A BRIEF GUIDE TO FINANCIAL FREEDOM

MONEY BO$S

MASTER YOUR MONEY – AND YOUR LIFE

A BRIEF GUIDE TO FINANCIAL FREEDOM
BY J.D. ROTH

*Dedicated to a decade of Get Rich Slowly readers —
and to the future readers of Money Boss.*

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INTRODUCTION

For many, money is a mystery. It's not the numbers that are complicated – the math behind wealth-building is shockingly simple – but it's the mental baggage that bogs us down: the psychology, the emotions, the discipline, the peer pressure.

While the majority of Americans struggle with their personal finances, the basics of business are baked into our national subconscious. We all *get* that in order to survive and thrive, a company has to make money. What most people fail to grasp, however, is that the same concept holds true for household finances.

I want to change that.

This brief guide to financial freedom has one goal: To teach *you* the fundamentals of financial independence.

If you implement the ideas in this book, you *will* build wealth. But this is no "get rich quick" scheme. These concepts are time-tested (and math-tested) methods for managing money. They're the very same techniques that quiet millionaires have been using for generations to accumulate cash and retire early.

Before we begin, let me give you a bit of background.

Who is J.D. Roth?

My name is J.D. Roth. For a decade, I've been reading and writing about personal finance. Today I'm financially independent, but ten years ago my money life was a disaster.

In 2004, I had over $35,000 in consumer debt — credit-card balances, personal loans, a car payment — and was living paycheck to paycheck on a salary of $50,000 per year. I spent every penny I earned and had no savings. Naturally, I decided to buy a new house. And that was the final straw.

I was flooded with financial obligations. I felt like I was drowning. All I wanted to do was bury my head in the sand, to play computer games and read comic books. I wanted to give up. Instead, I stopped shirking responsibility, buckled down, and got to work. Using skills I'd learned as a small-business owner, I began to methodically eliminate my debt.

> What do I mean when I say I'm *financially independent*? I mean that I have enough money saved and invested to fund my current lifestyle indefinitely. I enjoy financial freedom. This manual is all about how you too can achieve financial independence.

Like Father, Like Son

You see, my father was a serial entrepreneur: He was always starting businesses. Most failed, but some were wildly successful.

As a boy, I imitated him by starting kid-sized businesses of my own. My ventures were much smaller than Dad's, but they had similar ups and downs. The lemonade stand by the side of the road failed miserably, but I made a tidy profit re-selling used books and baseball cards to my friends. I made even more money by marketing a homemade comic book at the school store.

After college, I took a job as salesman at the family box-making factory. When Dad died in 1995, my brothers and I were forced to learn quickly how to manage every aspect of the company, from payroll to purchasing, from marketing to product design. Then, in 1998, I started a computer-consulting company to make money in my spare time.

As both businesses grew, I noticed something odd. My personal finances were a mess — I spent compulsively and was deep in debt — but when I managed money for the companies, I had a completely different mindset. I was careful, almost

parsimonious. This was partly to appease the IRS, but it was also a point of pride. Maybe I couldn't take care of my personal finances, but I was damn well going to run a ship-tight business!

I turned business management into a game. I imagined I was the Chief Financial Officer (CFO) of a Fortune 500 firm. Even when my consulting company was making less than $5000 per year, I challenged myself to make the best possible decisions. It worked. Even as my personal finances remained mired in muck, both businesses grew and prospered.

Becoming Boss of My Life

One night in October 2004, after I'd bounced yet another check and missed yet another payment, I reached rock bottom. I began to wonder why I didn't use my entrepreneurial skills at home. **What if I made decisions in my personal life as if I were making them for a business?** What if I installed myself as CFO of JD, Inc? How would I cut costs? How would I increase revenue? Where were the best places for me to direct my cash flow?

That night, I drafted a three-year plan to get out of debt. According to my calculations, I could pay off everything I owed by December 2007 — if I managed my money wisely. I decided to give it a shot.

I cut back on spending. I boosted my income. As JD, Inc. became profitable and my cash flow improved, I paid down debt. I tracked my spending and created monthly reports to document my progress.

The results were remarkable.

In less than a year, I had set aside a $5000 emergency fund and had increased my cash flow by $750 per month. I plowed that "profit" into debt-reduction. I continued to manage my life as a business, and in December 2007 — right on schedule! — I became debt-free for the first time in my adult life.

Today, nearly a decade later, I still manage my life as a business. Because I'm human, I sometimes make mistakes — occasionally I make dumb mistakes — and some years are more profitable than others. Through it all, I do my best to treat my money as if it belonged to a corporation and not to me. I believe my most important work is as CFO of JD, Inc.

And I believe that *your* most important work is the as CFO of You, Inc.

As I dug out of debt and built wealth, I wrote about my experience at a blog called Get Rich Slowly. I shared the things that worked — and the things that didn't. The site grew and prospered.

I sold GRS in 2009 and began writing about money for other outlets. I published *Your Money: The Missing Manual* in 2010. For four years, I wrote the "Your Money" column in *Entrepreneur* magazine. Then, in 2014, I released the year-long Get Rich Slowly course.

This book (and the Money Boss blog) builds on all of these projects, and is my attempt to provide a unified, cohesive philosophy to help others achieve financial independence.

Becoming Boss of Your Life

This guide is different than most of the personal finance books and blogs you've read.

Instead of assuming you're a victim of circumstance, I assume that you are the master of your own fate. Sure, you're a part of the overall economy and subject to both lucky and unlucky breaks, but ultimately you're in charge. Your circumstances may not be your fault, but they're your responsibility. **You are the boss of your own life.**

I won't pretend that you can meet your goals without doing the work. Some books would have you believe that you can get rich quickly with minimal effort. Gold! Passive income! Think and grow rich! Clip coupons until you have a million dollars! It doesn't work like that. Running a profitable business is hard work; managing the affairs of You, Inc. successfully may be the hardest work of all.

Still, I'll show steps you can take to boost profit quickly — if you've got the guts. You need a budget. You need to spend less than you earn. To have any chance of achieving your dreams while you're still young, you'll have to spend a *lot* less than you earn. That means cutting costs on transportation and housing while boosting your income in any way possible.

But I'll help you see that these choices don't have to be tortuous. I'll stress the power of purpose. Most personal finance advice skips this important step. The financial gurus will tell you how to scrimp and save, but they somehow forget to mention the why. **When you have a *why*, you can bear almost any *how*** because you understand that when you opt to save for the future instead of spending on today, you're not making a sacrifice. You're choosing to buy your future freedom.

Whether you hope to escape the chains of debt, to save for a one-year sabbatical, or to retire within a decade, you can have the financial freedom you desire — if you're willing to accept the role and responsibilities as boss of your own life.

Your motto must be, "The buck stops here!"

Don't blame anyone or anything else for your financial situation, and don't expect somebody else to rescue you. Your circumstances might not be your fault, but they're your responsibility. Your financial fate rests in your hands.

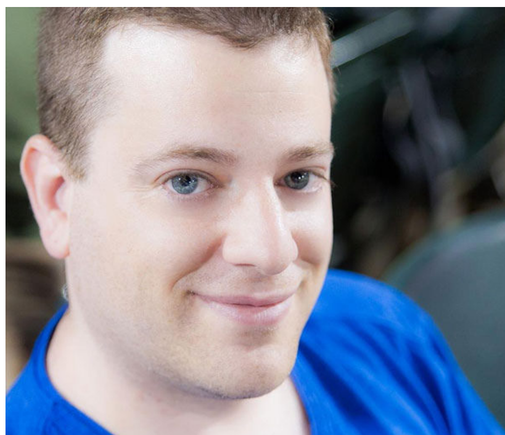
Let's get started!

CHAPTER ONE
BE THE BOSS

Here's the fundamental premise of my philosophy: **You should manage your personal finances the way a business owner would manage hers.**

To illustrate why I think this is so important, let me introduce you to my friend Harlan.

When he was 25, Harlan's world fell apart. In a matter of weeks, his girlfriend left, he lost his job, his car was impounded, and he was evicted from his apartment. When he moved back in with his dad, he knew he'd hit rock bottom.



While looking for work, Harlan did some soul-searching. He realized that for too long, he'd been letting life happen to him. He'd been letting other people and outside events control his destiny. He blamed his situation on the economy, on his boss, on his girlfriend – on plain old bad luck. He blamed everyone but himself.

But blaming others only left him feeling helpless.

Slowly at first, Harlan changed his mindset. He decided that failure or success was in his hands. He made it his mission to improve his life and his finances.

He moved to a new apartment, which he shared with three roommates. His rent was less than $350 per month and other expenses were split four ways.

He found a new, higher-paying job as assistant to the Chief Operating Officer in a division of a large financial firm.

Most importantly, Harlan began to actively manage his money. He tracked every penny he spent. He opened a savings account and began to save for retirement.

In short, Harlan took control of his life. He chose when (and why) to get out of bed in the morning. He decided how well he did the work his boss assigned him. He chose whether or not he was happy...every second of the day. He was calling the shots – *all* of them.

As part of his new job, Harlan got a glimpse at how big businesses operate. He saw what made them profitable, and he saw what made them fail. He decided to apply some of these business lessons to his own life.

For instance, because he'd been producing financial reports for a division of his company, he started creating financial reports for his personal accounts. At first, these reports were embarrassing. They revealed just how poorly he had managed his money. But Harlan found that running the reports kept him motivated. They were a way to "keep score" on his progress.

Harlan has made a *lot* of progress. After nearly fifteen years as a money boss, he's gone from deadbeat to hustler. He's now financially independent. (Yet he still treats his personal budget like a business.)

Calculating Net Worth

My goal is to teach you how to run your life like a business. I want you to earn enormous profits so that you can use the money to do whatever it is you dream of doing. But just as Harlan and I had to start at the very beginning, you will too.

Before we can begin, however, I have a task for you. I want you to take a snapshot of your current financial position by calculating your net worth. I'll explain how.

To measure the value of a business, companies talk about equity or "book value". Jargon, right? In personal finance, equity is known as net worth. It's exactly the same thing but on a personal level. Your net worth is an important number because it reveals how much the business of you is worth at the moment.

Still clear as mud? Maybe this definition of net worth from the blog Wait But Why will make more sense:

> *"What would happen if you sold everything you own, liquidated any investments you have, paid off all of your debts, and withdrew whatever cash you have in bank accounts? You'd be standing on the street naked, with nowhere to go, holding a bunch of cash, and people would be looking at you. And whatever cash you were holding would be your net worth."*

Net worth tracks your financial health in the same way that weight measures your fitness. Neither number tells the whole story, but as a measure of change over time each is a handy tool.

Calculating net worth is easy. It's what you own minus what you owe. That's it. Simple, right? Here's how to calculate your own net worth:

1. *List your assets.* Check all of your bank accounts and note their balances. If you have investment and/or retirement accounts, write down how much you have in them. If you own your home, use Zillow to determine its current value. If you own a car, use Kelley Blue Book to figure out how much it's worth. Add all of these together to find the total value of your assets.
2. *Next, list your liabilities.* Write down how much you owe on your car, the current balance of your mortgage, how much you have left on your student loans. Record the balance of each credit card and personal loan. The sum of everything you owe represents your total liabilities.
3. *Subtract what you owe from what you own.* Your net worth is your assets minus your liabilities.

To make things even easier, I've created a net worth spreadsheet in Google Docs for you to download or copy: **`tinyurl.com/MBnetworth`**. (Copy and paste that URL into your browser to get the template.)

Once you've calculated your net worth, write this number down. Burn it onto your brain. I want you to remember how much you're worth today so that we can see the progress you've made in six months. And a year. And ten years. As the business of you begins to make a profit, your net worth will grow.

CHAPTER TWO
KNOW YOUR MISSION

What do you want out of life?

Maybe that seems like a strange question in a book about financial freedom. What have goals to do with becoming a money boss? *Everything!* **Having a personal mission is key to running your life like a business.** Your goals help you decide how to spend your time and money.

When I think about the difference between people with purpose and people without, I always think of my friend Paul.

Twenty years ago, as I was swimming in self-induced debt, Paul was living a bare-bones lifestyle that seemed ridiculous to me. He didn't own a

television. He had few books and little furniture. His only indulgence seemed to be a collection of bootleg U2 albums.

"How can you live like this?" I asked him during one visit. "Where's all of your Stuff?"

He shrugged. "I don't need a lot of Stuff, J.D. Stuff isn't important. It gets in the way of the things I really want."

I didn't know what he meant. To me, life was all *about* the Stuff. I had hundreds of CDs and thousands of books. I had a TV, a stereo, a house, and a car. I wanted more.

