50/30/20 RULE

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MASTERING THE 50/30/20 BUDGET

Budgeting doesn't need to be complicated. In fact, taking a simple approach to budgeting can be the most effective way to manage your finances.

The 50/30/20 budget is a straightforward, high-level way to understand your financial needs, keep spending in check, and feel more confident that you are taking charge of your personal finances. When used effectively, the 50/30/20 budget can keep overspending in check, save you time, and help you build savings or pay down debt in a sustainable way.

Breaking It Down

Nobody likes painstakingly entering hundreds of transactions into a spreadsheet. Instead of taking an overly prescriptive approach to exactly which dollars should go where, the 50/30/20 rule breaks your money into broad spending categories.

Start by categorizing your monthly money as follows:

- **50%** of your (after-tax) income goes to non-discretionary expenses like housing, groceries, utilities, etc. These are the essentials, the kinds of expenses that can't be avoided.
- **30%** of your income after tax goes to personal spending. This is discretionary stuff like hobbies, entertainment, shopping, etc. These are nonessentials—things you like or want to spend money on but realistically could live without.
- **20%** of your income after tax goes straight into savings, preferably on autopilot so that there's no chance it ends up being spent on discretionary items. Alternatively, if you are struggling with a debt burden, this 20 percent could be split between savings and paying down debt.

Taking the time to allot your monthly income before it's even spent can help you stay on top of overspending and keep your money in balance. Plus, using these basic categories as a guide means you aren't spending time and effort logging each transaction and agonizing over small purchases.

Okay, Where Do I Start?

Taking control of your finances with the 50/30/20 rule can take less than half an hour if you're handy with your bank and credit card statements. Follow these three steps to get started.

Calculate Your After-Tax Income

This can be as easy as looking back at your last few pay stubs. If you receive the same amount in every check, even better!

If your pay fluctuates, look back over a few pay periods and get a sense of what you can expect on a monthly basis. Estimate on the low side to ensure you don't come up short at the end of the month.

Categorize Last Month's Spending

Look back at your spending in the last month to get an idea of how close you already are to the 50/30/20 ratio. It's important to be honest with yourself here—trying to fudge the numbers or sweep some transactions under the rug will only throw you off track going forward.

You don't have to agonize over each transaction. Is it a need, a want, or did it go toward debt or savings? Rent and groceries are needs. A new piece of décor or dining out several nights in a row fall squarely in the "wants" column.

Once you have numbers for your needs, wants, and savings or debt columns, total up each one.

Are you spending 50 percent of your income on needs? Are nonessential discretionary expenses taking up more than 30 percent of your income?

It's okay if your spending over the last month or so doesn't line up exactly with the 50/30/20 model—that's the point of this exercise!

The most important thing to accomplish in this step is to gain an understanding of where you are with spending, so you can adjust as needed in the next step.

Apply The 50/30/20 Rule

Now that you have a solid understanding of what your spending looks like, it's time to nail down the changes you'll need to make to start setting aside 20 percent of your income toward savings or debt.

Start with your nondiscretionary spending. If you're spending less than 50 percent of your income here, that's great! It means you are likely living below your means. Don't use this as a license to inflate the discretionary spending category, though—that extra money should be invested, used to pay down debt, put into savings, or contributed toward your retirement.

If you're spending more than 50 percent of your income on nondiscretionary expenses, it's time to make some decisions.

First, double-check your work. Did you mark any discretionary spending as an essential? Did you have any unexpected expenses like medical bills or emergency car repairs that might have accidentally been included in your calculations?

If your unavoidable expenses are truly too high to be covered by 50 percent of your income, look for ways to save money on your grocery bill or utilities, or consider changing your living arrangement to something more affordable.

Now that the essentials are out of the way, apply the same logic to the remaining discretionary 30 percent piece of your budget.

Examining Discretionary Expenses

For most people, this will be the area they have to work on the most. It's easy to spend money on things we don't really need, and it can be tough to keep discretionary spending in check.

Fortunately, there are approaches that have worked for others that can be a helpful guide for people looking to shrink their discretionary expenses and keep the "wants" portion of their budget under control.

The 72-Hour Rule

Not to be confused with the Rule of 72, the 72-hour rule can have a profound effect on the way you spend money on big-ticket discretionary purchases.

Here's how it works: the next time you're considering a large (or even fairly small) purchase, ask yourself, Can I wait 72 hours to make this purchase?

If you can, do so.

You will often find that the thing you felt you needed doesn't feel so necessary after a waiting period of 72 hours. Retailers spend lots of time and money trying to make us feel pressured to buy right then and there, because they know those tactics work. By waiting and thinking about why you really need the thing you were intent on purchasing, you will often find that you didn't need it in the first place.

Use Money Automation

The explosion in fintech (financial technology—think finance and banking apps) means that now more than ever the tools to take control of your finances are at your fingertips.

An automated savings plan is a great way to make sure you are socking away money without giving it a second thought. It can be hard to set aside money even when times are good, so be sure to bypass your own judgment and set your savings on autopilot.

A lot of new financial tools offer this feature, but even conventional systems can help. When setting up a direct deposit, you likely have the option to split your money between accounts meaning you can set aside a portion that goes straight into savings then and there.

Taking advantage of savings automation features means that the money goes straight into your savings account. With your money out of sight, out of mind, and, most important, out of your checking account, it's much easier to cut back on discretionary spending.