Chris Smith - I Am Net Worthy - Transcript

Tim Mullooly: Welcome back to Living With Money, this is Tim Mullooly. On today's episode, I am joined by Chris Smith. Chris is an expert on helping young adults achieve financial independence. After a career as a senior financial executive in technology, he's turned his attention to demystifying the financial world for others. He's well known for creatively using analogies, stories, and pictures to make complex ideas simple to understand. Most recently he's the found of I Am Net Worthy, a book/e-book, website, and tools aimed at improving the financial futures of young people everywhere. He describes his role as guardian of the financial content, fearless defender against unworthy financial practices, builder of the amazing team of millennials who do all the real work, and spiritual leader of the Net Worthy mission.

I love that description of the role, so Chris, thanks for coming on the podcast.

Chris Smith: Sure, thanks for having me, Tim.

Tim Mullooly: Before we dive into I Am Net Worthy and all of the work that you guys do there, let's start with just a quick background about your personally, and how you first became interested in finance, and money, and what you relationship with money was like growing up.

Chris Smith: My dad was an investment advisor, and that's what first got me interested. I mean, it was a pretty small town, and it's a town that he had grown up in, so most of his clients were people he'd known all his life.

Tim Mullooly: Right.

Chris Smith: I mean, I just admired the way that his knowledge about money put him in a position to help other people that he cared about. And that got my attention, and that was really the start of my interest in finance and money. When I got to college, those were the kind of courses I took, and oh man, I just got hooked right away. So it was economics, and math, and business, and all those kind of classes. Then I went on to get a master's in corporate finance. And that led me to a job offer in the tech industry, which was really like a new and small industry at the time, at a company called Hewlett Packard.

Now, here's where things take a turn though. Right before I started at HP, I went back to my hometown one last time and my dad called me into his den, and he says, "Young man, you're about to enter the financial world on your own for the first time-"

Tim Mullooly: Right.

Chris Smith: "There's a few things I think you should know about it." Me being about 21 years old, I just rolled my eyes and I wasn't so excited about ... I mean, that wasn't my idea of how to spend a Saturday night.

Tim Mullooly: Right.

Chris Smith: But he was persuasive, and he got me to sit down and listen. Thank goodness that he did. What he taught me that night and in a few sessions after that absolutely changed my future. It was about how to thrive in the financial world in ways that I hadn't been taught in any of my finance or business classes before. I mean, it wasn't secret formulas or anything like that, it was mostly just common sense principles, but they just made a huge difference in my life.

So I went on to work at HP, that was the bulk of my professional career. And the real point is thanks to what he taught me, I was able to retire from that job at an age that was much lower than I ever thought was going to be possible, and much earlier than other people that started at HP with me at that same time. Just about the time I was leaving HP, I have two sons, and they were college age themselves by that time. So you know what happened next? I called them into my den, and I said, "Young men, you're about to enter the financial world on your own for the first time." But that's when I got a real shock, and the shock is in just the one generation since my dad had taught me, the financial world had really transformed. It's as if it had been turned upside down.

The underlying principles are still the same and always will be the same. But what had changed so much is how complicated things had gotten.

Tim Mullooly: Right.

Chris Smith: And how the roles had changed. So the role of the employer, the role of the government, and the role that you have in your financial life had all been shifted around such that it's much more of a do it yourself proposition than it ever had been before. So now there's an even bigger premium on having knowledge about what to do with your money.

Once I realized that, I had to like call time out and say, "Hold that thought, young men, I've got some research to do."

Tim Mullooly: When you made that realization and you had to do that research, is that kind of what ultimately led you to want to write the book from what you found? Wrote the book I Am Net Worthy?

Chris Smith: Not exactly. That's almost what happened. But I had a false start first. That realization led me to do a bunch of research, so I was like interviewing experts, and it just ... it was a project that took on a life of its own. And after two years, I ended up writing a book about it, and that book was a different book called Securing Your Financial Future. I give myself a good grade for the content that I put into that, because that's ... I was so on fire to get the right content for young adults who are just starting out, that's where I put all my energy. But I give myself a really bad grade for understanding the form in which my intended audience wanted to learn that kind of stuff.

Tim Mullooly: Right.

Chris Smith: Basically, I wrote a big, fat finance textbook, because that's-

Tim Mullooly: Yeah.

Chris Smith: That's what I had learned from, and that's what I thought the right way to teach that was.

Tim Mullooly: And that wasn't too appealing to the younger folks who were trying to learn about their finances, no one had too much interest in sitting down and reading a textbook?

