Episode 162 - Should You Protect Sufficiency First?

Episode Transcription

"This episode is about 'Where does the good life start?' That's sufficiency. Sufficiency is when you've got enough income to be able to live a good life."

Paul Adams: Hello and welcome to Your Business Your Wealth. My name is Paul Adams, I am founder and CEO of Sound Financial Group, and I am joined today by Cory Shepherd, whose shirt is blue, but his attitude never is. [laughter] Cory, as always, I love having you here. And most importantly is, I've called and gotten some feedback from listeners, they really like having you here.

[laughter]

Cory Shepherd: Well, I think that my recent solo episode is one of our best downloads of the last few months, so I don't know what that points to, but it does not point at me. I just...

Paul Adams: But it does not point to me, I love that.

[chuckle]

Cory Shepherd: I was just gonna say, I love thinking about you. Well, I love thinking about you. Everybody just heard that. We'll keep that on the record. I've been thinking about you...

Paul Adams: We're gonna cut that out, post it to Twitter.

Cory Shepherd: No, no, it's gonna stay... Oh yeah, post it to Twitter. Thinking about you, staying up late at night in your journal writing all my intro lines, all the little things. I never know what you're gonna say, and I'm a little worried most weeks, but it usually turns out fine.

Paul Adams: It's okay, I have about 300 episodes of material ready to go in my journal. Now, with that we are so excited for today, 'cause we're gonna take our this week's in the news and we're actually gonna broaden it across our entire episode. Here's what we're covering, should you be building sufficiency first? And what does it mean to build sufficiency? And we're also gonna touch a little bit on how our culture tries to pull you off of sufficiency on a consistent ongoing basis. So with that, we're gonna start by sharing with you a concept called Gell-Mann amnesia. Now, many of you may not be familiar with this particular psychological distinction, but it specifically has to do with the news and media. And so, I'm just gonna read it, 'cause I don't wanna get this wrong, since it's an area of psychology. I'm not woe... I'm woefully under-prepared to have any deep discussion on.

Cory Shepherd: We are not a medical podcast, that's for sure.

Episode Transcription

"How many middle class families have $350,000 set aside for one kid, let alone to split between two."

Paul Adams: That's true. Briefly stated, the Gell-Mann effect is as follows: You open the newspaper to an article on some subject you know well. In Murray's case, physics, in mine, show business. You read the article and see the journalist has absolutely no understanding of either the facts or the issues. Often, the article is so wrong it actually presents the story backward, reversing cause and effect. I call these the 'wet streets cause rain' stories. Papers are full of them. Now, this is a quote from Michael Crichton. "In any case, you read with exasperation or amusement the multiple errors in a story, and then turn the page to national or international affairs, and read as if the rest of the newspaper was somehow more accurate about Palestine than the baloney you just read. You turn the page, and forget what you know." Now, here's the thing. We're gonna look at an article today that demonstrates this really well, that it's easy to brief by the facts when you're reading an article, because the Gell-Mann amnesia effect is nearly instant.

Paul Adams: If you're a businessperson and you read an article where you're like, "Well, that's a bunch of crap as the way the PNL is calculated," and then you turn to another page and they're dealing with personal finance, or they're dealing with economics in some area you're not as familiar with, you will think the journalists are writing an article that's relevant and accurate. Now, it's not their fault, journalists have to crank out content all day every day, that is their entire job, often tackling subjects they are woefully under-prepared to cover. Now with that, we're gonna start with this article. Cory, you wanna take us through?

Cory Shepherd: And... Yeah, I will. And my Michael Crichton, the dearly departed Michael Crichton, one of my favorite authors of all time and also show business writer and a study of the human condition, apparently. I didn't even know that he had written about that until today. So, this article, the title is, "This Budget Shows How a $350,000 Salary Barely Qualifies as Middle Class." So, picture that maybe you're in IT or your company is in manufacturing, and you've just read an article about that that makes no sense to you whatsoever, and you turn to this article, primed with the Gell-Mann effect to think that this is the bee's knees. That's the danger that we have to look out for. And so, I just wanna point you to the first two sentences of this article. For those who are just listening, I won't read it word for word, but the first two sentences basically say, "Most Americans would have a hard time wrapping their heads around a $350,000 dollar salary, 'cause according to government data, some 95% of the US households don't pull in that much." So right...

