Creating a Savings Plan

SEDPI

Active vs. Passive Income

Active	Passive
• Income derived from labor or work • Primary income – main source of income such as salaries • Additional income – income from sideline, over time pay, part time • Should only be used to fund basic needs	• Investment income you earn even when you do not work • Income earned from assets, investments or both • Use passive income only to fund periodic wants and further increase investments

Colayco, Francisco, Pisobilities: A Personal Finance Handbook for OFWs, 2008

Examples of Passive Income

- Dividends from stocks or profit-sharing from a business
- Interest income from bank deposits or loans you lent out
- Rent
- Royalty
- Capital gains from appreciation of assets sold

Financial Life Stages

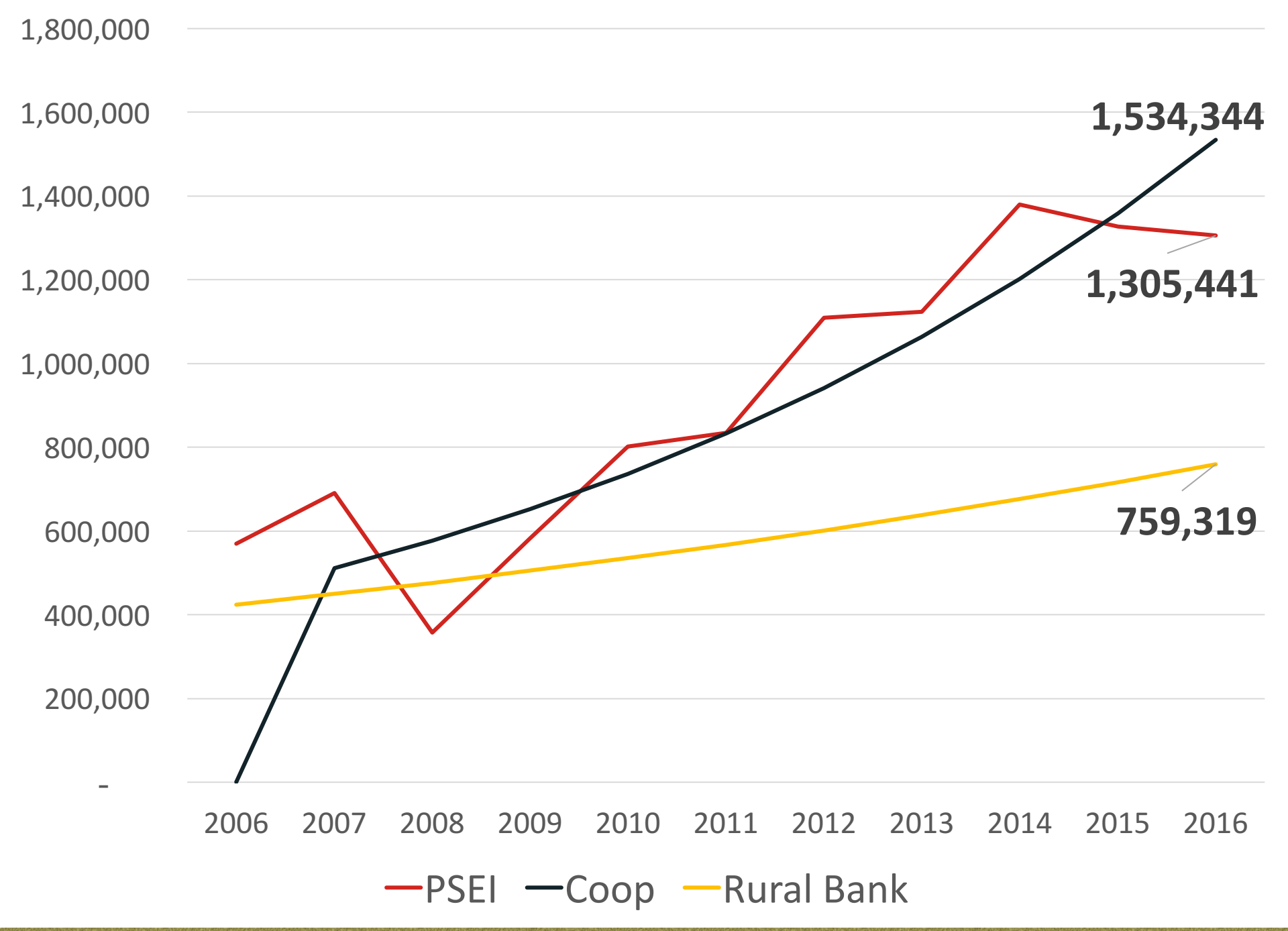
Financial Life Stage	Passive Income / Expenses	Suggested Age
Start Up	0%	21-22
Independence	1% to 10%	23-25
Growth	11% to 25%	26-35
	26% to 50%	36-45
Stabilization	51% to 75%	46-55
	76% to 99%	56 - 65
Freedom	> 100%	>65

Savings is the postponement of the pleasure of spending

Steps in Creating a Savings Plan

- Review your financial goals
- Review your present cash flow
- Research on investment opportunities or instruments
- Keep track of your progress

Save for sunny days!


