Sound Financial Bites 033 - Paul Adams

Episode Transcription

"The balance sheet rich live in decent houses and drive decent cars."

Hello! Paul Adams here. Welcome to Sound Financial Bites, where we help you with bite-size pieces of financial and life knowledge, to help you design and build a good life.

Hello, and welcome to Sound Financial Bites. My name is Paul Adams. I am your host and president and CEO of Sound Financial Group. We're glad to have you with us today. Today's topic is going to be a little bit different than most. Today we're going to have an analytical topic, but for those of you that don't consider yourself financial wizzes or analytics, hang in there with us. I think the topic today is going to be sufficiently interesting for you.

We talked a little bit about doing like an analytical cast today. We also do our business and career type cast, our financial philosophy cast — podcast, where what we're focusing on is this idea of are you really building a good life? We may have somebody who's in the health and fitness interviewed, or may have somebody that's about personal mindset, or may have something like a marriage counselor or parenting ideas, et cetera. So we're glad to have you with us today, and today we're going to be talking about why we should all stop acting rich.

For those of you that haven't had a chance to read the book yet, there is a book by the same, somewhat offensive title as today's podcast, and it's offensive to all of us because we don't think we're acting rich. I want to say that first and foremost, I don't think anybody who is acting rich feels like they are. They would have some other way that they talk about what it is that they're doing, but they certainly would not say that they're acting rich.

Here's what I want you to do for the rest of our episode today is just try this on. I want you to just kind of pretend like you're in a store, you're getting ready to put on a jacket, it may or may not fit you, you do not have to wear it when you leave the store, you do not have to wear it when you finish the podcast. But for now I just want you to sit with it, and it's this idea of we can be doing things with our finances today that do not lead to our overall financial well-being in the long run, and not because we're bad people. I just want you to consider it maybe because of literally just the current, which is like all of the information, all the conversations that are flowing at us every single day that we've just adapted. and we've adapted it somewhat blindly and without a lot of forethought or design. But to design and build a good life, we have to examine what we currently have. No different than if what you were doing was really considering taking a piece of property, buying it and building a house, where the first things you have to do is figure out what has to change in the current landscape to allow for your new house to be there. I promise you if we're going to increase any habits and practices we have now, whether it's health or money, you're going to have to tear down some existing habits and practices to make it more effective. That's what we're going to be working on today.

Keep in mind that while -- I'm not working to be motivational in our conversation today, you may be motivated during our conversation today. While I'm certainly not working to be confrontational, you may be confronted. So just let that be as it happens and I hope you enjoy the rest of this podcast.

“$750,000 of new income every year is necessary to maintain $500,000 in maintenance cost on a $20 million lifestyle.”

I'm going to start by sharing with you how somebody who's worth more than $20 million still may not be balance sheet wealthy. You see in the book Stop Acting Rich, Dr. Thomas Stanley, who is the same author of the book, The Millionaire Next Door, which I know many of you have read. Stop Acting Rich had a title that I think kept people from picking it up off the shelf because they want to read about somebody else, The Millionaire Next Door, but they're not necessarily wanting to read about why they should stop acting rich. If I could have given any piece of advice prior to that book being written, I wish you would've called it something different, because it wouldn't have been easier to give away to our friends and family and clients, if it had a different name. It's weird to say to somebody, "Have you read the book Stop Acting Rich?" This title Stop Acting Rich broke people into three different categories which I thought was brilliant, and really he did a great job of how he categorized people versus the book The Millionaire Next Door.

In Stop Acting Rich, he broke them to three categories. One is the glittering rich. So the glittering rich or the people that have so much capital, meaning they have over $20 million of net worth, and they have over $2 million a year of income. These are people, who without any major errors, probably cannot out consume what they have. So they can live however they want, massive consumption, spending is perfectly fine. Then you have the balance sheet wealthy on the other end of the scale, and these are the people who rather than, in a millionaire next door where he talked about it being a million dollars of investments or a million dollars of net worth. In this book what he did differently is that it had to do with how old you are, what your current net worth is, and how much your current income and spending are, and are you likely to intersect with enough money at age 65. What we could call “Would you be insufficient or surplus at age 65?” Then you are balance sheet wealthy if you're above that line.

Last, and in between these two is someone called the aspirational. The aspirational is somebody who has good income, but they have insufficient spending, and yet they have more than enough stuff. If you look at him from the outside, they really look like they've got it together. In fact, what they do is they acquire pieces of that glittering rich lifestyle. So for instance, they go out and buy a Mercedes, and they get a really really nice car, or a Tesla, or insert your favorite luxury car here. They go out and buy that car and that's what people see them pull up and which is the same car, they see somebody worth $20 or $30 million pull up in. That is the aspirational where they kind of want to purchase pieces of the glittering rich lifestyle, although for them it's financially inappropriate to do so.

