

the **Science**
of **Economic**
—F R E E D O M —



SPECIAL REPORT

My Spending Plan

Brought to you by Mercer Advisors

A spending plan focused on your financial goals.

This special report is designed to help you understand your current spending habits, and to create a new spending plan focused on your financial goals. Let's place some context around this report and the sequence of exercises you should have completed prior to starting your spending plan.

Economic freedom is available to every adult in America if they choose to pursue it.

To achieve economic freedom, you must:

1. Define this objective for yourself
2. Set your goals
3. Assess your current assets and liabilities
4. Build a spending plan that is aligned with your destination

We have provided two valuable tools to get you to this point. Those reports are, "Setting Your Goals" and "Balance Sheet Basics."

All the Science of Economic Freedom tools are at our website, scienceofeconomicfreedom.com. You should read those two reports and complete the exercises prior to building your spending plan.

This will be a more difficult exercise. While it just involves a set of numbers and some basic math, and isn't too demanding, the exercise is emotionally difficult because many people have trouble with their spending priorities. Therefore, your goals need to be clearly written out.

You must be motivated and enthusiastic about your future destination. You must have defined your idea of economic freedom. You must be prepared to improve your spending habits. You must fix what is wrong and realize that if you don't fix your spending, you won't be able to achieve economic freedom.

To quote our spending plan champion at Mercer Advisors, Laura Combs, "When cash flow works, everything works."

Without a handle on your cash flow you cannot produce excess reserves or savings. Savings is the result of your human capital after your expenses. Your efforts in your career produce cash flow. When your cash flow is working there is something left over—savings. Where to put your savings to work is a function of your goals. The result of these efforts shows up in your balance sheet.

“ Cash flow management is the single most-important factor to an individual's or family's financial success. **”**

— Kelly Palmer, 30-year veteran CFP™ at Mercer Advisors

The economic freedom human behavior principles

In episode No. 2 of the Science of Economic Freedom podcast, we talked about human behavior principles that are necessary to achieve economic freedom. Human behavior is something you can control and change. Here is a recap of the human behavior principles that you must abide by.

Knowledge is the acquaintance with facts, truths and principles. **Wisdom** is knowledge and judgment to do what is right for you. **Discipline** is behavior in accordance with a set of rules. **Open-minded** is open to change. Finally, **goal-oriented** is the ability to focus on an objective and take personal responsibility to get there.

This all ties back to the creation of your spending plan. Be courageous and confident, be positive and results will happen. With your goals set, your balance sheet known and your spending plan in place, you are on your way to achieving economic freedom. If you find yourself needing additional support and motivation, listen to the first six episodes of the podcast again to refresh your mind.

5 Human behavior principles for economic freedom

1. Knowledge
2. Wisdom
3. Discipline
4. Open-minded
5. Goal-oriented

The breakdown of a spending plan

There are five sections of a spending plan. Let's walk through these in some detail before we get to the worksheets.

1. Income

Today you may only have one income source. If you are married or in a partnership, there could be two income sources. If you own a business you could have income and annual profits that make up your total income picture. If you are retired you may have many separate income sources. For example, you could be receiving Social Security, a pension, dividend and interest income and income from rental property. Capital gains, bonuses and stock options are additional sources of income.

- W-2
- 1099
- Pension
- Social Security
- Interest and dividends
- Rental property
- Business
- Royalties
- Oil and gas income

If you are not satisfied with your income you can get a second job, or change jobs, to increase your income streams. One of the great opportunities we have as Americans in the largest economy in the world is to make more money. Don't ever think that your income is fixed. If you are young and have only one or two income sources, think about your future economic freedom and what you want it to be. Having multiple income streams is a great, long-term goal.

The 5 categories of a spending plan

Income: You may only have one source of income. If you are married or in a partnership you may have two or more. Most people don't have too much trouble nailing down how much income they have coming in.

Taxes: There is no escaping the tax man. Taxes include state, federal and payroll taxes. If you are receiving W-2 income and are employed by a company, these taxes are taken out of your paycheck. If you are self-employed and receiving 1099 income, you will be responsible for making quarterly estimated tax payments.

Debts: There is good debt and bad debt, but all debt must be kept current to keep your financial status in good order. Your goals should reflect your priorities relative to your debt payments. Good debt is supported by an asset or income stream. Bad debts are usually a symptom of over spending. Your mortgage or your rent would be in this category.

Lifestyle: This is the category that most spending falls into. When you think about it, most of your expenses tie to the lifestyle you are living.

