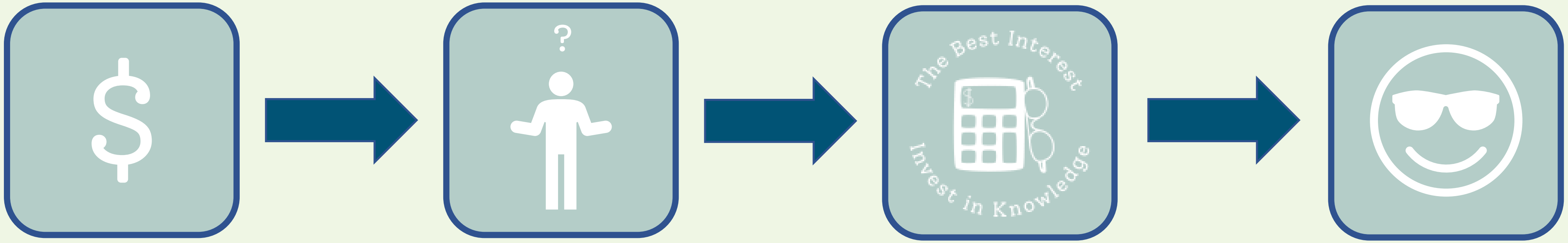
The Best Interest

The Financial Order of Operations



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The Most Common Question in Personal Finance

What should I do with my money?

Though your version of the question might sound like…

“I got a big bonus! Now what?”

“I have leftovers from my paycheck. What smart things can I do?”

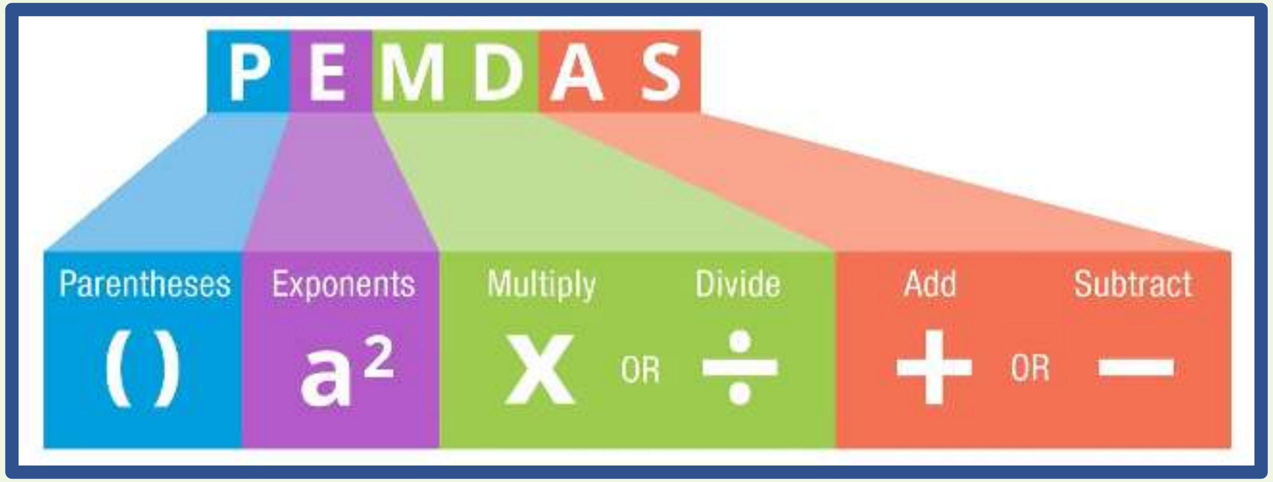
“Should I invest? Pay down debt? Save for a mortgage?”

All these questions are answered using

The Financial Order of Operations

Just Like Math's Order of Operations

- When you're facing a math question, you employ PEMDAS—the mathematical order of operations



Source: TheCalculatorSite.com

- Personal finance has its own version.
- **<u>It tells you the order you should solve your money problems.</u>**

The Basics – 10 Steps

There are **<u>10 basic steps</u>** in this order of operations…

1. Create a budget
2. Build a small emergency fund
3. Pay off high interest debts
4. Maximize employer matching on retirement funds
5. Build a 3-6 month emergency fund
6. Pay off "mid" interest debts
7. Max out Roth IRA, HSA (or similar)
8. Max out 401k (or similar)
9. Pay off "low" interest debts
10. Prepay future expenses

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links
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additional information.