[overlapping conversation]

Paul Adams: If we could have a record scratch...

Cory Shepherd: I know. Whirr... What? The first two sentences of the article refute the title of the article because they're saying right there that no, they're not in middle class, they are in at least the top 5% of income...

"The IRS did not create the 401(k) max as a number for you. They created it as a number for them."

Paul Adams: Of all households.

[chuckle]

Cory Shepherd: Of all households.

Paul Adams: Of all households.

Cory Shepherd: Yeah, we're primed to forget what that article is showing. Now, the article goes on to give a sample of a budget for a family of four living off of $350,000 in an expensive metro area, like a coastal city. They even reference that this applies to San Francisco and New York, or Boston, LA, San Diego, Seattle, etcetera. So, we've got a whole lot of data and not... Most of it doesn't really make sense for us. Now, Paul, you had... When we were talking and prepping, there was one that just was a jaw-dropper for you already.

Paul Adams: Yeah, one of the things the article talks about is that these folks have a $1.8 million home. Now, to start with, owning a $1.8 million home even in a nice city is not compulsory. You're not forced to do that, but it gives you great insight to the kind of marketing that's done to us on a consistent ongoing basis. And this article itself, actually, when you read it without a critical eye, puts you in a position where like, "Well, it's just normal that I'm not saving 20% of my income plus. It's just normal that I make $350,000 and I seem like I'm out money at the end of every month." Like literally, all they have at the end of each month to pay for any miscellanea stuff is $121 after maximizing their 401Ks. This is trying like to create an environment... Like, if I'm Mercedes, this is where I wanna advertise because I want people making $350,000 a year that think it's normal that they can't save any money.

Cory Shepherd: Also, I just noticed that... Something I didn't notice before. Right in the budget, they talk about property tax on this home, and it says in the notes, $1.8 million home versus $1.6 million median home price. So it's already saying middle class median, they're already pushing them above that.

Paul Adams: Well, middle class median in cities where the income itself is a lot higher. Now, I think you're dead on. That's a big house value.

Cory Shepherd: And you know, this is a great example of that toss up between home ownership and renting. We talk about, if you can pull it off, home ownership is probably the lower cost way to provide yourself some housing over the long term. But in this family's case, at least for a while, renting even at that same monthly mortgage costs would add about $25,000 a year in property tax and maintenance savings to their budget, which would be a nice addition to their emergency fund or their non-qualified investing fund. I also don't know where that mortgage number is coming from, right? Paul, unless... I mean, you're better at that quick math in your head, but unless they bought about 15 years ago for $800,000 or a million, they're not... They don't have that mortgage.

Paul Adams: Yeah, or they came up with a half a million dollar down payment, [chuckle] and where did that come from on this budget?

"Sufficiency will come back around, one way or the other, but many won't even be able to maintain sufficiency because of how long they lived in surplus before they had financial independence."

Cory Shepherd: Where did that...

[chuckle]

Paul Adams: So... But let's just think about this for a moment, okay? This episode's about where does the good life start? That's sufficiency. Sufficiency is when you've got enough income to be able to live a good life. Now, it may not mean any luxuries. It doesn't mean a lifestyle like this necessarily, but it is a good enough lifestyle. Like this budget is a great example of somebody living on surplus. And for most of you listening right now, because of the income level of our listeners, we know you're living in some level of surplus as it stands today. But it's really important for you to make sure that you understand your sufficiency and you have it, what we would call like, on deck.

Cory Shepherd: Well, and looking down the budget even more, they're paying $2000 a month for preschool for their 2-year-old, that's not middle class. I mean, saving $12,000 a year to a 529 plan is not middle class either. There's lots of articles you can find on the Internet about the middle class struggling to pay for college. So, I see more of a disconnect here.

Paul Adams: Yup, and I think we could be done with the article now, but let's... We're gonna keep referencing back to it. But keep in mind, it feels like middle class to them. See, if you're listening now and you make between say $300,000 and $2 million a year, for most of you, you probably live and socialize and hang out with a lot of people that are in that same income range with you. So you feel middle class for the group of people that you're in and you're around.

