To God who has given me the opportunity to learn, research and write about personal finance; and

To my wife, Alice, and my children, Elizabeth, Jonathan and Abigail for their love, support and encouragement.

B.K.

To my wife for her constant support and encouragement in writing this book.

F.W.M.
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This book grew out of our lectures on personal finance at the National University of Singapore. The course was introduced in 1995 at a time when local interest in personal finance was still in its infancy. We felt that there was a need for Singaporeans to realise the importance and pleasure of knowing how to manage their money well. We were convinced that increasing affluence alone will not result in financial well-being unless people take steps to set realistic goals, develop thoughtful plans to achieve their goals and learn to sacrifice short-term gains for long-term good. These are not ivory tower issues but real issues that affect our pockets. Lives can be ruined and families torn apart because we lose control over money matters. Financial planning can help us avoid such unhappy outcomes. Indeed, the primary goal of financial planning is to help us achieve better financial outcomes for ourselves and our loved ones. The purpose of this book is to show how we can do this.

There are, of course, many books already written on personal finance. However, most of these are US-based and therefore do not address issues that are unique to the Singapore context such as the Central Provident Fund schemes, local bank practices and tax policies. While there are a few books written for Singapore readers, none provides a comprehensive and in-depth treatment of personal finance.

This book is the first Singapore-based textbook on personal finance that provides in-depth analysis of a wide range of topics. Topics include the basics of financial planning, tools for financial planning, cash budgeting, managing liquid assets, credit management, buying a car, investing one’s money, life insurance, taxation, retirement planning, estate planning, risk profiling and asset allocation. Each topic is given a rigorous and balanced treatment. Readers will find a wealth of practical advice on how to practise better financial planning.

The target audience of this book consists of tertiary students and those who are taking financial planning courses leading to CLU, CFP, ChFC and ChFP accreditation. Financial planners and advisors in banks, insurance and stockbroking firms as well as independent financial planning consultants will find the book a useful resource for dispensing financial advice to their clients. As for general readers, we are certain that they will find the practical advice in this book useful.

It would not have been possible to write this book without the help of many people. We would like to thank our spouses for their understanding and patience in tolerating time overspent on the word processor.
INTRODUCTION

If you don’t know where you are going, no road will lead you there’. This well-known saying highlights the critical link between planning and goal achievement. Most people manage their personal finances in one of two ways. They either take the passive approach of reacting to financial circumstances as they unfold in their life, or they adopt the strategic approach of planning ahead to achieve their desired goals.

While it is obvious that the proactive (or strategic) approach is the superior approach, most people living in a fast-paced urban society tend to adopt the reactive (or passive) approach to personal financial planning. Many individuals make financial decisions only when pressured to do so. For example, many young graduates do not plan their career but instead settle for the first job that comes their way upon graduation. When it comes to buying a car, they make the decision abruptly when Junior comes along. They make no attempt to study the historical price trend to optimally time their car purchase. Even for the most important financial decision of buying a house, most contemplate this decision only when they are about to get married or when they dread the prospect of living with their in-laws. Very few people bother to study the underlying fundamentals that affect the demand and supply of residential properties and their price trends to determine the most opportune time to enter the property market. For many, retirement planning becomes an important issue only when they are about to retire. Few people consciously think about building their nest egg when they are still actively working.
As you can see, most individuals do not plan for their future. Instead, they hope that somehow the future will turn out well for them. While it is impossible to plan for everything, some financial decisions are predictable for most people and can be anticipated at specific stages of their life cycle. These include decisions related to career choice, buying a car and home, financial investments, insuring against death and disabilities and investing for retirement. Adopting a strategic approach requires individuals to think about such decisions long before they are made. This requires them to consciously set goals that they wish to achieve in their lifetime and develop systematic plans to achieve them. By planning ahead, individuals can make better decisions and obtain better outcomes from their personal financial planning.

**NEED FOR PERSONAL FINANCIAL PLANNING**

Personal financial planning is necessary if you wish to improve your standard of living, minimise the likelihood of financial disaster, invest optimally and accumulate sufficient wealth over time.

Most people desire to improve their standard of living over time. Some aspire to a comfortable lifestyle, one in which they need not worry about every single cent they spend. Others wish to upgrade their car, house or social status. To ensure that these wishes become a reality, it is necessary to consciously plan for these outcomes. Seldom do people attain their desired standard of living by luck. They must plan for it.

