The Millionaire Next Door.

Stanley and Danko—1996.

Introduction

- Many people who live in expensive homes and drive luxury cars do not actually have much wealth. Then, we discovered something even odder: Many people who have a great deal of wealth do not even live in upscale neighborhoods.
- Wealth is what you accumulate, not what you spend.
- Eighty percent of America's millionaires are first-generation rich.
- In the course of our investigations, we discovered seven common denominators among those who successfully build wealth.
    - They live well below their means.
    - They allocate their time, energy, and money efficiently, in ways conducive to building wealth.
    - They believe that financial independence is more important than displaying high social status.
    - Their parents did not provide economic outpatient care.
    - Their adult children are economically self-sufficient.
    - They are proficient in targeting market opportunities.
    - They chose the right occupation.

Meet the millionaire next Door

- Interestingly, self-employed people make up less than 20 percent of the workers in America but account for two thirds of millionaires.
- We are fastidious investors. On average, we invest nearly 20 percent of our household realized income each year. Most of us invest at least 15%.
- We hold nearly 20 percent of our household's wealth in transaction securities such as publicly traded stocks and mutual funds. But we rarely sell our equity investments. We hold even more in our pension plans. On average, 21 percent of our household's wealth is in our private businesses.
- Multiply your age times your realized pretax annual household income from all sources except inheritances. Divide by ten. This, less any inherited wealth, is what your net worth should be.
- We have developed another simple rule. To be well positioned in the PAW category, you should be worth twice the level of wealth expected. In other words, Mr. Duncan's net worth/wealth should be approximately twice the expected value or more for his income/age cohort, or $635,500 multiplied by two equals $1,271,000. If Mr. Duncan's net worth is approximately $1.27 million or more, he is a prodigious accumulator of wealth. Conversely, what if his level of wealth is one-half or less than expected for all those in his income/age category. Mr. Duncan would be classified as a UAW if his level of wealth were $317,750 or less s (or one-half of $635,500).

Frugal Frugal Frugal

- Their shopping habits certainly have something to do with the fact that they are not wealthy. Who are these people? Typically, they do not own their own business. They are more likely to be corporate middle managers (especially those who are part of a working couple). Attorneys. Sales and marketing professionals, and physicians.

- This last question is highly significant. Not only are the most prestigious accumulators of wealth frugal, their spouses tend to be even more frugal.
- Most people will never become wealthy in one generation if they are married to people who are wasteful. A couple cannot accumulate wealth if one of its members is a hyper consumer.
- The found stone of wealth accumulation is defense, and this defense should be anchored by budgeting and planning.
- Question 1: Does your household operate on an Annual budget?
    - We anticipate your question about those millionaires who don't budget. How did they become millionaires? How do they control spending? They create an artificial economic environment of scarcity for themselves and the other members of their household. More than half of the no budgeters invest first and spend the balance of their income. Many call this the "pay yourself first" strategy. These people invest a minimum of 15 percent of their annual realized income before they pay the sellers of their food, close, homes, credit and the like.
- Question 2: Do you know how much your family spends each year for food, clothing, and shelter?
- Question 3: Do you have a clearly defined set of daily, weekly, monthly, annual and lifetime goals?
- Question 4: Do you spend a lot of time planning your financial future?
    - Millionaires spend significantly more hours per month studying and planning their future investment decisions, as well as managing their current investments, then high income non-millionaires.
- To build wealth, minimize your realized (taxable) income and maximize your unrealized income (wealth/capital appreciation without a cash flow).
- That people accumulate significant wealth by minimizing their realized/taxable income and maximizing their unrealized/nontaxable income.
- It's easier to accumulate wealth if you don't live in a high status neighborhood.
- If you're not yet wealthy but want to be someday, never purchase a home that requires a mortgage that is more than twice your household's total annual realized income.

Time. Energy, and Money

- Efficiency is one of the most important components of wealth accumulation.
- PAWs allocate nearly twice the number of hours per month to planning their financial investments as UAWs do.
- Operating a household without a budget is akin to operating a business without a plan, without goals, and without direction. The Norths have a budget that calls for them to invest at least one-third of their pretax household income each year. In fact, during the year that we interviewed Dr. North, he and his wife invested nearly 40% of their annual pretax income.
- UAWs tend to produce children who eventually become UAWs themselves.
- When it comes to the allocation of my time, I place the management of my own assets before any other activities.