Cory Shepherd: Like middle of the class that they are in.

[chuckle]

Paul Adams: Yeah.

Cory Shepherd: I guess, not middle class. Well, let's take that $12,000 a year for college for... If you average the risk on and then off a few years before school starts... Like, quick math is they probably have something like $354,000 to split between two kids. Well, how many middle class families have 350k set aside for one kid, let alone to split between

"With your sufficiency, you can still build for surplus. But most importantly, you can put yourself in a position that, for your long-term definite financial independence, you can be in a position to set aside enough money to secure your sufficiency."

two? Clearly, these folks are living in some amount of surplus, which surplus doesn't mean you have loads of extra money hanging around, it just means you're living parts of your good life that are components of the budget that are spending above that necessary minimum for a good life. Like, their kid can figure out school eventually. They don't need that for a good life. There's loans and things like that, but that sufficiency would be, what's the minimum that keeps our family going without any unacceptable compromises.

Paul Adams: Well, that's it. It's just the good enough. Good enough school.

Cory Shepherd: Good enough.

Paul Adams: Good enough healthcare. Good enough education. Good enough healthy food, like safe enough neighborhood. All these things combine to create that sufficiency level income. And once you have that sufficiency lifestyle, spending over meaning, like if this person re-looked at this budget and said, "Well, what are the things here that we're really enjoying?" They are touches of luxury. They're things that we want to be able to do, but they're not sufficiency. Now, what we're not saying is that this couple or you should identify your sufficiency lifestyle, and then cut your budget to the bones and absolutely start setting aside all of the surplus. That's not it. It's to be aware and have your sufficiency on deck. Little to no households that we have a conversation with have taken the time to just understand what sufficiency is to them, to just take a look at their spending and say, "How much needs to be set aside?" Because they don't know. And without even knowing it, we have a hard time understanding how much we're living in surplus or how to even begin protecting sufficiency?

Cory Shepherd: So to talk about what trajectory they're on, we gotta make some assumptions. The article didn't say how old they are, but they're established. They've got this household income, that they have kids at two and four. So we're gonna call them about 40 years old, kind of the typical couple these days that's waiting a little bit longer to have kids, starting their professional career, living in that coastal city. So Paul, you've got some numbers about what track they might be on to hit sufficiency.

Paul Adams: Totally. Yeah, so this couple, it says in the article they're maxing out their 401Ks. And so, for the sake of this conversation, I just assumed that every single year here at age 40 and beyond... Now they may have something on their balance sheet already, but let's just look at their current activity, totally maxing out 401k. In fact, the media kinda leaves you under the impression that if you just maxed out your 401k every year, pretty much financial freedom is on the horizon. But if they're setting aside $38,000 every year, we're leaving out employer match, we're leaving out some of their existing assets, but they're gonna have $2.5 million. If they get 70% every year, linear, the entire time, they're gonna have $2.5 million. You see, they're not likely by any means to probably hit their sufficiency, 'cause I don't think this couple is likely to say that $100,00 maybe after tax, if they're smart about it, it's $80,000 year. Do you think that couple that's making nearly $400 a year now, is gonna be... Feel like sufficiency at age 65 is $80,000 a year after tax or let's look at their current income? If all they do is they never get another merit increase in their pay, all of their increase is limited to inflation 3% a year, this couple will be making a little over $730,000 a year by age 65. Meaning that that is a big lifestyle drop from over 700s down to 80.

Cory Shepherd: Big drop. And we've said it before, in different ways. And I'll say it again. The IRS did not create the 401K max as a number for you, they created it as a number for them. It's no kind of guideline of how much you need to put aside. So, $2.5 million allows them to jump from 700... Dive from 730 down to 100,000 a year of lifetime withdrawal. [chuckle] I'd say it's a good thing that they're saving money for their children's education 'cause one more bump in the road... I mean, not even any bumps in the road, they may have to live with their kids, so I hope that they have a good [chuckle] income to support them.

[laughter]

Paul Adams: Absolutely.

Cory Shepherd: So, from Michael Crichton, amnesia, and 401Ks, where will we go next? Stay tuned after this brief message from Sound Financial Group.