Paul didn't have any of these, but he had things I didn't have. He had happiness. He had freedom. He had money. He had goals.

A Man with a Plan

At the time, I earned at least twice Paul's income, but he had money in the bank while I had none. I couldn't see the connection between Paul's choices and his financial success. And I couldn't see the connection between my spending and my mounting debt. I was blind.

One day, Paul and I went for a hike. As we walked, he told me what he'd been up to. He was living in a small town in northern Washington, working two full-time jobs and a part-time job. He got free rent in exchange for housesitting with an elderly homeowner. "I've only had five or six days off in the past eight months," Paul told me.

"That's insane!" I said. "Why would you do that to yourself?"

Paul smiled. "I have a plan," he said. "I want see the world. I'm going to buy a one-way ticket to Thailand. I'm just going to go. I'll travel for as long as my money holds out. The more I work, the longer I'll be able to stay on the road."

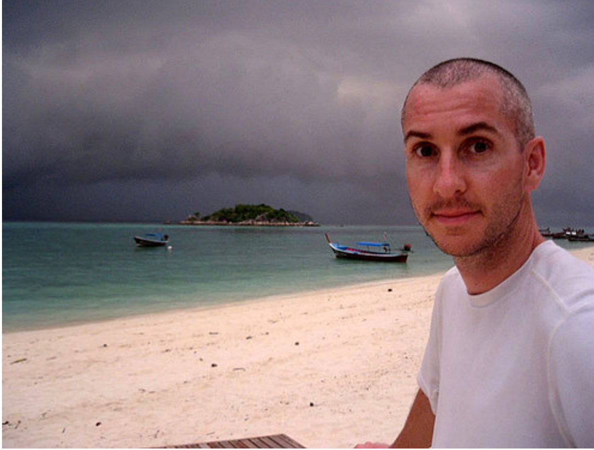
I heard what he was saying, but I didn't *really* understand.

"Do you want to come with me?" Paul asked. Of course I did, but I couldn't. I was in debt. I had no savings. I couldn't afford to leave work for a few days, let alone a few months. How would I pay for all of my Stuff?

Paul went on his trip. He backpacked across Europe and Asia, and he loved it. He sent me postcards from Thailand and India, from Nepal and Israel and Jordan. He was gone for five months. Then, because he'd built his life around this goal, he returned to a financial position similar to the one he'd left.

Back in Oregon, Paul settled down to a more "normal" way of life. He got a real job. He even bought a house. Still he pinched his pennies, spending only on the things that mattered most to him. In time, I began to see the connection between his lifestyle and his quiet wealth.

Here's what Paul taught me: **Have a plan so amazing, so glowing, that you're willing to walk blurry-eyed to work every day to make the money necessary to achieve it.**



Paul David Carlile, 1969-2009

What's Your Why?

What do you want out of life?

Too many people never take the time to answer this question. And of those who *do* answer it, a large number have only nebulous dreams and goals. I want you to do more. Today, I want you to create a personal mission statement.

To complete this exercise — which is based on the work of time-management guru Alan Lakein — you'll need about an hour of uninterrupted time. You'll also need a pen, some paper, and some sort of stopwatch.

> To make things easier, I've created a free PDF version of this project for you to download and print: **`tinyurl.com/MBwhy`**

When you're ready, I want you to do the following:

1. At the top of a blank page, write this question: *What are my lifetime goals?* For five minutes, list whatever comes to mind. Imagine you don't have to worry about money, now or in the future. What would you do with the rest of your life? Don't filter yourself. Fill the entire page, if you can. When you're finished,

spend an additional five minutes reviewing these goals. Make any changes or additions you see fit. Before moving on, note the three goals that seem most important to you.

2. On a new piece of paper, write: *How would I like to spend the next five years?* Spend five minutes answering this question. Be honest. Don't list what you will do or should do, but what you'd like to do. Suspend judgment. When your time is up, again spend five minutes reviewing and editing your answers. As before, highlight the three goals that most appeal to you.
3. Start a page with the question: *How would I live if I knew I'd be dead in six months?* Imagine that your doctor says you've contracted a new disease that won't compromise your health now, but which will suddenly strike you dead in exactly six months. There is no cure. How would you spend the time you have left? What would you regret not having done? You know the drill: Take five minutes to brainstorm as many answers as possible, then five minutes to go back through and consider your responses. When you're ready, indicate the three things that matter most to you.
4. At the top of a fourth piece of paper, write: *My Most Important Goals*. Below that, copy over the goals you marked as most important from answering each of the three questions. (If any answers are similar, combine them into one. For instance, if "write a novel" was one of your top answers to the first question and "writing fiction" was a top answer to the second, you'd merge these into a single goal.)
5. The final step requires a bit of creativity. Label a fifth piece of paper *My Mission*. Look through your list of most important goals. Does one stand out from the others? Can you see a common thread that connects some (or all) of the goals? Using your list as a starting point, draft a Mission Statement. Your Mission Statement should be short — but not too short. It might be anywhere from a few words to a few sentences. Take as much time as you need to make this the best, most compelling paragraph you can write.

When you've finished, I want you to set aside your Mission Statement and walk away. Go about the rest of your life for a few days. Don't forget about your mission, but keep it in the back of your mind.

Your Personal Mission Statement

After you've had time to stew on things, sit down and review what you've written. How does your Mission Statement make you feel? Can you improve upon it? **You want a vision to give you a sense of purpose that drives you day-in and day-out, through good times and bad.** Ideally, your mission will do for you what my friend Paul's did for him. It'll be so amazing, so glowing that you're willing to walk blurry-eyed to work each morning to make the money necessary to reach your goal.

> Your Mission Statement isn't permanent. As your priorities and tastes change, and as new opportunities present themselves, your mission will adapt and grow.

What does an actual Mission Statement look like? Good question! Here are personal mission statements from five famous CEOs: **`tinyurl.com/MB-ceo-mission`**. And here's mine:

> *"I want to be the best person I can be, both mentally and physically. I want to sample all that the world has to offer by fostering new relationships, exploring new ideas, and daring to try new things. I want to use my skills and experience to improve the lives of others while also improving my own."*

Sound boring? Not to me! I wrote this mission several years ago, and it still guides me today. When I set personal goals, I base them on this mission. When I make decisions about where to live and what to do with my life, I use this mission to guide me. Bottom line: This mission shapes the way I manage my money and my life.

After you've created a Mission Statement, your next assignment — if you're willing to accept it — is to brainstorm a list of Next Actions to support your Mission Statement. What kinds of things can you do to help you achieve this goal or pursue this mission? Write down anything that comes to mind.

When you have your list of Next Actions, pick the three you can do most quickly (these should become your short-term goals) and the three that would have the biggest impact on your life (these should become your long-term goals). Focus on these six goals!

What if you're *still* having trouble coming up with a mission? Don't give up. Try a different approach. Head to your public library and

borrow one of the following books, each of which has great info about figuring out what to do with your life:

- *How to Get Control of Your Time and Life* by Alan Lakein
- *The Seven Habits of Highly Effective People* by Stephen R. Covey
- *Wishcraft: How to Get What You Really Want* by Barbara Sher
- *The Magic of Thinking Big* by David Schwartz

If, after all this, you still need more help creating your Mission Statement, take a few minutes to walk through the Mission Statement Builder from FranklinCovey (**`msb.franklincovey.com`**). It's a free online tool that translates your goals and values into a statement of purpose.

CHAPTER THREE
TAP THE POWER OF PROFIT

In order to survive and thrive, you need to earn a profit.

You already know profit is the lifeblood of every business. It's like food and water for the human body. Although proper nutrition isn't the *purpose* of life, we couldn't exist without it. Food and water give us strength to do the stuff that matters most. So too, profit isn't necessarily the purpose of business — but a company can't survive without it.

Here's a secret: **People need profit too.**

In personal finance, "profit" is typically called "savings". That's too bad. When people hear about savings, their eyes glaze over and their brains turn to mush. *Bor-ing!* But if you talk about profit instead, people get jazzed: "*Of course*, I want to earn a profit! Who wouldn't?"

Profit is easy to calculate. It's net income, the difference between what you earn and what you spend. You can compute your profit with this simple formula:

PROFIT = INCOME - EXPENSES

If you earned $4000 last month and spent $3000, you had a profit of $1000. If you earned $4000 and spent $4500, you had a loss of $500.

There are only two ways a business can boost profits, and there are only two ways you can boost personal profitability:

- *Spend less.* A business can increase profits by slashing overhead: finding new suppliers, renting cheaper office space, laying off employees. You can increase your personal profit by spending less

on groceries, cutting cable television, or refinancing your mortgage.

- *Earn more.* To increase revenue, a business might develop new products or find new ways to market its services. At home, you could make more by working overtime, taking a second job, or selling your motorcycle.

When you earn a profit, you don't have to worry about how you'll pay your bills. Profit lets you chip away at the chains of debt. Profit removes the wall of worry and grants you control of your life. Profit frees you to do work that you *want* instead of being trapped by a job you hate. When you make a profit, you truly become the boss of your own life.

With even a small surplus, the balance of power shifts in your favor.

The Most Important Number in Personal Finance

Earlier, I asked you to calculate your net worth, the number that acts like a snapshot of your current wealth. Your net worth is the grand total of years (or decades) of profits and losses.

As the authors of *Your Money or Your Life* put it, "[Your net worth] is what you currently have to show for your lifetime income; the rest is memories and illusions." *Ouch!*

The greater the gap between your earning and spending, the faster your net worth grows (or shrinks). This may seem obvious, but it's important. Everything you do — clipping coupons, asking for a raise, saving for a retirement — should be done to increase your profit and wealth.

But profit doesn't mean much on its own. Is a $1000 monthly profit good or bad? Well, it depends on your circumstances.

If your income is $2000 per month (or $24,000 per year), a $1000 monthly profit is great. That's a saving rate of 50%. *Congratulations!*

On the other hand, if your income is $20,000 per month (or $240,000 per year), a $1000 monthly profit gives you a saving rate of 5%. That's average at best.

You see, it's not your total income that determines how wealthy you are and will become. Nor is it your monthly surplus. No, the true measure of progress is your saving rate — how much you save as a percentage of your income.

In business, saving rate is called profit margin. Naturally, we're going to call it profit margin too.

Pull out your personal mission statement. Look at your goals. **Your profit margin directly affects how quickly you'll achieve these aims.** A profit margin of 20% will allow you to reach your destination twice as quickly as a profit margin of 10%. And if you can save 40% or 60%, you'll get there even quicker. (We'll talk more about how to create a wealth snowball later in this book.)

Profit is Power

Now I'd like you to meet my friend Pete.

Online, Pete is better known as Mr. Money Mustache. He runs a popular website – also called Mr. Money Mustache – devoted to financial independence and sensible living.

Pete's personal mission is to enjoy a rich life with his small family in a small house in a small town in Colorado. He wants to pass his days slicing through canyons on his bicycle, building things in his workshop, and sharing quiet moments with his wife and son. And Pete doesn't want to be tied to a job.

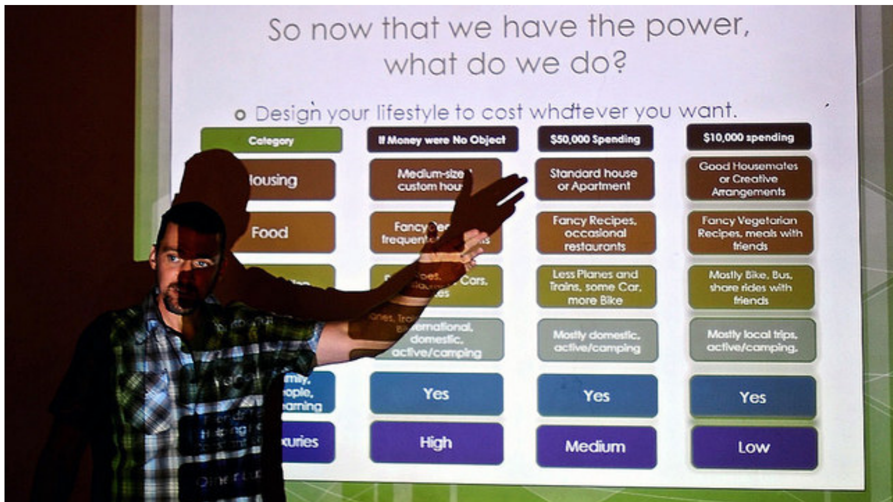
Following the standard advice to save between 10% and 20% of his income, it would have taken decades for Pete to achieve these goals. Pete is not a patient man. He didn't want to wait decades for financial freedom, so he deliberately pumped up his profit margin.

