FARNOOSH TORABI

PSYCH YOURSELF RICH

GET THE MINDSET AND DISCIPLINE YOU NEED TO BUILD YOUR FINANCIAL LIFE

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Preface

The arrival of this book and its message, I suspect, could not have been better timed. We're more than two years into this great recession, and many of us are more confused than ever about our personal finances. With the financial and employment landscapes evolving before us, it's difficult to return to the old, prescriptive advice we've grown accustomed to. Emotionally, we've got a lot going on; we're angry, hurt, confused, and we've lost confidence. Our emotions have (and continue to) run high. By now we recognize that we need to change our ways, but not in a knee-jerk, reactionary way. After all, economic volatility is cyclical and will likely return in a new form in the near future. What's needed is advice that doesn't just stem from the rules and regulations of the banking, credit, and financial world but is rooted in our behavior and habits. We need to understand ourselves, get honest, and make money one of the most personal issues and biggest priorities of our lives. If we can get a tighter hold on our minds, our actions, and our belief systems, we can be in control of anything, most importantly our financial lives.

When I first started developing this book, I struggled to succinctly describe its idea to my colleagues, friends, and family. Not because I hadn't a clue, but because my mind was racing. Only until I was deep into my writing could I possibly narrow it down, and even then my summary ran wild. "It's about how our emotions complicate our financial lives and hinder us from making the best financial decisions…It's about the complications of money and how it's actually never about the money…*ramble ramble ramble*…It's about how we have the ability to make better financial decisions, but rarely do…It's…well, it's complicated," went my usual rant (followed by awkward silence). My sympathetic listeners often responded with generous nods and smiles. They said they couldn't wait to read it, even though they weren't quite sure what the heck I was talking about!

This book has been an incredible learning process and has been, by far, my most challenging project. It's been a couple years since I've authored a book. The first was a financial guide for young adults, and as my readers and I matured, we reached a place where we demanded a deeper understanding and explanation of money. We wanted to get a better handle on our financial commitments and our future goals. We wanted to better understand our mistakes and learn how to lay a foundation for personal wealth down the road, especially with the recent financial crisis. This book teaches us how to stop second-guessing ourselves, how to differentiate what is financially right and wrong, and how to actually make the best decisions on our own terms.

Fortunately, I've always had a deep curiosity for understanding why we do the silly things we do with money, so researching the *why* for this book was quite entertaining at times. The behavioral research was available in abundance, thanks to some economic pioneers. Without them and their brilliant minds, this book would be just 50% complete. As for me, my promise was to provide the *what now* to readers. What do we do, now that we know we have irrational tendencies when it comes to money? How do we actually begin to embrace the *M* word in a more honest, personal, and rational way?

Finding solutions to these questions has been a journey of discovery. Looking back, it was a trip I believe that was launched long before I began developing the notion behind *Psych Yourself Rich.* It started when I began entering people's homes, watching them spend money and hearing them talk about their goals. There's nothing like the face to face. Participating in shows such as TLC's *Real Simple. Real Life* and SOAPnet's *Bank of Mom & Dad* allowed me to see and hear actual people struggling with money. Through them, I discovered how our emotions and our biases can deeply influence our financial decisions. And getting to the root of your emotions—and realizing you can control them—is the first *what now* step toward financial freedom. Along the way, I've learned and taught that financial freedom is also about respecting yourself, having a deep understanding of what you want and *don't* want in life, and of course, living within your means.

In the chapters that follow, I'll help you develop the discipline, behaviors, and habits that will lead you to make positive choices about your financial life. I'll help you dig into what's keeping you from being motivated and taking positive action, and look at the behaviors that make people "money zombies." Once those ingrained behaviors are exposed, we can explore the positive habits and the discipline necessary to build a secure financial future.

The methods in this book will enable you to pursue personal and professional goals and will result in achieving financial security, now, five years from now, and long into the future.

Your journey starts now.

Introduction

Being decisive about money can be a crapshoot. By the time you finish reading this book, you'll find out why and what you can do about it.

