

# FIRE Starter: Advice on Saving & Investing in Your 20s [Part 3]

*Zach is back with Part Three of his nine actionable tips for saving, investing, and growing wealth in your 20s. If you missed [Part One](#) or [Part Two](#), take a moment to get caught up, and then come back to read Part Three. The information in this series could change the rest of your life if you follow it.*

## **A Quick Reminder of Why I Started This Series**

*For the astute observer, you will notice that I have added three new series to the blog: [LateFIRE](#), [FIRE Starter](#), and [Chasing FIRE](#). Notice a theme? They all capitalize on the explosion - one might say the COMBUSTION - in the FIRE (financial independence retire early) movement. But let's set the record straight: on the GYFG blog, "FIRE" is defined in a slightly different way, as I see it meaning Financial Independence / Recreational Employment. That's because I am after **freedom**, not a typical retirement, and see myself working forever. But once I hit [my number](#), my employment will represent my recreational choice.*

*At 32, I find myself on the older end of the millenials' age range, which in 2018 is 22-37, [according to the Pew Research Center](#). Guys like Zach have got me thinking that there is a younger part of my generation that may not be able to relate to where I am in life personally. Thus the decision to bring on Zach as a regular GYFG contributor, to reach those younger millenials. He will be writing about earning, investing, and saving money in your 20s. At 24, with a net worth in excess of \$100,000 and an income approaching six figures (a significant portion of which is passive income), he is more than qualified. Believe me when I say there is always someone younger and better than you out there, and Zach is putting my own 24-year-old self to shame. I share that only to say that I wish I had been reading people like Zach when I was in my early 20s.*

*Without further delay, I figuratively pass the mic - take it away, Zach!*

This is a continuation of the nine actionable tips for savings, investing, and growing wealth in your 20s.

### [Tips 1-3](#)

### [Tips 4-6](#)

## **7. Invest in broad market index funds early and often.**

The most straightforward path to growing wealth in your 20s is to simply spend far less than you earn and invest the difference. And when it comes to deciding what to invest in, I personally draw upon the wisdom of investing legend Warren Buffett.

Buffett is a longtime advocate of index fund investing. In particular, he recommends that the average Joe simply invest in a low cost S&P 500 index fund, which holds the 500 largest publicly traded companies in the United States.

In fact, he believes so strongly in the S&P 500 that in 2007 he made a bet with asset management firm Protégé Partners that the S&P 500 would outperform a group of actively managed hedge funds over the following ten years.

In Buffett's own words:

*"To publicize my conviction that my pick - a virtually cost-free investment in an unmanaged S&P 500 index fund - would, over time, deliver better results than those achieved by most investment professionals, however well-regarded and incentivized those 'helpers' may be."*

