<u>**THE MILLIONAIRE NEXT DOOR**</u>

<u>The Surprising Secrets of Americaœs Wealth</u>

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<u>**Introduction**</u>:
(1) Wealth is not the same as income ... wealth is what you accumulate, not what you spend.
(2) How do you become wealthy ... most often itœs hard work, perseverance, planning and most of all, self-discipline.

<u>Millionaires</u>: nearly half of the USœs wealth is owned by 3.5% of our households.

. Minority of households have even the most conventional financial assets
. 15% ... have a money-market deposit account
. 22% ... have a certificate of deposit
. 4.2% ... have a money market fund
. 3.4% ... have corporate or municipal bonds
. 25% ... have stocks or mutual funds
. 8.4% ... have rental property
. 18.1% ... have US Savings Bonds
. 23% ... have IRA or Keogh accounts
. 65% ... have equity in their own home
. 85% ... own one or more cars

<u>The Seven Factors</u>: 80% of US millionaires are first-generation rich. Common denominators:

(1) They live well <u>below</u> their means
(2) They their time/energy/money <u>efficiently</u>, in ways conducive to building wealth
(3) They believe financial independence is <u>more</u> important than displaying social status
(4) Their parents did <u>not</u> provide Economic Outpatient Care (EOC)
(5) Their <u>adult children</u> are economically self-sufficient
(6) They are proficient in <u>targeting</u> market opportunities
(7) They chose the right <u>occupation</u>

CHAPTER ONE: Meet the Millionaire Next Door. Looks are deceiving ... some have

big hats, but no cattle.

Portrait of a Millionaire:

(1) 57 year old male, married w/3 children (20% are retired)
(2) Most are not driving this yearõs model car (only minority ever *lease* a car)
(3) 2/3rds are self-employed ... less than 20% of workers in US, but account for two-thirds of millionaires.
(4) Their businesses are typically ñdull-normalò.
(5) About half of the wives do <u>not</u> work ... most are meticulous planners & budgeters
(6) Total annual taxable income is $131K (median), but average is $247K ... a few <u>big</u> earners skew average.
(7) Median household net worth is $1.6M, average is $3.7M ... again, a few skew average up.
(8) On average, the total annual taxable income is less than 7% of ñwealthò.
(9) 97% are homeowners, average home value $320K.
(10) 80% are first-generation affluent (did not inherit wealth)
(11) They live well below their means
(12) They have accumulated enough wealth to live w/o working for 10+ years
(13) They have chosen wealth over high-status material possessions
(14) 20% HS grads, 50% half college degrees, 18% Masters, 8% lawyers, 6% MDs, 6% PhDs
(15) 17% of parents went to private schools, but 55% of their children go to private schools
(16) Education extremely important ... spend heavily for offspring education
(17) Invest 20% of income annually. 80% have account w/brokerage, but make own investment decisions.
(18) 20% of wealth is in stocks and mutual funds ... they rarely sell.
(19) Feel daughters are financially handicapped ... sons have cards stacked in their favor, need no subsidies.
(20) Most want children to provide service to wealthy ... accountants, attorneys, tax advisors, estate planners.
(21) Most are tightwads

Wealthy: Net worth of $1M+. Most own appreciable assets, do not display high-consumption lifestyles.

What should your net worth be? (10%) x (Age) x (annual household income)

<u>PAW</u> (prodigious accumulator of wealth) ... twice the expected net worth
<u>UAW</u> (under accumulator of wealth) ... half the expected net worth
<u>AAW</u> (average accumulator of wealth) ... in between

Facts about American millionaires:

(1) Less than 20% receive inheritance from trust/estate
(2) Less than 20% inherit 10% or more of their wealth
(3) More than 50% receive nothing in inheritance
(4) Less than 25% ever receive an ñact of kindnessò ($10K+) from family
(5) 90%+ never received any of the family business
(6) Nearly 50% never received college tuition from family
(7) Less than 10% believe they will ever get an inheritance in the future

Ancestry: Current achievements are more a factor in wealth accumulation than the past.