Savings: This is the category that is left over after taxes, debts and lifestyle. There can be three types of savings—retirement contributions, economic freedom savings or saving for a specific goal.

2. Taxes

This is the largest single expense of your lifetime. Many people don't give their taxes much thought. The purpose of taxes being a separate section of your spending plan is twofold. First, they must be paid before anything else. Falling behind on your tax payments is a huge mistake. Don't let it happen to you. If you're a W-2 wage earner then taxes are taken out of your paycheck automatically. You have some control with your exemptions, but not much. If you are receiving 1099 earned income or have income coming in from other sources, you should be paying estimated tax payments quarterly.

Your tax payments should be equal to the taxes you owe. You shouldn't be getting a large tax refund. We would categorize that as any tax refund more than \$500. If you did receive, say a \$3000 tax refund, which is an indication that you overpaid your taxes by almost \$300 per month for that tax year. There is no reason to overpay your taxes and loan the government money interest free. That would not be good cash flow management.

The second reason why you need to focus on your taxes is so you know what you're paying. There are three separate taxes that you could be paying: Federal, state and payroll (Social Security, Medicare, disability). You should know what tax bracket you're in, and what deductions you qualify for. You should know how far you are from the next tax bracket. You should be asking yourself what you can do to lower your taxes. We have a special report dedicated to managing taxes at scienceofeconomicfreedom.com.

One final recommendation on taxes. Using a tax professional to assist in managing your taxes is sound advice. The help of a tax professional is so important in planning and management of your taxes. The tax code is complicated and difficult. We do not advise doing your own tax returns.

3. Debts

Before we can enjoy our lifestyle, we must pay our debts. Keeping your financial standing in good order will allow you to have access to credit when you need it. Allowing yourself to fall behind on payments will come back and haunt you when you are seeking to borrow money in the future. Your credit score matters to your future economic freedom.

There are two kinds of debt; good debt and bad debt. Good debt is when there is a supporting asset or income stream to support the debt. In addition, there is a tax deduction that offsets some of the interest payment for that debt. Good debt falls into three categories; mortgage debt, business debt and student loan debt. Mortgage debt is tax deductible in most cases and supports the purchase of an asset that can appreciate or generate income. Business debt support an enterprise that can appreciate and generate an income for the business owner. Student loan debt can support a future career that will generate income to pay back the debt.

Good debt can turn bad. If you have loan terms that are unfavorable or outside of normal loan terms these can produce adverse effects on your income. An interest rate too high or unfavorable prepayment

terms can be two examples of that. If you take on too much debt and over leverage your balance sheet for the purchase of real estate or a business it can set you back on your journey to economic freedom if circumstances go wrong. Another example is a student loan that does not produce a degree or career path to repay the loan. This also can become bad debt.

Bad debt in general is a loan that does not support an asset or an income stream. Bad debt is usually a sign of overspending. Credit cards, personal loans, auto debt are examples of bad debt. As you're putting together your spending plan, paying down bad debt as quickly as possible is a good strategy. Remember that your balance sheet is positively influenced when you reduce your liabilities, so don't think that paying down debts is not making progress toward your goals.

4. Lifestyle

This is the section most of your discretionary spending falls into. Your lifestyle is where you live, what you do for entertainment, what you eat, the cost of raising kids, and your insurance and transportation costs—all of these costs go into this category. Lifestyle spending is everything else. As you're about to find out, when you look at your spending you'll see that lifestyle accounts for most of it. This is usually the category where you can find spending that can be controlled so you can produce more savings.

5. Savings

This section is where we want to increase our focus. Saving more money and adding cash flow to your balance sheet is the goal of your spending plan. This is the result of your working efforts, what you have left over after taxes, debt service and lifestyle. Your savings can be broken down into categories. This could include a family emergency fund, savings for a purpose like home ownership, or retirement savings. Whatever the category, all of your savings adds to the assets on your balance sheet.

When you are just getting started on the new lifestyle of economic freedom, you may want to consider using a bucket system to organize your savings. What this means is grouping your savings into different buckets. Your first bucket should be your emergency fund. We recommend all families have an emergency account. This should be two-to-six months of your monthly expenditures set aside in a bank or money market fund. This is your “sleep well at night” account. It is not for investing. It is there for an emergency, or just simply peace of mind. Next could be a savings account for a future purchase or investment. This could be a down payment for a home or rental property, or capital to start a business. This account could have a target date for use, and perhaps a lower-risk investment strategy. Finally, there is the bucket for economic freedom. This can include your retirement accounts and any long-term savings dedicated to your economic freedom aspirations.

