094 - Why We Should Talk, Part 1:
Do You Know How Much Capital is Required?
Episode Transcription

Paul Adams: If you don't know the destination, like how much capital is going to be required for whatever: college, buying a new house, getting a new car, taking a vacation, if you don't know how much capital is required to do those things, then how do you know whether or not you should take the next promotion?

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. The knowledge that has been shared from stages at conferences, pages of national business magazines, and clients living across America, our host, Paul Adams, now brings directly to you.

Paul: Hello, and welcome to Sound Financial Bites. I'm Paul Adams. I am your host today along with Cory Shepherd. So, Cory Shepherd, president of Sound Financial Group here, and with his super-gravelly post-holiday voice, which we're happy to hear. We're glad to have you on the program today, Cory.

Cory Shepherd: Glad to be here too. Glad to have survived the constant mist of sickness that is 11 nieces and nephews at Christmas time, and it was wonderful and well worth it, and I'm glad I could have an extra special radio voice for you today.

"Where we're at too often is living a life by default rather than a life by design, but a life that you desire must be by design."

Paul: I'm super-glad to have you here because it buys me time so that I can drink my coffee in between each different thing that I want to say. So, we are launching a new series today that we hope you're able to get a ton of value from. We've had some guest speakers on recently, people like Ed Moy, the former director of the U.S. Mint - incredible conversation - John Medina, author of Brain Rules for Aging Well, really helping our clients really think about they need to take care of this very important organ that's between their ears to make sure that they have the most productive lifespan that they may be able to have, or functional lifespan that they could have. We can take all the care we want of our money, if our health isn't there, we're not going to feel great about the amount of money we have, I promise you. And you could have really great health, and it will eventually break down if we don't take care of our money.

Those are two parts we really have to pay attention to. But, today, we're going to talk about WWST, "Why We Should Talk?". We're talking about why we should talk. Well, we thought it would do two things: one, many of you out there may wonder, as listeners, "What's the reason I would actually reach out to Sound Financial Group?" number one.

Number two, some of you are listeners that are currently clients, and you're doing this as a way to shut out a lot of the financial noise that's out in the marketplace. You can take this and be able to listen to it, because we're going to talk about the reasons why somebody may want to reach out to us, but then we're going to back that with the philosophies and principles behind our planning in the work we do with clients so that you'll take away with something very operable.

Last, but not least, you may currently have an advisor, and if you have an advisor right now, you may be able to hear, in these conversations, some very critical thinking that you could bring to the table to be able to chat with your advisor about and maybe change their mindset, or at a minimum, become a more savvy customer for the financial institutions that you're dealing with. So, today, Cory --

Cory: I wanted to say, as you were talking, the timing of this is perfect because with the podcast listener, viewership growing, we've got more and more people encountering us that we may never have even met before and we don't know, this growing third-party listenership. So, there's more people reaching out to us that say, "Can we have a conversation?" I think this series is going to help someone who has no other way of knowing kind of figure out if it's a good fit before they reach out to us.

Paul: Yes, and what we hope is even if we're not a good fit for you, we hope that the work that you do with us in listening to this podcast will make you a much more difficult customer for many of the financial institutions that would otherwise, perhaps, even take you for granted. Today's topic, Cory, is?

Cory: "You Don't Know How Much Capital is Required".

"People are not taught financial mechanics or financial philosophy about why they would do anything."

Paul: This is one that's a big deal for us. So, we now, if somebody were to call our office and potentially want to engage, I'll give you a sense of what that's like. One, you sit with us in a conversation that's just us sharing our philosophy. We don't ask you to financially open your kimono and show us what you have going on. Not that we don't want to be friends with you, but we're not looking to be your best buddy in the first phone call hoping that would have you transact with us in some way.

In fact, what we want to do is just be open and sharing with you so you know who we are and the way we think about the world, and then you and your spouse can make the choice as to whether or not you want to apply to become a client, and whether it's myself, or Cory, or one of our other advisors, there is nothing we're allowed to do. It's one of our rules as a company that we cannot make you an offer until you fill out that application. So, it allows anybody listening to that philosophy conversation really just take it in and learn.

Well, in that application process, Cory and I were talking earlier, we could not think of a single instance where somebody, where there's the box of how much capital is going to be required for you. Somebody's checked, "Yes, I know how much," and been able to write that number in.

Cory: You know, I thought of one, which is I think someone we knew and had attended a learning event together where that was talked about and we were actually -- I think you were actually in a group talking with them about that, which is what led to them coming to me.

Paul: Ah, yes, yes, I do remember that, and they wrote down the actual number we talked about at the event, yes. But, that's a great example is how little it's actually talked about. Even years ago, a company called ING had a commercial where people were walking around with their number under their arm, or floating around behind them, or taking care of their nest egg. The thing is you need to know that number. You need to know it.