(1) Russians and Scots have disproportionate numbers of millionaire households in US.
(2) Small size ancestry groups tend to produce large numbers of wealthy members ... but the longer in the US, the less the difference (socialized into hi-consumption lifestyle)
(3) Sons and daughters are <u>not</u> generally more successful than wealthy parents.

CHAPTER TWO: They Live Well Below Their Means

Frugal: Economy in use of resources (antonym: wasteful). Cornerstone of wealth-building.

Millionaire Lifestyle Factoids:
- Typically never spend more than $399 for a suit
- 30% hold JCPenny credit cards
- Only 10% have ever spent more than $300 on footwear
- 50% never spent more than $235 for a wristwatch

Playing Great Defense: Spouse is most frugal person in family
- 95% of millionaire households are married couples
- The men play great offense ... income generation (more than norm: $33K/yr)
- The household plays great defense ... hold down consumer spending
- Most people will never become wealthy in one generation if they are married to a wasteful person.

Foundation stone of wealth accumulation is defense ... anchored by budgeting & planning.

Millionaires became millionaires by budgeting and controlling expenses.
They maintain their affluent status the same way.
Most people don't have the discipline to do it.

Do you wish to become affluent and stay affluent? Answer these questions ñYESò:
(1) Does your household operate on an annual budget?
(2) Do you know how much your family spends each year on food, clothing, shelter?
(3) Do you have clearly defined daily, weekly, monthly, yearly, lifetime goals?
(4) Do you spend a lot of time planning for your financial future?

Ultimate Consumption Category: Income tax is the single largest annual expenditure for most households. The typical millionaire:
- Has total annual realized income of less than 7% of his wealth.
- Annual tax bill is about 2% of their wealth

To build wealth, minimize taxable income
& maximize unrealized income.

Millionaires measure their success by net worth, not by their realized income. Sacrifice high-consumption today for financial independence tomorrow.

If you're not yet wealthy but want to be someday, never buy a home that requires a mortgage more than twice your household's total annual realized income.

Living in a less costly area will enable you to spend less and invest more of your income.

CHAPTER THREE: <u>They Allocate Their Time, Energy and Money Efficiently, in Ways Conducive to Building Wealth</u>

<u>Efficiency</u> is one of the most important components of wealth accumulation. There is a strong positive correlation between *investment planning* and *wealth accumulation*.

**PAWs allocate nearly twice the hours/month
to planning their financial investments as UAWs**.

<u>Education</u>: High-income PAWs are <u>less</u> likely than UAWs to hold graduate degrees, law degrees or medical degrees. Why? . Extensive education delays earning and investing.
. Society ascribes a status to the well-educated ... they must play their part and incur high domestic overhead (expensive car, house, clothes, demands on time, charitable giving, etc).

<u>Planning and Controlling</u>: Key factors underlying wealth accumulation. PAWs, usually price sensitive, are much less so when buying services to control familyǿs consumption behavior.

Invest at least 15% of your pretax income each year.

<u>Car-Shopping</u>: Inverse relationship between the time spent purchasing luxury items (cars, clothes) and the time spent planning oneǿs financial future.
. Donǿt be penny-wise and pound-foolish
. PAWs allocate their spare time to activities that will enhance wealth
. More than 50% of millionaires never pay more than $30K for a car.

<u>Fears and Worries</u>: PAWs worry less ... have more time to spend wealth-enhancing areas.
(1) UAWs tend to produce children who become UAWs (exposure to high consumption), and having adult children who are UAWs greatly reduces the probability that the parents will *ever* become wealthy.
(2) UAWs main concerns:
. Higher Federal Income Taxes ... UAWs must maximize income to support consumption lifestyle.
. Higher Government Spending & Federal Deficit ... translates to higher taxes.
. Higher Rate of Inflation ... price increases on consumer items
. Higher Government Regulation ... employees are vulnerable to threats on earning income.