After college, Pete and his wife worked long hours at jobs that paid well. They moved to a town where the cost of living was low and they could bike anywhere they needed. They bought a modest home. The Mustache family generated a lot of revenue while keeping overhead low.

As a result, Mr. and Mrs. Mustache set aside more than half of their combined take-home pay. After ten years with profit margins near 70%, they were able to "retire". Pete was thirty years old. Now, a decade later, he and his wife continue to pursue their mission, happily ignoring detractors who say what they've done is impossible.

The more you save — the higher your profit margin —the sooner you can have the things you really want out of life.

This is the bottom line, the entire thesis of the Money Boss method: Profit is power.



Computing Your Profit Margin

To find your current profit margin, you need two other numbers: your monthly income and your monthly expenses. For now, let's look at only last month. (You're free to run the numbers on past months or years, but for this exercise last month is enough.)

Here's how to find your income and expenses:

- If you're a money geek who already generates a monthly income statement (a.k.a. profit-and-loss statement), just grab your total income and total expenses from the form.
- Many of you track your money in Quicken or through services like Personal Capital or Mint. These too make it easy to find your monthly income and expenses. Some will even compute your profit for you.
- If your finances aren't yet automated, it's not too tough to calculate the numbers by hand. Collect your brokerage, bank, and credit-card statements from last month. Use these to total your income and expenses. (You shouldn't have to do this line by line. Most statements total income and expenses separately in some fashion.)

- What if you don't track your money? Start! If you owned a business, you'd keep books. Well, a money boss keeps books too. It's the only way to spot trends and to measure progress. Pick a tracking method — many people like You Need a Budget (at YNAB.com) — and make tracking part of your weekly financial routine.

Now it's time for a little math. To find your monthly profit, subtract your income from your expenses. (If your income was $3500 and your expenses were $3000, your profit was $500.) To find your profit margin, divide your profit by your income. (Using the previous example, you'd divide $500 by $3500 to get 0.14286 — a profit margin of 14.3%.)

Burn this number onto your brain. We're going to spend the rest of this book looking at ways to make your profit margin grow.

If you want to get fancy, run the numbers again. This time subtract your mortgage and car loan and credit-card payments (and so on) from your expenses before calculating profit and profit margin. See how much profit you'll have once you've paid off your debt? Cool, huh?

CHAPTER FOUR
SAVE BIG

You don't need a high income to achieve Financial Independence. Making more money helps, sure, but if you're diligent about cutting costs, it's possible to reach financial freedom on even an average salary.

I want you to meet my friend, John. John is a 79-year-old retired shop teacher. He's a millionaire — but you'd never know it.

John started life as a carpenter. In his thirties, he went back to school to become a teacher. He spent the next twenty years teaching shop at a

junior high school in a poor part of town. He retired to financial freedom at age 58. He never had a huge income and he didn't inherit a fortune.

So, how'd he get rich? He pinched his pennies and doted on his dollars. John achieved Financial Independence by ruthlessly cutting costs.

- John doesn't live in a mansion. He lives in the same small ranch house he bought for $10,500 in 1962. He paid off his mortgage early, and has now lived in the place for 54 years!
- John doesn't drive a brand-new Mercedes or BMW. He drives a 1998 Chevy minivan he bought for cheap six years ago. It's ugly, but he doesn't care. It meets his needs and he has no plans to upgrade.
- John doesn't take lavish vacations. He spends his summers in southeast Alaska on an old 38-foot fishing boat that he bought with cash in 1995. He spends his winters doing volunteer work on farms and ranches in New Zealand.
- John doesn't like to dine in fancy restaurants. He'd rather make his own meals at home. "For me, restaurants are a waste of money," he says. “I don't appreciate them.”

Does John sound like a typical millionaire to you? If you were to believe TV, movies, and magazines, you might think most millionaires live like this:

We're constantly bombarded by messages that wealthy people enjoy lavish lifestyles filled with luxury. From my experience meeting with dozens of millionaires over the past decade, this kind of lifestyle is the exception not the rule.

Most wealthy people I know are like John. They're *quiet* millionaires. They practice stealth wealth. But don't just take my word for it. Let's look at what the experts say.

Lifestyles of the Rich and Fameless

In *The Millionaire Next Door*, authors Thomas Stanley and William Danko share what they learned through years of academic research into the habits of America's wealthy. Here's one key takeaway:

> *"What are three words that profile the affluent? FRUGAL FRUGAL FRUGAL...Being frugal is the cornerstone of wealth-building."*

They write that millionaires tend to "play great offense" with money – their incomes are much higher than average – but they also "play great defense". They're not big spenders. They're thrifty. They opt out of consumer culture, making purchases based on their personal needs and wants rather than status and fashion.

"Few people can sustain profligate spending habits and simultaneously build wealth," write the authors. "[Millionaires] became millionaires by budgeting and controlling expenses, and they maintain their affluent status the same way."

Study after study shows the same thing. To get and stay rich, you have to manage your lifestyle. **You can't outearn dumb spending.**

Great. You get it. To achieve your goals, you've got to cut costs. But how? There are two schools of thought:

- Most money writers emphasize saving on small stuff. They teach how to clip coupons, conserve electricity, and spend less on entertainment. These small wins are usually quick and easy to achieve.
- A few folks urge readers to pursue "big wins". They argue that the quickest road to wealth is to spend less on big-ticket items like your home and your car. The downside to this approach? Big wins take a lot of work, and opportunities to pursue them are rare.

I believe that a smart money boss does both. She practices thrift on a daily basis *and* she seizes every opportunity to slash spending on the big stuff.

Frugality is an Important Part of Personal Finance

You could save maybe 50 cents a day by drinking a glass of water instead of a can of soda. That doesn't mean much if you only do it once, but over the course of an entire year that single change would increase your personal profit by nearly $200. When taken together, many such small economies make a noticeable difference.

Small amounts *do* matter.

Rather than provide some made-up examples of how much you could save, here are actual numbers from my own life. When I dug out of $35,000 in debt a few years ago, I decided to:

- Switch my cable TV package from $65.82 per month to $12.01 per month, saving $645.72 every year.
- Get rid of my home phone line (roughly $46.50 per month) and my subscription to Audible ($21.95 per month), saving $821.40 per year.
- Cancel my magazine and newspaper subscriptions, saving $137 per year.
- Make use of the public library instead of shopping at bookstores, saving $391.95 in the first year.
- Plant a vegetable garden to grow my own produce, saving more than $300 per year. (Yes, I'm such a nerd that I kept a spreadsheet to track how much I saved!)

With these changes alone, I increased my cash flow by $2,281.61 per year. That's an additional profit of almost $200 every month.

You won't get rich–slowly or otherwise–by cutting your cable bill or growing your own tomatoes. But when small changes are part of an ongoing campaign of saving and investing, they can bring big changes indeed!

> True story: I recently had a friend ask me how to get out of debt. "You can start by getting rid of your $200 monthly cable package," I told him. "No way!" he said. "That's the first thing everyone says, and it'll be the last to go. TV is important to me." Right. More important than being debt-free, apparently.

The Magic of Thinking Big

While it's important to save money on everyday stuff, it's even more important to watch how much you spend on major purchases. By making smart choices on big-ticket items, a money boss can save *thousands* of dollars in one blow. If you spend fifty grand less when you buy a house, that's fifty grand you never have to earn.

Housing is the biggest expense for most Americans — and by a wide margin. According to the U.S. Bureau of Labor Statistics' 2014 Consumer Expenditure Survey, the typical American household spends exactly one-third of its income on housing, which includes mortgage (or rent), maintenance, insurance, interest, and utilities.

In an ideal world, you'd slash your housing expense by buying an affordable home in a city with a low cost of living.

While relocating to a cheaper home in a cheaper city would probably provide a *huge* financial reward, it's not exactly easy. A more practical alternative might be to move within your current city. Sell your home (or move out of your rental) and choose something more affordable.

Think about it: If you're an average American who spends $1483 per month on a place to live, dropping that expense by 10% would save you $150 per housing payment. Drop it by *30%* and you'll save more than $5000 per year!

> *"If you're not yet wealthy but want to be someday, never purchase a home that requires a mortgage that is more than twice your household's annual realized income. Living in less costly areas can enable you to spend less and to invest more of your income. You will pay less for your home and correspondingly less for your property taxes. Your neighbors will be less likely to drive expensive motor vehicles. You will find it easier to keep up, even ahead, of the Joneses and still accumulate wealth." — The Millionaire Next Door*

Transportation is our second-largest expense in the U.S. We spend an average of $756 per month (17 percent of the typical budget) to get around, including vehicle payments, gasoline, insurance, and repairs. I know Americans love their automobiles. They're loath to let them go, even in the face of logic. But imagine how much you could save if you could cut your car costs in half!

How do you do that?

- Sell your current car. Replace it with a used vehicle, one that's fuel efficient. (Side benefit: An older, used vehicle will cost less to insure!)
- Drive your car only when necessary. When possible, bike or walk to reach your destination. (Side benefit: Increased fitness, which also saves you money!)
- Make use of public transportation. (Side benefit: Time to read!)

When I recommend people change the way they get around, I'm usually met with a wall of resistance. Let me suggest that instead of looking for reasons you *can't* do this, instead look for ways you *can*. You'll save buckets of money.

Together, housing and transportation consume *half* of the average American budget. There are enormous opportunities to save if you choose to economize on these two categories. But you can achieve big wins in other areas too.

The Consumer Expenditure Survey shows that the typical household spent $1,786 on clothing in 2014, $4,290 on health care, $2,728 on entertainment, and $6,758 on food (which doesn't include the $782 that went toward alcohol and tobacco).

Because each of us is different and we spend in different ways, opportunities for big wins vary from person to person. After tracking my spending for the last half of 2013, for instance, I realized that I was spending way too much on travel. In 2014, I cut my travel costs in half. This allowed me to save money for other goals, such as buying a motorhome.

The Bottom Line

A few years ago, I asked my friend John if he had advice for young people who want to retire early.

"Here's the secret to financial freedom," he told me. "I don't care how much you make -- you spend less than you earn. You don't have to like it. You just have to do it. Because that *is* the secret."

The best way to spend less is to optimize the big stuff.

I'm not saying you shouldn't make your own laundry detergent or plant a vegetable garden. By all means, do these things! But understand that if all you do is the small stuff, your only hope is to get rich slowly. You can do better.

Pull out your personal mission statement. With that in front of you, brainstorm ways to reduce your spending. No idea is too small. No idea is too big. No idea is too stupid. Do a rapid braindump of any (and all) actions you could take to cut costs. **If all your spending were aligned with your goals and mission, where would the money go?**

After you're finished brainstorming, pick three specific ways – large or small – you'll reduce spending starting this week. (*Examples: I'll walk to the grocery store. I'll sign up for a library card. I'll finally cancel my landline.*) Also pick one "big win" that you will work to achieve in, say, the next two years. Make this a big, hairy audacious goal. (*Example: We'll go from a three-car family to a one-car family.*)

CHAPTER FIVE
EARN MORE

There's no question that frugality is an important part of personal finance—you can't outearn dumb spending—but trying to get rich by pinching pennies is like trying to win a car race by conserving gas. If you want to reach the finish line fast, you can't be shy with the accelerator!

Today I want to explore a better way to boost your profits. Let's talk about how you can make more money. Whether you're self-employed or working for somebody else, your income is determined by three factors:

- Your knowledge and skills. If you want to earn more, it pays to learn more.
- Your productivity. Both the quality and the quantity of your work affect how much people are willing to pay you.
- Your ability to sell yourself. To be paid what you're worth, you have to *ask* for it.

If you want to make more money, you have to become more valuable in the job marketplace—and demonstrate that value for the market to see. Let's look at how to make that happen.

The More You Learn, the More You Earn

In the United States, education has a greater impact on work-life earnings than any other demographic factor. Your age, race, gender, and location all influence what you earn, but nothing matters more than what you know. That's great news, really, because you have *total control* over your level of education.