Cory: Even though it's wrong.

Paul: Yeah, well it could be wrong, but here's the problem I have is so often, what people are doing is, if you asked anybody, "Hey, are you hoping to be really sick or near death's door at age 65?" and people are like, "No." They're planning to be in relatively good condition when they get that far out, right? So, the problem is if you're hoping to be in relatively good condition when you get there, and then you ask, "Forget financial independence. How about we just talk about a work-optional lifestyle." One day, you'd like to have a work-optional lifestyle, and people would say, "Yes, that's absolutely what I want," and if you were to ask, "How much does it take for you to have that?" and they go, "I don't know."

We're not talking about 20-year-olds. We're talking about 45, 50-year-old couples, oftentimes, people making three, four, five, 800, 900 thousand dollars a year. What I would say, lovingly, there's a woman named Dr. Susan Scott who wrote the book, "Fierce Conversations", and she talked about this idea of interrogating reality, which is not always comfortable, but in this case, what we need to do is interrogate reality enough and be like, "How much is enough for you to have a work-optional lifestyle, number one? Number two, if you don't have that number, how do you know what side of the bed to get up off each day?"

"Many of us are driving toward a future and we don't even know the destination we're heading towards."

Cory: People listening might be afraid to find out the number if they don't already know it, and I will just say that it may be painful to find out, initially, what it is, if you don't know right now, and I promise you the pain will be greater the longer -- if it's going to be painful now, it will be more painful to find out later.

Paul: Yeah, you can opt out of not having that knowledge, but you cannot opt out of the consequences of the future that's marching towards us. So, "How much is enough?" is really, I would say, I'm almost creating a paper tiger for a bigger problem. It's not just, "How much is enough?" although that's what people relate to. It's that people are not taught financial mechanics or financial philosophy about why they would do anything. Another question that we ask in our application is, "What's been your philosophy around protection, or savings, or investing?" and I cannot tell you how often, as you're listening to this, this might be you also, "Well, it's because that's what our advisor recommended." Why did you do a 30-year versus a 15-year mortgage? "Because, that's what was recommended." Everything is because somebody who felt pretty smart or had a good relationship with at the time recommended it.

What we're going to do in the remainder of this podcast is spend time, Cory and I, going back and forth, giving you some of these financial mechanics so that you can start doing some of this math on your own. Some of these may be worth actually pulling over, if you're driving right now, and jotting down a few things. We don't recommend you do that while driving, but we do recommend that you own these things, which might mean you need to listen to us again and hear the funny holiday story at the beginning, once again, with Cory's gravelly voice. With that, how much capital is required to replace my income, Cory? How do we teach people to do that?

Cory: Well, in number one, I wrote the question specifically like they're going to see you don't know how much capital is required. That's the title of this episode, and I hope that people ask, "Required for what?" because that gets us started in the right direction, because our first step is not how much income is required, but what is required of our life and what income is needed to support that.

Number one is, and it's not a deferred lifestyle, "What do you want life to be like 30 years from now, 20 years from now?" It's, "What does a good life look like today and are we in a position to support that life for the rest of our life?" The biggest problem in America, I think, is that people have this idea of life deferred. It's a future Cory problem, and let's let current us have a good life and receive those benefits of our planning now knowing that we get to continue that into the future. So, that's step one.

Paul: I was going to say, and something that Cory touched on there that I can't say enough about is if you don't know the destination, like how much capital is going to be required for whatever: college, buying a new house, getting a new car, taking a vacation, if you don't know how much capital is required to do those things, then how do you know whether or not you should take the next promotion? How do you know whether or not you should go get that master's degree? How do you know whether or not?

Well, I'll tell you how you know right now. You are floating along in the financial current, like being in a tube with a bunch of your friends, drinking beer, going down the river. You're just hanging out with a bunch of people and you're all kind of going the same speed, and when everybody else goes and gets a master, we go get it, and where we're at too often is living a life by default rather than a life by design, but a life that you desire must be by design. A desired life will not come by default. A desired life must come through design.

"You need to make sure you don't run out of money because you don't know when you're gonna die."

When it comes to how much -- let's say somebody says, "I currently make $400,000 a year."

Cory: Here's where I would start someone out is how much are you spending on your lifestyle -- no, how much are you making now? That produces a little bit of safety.

Paul: So, let's say 400.

Cory: 400,000. Divide that by .04.

Paul: Now, why is it .04, while we're digging into the financial philosophy?

Cory: Because, we're talking now about what we call the 4% rule, which is out of studies from Trinity University in Texas, and because if you have a portfolio that gets, on average, 8% per year for 30 years, if you actually took 8% out of it, you would decimate it in record fashion.

