Take Charge of Your Finances — Starting With Your First Real Paycheck

Advice for New College Grads

by Alexandra Armstrong, CFP, and Kelly Wright, CFP

In September, many fortunate recent college graduates are starting their first jobs. Their parents asked us to give them some general guidelines as they begin their working careers. You may have a child, grandchild or some other young person in your life who could use the same guidance. If so, please pass on these ideas, which we hope will help many young people establish good financial habits that will last for their lifetimes.

Develop a Budget

Once you know what you'll be earning at your new job, set up a budget right away and try to stick to it. Whether you're paid every two weeks or once a month, your starting point should be your monthly income. Keep in mind that your take-home pay may be significantly less than what you initially expect because of deductions for federal and state taxes, Social Security, Medicare and health insurance. You may be shocked to find out how little is left when you open that first paycheck.

Next, you need to list your expected expenses. The easiest ones to compute are your fixed expenses — the ones you know you'll incur each month, such as rent, transportation to work and car and student loan payments. Unless you really think you can afford the payments, we suggest you postpone buying a car if possible until you've accumulated some money.

Then factor in an amount for your variable expenses such as food, clothing, travel and entertainment. As part of this budget, we strongly urge you to immediately start setting some money aside for savings because it's critical to put away cash for emergencies. Once you've set this money aside, it makes sense to segregate it into a separate savings account so that it stays there and isn't used, if possible. You should aim to set aside 5 percent to 10 percent of your gross pay and use the first part to build a cash reserve.

Experts agree you should have three to six months living expenses set aside in cash. This "pay yourself first" approach enables you to accumulate a cash reserve to take care of unexpected expenses. After the cash foundation is set aside, consider putting small amounts in an investment account, if possible.

If you've never lived on a budget before, write down everything you spend for three months. Then compare it with the initial budget you put together. You may be surprised when you see some of the frivolous things you're buying each month (Starbucks, anyone?). Once you know how you spend your hard-earned money, you can eliminate the less essential expenditures.

Speaking from personal experience, Kelly recently worked with his son while he was still in college to track and categorize his expenses. He used a spreadsheet program, but other approaches will work as well. Doing this really opened his son's eyes as to how his money was disappearing! Just the exercise of tracking his expenses helped dramatically improve his son's spending habits. Using a bank card for most expenses is helpful as you can download much of your spending and categorize it more easily. We'd recommend you keep some kind of record of your income and expenses for this first working year. When you get a raise, make sure you allocate some part of it to be saved as well.

Pay Off Your Student Loans

Most college graduates leave school in debt with student loans. You do have to repay these loans, so don't ignore the notices when they start coming in and make sure you include them in your budget. You could end up with multiple payments because you may have taken the loans out at different times. You can get a list of your federal student loans at **www.nslds.ed.gov/nsldsSA**.

Remember, at tax time you can deduct up to $2,500 of your loan interest — note that the deduction begins to phase out for single-filers making more than $65,000 and is fully phased out above $80,000 of income.

Establish Credit

Most college students are offered credit cards while still in college. Actually, we're shocked at how easy it is for students without a visible form of income to get credit. These little plastic cards can be useful, but also can mean you've accumulated debt even before you are graduated from college. When you do graduate, you'll have some transition expenses such as renting an apartment, which may require putting down a month's rent as a deposit; furnishing your new place; and buying a new wardrobe for work.

It can be helpful to pay for some of these expenses, such as new clothes or furniture, with a credit card because you may not have the cash to pay for everything you need right now. But please understand this is real money you're spending, not plastic. It's tempting to pay only the minimum payment due when the bill arrives, but if you do that you may never pay off the bill because of the impact of compounding interest.

Avoid having multiple credit cards. Try to concentrate on one or at most two, and sign up for one with the lowest interest rate available. Credit-card companies often offer low teaser rates to entice you to use

their cards, but generally after a certain period the rates become very high. Keep in mind that this interest isn't tax-deductible. Establishing credit in your name and showing a consistent pattern of paying off debt and making payments for bills on time is important for buying a home or a new car later, but you don't want to take on more debt than you can handle.

Ideally, you shouldn't charge more than you can afford to pay off each month. Timely payment of all obligations is critical, so if possible go online and set your monthly bills to pay automatically.

Just be careful to budget for these payments and not overdraw your checking account. It's helpful to do the lion's share of spending from just one bank card so that you can track all your spending. Just remember to note all your purchases to make sure you have enough in the account. If you receive bonuses at your new job, be sure to use at least part of them to pay off your credit cards if you're carrying a balance.

Understand Your Medical Insurance

Now that you're not a dependent of Mom and Dad, you'll probably become responsible for your own medical insurance. Most employers offer it and it's important that you spend some time studying the options under your employer's plan. Ask the human resources person at your firm to help you if you don't understand the differences between the kinds of coverage offered.

If multiple options are provided, sign up for the program that best meets your needs by comparing the variety of coverage options, doctors included in each plan, services covered and cost. Typically, your employer pays part, but not all, the monthly premium, and you'll pay at least some of the cost when you actually incur medical expenses.

Whatever you do, don't go without medical insurance. In our early 20s, we tend to think we'll always be healthy; medical insurance isn't high on our list of priorities. But all it takes is one accident or unexpected illness to understand its true value.

"Establishing credit in your name is important for buying a home."

