The 11 Secrets Every Wealth Builder Must Know

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Introduction

This e-book is not something you can glance at, put on the shelf, and "get to later." The ideas and advice contained in this book are essential reading. And I mean for right now.

You must read this e-book from cover to cover. And if you have time, read it twice. I wouldn't have spent the time I did to write this, nor would my colleagues have spent the time editing and publishing it if we thought it was expendable. It is essential.

This book contains the core of my entire wealth-building philosophy. It also incorporates some of the smartest investing ideas Tom Dyson has ever told me. None of these are stock tips or little tricks. They are fundamental secrets and strategies that have worked over and over again for me.

Some of the ideas may seem familiar to you. That's because I write about them all the time. When you first subscribed to *The Palm Beach Letter*, you may have read some of the exact same essays. I've certainly written about the same ideas in my *Creating Wealth* essays.

But don't make the mistake of skimming through this e-book. Most of these are secrets I learned incrementally over 30 years. They mean much more to me now than they did when I first encountered them. The more you know, the more powerful these will be.

If creating substantial wealth in fewer than seven years could be done easily, I'd give you the easy way. The good news—and I think you can see this already—is that we are going to be with you every step of the way.

So you won't be alone. We will be here to guide and motivate you. Our job is to make you ever wealthier as long as you are a member.

Achieving financial independence is a great personal accomplishment. Very few people do it. We will get you there, and when you arrive, you should and will be proud of yourself. And we will be proud too.

To your continued success,

Mark

Chapter One:

The Secret of the Golden Buckets

Imagine a well with three golden buckets in front of it. One is labeled "spending"… the second is labeled "savings"… and the third is labeled "investing."

There's a sign on the well that challenges you to try your hand at a game. To win, you have to fill all three buckets to the brim.

It seems to be an easy challenge, but there are two problems:

The well will give you only so much water within a given time period.

If you look closely at the golden bucket marked "spending," you notice there is a sizable hole in it.

I'm using metaphors here, of course. The well represents your yearly income. The spending bucket, with the hole in it, represents the money you must spend to enjoy the quality of life you want. The savings bucket represents money you absolutely can't afford to lose. And the investing bucket represents your future wealth... what you will retire on.

If you manage to fill all three buckets, you win—you're rich!

So can this game be won? It can, if you play it smart. And you can win it relatively quickly if you use my system.

Simplicity Trumps Sophistication

The money-management system that I've used to generate more than $50 million in wealth is quite simple—very different from the complicated systems I was enamored with 30 years ago, when I was just beginning to learn about money. Those systems felt exotic, secret, exciting…

But as the years passed, I found they did not work as advertised. Eventually, I realized that sophisticated financial programs are like complicated toys. They look fantastic on the shelf—but when you go to use them, they eventually break... and when they break, you can't fix them.

As simple as it is, the system I'm going to introduce you to today will provide for all your financial needs. It will allow you to live well now... and live well in retirement.

As a *Palm Beach Letter* subscriber, you know our first rule for building wealth is "**Never, ever lose money.**" The primary characteristic of this plan is safety.

Our second rule for building wealth is "**Grow at least a little bit richer every day.**" And the second (and equally important) characteristic of this plan is its dependability. It will give you a regularly escalating net worth without significant setbacks.

I call my system "The Secret of the Golden Buckets."

The Golden Bucket of Spending

I grew up relatively poor, the second of eight children. My father earned

$12,000 per year as a college professor. As a teenager, I was ashamed of our small house, my hand-me-down clothes, and my peanut butter and jelly sandwiches.

I dreamed, literally dreamed, of living like a rich man. And so, when I got my first job at age nine as a paperboy and then at 12 as a lackey at the local carwash, I would spend my money on luxuries—a pair of brand-new Thom McAn shoes.

I worked every chance I got through high school, and then worked two or three jobs during college and graduate school. I spent 80% of my money on necessities: food, clothes, and tuition. But I always spent a bit on little niceties. Even back then, I had the notion that I didn't need to deprive myself now for some better life later.

I tell you this to emphasize a key part of my system. I don't believe in scrimping severely to optimize savings. I believe you can live a rich life while you grow rich, as long as you are willing to work hard and you are smart about your spending.

Think of the typical earning/spending/saving pattern of most wealth seekers…

During their 20s, they spend every nickel of their modest income to make ends meet. At that age, it is nearly impossible to put aside money for the future.

During their 30s, their income increases. But this is also when they start a family. Expenses soar. There are more mouths to feed, a "family" car to buy, and the dreaded down payment on a first house. They manage to save a little during these years, but not nearly as much as they thought they would.

If they work hard and make good career decisions, their income climbs much higher in their 40s and early 50s. They have more money to put aside for the future, but they are also tempted into buying newer cars, nicer clothes, more exotic vacations, and that dream house—the biggest wealth stealer of them all.

In their later 50s and 60s, their income plateaus or even dips… and they may have to start shelling out for college tuition. Then, aware that their retirement funds are being depleted rather than enhanced, they invest aggressively to try to make up the difference.

Finally, sometime in their mid to late 60s, they realize that they don't have enough money to retire. They have spent almost 40 years working hard and chasing wealth, but they never managed to attain it.

It's sad, but it's the reality for most people. And it is just as true for high- income earners (doctors, lawyers, engineers, etc.) as it is for working-class folks.

There are two lessons to be drawn from this: First, it is very difficult to acquire wealth if you increase your spending every time your income goes up.

Second, setting unrealistic investing goals means taking greater risks. And taking more risks, contrary to what many pundits say, will almost always make you poorer... not richer.

The truth is there is only a marginal relationship between how much you spend on housing, transportation, vacations, and toys and the enjoyment you can derive from them.

My golden bucket spending strategy is simply this: Discover your own, less expensive way to live a rich life. By a "rich life," I mean a life free from financial stress, but also filled with things that give you pleasure.

Your family can be just as happy in a house that costs $100,000 or $200,000 as one that costs $10 or $20 million. Likewise, a $25,000 car will get you where you want to go just as well as a car that costs 10 times that amount.

In fact, there are dozens of ways to live like a millionaire on a modest budget. If you learn those ways, you will have a tremendous advantage over everyone else at your income level. (In the Wealth Builders Club, I give lots of ideas for "living rich" without spending more. But for the moment, I am just going to assume that you agree this makes sense.)

Make smart spending decisions. Remember, the spending bucket has a hole in it. As you make more money, you might feel tempted to spend more of it. But if you're spending more of this money, that's the same thing as ripping a much bigger hole in your bucket.

All that extra money you're making is leaking out of the bucket at a faster rate. And that means you're not filling your savings or investing bucket any faster.

So stop thinking that because you're earning more money you should be spending more. **Your future wealth is determined by how much you save and invest**, not by how much you spend.

Here's what I'd like you to do: Figure out how much you need to spend every year to live your own personal version of a "rich" life. It might help to spend a few minutes thinking about all the things you truly enjoyed last year. If you are like me, you'll find that almost all of the things you enjoy require very little in the way of money. (Those are the true luxuries.)

Keep the biggest wealth-stealing expenses—such as your house, your cars, and entertainment—to a necessary minimum. And eschew any expenditure that has a brand name attached to it. Brand names are parasites that gobble up wealth.

What you are doing is determining the size of the hole in your spending bucket. It should be smaller than the hole you had last year, but big enough to contain inexpensive luxuries that will make your life truly rich.

Don't nod your head and promise to get to it sometime in the future. Do it today. Estimate, as well as you can, what you need to spend each year to have the life you want. I call this your LBR (lifestyle burn rate)—and I'll be talking more about it in an upcoming essay. This is a number that you must have firmly in your mind, if you intend to be a serious wealth builder.

The Golden Bucket of Savings

Once you have dealt with your spending bucket, you can start to figure out how much you can put in your saving and investment buckets.

You may be wondering what the difference is between saving and investing. To most people, they are the same. But I like to distinguish between them because it will help you acquire wealth safely.

Saving and investing are the same in the sense that you are setting aside some portion of your current earnings for the future. The difference is the purpose of saving is to *safeguard* that set-aside money, whereas the purpose of investing is to *grow* it.

The money in the savings bucket should comprise two things, really. The first is anything you are saving for that you will be paying for in less than seven years (more on that in a minute). Any type of big-ticket item.

That could be short-term things such as saving for a new car, upcoming vacation, or home renovation project.

Saving should also include long-term expenses such as a down payment on a house.

The second part of your savings bucket is what I refer to as your SOA (start- over-again) fund—the money you put aside in case of a financial disaster.

To start, your SOA fund should have a minimum of three months' living expenses. That would cover a couple of big, unexpected bills. Maybe a blown transmission. Or some expensive dental work from your kid chewing on too much candy.

But what if you have a bigger financial disaster?

What if, for example, you woke up one day to find the company that has employed you for the last 20 years has shut its doors, and the pension plan it was holding for you is suddenly worthless?

You would have to start over, right? You'd need money to pay for your expenses while finding a new job and you'd need money to start investing again. In a case like this, you might want a larger SOA fund. Maybe one year of living expenses.

How much you put in your SOA fund is a personal preference. At a minimum, set aside three months of expenses. If you can afford to, set aside more.

But where should you put your savings bucket money? This money has to be absolutely safe.

For example, you know you're going to need to replace your roof in two years. That money better be there when you need it. In other words: Don't invest that money in penny stocks or the latest tech stocks.

Or let me put it to you this way…

Imagine how you would feel if you called up your broker to let him know that you needed to cash in your start-over-again fund and he told you its value had suddenly crashed and was now worth 40 cents on the dollar?

Well, that's exactly what happened to millions of baby boomers during the financial crisis in 2008 and 2009. The reason it happened is because these people did not distinguish between saving and investing. They had their wealth—including their savings—in investments that were advertised as safe but were actually quite risky.

You don't want to take any risk with your start-over-again money. Or money saved for upcoming big-ticket purchases within seven years. The primary purpose of that money is to preserve, not increase, the capital you set aside. Putting it at risk, even average market risk, is too dangerous.

Debt Obligations

You need to be equally as careful with the money you set aside to repay debt. Because when the bill comes due, you must pay it. Keep that money safe. In other words, put your debt obligations in your savings bucket, never into the market, even if the market looks safe.

Why seven years?

It's somewhat arbitrary, but it is considered by some to be an average business cycle. The idea is this: You can put money away for retirement and your kids' college into investment vehicles, but when they get close—seven years or closer—move them into safer instruments so that you can be extra sure you will have enough.

If, say, your retirement is still 20 or 30 years away, you can afford to invest money set aside for that purpose in vehicles that are safe, but not super-safe. However, if you will be retiring in less than seven years, you can't take the chance of seeing your retirement fund drop by 20-30%, because you won't have time to let the market correct itself.

So if you plan to retire in five years and will be drawing on your retirement savings, you want to transfer at least five years' worth of your retirement fund from your investing bucket to your savings bucket. This ensures that you will be able to pay for the retirement life you want—you can't afford to have that money at risk.

To plan for this you will have to assume that the interest you'll be getting for those seven years will be small, because you'll be using the only the safest vehicles. So that means you will have to put more money into them than you would otherwise. This will take more work but it will provide more safety.

Are you with me?

For your savings bucket, your money should only be in super-safe investments—investments that are highly unlikely to go down in value in the next 10 years. These include bank savings accounts, money market accounts, CDs, and safe bonds with short-term durations.

I will write about what vehicles work best for your savings bucket in future issues of *Creating Wealth*. For now, it is enough for you to understand the distinction between saving and investing… and segregate your set-aside money accordingly.

The Golden Bucket of Investing

As I said, the purpose of your investing bucket is to grow your wealth. This is the bucket you will use to fund all future, long-term expenditures. By "long- term," I mean more than seven years.

If you are young, you may use this bucket to put aside money for your children's college expenses. But for the most part, the money in this bucket will be for your retirement. And when you look at investment returns from a long-range perspective like that, even a few percentage points can make a huge difference.

I won't spend any time here talking about how you should manage your investing, because Tom and his team do that in *The Palm Beach Letter*. But I will say this: The kind of stocks they recommend are the only kind that appeal to me. Every other stock investing strategy I've encountered (and I've been in the financial publishing business for more than 30 years) makes me uncomfortable.

The recommendations that you get every month from Tom and his team in *The Palm Beach Letter* are designed to give you an average, long-term return of 10-15%.

This might seem paltry to people who dream of doubling and tripling their money in the market every year, but those kinds of investors almost always end up broke. And making 10-15% on your money over the long term will give you terrific results.

I hope you can see that the investing bucket is the most important bucket of the three. It's what can give you the retirement lifestyle you so desperately want.

But—and this is a very big but—you won't get wealthy unless you invest enough money.

In other words, investing alone can't make you rich. So if you can afford to invest only a few thousand dollars per year, you will not get rich, even if you make 15% per year for 40 years.

To fill your investing bucket, you need to invest more than that—and if you can't invest more than that right now, you need to generate more income so you can.

That brings us back to the metaphorical well that represents your yearly income—the well you're going to use to fill all three of your buckets.

Your Golden Well

If your income isn't sufficient to fill all three buckets, you have only two options: You must increase the flow from the well you have, and/or you must dig some new wells.