Chris Smith: Exactly right. I mean, there was some niche interest, it ended up getting used as a textbook for personal finance classes. Not every school, not every college has a personal finance class, but some of the ones that do chose that as a book, and so there's a certain kind of reader that is drawn to that kind of book, but it is by far not the broad majority that I was hoping to appeal to. So I learned my lesson from that.

When I sat down to write I Am Net Worthy, there are two things about it that make it very different than what I had written before, and other books that are out there on the same topic. And the first one is co-authors. I decided I have all the content that I want to include in the book, but I shouldn't be the one to write it. It should be ... if the book is intended for millennials, it should be written by millennials for millennials. One of the sad truths about today's economy is that there are tons and tons of highly educated, highly talented young people that are available to work that can't find the kind of jobs that they are trained to do. I advertised on one of the big freelance job boards for co-authors. I basically said, "What we want here is somebody who's a good communicator, and who is on fire to deliver the message, here's how young adults can have a successful relationship with money."

I was overwhelmed by the response. There were literally hundreds of people that wanted to do that. So I thought at first I was looking for one co-author, I ended up ... there's nine chapters in the book, I ended up hiring one freelance co-author for each of the nine chapters in the book. And it's a really broad range of people. So I wanted it to be a really diverse group, and lots of different kinds of voices coming from different perspectives on the chapter that they were going to write.

In each chapter, the co-author not only explains the core content, but they all have some personal stories to tell about their experience in whatever the topic of that chapter is. So it's a lot more conversational, it's kind of like a magazine where there are sidebars, and the co-author puts in the sidebar some of their own stories that they've got. So that gives it a completely different kind of feel than a typical textbook.

And then the second thing that makes it different is what I call nuggets. The way I wrote the first book, and the way education used to work, was you would first lay the groundwork by talking about all these fundamentals, and then you would prove that each of the fundamentals was true, and then it's kind of like you're building a mountain, and at the very tippy top of the mountain was a nugget of golden information. Today's young adults, because they've been brought up in the information age, they can look up all the parts of the mountain, they just want to know what's-

Tim Mullooly: Right.

Chris Smith: The golden nugget at the top.

Tim Mullooly: Right, yeah.

Chris Smith: As I was-

Tim Mullooly: Skip all the rest, just give me the nugget.

Chris Smith: Yeah.

Tim Mullooly: Yeah.

Chris Smith: Yeah. 90% of the people don't want to hear all the rest, so ... 10% are interested in that, but don't drag the 90% through all these long explanations that only 10% wants to hear.

Tim Mullooly: Right.

Chris Smith: So the nugget is just the one or two sentence summary of here's the important conclusion of this part of the topic. So in each chapter, there's like eight to 10 nuggets, and so across the nine chapters there's 83 nuggets in all. So if all you want to do is just know what the conclusion is, you can just read the nuggets, and that's all there is to it. If the nugget makes sense to you, you can go on to the next one. Or if it doesn't apply to you at that particular time, you can skip it and go on to the next one. But if it interests you, and you want to learn a lot more about it, there are three to five paragraphs underneath each nugget that will spell it out for you and give you some other places to go to learn more about it.

Tim Mullooly: Yeah, I feel like it's a ... that definitely made it easier to read for a lot of folks, and hearing from different co-authors definitely lends itself to be more well rounded. You hear answers and personal stories from people from all different walks of life, so I think that that's a ... that was a good strategy going into writing this book.

But before we dive into the more specific material within the book, can you explain to the listeners just the background of I Am Net Worthy, and all of the other different services that you provide outside of the book?

Chris Smith: So I Am Net Worthy is a book, it's available as a paperback, or as an e-book in all of the major formats and platforms. But it's also a website, and on that website we've got lots of additional information and tools, and most of the information and tools on the website is free. So in particular, we've got a whole set of online calculators that help you take the Net Worthy principles and apply them specifically to your own financial life. The whole web is full of calculators, but what we've got on there are particular calculators that are different than you would typically see.

For example, almost every personal finance book talks about emergency funds, but there doesn't seem to be a clear consensus on how big your emergency fund should be. Well that's because-

Tim Mullooly: Right.

Chris Smith: I think how big your emergency fund needs to be depends on the level of risk that you and your household are encountering at the time. So you can go to this-

Tim Mullooly: Right.

Chris Smith: One calculator on the website that asks you a series of questions. And it only takes like 10 minutes to answer the questions, but it's like the number of earners in the household, and how firm a hold on the income level that they have, that each earner has and so forth, and by the time you're through with that 10 minutes worth of questions, you get a specific recommendation for you in terms of how many months your ... months of expenses your emergency fund should be based on the level of risk that you and your household are facing.