Let me pause on that for a moment. When I say financially inappropriate, what do I mean? Financially inappropriate for the sake of this conversation today, let's just couch that as spending money on something that is not an asset, that puts you personally in the position where you will not be able to one day have enough money to continue living the way you're living now or anywhere close to it. So we see pieces of these lifestyles being lived, and what I'll share with you is that the people that are balance sheet wealthy do not look from an outside consumption perspective anything like we've made up in our minds that they do. As an example, the most driven vehicle in the country at the publishing of this book, by those people who are balance sheet wealthy is the Ford F-150. Yep, just a Ford pickup truck, and not like a brand new one that's the Raptor version, that's $6,000 or $5,000, just a plain F-150. The most purchased car right now that's catching the F-150 is the Toyota Camry. So we're talking about some pretty normal vehicles here. That's one thing to keep in mind.

Second, their average home price is really low, and their average mortgage is really low. You can look at the types of wines that they buy. The average price bottle of wine for somebody who's balance sheet wealthy, that they have inner home that they serve the guest, is like $12.75. It's not $50, $60 expensive bottles of wine. So here's what I want us to be able to think and reflect on this maybe, and this is what it did for my wife and I, reading that book. It made my wife and I realize that as we saw all these consumption that people were in, whether it's the cars they drove or the houses they had, etcetera, the likelihood of that level of consumption actually reflecting back to the net worth is really really low.

I'm going to go walk you through a financial example here. I want you to imagine, you pick the town you live in and they're really really well to-do part of town. I'm just going to pick one of the communities we have here in the Seattle area that's on the water. So for those of you in Seattle area, just picture your favorite on the water beautiful neighborhood and just picture a $15 million home. So it's on the water, it's gorgeous, and up in this area, if you have a $15 million home, for the sake of conversation we're going to say, what's at the end of your dock is a $2 million yacht, and you also have just a vacation home of some kind, we'll call that $3 million. So right there is $20 million worth of stuff. If $20 million worth of stuff on your balance sheet and again, we're going to assume that that person has all of it paid for. They don't have any debt on any of those items. So let's pause here a moment.

"The book Stop Acting Rich changed the 'less than' feeling I had when I started living within my means."

What does it take taxes, upkeep, just to keep your yard looking good, keep that house maintaining at $15 million value, keeping it updated over time, being able to put fuel in the boat, use it periodically, like yacht, put the fuel in the yacht. For those of you that are boaters out there, a $2 million yacht is certainly not a boat. So it's a yacht, and we've got our cabin there. Our cabins are $3 million cabin, or vacation home, something out on the coast. Forget all these stuff, $20 million worth. All owned, totally outright life is good. Now here's the thing you consider, kind of sit back from this for a moment. What does it take to upkeep? Just the stuff that's paid for. Well, you know for much that stuff, it's probably not unlikely that that amount of stuff is going to take between $4- and $600,000 a year just to maintain. I mean maintenance, taxes, etcetera, so let's just pick the midpoint, call it $500,000 a year. $500,000 a year to keep everything painted, to pay the taxes on everything, and to keep fuel and insurance on the boat, and $20 million for the stuff. It's going to take $500,000 a year to maintain it.

Now the $500,000 -- that means we need investment capital to be balance sheet wealthy. We need enough invested capital to put this family in the position, our fictional family in the position where they can pay the expenses of $500,000 a year. Now most of that stuff is not tax deductible, some might be. So for the sake of this conversation, let's just assume that we need about $750,000 of new income every year to pay the $500,000 worth of expenses on the taxes, insurance, upkeep, of all these paid off stuff.

So if we need $750,000 a year, of income every year to upkeep our stuff, that means at our 4%

distribution rate, we need enough capital, what is the ECR, the equivalent capital required to have $750,000 a year. Well the math is not that complicated. All we do is divide is $750,000 by .04 or multiply $750,000 by 25. If you multiply $750,000 by 25, we're going to have about $19 million by the end of the year. We're going to need $19 million -- let's just round that up to $20 million, would be $800,000 a year of income to maintain all the stuff. So that means we now need $20 million of some kind of investments, and that's net value of investments. So if it's in a portfolio that were taking 4% a year off of stocks and bonds etcetera, 4% distribution a year, there's our $800,000.

If it's in real estate etcetera, it means we need $20 million of net value to to threw off that much cash flow, because we can still only take, to be prudent, 4% a year to be able to deal with vacancies, or repairing commercial buildings or rental properties that we have. So 4% a year, $800,000 pays the taxes and maintains the stuff. So so far, this person is worth $40 million to be balance sheet wealthy, and they have not yet gone to dinner or taken a vacation. So let's just stick with our philosophy that this family also needs to just have -- they just want to have about $600,000 a year, let's say $500,000 a year of spending. So this is going to be going out to dinner, this is their time that they enjoy on vacation, this is the clothes, gifts to family, etcetera, so they need another $800,000 a year to pay taxes and then have $500,000 a year, that's their consumption lifestyle.