Ask yourself: Why is it that even the best, most coherent, and logical financial advice does little to mobilize us into thinking about or taking control of our money in a meaningful way? Rarely does a lecture on retirement savings and life insurance inspire us to build a path toward improved security and financial well-being. When it comes to making decisive financial choices, there's a visible disconnect between our mind and our actions.

Between earning money and spending lies a world of uncertainty—a gray area. We lose sleep over finding the right answers to questions such as: *How much should I really spend on a house? Maybe I should just rent? Do I put more money into stocks? Where is my money best invested? Why can't I kick the credit card habit? How do I budget for uncertain times? Why do I make impulsive purchases? What was I thinking when I bought this Vespa? And why do I feel the need to keep giving money to mooching friends? Why, when I know better?*

Do you see yourself up there in that swirl of hows, whys, and wheres?

Psych Yourself Rich is based on the principal that our financial lives—much like life in general—are powered and transformed by personal choices and behaviors, both of which are rooted in our values, perspectives, goals, and financial means. Rarely, though, do we really consider all of these key variables when making a purchase, investing in stocks, building savings, or charging against a credit card. Sometimes we just look at price tags and shrug in compliance, or perhaps we're so narrow-minded about our goals we miss great financial opportunities. In other cases, we can't even get to the point of making any decisions. We feel paralyzed and stop dead in our tracks. Emotions prevent us from getting the right help. So instead, poor decisions are made, or worse, nothing at all is done.

A Behavioral Bubble

Emotions play an enormous role when managing personal finances. Many behavioral experts will go so far as to say that our emotions can potentially *destroy* the ability to make sound financial moves. The most recent recession is one such example of bad financial decision making. Finance and economic experts, including Curtis Faith and Dan Ariely (both best-selling authors), have told me that human behavior played a great role in the financial crisis that began in 2008 and continues to this day. Many were caught in a "behavioral bubble"—thinking and acting irrationally, expecting that home prices would rise generously year after year. This behavioral phenomenon was introduced in 2002 by Princeton University psychology professor Daniel Kahneman, who won the Nobel Memorial Prize in Economics for his work into how individuals approach uncertainty.[1] Kahneman's research sheds new light on the theory that investors are prone to behave irrationally. His argument debunked the traditional economic theory that investors make rational and calculated decisions when the stakes are high, that they learn from their mistakes, and are able to adapt to changes over time.

Since the 1970s, a growing group of economists have explored this fringe viewpoint of irrational investing, but it was Kahneman who brought it to the forefront of modern finance and gave a whole new momentum to what we now popularly discuss as *behavioral economics* or *behavioral finance*.

Behavioral finance has struck a major chord within the financial community—so much so that the big investment firms have begun to help their risk-averse clients regain confidence in the markets with internal teams of behavioral finance experts—Barclays Wealth in Europe, to name one. As the bank sees it, different individuals have a predisposition to their own type of investing that makes them more comfortable with that approach over time (i.e., they do what feels emotionally good). Greg Davies, the head of Behavioral Analytics at Barclays Wealth, explains in a bank report that "Everyone sees the world from a perspective which is uniquely theirs, and investing is no different. People have individual goals, requirements, desires, fears and hopes for their wealth. We all have different habits, different people we trust for advice, and different beliefs about the right decision on any occasion."[2]

We're only human, right? Our emotions play a massive role in practically all facets of life…why not money management? The trouble is that emotions often restrict us from making sound financial decisions. Jay Ritter, the Cordell Professor of Finance at the University of Florida and an expert on behavioral finance, recently told me that he believes we are all afflicted by "cognitive biases." Translation: mental barriers. We lean toward following easy, but not always helpful, rules of thumb. Some individuals (especially men) are overconfident about their decision-making abilities, which can manifest in investing excessively and not asking for help when it's really needed. I found this to be true, while doing research in 2009 on the trading strengths of women. A study[3] of 30,000 single male and female investors found that women's portfolios performed a slight 1.4% better than men's.