Personal financial planning also reduces the likelihood that you will be adversely affected by major financial disasters. Imagine that you are suddenly taken ill or retrenched. Under such circumstances, you may encounter severe cash-flow problems. You may not have enough savings to tide you over periods of illness or unemployment. As ill health and unemployment can strike anyone without warning, it is imperative to hedge against such contingencies. This can be achieved by maintaining an emergency fund. The size of this fund depends on your current lifestyle and the expected duration of the illness or unemployment. Generally, it is prudent to keep between three to six months of your salary in an emergency fund.

Instead of keeping all your hard-earned money in savings or time deposits that pay meagre interest that may not offset inflation, you should consciously look out for higher yield instruments to make your money grow over time. Careful investment planning allows you to exploit opportunities that may arise from time to time as conditions in financial markets change.

Personal financial planning also helps you to accumulate wealth for the future. Formulating a well thought-out plan and constant monitoring of the plan will allow you to take corrective action so that the likelihood of retiring from your working life with substantial wealth is greatly enhanced.
PERSONAL FINANCIAL PLANNING PROCESS

Planning your personal finances is relatively straightforward, with the process akin to planning a driving holiday. When planning a driving trip to Penang, the first step is to know where you are, that is, to identify your starting point (Singapore). Next, you determine where you intend to go: that is your destination (Penang). Thereafter, you plan the route that you wish to take from your starting point to your destination. What are the alternatives? You may choose the fastest route (North-South highway), the shortest route (highways bypassing towns), the most scenic route (roads along the East Coast) or even the most challenging route (local roads along hilly ranges). Your choice depends on your tastes, time constraints and your knowledge of the terrain. Once you have decided on your course of action, you start the engine and drive off. Suppose you had chosen the scenic route but midway you found that there was nothing interesting to see. You may decide to switch to the fastest route or the shortest route to reach your destination. Or perhaps you have lost your way and if time is running out, you may be forced to change your destination.

The steps of planning for your personal financial affairs are similar to planning for a driving trip. The process involves the following five steps:

1. Ascertain your current financial resources;
2. Define your financial goals;
3. Develop systematic financial plans;
4. Implement these plans;
5. Monitor the results and revise goals and plans whenever necessary.

Ascertain Your Current Financial Resources

The financial goals that you intend to pursue depend critically on your available financial resources. The more financial resources you possess, the more goals you can seek to achieve. Hence, the first step in the personal financial planning process involves ascertaining your current financial resources. This step is analogous to identifying your starting point in a driving trip. You can quantify your current financial resources by developing your personal balance sheet and income and expenditure statement. Your personal balance sheet shows the assets that you own and the liabilities that you owe others (see Table 2.1 in Chapter 2 for a sample balance sheet). The difference between the assets and liabilities constitutes your net worth, or your true wealth. Your personal income and expenditure statement shows how much income you earn annually and how much has been spent (see Table 2.3 in Chapter 2 for a sample income statement).
The difference between income earned and expenditures incurred is your net savings. If you save consistently, your net worth will increase over time.

**Define Your Financial Goals**

The second step of the planning process is to set goals that you wish to attain in the future. Without goals you cannot develop financial plans. Stating your desired goals is analogous to identifying your destination in a driving trip. Which goals should you pursue? The goals you choose often depend on your wants, needs, personality, attitudes and values. Some crave the 5Cs – career, credit card, car, condominium and country club membership. Hence, the 5Cs are based on your wants. If you intend to get married soon, your goal is to buy a house. If you are someone who cares deeply for your children’s future, your goal may be to set up an education fund for them. These two goals are determined by your need for accommodation and your desire to provide a good education for your children. If you are extremely risk averse, your goal may be to start a retirement fund now in order to retire comfortably. If you are thrifty and desire a simple lifestyle, then you may wish to acquire a HDB flat instead of a condominium for your accommodation. When setting financial goals, it is advisable to follow the guidelines listed below.

