

Money for Life

April 2004

Dear Readers,

Financial resilience is the ability to withstand life's events, both negative (e.g., loss of a job) and positive (e.g., birth of a child), that impact one's income and/or assets. This month's newsletter includes information from Rutgers Cooperative Extension on ways to increase your financial resiliency.



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“Bumps in the Road”



Some financially stressful events, such as increased family size, unemployment, divorce, widowhood, disability, and health problems, affect people individually. Others, such as

layoffs, plant closings, corporate scandals (e.g. Enron), recessions, stock market downturns, and acts of terrorism, affect large groups of people or society as a whole.

What factors enhance financial resiliency? Five recommended strategies can help you withstand the inevitable “bumps” in the road of life that occur.

Increase Emergency Reserves



A cash reserve is a key factor in financial resiliency and the best time to prepare for financial hardship is during more prosperous times. It may take a while, but many experts recommend accumulating a “rainy day fund” equal to at least three to six months of living expenses, to get through periods of financial difficulty. A December 2001 survey by Fidelity Investments found that 41 percent of American heads of households, which translates into 71 million Americans, do not have an emergency fund. Those without emergency reserves listed family and friends, savings accounts, and their retirement savings plans as their top three financial “fallbacks.”

Maintain a Low Debt-to-Income Ratio



Financial resiliency is increased when people live below their means and spend less than they earn, rather than live at the limit of their income. The consumer debt-to-income ratio measures one's ability to make current debt payments and is calculated by dividing monthly consumer debt payments (excluding a mortgage but including home equity credit lines) by monthly take-home (net) pay. A safe debt-to-income ratio is considered to be 10% or less and a ratio of 11% to 15% implies reduced financial flexibility. When a household's debt-to-income level reaches 16% to 20%, it is considered fully extended.

Purchase Adequate Insurance

Financial resiliency is enhanced with adequate insurance that transfers the risk of negative life events to a third party payer (insurance company). Financial experts advise spending the bulk of your insurance premium dollars to protect against catastrophic losses that can wipe out your assets and/or claim future income for years to come (e.g., a court judgment), a strategy called “the large loss principle.” Small expenses, such as a dented fender, can be covered through insurance deductibles or emergency fund savings. Adequate insurance should be purchased to protect against potential large dollar losses such as high medical bills, disability, liability, loss of a household earner’s income, and the destruction of one’s home.

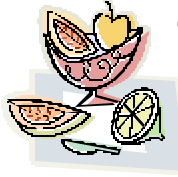
Develop Human Capital



Investments in human capital can increase financial resiliency by providing additional resources to cope with negative life events. Human capital is the process by which people invest in themselves and is one of the most important ways of saving. The most recognized way that people invest in human capital is through formal education that leads to a college degree, trade school certificate, or high school diploma. Other ways to develop human capital include on the job training and experiences,

non-credit courses (e.g., to learn the latest computer software program), and self-employment or consulting work that broadens one’s skill set and/or professional network.

Another way of investing in human capital is by spending time (e.g., exercising) and money (e.g., eating nutritious food and getting periodic screening exams), maintaining one’s health. The results are fewer days of sickness per year, a longer life expectancy, higher productivity both at home and at work, and lower health care expenses.



Stay Positive and Focused

A 1999 report by the University of Minnesota found that there are five personal characteristics that enhance people’s resilience in the face of life’s changes and challenges. These five characteristics are being positive, focused, flexible, organized, and proactive.

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