To learn why, I called Terrance Odean, coauthor of the study and the Rudd Family Foundation Professor of Finance at the Haas School of Business at the University of California, Berkeley. Odean told me that being too bold doesn't always pay off in the investment world. "We hypothesized men would trade more actively than women because of their greater overconfidence in trading ability…and this trading would hurt their returns. We were exactly right," he said. And not only are some of us too confident, we're sometimes too optimistic, a byproduct of human nature and an American culture that emphasize positive thinking.

According to Ritter, we tend to rely more on short-term patterns rather than long-term patterns, which can prove detrimental when making decisions that concern certain financial moves like investing in the stock market or buying real estate. "People tend to put too much weight on recent experiences," says Ritter. Just think about the latest housing bubble and how many of us were convinced real estate prices would never slow down. In addition to recency bias, another behavioral tendency that plagues us is "group think." For example, many individuals believed—and were told by experts—that high returns were normal and should continue. Humans are prone to trusting conventional wisdom, the actions of crowds, and staying on the beaten path.

Ritter, who also teaches a course on financial decision making, says another reason it's often hard for individuals to make money decisions is because they're not trained to think about things like mortgages, car loans, and investments on a *daily* basis. These topics are largely foreign until we are forced to deal with them. But what about spending, I asked? We certainly do that on a day-to-day basis, but still many times without really thinking about the consequences. "That's a matter of people putting more weight on current gratification versus thinking about the future." As humans, we emotionally prefer to live in the now and deal with tomorrow when it arrives. This explains well my irrational Vespa purchase in 2006. (Don't worry, Mom. I returned it.)

One study that really surprised me was a 2005 report published in the *Journal of Psychological Science*. Researchers from Carnegie

Mellon University, the Stanford Graduate School of Business, and the University of Iowa discovered that brain-damaged people with an inability to experience emotions made better financial choices. After completing a basic investment game that required math and logic, the mentally impaired individuals actually ended up with 43% more money than the mentally healthier participants. The conclusion: If you just stick to the facts and figures and take the emotion out of it, you'll have a better potential to make money.

But, of course, that was just a game. Interestingly, the study also discovered that while the brain-damaged were better at this one game, the healthier participants were better at dealing with day-to-day financial issues. So, emotions can come in handy. Intuition can be an important weapon in making healthy financial choices. As Ritter tells me, having a fishy feeling or thinking something is too good to be true is an example of tapping into your emotions. "You may just call that being skeptical, too," he says. And those intuitions can sometimes keep your money out of trouble.

To achieve the things you want, you need to understand your relationship with money, your belief system, and why you act the way you do.

The goal of *Psych Yourself Rich* is to help you become accountable for your financial decisions and to manage the behaviors that either bring you closer to or distract you from reaching your life goals.

That's the notion behind the title of this book. To "psych" yourself rich means to develop the brainpower—the mental discipline and positive behaviors—you need to traverse volatile times, build wealth, and secure your financial well-being.

You're in Control

The fact that you hold the power to control your financial destiny can be intimidating. But, it's indecision that is the real enemy. The fear of making the wrong decisions is paralyzing and can potentially jeopardize your security, finances, happiness, and health. After all, financial choices affect how well you can provide for your family, how early you can retire, how much house you can afford, and whether you can start your own business some day. But, the truth is, when it comes to finances, we all possess the ability to control the way we think, behave, and act.

My Story: The Fight to Mobilize

When I first began digging into the inner workings of personal finance and learning the techniques of smart money management about ten years ago, I wasn't convinced I had the chops. Even with a degree in finance and a Master's in journalism, I had serious insecurities. How would I fare as a reporter whose weekly assignments included the lowdown of no-load mutual funds and mortgage-backed securities? I daydreamed about meeting the editor of Time *in the elevators and how she, very impressed with my research on the underground culture in Iran, would lure me away from the thirty-second floor at* Money *magazine and allow me to enter the world of politics, international relations, and current affairs at the* Time *news desk.*

I admit I had my sights set on sexier assignments like journeying to the Middle East and reporting on freedom fighters in Iran (where my parents grew up). I wanted to travel the world and share important stories of poverty, crime, war, and injustice. Little did I know financial reporting would end up being a battlefield all its own.