So what we're talking about for that family to really be balance sheet wealthy. They need to be worth $60 million of invested capital, and I would encourage you to kind of think about this. It probably is not $60 million, there should all be -- if they're an entrepreneur, in the one company they they own. They've got one stock in the company they're in, or if they work for some large technology company or founded one. It's probably not prudent or lasting situation for them to have that all tied up and their company stock that's producing it.

So when you see these massive amounts of consumption, you're looking to these beautiful homes, the odds are not very high that every single one of those people, even in that level of wealth is in a position where what they're going to be able to do is to have a lasting balance sheet that's going to provide that outcome. Now most of them might be making $2, $3, $4 million a year of income right now, and they're saving some, they're living a decent lifestyle either because they founded a company, or they're a high end executive, or they're using their stock options and grants to be able to continue to fund that lifestyle. The bottom line is, they're not what we would call balance sheet wealthy, leaning on the book written by Dr. Thomas Stanley, Stop Acting Rich. They just wouldn't be balance sheet wealthy.

So here's the thing I want you to think about. As we drive through life, and we say, "Well I'm a car guy," or "Man! I really like nice homes," or whatever, just keep in mind, most of the people who are even in these uber over-the-top beautiful homes, likely they are not balance sheet wealthy either. Not like that's a problem. I'm not trying to admonish those people, whatsoever, rather I want us as observers of those people to not caveat what they have.

The book, what it did for me and my wife has changed the way we think about all these things that we see of other people having, realizing that most of the time, the statistical probability is they don't have a balance sheet that looks anywhere near as good as the car, which then allowed us to relax. Because even when we went to living well within our means, or just be kind of share my heart here with you, when we decide to live well within our means, here's what happen to us. I still felt like less than. I still felt as I drove some paid-off cars, after having -- and see the prior cars where Lexus or BMW or Lincoln, I drove these luxury cars and when I step down to this car I just had paid-off, no lease, no nothing, suddenly I felt less than as I drove up to a meeting. I felt less then when I drove up to the office, and it wasn't until I read the book Stop Acting Rich that that transformed for me personally. So if you feel that way -- and it's just sometimes hard to be so honest with yourself that you might realize you feel that way about your house or about our car, that that book, in this way of thinking can really change the way that you feel about money, and more importantly, how you feel about the people that are around you, and the way that they spend.

Literally realizing, that even somebody who's got a $20 million worth of stuff that's paid off -- home, vacation home, and yacht, even they are likely not balance sheet wealthy. So here's what we're going to do, we're going to take it in our next episode. I encourage you to listen in the next one next week, and what we're going to cover in our next episode is the other side of this equation. We just talked about how much net worth it takes to be balance sheet wealthy, given our degree of consumption. What we're going to do is approach it from the other side of current levels of income, and what it's going to take to be balance sheet wealthy on the other side of the equation where you stand now. Many of you listening to this are top 1% income earners right now, making net worth of $350,000 a year. What I want you to think about, whether you're making $350, $500, $700, or a million five a year, I want you to think about how much money needs to be reserve every year so that one day you find yourself in balance sheet wealth, and here's a little bit -- I'm just going to give you a little look into it. A little bit of foreshadowing, is that you are in total control of one of the most important parts of your financial life. You're in total control of it, and that's your spending. We're going to talk about that on our next episode. I hope you guys join us for that. Have a great rest of your day. We look forward to connecting with you. Don't hesitate to shoot us an email if you got an idea for a future episode.

Hi! Paul Adams here. I want to acknowledge you for taking your time to invest in yourself by listening to our podcast. Not everybody does that, and out of my commitment to you, I will take just a few of our podcast listeners between each of our episodes and spend time with them one-on-one, and if you think you'd like some of that one-on-one time to learn more about our process, our philosophy, or whether or not we'd be a fit to work together, just email info@sfgwa.com. That's info@sfgwa.com, and I'd be more than honored to take that time with you. Now you can also go to our website www.sfgwa.com, download the first three chapters in my book, see upcoming in person events that we have, or listen to past episodes. You can also go to our Facebook page and engage us there, our LinkedIn and send us questions for upcoming podcasts. You might hear one of your comments or questions on that future podcasts. For our full disclosure, you can check the description on this podcast, or on the podcast series or go to our website. Have a great day!

Paul Adams is a Registered Representative and Financial Advisor of Park Avenue Securities LLC (PAS). Securities products and advisory services offered through PAS, member FINRA, SIPC. PAS is an indirect, wholly owned subsidiary of Guardian. Sound Financial Group is not an affiliate or subsidiary of PAS or Guardian.

This podcast is meant for general informational purposes and is not to be construed as tax, legal, or investment advice. You should consult a financial professional regarding your individual situation.

Guest speakers are not affiliated with Guardian or PAS unless otherwise stated, and their opinions are their own. Opinions, estimates, forecasts, and statements of financial market trends are based on current market conditions and are subject to change without notice. Past performance is not a guarantee of future results.

2016-26675 Exp. 9/18

Each week, the Sound Financial Bites podcast helps you Design and Build a Good Life™. No one has a Good Life by default, only by design. Visit us here for more details: sfgwa.com