You can increase the income from your primary well—your job—by becoming a more valuable employee. I have written on this subject in several of the books I published under the pen name Michael Masterson. The one I recommend is *Automatic Wealth for Grads... and Anyone Else Just Starting Out*.

If you can become a more valuable employee, you should. But you may also want to create other streams of income.

One possibility would be to invest in rental real estate. If you decide to do that, it will become—after you have paid down the mortgages—its own well, pumping liquid gold to you every year thereafter.

Another option would be to start a side business and let your spouse or a relative run it. If you are interested in doing that, I recommend *Ready, Fire, Aim*, another book I wrote as Michael Masterson.

Our *Current Income* system could also be another well for you in the future.

Here's the point: If the income you are earning is insufficient to achieve your wealth-building goals, you should NOT try to get there by taking on more risk with your stocks.

Instead, work hard to create more income.

The Only Strategy You Need

This simple system for managing money and building wealth can work for you if you commit yourself to it. As I said, it's the system I used to build a net worth of more than $50 million—and it's still working for me and everyone else I know who has tried it.

So today, spend the time it takes to establish your own approach to "living rich" now... and in the future. Make the hole in your spending bucket big enough to allow you to enjoy your life now, but small enough to enable you to fill up your saving and investing buckets quickly.

You don't need to try any other wealth-building strategy. This one is infallible. The day you have your saving and investing buckets filled... you will have no reason to worry about money ever again.

You already know that it will work. You know it will work because it is so simple. It is based on our two fundamental rules for building wealth: Never, ever lose money... and become richer every day.

If you are over 40, you have no doubt experienced how wrong 99% of the investment schemes out there are. You tried them and discovered they made you poorer, not richer. You are ready for something simple and true, a strategy you know will work.

When Tom and I started *The Palm Beach Letter*, we made a solemn promise. We vowed to tell the truth about building wealth, rather than exciting our readers with the myths and lies that dominate the investment media.

We are proud of what we are doing and confident that it will help you become wealthier. Our goal is not—and never will be—to make you a "clever" investor. We simply want to teach you how to become wealthy. If that's what you want, you are in good company.

Chapter Two:

How a $10 Bill Made Me Richer Than All My Friends

Of the hundreds of wealth-building strategies I have tried over the years, the very best one was also the simplest…

Do everything you can to become a little bit richer every day.

This thought popped into my head almost 30 years ago, about a year after I "decided" to become rich. I was reading and thinking about wealth day and night, bathing my brain in the elixir of clever ideas. It was very stimulating. I had daily fantasies of getting rich in all sorts of fancy ways.

But deep down inside, I knew that these complicated strategies were not for me.

There were two reasons why I was doubtful.

The first was based on observation. I had an inside view of the financial services industry as an editor of about 30 business and investment publications. The fancy ideas, however compelling in print, never seemed to work out in reality.

The second was based on personal experience. I had already discovered that what had made me successful as a student, and as an employee, was extremely simple: I worked harder than my peers.

"Forget all the complicated strategies," I thought to myself. "What if there was a simple formula for getting rich?"

Several weeks later, the idea came to me…

What if I could get just a little bit richer every day?

How I Started Getting Richer

At the time, I had a net worth of zero. And, my annual salary was only $36,000 per year. With three small children and my wife in college, our expenses were gobbling up every nickel of my after-tax income. And so my first wealth-building goal was small: I would get richer by saving just $10 per day.

I knew that I would eventually raise the ante, but I wondered, "How much money would I acquire in, say, 40 years just by saving an extra $10 every day in an account earning 5% per year?" Ten dollars a day equates to $3,650 per year.

I did the numbers and was happy with the answer: almost half-a-million dollars.

Then I wondered, "What would happen if I put away $15 per day or $5,475 per year?" That came to $694,448.

Excited, I took it a step further. "What would my account grow to at 8%?" My final account balance totaled $1,531,801!

By putting away a measly $15 per day, I was guaranteed to become a millionaire! No sophisticated strategies I could barely understand. No risky investments that could backfire and devastate my net worth. Just the simple arithmetic of adding $15 per day to my stockpile of wealth.

I was excited. I was motivated. I was greedy.

This got me going. For the first time in my life, I was committed to saving. I began to measure my financial success not by my toys (house, car, clothes, etc.), but by my net worth.

I began to recalculate my net worth every month.

Of course, when you are earning only $36,000 and putting away $10 per day, your net worth is not going to jump up dramatically every 30 days. So every month, I had mixed emotions when I did my calculation. I was richer, but my wealth was accumulating too slowly…

The Shortcut to Supercharging Your Wealth

My simple plan was working: get richer every day. But I wanted to ratchet up that "get richer" part. There were only two ways to do that:

- Get a higher rate of return on my savings
- Earn more money.

I decided to do both.

I realized that the easiest way to earn more money was to get a raise. And the easiest way to get a raise was to become my boss's No.1 guy. Before then, my goal was to be a great editor. Now I knew I had to become a profit-making machine. I changed the way I worked immediately, and my boss noticed it.

Within six months he doubled my salary.

After taxes, that extra $36,000 came to about $2,000 per month. I was tempted to buy all sorts of toys with that. But, motivated by my "get richer every day" idea, I spent only 20% of that, or $400 per month, on fun stuff.

That meant my daily saving goal jumped from $10 to just over $50 ($1,600 divided by 30 days).

The second part of my plan was to increase the rate of return I was getting on that saved money. I knew enough about the stock market to realize I couldn't expect to earn more than 10% from stocks.

[For example, while the stock returned an average of 11.31% from 1928 through 2010, it returned an average of 3.54% from 2001 to 2010.]

So I saved that extra $1,600 per month in a bank account with the goal of using it to launch a business. I believed the returns I would get from starting a business would be superior to those I could generate from the stock market.

Six months later, I went to my boss with $9,600 and a business plan. It was actually much more than a plan. It was a product and a promotion, in rough- draft form. I told him I wanted to be his partner. He could have thrown me out of the office, but he didn't.

He agreed to take my idea and my money for 90% of the business. Meaning he gave me a 10% stake in this business.

I was smart enough to know that he was being generous.

I was lucky with that first effort. Within six months, that $9,600 investment had given me a return of more than 500%.

I was on my way.

But it all began with this very simple strategy: Get richer every day.

How My Simple Strategy Has Changed Me

I've learned a lot about business and investing since then, but I've never abandoned that simple strategy. I continue to check my net worth every month to make sure it is getting larger.

Nowadays, when I'm presented with a business or investing opportunity, I ask myself, "If this goes wrong, how will my bottom line look next month?"

Since I made this resolution in the early 1980s, I have never experienced a single day of being poorer than I was the day before.

Think about that.

I know people who have been rich and then poor and then rich again. I read stories about billionaires whose wealth fluctuates according to the price of their stock. I couldn't bear to live that way. I need the security of getting richer every day.

I don't feel greedy anymore. I don't need to get a lot richer every day. Ten dollars per day is enough, again.

I can sleep at night.

This simple strategy has had the most profound effect on me. It changed the way I thought about everything related to wealth building. It made me a harder and better worker. It made me a shrewder and more cautious investor.

It can do the same thing for you.

I invested my saved money in businesses. You might not be at that point yet. But it doesn't matter. You don't have to be able to start a business. The point is to find some way to increase the return on your saved money. For me, I did that through the huge return I enjoyed on the business I started. For you it could be finding an alternative, safe investment with higher returns. Our Performance and Legacy portfolios are two such high-return investment vehicles.

In any case, I believe that if you let this little idea of "getting richer every day" sink into your psyche, it will have the same effect on you.

It will make you less tolerant of risk. It will make it easier for you to understand the benefits and drawbacks of every type of investing. And it will turn you into an income addict, which is, in my book, an essential component of thinking rich.

How You Can Begin Right This Second

For today, I want to leave you thinking about this strategy for growing wealthier. I want you to consider making a commitment to setting aside a fixed amount of money each day.

You can begin, as I did, with a goal of $10 per day. Once that becomes easier, you will find that you want to raise the ante. You could hike it to $15 as I did my first year and then $50. But soon thereafter your addiction to savings will make it possible for you to raise your target much higher than that.

I have explained this strategy to many people over the years. And I don't think a single one ever took it seriously. Perhaps it didn't seem clever enough for them. Or perhaps they felt they were already doing well by following the investment schemes they were using at the time.

But none of them ever acquired the wealth I did. They sometimes had great individual hits that they'd tell me about—or even streaks of winners when the markets were favorable. But as time passed, Mr. Market always had his way with them.

In the race for wealth, I've always been a tortoise. But by following this simple rule of getting richer every day, I was able to do better than I ever expected without a single day of feeling poorer than I was the day before.

I want you to be in this position too. Get a bit richer by saving something, anything, and start today.

Chapter Three:

Breaking the Chains of Financial Slavery

Not long after we launched *The Palm Beach Letter*, I received an email from Jorge Izquierdo Jr., a subscriber who complained that "all the material being covered [in *The Palm Beach Letter*] is for long-term investing. What about short-term? I've been trying to free my family and myself from the chains of slavery for far too long now. Show me the truth."

I had three distinctly different thoughts when I read that.

The first was "Jorge, your desire for short-term success is a terrible impulse. It may be the reason you are in trouble now."

My next thought was "I bet a lot of *PBL* readers have different ideas about what 'long term' and 'short term' really mean."

Then I thought, "This guy is in trouble. He needs help, and he is a subscriber. I shouldn't criticize him. I should help him."

For better or worse, those were my thoughts.

Jorge's comments reveal a big reason why so many perfectly smart and hard- working people never break free from the "chains of financial slavery."

In today's essay, I want to address that.

Let's begin with a definition. What do I mean by "long-term" investing? I mean seven years.

I believe it is possible for anyone to get out of debt and acquire financial independence in seven years or fewer. I have been making that case since I started writing about wealth accumulation more than 13 years ago.

If you read the books *Automatic Wealth*, *Ready, Fire, Aim*, or—most appropriately—*Seven Years to Seven Figures*, you will see that my long-term framework has always been seven years.

It's not a magic number. It's a number that—based on my own experience of helping others acquire wealth—I feel confident is sufficient. Even if you are in debt.

The next thing I want to say on this subject is that going for short-term wealth is almost always a bad idea. If you are in business, you should go for short- term cash flow, and you should expect to make a profit in year two, but acquiring wealth—real wealth—almost always takes longer than one or two years.

When you are down and out, seven years seem like a terribly long time. But time passes regardless of how you feel about it or what decisions you make. If you spend your time and intelligence trying to get rich quick, you will almost certainly NOT be rich at the end of seven years. But if you are more realistic about it, you can accomplish all you need in that stretch of time.

And here is the *glicken*: If you follow the program I recommend, you will start feeling better about your situation in a matter of weeks. My idea is to get wealthier every single day. That means every single week and every single month and every single year.

If you accomplish that, you will feel better about everything almost immediately, and you will maintain your enthusiasm. You won't be making foolish decisions that set you back. This is the most important factor in creating significant wealth. You need to feel good about what you are doing. And that means you must be continuously moving in the right direction.

If you are in Jorge's situation, don't despair. Hope is not lost. You can turn your life around. You can eliminate your debt. You can acquire wealth. You have all the resources you need to accomplish that turnaround.

Here is what you must do:

First, you must read this essay about how investing in stocks and only stocks cannot make you rich. You must give up the idea that if you just buy the right stock everything will be okay.

Likewise, you must give up the idea that you can become financially independent in a year or two. You must accept the seven-year time frame.

Third, you must be open to expanding your efforts to build wealth. You must be willing to try the five wealth-building strategies I've outlined here.

If you can't honestly do those three things, you might as well cancel your subscription now and go buy yourself another investment newsletter that will tell you what you want to hear.

But you already know, deep down inside, that you don't want to do that. You already know that the desire to get rich quick is foolish. You've tried a few schemes and have lost money on them already. You know I'm telling you the truth. Just accept it.

If you are mentally ready to accept all that, the next thing I'd like you to do is think about what "financial slavery" means.

Here's my definition:

- You earn less than you spend.
- You owe more than you own.

If you earn less than you spend, you are in a constant state of stress. You must put off or partially pay your bills. You must appease creditors. And all the while, your debt is mounting.

If you owe more than you own, you can't buy a house, lease a car, or get a loan from anyone other than your parents. (And what if they are dead or tired of helping you… or don't have the money?)

Because you are in so much financial trouble, you can't even think about taking nice vacations or retiring someday. Instead, you have to worry about losing your job. So you keep working and reading investment newsletters. But as each month passes, your financial situation gets worse.

It's a miserable existence. But it doesn't have to last. You can break the chains and be free of them by reversing the two "facts" mentioned above.

Problem #1: You earn less than you spend.
Solution: Spend less and earn more.

Spend Less. A Lot Less

You can't break the chains of slavery with a nail file. You must smash them to smithereens with a big steel mallet.

What do I mean by that?

Most of the financial gurus who focus on "un-wealthy" people recommend cutting expenses in small ways. Spending less on cable TV. Buying less- expensive coffee.

When I read their advice, I get apoplectic. They must know this kind of "budgeting" won't do any good. Why do they keep on with it?

The only answer I can imagine is this: It is politically correct. They will never be criticized by telling people to be more frugal by small degrees. They will be praised by the liberal press. Their books will sell hundreds of thousands of copies.