**Distinguish Long-term and Short-term Goals**

It will be useful for you to distinguish your long-term goals from your short-term goals. Short-term goals are those that you wish to achieve within the next one or two years. In contrast, long-term goals are those that you wish to achieve in the distant future. You should pay close attention to short-term goals simply because you have
a shorter time frame to achieve them. Although there is less urgency to achieve your long-term goals, it does not necessarily mean that they are less important. In fact, you should ensure that long-term goals are broken into subcomponents that themselves become short-term goals. For example, if your long-term goal is to set up a nest egg of $500,000 for retirement in 20 years’ time, you need to save and invest $11,000 per year for 20 years. An investment plan of $11,000 next year becomes a short-term goal for you.

**Be Realistic**

The goals that you set must be realistic in that they are achievable over the target time horizon. It is wishful thinking to plan to buy a $10 million bungalow if your monthly salary is only $4,000 and if you have no other financial resources. Setting realistic goals also ensures that you avoid disappointments in your life.

**Be Specific and Quantify Goals in Monetary Terms**

As far as possible, you should specify and quantify your goals in monetary terms. A goal such as “to have a comfortable life” is not a very useful goal because it is not specific enough to allow you to work out a financial plan. A more specific goal may be “to have a comfortable life that entails having $5,000 to spend monthly, a two-litre car, a condominium and a country club with golf facilities”. Quantifying your goals allows you to plan how much you need to invest in order to attain the desired target.

**Set Target Dates for Achieving Goals**

By setting target dates, you inject some urgency into achieving the chosen goals. These target dates also help you determine if you have been successful in achieving your goals since they act as deadlines. If there are no target dates, most people tend to procrastinate. Consequently, you will never know whether you have achieved your desired goals.

**Prioritise Goals**

Most people have multiple goals. Given your limited financial resources, these goals must be prioritised. That is, you should identify which goals are most important and hence should be achieved first. Table 1.1 provides an example of the goals that you can set for yourself.

**Develop Systematic Financial Plans**

After having identified the goals that you wish to pursue, the third step is to develop financial plans to achieve these goals. The financial plans map out in detail the concrete steps that you should take to realise your goals. In other words, they
specify the actions you should take each month or each year to achieve these goals. Developing a financial plan is analogous to choosing the route of travel from the starting point to the destination on a driving trip.

Table 1.1  Personal Financial Goals

<table>
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<th>Financial goal</th>
<th>Priority</th>
<th>Target date</th>
<th>Amount</th>
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<tr>
<td>Increase income by 10% p.a.</td>
<td>High</td>
<td>31.12.2010</td>
<td>$12,000 annual increment</td>
</tr>
<tr>
<td>Free of debt by age 55</td>
<td>Medium</td>
<td>31.12.2034</td>
<td>Decrease principal by $20,000 p.a. for 25 years</td>
</tr>
<tr>
<td>Education fund for two children</td>
<td>High</td>
<td>31.12.2024</td>
<td>$60,000</td>
</tr>
<tr>
<td>New two-litre car</td>
<td>Medium</td>
<td>31.12.2012</td>
<td>$36,000 as downpayment</td>
</tr>
<tr>
<td>Freehold terrace house</td>
<td>Low</td>
<td>31.12.2020</td>
<td>$200,000 as downpayment</td>
</tr>
<tr>
<td>Annual vacation</td>
<td>Low</td>
<td>31.12.2010</td>
<td>$10,000</td>
</tr>
<tr>
<td>Start a retirement fund</td>
<td>Medium</td>
<td>31.12.2034</td>
<td>$15,000 p.a. for 25 years</td>
</tr>
</tbody>
</table>

To illustrate, suppose your goal is to buy a new car in three years’ time. You estimate that the cost of a new car in three years’ time will be $120,000 and the maximum financing available to you then will be $84,000. This means that your medium-term goal is to accumulate $36,000 in three years’ time. You can design two financial plans that would allow you to accumulate $36,000. The first financial plan requires you to set aside a lump sum now and invest in a time deposit earmarked for the car purchase. If the current interest rate is 4% per annum, you would need to save $32,004 now. The second financial plan involves saving a regular sum of $11,533 every year for three years. Either plan will provide you with $36,000 in three years’ time.

