You Can Save the Smart Way

by Laura Rowley
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The annual "America Saves Week," an event organized by more than a hundred organizations to encourage consumers to sock money away, wrapped up at the end of February. It's not having a huge effect, at least according to the latest numbers -- the January personal savings rate fell to 3.3 percent from 4.2 percent in December, the lowest rate in 15 months, the Commerce Department reported this week.

If savings behavior isn't changing, consumer attitudes may be. A recent Gallup poll found 62 percent of Americans say they enjoy saving more than spending, while 35 percent reported the reverse. Back in 2006, respondents were split about 50-50 on the question. Moreover, 57 percent say they are spending less money in recent months than they used to, up from 50 percent last July. Among the newly frugal, 38 percent say this spending pattern is the "new normal," while 19 percent say the budget cuts are temporary

The poll didn't examine how people are saving, but the latte-by-latte route is being challenged by some. "If you look at the things you spend the most money on, that's where you can save the most money," says Elisabeth Leamy, author of the new book "Save Big" and a "Good Morning America" consumer correspondent.

/>Leamy offers a hundred ways to save thousands of dollars on five top costs -- homes, cars, credit, food and health care. She argues that it's easier to squeeze money out of the big stuff than to pinch pennies. "I would rather focus ferociously on getting rid of junk closing costs when I buy a house or do the research every few years when I need to buy a car, than scrimping and struggling to save every day," she says.

The book offers step-by-step instructions to minimize closing costs on a house, negotiate the price of uncovered medical procedures and save on auto insurance, among other tips. Some suggestions are straightforward. You can save $9 a month by keeping your tires properly inflated, or save tens of thousands by buying a used car and paying cash rather than financing. (Been there, done that, it works; the only exception was the Kia we bought during the Cash for Clunkers program.)

Wiser Use

For consumers whose finances aren't particularly complicated, Leamy is a big advocate of pre-paying your mortgage. For example, suppose you take out a $200,000 mortgage for 30 years at 6.5 percent interest. The monthly payment is $1,264.14. Let's say you can afford to round up your monthly payment to $1,300, paying an extra $35.86 a month. You'll save $23,900 over the life of the loan.

But for me, this is the trickiest part of personal finance. There are multiple goals crying out for that extra $35.86 -- a fund for emergencies, college, retirement and those little expenses that make life worthwhile right now (like a vacation to Florida, especially if you lived on the East Coast this winter).

If you carry credit card debt, the best use of that $35.86 is paying down those cards as quickly as possible, because the high interest rate is dismantling your road to riches brick by brick. Three simple steps: 1) Take five minutes to call each card company and see if they'll lower your interest rate. 2) Make all your minimum payments on time and in full and shovel the extra $35.86 toward the highest interest-rate card. 3) When it's paid off, shift that minimum payment plus the extra $35.86 to the next card, and keep rolling until you are free of credit card debt. (Watch out for debt pay-down scams that charge you for that same advice.)

Next, I would allocate that $35.86 toward an emergency fund equal to three month's living expenses in a savings account. Personally, I keep my emergency fund in my checking account, because I get 3.5 percent interest on deposits up to $30,000 if I use my debit card 10 times a month. I know I can only spend the amount above my emergency fund "base." This works remarkably well if you're disciplined. (Rule of thumb: If you've had more than one overdraft charge this year, don't try this, because you don't have enough control of your finances to make it work.) First get a budget.

Now, let's assume you're free of revolving debt and have managed to save three month's living expenses. The next place I'd put the $35.86 is in a retirement account. If it grows at 5 percent for 40 years, you're looking at $32,864 (assuming a 2 percent rate of inflation). Click here for a method to compare the value of an extra mortgage payment to a 401(k) contribution.

Can We Have It All?

Frankly, I think you could make a good argument for splitting the $35.86 between a retirement fund and a vacation fund, because the days are long, life is short and all you take with you are memories.

Unless, of course, you have kids; then maybe you put one-third of the $35.86 to retirement, one-third to vacations and one-third to college. For instance, I used to make an extra mortgage payment but eventually allocated the money to my kids' 529 college savings plans. Why? Inflation on college tuition is running 7 percent. My returns over the last three years averaged 3 percent. The only way to reach our goal is to save more (and practice jump shots, on the outside chance the kids could ride a sports scholarship through college like their dad.)

Old-fashioned American optimism (and clever advertising) suggests we can have it all. Doing the math often demonstrates otherwise. At a certain point it comes down to making choices about the big things we want in life and setting goals to reach them, and then, as Leamy puts it, "buckle down and do the work."

It would be wonderful if America Saves Week inspires someone to skip a $3 latte and save the cash -- but even better if it gets people to think about what they really value, and use their money accordingly.