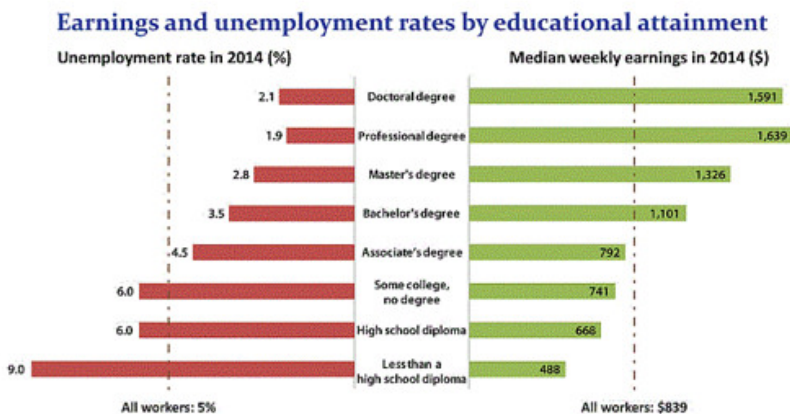
How much does schooling matter? Here are some numbers from the 2014 Consumer Expenditure Survey conducted by the U.S. Bureau of Labor Statistics:

Highest education in household	Average annual household income	Increase over level below
Advanced degree	$123,654	46.1%
Bachelor's degree	$84,628	39.5%
Associate's degree	$60,671	26.7%
Some college	$47,891	19.0%
High school diploma	$40,260	43.6%
No high school diploma	$28,031	---

The average college graduate makes twice as much as his friend whose education ended with high school.

Even a two-year degree from a community college helps. The average worker with an associate's degree earns *twice* the annual income of a high-school dropout and 50% more than somebody with only a high school diploma. Two years of community college typically boosts income by $20,000 per year. (That's almost *one million dollars* during an average 40-year career!)

Similar research from the Current Population Survey shows that education also affects unemployment rates:



A college degree doesn't guarantee you'll make more money, of course. Some philosophy majors wind up working in convenience stores for the rest of their lives, and some high-school dropouts become billionaires. (Richard Branson is a notable example of the latter.)

Outliers aside: **The more you learn, the more you earn.**

The best time to pursue education is at the start of your career, when you're young. The next best time is *now*.

I know it can be tough to find time and energy to go back to school once you have a family and career, but it *can* be done. Let's look at some examples:

- After ten years as a used car salesman, my friend Jeremy decided to become an accountant. He continued to sell cars and spend time with his wife and kids while he took online courses and studied for exams. Today, he's a full-fledged CPA.
- My girlfriend Kim was the office manager for a large dental practice near Sacramento. At age 35, she decided she wanted to make more money. She quit work to get a dental hygiene degree, and now enjoys better pay and increased job satisfaction.
- I've done this too. In 1997, when I was 28, I took computer programming classes at the local community college on evenings and weekends. In eighteen months, I was skilled enough to pick up programming work in addition to my main job as salesman for the family box factory.

If you can't commit to college, it's still possible to improve your knowledge and skills through an ongoing campaign of self-education.

I'm a vocal proponent of self-directed life-long learning. I'm always reading books and blogs about personal finance. I take writing classes at the local community college. I listen to podcasts and online courses. I attend conferences to learn from my colleagues. And as I write this book, I'm in the middle of a $2000 web-based course about how to build a better online business.

The more you know and the more you grow, and the more valuable you become in the job marketplace.

> A key change in my own life was moving from passive/consumptive hobbies—television, computer games, watching sports—to active/productive hobbies. I'm happier when I'm reading, writing, or doing web design (or exercising or building something) than I was with less-productive pastimes. *And* these things help me earn more money.

Work More. Work Better.

Education isn't the only factor that affects your income. Your pay is also based on the quality and quantity of your work. If you want to earn more, you can increase the number of hours you work, your output per hour, or the value of your output.

The quickest and easiest way to boost your income is to increase the number of hours you work each week. That might mean going from a part-time employee to a full-time employee. It might mean working overtime. For many folks, it means finding a second job.

Working two jobs can be tough, especially if you have young children. And some people feel like a second job is beneath them. To overcome these objections, recognize that a second job is *not* a life sentence. It's a way to supercharge your income for the short term.

- I know a highly-paid biologist who takes jobs at upscale clothing stores during the holiday season. She earns extra cash *and* gets an employee discount, allowing her to build her professional wardrobe on the cheap.
- After taking the computer classes I mentioned above, I found a couple of part-time gigs that put my new skills to use. For a while, I worked *three* jobs totaling nearly 80 hours per week. The hours were long, but the money I earned helped me pay down debt.
- When my ex-wife taught high-school science, it was common for her colleagues to put their summers to good use. They'd work in bookstores, act as tour guides, or even work as bartenders!

If you can't add hours to your workday, you can enhance your value by doing more work in the time you have. If you've been producing ten widgets per hours, challenge yourself to produce twelve. If you've been making forty sales calls each week, find a way to do fifty.

When you produce more, you're worth more.

In addition to increasing the quantity of your work, it pays to increase the quality of your work. This may seem obvious, but you'd be surprised at how many people "go through the motions" at the office every day. You'll never get ahead if you're only faking it.

It's tough to provide general advice on how to do better work. "Better" varies from job to job. But *you* know what quality output looks like for your profession. (If you don't, that's a problem you should solve immediately.)

Here's a non-intuitive way to enhance the value of what you do: Change where you work. Maybe that means moving to a different position within your current firm. Maybe that means taking a job with a competitor. Or maybe that means changing careers completely. (When my ex-wife decided she wanted to make more money, she left her career as a science teacher to become a forensic chemist. Same skillset, completely different job.)

Sell Yourself

Your income is dictated by the value of your work, and the value of your work is determined by your education and productivity. But there's one last piece to this puzzle. Your income is also influenced by how well you market yourself.

Like it or not, *you* are a product. Your work and expertise are commodities.

Your employer wants to pay as little as possible for your work. Your goal, on the other hand, is to be paid what you're worth. To bridge the gap between these two numbers, a smart money boss negotiates his salary.

Think of it like this. When you shop for a new car, you try to pay as little as possible, right? You might need that automobile, but you're not going to pay sticker price if you don't have to. At the same time, the dealer does its best to get you to pay more.

Your boss is the car buyer. She *needs* an employee but would prefer to pay less than "list price". You're like that car dealership. You want to convince the buyer – your employer – to pay a premium price for your services.

You can increase your lifetime earnings by half a million dollars—or more—if you learn the art of salary negotiation.

It's one thing to know that you *should* negotiate your salary, but it's something entirely different to do it. What's the trick?

In his excellent book *Negotiating Your Salary: How to Make $1000 a Minute*, career coach Jack Chapman promotes a five-step process that almost anyone can use:

- Delay salary discussions until *after* you're offered a job. (Same with raises: Discuss a pay increase *after* your performance review.)

- Let them make the first move. The first person to name a number loses, so always let the employer suggest a salary first. (For advice on how to deflect questions about your salary expectations, check out this video: **`tinyurl.com/theflinch`**.)
- When you hear the offer, repeat the top value—then stop talking. This "flinch" is a piece of play-acting that buys you time while putting pressure on the employer.
- Counter the offer with a researched response. Before the interview, do your homework so you know a reasonable salary for the position. Use this knowledge to ask for more. (Start your salary research at sites like Glassdoor and PayScale.)
- Clinch the deal—then deal some more. After you've locked in your salary, negotiate additional benefits like extra vacation days or a company car.

According to a recent study in the *Journal of Organizational Behavior*, failing to negotiate your starting salary can cost $600,000 during the typical career.

The same ideas apply when asking for a raise. The difference, of course, is that your company already knows whether you're an asset or a liability. To improve the odds of a salary increase during your next performance review, be prepared to state your case. Sell yourself!

Only about half of all employees in the U.S. negotiate their salary. A money boss *always* does.

There are other ways to market yourself and your career. You might, for instance, develop an ongoing portfolio of your accomplishments at the office. This is handy when asking for a raise or when applying for a new position. You're also marketing your skills and abilities when you network with colleagues at seminars and conferences.

You Are 100% Responsible for Your Income

How much you earn directly reflects what the market believes you're worth. Your income is based on the demand for your knowledge and skills, the quality and quantity of your work, and how well you market yourself to potential employers or customers.

If you want to earn more, you must be worth more.

What the market values might not seem "fair" to you—but "fair" is irrelevant. Is it obscene that professional athletes are paid so much?

Maybe. Should teachers be paid more? Perhaps. But it doesn't matter. These numbers are a product of supply and demand. If you want to increase your income you have to supply more of what employers want.

Now it's time to act. Spend five minutes thinking about each of these questions:

- What's one thing you can do to increase your knowledge or skillset?
- What's one thing you can do to increase the quantity or quality of the work you do?
- What's one thing you can do to better market yourself to your employer—or to other employers?

For each question, pick one best course of action. Now here's the tough part: Commit to yourself that over the course of the next six months, you'll actually *do* these three things.

CHAPTER SIX
THINK LIKE A BILLIONAIRE

Whenever you make a choice, there's a cost.

By choosing to buy one item, you pass on the opportunity to purchase other items. By choosing to do one thing, you pass on the opportunity to spend your time on anything else. **Opportunity cost is what we give up in order to have the thing we choose.**

Let's look at an example.

Imagine you own a delivery company. You have $10,000 to spend on new equipment. You could buy a new truck to add to the fleet, but then you wouldn't be able to replace the ten-year-old computers in the main office. But if you buy new computers, you won't have as many trucks available to make deliveries. No matter which option you choose, something is lost. That's opportunity cost in action.

While this concept is applied constantly in business, it's often overlooked in personal finance.

When *you* use money for one thing, that money can't be used for anything else. If you purchase a home with a $1500 monthly mortgage payment, for instance, you can't use that money to travel or to fund your retirement.

Opportunity costs are neither good nor bad. They're simply the price you pay to have what you choose. The problem comes when the choices you make aren't intentional — when you make them out of reflex or habit.

Every time you spend money, there's an opportunity cost associated with it. But you’re not just sacrificing other choices in the present; you're also sacrificing your future freedom.

The Magic of Compounding

American statesman Benjamin Franklin is credited with having said, "A penny saved is a penny earned." In reality, a penny saved is two pennies earned – or more.

When you buy something, you spend *after*-tax dollars. If you were to purchase a new $23,000 Mini Cooper, for example, you'd use money left over after paying the government. But in order to get that $23,000, the average American would have to earn *$30,000*. The other $7000 — in the form of 5-1/2 weeks of work — goes to taxes.

One dollar saved is worth more than one dollar spent.

In the United States, where the tax burden is low compared to other countries, the average worker must earn $1.33 to have $1.00 left over. (In some countries, a worker might have to earn $2.00 to have $1.00 remaining.)

It gets worse!

If you spend one dollar you could have invested, you don't just lose that dollar but any future return you might have earned on it. Assuming typical stock-market growth, that dollar would have a value of $1.93 ten years from now – and $7.20 in thirty years. (This effect is called "compounding", which Einstein reportedly called "the most powerful force in the universe".)

Now, watch what happens when opportunity cost and compounding come together.

The Wealth Snowball

You have to earn more than a buck to have a buck; and if you spend that buck, you're also spending its future value.

On average, each dollar an American spends represents $2.57 of after-tax value in ten years or $9.57 in thirty years. (If you live outside the U.S., the consequences of spending that dollar are probably even greater.)

The bottom line? **The opportunity cost of spending one dollar today is ten dollars you could have had in retirement.**

In fact, this single concept is the cornerstone of billionaire Warren Buffett's vast fortune. He recognized the idea when he was *ten years old* and it's guided his decisions ever since. Here's a quote from a recent Buffett biography:

> *"The way that numbers exploded as they grew at a constant rate over time was how a small sum could turn into a fortune. [Buffett] could picture the numbers compounding as vividly as the way a snowball grew*

> *when he rolled it across the lawn. Warren began to think about time in a different way. Compounding married the present to the future. If a dollar today was going to be worth ten some years from now, then in his mind the two were the same."*

This idea is so central to Buffett's philosophy that the author named the book after it: *The Snowball.* (It's a great book, by the way. I recommend it.)

A lot of experts urge people to use the "debt snowball" method to quickly pay down what they owe. I want you to apply the same concept to life *after* debt.

Your goal, like Warren Buffett, should be to create a *wealth* snowball.

> For a brilliant example of compounding in real life, turn again to Benjamin Franklin. When he died in 1790, Franklin left the equivalent of $4400 to each of two cities, Boston and Philadelphia. But his gift came with strings attached.
>
> The money had to be loaned out to young married couples at five percent interest. What's more, the cities couldn't access the funds until 1890 – and they couldn't have full access until 1990.
>
> Two hundred years later, Franklin's $8800 bequest had grown to more than $6.5 million between the two cities! True story.