I made the decision to stay in New York City, the heart of the financial world, and learned to love the craft of financial and business reporting. It was a conscious effort that involved whipping my brain into shape and convincing myself that the subject matter was, in fact, fascinating. I truly trusted that if I dug deep enough and wrote creatively enough, my stories would alter the minds and lives of readers for the better. As my journalism professor used to say (when she really thought an idea was hopeless): It was quite ambitious.

Month after month, I dove into assignments, which had at the very least, promising titles such as "How to Make Your Fortune Now" and "Best Mutual Funds to Buy." It wasn't long until I started to wonder whether I was really making a difference. I knew from the complimentary letters to the editor that some Americans were picking up on the advice and saving more, investing more wisely, building their retirement savings, and so on. Was that most people or was that just the savvy Money *magazine reader? The thought stuck.*

As a journalist who covered this area, I hoped everyone would agree that his or her personal finances were a priority and would want and need guidance in this department just as much as with issues pertaining to health, relationships, and careers. But while I was closing issue after issue of the magazine, growing more convinced that there was no end to giving away financial prescriptions, consumers were not quite tuning into the money-savvy messages spilled all over the media. In fact, many were in a major financial rut.

A decade later, the stats speak volumes about our long-running reckless ways:

- The average household carries roughly $10,000 in credit card debt, according to the Federal Reserve.
- Foreclosure experts at RealtyTrac predict four million homes will receive a foreclosure notice in 2010, about the same as in 2009.
- Expect more than a million individuals to file for bankruptcy in 2010.
- The Census Bureau estimates that by the end of 2010, there will be nearly 181 million credit card users in the United States, an increase from 159 million at the start of the millennium.
- Our collection of credit cards, when piled up, can physically reach more than 70 miles into space, and be as high as more than a dozen Mount Everests, according to researchers at CreditCards.com.

It's not a delightful picture. Financial advisors and journalists have tried hard to boost financial literacy, but have people been really listening or trying? I can see that our work has helped *educate* people on how to save more, spend less, and make wiser choices with their money. But can we execute on what we know? We still struggle to mobilize ourselves, to turn knowledge into action. Despite colorful lessons about credit scores, annual percentage rates, and the perils of overdraft fees, we're still a debt-ridden nation (especially younger adults). We tend to repeat our mistakes and perpetuate the cycle of debt. Why as a group are we such money zombies? And what does it take to really get a grip on your financial life?

Facing the Enemy

Behavioral finance experts have made it crystal clear that when it comes to managing money, we're irrational. Our decisions are influenced by deep-rooted emotions and perceptions that are hard to overcome. I've seen this while working with people in debt, and what I've learned is that one's lack of financial empowerment has a great deal to do with his or her personal insecurities, fears, lack of confidence, overconfidence, false perceptions, and misguided goals. As Napoleon Hill wrote in the classic book *Think and Grow Rich,* "Both poverty and riches are the offspring of thought."

My Story: Finding My Financial Persona

In my early 20s, I made more money mistakes than I'm willing to admit. But thanks to my constant exposure to all-things money and access to experts and professionals in every financial field, I was able to reverse those mistakes. This access alone wasn't what gave me the motivation or the drive to stick to a sound financial regimen.

For me, my financial confidence and empowerment was an emotional and psychological journey more than anything else. I discovered that you can learn all you can about the do's and don'ts of money management, but unless you have the mindset and the right behaviors in place, it's very hard to make intelligent moves. What were the emotions I channeled to help me find this strength?

First, I felt obligated *to be a financial do-gooder. I believed that if I was put in a position to offer people savings advice, I, for one, should not be in debt.*

I also knew I had no excuse but to make healthy choices with my money. Looking back at how my parents, who journeyed to the United States with two suitcases and very little money, managed to build their finances and *create a comfortable life for their family, I really had* no justification *for getting into financial difficulty.*

I assumed control *of the situation. I was also, frankly, a bit afraid of the consequences of* not *getting my act together. I knew that my parents wouldn't bail me out if I ended up over my head in credit card debt. (More on the benefits of scaring yourself straight in order to take control of your money in a later chapter.)*

And I felt a little obsessed with my money, wanting to make sure I never lived beyond my means.

