Sound Financial Bites 048- Paul Adams

Episode Transcription

"It's not a matter of 'saving' like the wealthy do. It's more important to spend like the wealthy spend."

Hello, Paul Adams here. Welcome to Sound Financial Bites, where we help you with bite-sized 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'm your host for today's episode, as well as the President and CEO of Sound Financial Group. I am so happy to have you with us today. Today, we're going to be hitting on a topic that's on financial philosophy in a way for you to think about your investing and some counterintuitive things that prevent people from building wealth. Some things that we normally think about that are so close to being accurate but not quite getting the job done for us. I'm going to help us walk through that conversation today. What I would hope is that if there is anything that you get out of this that's an aha, you want to discuss further, shoot us an e-mail, info@sfgwa.com. It's Sound Financial Group, WA, like washington.com We look forward to having that conversation with you. Our team is always more than willing to have one of those initial conversations to help support you in really taking more holistic view of your money and helping you and your family design and build a good life.

Let's talk about one of the ways that people really create significant amounts of wealth. I was just recently speaking at a conference called the Wealthy Wellthy conference down in Austin Texas led by a brilliant woman by the name of Krisstina Wise and her husband Gary. As I was at that conference, looking around the room, people that are there and they are there to learn more about financing your money and I was honored to be able to speak to this kind of unique cadre of folks, but all of those people there are increasing their human capital, increasing what they can do in the marketplace to then be able to produce a better rate of return on their income or in their businesses. This is everything from physicians to business owners to executives for Fortune 200 companies - a really unique group - yet we realize that, I think everybody gets that like well you know for sure one of the highest rates of return anybody is likely to get is going to come from their ability to invest in themselves.

For instance, most people could look at then having gotten their initial four-year degree that their initial four-year degree cost them X and that they can look at it the span of their career and say here's all the opportunities that afforded themselves that I couldn't have done if I didn't have a four-year degree and therefore great rate of return. How many of you have read a book that changed your career or changed your business and it was both buying the book and then taking the time necessary to invest in yourself to get through the material that then allowed you to bring that into your business or into your career and change everything. It's one way that we look and say "Yeah man, investing back in myself back in my career or for business owners back into the business is the highest rate of return that I get. I would agree that that's true.

Here's the thing that I want you to consider with that: it's that the highest rate of return that we can get on the current dollar being deployed but there is just a limit to how much it can be done. For instance, if like too often we make that declaration, what we do is we invest and I'm going to say somebody decides to invest $10,000 in educating themselves a year. Then they look out somewhere else at some set of investments they say that set of investments is only likely to do 8 or 9% a year. As a result of those investments doing 8 or 9% a year, that's not very good I'm just going to invest back in my career. We already know the financial principles that we talk about here on this podcast that really you're going to be saving 20% of gross. That person is not taking 20% of gross income and putting it back in their career. What they are doing instead, the mental checkbox is I don't like the 8% rate of return so what I'm going to do instead is it's just going to get spent. I don't say that explicitly but having looked at thousands of people's plans and intentions over the last nearly 20 years what I do see is that people end up using the idea that my business is my best rate of return to actually consume money elsewhere not to actually put it back in the business as an investment. I'm going to come to that back to that for business owners here in a minute.

It is a great rate of return for you. For any of you that took initial money to start a business and that business is now thriving, there is probably nowhere else you could have put the money that would have done what it did for you to get you over that initial hump and now be producing the income you're producing. That's true. But that leads us to the next place we need to invest our awareness and our education, and our relationship with our spouses is we need to now invest in our ability to control spending. You see, if we don't control spending like it's not a matter of "saving like the wealthy do" it's actually more important that you spend like the wealthy spend. How the wealthy spend their money is the first place they spend it is in acquiring assets. If you're going to set aside money and you're going to put that money first and foremost into a wealth coordination account so that now you got money set aside whose purpose is to buy assets before you spend any money on yourself, that's going to be the most important thing right alongside with investing in your career and investing in your business enough to drive your income upward. The next thing we have to do and it's almost like two sides of the same piece of paper. We can drive our income up but if we don't increase the discipline to be able to have our cash flow controls and to be able to have a significant amount of our income set aside for asset acquisition, guess what? Other than living a cool lifestyle for 20 or 30 years it will all be for naught because in the future we may have had a cool lifestyle with the kids get to go to private school and we drive late model cars, house on the water, lots of cool vacations, and then when we're old we're just hoping social security makes it to make the rent the next month.

"If we invest in our knowledge, we produce better returns. That's true."

