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SPEND LESS? RETIRE EARLY?

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STEP TWO: READ ON.

AT THE PITTSBURGH BUS STATION, right next to the county jail, a pixieish grad student in a plum-colored blazer is explaining how the experiment works. Two seats down, a lady in a white fur coat plays Texas Hold'em on a handheld console. Behind us, I hear the clump-jingle approach of a dapper little dude in a denim saddle coat and spurred cowboy boots. These are our subjects. This is our lab.

Emily Haisley, a grad student at the Center for Behavioral Decision Research at Carnegie Mellon University, is collecting data on why people buy lottery tickets. This is an important question, because buying lottery tickets is not rational. You know this, of course. Just as you know that starting to save for retirement in your 20s instead of your 30s is the difference between a seven- and six-figure nest egg. And that you should have 6 months of expenses set aside for rainy days. And that you should pay off your credit cards each month. Yes, you know this. We all do. But then . . .

Why do fewer than 45 percent of men under the age of 35 participate in their employers' 401(k)s?

Why do 55 percent of these men have a goose egg in savings?

Why does the average guy carry $8,562 in credit-card debt?

THESE ARE GOOD QUESTIONS. On the following pages, we answer them, with help from experts in the burgeoning field of behavioral economics. Your road to riches starts here.

BY OLIVER BROUDY
ILLUSTRATIONS BY JASON LEE
PHOTOGRAPHS BY DAVIES + STARR

"PEOPLE CANNOT BE COUNTED ON TO DO WHAT'S BEST FOR THEMSELVES."

So says professor George Loewenstein, Ph.D., Haisley's advisor and a trailblazer in the budding field of behavioral economics. This simple observation is what sets behavioral economics apart from neoclassical economics, the dominant school of financial thought today. That's been the problem with traditional economists: Their numbers are sharp and they give great graph, but they've been leaving *people* out of their equations. Now, psychology can provide answers to questions economics alone can't compute.

I spent half a day with Haisley and the rest with Loewenstein, who stuffed my head with the counterintuitive concepts, wily experiments, and shrinky insights that serve as the foundation of behavioral economics. After that, I spoke with a dozen other visionaries, including pension-fund managers and neuroeconomists, psychologists and business gurus. In the end, along with a crushing headache, I had a solid understanding of the new rules of money. And they are . . .

NEW MONEY RULE 01

Your brain wants you to be poor.

FINANCIAL PLANNERS and psychologists will tell you that taking care of credit-card bills and avoiding impulsive purchases is a matter of willpower. But a 2001 study of chronic undersavers by researchers at Harvard shows that, of the 35 percent of undersavers who expressed an intention to put away more in the next 2 months, only one in eight actually did so. Why? Because, it turns out, saving money has more to do with biology than with willpower.

"The rational part of our brain is the cortex, the folded tissue on top," explains David Laibson, Ph.D., a professor of economics at Harvard and one of the study authors. "It values the delayed future just as much as it values the immediate present. But beneath the cortex is an older neural system that values the present much more. So that system basically says, 'If it comes now, great. If it comes in a week, I really couldn't care less.'"

This neural system dates back to a time when staying alive—today—was the only order of business. And half-a-billion-year-old habits die hard. "As our cerebral cortex evolved, the first thing it did, as with any biological innovation, was fit in," says Read Montague, Ph.D., a professor of neuroscience at Baylor College of Medicine. "There was no biological incentive, financially speaking, for our rational structures to contravene our biological instincts."

And so, to this day, our rational brain still defers to our baser instincts. And your savings account remains empty.

PUT THE RULE TO WORK: Okay, so the lower brain calls the shots. How do you fight back? "How does a normal person fight Mike Tyson?" asks Montague. "The answer is, you don't. The answer to how to fight your midbrain is, you don't fight it. But you can put it to work for you."

The trick, he says, is to create an incentive structure that aligns the instincts of your lizard brain with the rational impulses of your cerebral cortex. Think about the way you tap into your anger to summon the energy to push through that last set of bench presses. The payoff—a bigger chest—may be far down the road, but it's worth the pain to you. Use the same strategy with your money. If your goal is to save $10,000 in 2007, promise yourself that if you achieve it, you'll reward yourself with that HDTV you've been eyeing.

MH FINANCIAL CHECKUP

What's in your wallet?

THE AVERAGE GUY HAS NINE CREDIT CARDS. "That's eight too many," says J.J. Burns, a certified financial planner in Melville, New York. "You need only one card to maintain a strong credit history." The key, of course, is paying off your balance each month. If you're still carrying credit-card debt, transfer it to a low-interest card, then start chipping away. We like the Simmons First Visa Platinum (simmonsfirst.com), which offers a fixed 7.25 percent APR and has no annual fee.