1,800,000
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1,534,344
1,305,441
759,319
2006
2007
2008
2009
2010
2011
2012
2013
2014
2015
2016
PSEI
Coop
Rural Bank

Savings Habit of OFWs

Item	Italy	Dubai
Percentage of migrants without enough emergency savings	86%	72%
Net income as percentage of total income	29%	38%

- OFWs have high propensity to save but this does not translate to adequate emergency savings

Save to invest!

Interest

- Interest is an amount paid to an investment or loan
- Basic Forms of Interest
  - Nominal Interest Rate
  - Simple Interest Rate
  - Compound Interest Rate
  - Real Interest Rate

Simple Interest

- Determined by the formula: Interest = Principal x Interest Rate x Time

Principal	x	Rate	x	Time	=	Interest
1,000	x	1% / year	x	1 year	=	10
1,000	x	1% / month	x	1 year	=	120

Compound Interest

- Interest computed on the sum of an original principal and accrued interest

Year	Principal	Interest Rate	Yield	Total
1	€ 1,000.00	3.6%	€ 36.00	€1,036.00
2	1,036.00	3.6%	37.30	1,073.30
3	1,073.30	3.6%	38.64	1,111.93
4	1,111.93	3.6%	40.03	1,151.96
5	1,151.96	3.6%	41.47	1,193.94

- Harness the power of compound interest when creating a savings plan

Calculating the Real Rate of Return

Identify anticipated total return	Nominal (Quoted Rate) = 11%
Subtract the impact of your marginal tax (Tax bracket) rate on anticipated total return to get the total return after taxes	Marginal Tax: 28% = 11% * (1-28%) = 7.92%
Subtract estimate of anticipated inflation from net return after taxes to get the real return	Annual Inflation is 3% = 7.92% - 3% = 4.92% real rate of return

Interest on Savings

Product	Deposit / Bank	Tax Rate	Inflation	Real Rate
Internet Savings	HKD100 – 1.2M 3.6% (1 year – ABN AMRO)	20%	1.6% (2006)	1.28%
Internet Savings	HKD100 – 1.2M 3.6% (1 year – ABN AMRO)	20%	2.1% (2007)	0.78%
Time Deposit	P50,000 7% p.a. Rural Bank	20%	6.2% (2006)	-0.60%
Time Deposit	P50,000 7% p.a. Rural Bank	20%	2.7% (2007)	2.90%

Create a Savings Plan

Age when you start saving	% of Salary Needed
20s	10%-15%
30s	15%-25%
Early 40s	25% - 35%
45	37%
46	41%
47	44%
48	48%
49	53%
50+	58% or more

Schwab Center for Investment Research, 2006

The Rule of 72

- Approximates the number of time periods needed to double the principal
- Formula: 72 / (*i* x 100) = n
  - Where *i* = interest rate; and n = time period
- Example: If I place a deposit in the bank that earns 3.6% per year, how long will it take to double my deposit?
- Solution: 72 / (3.6% x 100) = 20 years

How not to Succeed Financially

- Procrastination
- Lack of Specific Goals
- Lack of commitment to pursue goals
- Ignorance about investments
- Ignoring investments
- Following ill-advised tips
- Ignorance about taxes
- Payment of high insurance premiums
- Lack of diversification
- Lack of discipline in following investment tactics

Tips on Savings

- Save in strong cooperatives – members' earnings are tax free in coops
- Save in strong rural banks
  - Maintain savings up to 500,000 only to be covered with PDIC insurance protection
  - Place long term time deposits to negotiate for higher returns
  - Time deposits placed for 5 years and 1 day are tax free
  - If possible, create a settlement account for interest earned on time deposits

SEDPI

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Website

www.sedpi.com

Telefax

+632-433-8795

Office Address

Unit 303, Loyola Heights Condominium
23 Dela Rosa Street, Loyola Heights
Quezon City