[music]

Paul Adams: Hey everybody, I had to interrupt our show for just a moment to share with you something new. We've designed a new white paper that we think is gonna add you value in the way that you think about money. It's three of the biggest mistakes we see people make and six ways to fix them. Now, for some of you, you might not want the white paper, you might be ready to have a conversation with us and that is okay, you can email us at info@sfgwa.com, that's info@sfgwa.com. Find us on the web at yourbusinessyourwealth.com and any time on any of our social media platforms, send us a message and we can give you this white paper. But in the meanwhile, if you want to just skip over the white paper, have a philosophy conversation with us, we're happy to do that with just let us know. Philosophy conversation in the subject line and if you want this white paper, just put white paper in there, and we'll immediately get out to you this white paper on the three biggest mistakes that we see people make and the six things that you can do to fix them. And now back to our show.

[music]

Cory Shepherd: And welcome back to Your Business Your Wealth. We're talking about sufficiency, amnesia, and Michael Crichton. [chuckle] In case you missed the first half. I don't know why they would have missed the first half. They're not tuning in like a TV station or the radio. Maybe this will make it to some markets on the radio by the time that they listen to this, I don't know. [laughter] So Paul, you were talking about protecting sufficiency and the math that we need to do to make sure that they're on track for that.

Paul Adams: Well, the first thing you have to do if you're gonna protect anything, is you have to identify what you're protecting. We talked earlier about the fact that most people have never defined what their sufficiency income number is. That is that life that's good enough, putting you in the position that you realize that a lot of things could go wrong in life and you could retreat back to a sufficiency level of spending and more importantly, that being an agreement that you make with your spouse earlier rather than later. So when things happen that cause you to need to live in a sufficiency situation or parts of your life need to retreat to sufficiency, you already have an agreed upon strategy. It's not like coming at a left field and a spouse that's been in the dark financially had no idea that you might have to make some of these shifts.

Paul Adams: So, what you do first, is you just do a sufficiency budget. Look at your existing budget and take out all the things that you realize are surplus. This doesn't mean you're gonna stop doing those things right now, it just means you're creating the awareness of what it means. Now, once you've figured that out... So for this household, that's 350 a year, maybe they figure out, well, we could live in an $800,000 apartment. We could make this part of our life work, we could not send the kids to private school, we could make some of these other shifts. And if they did, maybe they'd find that sufficiency for them is more like 180,000 a year.

Paul Adams: It's still not a small amount of money but it's far in a way very different from what they're currently spending. Now, 1.8... Or $180,000 all you do to figure out your sufficiency capital is divide that by the sustainable distribution rate for money, which is 4%, so you take that number, $180,000, divide by 0.04. So if you're driving, I don't want you to wreck your car trying to do this calculation, I'll give you the answer, $3,750,000 is the amount of capital that you need to have set aside to be able to produce that $180,000 year. Now, by the way, and in comparison, it's nearly $10 million that has to be set aside to produce the $350,000 a year that the couple's currently consuming. So you can see, just having an awareness of your sufficiency number makes a difference.

Cory Shepherd: And I know what probably about 300 out of a 1000 people listening are thinking right now, which is how dare you tell me not to send my kid to school, how dare you tell me not to do this, or this? We aren't telling you, only you will know what your sufficiency really is, but reality, the world may one day tell you that that doesn't work. And that's what we're trying to help save you from. And you can use some...

Paul Adams: Like gravity, financial mechanics interest rates will tell you, but they won't deliver the news nearly as nicely as we are.

Cory Shepherd: Or in enough time to do anything about it and that's what we're after. So, once you've done the unique work of calculating your sufficiency, you can then go on to any number of simple online calculators to see if there's a gap between your current asset accumulation and your sufficiency number. And clearly, this couple, many listening, certainly a vast majority of people in the US, will not be able to maintain their surplus lifestyle that they're living now on into their old age. So, sufficiency will come back around [chuckle] one way or the other, but many won't even be able to maintain sufficiency because of how long they lived in surplus before they had financial independence.