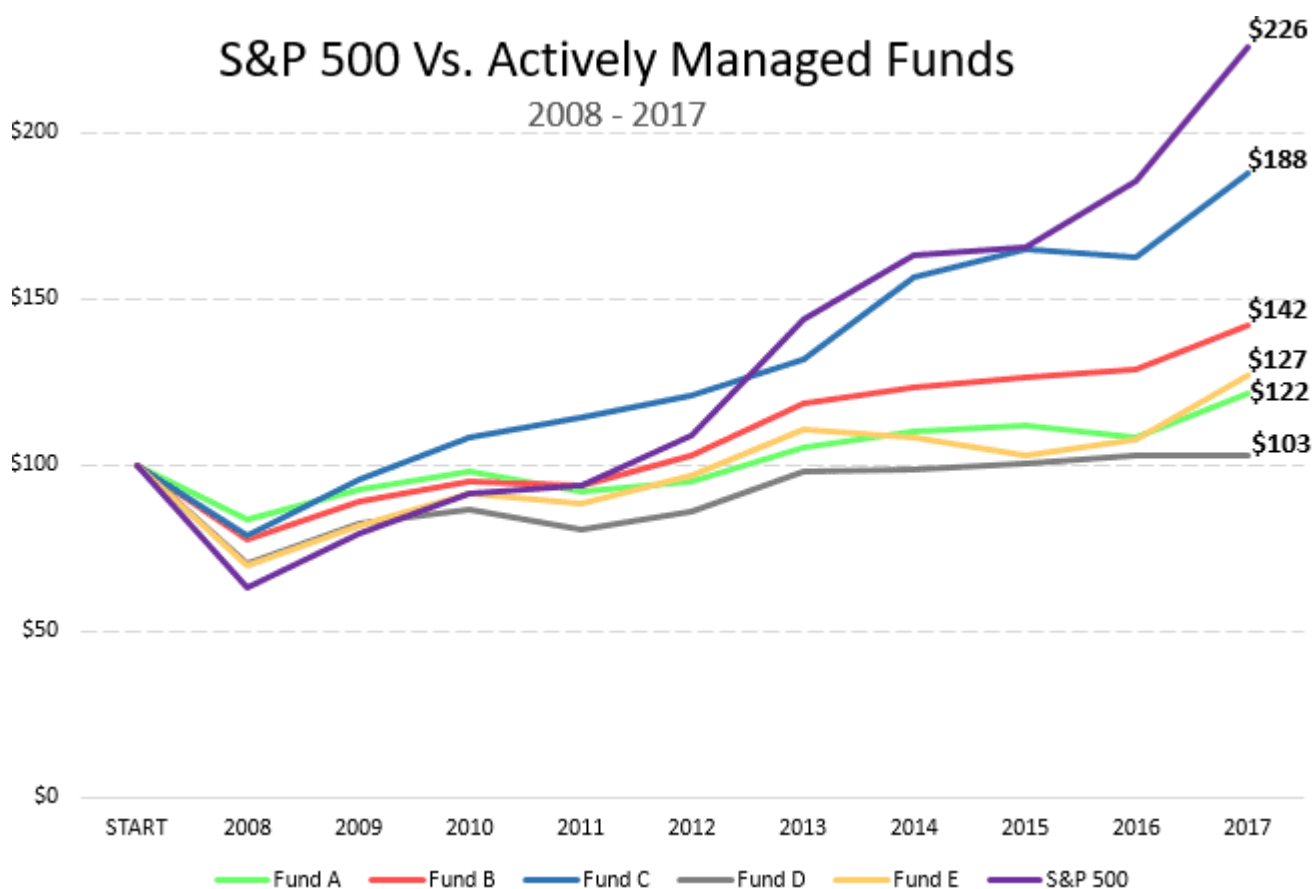
Buffett wanted to prove just how well an investment in a low-cost S&P 500 index fund could perform against the best actively managed funds on Wall Street.

This chart, taken from the [Berkshire Hathaway annual letter](#), shows the annual performance of the S&P 500 during this ten-year period as well as the five "fund of funds" handpicked by Protégé:

<u>Year</u>	<u>Fund-of-Funds A</u>	<u>Fund-of-Funds B</u>	<u>Fund-of-Funds C</u>	<u>Fund-of-Funds D</u>	<u>Fund-of-Funds E</u>	<u>S&amp;P Index Fund</u>
2008	-16.5%	-22.3%	-21.3%	-29.3%	-30.1%	-37.0%
2009	11.3%	14.5%	21.4%	16.5%	16.8%	26.6%
2010	5.9%	6.8%	13.3%	4.9%	11.9%	15.1%
2011	-6.3%	-1.3%	5.9%	-6.3%	-2.8%	2.1%
2012	3.4%	9.6%	5.7%	6.2%	9.1%	16.0%
2013	10.5%	15.2%	8.8%	14.2%	14.4%	32.3%
2014	4.7%	4.0%	18.9%	0.7%	-2.1%	13.6%
2015	1.6%	2.5%	5.4%	1.4%	-5.0%	1.4%
2016	-3.2%	1.9%	-1.7%	2.5%	4.4%	11.9%
2017	12.2%	10.6%	15.6%	N/A	18.0%	21.8%
Final Gain	21.7%	42.3%	87.7%	2.8%	27.0%	125.8%
Average Annual Gain	2.0%	3.6%	6.5%	0.3%	2.4%	8.5%

