In Search for Financial Independence: Key Ideas for Wealth Creation

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Abstract

An important skill that isn't taught in most schools is that of financial education. This highly important skill includes personal finance for wealth creation, both which are arguably more important than many of the other subjects that schools offer. This exclusion can be a significant handicap in trying to gain financial independence. This paper will look at how simple advice from well-respected authors and financial experts can help individuals achieve a certain degree of wealth and pave the way to financial independence.

Keywords: financial education, investing, self-interest, motivation

Introduction

We probably all have been reminded to invest in our future. By putting time and effort into an endeavor, we can ensure that a future goal will most likely be achieved. Having a growth mindset allows one to continue to learn and is indispensable for the building blocks needed to reach our goal (Dweck, 2006). The goal can be either personal or professional but it usually benefits us in some way.

One goal that is often overlooked by many, including people in academia, is personal finance for wealth creation. Although higher academia is filled with people who have a PhD or EdD, their personal wealth pales in comparison with Wall Street executives, management, consultants and brokers among others. Granted their focus usually diverges, but that shouldn't mean that being in academia handicaps them in gaining financial independence. Malkiel (Malkiel, 2003) states, "teachers are supposed to be 'dedicated,' or so politicians and administrators often say—especially when trying to justify the low academic pay scales. Academics are supposed to be seekers of knowledge, not of financial

reward." Shouldn't those in academia, who have devoted many years or a lifetime in their fields, be able to build wealth that will ensure them a sense of financial well-being and bright golden years.

How to become financially responsible

Being employed doesn't necessarily guarantee a stellar post-employment future. Unexpected circumstances and decisions can throw a wrench into even the best laid out plans. When it comes to personal finance and building wealth, some individuals might know what to do but few will try to actually do it. The future can always be "put off" to later since the "present self" doesn't accurately project itself to its "future self" (Goldstein, 2011). Take this example:

> The "present self" states, "I will write my research paper by the end of the month." The "future self" says, "I will submit the paper at the end of the month." On the first day, some event comes up so the "present self" says, "I will start it tomorrow." Throughout the month, these sorts of distractions prevent the "present self" from fulfilling the goal of writing the paper. At the end of the month, the "future self" is left with an incomplete writing because of the deferment caused by the "present self."

How can we assure our "present self" will take care of our "future self" in financial planning? Unsurprisingly, there have been many books written on this subject. In this paper, I will delve into five personal finance and wealth building books that can provide a base for achieving wealth that many of us dream of but few actually realize. Let's get started with my original story, The Five Financial Gurus, that illustrates some of the key points:

> Not so long ago on the cold, hard and no free lunch of Wall Street, five financial gurus met for their daily lunch at the library's cafe to discuss investment strategies. At the library's cafe, their discussion focused on investing in the unpredictable stock market which had multiple personalities being a bull or a bear and sometimes a little of both. Coincidentally, they all shared a common ground in that they had written fantastic financial books: George Clason (The Richest Man in

Babylon), David Bach (The Automatic Millionaire), Howard Marks (Mastering the Market Cycle), Seth Klarman (Margin of Safety) and Charles Ellis (Winning the Loser's Game).

Out of nowhere walked an individual investor and asked if he could ask a question to the gurus. The gurus, being helpful of others, agreed but since they were quite busy said that only one question could be asked. The individual investor after thinking about it for a long while said, "What should I do to become wealthy?" The five financial gurus discussed among themselves and finally Clason (Clason, 1955) said "You should pay yourself first every month and save it for your future". The individual investor realized that he had been paying others rather than himself by spending on things that he wanted but didn't really need. He thanked them and delightedly went his way with this cogent advice.

A year later, the same individual investor came across the five financial gurus and said, "I have paid myself first every month and my money has grown but I still am not wealthy. The gurus again discussed together but this time Bach (Bach, 2003) replied, "Put your saved money into something that can compound and outgrow inflation." The individual investor realized that his savings were in a bank and the interest rate there was below the inflation rate so he again thanked them for the sage wisdom and wasn't seen again for a year.

