

**How to Achieve Financial Independence at an Early Age**  
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Work a 9-5 until age 65 and then retire. Sell your time and energy to a corporation who has its own interests at heart, not yours. This has been the norm in our society for decades. Younger generations are skeptical and have begun challenging traditional thoughts on retirement and personal finance. What is offered in this discussion is a radical approach to personal finance. One that incorporates heavy savings, intelligent investing and minimization of expenses. The numbers show that even with a modest income, one can reach financial independence much earlier than expected if adhering to a few rather simple techniques.

Before continuing, it is necessary to first define what it means to be financially independent. For the purpose of this paper, financial independence will be defined as not having to work for money. Having enough money to be able to live comfortably off of your investments. "Comfortable" will vary from person to person, but the idea is if one's annual expenses total to say, \$50,000, then they can retire once their assets alone produce \$50,000 a year. So how can this be accomplished? It boils down to savings rate. The more percent of your income you are able to save, the faster you will be able to retire. By cutting down on your daily expenses, you are headed down the path of early retirement.

### **Saving and minimizing your expenses:**

A crucial part of the plan is to live significantly below your means, while many people may not be interested in living off of Ramen Noodles after graduation, this is a radical approach that requires some sacrifice. If you spend 100% of what you earn, no matter what your salary is, you will never be able to retire. However, if you spend 0% of what you earn annually, you are ready to retire today! The goal is to maximize the savings rate, while still maintaining happiness. By reducing the usual top 3 expenses of American households, housing, transportation and food, one can drastically increase the amount they save. Overconsumption is a part of American culture, by realizing this you begin to understand that we live in a capitalist society, where people are always trying to sell you something even if you don't need it. The truth of the matter is a single person can live comfortably for much less than you would expect, the

rest can be saved. While this is easier said than done, as long as the benefits of saving are recognized, savings becomes an activity to look forward to, rather than something dreaded.

- 1) Avoid lifestyle inflation – Many college graduates buy new cars and homes as soon as they secure their first “real” job. This sets them up for a lifetime of debt slavery. Getting trapped in credit card debt with interest rates in excess of 20% makes saving money nearly impossible and early retirement just a dream. The most important thing is to continue to live like a college student even once you have an “adult” salary.
  
- 2) Live close to work – Obviously the closer you live to your work, the less money will be needed to spend on gas and other auto related expenses, the average household spent nearly \$3000 on gas in 2012<sup>1</sup>. That’s a lot of money! If instead that money was invested in a mutual fund that earned 10%, that \$3000 would have turned into \$3300 plus any associated dividends. This step is important to keep in mind as college students graduate and start looking for their first job. Location should be a factor taken seriously.
  
- 3) Have low cost hobbies –Have you noticed that in order to have fun you have to spend money? While our society may have engrained that into our heads, plenty of fun can be had for free. Pick up hobbies like exercising, hiking or guitar rather than drinking, shopping and gambling and be amazed at how much money you save.
  
- 4) Cut down on eating out –Eating out can quickly drain your wallet. Eating out a few times a week can easily add up to hundreds of dollars. Try buying food in bulk and cooking meals for yourself, it will usually be healthier for your body and your wallet.

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<sup>1</sup> Report: U.S. Households Spend Record Amount on Gas in 2012

- 5) Make saving fun –Budgeting and saving money does not have to be something that you dread. Tons of software and apps like You Need A Budget (YNAB) and Mint help make the process easy and fun.

### **Investing Intelligently:**

As younger people, investing at all is a step ahead of most. This means being in a position financially to invest. There is no sense in investing if you have high interest credit card debt. Rarely would you ever make a return in the market that would be high enough to negate the interest charged by your credit card company. Also, before investing, a 3-6 month emergency fund should be built in the event that you lose your job or switch jobs. If you have money invested but and have to sell your positions and withdraw at a bad time you will most likely lose money in the market.

- 1) Index Funds –If you know nothing about the market and aren't interested in learning, invest in index funds. An index fund is a type of fund that tracks a market index like the S&P 500 or Dow Jones. They have very low fees as they don't have a team of managers actively picking the stocks for the fund. Index funds allow for a broad exposure to the market, meaning you're invested in a lot of different things, or very diversified. Index funds are considered a “passive” investment because they are not run by money managers. This means lower management fees. Historically, index funds have produced positive results (see figure 1) and outperformed mutual funds which is why they are usually the choice of investment in retirement accounts like 401k's and IRA's , and recommended to people who don't know much about the market or what to invest in.

