-making opportunities such as CashCrate or Associated Content. You will not get rich from these ventures, but every single dime you earn should go directly towards your newly established emergency fund. If you can work around your full time job schedule, also consider taking on some part time work. Deliver pizzas, toss papers or sign on with a large retailer. Most families can establish their first $1,000 in one month or less by boosting savings from their regular paychecks, selling items, and/or part-time earnings.

Day 3: Cut Up Those Credit Cards

The person that coined the phrase, “When you find yourself in a hole, stop digging” must have had credit cards. Used wisely, credit cards can prove to be a legitimate financial tool for covering expenses and consolidating automatic payments, monthly drafts, etc. However, most credit card users carry a balance from month to month, paying banks millions of dollars in interest and fees. If you are in the middle of a financial turnaround I recommend ridding your wallet of the temptation to spend plastic.

Put your credit cards on the chopping block. For some people this step causes more angst than all the others put together. People feel some sort of loyalty to these little pieces of plastic, and the banks that offer them. Cutting them up is about as easy as breaking off a friendship with your best childhood friend. If you are serious about turning your life around you must get rid of credit cards.

One caveat: hold on to your lowest-interest, no-fee card until you complete step two, building an emergency fund. This will leave you some available funds in the event of a major financial disaster. Once your three month emergency fund is in place cut up that last credit card and consider your emergency fund a personal credit line. Keep this last “emergency” card in a sock drawer at home and away from your wallet, else you might confuse the latest sale at Nordstrom’s with a true emergency.

When your financial turnaround is complete, resist the temptation to sign back up for a credit card. Despite what Visa and MasterCard would like you to believe, it is possible to live without credit cards. Debit cards offer the same convenience, and regulations protect debit card users against fraud in the same way credit card companies do. Many debit card products also offer rewards and travel points that use to only be associated with credit products. Remember, no one ever got rich off their Discover points so don’t worry over lost rewards. When you are a millionaire paying for an airline ticket or a Target gift card won’t cause you much heartburn. Continuing to deal with credit card companies might.

Day 4: Slash Your Expenses

At this step in your 7-Day Turnaround it is time to take a serious look at your expenses. To make a dent in debts, or boost your savings, you have to free up some income by either earning more, spending less or some combination of the two. Begin this process with a review of your monthly, non-utility expenses.

Gym memberships are usually the first to go. At $40-$50 a month for the average membership you are giving $500-$600 away that could be spent building your Roth IRA balance, or paying down your credit card debts. Buy a good pair of tennis shoes and some used dumbbells to simulate your gym experience at home.

Consider canceling the cable. The mere thought of living without television strikes fear into most people's hearts. Fact is, television programming today is filled with mindless reality shows and silly sitcom scripts that are far from educational. Spend your time away from work participating in things that enrich your life, not wasting it. Read a personal finance book, or a book on personal development. Grab those new running shoes and take your kids on a walk. Take up a new hobby. Volunteer your time for a cause you believe in. All of these things will enrich your life, both personally and professionally. Knowing the last five winners of American Idol will do little to further your career or your important relationships.

Adjust your W-4. Stop giving Uncle Sam an interest-free loan every year with biweekly contributions from your paycheck. Visit the IRS website, or PaycheckCity.com, and estimate this year's tax liability. Adjust your withholdings accordingly. Many taxpayers use the payroll tax system as a forced savings account and rely on their tax returns to plan for major purchases. If you depend on the federal government to save for your annual vacations you have a much bigger problem than credit card debt.

Brown bag it. There is never a shortage of broke people out on their lunch breaks waiting for a table at their favorite restaurant. The average lunch combo runs $7-$8 with drinks and a tip. That could push your "eating out" budget to $40 a week, or roughly $150 a month. A simple switch to bringing your lunch to work could save you enough to make an extra car payment, or start a 529 college savings plan for your child. Plan to take soups, sandwiches and dinner leftovers for one month and monitor your food budget. Chances are it will shrink significantly, and so will your waistline.

