



Habits and Your Financial Health

By: Joe the Investor

There is a saying “you are what you eat”. There is another saying that is equally as important – “you are a product of your habits”. Using an analogy of an ocean liner – how would you steer it to change course in a meaningful way? Very slowly but consistently. If you can envision an ocean liner, you would turn the heading ever so slightly – fractions of a degree toward the direction you want to go. Someone watching the ship would not even realize that anything had happened. As time passes on, the effect of the small change in direction compounds and becomes larger and larger. By the time you reach your destination, you may be hundreds or thousands of miles from the original navigation. If you tried to steer that ocean liner all at once, would you succeed? You would likely overdo it and cause an accident, or get so far off course that you would lose time correcting the direction again.

What does this have to do with money and habits? Everything. If you have a goal of making or saving more money and get a ton of great ideas, and then try to implement them all at once, what would likely happen? Failure! None of the multitude of changes that you tried to do would stick and there would be no effect. What about going to a semi-nar and picking one change that you can make easily, and you make this change for a long period of time? You would likely be more successful. This is one of the secrets of changing money habits and letting time do its magic. If you make a change that is hardly perceptible (i.e. painless), then this method will hardly be a strain.

What are some examples of this? Have you heard of the latte factor? The latte factor is making one incremental change per day – not purchasing that cup of coffee and saving the money. Due to the frequency of how many cups of coffee someone would buy over years of their lifetime, this would add up to meaningful savings. Another version is instead of buying a latte, you buy a regular coffee and add your milk or cream to it. This would save you \$2 per day as an example. After 365 days, you have saved over \$700 per year from this one incremental habit change. The ocean liner analogy shows the effect of compounding the change to make it even larger. What would you do with the \$700? Let’s say you invested it over 10 years. On top of the \$700 x 10 years of contributions, you are also making a return on this investment. As a wild guess, let’s say you made \$3500 in return over the 10 years – about 5% per year on average. Now the effect is compounded. You can then take this money and deposit it into an RRSP and get a tax refund which would amplify the effect a while longer.

The latte factor has been beaten to death in many blogs and financial circles. The point of the latte factor is an example of one small habit that can lead to large changes over a long period of time if applied consistently. There are many other habits that can achieve this result. How about saving \$1 per day on buying bananas from your local grocery store? How about negotiating a slightly better rate on your cell phone plan? How about purchasing the basic gym membership instead of the deluxe one that includes less but would suit your needs exactly? How about wasting slightly less food each day and

buying a little bit less? Maybe keeping the computer, cell phone or cars that you drive one year longer than you used to? Ask yourself what the trade-off may be in doing these things – but if there really isn't anything lost then you have found a habit that will create more money.

There are techniques that say you need to do a routine for 21 days to make it stick. This is basically saying that by doing it for this long, you are making the habit automatic. It will get to the point that when you don't do it, you will miss it! Why not be creative and see what habits you can change that add incremental effects over time?