Sound Financial Bites 032 - Paul Adams

Episode Transcription

"Too often people are not having effective conversations about money."

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.

Welcome to Sound Financial Bites. I'm Paul Adams, president and CEO of Sound Financial Group. I'm so glad you could be with us today. Today we're going to talk about something really unique, and that is watch what you say, it could cost you millions. Before we get into the topic today, we've talked about, several times we had, these four different sections of topics that we visit. We have this topic that is financial philosophy, and that's what today's going to be like, just financial philosophy. Then we have analytical financial cast, those are going to go a little more in depth, deep into the numbers. We're going to have cast that are really designed around designing and building a good life. That might be parenting, that might be marriage counseling, that could be someone that's a biohacker here on the show, and then last but not least, is this business and career philosophy. So today we're going to focus on that financial philosophy and you all know how to get a hold of us now, our website's www.sfgwa.com. You can email us and contact us there. We'd love to hear from you on LinkedIn, Facebook, etc.

What I want you to think about on today's podcast is who would you share this with, with are you going to text after this podcast today, and let them know about this say, "Hey! Listen to this podcast." This is going to be relatively short one, so I want you to engage other people with you in your life, and just start having some conversations. Too often people are not having effective conversations about money that generate new and more effective thinking. We're only talking about things that are dead end conversations like what do you have on the lease on your car? Or what's the interest rate on your mortgage? Versus, is your mortgage even in appropriate amount of debt should you not have done that? And it's totally normal. I was sitting with a huge community leader the other day, and they said something effective, "Well, you really stretched to get in that first house and then you grow into it, and I just, inside my head I'm going, "Oh my gosh, this is the kinds of advice people are getting all the time." So that big purchase ends up crowding out the amount of money that you need to have to grow a healthy and vibrant long lasting optimized balance sheet. People do it so early that they're actually impacting their exponential curves.

See, we only get one exponential curve of growth over our lifetime. We're not entitled to it, it's getting used up everyday that we don't use it. So if we don't get our money on that exponential curve as early as possible, it is costing us. If you get a chance to watch the YouTube cast that we have on Cash Flow Trumps Rate of Return. I also did a version of that as a podcast, but if you watch the YouTube version, you're going to notice this exponential graph, and near the back end of that exponential graph, it's really curious how big of a difference your money has in compounding. Even if you don't do the first five years, people think it's only the first five years they're missing. But what they missed is the last five years. So they missed the last five years, that's were the greatest amount of take off in exponential growth occurs. But we always get the first five years as long as we start and have five years, you always get those early years but you're not entitled to years 35 through 40. Wherever you are in your journey, you're losing some degree of those last years, and those are the biggest years. So we need to get started today and early.

By sharing this podcast to people in your community, whether you do it by social media, or you send them a text using your iTunes after this, you can hit those share button and text it somebody. By doing so, what you're going to do is give yourself a community of conversation around you that's going to help really extract you out of this kind of cultural common sense about money. So, I look forward to you doing that and I hope you get some great results from it.

"You break trust when you can't fulfill your promise quickly enough."

The topic today is all about watch what you say. Watch what you say because it could be costing you millions. So, on my computer here in front of me, though you all won't be able to see this, I'm pulling up just a simple lost opportunity cost calculator. You see, the things that we will do without thinking, is we make promises to people, and we make promises to people year after year after year, but what we're not doing is booking the present value of that promise. We're just simply not saying to ourselves, you know, one day we'll get a -- in ten years, when we retire, we'll buy a vacation home here. Well, you just created a liability. I mean, it's that what we do and we make promises to somebody, anybody, that's going to cost us money, we have to book a net present value of that liability, that is generally accepted accounting principles. We would simply have to say, "I promise X." For that matter, if what you say you want to do is one day be able to stop working, whether you choose to or not, but if you want to have the ability to, you instantly booked to your balance sheet a significant deferred liability.

So as an example, I was watching an interview, this is an older interview back in like 2011, and a gentleman by the name of Ben Stein. Many of you may have known him as the teacher from the Ferris Bueller movie. But Ben Stein was being interviewed about a book he had recently written, and the book was called How to Really Ruin Your Financial Life, and what I've done that you shouldn't do. During this interview, he was asked about debt. When he was asked about debt, the interviewer said, "Well, so in your book you talked about debt like credit cards, cars, all that kind of problem." He said, "No. That is not the debt people should be worried about." Yes, they need to be careful about those things. Yes, they need to be clear that you can get over your head and all of those things and it crowds out your ability safe, but the real problem is, the real problem is, the present value of the money they owe themselves to be able to retire.