Building Your Spending Plan

We begin the building of our new spending plan with a "look back" at the last two-to-six months. We need to gather information on what our income, taxes, debt service, lifestyle and savings have been. To do this, you need your pay stubs, bank statements, check register, credit cards and any other account information that can help you look back on your income and spending over this time.

Our goal with the look-back worksheet is to familiarize you with where your money went. When you are looking back, there is no right or wrong spending decision. There is only your actual spending that matters. Don't judge what happened. Just categorize and total up where the dollars went. We do want to come up with some average expense categories going forward. Once we have the look back completed, you will be able to do some analysis and diagnoses about the past.

Start with your gross income earned each month. If you have more than one income stream account for that. Sometimes it's helpful to have a copy of your most-recent tax return for reference. We suggest looking back six months, because this will give you a better reference than just 1-2 months.

Next, move to your taxes paid or withheld from your paycheck. Last year's W-2 may be another good reference tool. You are paying income taxes every month, or every quarter for the self-employed,

so there should be a number for taxes. There can be federal, state, Social Security, Medicare and disability taken out of your paycheck as taxes. Let's get all those taxes that apply to you documented on your look-back worksheet.

After income and taxes, we move to debt service. What debt payments have you made in the past six months? If you do not have a mortgage and are paying rent, include this in the debt section. Any business loans or student debt should be included. Then look at your credit card or other loan payments.

Next is lifestyle. This is the big one. You don't really know what you are spending unless you track it and add it up. This will be enlightening for most people. The categories of entertainment, dining out and enjoying life can be surprisingly expensive once we add it all up. Use the general categories we have listed, and then add your own if you need them. The object here is to seek the truth. Where is the money going now?

Finally, we have savings. What are your savings now? Is there a 401(k) or retirement plan deduction from your paycheck? How much are you saving each month?

Please print the following worksheets, and let's get started.

Look-back worksheet

Instructions: Look over these categories and fill in your monthly cash flow for the last six months. Then add up the totals in each section, income sources, taxes, debt service, lifestyle and savings.

CATEGORY	MONTH 1	MONTH 2	MONTH 3	MONTH 4	MONTH 5	MONTH 6
Income sources (list below)						
Total:						
Taxes						
Federal						
State						
Social Security						
Medicare						
SDI						
Total:						
Debt service						
Mortgage or rent						
Business loan						
Student loan						
Auto loan						
Credit cards (list below)						
Total:						

Form continues on next page.

Look-back worksheet (continued)

CATEGORY	MONTH 1	MONTH 2	MONTH 3	MONTH 4	MONTH 5	MONTH 6
Household						
Insurance						
Utilities (gas, electric, water, etc.)						
Property taxes						
Phone/cell						
Cable/internet						
Repairs						
Yard						
Other						
Total:						
Transportation						
Auto insurance						
Fuel						
Maintenance and repairs						
Registration/licenses						
Toll or train fees						
Other						
Total:						
Family insurance						
Health						
Dental						
Life						
Disability						
Other						
Total:						
Food & entertainment						
Groceries						
Dining out						
Entertainment						
Total:						

Form continues on next page.

Look-back worksheet (continued)

CATEGORY	MONTH 1	MONTH 2	MONTH 3	MONTH 4	MONTH 5	MONTH 6
Personal care						
Grooming/hair care						
Health club						
Dry cleaners						
Medications						
Other						
Total:						
Monthly miscellaneous						
Child care						
Child support/alimony						
Tuition						
Pets						
Holiday gifts						
Other						
Total:						
Charity & donations (list below)						
Total:						
Annual Miscellaneous						
Vacations						
Accounting fees						
Medical expenses						
Other						
Total:						
Savings						
Retirement plans						
College						
Economic freedom						
Other						
Total:						

Changes to your spending habits in the future.

This completes the look-back worksheets. Add up the totals in each section, income, taxes, debt service, lifestyle and savings. Now we can do some diagnosis. We can start to think about changes in spending habits we want to make. Now is the time to pull out your goals and balance sheet, and really look at your financial goals.

Here are some questions to answer to help you think through the changes in your spending habits you want to make in the future.

Answer the following questions about your spending over the past six months:

- What was the average spent under lifestyle?
- What were the big spending surprises from this exercise?
- What may change in terms of income or spending in the next six months?
- What changes do you want to make in your spending plan going forward?