NEW MONEY RULE 02

The answer to "Sure, why not?" is "Because you don't have enough information."

IN A SEPARATE experiment with lottery players, Haisley gave two groups of participants $5 in cash—theirs to keep, unless they chose otherwise. Then, over the next few minutes, she offered players in the first group five successive opportunities to buy a $1 lottery ticket. Next, Haisley asked members of group two if they wanted to purchase five tickets at once. The result: She sold 17 percent more tickets to group one.

Why were members of the second group more rational? Haisley says they were able to "broad bracket" the decision. In other words, they understood the risk in full: the loss of $5. And the potential reward: five lottery tickets. The first group, however, became stuck in the "Sure, why not?" rut. A dollar for a ticket? Sure, why not? Another? Sure, why not? . . . until they had no money left.

Haisley's experiment was inspired by a seminal 1993 study that demonstrated how people misjudge political candidates. One candidate would create 5,000 jobs but had a DWI conviction. The other man's record was clean, but he would create only 1,000 jobs. When participants rated the candidates one at a time, they preferred the one with the clean record. Researchers reasoned that most people aren't familiar with employment statistics, but everyone knows that a DWI conviction isn't a good sign. When the candidates were evaluated concurrently, however, participants could compare the job stats side by side and—given the fivefold difference—see that the DWI conviction shouldn't be the only factor.

In a 1997 study, the same concept was extended to why people make bad investment decisions. Eighty students were invited, in a lab setting, to invest a set amount of money in stocks and bonds. Over the course of the experiment, some investors were updated frequently, others less frequently, and a third group hardly at all. With each update, the investors could adjust their investment allocation. The investors who were updated the least often did the best. Why? They were able to keep the big picture in sight—that, historically, stocks deliver the best returns—and weren't freaked out by the market's day-to-day fluctuations.

PUT THE RULE TO WORK: Always be aware of your susceptibility to bias. Anytime you purchase a stock on a whim—or, worse, on the

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Call and threaten to switch to satellite. You might receive instant discounts of up to 20 percent.

SAVE MONEY ON YOUR CELL PLAN

If you use fewer than 400 minutes per month, prepaid plans are a better deal. If you use less than 100, they're a steal. For $100, you'll receive 1,000 minutes that won't expire for a year. The cheapest monthly bill plans cost around $500 per year.

SAVE MONEY ON GASOLINE

In October, the U.S. switched to low-sulfur diesel fuel, which makes modern diesel engines 20 to 30 percent more fuel efficient than their gas counterparts. Dozens of new diesel vehicles are coming.

SAVE MONEY ON A NEW HOME

You can have new construction at a 10 to 15 percent discount if you buy a builder's already-complete "quick delivery" home.

recommendation of a friend—you're buying into your bias. This is why individual investors are far more likely to lose their shirts than get rich quick in the stock market. And yet, according to a survey by the Securities Industry Association, half of men who own equities at all own individual stocks.

Buying stocks à la carte isn't necessarily your ticket to the poorhouse, of course. But a 2005 Harris poll revealed that 49 percent of men regularly adjust their portfolios based on the economic climate. That's often a mistake. Stocks pay in the long run. Assuming the fundamentals of your investments haven't changed, the best approach—as you've heard a quadrillion times—is to place your bets wisely and let them ride.

If you're determined to dabble in individual stocks, set up a few parameters you're comfortable with: a market value exceeding $1 billion, four straight quarters of earnings growth, and so on. Tweak your standards until you find a set you can live with, and then lock 'em in. Good luck. You're going to need it. We hear ethanol stocks are on fire.

NEW MONEY RULE 03

Cutting and running can make you rich.

WE LIKE TO think we're a fairly intrepid lot, adventurous, unafraid of risk. But just as we tend to think that the chances of winning the lottery are better than they actually are, we also tend to think that the chances of medium- and high-probability events—like modest stock-market gains, for instance—are worse than they actually are. According to Daniel Kahneman, Ph.D., a professor at Princeton and winner of the 2002 Nobel Prize in Economics, this suggests a deep-seated cautiousness, which he's dubbed "loss aversion." Loss aversion expresses itself as a lopsided response to a loss of money. To put it simply, we experience twice as much pain from losing $10 as pleasure from gaining $10. This phenomenon explains why we hang on to losing stocks: We're twice as averse to facing up to that loss as we are tempted by the potential gain of moving the money elsewhere.

Likewise, most men know socking away for the sunset years is a smart move. It's so damn hard because we experience it as a loss. The $1,000 you stick in your 401(k) decimates your take-home pay. Boom, it's gone. We register that loss with twice the intensity it deserves, even though we know it's the best investment we can ever make.

