THE WALL STREET JOURNAL

INVESTING BASICS

From Spender to Saver to Investor

It's a Process. Step No. 1: Get a Handle on Your Cash Flow.

By CAROLYN T. GEER

June 22, 2014

A reader in Minneapolis has an all-too-common problem. Despite holding down a job in luxury-car sales for the past eight years, he struggles to save money.

Jon Krause

Sure, he participates in his employer's 401(k) plan, but outside of that he and his wife and teenage daughter live "paycheck to paycheck," he writes. They "don't live a life of luxury," and he is "pretty obsessed" with watching what they spend.

"I have thought of talking to a financial adviser," he says, "but they all seem interested in my portfolio rather than helping me with my monthly needs, which I guess are minor to them in the scheme of things."

All he needs, he says, is someone to help him make a budget, set up a payment plan for some past-due bills, and put money aside every month without fail. In other words, he needs to transform himself from spender to saver to, ultimately, investor.

All of us fall somewhere on this continuum, with spenders on the left, savers in the middle, and "wealth creators," or investors, on the right, says Michael Chadwick, a financial adviser in Unionville, Conn., whom I asked to comment on this reader's situation. "And, in short, this man is too far left," he says. "What we want to do is move him to the right."

Like many Americans, he suffers from what Mr. Chadwick calls "checkbook syndrome," or spending just at or above the income he makes, regardless of what that income is. This can lead people to the erroneous conclusion that, if they just make a little more, they'll be home free.

His first order of business should be to start "keeping score" of his income and expenses, Mr. Chadwick says. He can pay an adviser by the hour or by the month to help with this (two sources are garrettplanningnetwork.com and the new xyplanningnetwork.com), or he can do it himself with pencil and paper, an Excel spreadsheet, or an online personal-finance tool such as mint.com.

Once he has a handle on his cash flow, he can draw up a budget and start reining in his spending.

Many people purposely avoid or bungle this step, Mr. Chadwick says, like the doctor he knows whose Quicken-generated spending chart showed 56% of his outlays going to uncategorized expenses. "Don't use miscellaneous as a category," Mr. Chadwick admonishes clients.

And don't forget to budget funds for savings (pay yourself first, as the saying goes) and some for paying down any debt that's dogging you.

Then, says Mr. Chadwick, "automate everything." You're more likely to stick to a plan when the money comes in and goes out electronically.

For the savings portion, start by automatically depositing a fixed amount each month into, say, a money-market account or a certificate of deposit, or anything guaranteed not to lose money and that doesn't have a debit card attached, Mr. Chadwick says.

Anytime income goes up (you get a raise) or expenses go down (you pay off the car loan), channel the windfall into savings.

Once you've accumulated enough assets for an emergency fund (three to six months' living expenses is often recommended) and you are safely out of spender hell and into saver purgatory, you can begin investing additional money for longer-term goals such as retirement. This is when your money starts making money.

It's a process, and you may have to give yourself time, years perhaps, especially if, like the Minneapolis car salesman, you didn't develop good money habits growing up. "No one in the past took the time to teach me how to save," he writes. "My foundations were never there as my dad was the one doing all the finances and never really spent time with me to teach me these things."

Indeed, the 60% of Americans who feel that their parents did a good job teaching them about money have significantly higher opinions of their own financial knowledge than their peers, according to the T. Rowe Price Group's 2014 Parents, Kids & Money Survey. But that doesn't mean the other 40% can't learn.

Mr. Chadwick says he grew up "broke" in a home where he was constantly told they couldn't afford things. Twenty years ago he started plowing $100 a month into a mutual fund. It took him 10 years to graduate to investor, he says, "but if you can live through a decade of discipline, it'll change your life forever."

— investingbasics.wsj@gmail.com