When they next met, the individual investor said, "I have paid myself first every month and put my money into the stock market to try and compound it so that it could outgrow inflation but I still am not wealthy. In fact, I have less money than that I have saved." The gurus were unsurprised and discussed among themselves. Marks (Marks, 2018) then offered this advice, "The stock market has had and will always have cycles so be aggressive or fearful by looking at the tendencies of the market environment." The individual investor now understood why his investment account looked like a zig zagged line causing him to feel either euphoric or depressed. He thanked the gurus and left with this insightful thought in his mind.

Upon meeting the gurus the following year, the individual investor told them, "I have paid myself first every month, put my money into the stock market to compound and beat inflation and paid attention to the cycles when investing but I am still not wealthy. My

money has increased a little but I could use more advice." The gurus seemed genuinely happy and after a lengthy discussion Klarman (Klarman, 1991) said, "If you decide to look for individual companies to invest in be sure that the companies are being offered at a discount and that their business model is secure." The individual investor realized that he had been randomly investing in companies that the cable networks had recommended so he thanked the gurus for this practical advice and went on his way.

In the fifth year of meeting with the gurus, the individual investor acclaimed, "I have paid myself first, put my money to work, paid attention to the cycles and invested in solid discounted companies but I am still far from being wealthy. I've also become a bit worried and anxious." The gurus seemed unfazed and after a brief discussion Ellis (Ellis, 2013) said, "Don't forget about investing risk and investor risk. It is always present and can leave a permanent loss in your investments so be sure that your asset allocation is diversified and matches your risk tolerance." The individual investor had only been investing in the consumer staples stock sector, so he then realized that he should have been diversified among the different sectors and also decided to include some fixed income to reduce his risk. He thanked the gurus and went on his way.

The gurus were surprised when they didn't see the individual investor the next year and the year after that. In time they forgot about him until one day 20 years later, the individual investor reunited with the gurus. The gurus were delighted to finally meet him again and said, "How have you been? Have you achieved the wealth that you so desired?" The individual investor replied, "Yes, I have thanks to all of your prudent advice. I have paid myself first every month, invested my pay into a compounding asset that beats inflation, looked rationally at cycles, researched and invested in profitable and strong companies that were on sale and decided on a diversified asset allocation that matches my risk. The gurus were impressed with his perseverance throughout the years and asked him what advice he would give another individual investor. Without any hesitation he said, "Accumulating wealth takes time. Having long-term investment objectives and sticking with them through the good and bad times allows one to become wealthy."