Because if you want to have $200,000 a year of income when you retire, that's $5 million of capital. So if you want to have $5 million of capital, and what you hope to be able to do, is be in a position where your money is going to grow at 5% after tax, so let's just call it about 7% before tax, 5% after tax every year, and you're currently 35 years old. For the sake of this, I'm going to say, no retirement savings and all right now, just because it's going to make the math a little easier. That means on your balance sheet, like right next to your mortgage, what you could throw in there, and we don't do this on the balance sheet with our clients but we do like people to be thinking about it, it will be the equivalent of a present value note that is do of $1.15 million, sitting on your balance sheet. That would have to be paid in full today, so that that money could grow enough to take care of the deferred liability of $5 million.

I want you to think about it, there's going to be an older you with like their hand out going, "Where's my $5 million so now I can invest it and retire." That person is waiting around for you to make the appropriate decision today to one day be able to do that. So that's one of the promises we make. You know that one, they're explicit and then implicit promises but I think whether you said it explicitly or not, I would encourage you actually to do this explicitly and I don't care how little your kids are.

"We make all these promises without the one promise that really ought to be made, which is we're going to be okay."

One of the things my wife and I have done is we'd actually talk to our kids who are currently -- at the end of this year -- four, five, and six, all our kids were born within 13 months. It is a busy house and yes, my wife is an absolute saint, and a total gift from God to me and my family. What I would suggest, go to your kids like we have and say, "Mommy and Daddy are going to be in a position one day where we don't have to live with you." So you can raise your family and have your marriage, because we want to make that promise because that promise can be very explicit about it, is absolutely going to trigger as in different actions when it comes to looking at that next car, the next house, or other consumable items like the trips to Hawaii that are always laid in front of us.

So for you, almost everybody listening to this has at least an implicit promise, whether it's to children or your family, your implicit promises that you're not going to live with them, that you're not going to be financially and obligation to them one day that they then have to choose, do I betray the fact that they're my parents? Or do I go ahead and take care of my family that I chose? Like you're literally -- many people listening to this are actually implicitly have made that promise but may not be in the financial actions they want to be in, to set aside the amount of money to fill that gap, to fulfill on that promise. That's one. Then implicit promise that one day, I'll have enough money that you, whoever the you is you're talking to, will not have to support me.

What are the other promises we make? Well, if you're a resident physician or you're in your fellowship right now listening to this, or anybody else who's in a professional education, that you know what, you're an attorney, a dentist, somebody that's going to come out of school and start making a lot more money, or you're going to make partners to start making a lot more money. Many of you have been grinding away for years, trying to get to that next level and you're looking at your spouse and you're saying, "You know, as soon as we get this squared away, I'm going to buy you a big nice house, up on the hill, the one that you want with the curvy driveway." Or you might be an entrepreneur, struggling early on like, "Honey, I'm so sorry about these long nights." What we will do after the business does X is we're going to go by one of these, and once again, have we counted the cost. Have we really counted the cost?

Now, when it comes to doing things prior to retirement, the cost is different. So we talked about the net present value of the future retirement. So there's almost like a negative on your balance sheet right now, simply because there's an implicit promise that you will not be relying on others. That's one type. The other is, lost opportunity cost, because if we make a promise to our spouse that we will go live in this other really cool location, and that's going to either take money off our balance sheet directly, like in terms of down-payment, or it's going to cost us to owe in degree of debt that is now going to draw out of our income and money that could've otherwise been set aside for asset acquisition and grown for our future. Either way, there's a lost opportunity cost.