There are people that are retired depending on social security today, who have had a life that look a lot like that where life was really really good while they are in their career and now it just doesn't look that good and people just don't talk about it. The reason you don't see that is the very same people that have their careers that look like that that then they retired and in the situation that was less than desirable. Certainly a situation that if you would ask them 20 years would you choose the outcomes you have now they would have said no but why don't we see them? That goes back to our availability bias. We don't see them, they are not available in our radar to make assessments of because they don't live in our neighborhoods anymore, they don't go to our church anymore, they had to move to an area of the country where the cost of living is really low and they are just not in our purviews we don't think about them anymore.

We got to control cash flow. So you can invest in yourself really really highly to increase your income and cash flow from your business. Now that's the investing in your human capital. Other places you can invest your human capital, it's going to be huge difference is if you chose to say I want to become a really really good investor in residential real estate. I want to become a really good investor in commercial real estate. We got enough cash flow and capital set aside, I'm going to get really good at that. Now, to get really good at either one of those does not mean you go out and find the real estate agent and say let's go find some property. I would highly encourage you to read at least five books on the topic before you take that real estate agent outfit for the first time because you need to get -- First, good enough to know all the terminology. Invest in your own human capital enough to understand all the words that those people are going to use so that at least you become a really strong and powerful customer of those folks that do know that domain, the lenders, the real estate agents or if you're going to go out and buy directly from other owners another owner. Keep in mind every time you're buying that piece of property you're hoping to buy -- you thinking it's a good deal. Whoever is selling it they have all the available information also and they think it's a good deal to get rid of it so it's why you have to educate yourself about any new topic before going in a new domain. Of course people do that in their business all the time but sometimes they look at something like real estate and say all I got to do is just go be in the transaction. Either we get a loan the math seems pretty simple and I will transact with a real estate agent to get it all handled. We have to invest in our own education before we pull the trigger on those kind of things.

But now what happens? We realize and we're right if we invest in our knowledge we produce better returns. That's true. Invest in your knowledge, in the marketplace, in your career, whether that's getting an MBA, going to an uncommon learning course, reading a lot of books. You will exceed in your career and produce great rates of return. Investing in relationships with others that's all human capital. That's all true. We need to invest in our knowledge around how our cash flow works as our household to be able to keep that money in our balance sheet.

"Our portfolio should grow wealth for us. We want it to grow wealth and outpace inflation, over time."

So you don't get to opt down to "I just don't like budgeting." Just figure out a way to manage your cash flow that gets you saving 20% however it works for you. If learning to breakdance in your living room on a piece of cardboard just happens to -- for you and your family get you to save 20% in your gross income then do that, but if what it is for you is that you take out the 20% first and you just spend whatever you spend that's left then great, do that. If your household does really well with deep Excel spreadsheets and budgets, then do that. Or increase your income by investing in human capital then we got to save 20%. I cannot tell you how much those things are true and accurate. Those are the two most important ways you can invest in your human capital to increase your income and then to invest in yourself and the way your household handles money enough that you are setting aside a significant amount of that income to acquire assets.

Now, this is where I know I'm sounding like a broken record but it's because this next part is what trips people up all the time and that's this last part. Because our real experiences that other people and ourselves can invest in their knowledge and then produce better returns in their career or in things like real estate or you know buying items on the internet that are antiques, and reselling whatever way you see people invest to their human capital to produce a better rate of return and then we turn to the stock market. As we turn to the stock market, we believe that what we might be able to do is pick stocks and we believe what we could do is choose a stock or a portfolio that's going to have a better rate of return in the market. As a result we make a litany of mistakes. Now that's the part that deceives us.

The deception is that because so many other areas of life, if we invest in our knowledge we can produce a better outcome, and that's true in so many areas. There's just zero academic evidence that that's true for us investing in equity markets. Why is that? When you -- let's say you're sitting back and you do some internet research - well, it's probably not internet research - let's just call it the difference between research and web search. So we do a web search. We find a stock like this looks pretty good. Here's what I think it's done over time and all the press releases, all that stuff. One, you are one single piece of information in this information machine called the stock market and those prices of all of these stocks are actually communicating information. Information held in little pieces by millions and millions and millions of people that own these stocks. We pick one. We're guessing as to what the outcome is going to be versus if what we were doing was looking at piece of real estate able to see the neighborhood like there's some real advantages you can have because you can have a piece of information on a piece of real estate that not everybody else has. That's not true in the stock market. By law, if you were trading on a piece of information that you had that nobody else has, that's called insider trading. If it's a viable piece of information that's from the inside track of that company you can't trade on that information. It's wired up in a way that doesn't allow us as individuals to end up with information other people don't have. Meaning, everything you're going to find when you web search a company is going to be already existing and available information.