Paul: Or, it would be great, and that's the problem is we don't know. Like, you could literally, if you guys get a chance to go on YouTube, watch the video on why humans are terrible at finance, we touched on this a little bit, and it's this idea that if you took out 8% and you ran an incredible market like '95 through 2000, no problem, take out 8%. The problem is if the twin brother that retired in 2001 and took out money for five years is totally decimated and would be out of money taking 8% in less than 10 years.

Well, how can that be, Paul? 8% should at least last 12 even with zero rate of return, and it's because the market goes up and down, and when you take out money, you end up accelerating the erosion of your capital in those down years. So, if the market goes down 15 and then you withdraw your 8, you're now down nearly 25%, which means that portfolio's got to come back alive to both rebound, period, plus sustain your 8% hit. So, the Trinity study out of Trinity University in Texas was one of the first studies that really went into the fact that you can't just take out any money at the average rate of return. You really have to take out 4% a year, and that's the high end of what the scholars are saying.

Cory: So, $400,000 of income, $10 million is how much you need.

Paul: $10 million capital at work. So, for one, by the way, that affects a lot of other decisions we might make. For instance, how valuable are we to our family. Well, let's take away the idea of me being a father, husband, spiritual leader for the household, all that stuff, and instead just tag it directly to how much income do I bring in, for every $400,000 of income, I'm worth $10 million of capital at work. That means I've got to have $10 million to replace that in my older age. Now, what if people say, "Well, I'm going to have a lower lifestyle"?

Cory: I want to cut through all that BS of what goes on right here at this stage of a lot of financial planning processes. I had to sit through, study for tests to get letters after my name that said, "Here's how you lay out a budget and get down to the penny what someone's going to need out into the future." We don't know. We absolutely don't know, and so we may do some kind of budget exercise with a client, we may do some very specific, "Here's what the progression is," to at least have done the exercise, but we always do it with a grain of salt knowing that's not what the future's going to look like.

We use that current income number because you may need less money because your mortgage is paid off, and you may need less money because your kids are out of the house and no longer a financial liability.

Paul: Or, you may need a lot more, because, right now, you're making $400,000 a year, you're 38 years old. Do you think, oh, maybe if you're doing that well in your late-30s, you might get more successful?

Cory: We might.

Paul: So, maybe you're making, by the time you're in your mid-50s, a million dollars a year. Well, if we did all your planning based upon 70% of your $400,000 a year income, that's going to be an epic fail.

Cory: And we've got the three stages of retirement commonly referred to as the go-go years, the slow-go years, and the no-go years. So, what's the first thing, if you ask someone the question, "Hey, what do you want to be able to do in retirement?" what's the first thing everyone says?

Paul: I want to take a vacation, travel the world.

Cory: Travel, yeah, they want to travel. Now, it's funny to see, in a couple, one of them will say travel, the other one will kind of roll their eyes and they say, "I just want to be able to sit home on the couch for a few minutes and rest." So, vacation costs more money, travel costs more money. So, we may actually have a higher lifestyle requirement in the first few years of retirement, and then that may go down over time as we slow down, but as we slow down and spend less on travel, we very well may be spending more on healthcare.

Paul: Or help.

Cory: Help?

Paul: Yeah, you can't mow the lawn anymore. Here's the thing. This is what most couples haven't even had the conversation of, okay? There's a scene from Breaking Bad where Walter White and his wife walk into a storage unit where, if you haven't seen this movie, long story short, an otherwise well-meaning chemistry teacher ends up as one of the biggest meth dealers in the southwest United States and he ends up making a lot of money. So, they go in to talk about the money and whether or not they can retire. So, this is what it's like when couples are trying to figure this out.

Skyler White: This is it. This is what you've been working for. I rented this place and I started bringing it here because I have nothing else to do. I gave up counting it. I had to. It was just so much, so fast. I tried weighing it. I figured if one bill of any denomination weighs a gram, there are 454 grams to a pound, but there's a variety of denominations. So --

Walter White: How much is this?

Skyler: I have no earthly idea. I truly don't. I just stack it up.

Paul: Which, by the way, in some ways, I cannot tell you how often we have seen relatively well-healed people who I think were just embarrassed to open their kimonos and say, "I don't know." I think one record was husband and wife with about 4 and a half million dollars that, now, we manage for them, they had it in 14 different accounts spread across past employers all over the place, and they really didn't know the current situation.

Skyler: Keep it dry, spray it for silverfish. There is more money here than we could spend in 10 lifetimes. I certainly can't launder it, not with 100 car washes. I want my kids back. I want my life back. Please tell me how much is enough. How big does this pile have to be?

Paul: Now, what you can see in that video very simply is that people just simply get hung up on the idea that, "How much is enough is just more than I have now," with no real intention or attention to what's going to be enough.

Cory: I see many people I talk with, their sense is, "How much do I need? Something more than now."