While it would be ideal to develop one master plan for all your goals, this is not possible in practice. Hence, you need to develop a different plan for different goals. Table 1.2 shows the types of financial plans that you can develop for various goals.
Table 1.2   Types of Financial Plans and Goals

<table>
<thead>
<tr>
<th>Financial plan</th>
<th>Goal</th>
</tr>
</thead>
<tbody>
<tr>
<td>Money management plan</td>
<td>Budget and control expenses.</td>
</tr>
<tr>
<td>Savings plan</td>
<td>Meet target expenditures and emergencies; acquire target level of wealth.</td>
</tr>
<tr>
<td>Investment plan</td>
<td>Acquire major real and financial assets.</td>
</tr>
<tr>
<td>Liability plan</td>
<td>Manage level/cost of borrowings.</td>
</tr>
<tr>
<td>Housing plan</td>
<td>Decide on optimal time to buy or sell property.</td>
</tr>
<tr>
<td>Insurance plan</td>
<td>Protect yourself/assets/dependents.</td>
</tr>
<tr>
<td>Retirement plan</td>
<td>Ensure financial security in old age.</td>
</tr>
<tr>
<td>Estate plan</td>
<td>Ensure orderly transfer of wealth to heirs.</td>
</tr>
</tbody>
</table>

The financial plans that you develop should not be static but must change as you age. This is because your desired goals change along with your age. The goals you pursue at each stage of your life are influenced by your income, risk aversion and needs. Typically, you will have no income while you are in school. Once you start working, you will earn an income that grows significantly as you progress in your career. However, your income will reach a plateau when you reach middle age and thereafter stabilise until retirement. Upon retirement, you will not have a regular source of income unless you have substantial investments in return-generating assets. The pattern of your income throughout your life constrains the type of financial plan you can adopt.

Since the goals you pursue are correlated with your life cycle, it is not surprising to find that some financial plans are relatively more important than others at different stages of your life. Table 1.3 provides an example.
Table 1.3  Relative Importance of Financial Plans

<table>
<thead>
<tr>
<th>Age group</th>
<th>Financial plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>20s/30s</td>
<td>Savings plan</td>
</tr>
<tr>
<td></td>
<td>Money management</td>
</tr>
<tr>
<td></td>
<td>Housing plan</td>
</tr>
<tr>
<td></td>
<td>Investment plan</td>
</tr>
<tr>
<td></td>
<td>Liability plan</td>
</tr>
<tr>
<td>30s/40s</td>
<td>College plan</td>
</tr>
<tr>
<td></td>
<td>Insurance plan</td>
</tr>
<tr>
<td></td>
<td>Investment plan</td>
</tr>
<tr>
<td></td>
<td>Tax plan</td>
</tr>
<tr>
<td>50s and beyond</td>
<td>Retirement plan</td>
</tr>
<tr>
<td></td>
<td>Estate plan</td>
</tr>
</tbody>
</table>

Implement your Financial Plans

Once you have drawn up your financial plans, they must be implemented. The challenge for most individuals is maintaining the discipline to implement their plans within the specified time frame. One way of instilling this discipline in ourselves is to specify a timetable for each plan.

Monitor the Results and Revise Plans or Goals Whenever Necessary

It is important to monitor closely the outcomes of your financial plans. This enables you to check whether you are progressing consistently towards achieving your goals. If there are deviations, you may have to take corrective actions to ensure that your goals are within reach by the target dates. These corrective actions may be minor or major depending on your progress and financial circumstances. Sometimes, if financial circumstances have changed so drastically that your goals have become unrealistic, it may be necessary to revise those goals as well.

The five-step personal financial planning process is circular in that the entire process must be repeated year after year. This may seem tedious but the effort involved in planning will eventually be richly rewarded.

REWARDS OF PLANNING

If you have been diligently executing the five steps in the personal financial planning process, you will achieve better management of your financial resources, improve your standard of living and accumulate wealth over time. These are the three key benefits of personal financial planning. Because you consciously think about the
goals you wish to achieve and you take time to design the most suitable financial plan for each goal, you are better positioned to exploit investment opportunities that may arise from time to time. Your financial resources will be efficiently utilised to generate higher returns for you. You will be able to enjoy a comfortable lifestyle while living within your means. If you consistently achieve your goals over the years, you will also be able to accumulate wealth. The accumulated wealth will afford you a comfortable retirement. Moreover, there may be sufficient wealth left over to bequeath to your loved ones.

THE PLANNING ENVIRONMENT

The focus of the five-step personal financial planning process is on your financial resources, your goals and your plans. However, it is important to realise that the outcome of your plans depends on both your actions as well as the actions of others. Other key players can also affect the outcomes of your plans. These include other investors, financial institutions and the government. It is the aggregate interactions of these players that determine the outcome of any financial plan.