One explanation for loss aversion is called the endowment effect. Richard Thaler, Ph.D., a professor at the University of Chicago, illustrates the principle with the example of a wine connoisseur who refuses to sell a bottle of wine for $200 but wouldn't pay half that to replace it if it broke. Owning the bottle distorts his perception of its value.

PUT THE RULE TO WORK: Money is a head game, and if you lose the head game, you're going to lose money. So don't hesitate to dump a bad stock if you've lost money on it, and the company's future doesn't look as rosy anymore. A bad stock is a bad stock, no matter how long you've been cheering for it. You'll get over it pretty quickly once you start reaping gains elsewhere.

The same goes for other losing propositions. Some men work for loser companies for years, simply because they're afraid to own up to how much time and opportunity they've squandered. The longer they stay, the harder it becomes to face that loss.

NEW MONEY RULE 04

You'll make a smarter decision bout tomorrow if you do it today.

FINE, LOSS AVERSION explains why saving is so difficult. But why don't we value tomorrow's dollars as much as today's? For that matter, why don't we give tomorrow's dollars even greater value? With interest, they'll be worth a lot more.

Those questions remained unanswerable until behavioral economists introduced the concept of "hyperbolic discounting," demonstrated in a 1998 study at the University of Leeds, in England. Participants were offered a choice between two snacks, one healthy (bananas) and one unhealthy (chocolate), to be served 1 week later. Recognizing that the healthy choice was better, 74 percent said they wanted bananas. The day the snack was served, though, they were asked again, and 70 percent preferred chocolate.

Likewise, if you were faced with the choice of either paying credit-card bills or meeting a pal for 18 holes of golf, you'd probably go with the golf. It's a lot more fun, at least in theory. But if you were asked which option you'd choose a week from now, you'd probably choose the bills. You know you have to reckon with those debts at some point, and the more remote the day of reckoning, the easier it is to discount the pain. The problem, of course, is that a week goes by, the golf option is still there, and to the links you go.

Credit-card companies exploit this vulnerability. They remove, as Loewenstein calls it, "the pain of paying." By the time the bill shows up, we've consumed whatever we've purchased, so it seems like we're getting nothing in return. We use that as an excuse to pay late, or make a partial payment. That's exactly what credit-card companies want, the bastards.

PUT THE RULE TO WORK: Let's say you've been meaning to pay your bills, or review your financial plan, or figure out how to refinance your debt. Committing to do the work next week shouldn't be difficult, thanks to hyperbolic discounting. The key to following through is holding yourself accountable to a third party—a financial planner, a sibling, or even a golf buddy. Invite him to join you for an afternoon of facing the music, and tell him to bring all his fine print. That commitment will ensure that you don't cancel.

MH FINANCIAL CHECKUP

How's your credit?

YOU CAN DOWNLOAD YOUR CREDIT REPORT for free at www.annualcreditreport.com. Problem is, other than for spotting identity theft, credit reports aren't that useful. What truly reveals your credit worthiness is your FICO score ($16, myfico.com). There's a lot at stake here—namely, better interest rates. Having a "good" score of 760, versus the average score of 723, would save you $15,000 in interest over the life of a $300,000 mortgage. Here's how to close that 37-point gap.

PAY YOUR BILLS ON TIME
Punctual payments represent 35 percent of your FICO score—that's a swing of 193 points between the lowest possible score, 300, and the highest, 850. "One payment more than 30 days late will depress your score for 7 years," says Craig Watts, of the Fair Isaac Corporation, inventor of the FICO score.

LOWER YOUR DEBT-TO-AVAILABLE-CREDIT RATIO
A good ratio is 30 percent or less. If you're using 90 percent of your credit line and you suddenly pay off those debts, your score can jump as much as 100 points within a month, says Watts.

STOP APPLYING FOR NEW CREDIT
"People should resist those department-store offers where you can save 10 percent if you apply for their card that day," says Watts. "Every one you open can lower your credit score."

CHECK YOUR CREDIT REPORT FOR ERRORS
Half of all credit reports contain mistakes that lower a person's FICO score, says Watts. If you find a late payment that wasn't or a line of credit that isn't, dispute it.

SAVE MONEY ON INSURANCE

Raising your deductible from $500 to $1,000 can save you up to 25 percent on homeowner's insurance and up to 40 percent on auto insurance.

SAVE MONEY ON A NEW CAR

How the vehicle holds its value matters as much as its MSRP. So figure what the vehicle will be worth in 5 years (at sites like www.intellichoice.com) and subtract that from the purchase price. The result is the true cost. You'll find that higher-priced vehicles are often cheaper.

NEW MONEY RULE 05

Your older self should always get a cut.

LET'S SAY YOU decided against buying that lottery ticket. Nice job. You pat yourself on the back, telling yourself you've "saved" \$2. In fact, that \$2 is now smoldering in your pocket. It's almost like you found the \$2 on the sidewalk, which makes it easier to spend. You treat yourself to a brew at the pub. Then you have another. By the time you're finished, you're blotto and out 50 bucks.

