

Managing Cash Flow

As the economic crisis grinds on, many people are struggling with their personal financial situation and how to make ends meet. If you can't get yourself to sit down and do a budget, consider the bucket model for managing your cash flow. You have three buckets that you need to fund.

The first bucket is for current fixed expenses based on past decisions (mortgage or rent, car payment, utilities, insurance, school loans, monthly bills, taxes, etc.). Include in this bucket any regular payments to which you have committed. You don't have a lot of flexibility with these expenses each month.

The second bucket is for current discretionary expenses, things you get to decide how much to spend on each month, like groceries, eating out, entertainment, etc. This is where a lot of us fritter away money without really knowing where it's going. What did I do with that \$20 I withdrew from the ATM?

The last bucket is for your future – an emergency fund, retirement savings, college savings, savings for a big vacation, etc. Obviously, the bigger the first bucket (fixed monthly expenses), the smaller the other two (for current discretionary expenses and your future) will have to be. If you have a lot of fixed monthly expenses and debt payments you will have less left over from your paycheck each month to buy groceries or set aside for retirement.

Each bucket should have its own account(s) associated with it. Take your monthly take-home pay (after paying for benefits, tax withholding, etc.) and figure out how much you need to put in the fixed expense bucket to cover each month's bills. Have that amount directly deposited in an account for fixed expenses, and pay those bills out of that account.

Now comes the hard part. Of what you have left each month after paying your fixed expenses, how much can you set aside into the "future" bucket, and how much do you want/need for current discretionary expenses? Obviously, you need to buy groceries, toothpaste, gas, and other basics out of that discretionary bucket. But, committing to saving some specific amount out of each paycheck (even if it's just a couple hundred dollars) can really add up over time. Be realistic, but determine how much you want to save each month and have those funds directly deposited into their own account (savings or money market), keeping your funds for discretionary expenses in your checking account.

Once you have 3-6 months (or more) worth of expenses set aside in the "future" bucket as an emergency fund, you can dedicate additional savings to paying down debt more

quickly and/or saving for specific future goals – down payment on a house, a big vacation, college expenses, retirement. For “future” expenses that you do not expect to incur for more than five years, you can set up an investment account (or a separate account for each specific goal). Of course, as explained in my last article, you will want to take full advantage of tax-deferred opportunities to save for retirement, and may have contributions to your work retirement account taken directly out of your paycheck.

The beauty of this simple strategy is that you don’t have to track each latte you buy, or struggle with the decision of whether you have enough money to buy new clothes. Your “discretionary” checking account (the second bucket) is what you have access to for spending. You need to be prudent so that it lasts you until your next paycheck, and if you spend less this month, you have more available in the following month. At the same time, you are saving for your future – for college, vacation, retirement, or whatever future expenses you determine.

For more information on this strategy check out the Introductory Video (7 minutes) at: www.firststepcashmanagement.com

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