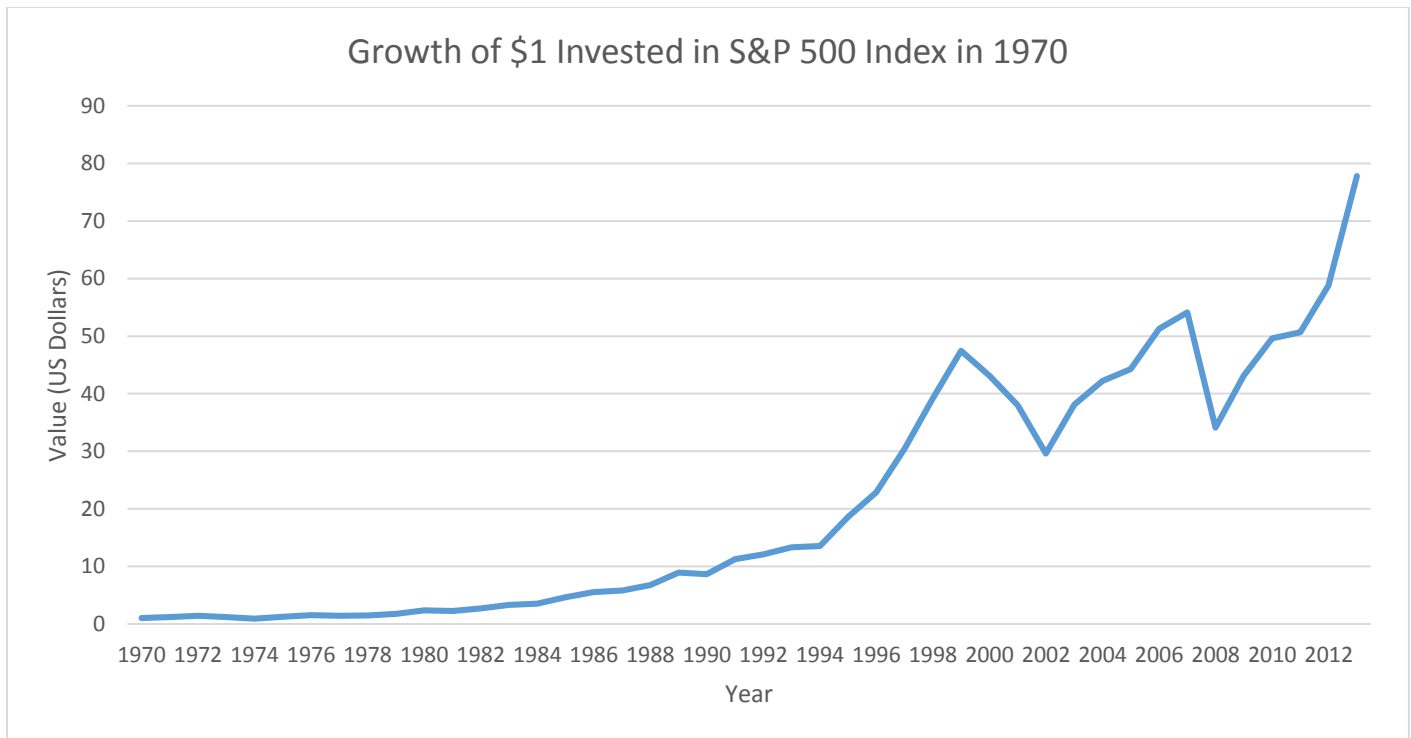


Figure 1. Growth of \$1 Invested in S&P 500 Index in 1970

- 2) Individual Stocks –If you are interested about the market, and have the time to do the homework on each stock you own, individual stocks are the way to go. All of the information is available online for free, all you need to know is what to look for.
  
- 3) Be Aggressive! –We are young so we have our entire lives to make up any money lost. Take a gamble on a speculative stock, or a company you believe in. Your portfolio should consist of 100% stocks for the foreseeable future. An old rule of thumb was your portfolio should consist of (in percent)  $100 - \text{your age}$ . If you are 20,  $100 - 20 = 80\%$  of your portfolio should be made up of stocks. That rule has been changed and people are now saying  $120 - \text{your age}$  is a better recommendation.