<u>Financial Goals</u>: Having goals does <u>not</u> mean there is a commitment to achieving them.
(1) Planning and wealth accumulation are significant correlates (even w/modest incomes).
(2) PAWs spend about 8 hours/month planning their investments.
(3) PAWs build wealth slowly.
(4) Definitions of ñinvestmentò vary:
. PAWs invest in areas that appreciate in value but produce no realizable income.
. UAWs consider money-market, savings, short term T-bills to be investments (easily accessed when consumption needs arise). UAWs tend to own expensive assets (cars, clothes) that depreciate.
(5) Millionaires are not ñactiveò traders ... 42% make no stock trades in a year.
(6) PAWs make their own investment decisions.
(7) Use a high-grade Financial Advisor.
(8) Employ a high-quality CPA ... not only for taxes, but all investment advice.

CHAPTER FOUR: <u>They Believe that Financial Independence is More Important than Displaying High Social Status</u>. Never extend credit to people with big hats, no cattle! If your <u>goal</u> is to become financially secure, youĝll likely attain it ... but if your <u>motive</u> is to make money to spend on the good life, youĝre *never* going to be financially secure.

Money should never change one’s values ... it’s only a report card, a way to tell how you’re doing. Building wealth is not something that will change your lifestyle.

<u>Automobiles</u>: Profile of a millionaire
(1) 81% purchase vehicles, 19% lease (implication: rest of us should purchase, not lease)
(2) 23% own new cars
(3) 25% have not purchased a car in the last 4 years
(4) Median car price is $24.8K (average for all buyers is $21K)
(5) Most millionaires drive ñDetroit metalò
(6) Millionaires have propensity for full-sized cars w/low cost-per-pound.

<u>Car Purchasing Behavior</u>: 45.7% are dealer loyalists, 54.3% are shoppers.
63.4% prefer new cars, 36.6% prefer used

<u>Dealer loyalist/New car (28.6%)</u>:
- Prefer to minimize their effort ... utilize networking instead
- More than 20% patronize dealers who are also clients/customers
- Another 20% patronize dealerships owned by relatives or friends
- 37% deal exclusively with the owner

<u>Shopper/New car (34.8%)</u>:
- Believe aggressive shopping/negotiating is worth time/energy
- They pay on average 14% less than loyalists
- They may take weeks or months to get the very best deal

<u>Dealer loyal/Used car (17.1%)</u>:
- Believe new cars are over-priced, first owner lost a lot in depreciation.
- Want appreciating assets balanced by desire for quality motor vehicle.
- 36% buy used cars from dealers who do business with them.

<u>Shopper/Used car (19.5)</u>:
- Most price sensitive, most aggressive bargain hunters.
- Most often buy from private parties ... very patient.

<u>What Car Purchasing Habits Reveal</u>:
- Factoring out dealer-clients/relatives/friends, US millionaire shoppers outnumber dealer loyalists 2-1.
- The wealthy are more likely to haggle and negotiate.
- Who is most frugal? *<u>Used car/Shoppers</u>*
  - Theyĝre most aggressive, most price sensitive, pay significantly less.
  - They have lowest average income of all groups, highest ratio of net worth-to-income
  - They have highest scores on all measures of frugality, much more likely to have had frugal parents
  - They are the highest percentage of PAWs of all the groups
  - Being frugal is a major reason Used car/Shoppers are prone to be wealthy.

It’s much easier in America to earn a lot of income than it is to accumulate wealth

CHAPTER FIVE: Their Parents Did Not Provide Them With Economic Outpatient Care (EOC). What are the results of big economic gifts and ñacts of kindnessò some parents give their adult kids and grandchildren?

The more dollars adult children receive, the fewer they accumulate. Those who are given fewer dollars accumulate more. Gifts for consumption and lifestyle maintenance are the single-most significant factor in the lack of productivity among the adult children of the affluent.

Sons and daughters of the affluent are high volume consumers of status products and services. Simple rule of EOC: Itôs much easier to spend others peopleôs money than their own.