Sometimes what will happen even though are lots and lots of companies out there that press the narrative in on us. If you just watch a professional sports game there's going to be plenty of people who are selling us the narrative that you can time the market, that you can buy a portfolio stocks and you can manage your own portfolio and we will teach you how. Now, it just so happens these are all people who also benefit from you being on their platform and you trading. You moving your money is the most important thing to them because that's how they are going to make their money. It's your money being in motion on a consistent and ongoing basis. Yet every study we can find points to the fact there's an individual investor trying to trade stocks like that or trying to guess at different indexes in the portfolio, it doesn't work out well for. What I mean by it doesn't work out well for you can look back at things like that. If you just Google Dalbar study individual investors, you are going to see this enormous gap between what the market did and what the individual investor's did. It's something like the market did eight and a half and the individual investor did three. That's an enormous gap over time and we're dropping ourselves that 3% category simply by going out and trying to buy and pick individual stocks. Sometimes we'll surrender that. Also, we're like, "Heck, I realize I can't do it so I'm going to hire an asset manager that does it." Once again we've talked about this. Because in life we see all kinds of evidence that, indeed, people invest in their knowledge, and as a result of investing in their knowledge, they now get better rates of return in their business, they get better rates of return in their real estate portfolio, they get better rates of return doing hard money lending. Whatever somebody does we see other people invest in themselves and have better outcomes and yet it's not the case even for all of the asset managers that we have access to. So, we go out in the marketplace and we say "Okay, I want to go hire asset manager xyz." Now, they may have some good years but even if they've had five or six good years going back to all the academic evidence and if you want to you can go to our illusions of investing talk on YouTube on the Sound Financial Group YouTube channel and what you'll see is all of the academic evidence that even in those cases the people who are paid hundreds and hundreds of thousands of dollars a year or millions of dollars a year to make these trading decisions, even they are unlikely to be able to outperform what the market would have done anyway.

Here's where I want to land this today. It's that we need to be present to the fact that it's nearly unlimited how much more opportunity we can have in our career or in our business or in things that you can bring human capital to table like real estate, you can bring your human capital, invest in yourself and produce huge opportunities in nearly every other domain of your life. Look at investing in your knowledge around health and how much healthier you can become as a result, yet when it comes to your performance of your portfolio your portfolio is not the place where you're going to get fabulously wealthy. Certainly, the person with the 50 foot yacht doesn't sit back and say, "Yeah, the reason I got this amazing boat, this amazing yacht is because my portfolio did really good." That's not the case. They made that money in some other business or in their career in some other way. What we need to realize is that our portfolio is going to grow wealth for us. Over time it should grow wealth and outpace inflation. It's the place our wealth grows in the sidelines and we have to invest enough in our human capital to understand how to be a disciplined investor. But after we get up to that level of understanding enough about our investing which is what we work to help our clients understand, it's you do not abdicate. Last thing in the world you should do in your investments if you find yourself right now listening to this conversation "Oh my guy just handles that." you may be abdicating that. Do not do that. What you want to be able to do is understand your portfolio and what you're doing financially enough that you can articulate it, that you can understand. You might still have help. I think it's a great idea to continue to have help. We are that team member for our clients. And yet when you get that help you still need to understand well enough what your money is doing and why it's doing it. When the market goes up or down, why is that? What is happening for your portfolio and what's your expectation of that portfolio over time? How much risk am I taking? Am i speculating and gambling? You need to invest enough to understand those key distinctions and then go invest your knowledge somewhere else. Go invest your knowledge in building a real estate portfolio, building your career, getting the next promotion or expanding your business but there's an absolutely not only fleeting but a massively negative potential rate of return we could have by trying to think that over investing in our human life value for the sake of trading stocks or finding an active manager that's going to consistently outperform the market. It's possible. We just have no academic evidence that we could find that person and that when we select them, they'll actually repeat any degree of their performance in the future.

In closing, I just want us to be present to the fact there are places we can invest our human capital, our knowledge that produce wonderful returns. If we do that, we then have to invest our human capital, time, effort, energy to spend like the wealthy spends which means we spend first on buying assets. Then last but not the least we need to invest in our human capital just enough to get the understanding and the fundamentals behind having a solid passive structure portfolio but then use the knowledge we have to resist what everybody else is selling us in the idea of and what we should do in our portfolios so that instead we can hold strategy on our investments and go right back to investing back in our career, expanding our income and our opportunity. I'm glad you're with us today. I look forward to seeing you on another episode.

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