Finally, I recognized I had milestones and goals *to achieve, and therefore I had the desire to become financially fit. I remember graduating from college and driving away from Penn State thinking, "My life starts now. No more waiting for when I 'grow up,'" and with that came immediate financial responsibilities. With everything having a price tag in life, I knew the earlier I started thinking and saving toward my goals, the more likely I could achieve them. Once I crossed that emotional and mental bridge, I was then able to execute on what I knew were sound financial methods. I never let go of these forceful emotions.*

Searching for answers as to why personal finance is so difficult to digest, so tough to triumph, has been a preoccupation and intellectual pursuit of mine for the past couple of years. Almost immediately after my first book hit the market, the economy went into a fetal position. We slid into a recession, and many of us felt we had gone back to the drawing board. We didn't just lose money. We lost our bearings. Many of the goals we had identified, chased after, and hoped for, vanished. For me, it was an extremely busy time, fulfilling editorial assignments, answering people's questions on- and offline, and going on TV to break down the stock market crash, the housing debacle, and to offer shreds of positive news in this wretched economic environment. I interviewed economists, fund advisors, investors, entrepreneurs, cab drivers, therapists, and, most important, everyday Americans for their insight into where we went wrong, what they wish they'd known, and their hopes for the future.

Sure enough, consumers could tell you exactly where they went wrong. They hadn't paid enough attention to the "signs," they trusted the wrong people, they didn't work hard enough, they got scammed, they were lied to, they had too much optimism, and so forth. But why bother with the past? Putting the pieces back together was the main issue at task now for most people.

To do this, you need to understand the behavioral and disciplinary commitments needed to build a financial foundation based on reason and personal aspirations. At this stage in one's life, years after college and working the grind, making plenty of mistakes, learning the hard way, and experiencing the real world first hand, your financial curiosities have evolved and tend to be more philosophical and open ended than technical. It's not so much about definitions or calculators. You're wondering how to move into a more elevated world of managing your money to bring security for today and the rest of your life. It is about money, but it's more about you.

My Story: Lessons from Reality

I was recently able to test this thinking on SOAPnet's Bank of Mom & Dad. *In 2009, I was intimately involved in this pioneering television series that revealed the financial skeletons in the participants' closets, making them come face to face with their financial hardships, their debt, and overspending. It was a far cry from the top-rated reality shows big networks backed season after season, like* American Idol *or* The Biggest Loser. *It was a risky show, not exactly escapist television. This was in-your-face, real-life drama about the one thing we, as a society, have yet to openly and wholeheartedly discuss: our money conflicts.*

My task each week was to provide the participants—women in their late 20s and early 30s—with solid advice that we hoped would give them the necessary tools to resolve their financial messes. In return, I received an education as to some of the reasons we, as a society and particularly women, overspend and compile debt. In many cases, these women were highly educated, came from supporting families, and made above-average salaries. So why were they $20,000, $30,000, or $60,000 in debt? It was not because they failed to understand the slippery slope of credit card usage, that spending $1,000 on boots was beyond their means, or that their daily $4 Starbucks latte destroyed their ability to save for a rainy day. The problem ran much deeper than that. To get to *the root of the issue, I needed to take money out of the equation, at least at first. Instead of beginning our meetings with lengthy sermons about sound money management, I dug into their childhood a bit, into their personal relationships, their goals, and what in life made them happy. I had to know, where's your head at? What do you want? Where do you see yourself in five years? What would Dr. Phil ask?*

I really got under people's skin for the first time in my career as I tried to open the emotional and mental floodgates and encourage these individuals to face their fears, weaknesses, and dependencies. My theory was if I could get them to care about their lives and their personal goals first, then suddenly making the right financial choices would not be so difficult or so detestable a task. And I was proved right.

