FIRE Starter – Tips on How to Grow Your Net Worth in the Early Years

You can find all of Zach's previous posts here.

Today, Zach is going to discuss how you can grow your net worth in the early years. Many people miss the fact that compounding takes a decade or longer to really work its magic. That is why I push the income side of the equation so hard. Your contributions (the gap between your income and your spending) make up the majority of your net worth for at least the first ten years in most cases. You could be the exception to the rule, but I wouldn't bet my – or your – financial future on that. I even wrote a post about the inflection point of contributions vs. compounding (that you should read after you read this post). Zach wraps up his post today stating that investment returns start to make a real difference after you hit milestone two of the five major milestones to financial independence. The first $100,000 is the hardest!!!

*I hope you enjoy Zach's latest **FIRE Starter** post below.*

First, 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, meaning, as I see it, Financial Independence / Recreational Employment. That's because I am after **freedom,** rather than 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 $130,000 and an income approaching six figures, 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.*

When you’re just starting out on your financial journey, it can be tough to get your net worth to grow as quick as you might like.

It can also be difficult to pinpoint exactly what you should be doing to grow your net worth as fast as possible. In particular, should you be focusing on reducing expenses, growing your income, diversifying your income streams, earning investment returns, or a combination of all these things?

In this post, I’ll share some important financial insights along with some simple math and charts to help you figure out how to best increase your net worth when you’re just starting out.

Starting out, a high income is the one ingredient that will get you moving the fastest.

There are two components that determine how much you’re able to save: your income and your expenses. The larger the gap between these two, the more you can save, and the faster your net worth will grow.

Keeping expenses low is important, but you still won’t get anywhere fast with a low income. Consider an individual who is able to live frugally on $25k per year. With a yearly income of $30k, they can only save and invest $5k per year. Assuming a 5% annual return on investments, they’ll only have $29k after five years:

Increasing yearly income to $40k, $50k, or $60k in those early years makes a huge difference:

Assumptions: $25k yearly spending, 5% returns on investments				
Yearly Income	$30k	$40k	$50k	$60k
Year	Net Worth			
1	$ 5,250	$ 15,750	$ 26,250	$ 36,750
2	$ 10,763	$ 32,288	$ 53,813	$ 75,338
3	$ 16,551	$ 49,652	$ 82,753	$ 115,854
4	$ 22,628	$ 67,884	$ 113,141	$ 158,397
5	$ 29,010	$ 87,029	$ 145,048	$ 203,067

With a $60k yearly income and $25k yearly expenses, an individual could literally accumulate over $200,000 in just five years with modest annual 5% investment returns. This is why focusing on growing your income is so important – it's the one factor that will truly move the needle early on.

Investment returns won't move the needle much in the early years.

In each of the above savings scenarios, investment returns would account for only 14% of the total ending net worth after five years:

A whopping 86% of your net worth (assuming 5% annual investment returns) will be composed purely of savings. This is why your savings rate is so important in the early years. It's the number one factor that determines how fast you can grow your net worth.

Although it might be tempting to think that investment returns are the way to wealth, the math simply says otherwise: investment returns won't account for much net worth growth early on, which is why it's best to focus your energy mostly on growing your income.

Lucky individual stock picks won’t impact your net worth much if you don’t have enough capital to work with.

In college, I used to dabble in individual stock picking. What I didn’t realize at the time was that I simply didn’t have enough money to invest to reap the benefits of lucky stock picks. At the time, I would typically invest $500 in a single stock and ride out the investment for a few months, hoping to sell for a quick gain.

Suppose I invested $500 in Facebook 5 years ago. Since July 2013, the price per share has risen from $25 to nearly $200 for a 8x gain.

Even if I had made a lucky pick with Facebook, an 8x gain on $500 would only be $4,000. More than likely I would have sold once the share price doubled, which would have turned my initial $500 investment into less than $1,000 after trading fees and capital gains taxes.

So, even if you get lucky and invest in the right individual stocks in your early years, you probably won’t have enough capital at work to actually see meaningful gains.

Side hustles can help increase your income when you’re at the bottom of the salary totem pole at work.

My sister works as a vet technician and makes about $16 per hour. She loves working with animals so she decided to sign up for Rover, a site where people in her area will pay her to watch their dogs.

Over the past year she has landed six or seven repeat-customers who pay her on a weekly basis to stop by and let their dogs out, take them on walks, or feed them. She typically earns around $200 per week doing this.

Her day job pays her ($16 * 40 hours) $640 per week, so she has effectively boosted her income by over 30% from a side hustle she loves doing.

Thanks to the internet, it has never been easier to connect with people looking for specific side hustle services. This can have a real impact on your earnings, especially if you’re just getting started in the workforce.

I personally tutor people in statistics for $40/hour, which is a niche topic that I have domain knowledge in. It’s a lucrative side hustle that boosts my own income.

Once you join the six-figure net worth club, investment returns start to make a real difference.

With $100,000 invested, a 10% up year for the stock market would increase your net worth by $10,000. That’s a noticeable amount.

In addition, with $100k invested, dividends start to become noticeable as well. A 3% yearly dividend on $100k is $3,000.

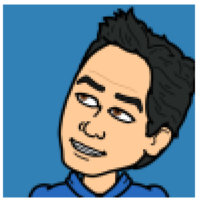
As I mentioned earlier, investment returns simply don’t move the needle much in the early years. As time goes on, though, you’ll eventually hit that six-figure mark and investment returns *will* start to have a serious impact on your net worth.

Patience is key in the early years.

Building your net worth is like getting a flywheel to start spinning. It’s annoyingly slow at first and requires serious work on your part to get it moving. But once it starts, it only moves faster and faster as time goes on. Investment returns eventually begin to make the journey easier and you’re able to grow your net worth at a faster rate without a noticeable increase in effort.

This is why it’s so important to cultivate patience when you’re just starting out. You likely don’t have a high income *or* investment returns to help you out. So, you have to quietly sit and work. Steadily save. Consistently invest. Live simply. Increase your income.

Your tiny daily habits will lead to visible net worth growth a few years down the road. Until then, practice patience.



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