



## Silver Bullet?

The financial planning field has been searching for years for an effective way to help people manage their spending. The obvious tool? A budget. You outline what's coming in, and then allocate that to various expenses and goals. You spend to the budget. End of story.

The problem is, we know that despite good intentions, people find it very difficult to create and hold themselves accountable to a budget. The advent of software like Quicken and Money didn't seem to help; when I started in this field, we gave every single client a copy of Quicken, but I can't think of a single instance where a client successfully adopted it. And now, online apps like [www.mint.com](http://www.mint.com) should make it really easy to budget and track your spending, but even there we're not seeing easy adoption.

So when two professional colleagues raved about a new cash management tool that they were using, I undertook to try it myself. I'll never give up my Quicken, which I've used for years, but I'm a convert to the new tool, and see it as a truly effective way for people to manage their spending.

The system is called First Step Cash Management, and was developed by a financial planner in Illinois, Marty Kurtz, who has used it for years with clients (and who, coincidentally, is national president of the Financial Planning Association this year).

It's a bucket system. You divide your cash into three buckets:

- Bucket 1 is for money already spent. These are commitments already made, like mortgage payments, utilities, car payments, insurance, and taxes.
- Bucket 2 is spending money: the cash you need to live your life, day-in, day-out, for groceries, gas, entertainment, restaurants, pet care, drugstore, clothing, etc.
- Bucket 3 is for goals: lots of separate sub-buckets that outline future spending on goals like vacations, a new car, home improvements, college savings, retirement savings, debt reduction, etc.

So to start, you have to outline your planned spending and your goals, just like with a normal budget. However, that's just the first step. The power is in the implementation:

- Each bucket has a separate bank account. Period. Based on the spending plan, you set up monthly recurring transfers from the paycheck's direct deposit account to the various buckets.

- The day-to-day bucket, Bucket 2, is a cash account or a debit card account. This element is key: you have to be able to see, in real time, the balance of this bucket.
- The goal buckets are savings accounts only. Money comes in via a recurring transfer each month; when you buy the car, or go on the vacation, you simply transfer the funds out of the goals account, into Bucket 1, where you write the check.

So here's the management part. Let's say you send \$2,000 a month into Bucket 2, your day-to-day bucket. It's the 25<sup>th</sup>, and there's \$300 left, which you can easily see as you look at your accounts online or on your smart phone. You'd like to buy your best friend a \$250 birthday gift, but know that you'll also need money for grocery shopping the next day.

So you have to make a choice: don't buy the gift, or move funds from another account to pay for it? That makes you stop and consider the expenditure, which is positive, but doesn't prevent you from spending money on what you really want. It just forces you to make a deliberate choice on which future goal bucket you're going to raid to cover the expense: the vacation fund? the new car fund? the retirement fund? You're perfectly free to raid them, you just have to face the implication. And the implication is staring you in the face every time you log on to your bank, and see your goal bucket balances. It's a direct, immediate, feedback system.

Using First Step finally pushed me into online banking (which I find to be a big timesaver), as that's fundamental here. You set up the monthly recurring transfers into each bucket once, and you're done. As you spend throughout the month, you transfer funds from future goals to current spending (or vice versa) by a simple online transfer. And pretty importantly, most banks will let you name your savings accounts: Car Fund. College Fund. Wedding Fund. Tahiti Fund. Highly motivating!

The drawback of First Step is that it gives you no visibility on where the money went -- it does not track spending. But what it does give you is extremely powerful: a way to automate savings for future goals, and set boundaries on day-to-day spending. The system is neither time-consuming nor complicated. As Warren Buffett says about investing: it's simple, but not easy.

If you'd like more information about First Step, just let us know.

-- Therese Govern. Posted 02/16/11.