6 WAYS TO AVOID THE FINANCIAL POTHOLES OF LIFE

If you've got your personal finances under control and in great shape, read no further. If you're confident and happy with the state of your finances, don't waste your time here.

On the other hand, if you'd like to improve your financial situation, avoid some of the more common money management mistakes, and achieve your financial dreams, take a few moments to consider the following tips for skirting the financial potholes of life.

1. Know thyself. How successfully we manage our money is as much about the mind as it is about the money. How often have you read about people who earned high incomes, won the lottery, or inherited large sums of money, yet ended up going broke? Or the reverse: people who earned modest incomes yet managed to build substantial wealth and live comfortably?

Most of us have a love-hate relationship with money, and understanding what makes that relationship tick can do as much for your finances as picking the next successful stock. What are your spending and investing habits, for example? Do you and your spouse have conflicting viewpoints regarding spending, saving, and investing?

Whether you do self-analysis (there are numerous books on money psychology) or work with your financial planner or a therapist, exploring and gaining understanding about your relationship with money will provide invaluable insights for making the right changes in your money management strategies.

2. Pay attention. Neglect is the stepfather of bad finances. Countless families have no household budgets and thus have no idea where their money goes. The majority of people have never calculated how much money they need to accumulate for a comfortable retirement—and hence have no idea if they're saving enough. Workers mistakenly believe their employer covers them with long-term disability insurance. No wonder their finances look like a garden of weeds.

Just starting a budget and thoroughly reviewing your financial situation will be huge steps toward putting your financial house in order.

3. Know your net worth. Your net worth is roughly the total value of your assets (home, retirement accounts, checking and savings, personal property, and so on) minus your liabilities (such as a mortgage or car loans). This is your benchmark by which you not only see how you're doing now, but how you're doing in the future (recalculate your net worth annually). Regardless of the exact return on your investments, if you're building your net worth, you're building financial security.

4. Increase your financial knowledge. Test question: if interest rates go up, do you know which way bond prices go? Seven in ten didn't get the right answer in a 2001 survey by American Century Investments. Yet anyone investing in bonds or bond mutual funds had better know the answer. Americans scored a "D" average of 67 percent on tests of knowledge of financial management principles conducted by Bankrate.com and the Federal Reserve.

5. Take personal responsibility. Too often people simply hand over management of their finances to financial professionals—stockbrokers, accountants, insurance agents, attorneys, financial planners—without staying involved. But the more involved and knowledgeable you are about your own finances, the better they can help you meet your personal goals. And unfortunately, some hucksters take advantage of people's ignorance and lack of involvement. Be involved—this is your money for your life.

6. Don't kid yourself. Financial overconfidence is another reason many families get into trouble. This became glaringly clear in the late 1990s when do-it-yourselfers overloaded on company stock or sank all their investment funds into high tech stocks, only to see their portfolios decimated from 2000 through 2002.

In another display of overconfidence, a third of the workers surveyed in 2004 by the Employee Benefit Research Institute (EBRI) and the American Savings Council (ASEC) concede that they haven't saved anything for retirement, yet nearly half believe they'll have enough by retirement time. And only 8 percent of current workers think they'll need about the same amount of post-retirement income as their pre-retirement income—despite the fact that 39 percent of current retirees in the survey say they're spending as much as they did before they retired and 13 percent say their income needs are higher.

Life is full of financial potholes. Those who avoid them are well-trained drivers who pay attention to the road to their financial success.

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