The gurus respectfully looked at each other and then at him and

THE TIME VALUE OF MONEY—Invest Now Rather Than Later

Age	Billy Investing at Age 15 (10% Annual Return) Invest $3K/yr	Billy Value	Susan Investing at Age 19 (10% Annual Return) Invest $3K/yr	Susan Value	Kim Investing at Age 27 (10% Annual Return) Invest $3K/yr	Kim Value
15	$3K	$3,300.00				
16	$3K	$6,930.00				
17	$3K	$10,923.00				
18	$3K	$15,315.30				
19	$3K	$20,146.83	$3K	$3,300.00		
20		$22,161.51	$3K	$6,930.00		
21		$24,377.66	$3K	$10,923.00		
22		$26,815.43	$3K	$15,315.30		
23		$29,496.97	$3K	$20,146.83		
24		$32,446.67	$3K	$25,461.51		
25		$35,691.34	$3K	$31,307.66		
26		$39,260.47	$3K	$37,738.43		
27		$43,186.52		$41,512.27	$3K	$3,300.00
28		$47,505.17		$45,663.50	$3K	$6,930.00
29		$52,255.69		$50,229.85	$3K	$10,923.00
30		$57,481.26		$55,252.84	$3K	$15,315.30
31		$63,229.38		$60,778.12	$3K	$20,146.83
32		$69,552.32		$66,855.93	$3K	$25,461.51
33		$76,507.55		$73,541.53	$3K	$31,307.66
34		$84,158.31		$80,895.68	$3K	$37,738.43
35		$92,574.14		$88,985.25	$3K	$44,812.27
36		$101,831.55		$97,883.77	$3K	$52,593.50
37		$112,014.71		$107,672.15	$3K	$61,152.85
38		$123,216.18		$118,439.36	$3K	$70,568.14
39		$135,537.80		$130,283.30	$3K	$80,924.95
40		$149,091.58		$143,311.63	$3K	$92,317.45
41		$164,000.74		$157,642.79	$3K	$104,849.19
42		$180,400.81		$173,407.07	$3K	$118,634.11
43		$198,440.89		$190,747.78	$3K	$133,797.52
44		$218,284.98		$209,822.55	$3K	$150,477.27
45		$240,113.48		$230,804.81	$3K	$168,825.00
46		$264,124.82		$253,885.29	$3K	$189,007.50
47		$290,537.31		$279,273.82	$3K	$211,208.25
48		$319,591.04		$307,201.20	$3K	$235,629.07
49		$351,550.14		$337,921.32	$3K	$262,491.98
50		$386,705.16		$371,713.45	$3K	$292,041.18
51		$425,375.67		$408,884.80	$3K	$324,545.30
52		$467,913.24		$449,773.28	$3K	$360,299.83
53		$514,704.56		$494,750.61	$3K	$399,629.81
54		$566,175.02		$544,225.67	$3K	$442,892.79
55		$622,792.52		$598,648.24	$3K	$490,482.07
56		$685,071.77		$658,513.06	$3K	$542,830.27
57		$753,578.95		$724,364.36	$3K	$600,413.30
58		$828,936.84		$796,800.80	$3K	$663,754.63
59		$911,830.53		$876,480.88	$3K	$733,430.10
60		$1,003,013.58		$964,128.97	$3K	$810,073.11
61		$1,103,314.94		$1,060,541.87	$3K	$894,380.42
62		$1,213,646.43		$1,166,596.05	$3K	$987,118.46
63		$1,335,011.08		$1,283,255.66	$3K	$1,089,130.30
64		$1,468,512.18		$1,411,581.22	$3K	$1,201,343.33
65		**$1,615,363.40**		**$1,552,739.35**	**$3K**	**$1,324,777.67**
	Total invested = $15,000 Billy's earnings beyond investment = $1,600,363.40		Total invested = $24,000 Susan's earnings beyond investment = $1,528,739.35		Total invested = $117,000 Kim's earnings beyond investment = $1,207,777.67	

Returns on all investment products will fluctuate. Investment return and principal value will fluctuate and your investment value may be more or less than the original invested amount.

Billy invested $102,000 less than Kim and has $290,585.73 more!
START INVESTING EARLY!

Figure 1. Paying yourself first (Bach, 2003)

they replied, "You have learned much in becoming financially independent! However, keep a growth mindset and always try to learn more." The individual investor thanked the gurus for all the advice and went on to live a financially free life.

The moral of the story is: A cumulative knowledge advantage gained by financial gurus can help individual investors achieve wealth.

This story illustrates just a few challenges that face individuals and how the key ideas collectively provided by financial gurus can contribute in gaining financial independence. The path of life is different for everyone, but the basic ideas highlighted from this simple story can provide the foundation needed to get started in developing a secure and confident future.

The authors of these bestselling books report on research based on certain behaviors of successful investors: "paying yourself first" (e.g., Clason, 1955; Bach, 2003); "beating inflation" (e.g., Bach, 2003, Ellis, 2013); "observing stock market cycles" (e.g., Marks, 2018; Klarman, 1991);

