Step 3: Treat Every Dollar as an Investment

Description

Most of us have heard the old adage, “Pay yourself first.” It has been trotted out so often that it’s part of the financial canon — the de facto Rule No. 1 for managing your money.

It’s certainly sound advice, but frankly, it leaves us Fools hanging: How much? How often? Where to put it? What’s next?

Don’t pay yourself just yet

As far as financial rules of thumb go, we think we’ve come up with a better one. Just in case you overlooked the big, bold headline, we prefer this mantra: *Treat every dollar as an investment.*

That’s the very foundation of successful investing. We like it because it offers a clear guideline for every financial decision you encounter.

Make one great investment every day

To us, an investment is more than something you make in your brokerage account. An investment is anything that affects the quality of your life. Once the basics are covered — food, shelter, workplace-appropriate attire — every dollar equals opportunity. And every day presents new opportunities to make your money work harder for you, whether for long-term gain (retirement savings), short-term safety (emergency fund), or immediate pleasure .

After a while “treat every dollar as an investment” becomes second nature. It seeps into your subconscious like a catchy song you just can’t shake. Soon you’ll be looking for “investment” opportunities in every nook and cranny.

But before you set up your brokerage account and dive in, make sure you’re not overlooking a few essential first investments.

Investment No. 1: Pay off The Man.

In almost every scenario, there is no better use for your first freed-up dollars than paying off high-priced debt, which, for most, means revolving credit card debt. We’ll prove it.

Consider the difference between setting aside $200 a month and coming up $200 short and covering it with a credit card. After five years of that — assuming you simply stuff your $10s and $20s into a coffee can, your credit card charges 18% interest, and you pay a minimum $15 a month toward the balance — here’s where you’d be:

Years	$200 in Monthly Savings Amounts to …	Putting $200 per Month on a Credit Card Amounts to …

1	$2,400	($2,652)
2	$4,800	($5,583)
3	$7,200	($9,088)
4	$9,600	($13,278)
5	$12,000	($18,288)

As you can see, “Pay yourself first” points you in exactly the wrong direction in this scenario. Stashing your cash in a savings account earning nearly 20 times less in interest than you’re paying on those lingering credit card balances leaves you $6,288 in the hole after five years, and you’ve paid nearly $7,000 in cumulative interest charges alone.

The bottom line: If you have credit card debt, invest in its destruction. Use the “[Should I pay off debt or invest in savings? calculator]” to see how much money you can save by making the investment to pay off the plastic.

Investment No. 2: Amass a cash cushion.

Stuff happens — stuff that requires money to fix, such as a job loss, car transmission issues, and a really bad haircut before your high-school reunion. If you don’t have the money on hand, you’ll have to make a crash financial landing, which could mean patching over the problem with a credit card.

Your emergency fund needs to be readily accessible in a simple savings account. Don’t expect to make a killing on this investment. The interest you can get on most savings accounts won’t even keep up with inflation.

How big should this essential investment be? Here are some basic guidelines:

If you …	Then your emergency fund should cover living expenses for …
Have no dependents relying on your income	3 to 6 months
Are the sole breadwinner or work in an unstable industry	6 to 12 months
Are retired and living on a fixed income	5 years

Sweat the big stuff and the 80/20 rule

One other thing we want to make clear: Not every “investment” has a dollars-and-cents return. Or, in more practical terms: Go ahead and enjoy your daily latte. At The Motley Fool, we’re hardly advocates of excruciating denial and extreme penny-pinching in the name of “investing.”

We’d much rather you spend your energy on the big stuff that really pays off — the 20% of line items on your budget that counts for 80% or more of your spending — things like your mortgage, cars, travel, insurance, and any four-figure line items in your budget.

Once you have that 20% cornered and under control, take that savings and put it to work in bona fide investments – in the traditional sense that is. Not coincidentally, the first step to making those traditional stock market investments is our next step.

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