## Numbers:

So all of this sounds too good to be true. Where are the numbers? How much do you need to save? A good number to shoot for is **25 times your annual spending**. If you're comfortable annual spending is say \$50,000, multiply that by 25 = \$1.25 million is how large your nest egg should be in order for it to last forever. This number allows you to safely withdraw 4% or, \$50,000/year. Where does the 4% come from? It is a conservative number assuming your investments on average gain 7% per year. 7% – 3% for inflation = 4%.

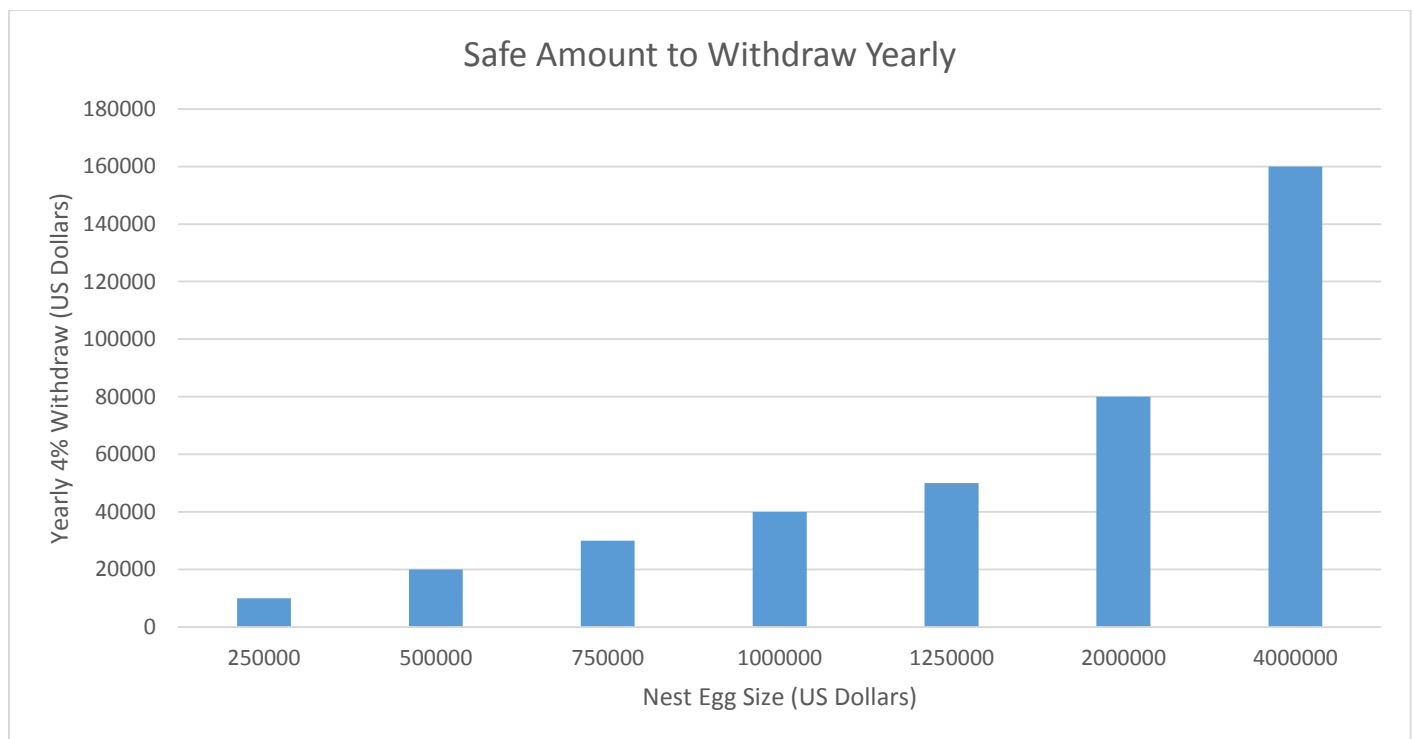


Figure 2. Safe Amount to Withdraw Yearly

## Conclusion:

With careful planning, discipline and a clear vision in mind, early retirement can be achieved. While it requires sacrifice and the possibility of your friends making fun of you, the benefits of not being controlled by money far outweigh the downsides.

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