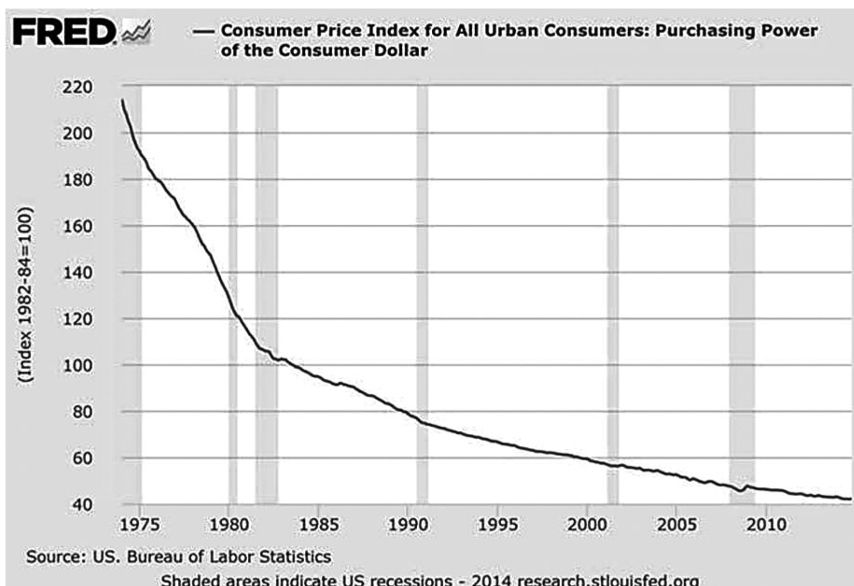

Figure 2. Beating inflation (Liquid Independence, 2020)

"investing in growing but discounted businesses" (e.g., Klarman, 1991, Clason, 1955) or "defining investor risk" (e.g., Marks, 2018, Ellis, 2013). Sometimes charts and data are all that are needed to illustrate a point so let's take a look at some.

The preceding table shows how effective paying yourself first in the early years can be. As Bach (Bach, 2003) states, "Time is your best friend when it comes to investing and can lead to significant differences in how much you end up with. Over time, money compounds. Over a lot of time, money compounds dramatically." Granted the annual returns are a bit high since the average rate of returns from the stock market is closer to 8.5% but the idea still is valid.

Figure 2 depicts how inflation relentlessly destroys purchasing power almost as rapidly as economic gains build wealth. Ellis (Ellis, 2013) wrote, "From 1900 to 2012 the purchasing power of $100.00 shrank to about $3.48 due to the corrosive power of inflation." Inflation is a fiscal pirate that must

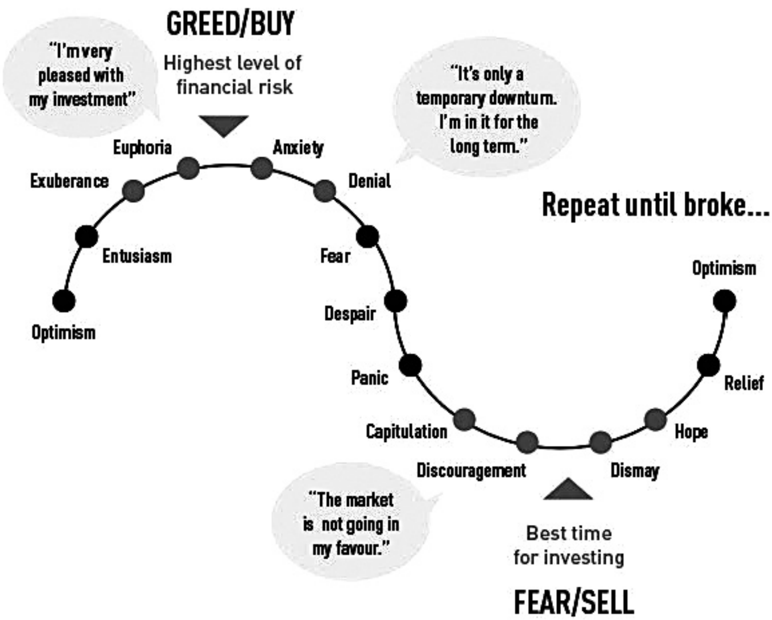

Figure 3. Observing stock market cycles (George Naylor, 2020)

be beaten in order to preserve capital. Hence, leaving your savings in a bank will be fiscally irresponsible even if you have to take on some risk.

Figure 3 shows a typical market cycle. Marks (Marks, 2018) remarks, " Cycles vary in terms of reasons and details, and timing and extent, but the ups and downs (and the reasons for them) will occur forever, producing changes in the investment environment." As can be gleaned from the market cycle, the time to buy is when there is fear in the market and everyone's feeling is at their lowest. An inverse relationship exists in the buying and selling of securities though most real investors hold through the good and bad times for long-term gains.