The 10 Steps Explained

But let’s go into a little more detail on each step…

1. Create a budget
    - A budget is your financial baseline. It allows you to understand three things:
        - How much money you have right now.
        - How much income you’re getting
        - How much of that income you’re spending

[More info → How experts budget]()

The 10 Steps Explained

2. Build a small emergency fund

- An emergency fund is money that just sits in your bank account, waiting for an important reason (an emergency!) to use it
- At this level, your emergency fund should be big enough to cover your insurance deductibles. You need to have money to cover your healthcare, car repair, or home repair *before* your insurance kicks in.
- Typically, this is around **$1000**

A real-life example → why an emergency fund is important.

The 10 Steps Explained (cont'd)

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3. Pay off high interest debts

- "High interest" is typically defined as 8% interest rate, or higher.
- Example: credit card debt (typically ~20%)
- Debt is like a leaking bucket—you just sit there and your money disappears. Before you fill up the bucket anymore, first you need to fix the leak!

The 10 Steps Explained (cont'd)

4. Maximize employer matching on retirement funds
   - Some employers will offer **free money** as a employee benefit. The catch is that you only receive the free money if you choose to invest in your retirement accounts—like your 401(k)
   - Get as much **free money** as you can!

Step by step → how I invest in my retirement accounts

The 10 Steps Explained (cont'd)

5. Build a 3- to 6-month emergency fund

- This is like **Step 1**, but bigger. Build up that emergency fund so it could cover your living expenses in the event of an unexpected loss of employment.

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The 10 Steps Explained (cont'd)

6. Pay off "mid" interest debts

- "Mid" interest debts are typically in the 6% to 8% interest rate range.
- You *could* invest money in the stock market—and you'd expect an average return of *about* 7% (**source**). Or you could just pay off these mid-interest debts and **guarantee** a 6-8% return.

The 10 Steps Explained (cont'd)

7. Max out Roth IRA, HSA (or similar) accounts
   - The government offers you a sweet deal: if you save money for later, they'll give you a tax break. The Roth IRA and HSA accounts are generally considered the optimal tax-advantaged accounts.

More info → Why long-term investing takes faith…

The 10 Steps Explained (cont'd)

8. Max out 401(k) account
   - After you get all the "free money" you can in Step 4, this step rounds out the benefits of your 401(k)
   - Similar to Step 7, this step ensures you get the biggest tax break you can.

Read this → But what about market crashes?

The 10 Steps Explained (cont’d)

9. Pay off "low" interest debts

- “Low” interest debts are typically 6% interest rate or less.
- Some student loans, most mortgages
- The idea here: an average 7% rate of return in the stock market is **better** than preventing a 6% (or less) loss by paying off a low interest debt

The 10 Steps Explained (cont'd)

10. Prepay future expenses
    - You might be saving up for a house or for retirement
    - You know someday you'll need a new car, to pay for kids' college, etc.
    - Spending will happen – why not save for it now?

More info → What about the "unknown unknowns?"

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The Detailed Flowchart

If the 10 Steps feel a little incomplete, then the flowchart on the next few pages should fill in the gaps.

The color scheme of the boxes link back to the flowchart as follows:

1) Create a budget & pay essential bills

2) Build a small emergency fund, then pay non-essential bills

3) Pay off high-interest debts

4) Max out employer matching

5) Build a 3-6 month emergency fund

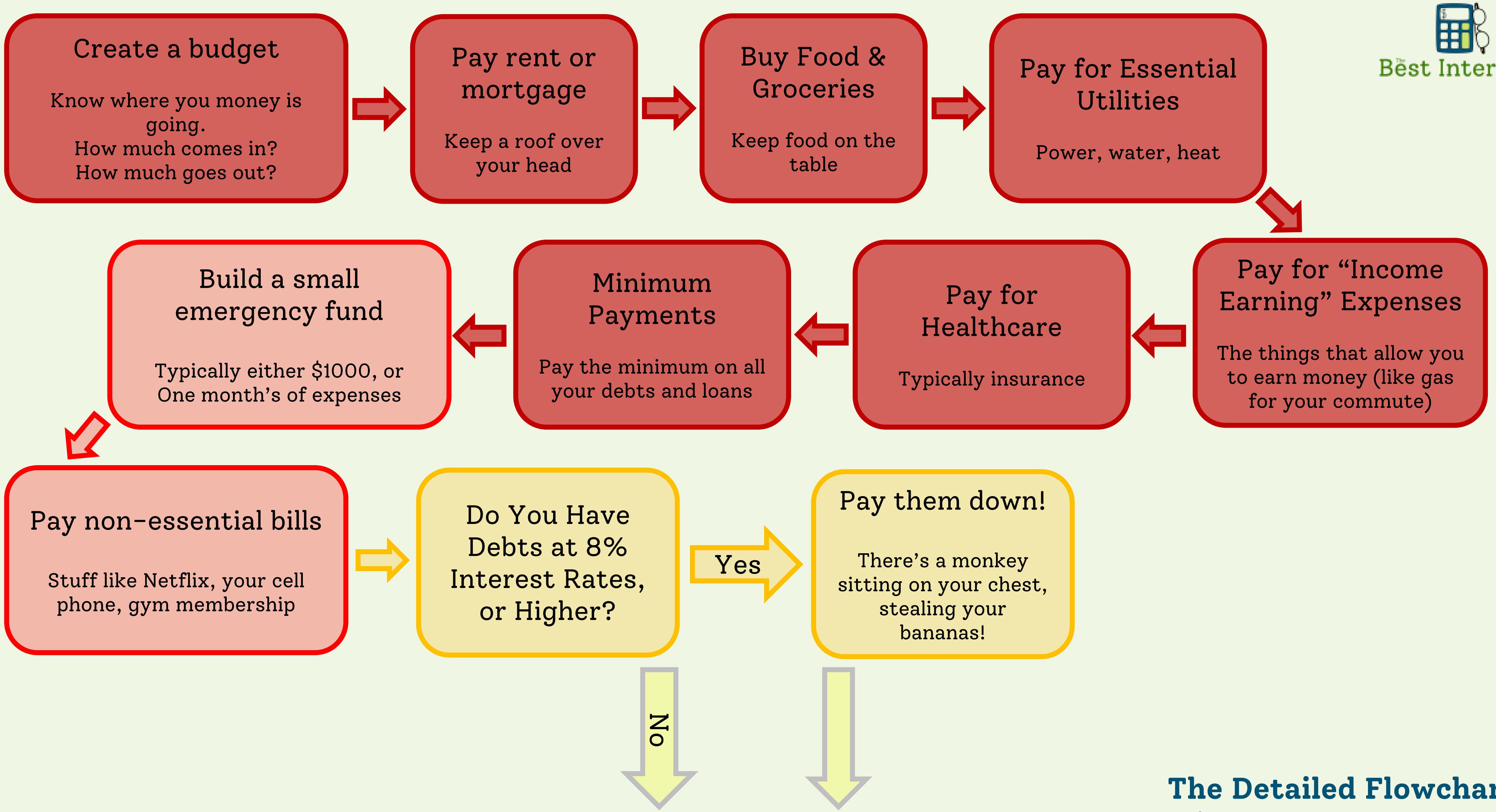
6) Pay off mid-interest debts

7) Max out IRA & HAS accounts

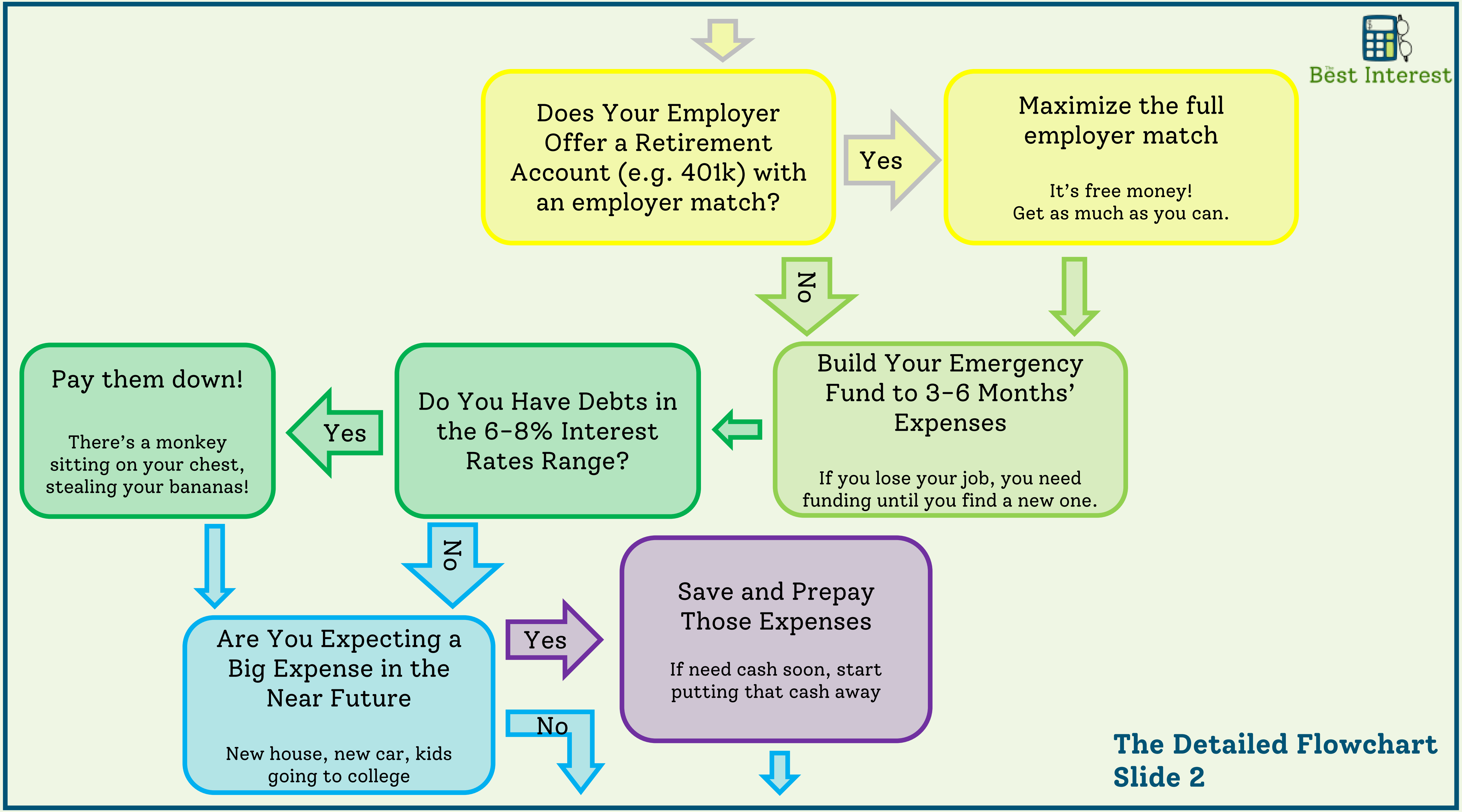
8) Max out 401(k), 403(b) or similar accounts

9) Pay off low-interest debts

10) Prepay future expenses



The Detailed Flowchart Slide 1



Does Your Employer Offer a Retirement Account (e.g. 401k) with an employer match?
Yes
Maximize the full employer match
It's free money!
Get as much as you can.
No
Build Your Emergency Fund to 3-6 Months' Expenses
If you lose your job, you need funding until you find a new one.
Do You Have Debts in the 6-8% Interest Rates Range?
Yes
Pay them down!
There's a monkey sitting on your chest, stealing your bananas!
No
Are You Expecting a Big Expense in the Near Future
New house, new car, kids going to college
Yes
Save and Prepay Those Expenses
If need cash soon, start putting that cash away
No
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The Detailed Flowchart
Slide 2

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Max out your Health Savings Account (HSA)

This is only offered with High Deductible Health Plans

Don’t worry if you don’t qualify…it probably means you’ve got a good health plan.

Max out your Individual Retirement Account (IRA)

Evaluate whether you’d rather have a Roth (post-tax) or Traditional (pre-tax) IRA

Max out your Employer Retirement Account

Such as 401(k) or 403(b)

Do You Have Any Remaining Debts?

At this point, they should be 6% interest or less

Pay them down!

Save and Prepay Future Expenses

New car? New house?
Savings for kids’ college?
Invest extra for retirement?

You know you’ll need money in the future, so why not start saving now?

The Detailed Flowchart Slide 3

...And Now What?

Now that you've mastered the order of operations, what's next?

1. I recommend setting some **simple financial goals**

2. Is your money on track? See **how your net worth compares to your age group.**

3. Not where you want to be? Use **this calculator** to set a savings goal for the next year.

If you enjoyed this guide and want to read more, come check out **The Best Interest.**

Best,
Jesse Cramer
Founder, The Best Interest