**The S&P 500 absolutely destroyed these funds as a whole.**

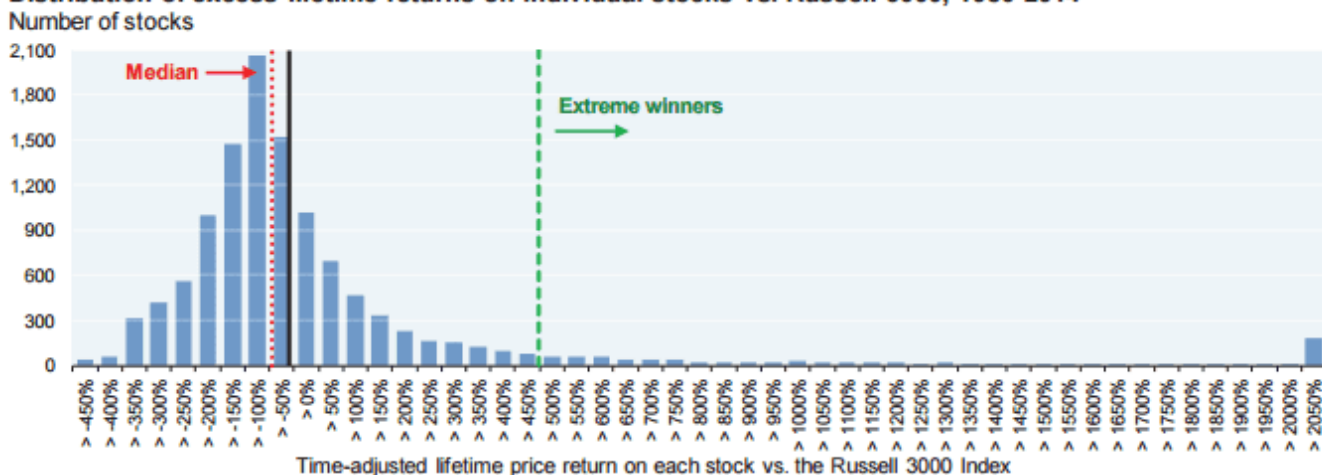
Here's a visual look at the performance of each of these funds over this 10-year period:



This bet serves as a nice reminder that 99% of us are better off investing in simple index funds rather than picking individual stocks, jumping in and out of the market, and paying money managers exorbitant fees who promise to deliver above-average market returns.

In addition to heeding Buffett's advocacy for index funds, research also tells us that it's incredibly hard to outperform index funds. In a [2014 paper by J.P. Morgan](#), it was discovered that the majority of investing returns actually come from a small group of stocks in the market. Researchers went all the way back to 1980 and looked at stock returns for all stocks that have been in the Russell 3000 (an index that tracks the entire stock market) and compared them to the market average:

**Distribution of excess lifetime returns on individual stocks vs. Russell 3000, 1980-2014**



**Two thirds of all stocks under-performed the market average during this time period**, while a select few “extreme winners” (about 7% of stocks) beat the average return by more than two standard deviations.

This illustrates an important point: Most actively managed funds were highly unlikely to pick only the extreme winners, but an index fund would have held all these extreme winners simply because it holds all the stocks in the market.

This helps explain why index funds have a tendency to outperform. They will always have the extreme winners in their portfolio, while very few of the actively managed funds will.