Day 5: Start Saving for Retir

Now that you have moved beyond the half-way point in your 7-day turnaround**,** it's probably a good time to look back and see what all you have accomplished. **After taking an inventory of your finances you established a three-month emergency fund to break the cycle of relying on credit cards**. In step three we cut up those credit cards, saving one no-fee, low-interest card for emergencies only. Slashing your monthly, non-utility expenses was a major emphasis in step four, requiring you to think long and hard about trading your hard-earned income for things like gym memberships and cable service. It's time to start saving for your retirement.

The first step in planning for your retirement is coming up with your "Number." Everybody has a "Number," but few of use know what it is. Your Number is the amount of money that will grant you the level of financial independence that allows you to quit working for money. *The Number*, by Lee Eisenberg, offers many strategies for calculating your "Number." It isn't good enough to say, "I'll retire when I have a million dollars in the bank." Determining your "Number" takes actual planning, determining how much working capital you will need to live off of your investments, and estimating expenses in your golden years.

Take advantage of matching funds from employer retirement plans. Most employers offer full time, professional employees the opportunity to invest in an employer-sponsored 401k plan (or 403b, if you work for a non-profit or educational institution). Many companies even offer to match employee contributions up to a certain percentage of the employee's income. This is like free money. Get your retirement savings started by enrolling in the plan and **contributing up to the percentage of income the company matches**. Don't worry if it is only 3% of your income, we'll use your remaining earnings to save in a different savings vehicle.

A Roth IRA is the best retirement savings vehicle around. Some experts argue over whether or not to fully fund a 401k or a Roth IRA. For me, the argument for Roth IRAs is explained beautifully in the following analogy:

> ***Would you rather pay taxes on the seed or the crop?***

In other words, would you rather pay taxes on your income now, when it is smaller, or later when you are a millionaire (and you will be if you stick to this plan!)? Easy choice. I would rather pay taxes on money now, and invest in a Roth IRA with after-tax dollars. When you withdraw that money in retirement Uncle Sam will let you keep 100% of the contributions and earnings, tax free! Conversely, 401k balances grow tax-deferred, which means you will save a little now diverting pre-tax income to your 401k plan, but you will have to pay more when making large withdrawals in retirement. Remember, the key to any good financial plan is to keep a long-term view. Sacrifice the reduced tax liability now offered by the 401k for a tax free payoff from the Roth IRA years down the road.

Day 6: Give the Gift of Education

One of the most valuable gifts we can give our children is the gift of education. Used properly, our kids can lead successful lives long after we are gone. I am not one of those that believe a college degree is an automatic path to wealth. What you do with your education is far more important than the degree hanging on your wall. Having said that, if you are in the position to help your children complete their education it will help them immensely because they won't owe Sallie Mae two years of their first salary earned out of school. Too many new graduates are saddled with huge student loan debt, stifling their financial productivity in those precious early years after graduation.

Start early. Like any type of investing, the key is to start early. College tuition continues to rise at a staggering rate, and by the time your newborn heads off to school it may costs as much as your mortgage, in today's dollars. The only way to beat that pace, other than hitting the lottery, is to get an early start and take advantage of 18 years of compounding growth.

Take advantage of tax-free savings vehicles. The government has made your job a little easier these days by offering two outstanding tax-free vehicles for college savings. Education Savings Accounts (ESAs), sometimes referred to as an Education IRA, may be opened with nearly any brokerage. Unfortunately, you can only contribute up to $2,000 a year, but the earnings do grow tax free. So if that $36,000 in contributions from birth to age eighteen grows to $100,000 you can withdraw 100% of the account balance tax free, as long as it is used for educational expenses.

Education Savings Accounts may provide adequate savings for your child, but in case they get accepted to attend an ivy league school it might also be a good idea to invest in a 529 College Savings Plan. 529 plans are sponsored at the state level, and many states offer tax deductions for contributions made to your in-state plan. If your state's plan is lousy, don't invest just for the tax deduction. You are able to invest in plans managed in other states; you just don't get a tax deduction on your state income taxes. SavingforCollege.com has a good 529 plan overview that lists all the state plans along with a review of each state's offering.

