MONEY FOR SOMETHING

A handy field guide for turning small investments into financial freedom.

A BOOK BY
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Money for Something

A Handy Field Guide for Turning Small Investments into Financial Freedom

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Introduction

Growing up in a family of modest means, I watched my parents spend much of their lives working to pay the bills. When I was 15, I got a job at a grocery store and began working long hours to pay my own bills, often wondering whether the choice of how I spend my time would forever be tied to the need to earn money.

The few people I knew who were financially independent had either inherited their wealth, or had started successful companies. Those who had started successful companies told me that, in all honesty, some luck was involved and that the majority of companies fail.

Hoping not to rely on luck, I began reading books about personal investment. What I discovered was very exciting—*that practically anyone can achieve financial freedom.* I put the principles I learned into practice, and over the next 15 years confirmed that they work.

It seems profoundly important that the path to financial freedom is so accessible—just by following a set of basic principles with discipline. At the same time, it seems profoundly sad that so many never find it, simply because they are unaware.

That's why I wrote this guide.

The problem with many books about personal investing is that they are too long and complex. The basic message that *everyone should be investing* gets lost in discussion of choices and optimization. My approach in this guide is to present the core principles as concisely as possible—hopefully both motivating you, and *convincing* you to get started *today*.

Who is this guide for?

Time is an essential ingredient in achieving financial freedom through personal investment. For that reason, this guide will be particularly relevant to those in their 20s, 30s and early 40sâ€”i.e. those with enough time to grow their investments while still at a relatively young age.

On the other hand, savings kept in a bank account will lose value (purchasing power) over time, due to the effects of inflation. The investment approach discussed in this guide has historically provided a return above inflation. Anyone, at any age, should be interested in at least preserving the value of their savings, and should therefore find valuable information in this guide.

This guide is for everyone.

What is financial freedom?

This isn't a book about getting rich; rather, it's a book about financial *freedom*. It's important to understand what that means, and what this guide offers in helping you get there.

The four percent rule

There's a rule of thumb which says that if you annually withdraw no more than 4% of your invested savings, chances are you will never run out of money. Using this rule, you can begin to view your savings in terms of the income they can provide, and in turn, begin to explore your own definition of financial freedom.

Say you want to stop working and that you need \$120,000 per year to cover your expenses. In this case you'd need to save \$3 million to achieve financial freedom, i.e. $120,000 divided by 0.04. If you would like to change careers and $10,000 of annual income would give you the confidence to do that, then you'd need $250,000 to achieve financial freedom.

At age 20, I began saving and investing a large portion of my earnings; income initially from a job at a grocery store, later from a job at a restaurant, and finally from my first job as an engineer.

Over the course of 15 years, my investments earned an annualized return of 11%. At age 35, those investments provided the security I needed to quit my job and finance a new business—allowing me to live where I wanted and do the work I love.

My savings didn't make me rich, but viewed in terms of the four percent rule had grown enough to provide the financial freedom to change paths in life.

It all starts with saving

For most people, like myself, achieving financial freedom will require the consistent saving of a large portion of their income, coupled with the growth that can be realized through investing. The following chapters will teach you about investing; concepts which are powerful enough to turn even relatively modest savings into surprisingly large amounts of money.

*That's why this guide is so important. *

But it all starts with regular savings, and the potential for your own success will ultimately be related to the amount and consistency with which you can save.

Financial freedom is having enough savings to provide a level of income necessary to achieve your own personal goals.

Compounding returns

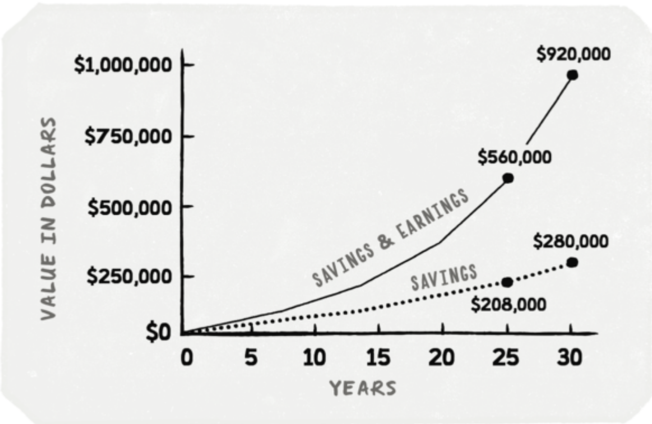
The powerful force that allows even those with modest incomes to accumulate large savings is called *compounding returns*. It's the notion of earning money on past earnings. If this is new to you, pay attention; this will be the most important chapter of the guide.

Say you have $100 in savings, earning 4%. After the first year, you'll have $104—your original $100, plus $4 of earnings. After the second year you'll have $108.16—another $4 earned on your original $100 savings, plus $0.16 earned on last year's earnings of $4. After the third year, $112.49—another $4 on your original $100, plus $0.33 on your *last two years earnings of $8.16.*

Earnings on earnings, year after year. It's hard to believe such a simple concept could be so important. But after many years of investing, the *majority of your savings will have come from compound returns, rather than original investments.*

Let's look at an example:

Stephanie is 25, and earns $50,000. Her salary increases each year with inflation. If she saves just 10% of her income, and earns an 8% annual return, then at age 55 she will have invested $280,000 of her income. Her invested savings, however, will have accumulated nearly *one million dollars*!



In the above chart, we see some interesting things about the growth of her savings.

- **The power of compounding returns.** After 30 years, far more of her final balance of $920,000 comes from earnings ($640,000), than from the money she actually saved ($280,000). Earnings on earnings.

- **The importance of time**. The power of compounding returns comes late in the game. Had she waited five years to start saving—delaying her start by 16%—her final balance after 25 years would have been reduced by 40% ($565,000 compared to $920,000).
- **The importance of the annual rate of return**. What if Stephanie had just put her money in the bank, earning 3% per year? Her final balance would be $420,000—i.e. decreasing her annual return from 8% to 3% decreases her final balance by more than half!

> **Over time, and with a good rate of return, compounding earnings can turn small savings into large sums.**