Paul Adams: Ah, it's such a great point. And here's the thing everybody, you may need to get help with this, meaning maybe you and your spouse are not on the same page financially or you think you are, but you find out [chuckle] once you're into some of these conversations maybe you are not. And you can get help... You can reach out to us, you know? If you're having trouble getting through the sufficiency calculation, you just wanna have a conversation with somebody to maybe sketch that future the way you'd like to live it and then figure out what the resources are that you currently have to make that a reality, we're more than happy to do that with you. We'll spend some time with any podcast listener to help them think through some things. And we may or may not be a right fit for you, but it is definitely worth taking the time, be in the assessment, and get some help in making that assessment.

Paul Adams: Let's get to it. What can you actually do from today? What can you do differently? What can you walk away today with a different mindset? First, realizing that you can control your sufficiency. As John Dewey said, who's a famous American philosopher, is he had this thing he would say is, "It will do." Like, it is good enough. Well, the thing is too often people don't do a calculation of good enough with their finances, they don't take the time to know this would keep me okay. Now, for the time being, you can divorce yourself a little bit from it being your current budget. Just think, if I were retired today, what would be the minimum that would need to come in for me to have a good life? And as soon as you can identify that number, instantly you do something to cultivate contentment. There's a famous business coach by the name of Dan Sullivan, he talks about something called the horizon.

Paul Adams: And that for many of you listening, especially those of you who are business owners, which we know is a majority of our audience, you look and you keep setting new objectives for yourself, you keep moving the goal of happiness over the cognitive horizon, like trying to catch an actual horizon. It actually doesn't exist. The horizon itself doesn't even exist, it is just where land and the sky meet in the distance. It is a, literally, a linguistic construct and yet that's what we do with our own achievements. We're constantly looking forward, hoping what we can do is achieve that un-achievable, achieve that future objective. But what it does, it leaves us as a constant goal striving mechanism of a human being, never really getting a chance to celebrate or cultivate the contentment that we can produce by realizing we've already covered a great deal of ground.

Paul Adams: And as soon as you realize that you've designed your sufficiency, that you and your spouse have chosen that this is a good enough life for us, you put yourself in a position to better appreciate the life that you have now and resist many of the urges marketing messages and peer pressure to consume. It puts you in the position where what you can do is sit back, realize that you have got a great life as it stands now, that you are living in surplus. When every message coming at you wants you to be dissatisfied with what you have now: Get the car with the newest features, get the house with the wine cellar, get the... Whatever it is. And it's okay to do all of those things.

Paul Adams: But do them in the context of already realizing what you're sufficiency is, because with your sufficiency, you can still build for surplus. But most importantly, you can put yourself in a position that for your long-term definite financial independence, you can be in a position to set aside enough money to secure your sufficiency, to build your surplus, to orchestrate those decisions in a way that you have the greatest likelihood of having a good life. Not for now, like this couple. They're gonna have a good life right until the time they have to step off and live off their assets. And there are reasons why some executives don't have the options that they're continuing to work until their late 60s and 70s. Why some business owners never sell their business, because they find out when they go to sell it, it doesn't get them as much as they would need to replace the income they had while they were working there.

Paul Adams: In fact, what you can do is realize here's my sufficiency. I'm going to build the surplus. When you get that next pay raise, when you take those additional K1 distributions, you realize you're already in the position to have your sufficiency handled, giving you a better chance to set aside more money for the future to create the surplus for the rest of your life. To put you in a position to have a good life for the rest of your life. Now, as always, we're glad that you guys are here. We love and it makes a difference, share this episode with one person. You can go right to your favorite podcast app, you can send a text message to somebody saying, "I just heard this great episode. I think you'd get value," or have a cup of coffee with somebody and discuss it. Have financial conversations, this taboo thing come into your life because you've got to care for it. It would be like not having parenting conversations with your friends to not talk at all about money or what people are doing with their money to make sure that they've got their long-term sufficiency handled.

Paul Adams: You can forward this episode, open up a new conversation, send it to your closest friends, the people in your Bible study, the people that work for you as key executives inside your company. It will make a difference in the conversations you get to have about money and in all likelihood will increase your performance with money because you're having conversations about it. It's not just me, you, and Cory, kinda fireside chatting here. We're glad you could join us today. And we hope that this episode, like all our episodes, has been able to contribute to you being able to design and build a good life.

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