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Why Millennials Spend More Than They Should

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MANISHA THAKOR: What do you wish you had done differently with your finances as a young professional in your 20s? The most common response I hear to that question is, "Save and invest more." As we get older, the tremendous power of compounding becomes all too apparent.

Are you in your mid-20s and want to become a (nominal) millionaire by 65? Save $5,000 a year, every year, for 40 years. If you earn annualized returns of 7% after fees, you will have a seven-figure nest egg. If you wait until you are in your mid-40s to try this same exercise, you would need to save nearly five times as much–nearly $25,000 a year, every year–for 20 years to end up in the same place.

So, starting to save and invest early on means that over the years less money comes out of your pocket and more is added to your nest egg, all through the magical twin powers of time and compounding.

Alas, this answer assumes it is easy to simply start saving in one's 20s. For me, therein lies the most surprising (and usually unintentional) error professional 20-somethings make with their money. I have observed many young professionals mentally anchoring expectations about what their day-to-day lives should look like right out of school to one of two false images.

The first is the standard of living they recall their parents had achieved right before they left for school. Newly minted young professionals tend to see this as what "adult life" looks like. Alas, it probably took mom and dad a good 30 years or more to build up to that standard of living. Expecting to reach it in the first few years of working is not realistic.

Second, we are continuously bombarded by unrealistic images in the media. They portray an "average" lifestyle for a young professional that is anything but. Take a popular legal show, such as "Suits." To dress like, dine out and live in apartments similar to the size and quality of those belonging to the paralegals and freshman lawyers on that show would likely require a salary a good 20%higher than what those positions actually pay. Or conversely, that lifestyle may represent 20% of a salary that could have gone into long-term savings instead of present consumption.

I've written a lot about my favorite "balanced spending" rule of thumb, which comes from a book Sen. Elizabeth Warren wrote with her daughter back in the days when she was a bankruptcy professor at Harvard University. The rule is 50/30/20. In an ideal world, 50% of your take-home pay goes to needs, 30% to wants and 20% to savings.

In the absence of having a clear goal regarding how much money to allocate toward savings–and in the face of unrealistic lifestyle images–young professionals find themselves unable to pursue what so many of us down the road would say is the financial gold standard: save and invest, early and often.

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