But their advice is bullshit. The truth is that you will never be able to become financially independent by cutting $10 here and $50 there.

You need a big, big mallet. My recommendation is to cut your expenses by 30- 50%.

I know that sounds crazy. And it may even be impossible, in some cases. But for millions of middle-class Americans, not only is it possible, it is the only option.

Don't dismiss this idea until you hear me out.

The primary factor in how much you spend every month is the neighborhood you live in.

Huh? What is Mark talking about?

Listen, I've been thinking about this for a long time. And although I've never heard anyone else say this, I'm very confident this is true. Your neighborhood creates the financial culture that presents the spending choices you make.

Let me give you a few examples. If you live in a community of million-dollar homes, there is a 90% probability that you drive a $60,000 car, take European vacations, send your kids to expensive schools, and spend $200 every time you go out to dinner.

If you live in a community of $350,000 houses, there is a 90% probability that you drive a $35,000 car, stay at $250-per-night hotels, spend $600 for a new sofa, and spend $100 every time you go out to dinner.

And even if you live in a neighborhood of $180,000 homes, you still have a lifestyle that costs you more than you need to spend.

How much you spend on transportation, education, entertainment, and everything else depends very heavily on the neighborhood you live in.

So if you want to really cut your expenses, you have to downgrade your neighborhood.

Stay with me. I know you don't like this.

I have friends and family members who, while not absolutely broke, live in financial stress because they refuse to downgrade.

They live in $350,000 homes in beautiful neighborhoods and have new cars, but the cost of all these "necessities" is keeping them in debt. Most of them, in fact, are getting poorer every month.

Yet when I suggest they downsize, they look at me like I'm crazy. No, it's worse than that. They look at me like they believe I want them to suffer. They don't stop to realize they are suffering already. My advice is the only thing that will take that suffering away.

Holding on to a lifestyle you can't afford will make you poorer—every month. And it will make you more fatigued and more angry. And it will goad you into making bad financial decisions, such as investing in schemes that promise to solve all your problems in "the short term."

Moving to a less expensive neighborhood is the quickest, biggest, and surest way to bring your spending down by 30-50%. It is the big steel mallet. Pick it up. Feel the weight. You know it is the only thing that will break those chains!

Earn More

The second big thing you must do is to earn more money than you are earning now.

Again, I am sure you don't like hearing this. I'm sure you are thinking, "Easy for you to say. I work my butt off as it is. I have responsibilities. I don't have an ounce of energy or an hour of extra time to devote to increasing my income."

You may be thinking that, but if you are, hear this: You are wrong.

You can always earn extra money. I won't prove this point to you now. I will do that in future essays. I will simply state here that I know from my own experience and from working with dozens of people that anyone can increase the income they are earning.

Your goal should be to increase your income by 20-50%. Yes, that is radical. None of the self-help gurus on the best-selling lists would even suggest such a thing. But I'm telling you: This is a must. It is just as important as radically cutting expenses.

There are dozens of ways to increase your income. I will talk about none of them here. Expect to see plenty of ideas in the future.

Problem #2: You owe more than you own.
Solution: Start owing less and owning more.

Owe Less

If you have accumulated a lot of debt, it means that you don't see debt as financially dangerous. You have made decisions that put you into debt.

Decisions you didn't have to make.

Again, you may want to argue with me on this point. Don't waste your time. This is not about my financial situation. It is about yours.

You must accept the fact that most debt is bad for you. You must develop a loathing for debt.

There are a few exceptions: mortgage debt (when interest rates are low) and business debt (when the business is sound and you are not personally liable). But I don't want to talk about these now, because these are not the sorts of debts that have debilitated you.

The reason you are in debt is because you did something you should not have done if you had the proper hatred for debt. Did you refinance your home when its value soared eight or 10 years ago? Did you buy cars and TVs and appliances on credit? Did you leverage your investments?

After accepting the danger of debt, the next step toward fixing your financial situation is to get rid of every credit card you have, as well as any credit you have with your bankers. Use cash or debit cards for your shopping.

Yes, that means there will be lots of things you can't buy every month. That's a good thing, not a bad thing.

If you have a lot of existing credit card debt, you need to consolidate it. Then work with a professional to pay it off at reasonable interest rates.

And here is the big one: If you are lucky enough to have equity in your home or in your cars or in any other non-appreciating assets, you should sell them and buy something cheaper.

If you have $130,000 in a $350,000 house, you should sell it and buy a house for $150,000. Take the $50,000 in cash you get back (after putting aside $70,000 for the down payment) and invest it in an *appreciating* asset.

Own More

The next important thing you must do is increase what you own.

By that, I do NOT mean buying more cars or boats or furniture. I mean buying assets that are likely to appreciate. You should also put at least 80% of the extra income (see above) you earn into such assets.

Appreciating assets include quality stocks and bonds but also real estate and entrepreneurial businesses.

I will have lots to say about these "outside Wall Street" asset classes in the future. (Just know now that these are going to be an important part of your recovery and wealth-building plans.)

Being financially independent is not about having a big house or driving new cars or taking fancy vacations. There are millions of people who have expensive houses and cars but who are financial slaves. You don't want to be like them. You don't want the stress. You don't want the turmoil. Being financially independent means having more income than you need and owing far less than you own.

Being financially independent means knowing that you won't be harassed by bill collectors or embarrassed at the supermarket. It means you have money put aside to take care of any emergencies that come up, and it means a savings account that gets substantially bigger every year.

As I said earlier (and will explain in detail later), becoming wealthy will take you as many as seven years. But you can break the financial chains that bind you almost immediately if you follow the very simple guidelines I've just given you.

The hardest part is recognizing the chains that are binding you—earning less than you spend and owing more than you own—and deciding to do something serious about them.

This is my plan for Jorge, and it is my plan for any *PBL* subscriber in his situation. It is a realistic plan. It is a plan that will work for you. It is, in fact, the only plan that will work. It is up to you whether you follow it or send me an email explaining why you can't.

Chapter Four:

My Message to a 47-Year-Old With No Money

A reader wrote recently to say that although he's "learned a lot from *PBL*," he feels that most of the advice is not for him. Why? Because he is 47 and has a net worth of only $25,000.

He is not interested in long-term saving strategies. "I don't want $1 million when I'm 70," he says. "I want it now."

Plus, he believes that many of the wealth-building strategies we recommend are for only the rich, not for people like him.

> "What's the average person to do?" he asks. "He makes $27 per hour with no chance for overtime. He has debts. He needs a new car. He can't invest in real estate like Mark. He can't open six businesses in Nicaragua like Mark. And he doesn't write a newsletter with 100,000 subscribers that earns millions every year."

Since we started publishing *The Palm Beach Letter*, we've gotten a number of letters like this. This tells me two things: We are hitting a nerve by telling the truth, and there are many *PBL* readers who have few financial resources and are worried about the future.

If you have had some of the same thoughts or feelings, this essay is for you.

You are middle-aged. Your net worth is meager. Your income is barely sufficient to meet expenses, and those expenses are going up. Instead of getting stronger, the economy seems to be teetering on the edge of collapse.

So should you give up your dream of retiring comfortably one day? Should you accept the prospect of living in a shabby apartment and subsisting on ramen noodles? Should you grow bitter? Should you curse big government and big banking and big business for putting you in this situation?

Or should you take responsibility for your future well-being?

That last question was, of course, rhetorical. Yet when I hear comments such as, "What's the average person to do?" I wonder if people understand that they have options. You certainly don't have any choice about how our government is going to spend your tax money. And you may not have a choice about whether the company you work for is going to be in business next year. But you can choose how you respond to your current financial worries.

I believe—no, I am sure—that anyone who has modest intelligence and a positive attitude can become financially independent in seven years or fewer if he or she is willing to work smart and hard.

But I also understand that when you are halfway through your life and barely making ends meet, it seems like the only chance to become financially secure is to win the lottery (either an actual lottery or the stock market equivalent).

So when you hear some rich guy from Palm Beach telling you that you shouldn't trade options if you have less than $25,000 set aside just for them, it may be frustrating. And when he talks about what he and his rich friends are doing—buying rental properties and starting businesses overseas—you might feel that you can't use his advice.

If you feel that way, you are wrong. You are not wealthy now, not by a long shot. But you do not have to give up on your dream of becoming wealthy.

It will take time and patience. You may have to change some of the thoughts and feelings you have about wealth. And you will certainly have to make changes in what you are doing, for what you have been doing has brought you to where you are.

Your path to financial independence begins with four simple steps.

1. First, accept the fact that *you are solely and completely responsible for your current financial situation*.

   Before you react defensively, read that sentence again. I didn't say you are the *cause* of your situation. I said you are *responsible* for it.

   By taking responsibility for your current situation—even if it was "not your fault"—you assume responsibility for your financial future. That is a *good* thing. Hoping for someone, something, or some event to fix your problems is futile and foolish. Time, precious time, ticks on as you sit and wait.

The sooner you accept the reality that you are going to be your own salvation, the sooner your fortune will start to change. The first and most important benefit is that you will shed the anger and frustration you have been carrying around for so many years. And then, gradually, as you apply your new thinking to taking action, you will begin to feel the opposite of anger and frustration. You will begin to feel financially powerful.

The feeling that you have the capacity to create wealth is the single most important tool in your wealth-building kit.

2. Second, set realistic expectations.

I can't tell you how many times I've heard people scoff at the idea of making 8% or 12% returns—the sort of returns we look for in our Performance and Legacy Portfolios. They tell me returns like those are "boring." They want stocks that double and triple, they say, because that's "the only way to acquire wealth."

I once made a presentation to a small group of investors about an investment I liked. My projection was that it would provide a return of 25-35%, with some fringe benefits. A man in the back interrupted me to tell the audience that they would be wasting their money by investing in my idea. "Unless you can give us a 10-to-1 return, I'm not interested in what you have to say," he announced. A few people applauded him.

It's funny. I never hear wealthy people voice this idea. It is always either people who are not-yet wealthy or stockbrokers. (My interrupter looked like a stockbroker. And I think he probably signed up some clients after my presentation.)

Yes, 10-to-1 returns happen. But they rarely happen in the stock market. Your chances of building a fortune by seeking out 10-baggers (as they call them) is about the same as playing the lottery.

Know this: 8-12% is a high rate of return. If you get an 8% return, you'll double your money every nine years. If you get a 12% return, you'll do it in six years. You can get *very rich* by doubling your money every six years.

Think of it this way: Warren Buffett—the most successful investor of all time and the third-richest person on the planet—has averaged 19.8% on his investments over his entire career. Expecting to make returns that are five times what the greatest investor has made is just plain foolish.

3. The third thing you must do is to understand how wealth builders really create wealth.

   The public today has been deceived on this important point by reading stories about individuals who invested every cent they had in a business idea that exploded into a billion-dollar bonanza. These are great, inspiring stories. But they are not normal. For every person who got rich this way, there are 999 who went broke doing the same thing.

   I'm not diminishing these guys. They were brilliant and shrewd. But they were also rare exceptions. Using them as models is like a kid in the ghetto deciding he's going to get rich by becoming the next Tiger Woods or Michael Jordan.

   When you accept this, you will discover something I've been telling investors since we started *The Palm Beach Letter*: It is very difficult to become wealthy by investing in only one way. You must open your mind to many powerful wealth-producing strategies.

4. Your fourth step to financial independence is to recognize that your net investible income (the amount of cash you have after spending and saving) is *the single most important factor in determining how quickly you will become wealthy*.

   I will venture to say that you have never heard any other investment newsletter writer say this. But it needs to be said. You simply cannot get wealthy by investing unless you *invest enough money*.

   This leads us to being open to real estate and entrepreneurship. It also leads us to strategies for spending less of the income you earn on the things you are paying for now. I have developed guidelines for each of these strategies. One of them—which I call the Golden Buckets—will give you a clear breakdown of how to spend less, save more, and invest wisely.

   You will read about all of these strategies in my *Creating Wealth* newsletter. And you can get detailed programs on them as a member of the Palm Beach Wealth Builders Club.

   The idea is to add to the income you have now by creating additional streams of income and then directing those extra streams to investing. I will show you exactly how to do it in future issues of *Creating Wealth*.

> One more point I want to make here: **The journey to millions of dollars is earned $100 at a time**.
>
> Many people I speak to, when I talk about extra income opportunities, tell me that they are interested only in opportunities with the potential to bring them tens or hundreds of thousands of extra dollars per month. This is the same kind of foolishness I hear from people who are interested only in stocks that could maybe/possibly/perhaps give them a 100% return on their money.
>
> To find an extra $10,000 to invest this year, you don't need to come up with a $10,000 idea. It's easier and smarter to come up with several $100 ideas and then repeat them over and over again.

If you are not yet wealthy and are worried that you will never be able to achieve financial independence, take heart. During the course of your subscription to *Creating Wealth*, I'll give you dozens of ways to develop real wealth—even if you are 47 years old and making $27 per hour.

The world of wealth is governed by universal dynamics: supply, demand, wealth, greed, etc. These dynamics are as old as civilization. Winning the wealth-building game is about recognizing and exploiting those dynamics, not denying them.

Our job at *The Palm Beach Letter* is to highlight those dynamics on a weekly and monthly basis and then help you make smart, enriching decisions—the sort of decisions that have made men wealthy for thousands of years.

