Your Most Valuable Asset? That Would Be You

You look like a million bucks. Suppose you were drawing up a list of your assets. Sure, you would consider including your house, stocks, bonds, mutual funds and savings account.

But if you are in your 40s or younger, the assets you have amassed likely pale next to the value of your "human capital," which is your ability to haul in a paycheck. Let's say your annual salary is $60,000. To appreciate how valuable this income is, think about how much you would have to invest in certificates of deposit to get back interest of $60,000 a year. The implication: Your earning power might be worth $1 million – and maybe much more.

All this raises some key questions. How can you make the most of your earnings potential, how should you protect it – and how does your paycheck fit into your bigger financial picture?

GIVING AND GETTING

Your income-earning ability will hinge on a host of factors, most likely including your work ethic, education, network of business contacts, employment experience, how rare your set of skills are and how creative you are in coming up with new products, new services or better ways of performing existing tasks.

This is typically what you have to offer, whether as an employee or as a business owner. But what do you get in return? It isn't just dollars and cents.

Your employer may provide valuable perks such as life insurance, medical insurance, disability insurance and retirement plan contributions. There are also harder-to-measure benefits, such as job security, a pleasant office environment, the ability to work from home and having a position you find especially fulfilling.

Given that your job likely consumes a big chunk of each week, the quality of your work life is critically important. Indeed, there's a sense that the work world has become increasingly divided – with many folks at the mercy of the economy, while others are highly prized, enjoying healthy paychecks, exciting jobs and ample opportunities.

CAPITALIZING ON YOURSELF

How does all this fit with your larger financial life? Here are seven implications:

- Education can be a great investment, because it could enhance your earning ability and widen your employment opportunities. What sort of payback can you expect from any extra years of education? According to the Economic Policy Institute, college graduates are not only less likely to be unemployed, but they also earn an average of 75% more than workers with only a high school diploma.
- If you find it tough to make ends meet, maybe you should focus less on cutting spending – and instead think more about how you can boost your income.

  That might mean seeking a job at a rapidly growing company or relocating to a faster-growing part of the country. That might mean taking advantage of training courses at work or looking into the classes offered at the local community college. That might mean developing a strong network of contacts, by staying in touch with school friends and former colleagues and by regularly talking to headhunters.
- Given the value of your earning ability, you need to protect it. If you have family that relies on your paycheck, you should probably have life insurance. Similarly, for both your sake and the sake of any financial dependents, you may need disability insurance in case you can't work because of an accident or serious illness.
- Think of saving for retirement as the gradual replacement of human capital with financial capital. When you enter the work force in your early 20s, you likely have very little savings, but your earning ability is hugely valuable. Over the next 40 years, your goal is to build a big enough nest egg so that you no longer need a paycheck and you can afford to retire.
- This shift to financial capital also has investment implications. Your regular paycheck is similar to receiving income from a bond, a certificate of deposit or some other interest-paying investment. Early in your career, with four decades of paychecks ahead of you, this "bond" dominates your total wealth, which is why you should consider investing more heavily in stocks with your savings.

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But as you approach retirement and your last paycheck, you will want to buy more bonds in your portfolio, to replace your disappearing paycheck, though you probably shouldn't abandon stocks entirely. You can also replace your paycheck with income from Social Security, immediate-fixed annuities and any pension you're entitled to.

One caveat: Not everybody's paycheck is bond-like. If you run a small business or you work on commission, your income might fluctuate sharply from month to month – and thus you might want to be more conservative with your investment mix, to complement the uncertainty of your paycheck.

- We all favor investments we know well and that we're most comfortable with. But this can be dangerous. For instance, some employees invest in their own company's stock. But if the company gets into financial trouble, these employees may face a double whammy, potentially losing both their savings and their jobs.

  This highlights the need to take a broader view of diversification. If you work for an oil company, you may want to steer clear of energy stocks, so that you don't have both your paycheck and your portfolio riding on the success of the energy sector. Similarly, if you work in real estate, you probably shouldn't sink a hefty hunk of your wealth into rental properties.

- If you are approaching retirement and you don't have quite enough financial capital, consider relying partly on your income-earning ability – by working part-time in retirement. As a rule of thumb, once you're retired, you can withdraw $4,000 or $5,000 a year from your portfolio for every $100,000 saved. In other words, if you can earn $12,000 a year working part-time in retirement, that's like having a nest egg that is maybe $300,000 larger.

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Sourcing: Data on earnings of college vs. high school graduates reported in *The Wall Street Journal*, July 17, 2008.

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