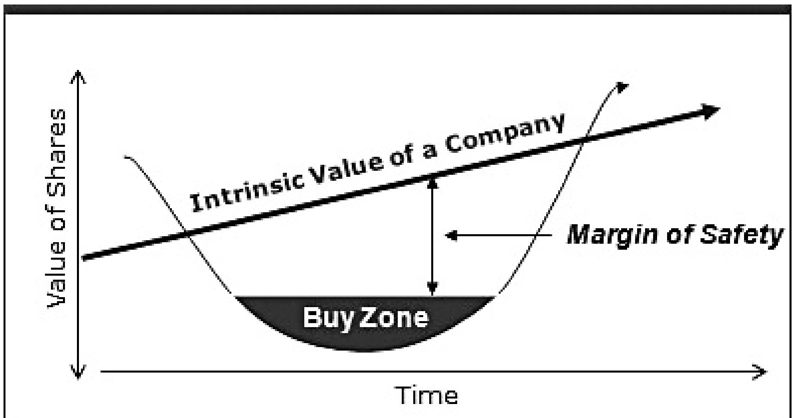

Figure 4. Investing in growing but discounted businesses (David Pinsen, 2020)

The preceding chart shows how investing in a discounted business can provide a margin of safety. "A margin of safety is achieved when securities are purchased at prices sufficiently below underlying value to allow for human error, bad luck, or extreme volatility in a complex, unpredictable, and rapidly changing world. The cheapest security in an overvalued market may still be overvalued," states Klarman (Klarman, 1991). Of note, the intrinsic value of the business is growing with time which usually means that the business model is healthy.

Figure 5 illustrates risk when investing. Investing whether it be in stocks, real estate or foreign exchange involves risk. Clason's (Clason, 1955) warning is that "The penalty of risk is probable loss." Risk cannot usually be avoided but investors should remain prudent in exposing themselves to

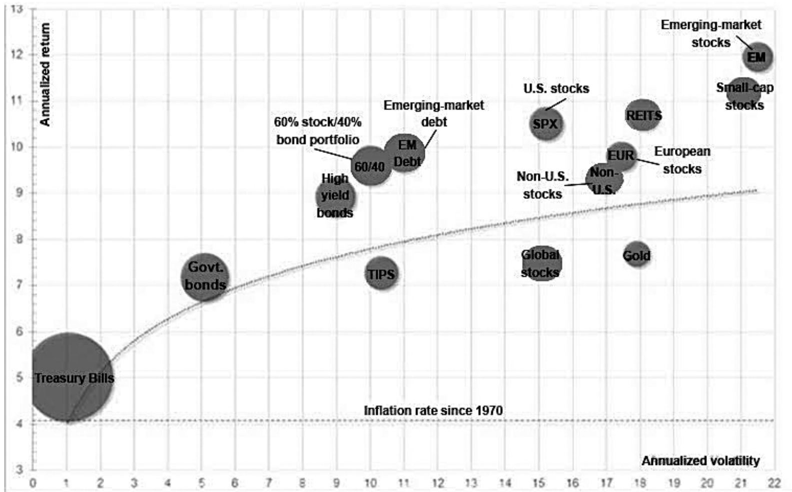

Figure 5. Defining investor risks (Tim Ranzetta, 2020)

risk. Controlling risk can be done by establishing long-term goals and setting up an asset allocation that suits your risk tolerance. Even if you decide not to invest in some chancier asset class and instead keep your savings in a bank, the risk you face will be the loss to inflation.

Conclusion

Warren Buffett, a well-respected and admired fund manager of Berkshire Hathaway who has achieved fantastic returns for his company and shareholders, once said, “Someone’s sitting in the shade today because someone planted a tree a long time ago.” As most education programs, do not include financial education in their curriculum, it is important that each individual make an attempt to learn about it. Not following through with financial planning can change your post-employment years from Golden to Bronze or worse. This stark vision would disappoint your “future self” so demand that your “present self” start the planning and preparations necessary for a brighter future and not wait until tomorrow.

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