It's not fun to realize, in the middle years of your life, that you haven't acquired the wealth you want. But the good news is that you can begin to change your fortunes today by taking the four steps I just told you to take. And you can take all four of those steps in the next hour—if you simply open your mind to them.

Let me be a bit more specific:

- Accept responsibility for your future. Refuse to complain, criticize, or condemn. If you want us to help you achieve your goals, trust in and follow our advice. Stop doubting it. Stop denying it. Have faith.
- Give up the foolish notion that you must get rich "now." Be happy to earn 8-12% on your stock market investments. Realize that if you make 8-12%, you will be ahead of 99% of your fellow investors. Embrace the huge impact this will have on your wealth over time.

- Begin to allocate your income according to the Golden Buckets. With every paycheck you get, first cover your necessary expenses (bills, mortgage, etc.). Then put some money toward saving some money toward investing. Then and only then—after you have "paid yourself"—do you add to your "spending" account.

- Stop complaining about making "only $27" per hour. That's more than many people make. Be grateful you earn that much. Commit to add to that with a second income. Make an honest count of the number of hours each month you devote to television and other non- productive activities. Devote those hours to wealth building instead. Cast aside the comfortable shoes of victimization. Put on the working boots of a financial hero.

If you are willing to do that, we can help you succeed. We are giving you investment recommendations that will give you realistic 8-12% returns (and sometimes much more.) You can buy the books I've written on how to earn more money and save more money. And we will be preparing additional reports on these subjects exclusively for our *Palm Beach Letter* subscribers.

We are fully committed to giving our readers more valuable and realistic wealth-building advice than any other investment newsletter. We have the experience and the know-how to do it. We will deliver if you do.

Before I end this essay, I want to address two more things my 47-year-old correspondent said. And I am going to speak directly to him:

You suggest that you don't have the wherewithal to implement some of my recommendations. You say that buying real estate and starting businesses in Nicaragua are things only wealthy people can do. You are dead wrong on this. If you are willing to work hard and smart, you can begin building a rental real estate empire with as little as $1,000.

And the businesses I've started in Nicaragua can all be started for that kind of money or less. This is something else that I will be explaining in future issues and reports. If you stick around and trust us, you'll learn how you can do it too.

The other thing I want to address is your suggestion that I am raking in a ton of money with *The Palm Beach Letter*. The implication, in fact, is that I am in it only for the money. While I don't deny that I am generally in business to make money, you are wrong about this also.

I am going to say something now that I haven't said before because I didn't think it was necessary. But apparently it is.

So here goes…

Personally, I am not making any money from my work for *The Palm Beach Letter*. And I never will. Every cent of the compensation I am paid as a contributor goes directly into my charity in Nicaragua.

I'm not Mother Teresa. I'm a rich man who can afford to put hundreds of thousands of dollars into charity. But my motivation in writing *Creating Wealth* and in developing all the programs for the Palm Beach Wealth Builders Club is not about personal financial gain. I'm in this to see if I can help thousands of individuals like you—people who are not yet wealthy— become wealthy by doing exactly what I've done to achieve the wealth I have.

If I were in this for the money, I might be tempted to tell you what you want to hear so that we could sell more subscriptions. I could tell you, for example, that you can invest $25,000 in certain stocks and end up a millionaire in just a few years. But we are hoping that we can be successful publishers of good and useful information without making such promises. We want to help you by telling you the truth.

You are only 47, not 87. You have plenty more years to increase your income and grow your net worth. Don't assume that all is lost when you have a wonderful life ahead of you, a life that can be rich in so many ways.

Everybody in your situation has the same choice: You can complain about it or you can dedicate yourself to changing it. We can show you how.

For the equivalent of a tank of gas or a dinner out, you are getting a whole year of realistic investment and wealth-building advice from *The Palm Beach Letter*.

You have what you need to get your gravy train moving. But you are the engineer. Nobody can do it but you.

Chapter Five:

Don't Count on the Stock and Bond Markets to Make You Wealthy

Do these five things instead…

In my ongoing effort to shock you with contrarian (and sometimes counterintuitive) truths about building wealth, I give you this little nugget to chew on today:

You cannot become wealthy by investing in the stock and bond market.

(Please keep this on the down low. If my colleagues in the investment newsletter industry knew I said that, they would have me tarred and feathered!)

The investment advisory industry—and by that I include brokerages, private bankers, and insurance agents, as well as investment newspapers, magazines, newsletters, and Internet publications—is a huge multibillion-dollar business based on hard work, clever thinking, and sophisticated algorithms. But also on one teensy-weensy lie.

The lie is that you can grow wealthy through investing in stocks and bonds.

It's not a big, black lie. There is plenty of evidence that strategic stock investing can provide returns that exceed investment costs (brokerage fees, management fees, subscription fees, etc.) and even produce positive returns after inflation.

But to do that, you need time. More time than you probably have.

Let's say you have $50,000 to invest. And let's say you invested it according to a really good investment strategy (such as the ones you will get with your subscription to *The Palm Beach Letter*). And let's assume that things go well. And by well I mean that you make, on average, 10%. If you started on January 1, 2012, by December 31, 2021, your $50,000 would have increased to $129,687.

That's not bad. But it hardly makes you wealthy. So let's say you were willing to extend your investment horizon to 20 years. Beginning at the same time with the same $50,000, you would have $336,375 on December 31, 2031.

That's better, but it's still a far cry from making you wealthy. So let's push the investment horizon to 30 years. By December 31, 2041, you would have $872,470.

If you made 10% on that $872,470 nest egg, you'd have a yearly income of $87,200. After taxes, you'd take home about $65,000 per year. That's okay, but it's hardly wealthy. And that's after investing for 30 years!

Most of the people reading *The Palm Beach Letter* don't have 30 years to wait. Based on what I know about our readership, I'd say our readers' average wait period is 10-15 years.

So what's a middle-aged (or older) wealth seeker to do? You can start by deconstructing the little lie.

Building wealth involves much more than just investing in stocks and bonds. Most rich people get that way by consistently doing the following five things:

1. They understand and manage their debt. They don't let debt manage them.
2. They are abstemious spenders and aggressive savers, far outpacing their peers.
3. They invest in stocks and bonds with discipline. But they don't expect stocks and bonds to make them wealthy.
4. Their primary focus is on increasing their active income. Usually, this comes from a business they know inside and out.
5. They invest in real estate and other "outside Wall Street" opportunities.

As you can see, investing in stocks and bonds is only one of five strategies you must follow to become rich.

In fact—most of the rich guys I know spend little or no time investing in stocks and bonds.

Phil, a very wealthy friend in his 40s, invests in stocks and bonds. He favors municipal bonds, and he is a true expert at them. But he didn't become wealthy by investing in bonds. He got wealthy as a marketing and Internet entrepreneur and by leveraging some debts and eliminating others. Nowadays, he buys and sells bonds, but that takes him only a few hours per month. For Phil, investing is a part-time way to increase the value of his savings. It is not— and has never been—his primary road to wealth.

Bob, a mega-wealthy friend of mine who lives on my block, also invests in stocks and bonds. He too is a very smart guy and makes good returns on his stock and bond portfolios. But like Phil, he didn't make his fortune that way. He got rich as a commercial real estate developer. He also made millions investing in fine art.

It's the same with all my millionaire friends. They all have their own stock and bond investments, but like Phil and Bob, they got rich by putting their money and their time into other investment activities.

As for me, I paid only a minimum amount of time and effort into stock and bond investing until I started writing *The Palm Beach Letter*. Yet I managed to go from broke to having a net worth well in excess of $60 million—mostly by outside-Wall-Street investment strategies.

Don't get me wrong. I'm not saying that investing in stocks and bonds has no value. It is essential. And now that I am investing in Tom's recommendations, I'm doing better in the stock market than ever. But it was not and will never be my core strategy for accumulating wealth.

It is certainly possible to become wealthy through stocks and bonds. But you have to devote 40-plus hours per week to it. And you have to be very disciplined. And you have to do it for a long, long time.

If you don't have that time, you have to take another course. And the entire reason for my writing *Creating Wealth* is to help you supplement your stock and bond investing by putting into play the strategies that my rich friends and I used to become wealthy.

I will never be a full-time stock and bond investor. I am willing to spend an hour or so a week. And that time is primarily invested in reading what Tom and his team have to say and following their advice. The rest of the time is devoted to what I've always done. I want to talk a bit about that today.

If you want to get wealthy in fewer than 30 years, you should pay attention. Devote a couple of hours per week to managing your stock and bond investments and spend the rest of your working time on the other wealth- building strategies listed above.

You may be thinking, "I don't need to be told to limit my spending or manage my debt. I already know how to do that." My response to that: Do you?

Or you may be thinking, "I already lost money in real estate. I have no interest in doing that." My response: If you lost money, it is because you did exactly the wrong thing. Real estate investing, if you do it the right way, is the easiest way to build wealth. That is why most self-made billionaires have large real estate portfolios.

Or perhaps you don't like my idea that you must—must—increase your income. Most people reading *The Palm Beach Letter* have been working hard for 30 or more years to raise families and put their children through school. They want to stop working for income. They want to quit their jobs and invest in stocks and bonds. They want to take it easy.

Giving up your active income, as I next explain in "How the Big White Lie of Investing Almost Cost Me My Retirement," is the single biggest financial mistake you can make. Your active income is essential to building your wealth. If you want to retire some day and don't have at least $250,000 put aside for that purpose, you need more income.

The good news is that there are all sorts of ways to do that. Just as there are all sorts of clever ways to manage your debt, get more value out of your spending, and ratchet up your savings.

As contributors to *The Palm Beach Letter*, we consider our stock and bond investment recommendations to be the core of our service because we know that's what you want. But we also want to help you grow wealthy. And that's why in *Creating Wealth* we talk about these other financial strategies.

Each month, *The Palm Beach Letter* will bring you at least one solid stock recommendation. Tom and the whole team at *The Palm Beach Letter* spend hundreds of hours every month researching the markets and double-checking their facts to give us a very good chance for an 8-12% return on your money.

I have a highly paid broker whose job is to follow Tom's recommendations. He reads *The Palm Beach Letter* and follows its Performance Portfolio. He reads our Legacy Portfolio and follows that. And he also follows our strategy for investing in options. He invests millions of dollars of my money that way.

He likes it because it is simple to follow, but he also likes it because he knows it works. He makes me money. He takes his cut.

Meanwhile, I'm spending most of my time doing what I always did: investing in entrepreneurial businesses, real estate, fine art, hard assets, and more.

And I spend a good deal of time every month making sure I am spending less and saving more. This is very basic stuff. Wealth-building strategies that your grandmother would understand.

Simple—for some people—is not interesting. Some people think complicated works. I know it doesn't.

So, in addition to following the recommendations you get in *The Palm Beach Letter*, read *Creating Wealth* and put those strategies to work for you too.

Chapter Six:

How the "Big White Lie" of Investing Almost Cost Me My Retirement

Learn from my mistake and discover the most important factor in building wealth quickly

I consider myself an expert of sorts on retirement. Not because I've studied the subject, but because I've retired three times.

Yes, I'm a three-time failure at retiring. But I've learned from my mistakes. Today, I'd like to tell you about the worst mistake retirees make.

It's a very common mistake. Yet I've never heard it mentioned by retirement experts. Nor have I read a word about it in retirement books. **The biggest mistake retired people make is giving up all their active income.**

You can get two different types of income. Active income is the money you make through your labor or through a business you own. Passive income refers to the income you get from Social Security, a pension, or a retirement account. You can increase your active income by working more. But the only way you can increase your passive income is by getting higher rates of return on your investment (ROI).

[A return on investment, or ROI, is a profitability measure that evaluates the performance of a business by dividing net profit by net worth.]

When you give up your active income, two bad things happen:

First, your connection to the source of your active income is cut. I'm talking not just about the business you had or worked for, but also the people you knew. (These are valuable connections you might want to go back into some day. But with every month that passes, it becomes more difficult to get back.)

Second—and this is something you may not have considered—your ability to make smart investment decisions is debilitated because of your dependence on passive income. (I'll explain this later.)

Retirement is a wonderful idea: Save a portion of your income every month, let it grow in a tax-deferred investment vehicle, and accumulate a vault of wealth. Then, 40 years later, tap into that vault to fund 20 years of easy "retirement" living. No work. No stress. Nobody to kowtow to. Just traveling, golfing, going to the movies, and visiting the kids and grandkids.

Yes, it's a great idea. But it was never realistic. Prior to the 20th century, retirement was a rarity. Most people worked until they could no longer work and then "retired" into the houses of their children.

The only generation that experienced "the dream" was my parent's generation—the men and women who bought starter homes and entered the workforce after World War II. They had good timing—as the USA was entering a 30-year growth spurt in business and real estate.

They made and saved money, but the bulk of their retirement funds came from selling their homes—homes they had bought for $10,000 or $15,000 in 1950 for 10 times that amount in 1980.

For every generation since then, the promise of that kind of retirement has been nothing but a big white lie.

Consider this: A retirement lifestyle for two, like the one I described above, would cost on average, (depending where you live), $75,000 per year.

But that's after tax dollars.

