Five Tips for Living Frugally Yet Prudently

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In an era of rising living costs, mastering the art of living frugally while maintaining prudence in financial matters is more important than ever.

A well-managed household budget not only can help in navigating through challenging times, but also to foster long-term financial stability.

To help you live a frugal yet prudent lifestyle, below is a list of practical suggestions developed by Kirk Ito, a financial planning analyst at Index Fund Advisors.

Tip #1: *Tracking Expenses*

A budget is an essential tool for managing household finances, according to Ito, who is a certified financial planner (CFP). To begin, he recommends starting by tracking income and expenses each month on a consistent basis.

"But in order to gain a clear understanding of where your money goes," says Ito, "you really need to understand when and where you're spending that income."

Too many people just don't track expenses, he adds. "It's usually easier for people to keep up with what's coming into the household than what's going out," says Ito. "The spending side is what can really trip you up. It's critical to get it right."

A basic strategy might be to start categorizing expenses into two distinct categories. In such a plan, one group would represent "fixed" costs. These can include items like rent, mortgage and utility bills. By contrast, a second "variable" category could be used for expenses such as groceries, entertainment and travel-related expenses.

"In this manner, you'll be able to allocate funds to each category based on priority," says Ito, "and adjust your budget accordingly." He adds, however: "You need to keep in mind that a budget which is too restrictive can backfire and lead to overspending. So, make sure to be realistic and flexible."

Tip #2: *Realize the Power of Emergency Savings*

Wealth advisors typically recommend that clients build an emergency fund as a backup plan.

Although the amount can vary greatly by each person's unique financial situation, Ito finds that a general rule-of-thumb is to save three- to-six months' worth of living expenses.

"This fund can act as a safety net during unexpected events such as job loss, medical emergencies or major home repairs," he says. The idea is with a financial cushion, "you can avoid taking on debt during difficult times," thereby "maintaining a stable financial situation," according to Ito.

Tip #3: *Address How to Cut Costs While Maintaining a Sufficient Lifestyle*

Living frugally doesn't mean you've got to give up the things you enjoy, notes Ito.

"It's all about being practical yet proactive in setting budgeting priorities," he says. "In other words, try to look for ways to cut costs without sacrificing your quality of life."

For example, you might want to consider cooking at home more often. Ito also finds that many families opt for free or low-cost entertainment options around town.

In general, he adds, there are probably some very creative ways you can identify to shop a little smarter. "For example, you can try to negotiate better deals for services such as cable, Internet or phone plans," says Ito. "Tracking those types of transactions for services that really eat away at your budget can really help over time."

Tip #4: *Make a Concerted Effort to Lower Debt and Avoid New Charges*

Debt can be a major roadblock to gaining financial freedom, warns Ito. "Focus on paying off high-interest debt first," he says. "The objective here is to build a debt repayment plan that works for you over time — and one that can keep you from simply reacting to a pile of bills each month."

From a behavioral standpoint, Ito cautions, not forgetting about low-interest debt should also be a major focus.

"This is called the snowball strategy since these lower balances represent the majority of a family's bills," he says. "From a psychological perspective, these are the types of budgeting wins that help to build confidence and encourage people to retire the ‘bad' debt sooner rather than later."

As you eliminate debt, he finds there's another part of the equation to not forget — namely, making sure to avoid taking on new debt. "Use credit wisely and only borrow what you can afford to pay back," says Ito.

Tip #5: *Invest in Your Financial Future*

While living frugally is essential, Ito likes to remind IFA clients that it's also important not to sacrifice investing for future financial necessities.

A common phrase he hears wealth advisors tell clients when considering how to prepare budgets for families with children: "Don't forget to pay yourself first." You can do this, observes Ito, by adding a line item for "savings" at the top of your itemized budget.

"Good budgeting needs to go hand-in-hand with saving and investing to meet your long-term financial goals," says Ito. This means "keeping a big picture view" of the budgeting process and finding "creative ways to keep contributing to your retirement accounts" through index funds and exchange-traded funds.

"By developing a frugal budget now," says Ito, "you're building a strong foundation to achieve financial stability and your longer-term financial goals."