Other Insurance

If you're renting, also remember to purchase renter's insurance. Your landlord will have coverage on the building, but this doesn't cover any of the things you intend to bring with you. You'll probably also need to inform your automobile insurance carrier of your new location, so you can purchase renter's insurance at the same time and your car is properly covered.

Building Your Retirement Fund

Typically, your new employer will offer some sort of a retirement plan such as a 401(k) or 403(b). Sign up for it as soon as you can and try to contribute the maximum you can.

Our last article covered the importance of building your retirement fund early. Whatever you invest in a regular retirement plan reduces your current taxes because these contributions won't be currently taxed. This money grows tax-deferred, which allows you to accumulate more over time. And when you get a raise, increase the amount you are contributing to your retirement plan.

In addition, your employer may even match the amount you're investing in the plan. If you can't afford to invest the maximum, at least invest as much as is matched. Check into what happens to the matching money.

Sometimes you have to stay a certain amount of time before you're "vested" in this matching money. This means if you leave before the required time, you'll forfeit the matching money. The amount you contribute plus what is earned is always yours to keep. Having time on your side and beginning at a young age are what make the difference! And if you can save more than we've illustrated, these numbers would be greatly improved.

Your Employer's Retirement Plan

In the case of regular 401(k), 403(b) and 457 plans, you can contribute as much as $16,000 to this plan in 2015 (assuming you earned this amount). You'd receive a deduction of the amount of your contribution from your taxable income, the money would accumulate tax-deferred and when you retire whatever you take out is taxed.

Note that some employers offer Roth 401(k) contributions as well. Although you don't get a tax benefit now for a Roth 401(k) contribution, the amounts aren't taxed when taken out. This offers tax diversification and choices in the future that may help you to maximize your after-tax value.

For example, in a high tax year during retirement, taking out of the Roth 401(k) would be beneficial, and in a lower tax year using the regular 401(k) assets would be more tax-efficient.

In addition (or instead), in 2015 you can contribute as much as $5,500 to a Roth IRA if you're single and have an adjusted gross income of $116,000 or less. Your Roth IRA accumulates tax-deferred and, best of all, when you finally do retire, whatever you take out of a Roth IRA is tax-free.

Of course, most people can't afford to take this much out of their paychecks initially, as they wouldn't have anything left to pay the rent and eat. Most advisers recommend that young workers contribute first to a Roth IRA, since typically this is the lowest tax bracket they'll ever be in. But we'd recommend you consider investing something in your retirement plan at work even if it's the bare minimum. Also, if you have

affluent and generous parents, they might help you fund the Roth IRA or your retirement plan.

The 401(k) really forces you to save because it happens automatically and your contribution is locked in until the next open period, when you can change the amount you invest. Some people need that forced savings element to stay disciplined.

Build a Cash Reserve

When you're facing all these initial expenses, it's hard to think about building a cash reserve. But as we mentioned before, it's important to build a nest egg of cash in the event you have an emergency such as your car needing repair — another reason not to buy a car!.

Your ultimate goal is to have three to six months' worth of your expenses in a cash account. You won't know what those expenses are unless you have done a budget. Once you accumulate enough in your cash reserve account, you can begin investing any excess cash that you earn each month into other types of investments. This can help fund future financial goals such as purchasing a new home or taking a special vacation.

We recommend building your retirement fund, but would suggest trying to build your cash reserve at the same time. Establishing good financial habits early in your career will reward you over your lifetime. Although disciplining yourself financially will be hard at first, you'll find it very worthwhile when you gain better control of your financial future! ■

Alexandra Armstrong is a certified financial planner practitioner and chairman at Armstrong, Fleming & Moore, Inc., a registered investment advisory firm located at 1850 M St., N.W., Suite 250, Washington, D.C. 20036-5813; telephone: 202/887-8135. Securities are offered through Commonwealth Financial Network, member FINRA/SIPC.

Kelly Wright, certified financial planner practitioner, co-author of this article, is vice president of financial planning at Armstrong, Fleming & Moore, Inc.

Investment advisory services are offered through Armstrong, Fleming & Moore Inc., an SEC-registered investment adviser not affiliated with Commonwealth Financial Network.

Consult your personal financial adviser before making any decisions. Ms. Armstrong and Mr. Wright can't answer individual inquiries but welcome suggestions for future article topics. This material has been provided for general informational purposes only and does not constitute either tax or legal advice. Investors should consult a tax or legal professional regarding their individual situation.

StockUp

Register for the Next Live StockUp Webinar

Jumpstart Your SSG Skills • September 9th, 8:30 PM ET

Join the instructors for an interactive session as they complete a Stock Selection Guide (SSG) using the CoreSSG Online Tool.

If you missed any of these live StockUp webinars you can still watch them online.

- Buy the Best!
- Bridging the GAAP — How to Evaluate Data Differences
- A Look Under the Hood of LKQ Corp
- Shopping In Your Portfolio
- Feeding and Weeding Your Portfolio
- The StockUp Book Club — Meeting Number ONE
- A Bull/Bear Debate on Apple APPL
- Yes! We Do Sell Stock!
- Keep Current: Make Sure Your SSG Speaks to You

To view these pre-recorded StockUp webinars or to register for a live StockUp session visit: www.betterinvesting.org/stockup

StockUp Is an Exciting Program That Presents a Variety of Important Investing Topics in a Fun and Informative Format