[Taxes can be complicated, with several tax rate percentages (marginal rate and effective payable rate) that combine to equal what you actually pay. Taxes rates right now are some of the lowest in a long time. To keep things simple for this essay, we're going to focus only on the net rate that you actually end up paying. And we'll use a higher amount to account for what will most likely be higher rates in the future.]

If you were in the 32% bracket, you'd have to earn about $110,000. So let's use this $110,000 figure.

How big of a retirement account do you need to produce $110,000 of cash flow each year?

Let's assume that you and your spouse could count on $25,000 per year from Social Security and another $25,000 from a pension plan (two big "ifs"). To earn the $60,000 balance in the safest way possible (from a savings account), you'd need about $6 million, because savings accounts pay—at best—only 1% right now.

If you were willing to take more risk and invest in tax-free municipal bonds, you'd need $2.1 million.

[Municipal bonds are tax-free. So you wouldn't need to earn $110,000 to net $75,000. You'd need to earn only $75,000. At best, you can expect to get a 3.5% return on municipal bonds today. So that means you'd need a retirement account of about $2.1 million.]

But let's say you were confident you could earn 10% from the stock market. You'd still need a nest egg of $1.1 million to gross $110,000 per year.

The problem: Most middle-class American couples my age are trying to retire with an account in the $250,000 to $300,000 range.

And that's where the trouble begins. To achieve a return of $60,000 on

$300,000, you'd need a return of 20%. Getting 20% consistently over, say, 20 years may not be impossible, but it's very difficult and very risky—too risky for my tastes.

A Lesson Learned From Retirement No. 1

I retired for the first time when I was 39. I had a net worth of about $10 million, half of which was liquid. I thought I had all the money I would ever need.

As it turned out, my retirement lifestyle was more expensive than the one I described above. I liked first-class travel, five-star hotels, and fancy cars. My yearly net was close to $500,000—*after* taxes.

To generate $500,000 in after-tax dollars, I would have had to earn $900,000 in passive-interest income on that $5 million. That represents a return of 18%. I understood enough about stock market performance to know that was impossible.

I should have cut my expenses drastically. But I didn't want to. I enjoyed the lifestyle I had. I was still a big spender. So I had no choice. I had to go back to work!

I put the word out and got a few offers. A month later, I was back at work. I half expected to feel miserable, toiling away again. But the moment I started earning money again, I started to feel better.

How Retirement Should Feel

Retirement isn't supposed to be about money worries. Yet, if you retire with too little, that is exactly what you will get. Trying to get above-market returns is very challenging under any circumstance. But when you have to get high returns to pay the bills, it can be extremely stressful.

As I write this, millions of Americans my age are quitting their jobs and selling their businesses. They are reading financial magazines and subscribing to newsletters. They are hoping to find a stock-selection system that will give them the 20% and 40% returns they need.

But they will find out that such systems don't exist. They may have a few good years, but eventually the returns they will get will drop to 10% or less. Or there will be another stock market crash.

At that point, things will get bad fast. But it doesn't have to be this way.

Let's go back to the example of the couple with the $300,000 retirement fund and the $100,000-per-year retirement dream. Assuming, as I said, that they had a total of $50,000 per year coming from Social Security and pension payments, they still need $60,000 per year in pre-tax passive income.

To earn $60,000 on $300,000, they would need a return of about 20%. That is, as I said, highly improbable. But if they got part-time jobs that gave them an extra $15,000 in active income ($7,500 each), they would need a return of only about 8% on their retirement account, which is very doable.

I am not saying that you should give up on the idea of retirement. I'm saying that you should think of retirement differently. It is a wonderful time of your life when you change the ratio of work and pleasure.

Instead of spending 80% of your days working for money and 20% having fun, you spend 20% of your time working and 80% having fun.

That doesn't seem so bad, does it?

And if you are smart about what kind of work you do, you can actually have fun working!

Paint a new mental picture of what retirement can be: a life free from financial worry that includes lots of travel, fun, and leisure—funded in part by active income from doing some sort of meaningful work.

There are many ways for a retired person to earn a part-time, active income. You could do some consulting, start your own Web business, or earn money doing any sort of purposeful work.

How much active income do you need? That's easy to figure out.

A. Determine what you need to spend each year for your retirement.

B. Determine how much money you will have in your retirement account.

C. Assume that you get no more than a 10% yield on your retirement account

[You'll be able to get these returns following the asset allocation model we discuss here.]

Subtract C from A. That is what you need to earn.

The first benefit of including an active income in your retirement planning is that you will be able to generate more money when you need to. But the other benefit—the one that no one talks about—is that it will allow you to make wiser investment decisions.

This is an important point. When you are a slave to ROI, you will feel pressure to invest in higher-risk propositions. A few of these might work out well. But most of them will disappoint you. Some terribly.

Making an 8% or even a 10% return on your retirement account is easy to do safely. But trying to make twice that much—that is something you don't want to do.

Chapter Seven:

What's Your Magic Number: Figuring out How Much Money You Need for Retirement

How much money do you need to retire? A hundred grand? A half-million? Ten million?

I'm getting ahead of myself. Have you even tried to calculate how much money you'll need to retire? Chances are you haven't.

The Employee Benefit Research Institute reports that 56% of workers haven't made an effort to figure it out. Maybe that's why statistics show nearly 75% of retirees haven't saved enough and say they would save more if they could do it all over again.

How much money do you need, then?

In his book *The Number*, former *Esquire* editor-in-chief Lee Eisenberg talks about why "the number" is so important. He says that, for most people, it represents a free pass to a great life without financial stress.

That's what it always meant to me. When I was in my 30s, I had a number in mind. It was a net-worth number. I was determined to achieve it in fewer than 10 years. And I did. But after retiring, I quickly discovered I was using the wrong number.

Net worth matters, but it is not "the number" you need to plan your retirement. Your net worth includes all assets—including your house and your favorite "toys"—which you may not be willing to give up in retirement. That's what happened to me. I wasn't psychologically able to move into a smaller house, get rid of my little fleet of vintage cars, desist from buying fine art, etc. It was a big lesson.

Your **Magic Number** is how much you need to replace your active income and pay for your expenses... after you've quit your 9-5 job.

Because I used the wrong number, I had to go back to work. I picked a new number, a real number, and worked another 10 years to hit it. When that day arrived, I felt fantastic.

I also changed my priorities. Making money was no longer my No. 1 goal. I could spend more time on hobbies—some of which were businesses (such as my art gallery and my film production company) that had little chance of making serious money.

This is a good feeling, one I can recommend to you. If you haven't had that feeling yet, I hope that what I'm about to tell you will put you on the right track...

Most people fail to achieve their retirement dreams, Eisenberg says, because they make two mistakes:

Many people enter their 40s and 50s "ensconced in a cloud of avoidance and denial about the years ahead of them." They spend their early years not doing any serious retirement planning.

"They sense they are far behind from where they should be, but they don't want to face the truth. These are the procrastinators," Eisenberg says.

Other people do retirement planning, but they're sloppy about it. They don't know how to calculate their Magic Numbers correctly, so they pick arbitrary numbers and hope for the best. Eisenberg calls these people "pluckers" because they pluck numbers out of nowhere.

You don't have to make these mistakes. They are actually easy to avoid. Let's do that now. Let's figure out how much money you have to save in order to quit work and enjoy retirement fully. I call this your "Magic Number."

Five Steps to Finding Your Magic Number

I am going to give you five calculations. Each one should take just a few minutes. The entire process, including all five steps, should take no more than a half-hour.

Please do it now. In terms of your future wealth and happiness, it may be the most fruitful 30 minutes you ever spend.

Step 1 – Calculate How Much Money Your Current Lifestyle Requires

The first step is to calculate your Lifestyle Burn Rate (LBR). This is the amount of money needed each year to enjoy your lifestyle.

It's easy to determine this number. Simply calculate how much you are currently spending to live life each year.

I find it helps to group the expenses into five categories: housing (including maintenance and taxes), basic living expenses (food, clothing, health care, etc.), education (if applicable), entertainment (including travel), and charity (if you believe in it).

This exercise may be illuminating. (When I redid it recently, I was shocked to find how much money I'm spending on cigars—$14,000!) You may find this exercise alters your idea of a quality life. (I'm cutting back to one stogie per day.)

Mint.com

If you have no budget or don't have a clue how much you spend each month and year, try mint.com. It can sync with your bank account and make it easy for you to categorize your expenses. Once you do this, you can easily find out your LBR without having to add it up manually on a paper or Excel spreadsheet.

It will also make it easier to make adjustments in the future, if your lifestyle changes (see sidebar below).

Don't guess at these numbers. Guessing, in my experience, correlates with grossly underestimating. Use your actual costs from the past year.

Your LBR is a critical number. Without it, you can't make any other financial planning calculations—such as how much money you need to save for retirement. And that's our next step.

The Three Stages of Your Financial Life

Your Lifestyle Burn Rate (LBR) is likely to change three times.

The first stage is up until you have your first child. The second stage begins when you have your first child and continues until your children are gone and their college expenses (if you are paying them) taken care of. The third stage begins after you are free and clear of dependencies, and it continues until you pass away.

For most people, the first stage has the lowest lifestyle burn rate. You are young and relatively unburdened. If you are wise, you will limit your expenses to necessities and drink cheap wine.

The second stage, typically, has the highest lifestyle burn rate. You have larger home expenses, bigger basic living and entertainment expenses, and educational expenses for your children. For some people, this stage extends in time if you're required to provide for aging family members.

The third stage has a LBR that will likely be twice that of the first stage, but significantly less than the second stage. This is—or can be—a wonderful part of your life during which you can enjoy traveling, hobbies, and entertainment without working more than you want to.

To complete this exercise, you'll need to calculate your LBR for your current stage and for stages you haven't completed. If you are in stage one, you'll need to figure out your current LBR and estimate it for the second and third stages as well.

Step 2 – Adjust Your LBR to Account for Any Changes in Spending Patterns That Will Be a Part of Your Retirement Lifestyle

The next step is the one most people start with: deciding how much money you'll be spending each year in your retirement to enjoy the lifestyle you want.

I just told you how to calculate your Lifestyle Burn Rate (LBR). What you are doing now is figuring out your Retirement Lifestyle Burn Rate (RLBR).

Take your current LBR, the one you just figured out above. Now add to it any "extras" you want to enjoy during retirement and remove any expenses you won't have in retirement.

Let's say, for example, that your current lifestyle burn rate is $80,000 per year. To make your retirement more fun, you want to own an extra car—a sports car—and join a golf club. This will cost you an extra $10,000 per year. Add $10,000 to the $80,000 and you have $90,000.

Or maybe you plan to travel Europe. Or you want to help finance a grandchild's education. Regardless of what it is, here's where you add in those anticipated costs.

Now subtract from that total number (in this example, $90,000) any expenses that you currently have but will no longer have when you are retired. This commonly includes expenses for your children and other expenses related to having a family with children.

For example, if those expenses are currently $15,000, you will deduct that $15,000 from the $90,000. That would leave you with $75,000. Got it?

Step 3 – Adjust Your RLBR to Account for Any Additional Sources of Income

The next step is to take your RLBR and subtract from it any income you are confident you'll receive during your retirement. This income could include Social Security, a company pension, or side-business income.

For example, if you trust that Social Security will still be around when you retire, you can find out what your projected yearly Social Security income will be.

Slash that by 50% (see the sidebar for why I recommend this) and subtract that from your RLBR.

You can do the same with any pension income you expect. And finally, if you intend to work part-time during retirement, you can deduct that, too.

Let's get back to the example. Let's say you just calculated your RLBR and found you'll need $75,000 per year. To make these new calculations, you would deduct, say, $15,000 per year you expect to get from Social Security.

Then you'd deduct another $5,000 per year you expect to get from some pension. And finally, you'd knock off another $5,000 per year you expect to get by working as a golf ranger two days per week.

This reduces your RLBR from $75,000 to $50,000.

This is your Net Retirement Lifestyle Burn Rate (NRLBR). It's an important number.

Should You Rely on Social Security?

It's no longer a certainty that Social Security and your pension will be able to pay you the full amounts they should. Our Social Security system currently dispenses more money than it brings in. That makes the money you hope to receive from it in the future less certain.

The same is true with many pensions these days—too many pensions are terribly underfunded. This means that when payout time comes, there's a risk that some people won't receive the income they've been promised.

On top of this, you have to factor in future rising inflation. As Social Security and pensions try to increase their current payments to match rises in inflation, it's another drain on the already limited dollars in those accounts.

For these reasons, I want you to discount your projection of how much money you'll receive from Social Security and pensions. Hopefully, you'll get 100% of it. But to play it safe, I suggest you assume you'll receive only 50%.

Step 4 – Determine What Rate of Return You Expect to Get on Your Savings

You've just gone through the steps to calculate your Net Retirement Lifestyle Burn Rate. In our example, that amounts to $50,000 per year. This is the amount needed to live the retirement you want.

There's one last thing we must know before figuring out your Magic Number. It's the rate of return you can expect to get on your retirement savings.

For instance, if you expect to get only 5% on your money, then your Magic Number—the amount you'd need to save before retiring—would be $1 million. ($1 million generates $50,000 per year at 5%.)