And we're just now in the process of launching individual coaching sessions that you can sign up for. So we've got these people that we're calling Net Worthy Know It Alls, and they'll take you through all the Net Worthy principles on individual phone sessions.

Tim Mullooly: Right.

Chris Smith: And that's just getting launched now too, so all of that is available on the website that's called iamnetworthy.com.

Tim Mullooly: Awesome. On top of the book and the e-book version, I feel like those are definitely useful tools to enforce the topics and the lessons that are explained in the book, so that's great. And for the listeners, we'll link in the show notes to iamnetworthy.com where you can check out all the tools, as well as the book.

There are so many different topics covered in the book, all of them are extremely important, but kind of on a high level, if you could have a reader take away just one main thing from reading the book, what would you want that to be, and why?

Chris Smith: Yeah, so the one most important thing I'd want any reader to walk away with is to really, truly understand what the object of the game is when it comes to your financial life. Here's what I mean by that. You remember the first time you played the game Monopoly-

Tim Mullooly: Right.

Chris Smith: Or any board game like that, but I'll just use Monopoly because that's pretty commonly understood. I mean, it's-

Tim Mullooly: Yeah.

Chris Smith: When you're a new player it can be confusing at first, there's lots of moving parts, literally, and there's all these properties-

Tim Mullooly: Yeah.

Chris Smith: And rent to pay, opportunities to buy things and all that, and you can even end up in jail if you screw up.

Tim Mullooly: Yeah.

Chris Smith: Experienced players know what they're doing, but if you're a newbie at the game all you can do is just try and survive until you can figure out what the best moves are, and the way you figure that out is by watching everybody else, and trying to kind of mimic what they do. And then learn from your mistakes.

Tim Mullooly: Right.

Chris Smith: It's much easier, and you have a much better chance of winning, if somebody explains to you right at the start what the object of the game is. Your real financial life is about a thousand times more complicated than Monopoly. But this is no game. And the outrageous truth, or I think it's outrageous, about 21st century financial life is that almost nobody is taught the object of the game. Not in school, not in early financial life when it would do you the most good. People just get thrown into the game. The unwritten understanding is, well, just figure it out and go from there.

Tim Mullooly: Right.

Chris Smith: But there's all kinds of grim financial statistics, and you know you see them too, Tim, out there, that just show-

Tim Mullooly: Yeah.

Chris Smith: That most people don't ever get a good handle on what the object of the game is. That's the one thing I'd want. Every ready should walk away-

Tim Mullooly: Okay.

Chris Smith: From that book with a rock solid understanding of what the object of the game is.

Tim Mullooly: That makes sense. I mean, it's hard to win the game if you don't know the object.

Chris Smith: Exactly, yeah.

Tim Mullooly: So let me ask you this. If knowing the object of the game is the most important thing, what is the object of the game that we're playing with our finances?

Chris Smith: Bingo, so I use a really simple analogy to explain it. And it's a bathtub analogy. So just imagine a plain old every day bathtub like you've seen a million times.

The water coming in through the faucet represents your income. The water going out down through the drain represents your spending level, or you can think of it as the lifestyle that your spending supports.

Tim Mullooly: Right.

Chris Smith: The most important part of the analogy, and the thing you should keep your eye on at all times, is the water level in the bathtub, that's the key. It's not the faucet, it's not the drain, look at the water level in the bathtub. And your job is to make that water level rise. Month after month, and year after year.

Tim Mullooly: Right.

Chris Smith: How do you do that? Well the bathtub analogy makes it obvious. The only way you can do that is to consistently spend less than you earn.

Tim Mullooly: Right.

Chris Smith: If you do that long enough, the water level will really get high. Now imagine that there's an imaginary dotted line kind of up at a high level in the bathtub, and we'll label that dotted line "enough".

Tim Mullooly: Yeah.

Chris Smith: That means once you've gotten enough water in your bathtub, you've got enough in there to last you for the rest of your life. So you've got enough financial resources to pay for all your living expenses, such that you can turn the faucet part way off or all the way off if you want to. That's financial independence. You've got the resources to cover your living expenses for the rest of your life.

Tim Mullooly: I was going to say, I liked, too, while you were explaining that you weren't using ... you weren't using exact dollar numbers in terms of enough or money going out the drain, or in the drain. Because I'm sure you would agree, it's different for everyone, so that dotted line of enough is going to be ... in terms of dollars, is going to be different for everyone, right?