Answer these questions about your goals and balance sheet:

- What is your top priority in the next 6-12 months?
- Is there any bad debt you want to knock out in the next six months?
- Is your family emergency account funded to your satisfaction?
- Are you funding your retirement accounts to your desired level?

Before we start building your new spending plan, let's think about those annual expenses that come along every year. These are spending categories that don't show up monthly but need to be accounted for in your projections. Review the annual spending form included in this report. Fill in the categories that fit your lifestyle. We will want to account for these annual expenses in our projections for the next six months.

Quick reference guide for the spending plan worksheets

There are three worksheets contained in this report. They are the look-back worksheet; annual expense form, and projections worksheet. Let's take these one at a time so you know how to use them.

Look-Back Worksheet: This is designed to help you analyze where your spending has been going during the past two-to-six months.

Annual Expense Form: This lists categories that may not show up in your monthly expenses but that you want to plan for in the future.

Projections Worksheet: This is to help you build your new spending plan. You will be projecting forward your income and spending for the next six months with a specific focus on net cash flow and your short- and long-term goals.

Annual expense worksheet

Instructions: Fill in any annual expenses you have had in the last 12 months that would not show up monthly. In addition, use this form to consider any additional expenses you may have in the next 12 months.

CATEGORY	AMOUNT
Home repairs (list below)	
Total:	
Major purchases (list below)	
Total:	
Insurance	
Life insurance	
Disability	
Long-term care	
Homeowners/renters insurance	
Umbrella insurance	
Auto insurance	
Total:	
Vacation & travel (list below)	
Total:	
Medical expenses (list below)	
Total:	
Category	Amount
Gifts (list below)	
Total:	
Memberships (list below)	
Total:	
College/school tuition & expensises (list below)	
Total:	
Other (list below)	
Total:	

Build where you want to be.

The categories on your look-back and projections worksheets are the same, with one exception. We have moved the savings category under your income. This is purposeful. The reason why is to have you add your savings in after your income. This is called paying yourself first. Remember, this is a projection. There can be unforeseen expenses and income in your future. We are building where we want to be. Fill in each category and compare to your look-back worksheet for changes and adjustments. Consider your goals. Plan any debt repayments. Finish your projections worksheet.

Now we have a spending plan, and your next step will be implementation. This is when you stop and look at the beginning of each month and compare your spending with your projections. Do this month after month. Once you have gone through the first six months, start again.

Managing your cash flow is the single most important factor to achieving economic freedom. You are in control of all your spending decisions. There could be some mistakes from the past you need to overcome, but getting a handle on this will insure you reach your destination.

Projections worksheet

Instructions: Fill in and total the projected expenses you will have for each category in the next six months.

CATEGORY	MONTH 1	MONTH 2	MONTH 3	MONTH 4	MONTH 5	MONTH 6
Income sources (list below)						
Total:						
Savings						
Retirement plans						
College						
Economic freedom						
Other						
Total:						
Taxes						
Federal						
State						
Social Security						
Medicare						
SDI						
Total:						
Debt service						
Mortgage or rent						
Business loan						
Student loan						
Auto loan						
Credit cards (list below)						
Total:						

Form continues on next page.

Projections worksheet (continued)

CATEGORY	MONTH 1	MONTH 2	MONTH 3	MONTH 4	MONTH 5	MONTH 6
Household						
Insurance						
Utilities (gas, electric, water, etc.)						
Property taxes						
Phone/cell						
Cable/internet						
Repairs						
Yard						
Other						
Total:						
Transportation						
Auto insurance						
Fuel						
Maintenance and repairs						
Registration/licenses						
Toll or train fees						
Other						
Total:						
Family insurance						
Health						
Dental						
Life						
Disability						
Other						
Total:						
Food & entertainment						
Groceries						
Dining out						
Entertainment						
Total:						

Form continues on next page.

Projections worksheet (continued)

CATEGORY	MONTH 1	MONTH 2	MONTH 3	MONTH 4	MONTH 5	MONTH 6
Personal care						
Grooming/hair care						
Health club						
Dry cleaners						
Medications						
Other						
Total:						
Monthly miscellaneous						
Child care						
Child support/alimony						
Tuition						
Pets						
Holiday gifts						
Other						
Total:						
Charity & donations (list below)						
Total:						
Annual Miscellaneous						
Vacations						
Accounting fees						
Medical expenses						
Other						
Total:						

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