When you look at things like Warren Buffett, it's easier to see that **saving is *not* sacrifice**. When you save, that money's still spent. But it's not spent on a Mercedes or a big house. It's spent buying your future.

The opportunity cost of starting late, a foolish purchase, or a bad investment isn't lost income or lost compounding. It's lost time – lost experience and lost life.

I'm not arguing that you should live like a monk — far from it! — but it's important to consider the opportunity costs of every purchase you make. **When you buy something, you should do so intentionally** because the opportunity cost of buying on impulse is enormous.

Mindful Spending

I endorse a concept called conscious spending, which I learned from Ramit Sethi, author of *I Will Teach You to Be Rich*.

"Being a conscious spender is about making your money match up with your values guilt-free," Sethi says. "It's about spending

extravagantly on the things you love while cutting costs on the things you don't." (Some experts use the term *mindful spending* to refer to the same concept.)

Conscious spending means actively choosing to spend on some things and not on others.

Contrast this with how most people spend.

We buy things because we're expected to. We spend to have what other people have. We sign up for gym memberships that we never use, subscribe to magazines we never read and pay for golf clubs that get buried in the garage. We make impulse purchases at the grocery store – or even on large items, like computers and cars. In other words, we tend to spend without thinking.

The opportunity costs of these unconscious purchases are significant. We're sacrificing our futures for lesser pleasures today.

With conscious spending, you evaluate every purchase, asking yourself:

- "Why am I buying this? Will it make me happier? Will this help me meet my long-term goals?"
- "Would I rather have this now, or would I rather have something bigger and better next year?"
- "Are there other, cheaper options? Could I borrow this? Could I buy it used?"

Mindful spending forces you to become more aware of every purchase you make.

Putting It All Together

For a long time, I was willing to spend $200 each month on gym and fitness programs because doing so helped me to lose fifty pounds and become fit. I made an active, conscious decision to spend that money, and I made certain that I derived value from it. I recognized that I was sacrificing a great deal in the future, but I believed my improved health was a worthwhile reward.

On the other hand, I'm unwilling to own a new car. Financial considerations aside, I don't care enough about features and flash to make such a purchase worthwhile. For somebody else, though, the car might be a worthwhile purchase and the gym membership a waste of money.

"There are things we love, and it's okay to spend on them," says Sethi. "But you can't afford to have everything. So ask yourself what you

don't care about when it comes to spending. Choose to spend your money on what you love instead."

My colleague Todd Tresidder (from FinancialMentor.com) recently explained it to me this way: "Decide the level of comfort that's right for you. There's no right or wrong. **You just have to be willing to pay the price for the lifestyle you choose.**"

- If you choose to save for the future, you give up comfort in the present.
- If you choose to live large today, you sacrifice a richer tomorrow.

That's opportunity cost in action. Neither option is correct, but you can't have both. It's up to you to decide what matters most. Truthfully, there's a balance to be had.

When you spend, be sure it's aligned with your purpose and mission.

CHAPTER SEVEN
INVEST SIMPLY

As you put the Money Boss method into action, you'll begin to earn a profit. Maybe at first you'll have a few dollars per month in surplus. Eventually, however, you'll find that you're saving 10%, 20%, or even 50% of everything you earn.

The average person spends his surplus on whatever wants come to mind. Instead of using the money to get ahead, he stays in the same place. Or, worse, he falls behind by taking on debt. **A money boss puts her profit to use by investing for the future.**

At first, you'll pursue short-term goals.

- If you're in debt, get out of debt. Destroying high-interest debt offers the best possible return for your money. (For more advice on debt reduction, see Appendix A.)
- Build a cash reserve. It's smart to have money in a savings account to cover short-term emergencies.
- Invest in yourself. Remember: the more you learn, the more you earn. Increase your skills and education. Update your wardrobe and improve your health. Become a better you.
- Pursue your personal mission: fund college funds for the kids, pay off the mortgage, start a business, spend a year in southeast Asia. Use money as a tool to improve your life.

After your near-term wants and needs are satisfied, it's time to look farther into the future, toward retirement and Financial Independence. You know what that means, right? It's time to invest in the stock market!

Don't let the stock market frighten you. **Investing doesn't have to be difficult.** If you keep things simple, you can invest yourself and receive reasonable returns — all with a minimum of work and worry.

First, lets look at what *not* to do.

The Worst Investor I've Ever Known

Allow me to introduce you to the worst investor I've ever known. His name is J.D. Roth:

That's right, I'm using myself as an example of what not to do when investing.

You see, for a long time I didn't understand how the stock market worked. I treated it as if it were a casino. I picked a stock, put all my money into it, and crossed my fingers. I took risky gambles hoping to strike it rich.

Unsurprisingly, I lost a ton of money.

During the late 1990s, I formed an investment club with some close friends. Each month, we contributed money and picked where to put it. We chose stupid, stupid stocks – whatever was riding high at the moment. When the tech bubble burst, so did our bankroll and our enthusiasm.

In 2000, enamored by PalmPilot, I bought stock in the company that made the devices. I paid close to $90 per share. Just over a year later, the stock had lost 90% of its value. *Oops.*

One of my friends worked for The Sharper Image. In 2007, the company was struggling and the stock was in the toilet. At dinner one night, my friend told me how management was trying to turn things around. Sounded promising, so I put my $3500 Roth IRA contribution into the company's stock. The company soon went bankrupt and my 2007 IRA contribution is now worth nothing.

During the banking crisis, I invested in Countrywide Financial. "Countrywide is on your side," right? Wrong. Yet another stock that went to zero.

Look, I was dumb, and I know it. Unfortunately, my story is far from unique.

During the 1980s, my father bought gold at over $500 per ounce only to watch it fall to $300. More recently, I have friends who've bought Bitcoins for $700. And readers often tell me about how they've lost by speculating in the stock market like I did.

In the past decade, I've mended my ways. I no longer treat the stock market like a casino game. Today, I take a different approach, the same strategy recommended by Warren Buffett and lots of other smart folks.

Before I share this strategy, however, let's talk a bit about philosophy.

The Money Boss Investment Philosophy

Your investment philosophy contains the core beliefs that guide your actions and decisions when saving for the future. It's like your money blueprint for the stock market. Without a defined philosophy, your choices are arbitrary. You buy and sell based on whim and emotion. When you have a clear ideology, your options become limited to strategies that fit your beliefs.

Here's how author Rick Ferri describes the difference between investment philosophy and investment strategy:

> *"Philosophy is universal, strategy is personal, and discipline is required. Philosophy acts as the glue that holds everything together. Philosophy first, strategy second and discipline third. These are the keys to successful investing."*

Back when I was doing stupid stock-market tricks, I didn't have a coherent investment philosophy. Today, I do.

After a decade of reading and writing about money, I've come to believe that a smart investor heeds the following advice.

Start early. "The amount of capital you start with is not nearly as important as getting started early," writes Burton Malkiel in *The Random Walk Guide to Investing*. "Every year you put off investing makes your [goals] more difficult to achieve." The secret, he says, is the extraordinary power of compounding. Given enough time, even modest investment returns can generate real wealth.

Think long-term. It takes time–decades, not years–for compounding to work its magic. Plus, there's another reason to take the long view. In the short term, stocks are volatile. The market might jump 30% one year, then fall 20% the next. But in the long run, stocks return an average of around 10% per year (or about 7% when you factor inflation).

Spread the risk. Another way to smooth the market's wild ups and downs is through diversification, which simply means not putting all of your eggs into one basket. Own more than one stock, and own other types of investments (such as bonds or real estate). When you spread your money around, you decrease risk while (counter-intuitively) earning a similar return.

Keep costs low. In *Your Money and Your Brain*, Jason Zweig notes, "Decades of rigorous research have proven that the single most critical factor in the future performance of a mutual fund is that small, relatively static number: its fees and expenses. Hot performance comes and goes, but expenses never go away." Warren Buffett has bet a million bucks that, because of high fees, an actively managed hedge fund cannot beat an average market index fund. Seven years in, he's winning the bet, and by a wide margin.

Keep it simple. Most people make investing *far* too complicated. There's no need to guess which stocks are going to outperform the market. In fact, you probably can't. For the average person, it's much easier *and* more profitable to simply buy index funds. (About which, more in a moment.)

Make it automatic. It's important to automate good behavior so that you don't sabotage yourself. You want to remove the human element from the equation. I recommend creating a monthly transfer from your checking account to your investment account. And if you have a retirement plan at work, ask HR to max out your contribution via payroll deduction.

Ignore everyone. You might think that a smart investor pays attention to daily financial news, keeping his finger on the pulse of the market. But you'd be wrong. Smart investors *ignore* the market. If you're investing for twenty or thirty years down the road, today's financial news is largely irrelevant. Make decisions based on your personal financial goals, not on whether the market jumped or dropped today.

Conduct annual reviews. While it does zero good to monitor your investments day to day, it's smart to look things over occasionally. Some folks do this quarterly. I recommend once per year. An annual review lets you shift money around, if needed. And it's a great time to be sure your investment strategy still matches your goals and values.

This philosophy — which is based on years of research and experience — limits the number of investment strategies at my disposal.

The Money Boss Investment Strategy

How would you put the Money Boss investment philosophy into action? The answer is surprisingly simple: **Set up automatic investments into a portfolio of *index funds***, mutual funds designed to match the movement of the stock market (or a portion of the stock market).

It's easy to get started. Here's how a money boss invests:

- Put as much as you can into investment accounts — as soon as possible. Fund tax-advantaged accounts (such as retirement accounts) before taxable accounts.
- Invest in low-cost index funds, such as Vanguard's Total Stock Market Index Fund (VTSMX) or Fidelity's Spartan Total Market Index Fund (FSTMX).
- If the stock market makes you nervous, or you want to spread the risk, put some of your money into a bond fund like Vanguard's Total Bond Market Index Fund (VBMFX) or Fidelity's Total Bond Market Index Fund (FTBFX).
- If you want diversification with less work, invest in a low-cost combo fund like Vanguard's STAR Fund (VGSTX) or Fidelity's Four-in-One Index Fund (FFNOX).

After that, ignore the news no matter how exciting or scary things get. Once a year, go through your portfolio to be sure your investments still match your goals. Then continue to put as much as you can into the market — and let time take care of the rest.

That's it. Seriously. **Do this and you should outperform most other individual investors over the long term.**

This strategy isn't just great for investing novices. Even market professionals endorse it. In his 2013 letter to Berkshire Hathaway shareholders, for instance, Warren Buffett outlined what will happen to his vast wealth when he dies. Most of it will go to charity; some will go to his wife. How will his wife's money be handled?

> *"My advice to the trustee couldn't be more simple: Put 10% of the cash in short-term government bonds and 90% in a very low-cost S&P 500 index fund. (I suggest Vanguard's.) I believe the trust's long-term results from this policy will be superior to those attained by most investors..."*

Are there other investment strategies that might provide similar returns? Sure.

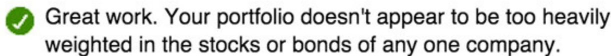
In the future at the Money Boss blog, we'll explore value investing, dividend investing, and the Permanent Portfolio. Each of these approaches has merit. But each of these approaches also requires greater education, sophistication, and attention on the part of the investor.

Unless you're *certain* that you have this knowledge, sophistication, and attention, you're better off sticking with index funds.

The Bottom Line

Do I practice what I preach? You bet! All of my money is in index funds and individual bonds. Here are my top four holdings as of today:

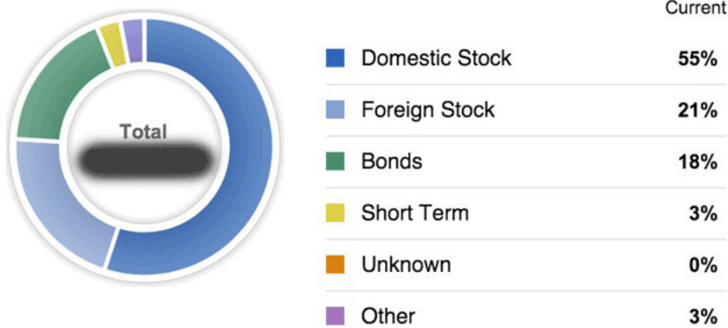
Top Positions & Ratings


Great work. Your portfolio doesn't appear to be too heavily weighted in the stocks or bonds of any one company.