If you could get 10% on your retirement funds, you could retire much sooner... since you'd need only $500,000 at 10% to generate $50,000 in annual income.

So what rate of return should you plug into this equation?

That depends on what kind of investments you use. Most financial planners will spread your money into an assortment of stocks, bonds, and cash.

But I don't like the idea of having my retirement fund in just stocks and bonds because the market can fluctuate greatly from year to year.

A better choice would be to follow the asset allocation model we've designed for *Palm Beach Letter* readers. It includes seven different asset classes.

[Asset allocation is the process of dividing one's wealth into different asset types such as stocks, bonds, real estate, gold, and cash. The *PBL* asset classes are rental real estate, stocks (Performance Portfolio, Legacy Portfolio, and Safe Speculations Portfolio), bonds, gold, cash, and income (*Palm Beach Current Income*).]

With the asset allocation model we suggest, you can expect to earn a 10% return each year. We'll update this expected return each year depending on market conditions. But for simplicity's sake, let's look at a basic example.

Let's say you own investments in only three classes: stocks, rental real estate, and bonds. And let's say you weighted your investments equally in each class. It would be reasonable to expect the following returns on those asset classes (after taxes):

Stocks: 9%
Rental Real Estate: 12%
Bonds: 3%

Since you have equal amounts invested in each asset class, that means your total expected after-tax rate of return would be 8% (the average of all three asset classes).

You now know how much money you need to earn annually to enjoy your retirement. And you know the rate of return expected from your lump sum of allocated investments. That means you have the tools to calculate your Magic Number.

Step 5 – Calculate Your Magic Number

To figure out your Magic Number, start with your NRLBR. In our running example, that was $50,000.

Now, divide it by the expected rate of return you just calculated.

Using the same example, you would divide the $50,000 (NRLBR) by the expected rate of return, 8%. Fifty thousand dollars divided by 8% (0.08) is $625,000.

That is your Magic Number! If you had this amount of money invested right now making 8% each year, you could retire.

If your net RLBR were $100,000, your magic number would be $1.25 million. If your net RLBR were $300,000, your magic number would be $3.75 million.

Get it? Just divide the income you will need in retirement by your after-tax expected interest rate.

In case you are lost, let me break it down for you again, using the original example. The following is just an approximation…

Check your bank ledger and credit card statements and figure out how much you spend each year (this is your LBR). In our example, this is $80,000.

Adjust your LBR for how much money you'll need to spend during retirement to provide the type of lifestyle you want (this is your Retirement Lifestyle Burn Rate, or RLBR). This gives you $75,000.

Adjust your RLBR lower to account for any income you expect to receive during retirement. This gives you a Net Retirement Lifestyle Burn Rate of $50,000.

Determine the after-tax rate of return of all your investments combined that you can expect to receive on the money you have invested. In our example, that is 8%.

Calculate your Magic Number by dividing your NRLBR by your rate of return. $50,000 divided by 0.08 = $625,000.

Congratulations. You just figured out exactly how much money you need in order to retire. Write it down on a sticky note. Put it on your office desk or file cabinet. Always keep this number. The magic number you need to hit.

How Does Inflation Affect Your Magic Number?

When planning for your retirement, you have to consider the effects of inflation on the value of your portfolio. That's because, in most cases, inflation makes future dollars less valuable than they are today. The $80,000 per year we've been using in this essay, for example, will still be $80,000 in 10, 20, or 30 years… but it will buy fewer things than it can buy today.

[Inflation is the rate at which the general level of prices for goods and services rise each year. For example, if inflation were 3%, the loaf of bread that cost you $1 last year would cost $1.03 this year. Its price went up… and because it went up, you'll end up buying less bread this year.]

So how do you account for inflation in your Magic Number planning?

Bond yields should increase in the years to come as well. Today, they are low... and our plan is based on a 3% yield. But these are likely to increase in the years ahead. So that will help, too.

One way is by owning businesses that keep pace with inflation. Companies like this raise their prices to match inflation. Many of the stocks we recommend in our portfolio are of that kind. Having 20% of your portfolio in such stocks will help.

But the main inflation hedge you have in the portfolio I recommended is the rental real estate portfolio. Real estate, as a tangible asset, appreciates during inflationary times.

According to the Case-Shiller index, which has tracked real estate sales of existing homes since 1987, the average annual increase for real estate is 3.6% over this 25-year period. Compare that to the reported Consumer Price Index during the same period, at 2.9%.

More importantly, as a landlord, you should be able to increase your rent to match inflation. I've been doing that with my rental real estate portfolio for more than 20 years.

These factors should go a long way toward protecting the validity of your Magic Number. But if you want to be extra sure, you can simply use a smaller interest rate to calculate your Magic Number.

In our existing example, we're dividing $50,000 by an 8% interest rate (0.08). This gives us a Magic Number of $625,000. But if we want to be more conservative, you could lower your interest rate to 7% (0.07). This would increase your magic number to $714,285.

If you have 20, 30, or 40 years to go before retirement, you might want to use a more conservative interest rate.

Chapter Eight:

Your Personal Retirement Diagnostic: How Close Are You to Reaching Your Magic Number?

In "What's Your Magic Number?" above, I gave you step-by-step instructions for how to calculate your Magic Number.

Remember, your Magic Number is the amount of money you need to have saved and invested in order to quit work and enjoy retirement. In other words, a lump sum of money that can provide interest income to live off of.

Today, we're going to take the next step: We're going to run a personal financial diagnostic. I'm going to walk you through a check-up to determine exactly how close you are to reaching your Magic Number.

I'm going to show you two ways to analyze how far along you are toward achieving your goal.

Using the first way, I'll show you how long it will take you to reach your Magic Number if you keep saving money at your current rate.

Using the second way, I'll show you how much money you must begin saving each year in order to reach your Magic Number by a specific future point in time.

Let's get started.

Step 1: Calculate How Much Money You Have Already Saved

Write down how much money you have already saved toward retirement. This should include liquid assets (i.e., cash, stocks, mutual funds, and bonds in brokerage and qualified plan accounts or things such as gold).

It should also include any illiquid assets (i.e., an auto collection, a rare piece of art, or a second home) that you plan to sell prior to retiring.

If you live in a large house now but plan to live in a less expensive house in your retirement years, add expected profits from the sale into your retirement savings. But be conservative.

For example, if the house you live in now is worth $350,000 and you will be happy in a smaller house that will be $100,000 cheaper, add $100,000 to your retirement savings.

Do this right now. Figure out exactly how much money you have in retirement investments/savings today.

Step 2: Compare This Number to Your Magic Number

Let's say you just added up all the money you have saved and invested and it amounts to $250,000. Our next step is to compare this to your own personal Magic Number, which I showed you how to calculate in the previous essay.

In our example from that essay, we discovered that our Magic Number was $625,000.

So now we take that Magic Number and subtract from it the amount we have currently saved and invested.

$625,000 - $250,000 = $375,000

We now know that we have to save an additional $375,000 before we're able to hit our Magic Number and retire.

It's here that we come to a decision point.

You have two options: You can calculate how long it will take you to save this

$375,000 and reach your Magic Number at the current rate you're saving. Or you could calculate how much money you'd be required to save each year if your goal was to retire at a specific time in the future.

Let's calculate both, because each is useful.

Step 3: Calculate How Long Till You Hit Your Magic Number at Your Current Savings Rate

To do this, we look at how much money you're saving each year. These savings can come from money you set aside from your paycheck. Or it can come from dividends you receive from stocks or other investments… maybe both.

Whatever the source is, it all funnels to the same place: your retirement savings account.

For this example, let's say you're able to save $35,000 per year from your paycheck and stock dividends.

Now we simply divide that $375,000 (the amount we still need to save) by $35,000.

$375,000 divided by $35,000 = 10.7.

This means that, at your current savings rate, it will take you nearly 11 more years to retire.

Is this good or bad?

Well, it depends on your age. If you're in your early 50s and had planned to retire at 65, you're in great shape.

But if you're 58 and had wanted to retire at 65, this reveals that your goal isn't realistic at your current savings rate.

Let's say you just crunched these numbers and you've discovered you're not saving enough to retire at 65. You'd probably want to know, "Well, how much would I need to be saving to make retirement at 65 a reality?"

That leads us to the second way you can analyze how to reach your Magic Number.

Should You Include Capital Gains in Your Calculations?

In Step 2, you compared how much money you've already saved toward retirement to your Magic Number. Whatever the difference is will be how much money you must save before you can reach your Magic Number and retire.

I said you'll need to accumulate this amount of money through savings from your paycheck or stock dividends.

You might have noticed I didn't suggest you should include any capital gains from your invested "savings" (for instance, if you're investing your savings in a basket of safe stocks that are gaining value at 8% per year).

I did this to make things simpler. You could choose to include forecasted gains from your investments. And if you do this, it will shorten the expected time it takes you to reach your Magic Number. But I don't recommend this.

That's because not including these gains will give you an extra cushion. Unforeseen expenses will certainly arise that will eat into your savings. Not including these gains in your calculations gives you more breathing room.

Also, these are unrealized gains. That means they're not certain. Therefore, if your projection is wrong, it will distort the accuracy of when you reach your Magic Number.

But if you decide that you want to include expected capital gains anyway, at least be conservative.

Step 4: Calculate How Much More Money You Must Save in Order to Retire at a Desired Time

You're 58 years old. You need $375,000 more to retire. You want to retire at age 65. How much do you need to be saving each year to reach your goal by age 65?

It's simple. First, calculate how many more years you have until you want to retire. In this case, that's seven (65 - 58).

Then you just divide how much more money you need to save by seven. In this case, that's $375,000 / 7 = $53,571.

Is this realistic or not?

Well, compare it to your current savings rate.

$53,571 is about 50% greater than $35,000.

I think it's unrealistic to think you could instantly begin saving 50% more money. That means either you'll need to push your retirement date further back, or you'll need to find a way to begin saving an extra $18,571 per year ($53,571 - $35,000).

Regardless of what you decide, going through this diagnostic process will tell you exactly where you are on your retirement journey, and how to get where you want to be.

Be Sure to Give Yourself an Annual Check-up

Doing all these calculations just one time won't cut it.

The inputs are going to change over the coming months and years. Your income could change (a new job or promotion). And that means your retirement road map will change too.

For instance, what happens if your 16-year-old daughter gets her driver's license… and proceeds to rear-end a brand-new $90,000 Maserati?

What happens if your spouse's deceased great-aunt leaves you an unexpected $100,000?

What happens if some of your investments turn south and your expected rate of return drops by half?

Unforeseen events that affect your finances are going to happen. And those events will alter your retirement plan. That's why you should make this an annual checkup.

The Employee Benefit Research Institute recently conducted a study. It measured how confident Americans feel that they have enough money to retire comfortably.

The conclusion? The numbers came in at the lowest level ever in the study's 23-year history.

But we are not counting you among those people. You now have the tools to take control of your retirement planning.

To summarize, first, calculate your Magic Number. Then, calculate how close or far off you are from achieving it. Then, make the decisions to earn more money or delay your retirement goals.

I hope you take the time to get started right now.

Chapter Nine:

How to Safeguard the Wealth You Are Building

Bill, a new subscriber, recently wrote us this note:

> *Dear Friends at The Palm Beach Letter:*
>
> *You guys do great work and I'm a huge fan, but I have a question.*
>
> *I have read from a number of publications that an exit strategy is as important as any other aspect of investing. I have gains in the fine stocks you have recommended, but I'm not sure about the exit strategies for each.*
>
> *I happen to believe that the good times are short-term, and that a day of reckoning, or prolonged austerity, is near at hand.*
>
> 1. *So how do I protect the investments I already have?*
> 2. *If it all hits the fan and we go into another downturn or worse, how do we*
>   - *Protect what we have, and*
>   - *If possible, grow our nest egg during the downturn?*

Bill is asking several related questions.

Protecting Your Performance Portfolio Gains

First, he wants an "exit strategy" to protect the gains he has realized following our monthly stock recommendations (in *The Palm Beach Letter* Performance Portfolio). This is a good question. A shrewd investor always has a Plan B in place to limit losses if his investment begins to move the wrong way.

Our exit strategy for the Performance Portfolio is to set a trailing-stop order.

[A stop loss is an order you give your broker to sell your stock if its price dips below a certain point. For example, if you buy a stock at $40 and set a 25% stop loss, your broker will sell it the moment it hits $30 (10 points, or 25% less than $40, the price you paid for it).

A trailing stop loss means that the stop loss is triggered not by the price you bought it at, but by its highest price. Thus, if the $40 stock goes to $50 and then drops, your broker will sell it at $37.50, which is 25% less than $50.]

Using a trailing stop loss means that, at worst, your stock portfolio won't decline more than that percentage. In a rising market such as we've experienced, it's quite possible to protect not just your original investment, but also your profits with this strategy.

I know what you are thinking: You don't want to lose any percentage. But you can't have zero downside with stocks. My first rule of investing ("Never, ever lose money")—which I've recently discovered is Warren Buffett's first rule—is managed by doing all the other things I am about to tell you.

So that answers the first question about an exit strategy for *The Palm Beach Letter* Performance Portfolio stocks.

Bill's second question is, "How do I protect the investments I already have?"

We don't know what other investments Bill has, but let's assume he has some equity in his home, some other stocks, and some cash. He's worried that the economy and/or the stock market might take another nosedive—"or worse."