Factoids:
(1) 46% of affluent Americans give at least $15K to adult children or grandchildren.
(2) In future, affluent population will increase 5-7 times faster than the general population. EOC will, too.
(3) As affluent grow older they will increase size and incidence of EOC to reduce tax burden on their estates.
(4) 43% of millionaires pay all or part of grandchildrenôs private school education.
(5) Because of UAWs on EOC, 30% of US households live in $300K homes with incomes of $60K of less.
(6) Adults sitting around waiting for the next dose of EOC are not very productive.

Why do gift receivers have a lower propensity to accumulate wealth than non-receivers?
(1) Giving precipitates more consumption than saving & investing. Gifts can place recipients on a treadmill of consumption and continued dependence on the gift giver.
(2) Gift recipients donôt distinguish between their wealth and the wealth of their gift-giving parents. Adult children of the affluent feel their parentôs wealth is their income ... to be spent.
(3) Gift recipients are significantly more dependent on credit than non-receivers ... believing a sizable inheritance is coming their way.
(4) Gift recipients invest much less money than do non-receivers (65% less):
. They are hyper-consumers and credit prone.
. They live well above the norm for others w/comparable incomes.
. They donate significantly more to charity.

Whatever your income, always live below your means!

Teach your Children: Donôt give them fish, teach them to fish.
(1) They must be frugal.
(2) If you must give them EOC ... pay for an education, teach them to live on their own.

Paradox of Wealth: Affluent parents (frugal, living below means) give EOC to children to ensure they enjoy the good life (consumption, status), which ensures that those children will not be affluent themselves.

The Product of Zero EOC: Courage ... what all successful business owners possess. But it canôt be nurtured in an environment that eliminates risk, difficulty, danger.

CHAPTER SIX: Their Adult Children are Economically Self-Sufficient.

Affirmative Action: Family Style
(1) Non-working adult daughters and ñtemporarilyò non-working adult sons tend to receive heavy EOC and disproportionate share of parentsô estates.
(2) Economically successful children receive smaller levels of EOC and inheritance.
(3) Most highly productive sons and daughters receive no wealth transfers.

Housewives: 3 times more likely to receive inheritance and EOC
(1) Type A: They marry successful/high-income men, take leadership in caring for elderly parents, well-educated. They get gifts/inheritance from parents because they provide them emotional/medical support.
(2) Type B: Dependent, followers, live close to parents. These adult children are cared for by their parents instead of the other way around, and receive EOC and inheritance as support.

Affirmative Action for Women:
(1) Women are 46% of the workers, but represent 20% of those earning $100K or more.
(2) Professional women earn only 49% of what professional men in same occupation earn.
(3) Most non-working women w/incomes over $100K inherited it and/or received substantial gifts.
(4) Women own nearly one-third of businesses, but two-thirds of them have annual revenue under $50K.
(5) Working women are 4 times more likely to leave the workplace than are working men.

Odds are against women earning high incomes.
Could EOC from affluent parents help perpetuate this inequality?

Factoids:
(1) Unemployed adult children are significantly more likely to get EOC than working siblings.
(2) Male adult children are twice as likely to live at home than female adult children.
(3) UAWs speak of income, consumption habits, status artifacts ... PAWs speak of achievements, scholarship and how theyôve built their businesses.
(4) At least one outsider should be co-executor of your estate ... better for heirs to be mad at the arbitrator.

Rules For Affluent Parents and Productive Children:
(1) Never tell children that parents are wealthy ... adult UAWs are the product of parents who lived in ways they thought appropriate for wealthy people to act.
(2) No matter how wealthy you are, teach your children discipline and frugality ... kids are smart, they will not follows rules that their parents themselves do not follow.
(3) Assure that your children wonöt realize your affluence until after they establish a mature, disciplined and adult lifestyle and profession ... set up trusts.
(4) Minimize discussions of the items heirs will receive as inheritance ... you may forget, but they never will.
(5) Never give cash/gifts to one as appeasement for cash/gifts to another ... generates guilt, creates conflicts.
(6) Stay out of your adult childrenös family matters ... they resent this kind of interference.
(7) Donöt try to compete with your children ... most children of the affluent do not become business owners. Money is 2nd or 3rd on their lists of goals and achievements.
(8) Always remember that your children are individuals ... subsidies enhance differences in wealth.
(9) Emphasize your childrenös achievements, not symbols ... achievement, not consumption, is important.
(10) Tell your children there are lots of things more important than money ... good health, happiness, friends.