The emotional baggage on Bank of Mom & Dad *ran the gamut—from poor self-esteem to strained personal relationships, dependency on others, and a reluctance to just "grow up."*

For some women, their money (or borrowed money, as it usually was) had become a substance that they abused to make themselves feel better and live their ideal life (or what they perceived *to be ideal).*

Shameeka, a 29-year-old nurse from Brooklyn, New York, came on the show, desperate to rein in her $60,000 of debt and begin a new chapter in her life that included marriage and family. Granted, most people may not be *in as dire straights as Shameeka. (In fact, viewers would write in to me, relieved to know that their financial mess wasn't as bad as the women on* Bank of Mom & Dad.*) That said, the show had significant takeaways for people experiencing difficult financial circumstances. Money aside, many viewers could still relate to Shameeka. She was the girl next door, a hardworking nurse with a beautiful smile. She was your friend who always dressed perfectly and gave the best restaurant recommendations. But beneath the Louis Vuitton handbag and Tory Burch flats, Shameeka was an emotional mess who used money like a pill. Spending money made her feel better, but only for a short while, just until her underlying pain resurfaced. She knew enough to realize there was a better life out there for her, but didn't know how to cross that bridge and start building her financial life. She just wanted to be happy.*

As was usually the case with the participants on Bank of Mom & Dad, *their drama was never over the money. Their behavioral issues with money stemmed from deep-rooted emotional struggles. Shameeka, for example, had an extremely strained relationship with her mom. Just as much as she wanted to be debt free and have a clean financial start, she wanted to develop a closer bond with her mother. In our first meeting, she confessed that she wished she had a healthier relationship with her mom and that until that was achieved, she couldn't imagine getting out of her rut. She filled the void in her heart by* *filling her closet with high-end clothes and shoes and by taking expensive vacations. Her bond with her mom was cordial at best, volatile at worst. Some background: Mom had Shameeka when she was just a teenager, and it was decided that Shameeka's grandmother would assume the role of Shameeka's primary caretaker. As a result, that mother-daughter bond never quite formed, and now almost 30 years later, Shameeka desperately longed for a deeper connection with her young mother. But the two often failed to see eye to eye, and knowing Shameeka's money troubles, her mom was openly critical, which didn't do much to help her daughter's confidence.*

Their relationship continues to be a work in progress. But after coming to terms with the ultimate root of her financial mismanagement and confronting her mom and getting her feelings out on the table, Shameeka felt a huge weight lifted and was compelled to finally change her behavior and begin building a foundation for a secure financial life, with or without her mom's companionship. Her mom didn't quite give her the support she was hoping for, and although Shameeka felt lonely, she somehow found it within herself to commit to change, to dedicate herself to her future, and to ignore the hurt feelings stemming from her past. Shameeka accepted that she is the only one responsible for her actions and must therefore face reality on her own.

Psych It Up

Just like when you're trying to become more physically fit, sure you need to count calories and fat grams, but you need to *psych yourself* into it first. You need to accept your current weight and your bad habits, understand why you are having difficulties, commit to goals, and get into the right eating and exercising habits for long-term health. The same is true of turning the corner with your finances. It is critical that you first establish and learn how to maintain certain behaviors in order to secure your finances now and ensure future wealth building throughout life.

To psych yourself rich, you need willpower, a confident spirit, intuition, a commitment to your personal and professional goals, and sometimes a little thinking outside the box.

It's not enough to examine pie charts, pay your bills on time, clip coupons, and subscribe to the *Wall Street Journal.* That's all wonderful, but building a sound financial foundation that will last for your entire life is a mental and behavioral journey, not unlike trying to live healthier, transitioning to a new job, or preparing for a marathon. When you find yourself stuck answering questions like…

Should I buy or rent?
How do I make extra money?
Where to invest my money?

…you'll only have to refer back to your personal financial philosophy, your goals, and your strengths and weaknesses to give you most if not all of the answers you need. This book will give you the right tools to understand and address key issues from your relationship to money to your personal and financial obligations.

[1] Daniel Kahneman and Amos Tversky, "Prospect Theory: An Analysis of Decision Under Risk," *Econometrica* 47(2), 1979.

[2] Barclays Wealth, "Behavioural Finance, The Psychology of Financial Decision Making," 2008.

[3] Brad Barber and Terrence Odean, "Boys Will Be Boys: Gender, Overconfidence and Common Stock Investment," *Quarterly Journal of Economics,* February 2001.

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