So let me tell you kind of a personal story. Being in the position that I'm in between owning the firm and having the podcast, and most recent kind of high-fiving my wife over is that we had an interview with me published in Forbes. All that stuff is great and I have an amazing group of advisers and staff, and as we are talking about what we're doing, one of the conversations that become very publicly, both among my team and with my wife, and with my bible study is, should we because the position I have in this company and in this community, should I move my family to a more expensive part of town? You know, we kind of live in the suburbs of Seattle right now, so should we be right down in Bellevue? Should we be right in the heart of Kirkland? Should we be right in the heart of downtown Seattle? And basically what we did -- this is easy math, is we did the math of if we took $800,000 of either additional debt or money off our balance sheet to buy a home in those places, which our same home with a little bit less land but similar size footprint would cost $800,000 more, in any of those kind of more -- oh, we live in a wonderful community now, like beautiful master plan, near the country club, like life is really good. We're not far from the town center, we live in a good spot. But to live in those places would be an extra $800,000. So if we had an extra $800,000 that in some way exited our balance sheet today, and then for 30 years -- we really dug into this assessment back a couple of years ago.

So as 35 years old, we're looking at this, doing the analysis, and here's what we found out. We talked about that rule of 72 earlier, so if we ended up with a 7.2% after tax rate of return, what would that look like? Well, $800,000 on our balance sheet. 35 by 45 becomes $1.6 million, and by 55, becomes $3.2 million, and by 65, becomes $6.4 million of lost opportunity cost because we bought a really cool house in the cool part of town. Same square footage, probably about the same level of appointments to our current house. Now that's not taking into account all the extra taxes that will be do on the more expensive home. That's not taking into account any additional maintenance, and it's also not taking into account the kind of thing that Dr. Thomas Stanley talked about in the book, The Millionaire Next Door, which is if you live in those neighborhoods, you're more likely to have pressure of vacation at certain places, you're more likely to buy a nicer car, you're more likely that want to send your kids to a different school or more expensive camps, and there's all these like, extra consumption that occurs on the margin because of who you're around.

So we only count the cost, of the additional cost, the home that's $6.4 million, and really struggled with this for about six months to a year where my wife and I were really digging it and talking about it, and here's where we came to. One day, I was in the shower, I came out and I talked to Chris and said, "Let me ask you a question. If what we did is somebody --" just some super wealthy person said, "Paul, I just don't want you to live close to downtown Seattle or anywhere near me. So, here's a big red circle all around the Seattle area, and if you will promise to live outside that red circle, you can come in whenever you want, you can drive back and forth, you could do all those things but you need to abide your residence outside of this circle. If he drew that, and then said, "If you'll do that. If you'll agree to live outside that circle, I'll give you $6.4 million dollars at your age 65." I would take that deal. I would absolutely take that deal. That's the lost opportunity cost that occurs from the promises we make.

So, if what I did was willy-nilly, kind of promised my wife we'll do this, we'll do that, and as we know, when we make promises to our spouse or to our children and we either A: don't just clean up that promise and say, "Listen, I know we talked about that. Here's why we can't keep that promise." That promise will live a life, live a life in you creating cognitive load over time, preventing you perhaps from being as effective as you have been, number one. Number two: it's a cognitive load for them because they're waiting for when you're going to fulfill, likely breaking trust if you can't fulfill quickly enough. The real problem is, it puts us in a position where the more important implicit promise that people aren't are, people were more quickly promise their kids a college education, then they will look at their spouse and promise, promise. Like, I will do whatever I can to make -- I promise we will be financially secure in retirement.

In fact, if you're riding in a car right now with your spouse, I would encourage you to turn to them right now and say, "I promise you, I will make sure that we have a security retirement. If you're the non-primary bread-winner spouse, you can make that promise also. You can look back and say, "I promise you that the way we spend, the way we track our spending, they way we talk about money, the people we hang around with, will contribute to us being able to be financially secure one day in retirement." You can promise each other that because people instead are saying, "I promise we'll get a bigger home. I promise we'll take a vacation to Hawaii next year. I promise that we'll pay for our kids college education." I'm going to come back to the lost opportunity cost of that in a minute. We make all of these promises without the one promise that really are to be made which is we're going to be okay, and I'm going to take actions.

Maybe, as often as daily. Like maybe I'll be reading financial stuff, or at least as often as monthly that I'm going to take part of our cash flow, put it into a wealth coordination account which gets exposed to back in podcast one. I'm going to set aside money that's meant for asset acquisition, so that one day we are okay, because I guarantee -- guaranteed, if you don't die early, like we had one day the marketplace is not going to value what you do, the degree to which they value it now. I mean that's just a fact of life that one day we do need capital to be able to live off of. So if you're going to need capital, we know that's the case, are we promising anybody that we're going to be responsible for that and take care of it. So we make the promise to pay for college. So here's our fund, let's take my three kids.