Financial aid is still available. Neither type of college savings plan are considered student assets in the eyes of federal financial aid providers, and therefore will not significantly reduce your child's eligibility to receive federal financial aid. However, since most needs-based scholarships are offered at the individual school level the schools may have different rules on how assets are treated.

Chart your own course. Regardless of the savings vehicle you choose be sure to select your own investments. Some of the best 529 plans offer a wide range of investment options in top mutual fund brokerages such as Vanguard or TIAA-CREF. Others offer only "**managed allocation**" options based on when your child plans to attend college. The plan administrator may not have the same tolerance for risk as you, and move your child's savings balance to more conservative options too early.

What if my son or daughter decides to take a different path? If your child decides not to attend college you may assign another family member as beneficiary, which could be a nice gift for a brother, sister, or favorite niece or nephew. If you have a small family with no other beneficiaries available you can always cash out the savings and pay a 10% penalty, in addition to your ordinary income tax rate.

Day 7: Invest for an *Early* Retirement

The word “retirement” has always evoked day dreams of playing out the remainder our lives fishing, golfing and joining a bridge club. However, with improvements in preventive medicines people are living longer, and with a bull market at the end of the last decade, many of those people are “retiring” earlier. Instead of retiring from the work world entirely early retirees are simply hanging up their careers and looking for more fulfilling work. That is a noble goal. We spend the majority of our early careers working to pay for things (houses, cars, college for the kids). Why not start saving for an early retirement from your day job, so you can then go do something you have always wanted to do, regardless of the pay?

Invest outside of retirement accounts. We’ve already learned the virtues of investing inside retirement accounts, but in this final step let’s start to invest outside of retirement accounts so that money is available to tap before 59 1/2, the current minimum age to withdraw from an IRA. This step requires closer scrutiny of investment options than investing inside retirement accounts. For one thing, your time horizon is shorter so you have less time to recover from making a bad investment selection. You also have less time to recover from a market downturn, so riskier investments are usually off the table for this type of investment. Capital ***preservation*** is nearly as important as capital ***appreciation*** in this step.

Don’t forget about taxes. Since these investments are outside a tax-deferred or tax-free retirement account you have to be more conscious of the tax implications. Consider investing in a more conservative mix of index mutual funds with a low turnover to minimize taxes. Vanguard’s Total Stock Market Index Fund and 500 Index Fund are good examples of low-cost mutual funds with low turnover. With interest rates hovering near record lows, high-interest savings accounts are not as attractive an option as in times of higher rates. Still, keeping a portion of your “early retirement” fund in cash may make sense if you can find rates that significantly out-pace inflation. Treasury bonds, high-interest bearing CDs and money market mutual funds offer decent returns with minimal risk, but should only represent a portion of your total early retirement fund in the beginning stages. You need growth on your side up front, and once you’ve earned that growth you can begin to take those profits and preserve them in these safer savings vehicles.

At some crossover point in the future your monthly investment income will match your monthly expenses. At this point the money in your "early retirement" account is generating enough working capital to pay your monthly expenses. You are no longer dependent on earning a wage to provide necessities. This point was best illustrated in the book *Your Money or Your Life*. Author Joe Dominguez used a graph to plot monthly expenses and monthly investment income. Over the years his investment income grew, and as he practiced frugal living principles his expenses decreased. One day the two figures met. It is at this point that you can finally break away from the daily grind. What is it you've always wanted to do, but could never afford to start? Maybe you want to start your own business, or perhaps you would like to volunteer more of your time towards a particular cause. Regardless of your chosen endeavor, you are now free to make the jump without worrying about how much money is involved. With that kind of freedom creativity is released in waves, and you just might find yourself making more money than you made in your working lifetime.