Symbol	Percent (%)	Rating		As of Date
FUSVX	23%	★★★★	1372 Large Blend funds rated	10/31/15
FSEVX	18%	★★★★	358 Mid-Cap Blend funds rated	10/31/15
FFNOX	18%	★★★★	400 Aggressive Allocation funds rated	10/31/15
FSIVX	16%	★★★★	684 Foreign Large Blend funds rated	10/31/15

★ Overall Morningstar Rating View additional rating information

That gives me an overall asset allocation that looks like this:



I'm 47 years old and have 76% of my portfolio in stocks, 21% in bonds, and 3% in other investments. I do still own 1115 shares of now-worthless Sharper Image stock. I keep it to remind me of my past stupidity.

One of my personal goals over the next few years is to gain the knowledge and sophistication necessary to dabble in other forms of investing. (I believe I have the mindset already.) For now, I'm content heeding Warren Buffett's advice. It's served me well.

Here's an exercise for you: Whether you're new to investing or already have millions in the market, it's important to define your investment philosophy. To start, create an investment policy statement, which is like a blueprint for your investments. An IPS will help you decide how much to invest in stocks and how much to invest in bonds. It'll also help you stay on course instead of trying to take shortcuts (by doing things like chasing hot stocks) or panicking when things fall apart (such as during 2008's market crash). Learn more about investment policy statements at Morningstar: **`tinyurl.com/mstar-ips`**.

CHAPTER EIGHT
DO THE RIGHT THING

Three thousand years ago, there lived a great hero named Ulysses (or Odysseus, if you prefer), king of Ithaca, champion of the Trojan War, and, it turns out, pioneer of personal finance.

Ulysses wrestled Ajax, retrieved the body of Achilles (the hero shot in his heel), and devised the clever Trojan horse, which allowed the Greek army to infiltrate Troy and end the decade-long struggle.

When the conflict was over, Ulysses spent another ten years desperately trying to sail home to Ithaca. He visited the lotus-eaters, was captured by (and escaped from) the Cyclops, evaded both cannibals and the witch-god Circe. He slipped past the six-headed monster Scylla and the whirlpool called Charybdis. After all these troubles (and more!), Ulysses reached Ithaca and regained his throne.

Ulysses was mighty. He was tough, both mentally and physically. But he was only human.

Like anyone, he was subject to temptation. He was deceitful. He was rash. He sometimes shirked responsibility. (He and his men wasted an entire *year* on Circe's island "feasting upon an untold quantity both of meat and wine".) Most of all, Ulysses was proud. Immodest. Boastful.

Fortunately, Ulysses was also self-aware.

In an episode combining both his strength and weakness of character, Ulysses decides he wants to hear the seductive song of the Sirens. Foolish, yes, and he knows it. Because he realizes he's doing something dumb, Ulysses orders his men to prepare for possible problems. He plugs their ears with wax.

But first he commands: “Take me and bind me to the crosspiece half way up the mast; bind me as I stand upright, with a bond so fast that I

cannot possibly break away, and lash the rope's ends to the mast itself. If I beg and pray you to set me free, then bind me more tightly still."

"Come here," the Sirens sing. "No one ever sailed past us without staying to hear the enchanting sweetness of our song."

No one, that is, until Ulysses.

The Power of Barriers and Pre-Commitment

By planning in advance, Ulysses escaped destruction. He and his men survived because he *pre-committed* to the correct course of action and established a barrier between willpower and temptation.

Like Ulysses, a money boss understands that **pre-commitment is a powerful tool**. In fact, it's one of the most powerful tools in personal finance.

Because we're human, we each have weaknesses. For me, it's books and comics and travel gear. For you it might be shoes or tech toys or fancy restaurants. Like Ulysses, you want to find a way to bind yourself to the metaphorical mast so that you cannot be lured to your destruction. You want to use pre-commitment to make it difficult to do dumb things.

When I was digging out of debt, I was frequently seduced by the siren song of books and comics. I *knew* it was dangerous for me to walk into a bookstore or comic shop, but I did so all the same. I spent a lot of money because I was foolish. (In 2006, I spent $692.96 on books and $3202.91 on comics. *Yikes!*)

As I started to master my money, I discovered ways to "tie myself to the mast", to resist temptation.

For instance, I found that if I didn't enter bookstores or visit Amazon, I wouldn't buy books. If I didn't walk into a comic store, I wouldn't buy comics. By refusing to even browse, I had pre-committed to doing the right thing. My spending on books and comics plummeted, and I began to repay my debt more quickly.

This experience taught me an important lesson about pre-commitment: **The best way to resist temptation is to never be tempted.** Obvious, I know, but it's shocking how many people overspend simply because they expose themselves to the object of their desire.

Avoiding temptation is a great barrier to bad behavior, but there are plenty of other ways to practice pre-commitment.

- Some experts advise that if you have trouble with debt, you should freeze your credit cards in a block of ice. Although it sounds crazy, this can be an effective deterrent for chronic debtors. I had to take things further when I was in bad shape. I destroyed my credit cards and hid the account numbers. (Even that wasn't enough. Ultimately I had to cancel the accounts!)
- I used to find it hard to build savings. As quickly as I put money away, I spent it. Part of the problem was easy access. My checking account and savings account were held at the same credit union. Eventually, I got wise to myself. I moved my savings account to a different bank (an online savings account) and established a link between the two. When I got paid, I put my money into savings first. I only moved money to checking when I needed it. This one act made a huge difference to my impulse spending.
- When I go grocery shopping, I use a list. I walk to the store instead of drive. I shop the perimeter. I consciously avoid looking at the impulse items at the cash register. Each of these is an intentional barrier I build between bad choices and me. (All the same, I occasionally make it home with a bag of chips or six-pack of beer. Or a fruit pie.)

Barriers are like walls. When used strategically, they prevent you from doing the things you wish you wouldn't do. Unfortunately, barriers can sometimes prevent you from doing the things you *do* want to do. That's okay. Pre-commitment can help you build walls you want, but it can also help tear down barriers to financial freedom.

Do the Right Thing—Automatically

My cousin Nick has always been good with money — for the most part. His earning far outpaces his spending, and he uses his profits to invest for the future. But he used to have a costly problem caused by a simple barrier: envelopes.

When he came home from work, Nick would toss his mail on a table. He was tired and didn't want to hassle with opening bills and writing checks. (This was in the olden days—like 1995.)

Over days and weeks, the stack of mail would grow into a paper mountain. The longer he delayed dealing with the bills and notices, the more onerous the task became. He dreaded it. And because he dreaded it, he continued to ignore the fact that his bills were now past due.

Eventually, of course, he would have to deal with the problem. He'd set aside a Saturday morning to open his mail and pay his bills. It took a long time, which he hated, and he also had to pay late fees and interest charges, which he hated even more. After he'd finished, this cycle would begin again.

All of this because of a simple barrier: the act of opening mail after work and dealing with bills immediately.

Nick's story isn't unique. In fact, I've struggled with a similar problem in the past. After becoming the boss of my own life, however, I've used a couple of tools to destroy the “envelope barrier”—and other obstacles between me and financial success.

First, and most importantly, I've learned to love automation. **Automation removes roadblocks to good behavior.**

When I set up automatic bill payments, for instance, I no longer had to worry about bills piling up on my desk. I also used automation to start saving for retirement. I had 401(k) contributions deducted from my paycheck, and I scheduled monthly transfers to my Roth IRA account. When I decided to eliminate my mortgage, I established automatic payments with an extra amount built in. And so on.

Removing *me* from the equation made my entire financial life run more smoothly. Automation made financial success almost inevitable! It certainly made it much easier to do the right thing.

Sometimes, like Ulysses, you need to pre-commit to the right action by building barriers to temptation. You need to bind yourself to the mast. Other times, you need to try the opposite approach, practicing pre-commitment by tearing down walls.

In either case, your goal is to the same. Instead of being your own worst enemy when it comes to money, you want to become your best ally in the fight for financial freedom.

Now I want *you* to discover the power of pre-commitment. Ready? Set aside one hour of uninterrupted time. Grab pen and paper.

First, review your financial goals and personal mission statement. Also look through your monthly financial statements. What can you automate? Debt installments? Retirement contributions? Extra mortgage payments? What about using a money-management tool like Mint or YNAB?

Next, think about where you're weak with money. Where do you spend too much? What tempts you? Pick three problem areas you'd like to address. For each, brainstorm three ways you might be able to "bind yourself to the mast" like Ulysses to avoid temptation. How can you create barriers between you and bad behavior? Do date nights with cash instead of a credit card? Block Amazon from your web browser?

The final step, of course, is to put these ideas into practice. Pre-commit to doing the right thing.

CHAPTER NINE
BUILD A WEALTH SNOWBALL

I want to tell you more about one of my money heroes, Warren Buffett, and his vast snowball of wealth. Buffett wasn't always a billionaire. He started from scratch, just like you and me.

Here he is in 1948—when he had less than $10,000 to his name:

Do you think anyone could have guessed that this colossal dork would eventually become one of the world's richest men? I don't think so.

Buffett began making money when he was six years old. He'd buy packs of chewing gum for three cents each, then go door to door selling

them for a nickel. (He refused to sell individual sticks; you had to buy an entire pack of Doublemint or *nothing*.)

"He could hold those pennies, weighty and solid, in his palm," writes Alice Schroeder in her excellent Buffett biography, *The Snowball*. "They became the first few snowflakes in a snowball of money to come."

From chewing gum, Buffett graduated to soda pop. He sold bottles of Coca-Cola to his neighbors in Omaha, and he even peddled his wares to sunbathers while vacationing at Lake Okoboji in Iowa. Buffett sold used golf balls. He hawked peanuts and popcorn at University of Omaha football games.

All the while, he kept score. He deposited his pennies and nickels in the bank and kept track of his savings in a passbook.

At a young age, Buffett began to grasp the extraordinary power of compounding. Again from Schroeder's book: "The way that numbers exploded as they grew at a constant rate over time was how a small sum could turn into a fortune. **He could picture the numbers compounding as vividly as the way a snowball grew when he rolled it across the lawn.**"

When he was ten years old, Buffett vowed to become a millionaire by age thirty-five. By the time he turned eleven, he'd accumulated $120. He used his cash to buy his first three shares of stock. He had 24 years and $999,880 to go to meet his goal.

When Buffett left Omaha for college at age 20, he'd saved $9804, some of which was in stocks. He moved to New York to attend Columbia University, where he took finance classes from Benjamin Graham and David Dodd. He continued to invest, both for himself and now for family and friends. He wrote articles about the stock market. (Even back in 1952, he was obsessed with GEICO stock.) He bought his first business, a service station.

Buffett got married and had kids. He earned more money, both from work and investing. All the same, he was reluctant to spend. He was frugal—almost miserly. He didn't like to buy new clothes. He made a deal with a nearby newsstand to purchase outdated magazines at a discount. For a long time, he didn't own a car. (After he did purchase a vehicle, he'd only wash it when it rained.)

Like a money boss, Buffett kept his costs down while boosting his income.

"For Warren, holding on to every penny this way, since he had sold that first pack of chewing gum, was one of the two things that had made him comparatively rich at age twenty-five," writes Schroeder in *The*

Snowball. The other contributing factor? Buffett was making money at an ever-increasing rate.

The years and decades passed. Buffett continued to invest. His snowball grew exponentially.

- By age 11, Buffett had saved $120.
- By age 21, Buffett had a net worth of $19,738.
- By age 26, Buffett was worth $140,000.
- By age 30—five years ahead of schedule—Buffett was a millionaire.
- By age 40, Buffett had more than $25,000,000.
- By age 50, Buffett had accumulated over $150,000,000.
- By age 60, Buffett had become a billionaire.

Today, Warren Buffett is worth $67 billion. He's the third-richest man in the world. During his 85 years, he's created the greatest wealth snowball the world has ever seen.

And it all started with chewing gum.

I can't promise that you and I will become billionaires. In fact, our chances of doing so are exceedingly slim. But I *can* promise that if you follow the steps outlined in this guide to financial freedom, you will produce a modest wealth snowball of your own.

Your Wealth Snowball

You begin rolling *your* wealth snowball the moment you achieve a positive cash flow – as soon as you're earning more than you spend. **Each penny of profit adds to your fortune.**

- When you stay late to work overtime, you add do your wealth snowball.
- When you choose to bike instead of drive, you add to your wealth snowball.
- When you decide to downsize your home or work a second job or skip the new iPhone, you add to your wealth snowball.

The bigger your profit margin, the faster the snowball grows.

It's not just earning and spending that affect your wealth. Your investment returns play an important role too. In the short term, your contributions have a greater impact than investment performance, but

over the long term the extraordinary power of compounding comes into play.

