4 rules to help you become rich

A week ago, a friend called to discuss about the current recession. He has a well-paid job but unsure about the future.

After the usual exchange of pleasantries and enquiries about each other's family, the conversation settled on whether to save for the rainy day (because of the uncertainty of the future) or tempted by potential windfalls of investing in the fallen markets.

My friend was worried about virtually everything under the sun -- whether he should invest in stocks or buys a home instead, whether he would have ample money for his retirement, and so on and so forth.

He asked me for suggestions but refused to disclose any financial details, be it his salary or the amount he has available for investing.

Which brings me to the first rule of money management: Honesty works. Be honest with yourself and, if possible, with a financial planner or someone you trust.

Since he refused to part with any information, I ended the conversation with some general suggestions I hope will help him. You might find them useful too.

1. Get real

I, for one, would love to have $1M in my bank account by the time I turn 65. It's a great wish to cling to. But is it even vaguely realistic? Do I have any notion of how much I have to save to get that amount?

If I am 30 now and want $1M when I turn 65, let's see how much I would have to save, starting now.

Assuming Net rate of return: 4%

Time period: 35 years

Current savings: Nil

To reach my target, I will have to save $335 every week or $1496 per month and it should earn a return (after tax) of at least 4% per annum. This is not an impossible target, but it does not mean I will be rolling in luxury when I turn 65. Assuming I'm saving 10% of my net income, I'll have to earn about $15,000 (net of taxes) a month to be anywhere near my goal. This surely may not be realistic for a lot of people, definitely not for me.

You need to figure out what you are saving for, how much you need to save for it and how you are going to do it.

Use the following links to calculate:

http://www.sorted.org.nz/calculators/goal-machine

2. Get cracking

The key is to make your money works for you.

In the above example, we assumed a return of 4% per annum. Keeping your money in a savings bank account will not earn you that kind of interest. Despite occasional rises, interest rates in the Western world are on a gradual decline.

So, let your money work for you. Amongst fixed return investments, corporate bonds (A or AA rated) are a good option.

The younger you are, the more you should invest in stocks because time is on your side to ride the lows of the stock market. Over time, stocks give the highest return when compared to other forms of investment.

If you don't want to take the plunge into stocks, try diversified equity managed funds. These are funds that invest in the stocks of various companies in various sectors. Else, try balanced funds. These are managed funds that invest in both equity (shares) and debt (fixed return investments).

3. Learn to save

Investing smart is one thing. Spending wisely is another.

To get something, you have to sacrifice another. No one is asking you to live like a monk, but neither is it healthy to live like there is no tomorrow.

Take a good look at what is really eating away your income.

Is it the incessant partying and pubbing or shopping and eating out? Even if you cut your frivolous expenditure down by just $500 a month, you have an extra $6000, or maybe more if you regularly invest it, at the end of the year.

My friend claimed that spending on cabs and eating out was chipping away at his bank account because he did not want to travel by trains or buses.

4. Are you honest?

You must be honest with yourself; with what you want and whether or not it is achievable. If not, see where you can compromise.

You may want to head to Europe for a holiday, but can you really afford it? It may work out better for you to substitute it for a holiday in New Zealand. Or maybe an Australian destination.

You may want a four-bedroom house, but can you afford it? You may be able to if you settle for a city where real estate is not too expensive or a home in the far-off suburbs if you choose Auckland.

Also, you may want to buy a home when you are 22 and have just landed your first job. It may, however, be wiser to wait for a few years till you have a higher salary and more savings to make a larger down-payment.

It's all right to dream. But don't let your dreams cloud reality. Once you get a grip on what you are saving for, you will be able to achieve it.