Let's say, if we're fortunate and all the kids go to college and it cost us $100,000. By me saying, I promise we'll pay for your college, the day that I promised that, I'm going to share with you what goes off my balance sheet, at least, as that deferred liability. So my kids will all be through college in -- let's call it on average between the three kids in about 18 years. Yeah, that's about right. So 18 years from now, which would put me at age 55, 56. So it gives me 11 more years to retirement and $300,000 off my balance sheet. Now, that's if college costs doesn't go up. That means that by age 65, $488,000 is not on my balance sheet that could be. Now, I've done the math and we can take that hit, but we can take that hit because we live radically within our means, and we save a lot of money. But most people have never done the math on what it takes to take that hit, but here's another one that consider. Very interesting conversation you have with your kids.

Remember I talked about how long we're likely to live? So my wife and I are likely to live as long as we're healthy at age 65, another 30 years. One of us, at least is likely to live another 30 years. So that means we've got 40 years of lost opportunity cost on this money. So what's that cost? That's $2.1 million of inheritance our children are not going to get one day, because we chose to pay $400,000 for the college. Now we talked about strategies, you can read in my book, I think it's chapter five talks about sending your money to college, and we talked about ways to at least diminish the amount of lost opportunity cost created by college, and yet, when you make that promise, you maybe taking millions of dollars off your balance sheet if you intend to keep it. People say they're going to do a lot of things then don't do them, but I think it's a big deal in life and it's a big deal in your career if you treat it like I said I would do X and then you actually do X. People get used to you doing that, it creates a great deal of power, trust, and an intimacy in many relationships that a far too many people do not have.

So what I want to encourage you to do, like the call to action for you, after listening to the podcast today, get out there. Promise somebody, promise everybody that you're going to be okay one day in retirement, and that you will be responsible for it. We're always here to help you design and build a good life, because I've seen the folks, you've probably seen them too if people have been vulnerable enough with you, that are 60 years old, that don't have enough money, that don't look like they're going to retire and it's not like they really enjoy that last five years before they punch out. It's a little miserable for them because they know, they know, if you were being slowly pushed off a cliff and you know you're going to fall off at the other end of that cliff, that's not an enjoyable last five years to a lot of people. I want all of you to have the opportunity to enjoy that. I want you to be able to be in effective action. I want you to share this with other people so that you can have a conversation with four, five or six of your closest friends say, "I want you to know, I'm going to be responsible. I will be responsible and I promise you I'll be financially secure in our old age."

One last thing when it comes to friends. Many of you have grown your income significantly. You had friends from high school and college that maybe didn't grow their income as quickly, and we all know what that feels like to just not have the time or availability, or maybe not sharing the same concerns that they have, because those people we spent four, six, eight years with through high school and college, that those people were not as close with because our concerns in life changed. There's a little bit of a loss we can all feel. Well, here's I want you to think about, is if you're financially responsible and you keep that to yourself, and you don't teach other people around you to do it, look at you getting passed age 65, and now it's not the people you drank with in college that you're not around. It's the people that you raised your family with, for some people, it maybe the people you helped to build a church with, these are the people that you live next to for years, went on vacations with. Went to each other's children's, high school graduations, college graduations and weddings together, and now, for this huge, a long period of your life, maybe 30 years in old age in retirement living off our assets, those people may not be able to be around us, or we're not going to have anything in common with them because they're more worried about which half of their medication do they take today, because the Medicare isn't going to pay for all of it, and they're living of -- so security, while we take amazing vacations, while we have all of these financial freedom. I don't want anybody I know, love, and care about, or that I build a life with, that I've done life with for my entire career with my wife and I, and then have those people not be able to be around us as in our old age. We do that by looking at one another and promising to be responsible for our financial future.

Instead of promising all the stuff to people. We do that all the time. Promise to get you a new mower honey, or I promise to get you a house, those are all fine things. You should promise them, you should enjoy your money, but are you making them all -- are they all in a hierarchy going below your promise to design and build a good life. I encourage you to make that promise to as many people as you can in the coming week, and we'll look forward to having you on the podcast next week.

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!

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