Assume you make a one-time $5000 contribution to your retirement account at age twenty and manage to earn an 8% return every year. If you never touch the money, your $5000 will grow to $159,602.25 by the time you're sixty-five years old. But if you wait until you're forty to make that one-time investment, your $5000 would only grow to $34,242.38 before you retire. **Compounding is the reason it's so important to begin investing when you're young!**

When you add to your wealth snowball regularly, its growth accelerates.

If you were to invest $5000 each year for forty-five years, for instance, and if you left the money to earn an 8% annual return, your savings would total over $1.93 million. You'd have more than eight times the amount you contributed. *This* is the power of compounding.

Because you're a money boss, you don't want to wait forty-five years to achieve Financial Independence. You want to reach your goals in ten or fifteen years, not fifty. With a short investment horizon, there's less time for compounding to do its work. That's why it's so important to save half of your income—or more.

Here's what Mr. Money Mustache calls the shockingly simple math behind early retirement:

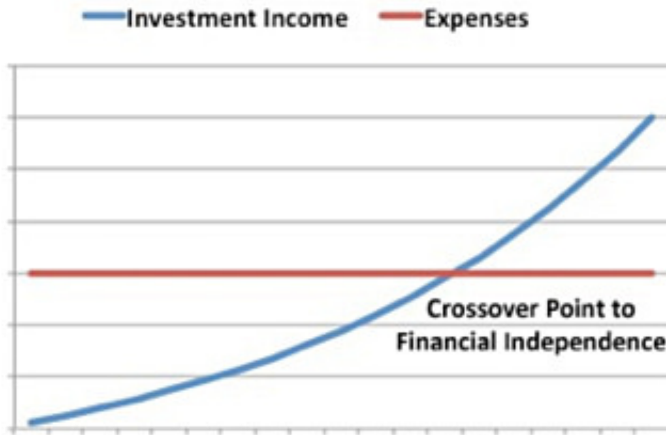
- With a 10% profit margin (or saving rate), you'd need to work for 50 years to reach Financial Independence. Your wealth snowball grows – but not quickly.
- With a 20% profit margin, you'd need to work for 37 years to achieve Financial Independence.
- With a 35% profit margin, you'd need to work for 25 years to achieve Financial Independence.
- With a 50% profit margin, you'd only need to work for 17 years to achieve Financial Independence.
- And if you can manage to save 70% of your income, you could achieve Financial Independence in 8-1/2 years!

Pull out your mission statement. Look at your goals. Your profit margin directly affects how quickly you'll achieve these aims. **The sooner you grow your wealth snowball, the sooner you can do the things you dream of doing.**

The Crossover Point

At some point in the future, your wealth snowball will be so large that it'll last the rest of your life. You'll never have to work for money again unless you *choose* to. It's at this point that you'll have reached Financial Independence.

At this crossover point, your investment returns provide more than you spend.



Realistically speaking, it's important to have a margin of safety. (In fact, this is one of Warren Buffett's core beliefs!) To that end, I make the following assumptions when I calculate whether somebody has reached the crossover point:

- You'll spend as much in the future as you do now. (About one third of people spend more, one third spend less, and one third spend the same.)
- If you withdraw about 4% from your savings each year, your wealth snowball will maintain its value against inflation. During market downturns, you might need to withdraw as little as 3%. During flush times, you might allow yourself 5%. But around 4% is generally safe.

Based on these assumptions, there's a quick way to check whether or not Financial Independence is within your reach.

Multiply your current annual expenses by 25. If the result is less than your savings, you've achieved Financial Independence. If

the product is greater than your savings, you still have work to do. (If you're conservative and/or have low risk tolerance, multiply your annual expenses by 30. If you're aggressive and/or willing to take on greater risk, multiply by 20.)

For instance, I generally spend about $36,000 per year. That's how much my lifestyle costs when I'm not traveling the U.S. in a motorhome. Based on the above, I achieved Financial Independence once I had $900,000 saved (or 25 times my annual spending).

If you'd prefer, you can approach the problem in reverse. Start with your current wealth snowball and see how long it'll last.

To keep things simple, we'll work with net worth. If you calculated your net worth during the first chapter of this book, use that number. Otherwise, you can download or copy this net worth spreadsheet I created in Google Docs: **`tinyurl.com/MBnetworth`**.

Once you have your net worth, multiply it by 4% (or by 0.04). Based on recent history, this is how much you could safely spend each year without draining your savings. (If you want to be conservative, multiply by 3%. If you're feeling bold, multiply by 5%.)

How do these numbers make you feel? Is your wealth snowball bigger than you thought? Or is there work to be done before you'll feel secure? How much money will be enough for you?

CHAPTER TEN
SIX DEGREES OF FINANCIAL FREEDOM

Allow me to introduce you to my friends Mac and Pam.

Pam is a pathologist and an elite ultra-runner. Mac is a former high-school science teacher and current stay-at-home dad. Together, they form a formidable financial team.

Mac and Pam have *always* put an emphasis on saving. But they don't just pinch pennies. They've optimized their lives to boost their income *and* their happiness. They're well on their way to financial independence. In many ways, they epitomize the ideals espoused by my Money Boss philosophy.

The Money Boss Method in Real Life

When Pam was in her final year of med school, for instance, Mac worked as a research tech at a neuroscience lab. He brought home only $18,000 but they were careful to avoid living paycheck to paycheck.

"We would pay the rent," Mac says, "we would put money into savings, and we'd still have money left over at the end of the month. **We made choices not to buy the little things that could have killed our future.** "

After med school, Mac and Pam moved to Portland. While Pam did her pathology residency at Oregon Health & Science University, Mac taught high-school science. At that time, their salaries were similar.

When their first child was born in January 2005, Pam took maternity leave until Spring Break. From Spring Break until the end of the school year, Mac brought the baby with him to work and placed her in the student-run daycare.

"Counting the cost of daycare, my teacher's salary went down to minimum wage," Mac says. At the end of the school year, he asked for a year off. That year turned into forever. "It came down to whether I wanted to raise other people's kids or whether I wanted to raise my own."

The traditional choice is for the mother to stay home with the kids, but that seemed silly in their situation. With her residency completed, Pam could earn four or five times what Mac could make as a teacher. "It didn't make sense to throw away the money we spent on Pam's education to not reap the benefits of that education."

For the past decade, Mac and Pam have worked in tandem toward family and financial goals. Pam makes the money. Mac takes care of two kids and day-to-day household operations while also managing their investments. They're *both* careful with spending.

"We spend a lot less than all of our friends who earn similar amounts," Mac says. "Lots of our doctor friends have multiple houses. They own fancy cars. They spend lots of money and we don't. Neither of us wants a second home. I drive a 2007 minivan and Pam drives a 2004 Avalon. Our only debt is our house. We pay off our credit cards every month and we have no car payments."

From the beginning, saving has been a priority for Mac and Pam. And as they earned more, they saved more. It's true their spending increased too, but at nowhere near the same rate. A higher income meant they could put more in the bank — not buy more stuff.

Because they've been so diligent for so long, Mac and Pam will be able to retire in their forties. They've made the choices and done the work necessary to achieve Financial Independence at a young age.

"We'd rather accumulate our wealth, to live how we want later in life than spend on things now," Mac says. Yes, they could afford to buy things today, but doing so would require sacrificing more important opportunities tomorrow.

These two are money bosses! They've been climbing the ladder of financial freedom for a long time.

The Six Stages of Financial Freedom

I used to believe that financial freedom meant just one thing: Having enough money that you never had to work again. Over the years, people like Mac and Pam have taught me that financial independence exists on a continuum. It's not "all or nothing", but an ever-increasing range of options. It's a process.

Each stage of financial freedom allows you greater autonomy and self-expression, and these are qualities that lead to happiness.

A few years ago at Get Rich Slowly, I came up with what I called the three stages of personal finance. Later, I expanded these to four or five stages. Today, I recognize there are *many* degrees of financial independence.

For our purposes, let’s keep things simple.

After blending my ideas with those of Joshua Sheats (host of the excellent Radical Personal Finance podcast), I've come up with a model that tracks six stages from financial dependence to financial abundance.

But before you can begin progressing through the six stages of financial freedom, there's a preliminary hurdle you have to clear. You're in this "zeroeth stage" if your expenses exceed your income.

Stage 0 - Dependence

In this stage, your lifestyle depends on others for financial support. We *all* start here. We're born this way. How long it takes to break free varies from person to person. You're in this stage if you rely on financial support from your parents. You're in this stage if you spend more than you earn. You're in this stage if your debt payments exceed your income.

After you begin to earn a profit, you begin to progress through the six stages of financial freedom. The first three are the "surviving" stages.

Stage 1 - Solvency
Solvency is the ability to meet your financial commitments. You reach this stage when you no longer rely on anyone else for financial support — when your income exceeds your expenses, when you are no longer accumulating debt. When you are earning a profit, you have achieved solvency. Some people reach this stage in their teens. Some *never* reach it. (I reached it at age 35 in October 2004, when I stopped debting and began to repay what I owed.)

Stage 2 - Stability
You achieve stability once you've repaid your consumer debt, established some emergency savings, and continue to earn a personal profit. You may still possess some "good debt" — college loans, a mortgage — but you've eliminated other obligations and built a buffer of savings to protect you from unfortunate events. (I reached this stage at age 38 in December 2007, when I made my final debt payment.)

Stage 3 - Agency
The final "surviving" stage is free agency, the ability to work and live how and where you want. In this stage, you've eliminated *all* debt (including student loans and mortgage) and you have enough banked that you could quit your job at a moment's notice without hesitation. This is commonly called "screw-you money". (I achieved agency in March 2008.)

> I know first-hand there are times you might prefer to carry a mortgage even if you don't have to. For the purposes of this stage, if you have enough saved and invested to pay off your mortgage, it's the same thing as not having one.

In the final three stages, you move from surviving to thriving. Money is no longer a safety net, but a tool to help you build the life you envision for yourself and your family. Remember our discussion of the “crossover point”? That concept is key to defining where you are in these latter stages of financial freedom. (Each of these stages assumes no debt. Or, as explained in the note above, enough cash on hand to instantly repay your debt.)

Stage 4 – Security
You achieve financial security when your investment income can cover your basic needs. That is, based on how much you have saved and invested, you could live a meager existence for the rest of your life. Even if you never worked another day in your life, you have enough to afford simple housing, basic food, essential clothing, and insurance.

Stage 5 - Independence
Financial independence is the ultimate goal for most folks. At this stage, your investment income is sufficient to fund your current standard of living for the rest of your life. You can afford the basics, but you can afford some comforts too. You have Enough. (I leaped from agency to independence in April 2009. This is the stage I'm in today.)

Stage 6 - Abundance
In the final stage of financial freedom, you have "enough — and then some". Your passive income from all sources will not only fund your lifestyle indefinitely, but grant you the freedom to do whatever you want. You can share your wealth with others. You can indulge in luxury, explore the world. You can build a business empire.

What stage am I in today? I enjoy financial independence and am working toward financial abundance. My wealth will support my standard of living indefinitely, and even allow for a few indulgences now and then — such as an 18-month RV trip around the U.S. But I can't get too extravagant or I'll have to re-adjust my lifestyle.

The more money you save, the more freedom you have, and the greater risks you can take. As your financial independence increases, you chip away at the wall of worry. You're able to make decisions based on happiness and not on dollars.

And here's the thing: As you develop smart money habits and skills, these will not only help you obtain whatever immediate level of financial freedom you're working toward, but also progress toward future levels of freedom.

If you're working toward debt freedom, for instance, as you learn to spend less and earn more, this profitability will continue to help you once you've achieved solvency. You can apply the same ideas as you work to obtain stability, and then agency.

Summing Up

Over the past sixty pages, I've shared the nuts and bolts of my financial philosophy. To summarize:

- You are the boss of you. Nobody cares more about your money than you do, so assume responsibility for your financial future. Run your life like a business.
- The best way to get what you want is to become clear on your goals and values. That's why everyone should craft a personal mission statement.
- Profit margin is the most important number in personal finance. Profit gives you the power to do what you want.
- Frugality is the cornerstone of wealth-building, but Big Wins are the best way to spend less.
- You are 100% responsible for your income. To earn more, learn more. Work more and work better. Sell yourself. If you take the time to supercharge your income, your profits will soar.
- Think like a billionaire by carefully guarding each dollar you earn. Recognize that every time you spend today, you're sacrificing a piece of tomorrow. Practice mindful spending.
- Invest wisely. Don't try to get rich quick. Develop an investment philosophy and develop a strategy to back it up.
- Use barriers and pre-commitment to automatically do the right thing – every time.
- As you adopt this philosophy, your wealth snowball will begin to grow. The more you work at it, the bigger it'll get. Protect it. Your wealth snowball is the key to your financial future!