## **8. Your Savings Rate is the Number One Metric that Determines When You’ll Be Financially Independent.**

“Financial independence” is typically defined as having 25 times your annual expenses saved up. This grid shows how many years it will take to achieve F.I. based on your after-tax annual income and annual spending:

*Note: This grid assumes you start with a net worth of \$0 and that you invest all of your savings at a 5% annual rate of return.*

Years Until Financial Independence																							
	Annual Spending	After Tax Annual Income																					
		\$20k	\$30k	\$40k	\$50k	\$60k	\$70k	\$80k	\$90k	\$100k	\$120k	\$140k	\$160k	\$180k	\$200k	\$225k	\$250k						
	\$225k																51.4						
	\$200k															49.1	36.7						
	\$180k													51.4	36.7	29.5							
	\$160k											49.1	36.7	28.8	24								
	\$140k									46.7	34.5	28	22.9	19.5									
	\$120k							43.9	31.9	25.7	21.6	18.2	15.7										
	\$100k							40.6	29	23.1	19.3	16.6	14.2	12.4									
	\$90k							51.4	31.9	24.2	19.6	16.6	14.4	12.4	10.9								
	\$80k							49.1	36.7	25.7	20.1	16.6	14.2	12.4	10.8	9.5							
	\$70k							46.7	34.5	28	20.7	16.6	13.9	12	10.5	9.2	8.1						
	\$60k							43.9	31.9	25.7	21.6	16.6	13.6	11.5	10	8.8	7.7	6.8					
	\$50k							40.6	29	23.1	19.3	16.6	13.1	10.8	9.2	8	7.1	6.3	5.6				
	\$40k							36.7	25.7	20.1	16.6	14.2	12.4	10	8.3	7.1	6.3	5.6	4.9	4.4			
	\$30k							31.9	21.6	16.6	13.6	11.5	10	8.8	7.1	6	5.2	4.6	4.1	3.6	3.2		
	\$20k							25.7	16.6	12.4	10	8.3	7.1	6.3	5.6	4.6	3.9	3.4	3	2.7	2.4	2.1	
	\$10k							16.6	10	7.1	5.6	4.6	3.9	3.4	3	2.7	2.2	1.9	1.6	1.5	1.3	1.2	1

This grid tells a simple tale: The larger the gap between your income and your spending, the sooner you will achieve financial independence.

It's also important to keep in mind that your savings rate is dependent on two variables: your income *and* your expenses. It's not enough to just earn a high income. You need to be able to save a huge chunk of that income if you hope to increase your net worth at a quick pace.

As cartoonist and author Scott Adams explains in his book "[How to Fail at Almost Everything and Still Win Big](#)," **the best way to find success is through being *pretty good* at two complementary skills, as opposed to being *excellent* at one.**

Scott used this formula to find his own success in the cartoon industry by creating *Dilbert*, one of the most successful comic strips of all time. He recognized that his drawing skills were *pretty good*, but not great. His ability to tell jokes was *pretty good*, but not great. But through combining these two *pretty good* skills, he could be a *great* cartoonist.

In Scott's own words,

*"My combined mediocre skills are worth far more than the sum of the parts. If you think extraordinary talent and a maniacal pursuit of excellence are necessary for success, I say that's just one approach, and probably the hardest. When it comes to skills, quantity often beats quality."*

This idea can be applied wonderfully to personal finance. You don't have to earn a six-figure income to achieve financial freedom. Nor do you have to live on rice and beans to save a significant amount of money. For most people, the most sure-fire approach to improving their finances is through becoming *a little better* at earning and *a little better* at saving.

To illustrate this point, let's return to the grid above. Consider a family who brings in \$60k per year and spends \$50k per year. Starting from zero, they can achieve financial independence in a little over 41 years:

Years Until Financial Independence																	
Annual Spending	\$95k																62
	\$90k															62	51.4
	\$85k														62	51.4	41.5
	\$80k													62	47.5	41.5	36.7
	\$75k												62	47.5	41.5	34.7	31.1
	\$70k											62	47.5	39	34.7	31.1	28
	\$65k									56	44.3	39	32.8	29.5	26.6	24	
	\$60k								56	44.3	36.7	31.1	28	25.2	24	21.6	
	\$55k							56	41.5	34.7	31.1	26.6	24	22.8	20.6	18.5	
	\$50k						51.4	41.5	32.8	29.5	25.2	22.8	20.6	19.5	17.5	16.6	
	\$45k					51.4	39	31.1	28	24	21.6	19.5	17.5	16.6	15.7	14	
	\$40k				47.5	36.7	29.5	25.2	22.8	20.6	18.5	16.6	15.7	14	13.2	12.4	
	\$35k			47.5	34.7	28	24	20.6	18.5	16.6	14.9	14	13.2	11.7	10.9	10.2	
	\$30k		44.3	31.1	25.2	21.6	18.5	16.6	14.9	13.2	12.4	11.7	10.9	10.2	9.5	8.8	
	\$25k		41.5	29.5	22.8	19.5	16.6	14.9	13.2	11.7	10.9	10.2	9.5	8.8	8.1	7.5	6.8
	\$20k	36.7	25.2	20.6	16.6	14	12.4	10.9	10.2	8.8	8.1	7.5	6.8	6.5	6.2	5.9	5.6
			\$25k	\$30k	\$35k	\$40k	\$45k	\$50k	\$55k	\$60k	\$65k	\$70k	\$75k	\$80k	\$85k	\$90k	\$95k
After Tax Annual Income																	

That's a long time.

But if this family can bump up their annual income to \$75k and reduce their annual spending to \$40k, **they can achieve financial independence in only 18 years.**

Years Until Financial Independence																									
Annual Spending	\$95k																62								
	\$90k															62	51.4								
	\$85k														62	51.4	41.5								
	\$80k													62	47.5	41.5	36.7								
	\$75k												62	47.5	41.5	34.7	31.1								
	\$70k											62	47.5	39	34.7	31.1	28								
	\$65k										56	44.3	39	32.8	29.5	26.6	24								
	\$60k									56	44.3	36.7	31.1	28	25.2	24	21.6								
	\$55k									56	41.5	34.7	31.1	26.6	24	22.8	20.6	18.5							
	\$50k									51.4	41.5	32.8	29.5	25.2	22.8	20.6	19.5	17.5	16.6						
	\$45k									51.4	39	31.1	28	24	21.6	19.5	17.5	16.6	15.7	14					
	\$40k									47.5	36.7	29.5	25.2	22.8	20.6	18.5	16.6	15.7	14	13.2	12.4				
	\$35k									47.5	34.7	28	24	20.6	18.5	16.6	14.9	14	13.2	11.7	10.9	10.2			
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	\$20k									36.7	25.2	20.6	16.6	14	12.4	10.9	10.2	8.8	8.1	7.5	6.8	6.5	6.2	5.9	5.6
			\$25k	\$30k	\$35k	\$40k	\$45k	\$50k	\$55k	\$60k	\$65k	\$70k	\$75k	\$80k	\$85k	\$90k	\$95k	\$100k							
After Tax Annual Income																									

This is the magic of being pretty good at both earning and spending. A household income of \$75k is not astronomically high by any means. Annual spending of \$40k isn't unusually low. Yet, when you combine these two, the results are incredible. **It enables a family to achieve F.I. 23 years sooner.**

This holds true for any income level. Moving down and to the right on this grid is pure financial magic:

Years Until Financial Independence																						
	Annual Spending	After Tax Annual Income																				
		\$25k	\$30k	\$35k	\$40k	\$45k	\$50k	\$55k	\$60k	\$65k	\$70k	\$75k	\$80k	\$85k	\$90k	\$95k	\$100k					
	\$95k																62					
	\$90k															62	51.4					
	\$85k														62	51.4	41.5					
	\$80k													62	47.5	41.5	36.7					
	\$75k												62	47.5	41.5	34.7	31.1					
	\$70k											62	47.5	39	34.7	31.1	28					
	\$65k										56	44.3	39	32.8	29.5	26.6	24					
	\$60k									56	44.3	36.7	31.1	28	25.2	24	21.6					
	\$55k								56	41.5	34.7	31.1	26.6	24	22.8	20.6	18.5					
	\$50k							51.4	41.5	32.8	29.5	25.2	22.8	20.6	19.5	17.5	16.6					
	\$45k						51.4	39	31.1	28	24	21.6	19.5	17.5	16.6	15.7	14					
	\$40k						47.5	36.7	29.5	25.2	22.8	20.6	18.5	16.6	15.7	14	13.2	12.4				
	\$35k						47.5	34.7	28	24	20.6	18.5	16.6	14.9	14	13.2	11.7	10.9	10.2			
	\$30k						44.3	31.1	25.2	21.6	18.5	16.6	14.9	13.2	12.4	11.7	10.9	10.2	9.5	8.8		
	\$25k						41.5	29.5	22.8	19.5	16.6	14.9	13.2	11.7	10.9	10.2	9.5	8.8	8.1	7.5	6.8	
	\$20k						36.7	25.2	20.6	16.6	14	12.4	10.9	10.2	8.8	8.1	7.5	6.8	6.5	6.2	5.9	5.6

The lesson here is simple: focus on boosting your savings rate through increasing your income *and* decreasing your spending. The more you can do this, the faster you'll reach financial independence.

### 9. Be patient.

Lastly, be patient. In the early stages, most of your wealth accumulation will come purely from the difference between your income and your expenses.

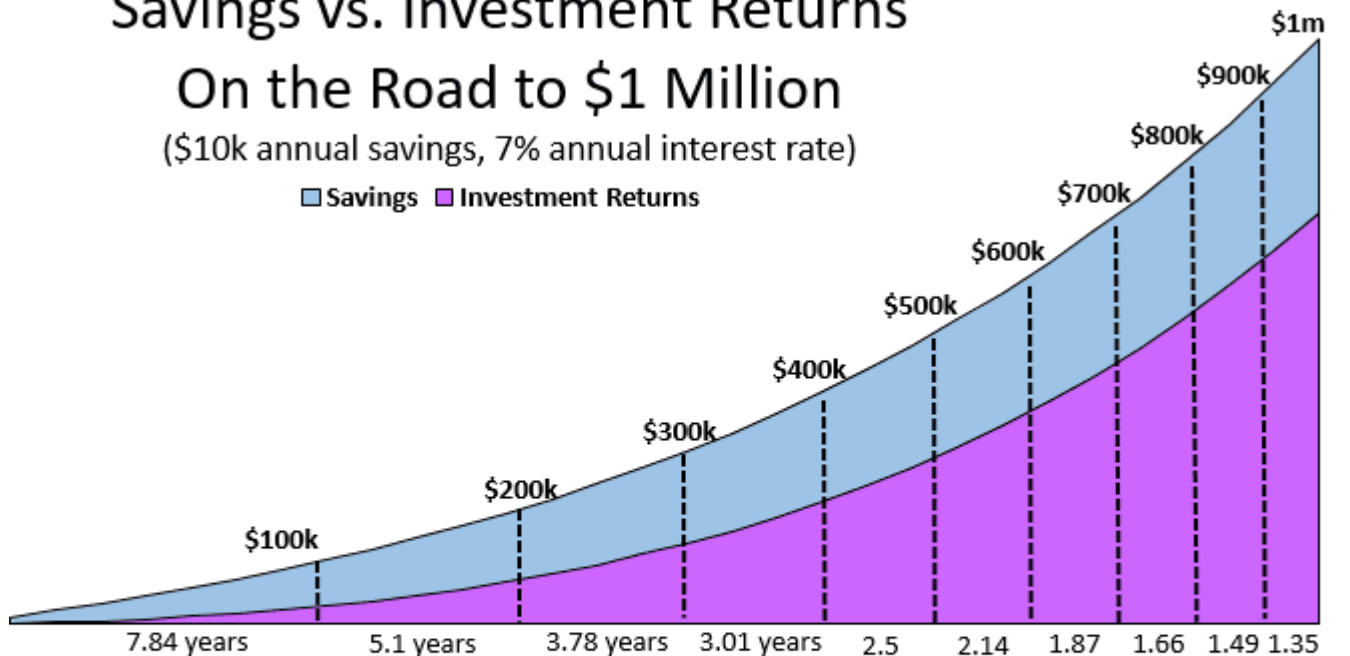
[As time goes on and you begin to invest more and more savings, investment returns begin to help you.](#) This chart illustrates that point:

# Savings vs. Investment Returns

## On the Road to \$1 Million

(\$10k annual savings, 7% annual interest rate)

■ Savings ■ Investment Returns



Savings	78%	51%	38%	30%	25%	21%	19%	17%	15%	14%
Returns	22%	49%	62%	70%	75%	79%	81%	83%	85%	86%

When you increase your net worth from \$100k to \$200k, 51% (\$51,000) of that increase will come from savings and 49% (\$49,000) will come from investment returns.

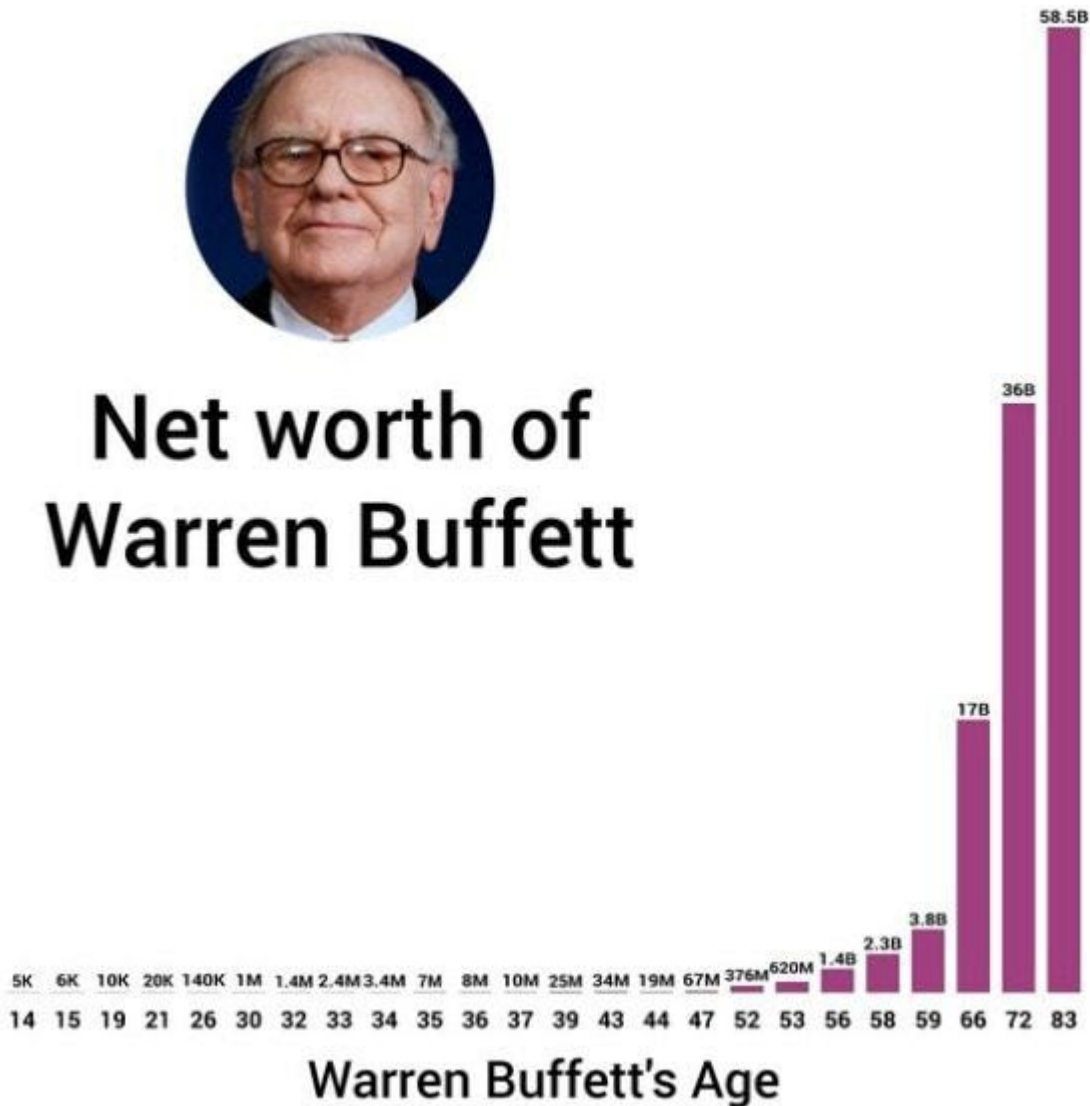
If you invest \$10k each year at a 7% annual rate of return, you'll be able to save \$100k in 7.84 years. A whopping 78% of this \$100k will come purely from your savings. However, by continuing to save and invest \$10k each year, your net worth will hit \$200k in just 5.1 more years, and nearly half of that additional \$100k will come from investment returns! This shows that as time goes on, investment returns become more and more influential in your net worth journey.