- Conversely, UAWs tend to agree with the following statements:
    - I can't devote enough time to my investment decisions.
    - I'm just too busy to spend much time with my own financial affairs.
- UAWs consider cash/near cash and equivalents, such as savings accounts, money market funds, and short-term treasury bills, to be investments. UAW's are nearly twice as likely as PAW's to hold at least 20% of their total wealth in cash/near cash. Most of these cash categories are federally insured. Most are easily accessed when consumption needs arise. And, of course it takes less time to plan cash related investments than it does to allocate wealth the way PAW's tend to do. PAW's are more likely to invest in categories that usually appreciate in value that do not produce realized income.
- In sharp contrast, most of the PAWs we have interviewed make their own investment decisions.
- How did you hire your household's financial advisor? Did you list the position in the help-wanted section of your local newspaper? Did you evaluate the stacks of resumes your advertisement generated? Or did you ask your accountant, attorney, or minister to help you find a quality advisor? Many people tell us that such methods are just too much work.
- "I am a businessman who goes out and tests people. Brokers call me a lot. They say, "I have a great deal of experience in Wall Street's best offerings. . . I have a fantastic track record of making money for my clients. I always say: "Do you have some good investment ideas for me—really good" He says, "Absolutely, especially if you're willing to make trades in your portfolio. I only handle accounts with a minimum of $200,000. Then I tell him, "So you're really good. Well, I'll tell you what. Send me a copy of your personal income tax returns from the last few years and a list of what you have had in your own portfolio for the past three years. If you made more money than I did from investments, I'll invest with you. Here's my address." When they say, "We can't show that to you," I tell them. 'You are likely to be full of baloney." This is my strategy for checking people out. It works. I check them all out this way. I mean it very honestly.

You Aren't What You Drive

- If your goal is to become financially secure, you'll likely attain it. . . . But if your motive is to make money to spend money on the good life . . . you're never gonna make it.

Economic Outpatient Care

- Conversely, what is the effect of cash gifts that are knowingly earmarked for consumption and the propping up of a certain lifestyle? We find that the giving of such gifts is the single most significant factor that explains lack of productivity among the adult children of the affluent. All too often such "temporary" gifts affect the recipient psyche. Cash gifts earmarked for consumption dampen one's initiative and productivity. They become habit forming. These gifts then must be extended throughout most of the recipient's life.
- Whatever your income, always live below your means.

Affirmative Action, Family Style.

- Most affluent parents who have adult children want to reduce the size of their estate before they pass away. Certainly this decision makes sense, given that the alternative is to leave their children with a significant estate tax liability.

- Parents with nonworking adult daughters and "temporarily" unemployed adult sons have a high propensity to provide these children with heavy doses of economic outpatient care (EOC). These children are also likely to receive a disproportionately large portion of their parents' estates.
- Daughters who are not housewives but are employed in full-time positions are less likely to receive cash gifts and inheritance than their nonworking sisters.
- I have two children. They are close to each other. They can settle my estate between them… But they will have to do it along with my attorney… The children and my attorney are executors of my estate. I put the attorney in just to keep the balance. . . . You know when money's involved what can happen. I want to keep good relations . . . But good relationships may deteriorate at the last moment without an experienced professional.
- I never knew my dad was wealthy until I became executor of his estate. He never looked it.
- No matter how wealthy you are, teach your children discipline and frugality.
- Kids are very smart. They will not follow rules that their parents themselves do not follow.
- Give because of love, even obligation and kindness. Adult children often lose their respect and love for parents who submit to high pressure and negotiation tactics.
- Tell your children that there are a lot of things more valuable than money.

Find Your Niche

- Very often those who supply the affluent become wealthy themselves.
- The affluent are not at all frugal when it comes to buying products and services for their children and their grandchildren.

Jobs: Millionaires versus Heirs

- By now you probably can predict the answer. Most of the affluent in America are business owners, including self-employed professionals. Twenty percent of the affluent households in America are headed by retirees. Of the remaining 80 percent, more than two-thirds are headed by. Self-employed owners of businesses. In America, fewer than one in five households, or about 18 percent, is headed by a self-employed business owner or professional. But these self-employed people are four times more likely to be millionaires than those who work for others.
- You can't predict if someone is a millionaire by the type of business he's in.
- The character of the business owner is more important in predicting his level of wealth than the classification of his business.
- Fewer than one in five millionaire business owners turn his business over to his children who own and operate.
- Dull companies with steady earnings growth may not make for stimulating cocktail party chatter, but over the long term they will make the best investments.
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