It was a lot of work to put this guide together, but it was also a lot of fun. I'd love feedback if you have it. **I want this info to be as useful as possible to future readers, so drop me a line to let me know what you liked—and what you didn't.** Constructive criticism will *not* offend me.

Now that we're done discussing these core concepts, it's time to begin an ongoing exploration of financial freedom. Come join me at MoneyBoss.com as we learn together how to master not just money, but all aspects of our lives!

MONEY BO$S

MASTER YOUR MONEY – AND YOUR LIFE

THE ROAD TO FINANCIAL FREEDOM

STAGE 0 - DEPENDENCE

Your lifestyle depends on others for financial support. You're in this stage if your parents still give you money. You're in this stage if you spend more than you earn. You're in this stage if your debt payments exceed your income.

STAGE 1 - SOLVENCY

You can meet your financial commitments without outside help. You reach this stage when you begin earning a "profit", when your income exceeds your expenses. You're using the surplus to repay debt and to meet immediate financial obligations.

STAGE 2 - STABILITY

You no longer have consumer debt. You've repaid your credit cards, auto loans, and so on. You may still have some "good debt" – college loans, a mortgage – but you've eliminated other obligations *and* built a buffer of emergency savings to protect yourself from unfortunate events.

STAGE 3 - AGENCY

You have the freedom to live and work as you choose. You've eliminated *all* debt, including student loans and mortgage (or you have the cash to do so, if you wanted). You have enough banked that you could quit your job at a moment's notice and feel no trepidation for the future.

STAGE 4 - SECURITY

Your investment income covers your basic needs. The money you've saved and invested would fund simple housing, basic food, essential clothing, and insurance – even if you never worked another day in your life.

STAGE 5 - INDEPENDENCE

Your investment income supports your current standard of living. The money you've saved and invested would allow you to live like you do today...until the day you die. It covers the basics *and* creature comforts. You have enough.

STAGE 6 - ABUNDANCE

You have enough – and then some. Your passive income from all sources will not only fund your lifestyle forever, but also grant you the freedom to do whatever you choose: indulge in luxury, build a business empire, explore the world.

Visit moneyboss.com to learn more about financial freedom.

APPENDIX A
GET OUT OF DEBT

Some of you might have noticed that I didn't cover debt reduction in this book. *A Brief Guide to Financial Freedom* focuses on advanced personal finance skills, not the basics. Besides, I've come to believe that **debt reduction ought to be a side effect and not a goal**.

Having said that, I realize that a lot of you are probably still struggling to get to square one. To that end, this appendix is meant to be a definitive guide to getting out of debt.

Before you can begin repaying your debt, you *must* be earning a profit. Unless your income exceeds your expenses, your debt is actually *increasing*. If you're continuing to add debt, or if you're only able to make minimum payments, you must first reduce your overhead and increase your revenue until you have a positive cash flow.

After you're earning a personal profit, you can (and *should*) make debt elimination a priority.

Why Debt Sucks

Debt repayment can improve your credit score, meaning you'll pay less on everything from rent to car insurance to future borrowing needs. Plus, debt reduction is one of the best returns you can earn on your money.

Investing in the stock market provides an average annual return of about 10% — but that return isn't guaranteed. Some years the market is up 30%, but other years it drops by 40%. When you pay down a credit card, you earn a guaranteed return of 20% (or whatever your interest rate is). That's tough to beat.

If your employer matches your retirement contributions, it might make more sense to put your profit there. That 50% to 100% immediate

payoff is a better return than you'll get paying off your debt (or anywhere else). Yet while this is the best option mathematically, remember to consider psychological factors as well. It may be best to get out of debt before focusing on retirement.

There are other non-financial benefits to paying off debt, including:

- Simplicity. The more debt you have, the more bills you have. One of your goals as a money boss is to create a simple, efficient financial infrastructure. Each time you pay off a debt, you move one step closer to this ideal.
- Cash flow. Whenever you eliminate a debt, the money formerly used for that monthly payment becomes available to pursue other goals – including fun stuff like ski trips and knitting supplies.
- Freedom. When you have monthly payments to meet, you're chained to your job. You're unable to take risks. Once your debt is gone, a wider range of options becomes available to you.
- Peace of mind. Best of all, once you're debt-free, you can sleep easier at night. You'll put less pressure on yourself, and you'll have fewer fights about money with your partner.

When I first tried to get out of debt, I lacked a system. Without a plan, I sent extra money to one credit card and then another. As a result, I never seemed to make any progress.

After deciding to become boss of my own life, however, I researched how to get out of debt. Many books recommended a strategy called the "debt snowball". Although I was skeptical, I gave it a try. The method worked. Using it, I managed to eliminate my debt and begin saving for the future.

The Debt Snowball

With the debt snowball, you set aside a specific amount of cash each month to pay off the money you owe. At first, progress is slow. In time, however, you begin to make rapid progress, picking up speed like a snowball rolling downhill.

The first step is to make a list of your debts. For each obligation, include the balance you owe, the interest rate, and the minimum payment. **Arrange the list so that the debt with the highest interest rate is on top.** Next comes the debt with the second-highest interest rate, and so on, until you reach the final debt on the list, which will be the one with the lowest interest rate.

For instance, here's the actual list of my debts from October 2004, ordered by interest rate:

- Computer Loan: $1116 @ 15% ($48 min)
- Business Loan $2800 @ 11% ($30 min)
- Home Equity Loan $21000 @ 6% ($100 min)
- Car Loan $2250 @ 5% ($170 min)
- Personal Loan $1600 @ 3% ($100 min)
- Personal Loan $6430 @ 0% ($60 min)

I had $35,196 in debt and my minimum payments totaled $508 per month.

Once you've listed your debts, decide how much you can afford to pay toward them each month in total. This should be at least the total of your minimum payments ($508 in the example above), and preferably more. In my case, I started by allocating $700 every month toward debt reduction.

Now, for all of your debts *except* the debt with the highest interest rate, make minimum payments every month. Use the rest of the money you've allocated for debt reduction to pay down the debt with the highest interest rate.

The computer loan topped my list of debts with an interest rate of 15%. The minimum payments for the other debts combined to $460 per month. Under this plan, I'd then take the remainder of the $700 I'd allocated toward monthly debt reduction and apply it to the computer loan. Instead of making the $48 minimum payment, I'd pay *$240*.

Repeat this process every month until the debt at the top of the list has been eliminated.

Here's where this method gets powerful. With your first debt defeated, you don't use your improved cash flow to buy new things. Instead, you use the extra cash to attack the next debt on your list.

If I start by applying $700 toward debt each month, for example, I continue to apply $700 toward debt each month until all of the debt is gone. After the computer loan is retired, I focus on the business loan. Because the minimum payment on my other debts would be $430, I could funnel $270 to pay off the business debt every month.

When the business debt is gone, I'd then throw $370 per month at the home equity loan, and so on. Ultimately, I'd be left with a single loan: the $6430 personal loan at 0% interest. Every month, I'd apply all $700 to get rid of this debt.

The debt snowball is powerful and effective. Mathematically, it's the best way to get rid of your debt. There's just one problem.

When you attack your debts from highest interest rate to lowest, you'll pay less money in the long run. Unfortunately, many folks – including me – find the going difficult. In my case, I hit a wall when I reached the third debt on the list, my home equity loan. That $21,000 balance was going to take years to repay. I didn't have that kind of patience.

Fortunately, I learned there were other ways to order your debts. You don't have to tackle the high interest rates first.

Building a Better Snowball

Humans are complex psychological creatures. They're not adding machines. Many of us know what we ought to do but find it difficult to actually make the best choices. (If we were adding machines, we wouldn't accumulate consumer debt in the first place!) It's misguided to tell somebody so deep in debt that they must follow the repayment plan that minimizes interest payments. The important thing to do is to set up a system of positive reinforcement.

Because of this, many people prefer slight variations on the debt snowball method. These methods ignore math in favor of psychology.

Financial guru Dave Ramsey has popularized one variation of the debt snowball. Instead of ordering your debts by interest rate, he suggests you attack those with the *lowest balances* first.

Using Ramsey's method, my debts from 2004 would thus be ordered like this:

- Computer Loan: $1116 @ 15% ($48 min)
- Personal Loan $1600 @ 3% ($100 min)
- Car Loan $2250 @ 5% ($170 min)
- Business Loan $2800 @ 11% ($30 min)
- Personal Loan $6430 @ 0% ($60 min)
- Home Equity Loan $21000 @ 6% ($100 min)

As with the standard debt snowball method, I'd make minimum payments on each debt *except* the top one on the list. At it, I'd throw everything else I've allocated for debt reduction each month. When the top debt was eliminated, I'd move on to the one with the next smallest balance.

Ramsey's variation isn't as quick as paying high-interest debt first, and in the long-run, you'll lose slightly more to interest payments. However, there's a psychological advantage to doing things this way.

By attacking your smallest debts first, you get some quick wins, which provide a mental boost. This psychological lift provides extra motivation to keep attacking that debt. Every few months, you get the satisfaction of crossing another debt off the list! Ramsey says this is "behavior modification over math", and he's right. In fact, I opted to use this variation of the debt snowball when I repaid my own $35,000 of debt in 39 months.

Other experts, including my buddy Adam Baker from Man vs. Debt, suggest yet a third alternative they call the debt tsunami. They argue it's best to pay off your debts in order of their emotional impact. Attack your debts from smallest balance to highest, they say, but for added psychological boost, prioritize any debt that particularly bugs you.

"I used to be addicted to gambling," Baker says, "and I had debt that was specifically associated with gambling. To pay that off first changed me as a person. To pay off the $600 I owed on a credit card was great, but it didn't change me. It didn't signify that my life was going to be different and that I was going to live in a different way."

But paying off his gambling debt did mean something to him, so Baker attacked that first.

Here's another example: Many people borrow money from their parents. These loans may carry interest rates of only two or three percent (or maybe they're interest free), but they come with a lot of psychological baggage. This is another instance where it might make sense to pay down low-interest debt first because the non-financial rewards are so great.

The most important thing when paying off your debts is to pay off your debts; the order in which you do so is ultimately irrelevant. Find a system that works for you and develop the discipline to stick with it.

The Bottom Line

As I mentioned at the beginning of this appendix, I've come to believe that debt repayment is a side effect and not a goal. You shouldn't make it your primary purpose.

If you do the other things I recommend, such as creating a personal mission statement and boosting your profit margin, you will naturally pay off debt as a matter of course. And by doing it my way, you'll enjoy a benefit many people don't have once their debts are gone.

You see, a lot of people feel lost once they've dug out of debt. Search online and you'll find *tons* of questions and conversations about what to do next. Debt repayment had given them purpose, and now that purpose is gone. As a result, they lose financial direction. And like a dieter who had aimed for a weight instead of a lifestyle change, an unfortunate few of the newly debt-free find themselves resuming bad habits.

If you're pursuing other goals and intentionally building good habits, you'll get out of debt. And once you get out of debt, the good times will continue. That debt snowball you've been building will transform itself into a *wealth* snowball.

It’s less imperative to repay low-interest debt, especially if you're well on your path to Financial Independence. Businesses use “leverage” to borrow money cheaply so that they can earn higher returns elsewhere. You do the same when taking out a mortgage at low rate (like three percent) or using school loans to improve your education (which will, in theory, provide high future returns).

It’s good to repay all of your debt, of course, but it’s okay to make repaying the mortgage a long-term goal instead of lumping it in with your debt snowball.

ABOUT THE AUTHOR

J.D. Roth is an accidental personal-finance expert, a regular guy who found himself deep in debt. After deciding to turn his life around, he read everything he could about money and finance.

In 2006, he started the award-winning GetRichSlowly.org, which *Money* magazine named the web's most inspiring personal-finance blog. Get Rich Slowly has grown into an active community in which thousands of readers every month share ideas on how to improve their financial lives.

Roth is the author of the book *Your Money: The Missing Manual*, about which *Wired* co-founder Kevin Kelly raved, "This is the best user-guide to personal finance I've found, and I've probably read them all. It is certainly the sanest and most level-headed."

For four years, Roth contributed the "Your Money" column to *Entrepreneur* magazine. He also wrote for Time.com and Money.com. In 2014, he published the "Get Rich Slowly" course, an unconventional guide to money.

Roth now writes about financial freedom at MoneyBoss.com. He's also in the middle of an extended RV trip around the United States. You can reach him at **jdroth@moneyboss.com**.