This is why it's so crucial to be patient. **Wealth accumulation takes years and decades, not weeks and months.**

Even someone like Warren Buffett didn't become a millionaire overnight. Check out the following chart that shows Buffett's net worth growth over time:



# Net worth of Warren Buffett



dadaviz.com

He didn't become a millionaire until age 30 or a billionaire until nearly age 60. His path to wealth was built on patience.

Unfortunately, patience seems to have become a virtue of the past. In a world where technology has made instant gratification faster than ever, patience is a virtue that is quickly vanishing. Overnight shipping, high-speed internet, lightning-fast WiFi connections, microwave dinners, and fast food restaurants all subtly influence our expectations on how long we should wait to receive something.

We want our food, our products, and our entertainment at our fingertips in minutes. We hate waiting. Unfortunately this means we are becoming more and more impatient with our personal goals as well. We all want wealth, freedom and success *now*.

This means the world is full of sprinters, but sorely lacking in marathon runners.

To accumulate wealth, you need to be a marathon runner and commit to the long game. Don't stress out about not being rich today, next week, or next month. Be patient. As author Steven Pressfield said in *Tribe of Mentors*:

"I'm 74. Believe me, you've got all the time in the world. You've got ten lifetimes ahead of you. Don't worry about your friends "beating" you or "getting somewhere" ahead of you. Get out into the real dirt world and start failing."

Don't obsess over getting somewhere faster than your peers. Just implement healthy financial habits (like these Tips 1-9), keep your spending reasonable, grow your income steadily each year, and be patient. Wealth will come.



## Gen Y Finance Guy

**Hey, I'm Dom** - the man behind the cartoon. You'll notice that I sign off as "Gen Y Finance Guy" on all my posts, due to the fact that I write this blog anonymously (at least for now). I like to think of myself as the *Chief Freedom Officer* here of my little corner of the internet. In the real world, I'm a 30-something former C-Suite executive turned entrepreneur turned capital allocator. I am trying to humanize finance by sharing my own journey to Financial Freedom. I believe in total *honesty* and *transparency*. That is why before I ever started blogging, I decided that I would share all of my own [financial stats](#). I do this not to brag, but instead to inspire motivate, and also to hold myself accountable. My goal is to be a beacon of hope, motivation, and inspiration for *you*, the reader, by living life by example and sharing it **all** here on the blog. My sincere hope is that you will be able

to learn from me - both from my successes and my failures! [Read More](#)