

Simple Financial Planning

For A YOUNG GRADUATE

By Wilfred Ling



Financial planning for a young graduate is very easy. This is how it can be done using the 1/3 rule.

The 1/3 rule is:

- Set aside 1/3 of your salary for savings;
- 1/3 for spending like clothes, boyfriends, girlfriends, handphoned, internet, travel and parental support;
- Another 1/3 for insurance.

Some practitioners advocate that we should be saving at least 10% of our salary. Personally I think it is more prudent for the young person to save more.

The following is a profile of a typical young graduate called **Ms Prudent**:

Profile of Ms Prudent

Age: 25
 Initial gross salary: \$2,800 per month or \$33,600 per year
 Yearly pay increment: 2% per annum
 Annual Saving Rate: 33% (or 33% x 33600 = \$11,200)
 Return on savings: 5% per annum
 Amount set aside for insurance: 33%
 Amount set aside for spending: 33%

The following is the table that shows that by end of age 60, this person would have accumulated \$1.4 million. I have used 5% per annum in return and I think this is achievable given a time horizon of 35 years.

Amount of wealth built up by Ms Prudent

Age	Annual Savings	End of the year @ 5% per annum
25	\$11,200	\$11,760
30	\$12,366	\$83,862
40	\$15,074	\$317,555
50	\$18,375	\$737,844
60	\$22,399	\$1,470,756

Consider another scenario for another individual called **Ms Irresponsible**:

Profile of Ms Irresponsible

Age: 25
 Initial gross salary: \$2,800 per month or \$33,600 per year
 Yearly pay increment: 2% per annum
 Annual Saving Rate: 70% (70% x 33600 = \$23,520)
 Return on savings: 1% per annum
 Amount set aside for insurance: 0%
 Amount set aside for spending: 30%

The main difference is that Ms Irresponsible has a high saving rate of 70% but due to ignorance places all her money in saving account yielding only 1% per annum. She does not buy any insurance because the remaining 30% is for expenditure. The table is a summary of how her savings will grow:

Amount of wealth build up by Ms Irresponsible

Age	Annual Savings	End of the year @ 1% per annum
25	\$23,520	\$23,755
30	\$25,968	\$153,559
40	\$31,655	\$475,596
50	\$38,587	\$898,331
60	\$47,037	\$1,446,973

It can be seen that at 60, the cumulated wealth is \$1.4 million as well. Both Ms Prudent and Ms Irresponsible achieve the same amount of wealth upon retirement.

However, Ms Irresponsible is at greater risk than the first. She is not insured. Should an illness or accident occur resulting in say a loss of income, or incurs high medical cost, she is not going to achieve her \$1.4 million. In fact it is possible to become financially insolvent (liabilities more than assets).

On the other hand, Ms Prudent saves and insures herself. If an unfortunate event occurs, the retirement plan is likely to continue as usual due to the insurance cover.

Ms Prudent's expenditure is similar to Ms Irresponsible. Both spend nearly 1/3 of their salary. Ms Prudent still has 1/3 every month to spend on clothes and holidays (in this example, she spends $2800/3 = \$933$ every month which I think is very comfortable for a young graduate).

Here are a further few points to note:

- Both wealth protection (insurance) and wealth accumulation (savings) work hand-in-hand. Both are dependent on each other. Having a protection plan without savings will cause an individual to be very poor later on in life. On the other hand without protection, any saving plan is at risk of not being sustainable upon occurrence of an unfortunate event.
- Do not spend on unnecessary insurance products. These are insurance policies with very high premium but do not give that necessary cover in times of need.
- Conversely, get insurance cover that is suitable and get it at the lowest cost. There is no point spending an additional 1% if there is another product that has identical features but at lower cost.
- The interest rates used in these two examples are different. Ms Irresponsible uses a 1% per annum (equivalent to fixed deposit) and Ms Prudent uses 5% per annum. 5% is not difficult to achieve. A moderately conservative person can achieve it. A combination of regular premium endowment (a good one I mean) plus a small part in high risk unit trusts will do the trick. For those who are highly aggressive, they can put more into equity unit trusts regularly.
- In the above illustrations, I used gross salary and have not taken into account CPF contributions and the AWS. The employer's contribution at age 25 is 14.5% of gross salary. This implies that the total salary is actually $2800 \times 114.5\% \times 13 = \$41,678$. Thus, spending \$11,200 in insurance a year is equivalent to $11200 / (41678) = 27\%$ which is less than 1/3. That means there is actually more money for expenditure and savings. ■

This short article is to demonstrate that a financial plan for a young person can be very simple. There is no rocket science to it and it is just based on pure mathematics and reasoning. Ensure that you have a good start in your career and you will achieve your financial independence with just a simple plan.

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