The classic way to protect against market fluctuations is by diversification. Diversification means that you don't invest in just a single type of investments. You spread your bets out, as it were, so that if one part of your investment portfolio goes down, other parts that may hold steady or even go up can protect you.

I'm a big believer in diversification because I've learned from experience that I'm not infallible or clairvoyant. As much as I know about my own industry, I don't know enough to predict the performance of the companies I own, let alone companies I don't. And as for other industries? I'd be kidding myself to think my investments were certainties.

Diversifying, like setting stop losses, is a statement of humility. I do it because I realize I can't be 100% sure.

Diversification works like insurance. There is a cost to it (getting lower yields), but I'm happy to pay that cost because I simply refuse to ever become poorer.

When most financial advisors talk about diversification, they mean a mix of bonds and stocks. That will give you some protection in normal times, but with most of the Western world in bankruptcy, this kind of diversification is not nearly enough. In fact, having a portfolio of only stocks and bonds over the past 20 years hasn't been effective. It may be even less effective in the next 10 years.

Here are the ways I have diversified my wealth:

Have Some Escape-and-Start-over-Again Gold

I have a considerable amount of money invested in gold (and now platinum) coins. I like coins for many reasons. They are tangible, portable, transportable, and private. In other words, they are perfect if things get "much worse," as Bill from above worries they might.

My coins have already tripled in value, so I can't feel certain they will continue to appreciate. But that's not why I own them. I own them because I know they will always have value, and I will always be able to spend them. I've put them in my escape-and-start-over bucket. (Refer to Chapter One: The Secret of the Golden Buckets.) And that's where they will stay.

If you have no gold coins, you should buy some, even at today's high prices.

And Don't Forget Rental Real Estate

Another excellent way to diversify today is by investing in rental real estate. I've been recommending this because, like precious metals, real estate is tangible. But better than coins, the right kind of real estate will give you a lifetime of income.

I've been investing in rental real estate for about 30 years, and, except for my first investment, I've never lost money on it. I stopped investing in 2006 because it was easy to see we were in a bubble. And I got back into it in 2010 because it was easy to see that it would be very profitable. Despite the idiocy of millions who "never saw it coming," real estate is the simplest and easiest investment in the world.

And there is one more reason I like real estate. It can be very profitable. That's because you can leverage it with financing. I've probably earned more than 20% per year on my real estate over the years. It's made me many millions of dollars.

If you have no real estate, I recommend it. This will likely be the best time in your life to get into it. But the window won't stay open forever. (See My Retirement Plan for the Unwealthy. I will also be discussing investing in rental real estate as part of a whole series in the Wealth Builders Club.)

Finally, you don't need to be rich to play this game. You need a minimum of $10,000 and a modicum of common sense.

And Cash…

The fifth element of my diversification is cash. I always keep a stockpile of cash around—not for emergencies (a dumb idea in my opinion) but for *opportunities*. Having a store of cash has allowed me to jump into the real estate market after it tanked. When disaster hits, cash is king.

Those five are the main components of my diversification: stocks, bonds, gold, rental real estate, and cash. For most investors, that should be enough to stay safe. But for *Palm Beach Letter* readers who are better heeled and more adventurous, I will mention some additional ventures.

For the Sophisticated Investor

I regularly invest in start-up businesses. This is an especially important tactic for anyone who is seriously worried about an economic collapse.

When I buy into private businesses, I don't take long shots. I invest almost exclusively in businesses that:

1. *I understand*
2. *Are headed up by people I know and believe in*
3. *Are likely to do well if the market crashes*

Of all my investments, I have made the most money investing in start-up businesses. It takes hard work in the beginning, but the payoffs can be great. I have doubled, tripled, and quadrupled my money countless times this way. In future issues I'll be discussing this strategy.

Another way I hedge my bets is by investing overseas. I own businesses and real estate in probably a dozen countries. In every case but one I have trusted overseas partners. This isn't as "simple" as local real estate, but it can be very profitable.

A third way I have diversified is by investing in collectibles. Collectibles have the benefits of being tangible, portable, and private. Most importantly, investing in collectibles is fun. (If you are interested, see my *Intrinsic Art* report.)

And finally, I'm using the *Palm Beach Current Income* options strategy. I sell put options on high-quality stocks, and I use covered calls. I'm generating over 10% a year from this strategy, which has no correlation to my other investments. In fact, the *Palm Beach Current Income* strategy will work even better in hard economic times because volatility will rise, increasing my returns.

[Selling puts and covered calls are two options strategies for investing. While most options strategies are risky, the ones we use with *Palm Beach Current Income* are safe. By selling options we make low-ball offers on high-quality stocks. And by selling options you earn income. We'll explain more about options and how the *Palm Beach Current Income* strategy can help you in the future.]

Protect Yourself from Legal Risks

As you can see, I am extremely diversified in terms of the kinds of investments I've made. Again, I do this not because I am positive each of these sectors will perform especially well, but because I'm honest enough to admit that I'm not certain.

Besides all of these investment strategies, I take full advantage of any legal strategies I can to safeguard my wealth from legal attacks. I do that by using a variety of trusts and limited partnerships.

Pay the Taxman Only What He Is Due

And finally, I do whatever I can to safely minimize my taxes. In my tax bracket, saving $1 is like earning $1.50.

But I'm not a nut when it comes to avoiding taxes. By that I mean I won't spend a lot of time on it and I won't take any risks, especially with the IRS. I've been an advisor to tax-avoidance publications for more than 20 years, and I know first-hand many of the top experts in the field. There is nothing that any of them has ever shown me or told me that has tempted me to try to fool the taxman. If you are considering aggressive (i.e., possibly illegal) tax strategies, I advise you to put your energy into making money. It's easier and a lot less risky.

At *The Palm Beach Letter*, our first rule of investing is never lose money. That may sound like an impossible feat, but I can assure you from personal experience that it can be done. Using trailing stop losses, diversification, legal structures, and tax minimization strategies will go a long way to protecting your wealth. But to achieve my overall goal of *growing richer every day*, I do one more thing that I'll be recommending to you: I keep earning money, even when I don't need to, by creating multiple income streams.

Multiple Streams of Income

Having multiple income streams is the ultimate assurance that you will always be wealthy. I have worked very hard over the years to establish at least a half- dozen revenue streams that bring me lots of income every month. They all began small, but they all grew over time. Any one of them can keep paying for my lifestyle burn rate (see Chapter 8). So even if all of my assets somehow disappeared, I'd still be a wealthy guy.

I know this may be a lot to digest right now—especially if you are a novice investor. That's okay. If you stick with *The Palm Beach Letter*, Tom and I will give you a blueprint for everything I've laid out here.

For the time being start with what you have. Make sure you understand how to set trailing stop losses on the stocks you've been buying. And be sure to reread Chapter One: The Secret of the Golden Buckets before you do.

Each thing you do will make it easier for you to sleep at night, knowing your wealth will continue to grow.

Chapter Ten:

Making Friends With Your Financial Fears

In the previous chapter, I wrote about protecting your wealth by using stop losses, diversification, legal strategies, and tax planning.

I initially thought it covered everything I knew on the subject. But I've been thinking about it and realized that there was one important idea I did not include. It is perhaps the most important idea.

You see, that chapter was my "response" to a reader who was obviously afraid of losing the wealth he had. The fear of losing something you value is completely natural. And it is also healthy as long as the fear is not too great.

But when fear is great—and I sensed that for this person it was—it can be destructive. Unbridled fear produces two negative responses: immobility and rashness.

When you fear too much, you won't take the positive actions you suspect you should. When opportunities are presented, you'll shun them for fear of the potential dangers and downsides.

Tim Mittelstaedt, your Wealth Builders Club director/liaison, sent me the following note after he read the first draft of this chapter:

> *I've wanted to buy rental real estate since graduating from high school more than 13 years ago, but fear has prevented me from doing it all of these years. And at times I've wanted to start a business, too, but fear got in the way. Do you have ideas on how I can overcome my fears?*

Tim isn't alone. Years ago, when gold was trading at around $500 per ounce, fear was the reason why so many of my friends and colleagues were afraid to invest in gold despite my urging them to do so. It is the reason that many *Palm Beach Letter* readers are ignoring my advice to buy real estate now.

It's important to remember that the major media are almost always wrong about investing. When prices skyrocket, they write stories about people making money. When prices drop, they write stories about people losing money. Most readers have a hard time disbelieving the major media. They wonder, "How could all of these pundits on TV be wrong?" So they stay on the sidelines, waiting for positive confirmation from their favorite newspaper or television channel. But that never comes until it is too late.

Some investors who don't trust the major media are fearful, too. They are persuaded by what they read in the alternative press—about government debt and worldwide economic collapse. So they put all of their money into gold or bury it in their backyards. And when gold soars, they are afraid to cash in and invest in the stock market. The end result is just as bad for them as for those who foolishly trust the mainstream media.

I see how fear impoverishes people in the world of business all the time. Smart, hard-working people who want desperately to quit the nine-to-five routine and start their own businesses fail to do so because they can't get the threat of failure out of their minds. I spent 10 years writing books and essays on entrepreneurship and taught hundreds of thousands of people the secrets to business success. But only one in 10 was actually successful. When I met them at conferences and got to know them, the reason was obvious. They were simply scared.

If you fear losing money too greatly, you will never implement the knowledge you gain. You may invest money in investment education—thousands and thousands of dollars over time—but you won't put the ideas you learn into action. Instead, you will do only the few things you are comfortable with. As a result, you will make no progress toward your wealth-building goals.

So that's what I want to talk about today: how to make friends with your fear of losing money.

This is how I did it.

I was 26 years old. I was halfway through a two-year Peace Corps stint as a teacher of English at the University of Chad. (Chad is in Africa.) My new wife and I were living in a three-room, plaster-coated mud house. We had no kitchen, and the bathroom was a latrine.

But we had a porch that overlooked a garden of Eden frequented by a family of monkeys and a dog that barked at them insanely when they hung over the roof, begging for food. We also had neighbors who became lifelong friends. On weekends, we had parties at which African friends and Peace Corps volunteers would drink copious amounts of Gala beer and dance madly until the sun rose.

I was sitting on that porch one afternoon, sipping whiskey, when it suddenly occurred to me that I would never have a nicer house or a nicer life than I had right then. I knew—or I sensed—that one day I'd be wealthy and live in a mansion and all that, but I knew that it would never be better than the plaster- coated mud house.

So I said to myself, very consciously, "Mark, life will never be better than this." I said that because I knew that when I started making big money, I would become afraid of losing it, and I somehow knew that the fear of losing what I didn't need could hurt me. I didn't want that kind of hurt.

My intuition was right. I came back to America and became a writer for a newsletter on Africa. Six years later, I was a multimillionaire. I bought a $170,000 house and then a $550,000 house and then a $5.5 million house. But I never forgot the truth I had discovered then. I have loved all of the houses I've owned since then, but none better than that first house, which I could have bought for $1,000.

That thought helped me a great deal over the years, and it still helps me today. Whenever the fear of losing wealth invaded my consciousness, I was able to remind myself of how little I really needed to be happy.

So now, when I get that fear—and I have it from time to time—I simply remember how beautiful my life was when I was making $50 a week and living in a $1,000 mud house.

Warren Buffett seems to understand this, too. In fact, he's famous for still living in a house he bought 50 years ago for $31,500. He enjoys his wealth, but he doesn't fret over it. He makes better financial decisions because he doesn't let the fear of loss control him.

You may be thinking, "That's fine for you to say. You are rich. You can afford to lose money."

But that's exactly my point. Because I am not afraid to be poor, I don't make foolish mistakes born out of fear. I don't let good investments—investments that are sound and well-priced—pass me by. As I explained in the last essay, I don't put all of my eggs in one basket. But I do take action.

That's what I forgot to tell this reader: The most important secret of wealth preservation is to make peace with your fear of becoming poor.

You can't control the economy. You can't control the forces that affect your business. But you can control your emotions. By making friends with fear, you will enjoy the wealth you have and make smart, wealth-building decisions.

You don't want to be forever on the sidelines, watching other people make money. And you don't want to put all of your money in gold, hoping for Armageddon.

To make friends with fear, you have to imagine yourself living a simple life, one that can be supported by a modest income, enjoying your work and the time you spend with your family and friends. Imagine that until you feel comfortable with it. What will happen is that your anxiety will disappear and, counter-intuitively, you will make better financial decisions.

If you are scared to start a business, imagine yourself failing. Then imagine feeling okay with it. (You will be okay financially if you have limited your risk as I recommended in Chapter 9: How to Safeguard the Wealth You Are Building.) Imagine yourself smiling to your spouse and saying, "Well, that didn't work out."

If you are scared to invest in the stocks we are recommending, imagine your portfolio dropping 25%. (It won't, but you must imagine it.) Imagine yourself thinking, "Okay, I've been stopped out. Now I will pick myself up and start over again."

[Being "stopped out" comes from setting stop losses on your stocks. A stop loss is an order you give your broker to sell your stock if its price dips below a certain point. For example, if you buy a stock at $40 and set a 25% stop loss, your broker will sell it the moment it hits $30 (10 points, or 25% less than $40, the price you paid for it.]