Behavioral economists call this "mental accounting," a concept introduced in 1988 by Thaler, who proposed that people organize money into separate mental accounts and spend it differently depending on which account it's in. This concept also explains why people travel 20 minutes to save 5 bucks on a \$15 item, but don't bother if it's a \$150 item.

Kahneman once asked 200 people to imagine they were going to a movie. Upon arrival, half discover they've lost their tickets, valued at \$10 apiece, while the other half discover they've lost \$10 in cash. Only 12 percent of the participants who lost tickets said they'd buy replacements, compared with 54 percent of the cash losers. The tickets were regarded as an entertainment expense; but the cash had yet to be entered in any spreadsheet.

PUT THE RULE TO WORK: When you're suddenly awash in extra cash—even if it's a 3 percent raise—lock in a higher savings rate, says Shlomo Benartzi, Ph.D., an associate professor at UCLA. The key, of course, is to commit now. Ask your employer about Save More Tomorrow, a savings program created by Benartzi and Thaler. Employees commit now to putting a portion of future salary increases toward retirement or college savings.

NEW MONEY RULE 06

You'll save more if you spend more.

ANOTHER CHALLENGE with saving money: knowing how much is enough. You can figure out what you'll need to retire comfortably by using any one of a number of online calculators, but daily decisions aren't made with calculators. We rely on mental accounting.

"Consider heroin," Loewenstein says. "Solving the self-control problem is easy: Don't take it. Solving the self-control problem of money is difficult. You can't just tell people, 'Don't spend money.' "

Loewenstein is unusual in that he advises against both spending too much and spending too little. In a 2006 study, he divided participants into two groups—"spendthrifts" and "tightwads"—based on their responses to a survey. He described spendthrifts as those who experience pleasure at the prospect of spending money, and tightwads as those who experience pain. Funny thing is, spendthrifts generally feel worse after spending money, and tightwads generally feel better.

Both groups were presented with the opportunity to buy a variety of products. But first they were asked to enumerate the advantages and disadvantages of each. This enforced period of deliberation had the opposite effect on each group: Spendthrifts bought less; tightwads bought more. From this, Loewenstein concluded that tightwads are no more "rational" than spendthrifts. They're both screwy, but in different ways.

PUT THE RULE TO WORK: If you're a tightwad, using a credit card more often could be a good thing, since it eliminates the pain of paying. If you're a spendthrift, pay with cash as often as possible. But those aren't the major takeaways from this research. Above all, Loewenstein's study revealed that enforced deliberation can help you, regardless of how bent you are. In other words, sleep on it. ■

MH BUDGET BUILDER

Seize control of your spending.

YOU'VE HEARD IT BEFORE: Create a budget and stick to it. Spot-check yourself twice a year using the worksheet below (or at MensHealth.com/checkup). Hitting these targets? Great, but don't forget: "You should be saving for a few long-range goals," says Burns. "If you want to buy a house in 3 years, you need to find 5 to 10 percent more to set aside."

HOUSING (target: 20%)

Rent or mortgage payment \$______
\+ Insurance and taxes \$______
\+ Utilities .... \$______
\+ Other .... \$______
= \$______
÷ Your monthly gross pay .... \$______
= ______%

PERSONAL EXPENSES (target: 15%)

Groceries .... \$______
\+ Clothing (and dry cleaning)..... \$______
\+ Commuting expenses .... \$______
\+ Child and medical care........ \$______
\+ Miscellaneous .... \$______
= \$______
÷ Your monthly gross pay .... \$______
= ______%

SAVINGS AND INVESTMENTS (target: 25%)

Retirement savings .... \$______
\+ Rainy-day savings........ \$______
\+ Other .... \$______
= \$______
÷ Your monthly gross pay .... \$______
= ______%

DEBT (target: 20%)

Student and car loans .... \$______
\+ Credit cards........ \$______
\+ Life insurance........ \$______
\+ Other .... \$______
= \$______
÷ Your monthly gross pay .... \$______
= ______%

DISCRETIONARY SPENDING (target: 20%)

Restaurant and bar tabs \$______
\+ Recreation........ \$______
\+ Her........ \$______
\+ Miscellaneous .... \$______
= \$______
÷ Your monthly gross pay .... \$______
= ______%

MH FINANCIAL CHECKUP

Are you saving enough for retirement?

YOU SHOULD BE INVESTING AT LEAST 22 PERCENT of your net income each year in a 401(k), 403(b), or IRA, says Burns. "If you can do this starting in your mid-20s," Burns says, "your yearly retirement income should equal 70 to 80 percent of your annual preretirement income."