CHAPTER SEVEN: They are Proficient in Targeting Market Niches.

Affluent are frugal, but <u>not</u> so much when it comes to wealth & health-related services. They are *not frugal at all* when it comes to buying products and services for their grandchildren.

<u>Follow the Money</u>: Opportunities to serve the wealthy will be greater than ever
(1) 3.5 million wealthy households account for nearly half of all private US wealth.
(2) In next 10 years household wealth is expected to grow 6-7 times faster than the population.
(3) In the next 10 years 690,000 decedents will leave estates worth $1M or more. Those who receive that inheritance have a significantly higher propensity to spend it than non-receivers.
(4) In the next 10 years parents/grandparents will give gifts of more than $1 trillion.

Businesses and Professions likely to Benefit from the Affluent:

(1) **Specialist Attorneys**: There arenꞌt too many attorneys ... too many *law school graduates*.
. <u>Estate Attorneys</u> ... growing business and need (Ca, Fl, NY, Illinois, Tx, Pa)
. <u>Income Tax Attorneys</u> ... income tax is the #1 income-consumer among the affluent. Several states already have a wealth tax. Affluent will need every option to remain affluent.
. <u>Immigration Attorneys</u> ... it will become more and more difficult to immigrate to the US, at the same time as the demand is increasing greatly.

(2) **Medical & Dental Care Specialists**: enormous non-insurance dollars to be spent for health
. <u>Plastic Surgeons</u> . <u>Psychologists</u>
. <u>Dermatologists</u> . <u>Psychiatrists</u>
. <u>Allergists</u> . <u>Chiropractors</u>

(3) **Asset Liquidators, Facilitators, Appraisers**: For non-cash intergenerational gifts.
. <u>Appraisers & auctioneers</u> . <u>Pawn brokers</u>
. <u>Coin and stamp dealers</u> . <u>Real Estate management professionals</u>

(4) **Educational Institutions and Professionals**: accelerating demand for private school teachers and proprietors in general ... and specialized (music, drama, arts, special ed)

(5) **Professional Services Specialists**: Attorneys and accountants

(6) **Housing Specialists**: Affluent will provide assistance for offspring to purchase home.
. <u>Builders & contractors</u> . <u>Residential RE Agents</u>
. <u>Mortgage lenders</u> . <u>Paint, wall covering, decorating retailers</u>
. <u>Remodelers/Renovators</u> . <u>Alarm/Security marketers & consultants</u>
. <u>Residential RE Developers</u> . <u>Interior designers</u>

(7) **Fund-Raising Counselors**: philanthropic research, strategy, counsel

(8) **Travel Agents & Consultants**: Marketers for affluent vacations

CHAPTER EIGHT: They Chose the Right Occupation.

Who are the affluent? ... mostly business owners, including self-employed professionals.
What businesses do they own? ... not predictable

The *character* of the business owner is more important in predicting his wealth than the classification of his business.

Self-employed Professionals vs Other Business Owners:
(1) Fewer than 20% of millionaire business owners turns his business over to his children ... the odds for success are so small, threats are everywhere.
(2) Millionaire business owners encourage their children to be self-employed professionals.
(3) Millionaire couples are 5 times more likely to send their children to Medical School, and 4 times more likely to send them to Law School.
(4) The profitability of most professional service firms is substantially higher than the average small business.

They can take your business, but they can't take your intellect ... and it's portable.

Why do some people operate their own businesses?
(1) Tremendous freedom ... they are their own bosses
(2) Less risk ... risk is being an employee w/one income source. Business owners have many income sources.
(3) The entrepreneur deals with risk every day, tests his courage every day ... learns to conquer fear.