When planning, you should understand the government’s monetary and fiscal policies and regulations. The monetary policies of the government affect the money supply, the reserve requirement and the discount rate. These, in turn, determine the interest rates and inflation rates in the economy. The fiscal policies of the government relate to taxes and government expenditures. These policies can lead to an expansionary or contractionary economy. The aggregate impact of the government’s monetary and fiscal policies can ultimately affect the returns that you generate from your investments.

Before committing your hard-earned money to risky investment, it is necessary for you to understand the unique characteristics of the financial markets that you wish to invest in. Financial markets are of varying degrees of efficiency. Efficient financial markets tend to incorporate new information very quickly so that it is difficult to exploit the information that has been announced publicly. Conversely, inefficient financial markets incorporate information slowly and hence prices tend to register trends. By being close to the market grapevine and by studying price trends and volume statistics, you may be able to outperform the market.

Most asset markets undergo periods of boom and bust. In other words, there are price cycles in financial markets. Understanding how asset price cycles are related to the business cycle can help you to time your investment. To make money, you basically have to buy low and sell high. This means that you should buy assets when the cycle is at the trough and sell them when it is at the peak.

One way to understand the business cycle is to study the trends of major economic indicators. Some of these indicators are leading (lagging) indicators in that they lead
(lag) the business cycle. By focusing on the performance of the leading indicators, you can forecast where the economy is heading, that is, whether it is in a growth phase or a contraction phase.

The other financial variables that should be of interest to you include inflation rates and interest rates. In a highly inflationary economy, holding cash results in decreasing purchasing power. Furthermore, if you are investing in instruments that generate a fixed income, the real return of these instruments declines over time. Hence, if inflation rates are high, it is prudent for you to invest in instruments that hedge against inflation, such as property, commodities or common stocks.

Investors should also keep track of interest rate fluctuations. In an environment where the interest rate is high, the opportunity cost of investing is also high. This is because investors can always put their money in fixed income instruments such as bonds in order to earn a high interest yield. If you are a borrower, such as a margin trader, a high interest rate means a high cost of investment. Hence, whether you are an investor or a borrower, it is necessary for you to monitor the interest rates prevailing in the market.

**PERSONAL INCOME**

It takes money to make money. The return on your investment depends also on the amount of capital invested. If you invest a large sum in a high-yield instrument, the absolute return can be substantial. Most people do not have the good fortune of receiving an inheritance from their parents or relatives. Their basic source of income is their wages. By understanding the factors that determine your wages, you can manage them to enhance your earning capacity.

There are three main factors that you should consider. The first factor concerns your income’s life cycle. The income you receive will fluctuate within your lifetime. This means that at the beginning of your working career, your income will be low. Your income will rise to a peak around age 40 to 50. Thereafter, your income will tend to stagnate. You should incorporate the life cycle of your income into the planning process.

The second factor that affects your income is education. Your income tends to increase with your level of education. Individuals with tertiary education generally earn more than those without tertiary education.

The third factor that affects your income is your career. Vocations that require special skills command higher income. Hence, a banker, doctor, lawyer or accountant will tend to earn a higher income than an administration manager.
CONCLUSION

Most people desire a high standard of living and a comfortable retirement. Yet very few consciously plan to achieve these outcomes. This is because most people tend to adopt the reactive approach to managing their personal finances.

This chapter shows how you can be proactive and plan your finances in a systematic way. Financial planning involves a five-step process: ascertaining your current financial resources, setting goals, devising financial plans for desired goals, executing your financial plans and monitoring to ensure that you are progressively moving towards your goals.

If you adopt this five-step financial planning process consistently, you will increase the likelihood of reaping the rewards of planning: a high standard of living, better management of your financial resources and accumulation of wealth over time.

To be successful in planning, it is necessary for individuals to understand their financial environment as well as the factors that provide them with income to invest. The outcome of their financial plans depends on both their actions and the actions of others such as the government, other investors and financial institutions. Understanding the unique characteristics of financial markets, financial institutions and the policies of the government is critical in securing success in investment.

Remember this: individuals who fail to plan, plan to fail. Those who plan have an edge over those who don’t.
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