Paul: Yep. Now, in that case, if you guys would watch that series, this is actually a very cruel turning point in the series where he just wants to continue working because he's addicted to that.

Yet, what I would say for many people is the problem is they don't know how much is enough when they go in. That's the name of that clip on YouTube is "How Much is Enough?" The question I would have you ask is for you to know how much is enough. We also teach people there should be a sufficiency number and a surplus number.

There might be a number that keeps you in your house, and comfortable, and fine that's 180 a year, and then there might be the surplus number that's 400 and you should understand how much it is to meet both of those and have a path to intersect with both so that you know whether or not to take the next job. Maybe it does make sense to take a job for four years that's going to be heavy travel if what it means is you're done after that. That becomes the key and then it also becomes the conversation of, "How much is enough to be able to 'retire'?" if what you wanted to be able to do is help your kids pay for college, which we're going to cover later on in this 10-part series.

But, in reality, do you know how much is even the amount that you think you want to have set aside for their college? Most people don't. They don't even have a number that they're shooting for. They're just doing it. What I would say, in some ways, I think people are just doing it because they think they should and they're just should'ing all over the place, right? They're just should'ing all over their finances and you could be doing the same thing if, as you're listening now, you can't reflect on the amount of money that you need to accumulate in capital so that you have a work-optional lifestyle, then I think you may want to talk to us, or you need to talk to someone like us. If I knew who they were that were like us, I would send you to them, but I don't know who they are.

Anything else you would have people land with in this conversation about how much is enough capital at work? Any other financial mechanics you want them to know? So, 4% distribution, which means you multiply your income number by 25, or divide your income number by .04, and that will pretty well handle a portfolio that should be able to have no sustainability issues, which means you don't run out of money. And, by the way, one other financial mechanic, you need to make sure you don't run out of money because you don't know when you're going to die.

People say, "I don't want to leave my kids rich." That is not the concern here. The concern is you could be a very healthy 85-year-old and have spent down some of your money going, "Uh-oh, I'm going to run out, it's not going to work well." So, that's where we'd have you guys focus is just make sure you're understanding how much is enough. How much is enough sufficiency income, how much is enough surplus income, and that's going to guide other decisions like, "How much life insurance should I get, how much disability insurance, how big of an umbrella policy do I need?" That's going to drive, "How much do I put in my 401(k), how should I be allocated, how much money do I need outside of retirement plans?" That's going to guide a lot of decisions because at least you're going to have a number you're headed toward. When we took the trip this summer when my family and I went to Wyoming for 40 days, and what was -- I mean, yes, everybody does this, but what did I do every time before we pulled up stakes and had to do another part of Wyoming? What did I have to do before we left?

Cory: What did you have to do? Get out of the car?

Paul: Yeah, got in and then I had to know where we're going. Now, we take that so for granted, it didn't even occur to you. Like, of course, you need to know where you're going. I'm telling you, most of you listening right now don't even know where you're going. You don't know the destination to which you want to arrive, meaning people said, "Where are you going?" and I said, "To Wyoming," it's a big place, but there was a location I was headed to. When I was headed to Yellowstone, there was a campsite reserved to us. There wasn't just a Yellowstone, which is also quite large. There was a campsite I was headed to. When we went to Southern California for most of the month of October with my family and I, we were driving the RV down to a particular place in Newport Beach, California.

Now, along the way, there was all kinds of fun stuff that we did. Unplanned, but pretty much, it was like, "Yeah, we are headed to this place and this is the route we're going to take," and if that's what we do on a two or three-day drive, everybody would do that. You would not head to New York City with putting in New York State in your navigation. Even if you were starting in Seattle, you would definitely put in the location you were going to. Same thing here. Many of us are driving toward a future, and we don't even know the destination we're headed towards. So, first and foremost, make sure you know the destination you're headed toward and what that financial picture, what your financial picture needs to look like to produce the future that you want to have by design rather than by default. Cory, if people wanted more information, what are they going to do from listening today?

Cory: Our website's a great place. There's show notes for this episode.

Paul: With SoundFinancialBites.com.

Cory: Good, thank you. I'm going to need some help on these. And we have a new white paper as a way for folks to be introduced to us and some of our philosophies. It is humanity, dot --

Paul: Sfgwa.com.

Cory: Humanity.sfgwa.com. That white paper is called "Money Where Humanity and Hard Members Meet".

Paul: I think that will give you all a great sense if you download that, read it through. Reach out to us if you want to have a philosophy conversation - happy to do it. But, more importantly, really happy if you send us the report of what this did for you. Email us at info@sfgwa.com. Hit us on Facebook, LinkedIn, Twitter, and let us know what else you'd like to see us do on these episodes. We'd love to be able to integrate our audiences into our future episodes, and we hope that this has been a contribution to you being able to design and build a good life.

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