Ideas for Young Adults

[by John Gustavson]

The vast majority of assets in this country are owned by the Baby Boomers and their predecessors. Accordingly, most financial advice is tailored to them. However, people just starting their careers can benefit from solid advice, too. Though everyone's circumstances are different, the following issues are of particular interest to young adults.

Got health insurance?

Most of the uninsured are young people who can't afford health insurance on their own, and their employers do not provide it. This is a huge risk area, because a hospital stay could put you in debt for years.

One possible option is to investigate high-deductible health plans. The premiums are much lower than traditional coverage, but the trade off is that full coverage doesn't kick in until you've reached your high deductible. Health savings accounts (HSAs) are often used in combination with these plans. These plans are inexpensive and provide a basic safety net for medical emergencies.

Plan for retirement before you get old.

If you start saving when you are young, you get the most out of the interest added to your initial investment year after year. Decades of compounding interest can make a huge difference in the size of your nest egg when you finally retire.

There are many ways to save for retirement. The Roth IRA works especially well if you are in a low tax bracket, which is likely if you are just launching your career. A Roth IRA does not allow any current tax deduction for contributions; however, most distributions in retirement are tax-free. With a traditional IRA, you get a deduction when you make the contribution, but distributions are usually fully taxable.

The difference between these two plans is your current tax rate (presumably low) and your tax rate when taking distributions (presumably higher after a career of growing paychecks). With the Roth IRA, you forego a small tax deduction right away for tax-free distributions when your tax bracket may be higher.

If your employer offers a Roth 401(k), consider making contributions to it. If your employer offers a 401(k) match, contribute at least enough to get the match. Don't let this free money pass you by. But whatever you choose, commit to saving.

Life insurance—buy term.

Young people do not require a lot of life insurance. If you are single and don't have dependents, employer-provided insurance or a small term policy should suffice. Don't buy more expensive, permanent whole life or universal life insurance at this stage of your life. You can buy term policies with a rider that converts to a permanent policy if you are concerned about health issues that might affect insurability in the future.

Stick to the b-word.

The foundation for future investing is created through budgeting. A budget simply shows where your money is going. Major corporations use budgeting to track their cash flow and you should, too. Begin by tracking expenses for one month and placing your spending into various categories. You may be surprised how recurring small expenditures, like your morning espresso, add up. You may find that you are outspending your income, which is why your debt continues to increase. Maintain and adjust your budget as your circumstances change—the penalty for not knowing your outflows include bounced check fees and credit card late fees.

Use credit wisely.

Debt will be difficult to avoid at this stage of life. Debt incurred for a home (mortgage debt) or future income potential (education debt) is productive debt. Debt incurred for vacations and enhancing your lifestyle is unproductive debt and will sap your ability to build wealth. Try to consolidate loans and pay off your credit card balances each month to avoid interest expenses. For most young people, eliminating credit card debt should be their highest financial priority. Be aware of credit card transfer fees and when low introductory interest rates expire. Good credit history is the key to getting a mortgage for your dream house in the future. Also keep in mind that potential employers and insurance companies may review your credit history in making business decisions about you.

Your 401(k) is for retirement.

Finally, for those fortunate enough to accumulate balances in their 401(k) accounts, do not use them like piggy banks. It may be tempting to borrow from your 401(k), but don't do it. While you will pay yourself back with interest, the borrowed money temporarily reduces your long-term investment and its compounding interest. In addition, if you leave your employer, you will need to repay the loan entirely or pay income tax on the balance and a 10 percent penalty. Even if you repay the loan in full, you end up paying income tax twice, because you pay back your loan with after-tax funds and then pay tax again when the funds are distributed from your 401(k) in retirement.

I do not often get the opportunity to counsel young professionals. Their needs, financial risks, and opportunities are much different than those of their parents and grandparents, but no less important. After all, years from now, these young professionals will be looking at retirement, too.

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