If you are afraid of investing in real estate, imagine the worst thing that could happen. You sell the property and take a 10% to 15% loss. (This is highly, highly unlikely.) Imagine yourself being okay with that.

In other words, do everything I suggested in that essay. Use moving stop losses to protect your performance portfolio. Diversify your investments to include debt instruments, precious metals, and real estate. And take full advantage of legal structures and tax-minimization strategies. But don't live in fear. Life can very sweet—and rich in pleasure —even if you do lose money, which will probably not happen if you aren't afraid.

Chapter Eleven:

How to Invest in Stocks for Lifetime Wealth

A while ago, I wrote a short essay about how Warren Buffett became so rich. But I failed to mention how rich he became.

With a net worth of $68.4 billion, he's the second-richest man in America and No. 3 on the *Forbes* billionaires list (as of 4/29/2016).

["Net worth" is the amount by which your assets (what you own) exceed your liabilities (what you owe). Assets are things like stocks, bonds, cash or gold. Liabilities are things like a mortgage, credit card debt, or student loans. Net worth can apply to both to individuals and businesses as a key measure of how much an entity is worth.]

Most people know Buffett as a great investor. But few know that he wasn't always good at his trade.

Why? Early in his investing career, he realized that there were certain businesses that had strategic advantages—advantages that allowed them to continue to grow bigger every decade, crushing their competition over time. He figured that if he could buy those businesses when the price was right, the market would guarantee him huge, long-term profits.

And that's exactly what he did.

Berkshire Hathaway, the company Buffett took control of in 1965 to buy such companies, has produced an average 19.8% annual return on investment (ROI) since then.

[Return on investment (ROI) is a measure used to evaluate an investment's performance. To calculate ROI, divide the investment's return by the initial cost of the investment. For example, let's assume I invest $100 this investment returns $19.80 to me by the end of the year. The cost of my investment was $100 so my ROI is $19.80 divided by $100 or 19.8%.]

Being a new student of investing, I have been wondering: If Buffett's system is so great, why doesn't every investor—professional or private—follow it?

I believe I know the answer. It's an answer that anyone who has been successful in business over several business cycles knows. The investment advisory industry—at least the way it is practiced by more than 95% of the professional community—is not geared toward long-term wealth.

Why Doesn't Everyone Do What Buffett Does?

Although most wouldn't admit it, investment advisors (brokers or financial gurus) have an entirely different objective—one that runs contrary to the long- term acquisition of wealth.

That objective is *yearly* ROIs.

It is perhaps the greatest stupidity of the investing world, but the investment industry enslaves nearly everyone to yearly report cards. Investment bankers, brokers, financial planners, and advisors all have their performances rated annually. Once per year, the whole world gets to see how they did, compared with their colleagues.

This is *just as true* for the independent investment newsletter industry.

Our performances are calculated, rated, and reported every year by various industry "watchdogs." These yearly report cards are open to the public. And they get a lot of press. The advisories with the best **one-year** track records enjoy big influxes of new customers.

The industry watchdogs report longer-term track records too, but no one pays much attention to them. Consumers are hardwired to focus on "who's hot"— and that means who was hot last year.

This creates enormous pressure to produce short-term annual gains.

I was reminded of this recently when Agora's founder and president sent out a memo to Agora's publishers saying that he wanted them to spend more money on research and the quality of our writing. He then said that he would like to see all of our publications at the top of Mark Hulbert's list—an annual list of the best-performing newsletters in the industry.

Hulbert tracks newsletters on a long-term basis, but the entire industry gives scant attention to that. The industry treats yearly winners like Academy Award winners. They get the attention and the spoils.

The irony here is that Agora's founder, the man who wrote this memo, knows that short-term gains have nothing to do with long-term wealth. He has created a family office to protect his wealth over many generations, and one of the primary rules of that office is to invest for the long term. By that, I mean 50-year increments.

[A family office is a private wealth management firm designed to provide investing and financial services to an affluent individual or family.]

The point I'm making here can't be understated. ***The bias toward short-term profits is antithetical to long-term wealth building.***

You need to understand this if you want to develop long-term wealth.

I can hear some of you shouting already. "I don't care about long-term wealth. I want to start making good money now. In fact, I want to get rich now!"

I hear you. But the fact is that you can't get rich quickly in the stock market unless you are both extremely foolish and also extremely lucky. But what you can do, if you are smart, is generate a *reasonable* amount of short-term income while you are building up a retirement nest egg that will cover all of your lifestyle expenses after you stop working.

I've written on both of those subjects before and will do so again, but today I want to focus on Buffett's secret: generating nearly guaranteed long-term wealth.

Putting My Money Where My Mouth Is

Since having my own, personal Warren Buffett insight, I've made some personal decisions. I asked Tom Dyson and his team to recommend four Warren Buffett-like stocks. (Not the exact same stocks that Buffett owns but ones that make sense for me at this particular time.) I then invested $25,000 in each of them. Since then, I've made two more investments of the same size.

My intention is to have $1 million in that account in the next 12 months. I'd do it sooner, but I need to wait until Tom and his team pick more stocks. One of the keys to this strategy, as I'll explain in a moment, is a modest degree of diversification. You can't do it with four or even six stocks. I'm thinking 10 stocks will be perfect, but we'll wait until Tom and his team have completed their work before we will decide for sure.

That's a good start for me, but it does you no good. So we've built a new portfolio that recommends Warren Buffett-type stocks to *Palm Beach Letter* subscribers.

Before I recap exactly how this new portfolio works and how it will all but guarantee long-term wealth, I want to restate clearly something that I have just implied.

Three Different Kinds of Investing

When it comes to investing in stocks, there are, basically, three goals most people have:

- The production of current income
- Saving for retirement
- Developing wealth.

You know from reading this book, especially Chapter One: The Secret of the Golden Buckets, that I believe each requires a separate and distinct strategy.

The Palm Beach Letter has a very good strategy for current income. That is our options course and advisory, ***The Palm Beach Current Income***.

To help *Palm Beach Letter* readers save for retirement (and other goals, such as college tuition), we have our **Performance Portfolio**, which is designed to produce solid, above-market returns year after year. This is the best *yearly* investment savings strategy I know of.

We also have the **Perpetual Income Program**, which comes free with your subscription. This is our bond-laddering strategy, the same one I used to create a seven-figure income for my family and me if and when I retire.

Introducing the Legacy Portfolio

This brings us to our long-term portfolio. We call it the **Legacy Portfolio**, because it will eventually be a fortune that you can retire on or leave to your children or give to the charity of your choice.

Of course, you might one day use the Legacy Portfolio to buy boats, houses, or any other unnecessary luxuries you want. But my hope is that you won't. You can use our other portfolios to take care of your present needs. If you follow the strategy I outline in "What Is Your Magic Number?," you won't need to draw from the Legacy Portfolio "bucket" for as long as you live.

You will be able to, if you want. But you won't need to.

Because it has a different purpose, the Legacy Portfolio also has a different investment time frame, a different buying-and-selling strategy, and a somewhat different selection of stocks.

The Five Benefits of an Extended Time Frame

To get the full benefit of the Legacy Portfolio, you need to follow the rules. You need to select only very safe and very protected businesses. And you need to stick with them regardless of yearly results.

If you do, you will benefit from the enormous advantages of Legacy investing.

The most important of these advantages is **the power of compound interest**.

["Compound interest" includes reinvesting any interest you earn to your original principal balance. For example, let's say I invest $100 in year one and earn $5 in interest. In year two I reinvest the interest I received. Now in the second year, I will earn interest on a higher balance of $105 instead of $100. In year three, I will earn interest on an even higher balance of $110.25. Each year I reinvest the interest it compounds and grows my initial investment at a faster rate.]

If you have ever looked at a compound interest chart, you've noticed that the upward curve of wealth accumulation begins slowly over the first 10 years and then increases rapidly after that. By year 30, the numbers are really enticing. At 40 years, they are simply unbelievable. For investors with meager means, they will be in the millions. For mid-level investors, they will be in the tens of millions. And for affluent investors, they will be $100 million or more.

The second advantage of this long-term time frame is **simplicity**. As I'll explain in a minute, you won't have to regularly monitor the markets or even worry which way they are going. You can pretty much set up the Legacy Portfolio strategy and leave it be.

The third advantage is **peace of mind**. With this sort of strategy, you don't worry about stock market fluctuations. Not even big ones like we've experienced recently. (Buffett says that if they closed the market for five years, he wouldn't care.) In fact, you are happy when the market declines—even when the stocks you are holding drop, as I'll explain.

The fourth advantage is that the Legacy Portfolio **prevents you from paying unnecessary fees** to money managers, brokers, and financial planners. Over time, the fees siphoned away by these professionals erode your wealth significantly.

Fifth, investing in stocks in the Legacy Portfolio **keeps you from being too conservative** with your money. One of the greatest risks you run is losing money to inflation in overly conservative investments such as cash, CDs, money market funds, and bonds. By investing in the best companies in the world, you'll grow your money at much higher rates of return. Rates that beat the pants off inflation's wealth-eroding effects.

Buying and Selling Strategy

The Legacy Portfolio has a different buying-and-selling strategy. Like Warren Buffett, we won't be selling our stocks if they dip down. Whereas a trailing stop loss is essential for the Performance Portfolio, it is unnecessary and even counterproductive for the Legacy Portfolio. If and when the share price of any of our stocks goes down significantly, we'll be buying more, not getting out.

[A stop loss is an order you give your broker to sell your stock if its price dips below a certain point. For example, if you buy a stock at $40 and set a 25% stop loss, your broker will sell it the moment it hits $30 (10 points, or 25% less than $40, the price you paid for it).

A trailing stop loss means that the stop loss is triggered not by the price you bought it at, but by its highest price. Thus, if the $40 stock goes to $50 and then drops, your broker will sell it at $37.50, which is 25% less than $50.]

The reason for this is that our objective **is not** yearly ROIs, which are the bane of the financial industry, as I explained above. The objective of the Legacy Portfolio is to accumulate as many shares as we possibly can of the 10 (or so) companies we believe in. We will be getting richer by having progressively larger shares of those companies, not by trading them to optimize profits.

Respecting this different objective, we won't be reporting on our performance in the usual way. We won't be sending you a yearly report card based on 12-month results. Instead, we will be using a new and unique program that projects forward the value of our investments over 10, 20, 30, and 40 years.

Looking for Enduring Strategic Advantages

Before I joined *The Palm Beach Letter*, I worked as an entrepreneur for 30 years. I invested in and ran dozens of businesses whose revenues ranged from $5 million to $500 million.

I learned many lessons about investing. Among the most important was that it very rarely pays to invest in long shots. Building wealth is much easier if you buy into proven businesses that have distinct, competitive advantages.

Take Agora Inc. (the parent company of our business, the Palm Beach Research Group) as an example. Agora has always attracted independent thinkers. This made it impossible to have a corporate-wide philosophy of publishing. No sooner had one group succeeded with a certain type of product than another would splinter off and create a second group that would compete against it. By providing a safe place to exercise this independence, Agora grew into a holding company of several-dozen independent publishing entities competing first against one another and then against the rest of the industry.

This was not only a competitive advantage, but also one that was very difficult to emulate. Other publishers were simply not interested in suffering through the chaos that such a free-market-based management system must allow for. This allowed Agora to grow during my tenure from a company with about 10% of the market to one that has more than half of the market today.

If you could have invested in any of Agora's competitors 30 years ago, you might well have chosen any of a dozen that were bigger and more impressive at the time. But had you recognized the competitive advantage that Agora had back then, your investment would have turned out very nicely indeed.

In fact, when I entered the picture, there were two "outsiders" who had shares in Agora. One believed in the company's prospects and held his shares continuously in the good times and the bad. The other sold his shares piecemeal when trouble seemed to be looming. The first investor's stake (an investment of less than $50,000) is worth tens of millions of dollars today.

The second investor regrets what he did.

I can give you other examples, but I think you get the point. When you have an interest in a business that you believe in, you don't sell your shares simply because of some temporary downturn. Instead, you will use that

advantage to buy up more shares, as Agora's founder did. Since your goal is not yearly profits or even yearly cash flow but long-term asset appreciation, you buy more when the price dips down, and you don't sell unless the competitive advantage disappears.

In constructing the Legacy Portfolio, we are seeking to replicate the lessons we have learned as private investors, as well as the lessons Buffett learned early in his career. Most of the principles are the same. The Legacy Portfolio stocks we are and will be investing in must meet the following criteria:

1. It must be a continually growing business. One that has demonstrated consistent growth over time.
2. It must be a cash-rich businesses. These are companies that regularly produce excess cash and have lots of cash on their balance sheets.
3. It must be a consistently profitable business. These are companies that have track records of relatively consistent profits over many years.
4. It must be an industry dominator. These are companies that dominate their industries and have established and well respected brands.
5. It should be a dividend-paying business. One that returns excess cash to shareholders in the form of ever-increasing dividends.
6. It must have enduring, competitive advantages. These are companies that have a unique technology, a patent, a monopoly or powerful brand that will give it an edge over the competition for a long time to come.
7. It must be resistant to recession. These are companies that stay profitable even during extended industry downturns.
8. It must be well-priced: These are companies we can buy at price levels that are below their historic averages.

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