Chris Smith: Absolutely, and I get that question all the time. People understand the bathtub analogy pretty quickly, and that leads them to ... and I love when I get questions about it, and one of the most common questions is, "Okay, so how much is enough in today's world? Would one million dollars be enough? Would two million be enough?"

Tim Mullooly: Right.

Chris Smith: And it depends completely on you and the lifestyle that you choose.

Tim Mullooly: Absolutely, it totally does. And I feel like having set on a specific dollar number for people, whether it's one million dollars, two million dollars, might be a big misconception about the objective. Like when I get to this dollar number, then that'll be enough. Are there any other kind of misconceptions about the objective of the bathtub model, and the objective of the game that you can tell the listeners about, and how they can kind of lead people towards trouble?

Chris Smith: Absolutely, yeah. So once people understand the bathtub analogy, it's easier to understand why some of these other object of the game misconceptions are not a good idea. One of them is a common misconception that people have, is it's all about income, and that's all that matters.

Tim Mullooly: Right.

Chris Smith: So it's like if I'm on a ... if I'm in a job search, my objective should be to just maximize the salary. There's this feeling among people that have this misconception that people that earn 100 thousand dollars a year are twice as successful as people that earn 50 thousand dollars a year. The real truth is, it doesn't matter nearly as much how much you make as much as it matters how much of that you keep.

Tim Mullooly: Right.

Chris Smith: So you can achieve financial independence from almost any income level. Income isn't nearly as important as it used to be a generation ago. A generation ago, income determined things like what your retirement plan was going to look like, things like what your Social Security level was going to look like, things that don't count as much anymore. Now-

Tim Mullooly: Right.

Chris Smith: It's all up to you to figure out how much you're going to save from that amount. And so it's not just about maximizing income. Now, to be sure, you can fill your bathtub up faster with a higher income, but there's no guarantee that you will, and there's lots of people that earn a very high income that have an empty bathtub.

Tim Mullooly: Right.

Chris Smith: So it's not just about income. Income is only one of the variables there.

Tim Mullooly: Yeah.

Chris Smith: Another misconception, and I think this comes from popular culture, is that financial success means you live an impressive lifestyle. The way financial success is portrayed like on TV and in movies, seems to suggest that unless you've got a lot of bling, you must not be-

Tim Mullooly: Yeah.

Chris Smith: Financially successful.

Tim Mullooly: Right, big house, fancy car, all that flashy stuff.

Chris Smith: Yeah. Exactly. And it's like the truth is, every dollar you spend on bling takes you further away-

Tim Mullooly: Yeah.

Chris Smith: From financial independence, not-

Tim Mullooly: Right.

Chris Smith: Towards financial independence. You're probably familiar with the famous book, The Millionaire Next Door, which really-

Tim Mullooly: Yes.

Chris Smith: Yeah, it really explodes that myth. The typical American millionaire is nothing like the way it's portrayed in popular culture, so that's something, when I do live teaching I spend a long time talking through that concept from the book, because I think that's just repeated so often in popular culture people have a belief that if they're not living that kind of lifestyle, they must not be successful.

Tim Mullooly: Right.

Chris Smith: But nothing could be further from the truth.

Tim Mullooly: Yeah.

Chris Smith: Then there's one more misconception, and that is ... I call it the I'm just going to pay my bills and stay out of trouble strategy. This is like a completely reactive strategy. People will learn eventually from their credit score, and from their creditors, that if they don't pay their bills they're going to get in trouble. So that can kind of lead you into a ... what starts out as a temporary strategy of okay, this month I'm just going to make sure that my bills get paid and I've got a little bit of money in the bank. That kind of keeps the urgent wolves away from the door. And so you just complete that the next month, and the next month, and the next month.

Well, if you go through your whole financial life doing that, you're not going to set off any alarm bells. But you will be approaching your 50s, and then maybe your 60s, and you will have nothing set aside for your future after you have begun to work.

Tim Mullooly: Right.

Chris Smith: Or after you have stopped working.

Tim Mullooly: I feel like that's a very short term mindset in terms of just paying month to month and not thinking about the long term, towards, like you're saying, retirement-

Chris Smith: Right.

Tim Mullooly: In your 50s and not planning for the future.

Chris Smith: Right. People have such busy lives, that you think if I can just-

Tim Mullooly: Yeah.

Chris Smith: Take care of this month, I'll worry about the future in some future month when I have more time. And of course, the future month when you have more time never arrives.

Tim Mullooly: Never comes.

Chris Smith: Yeah.

Tim Mullooly: Yeah.

Chris Smith: And so the only way you can make saving for the future urgent, is if you make it urgent yourself.

Tim Mullooly: Right.

Chris Smith: I mean, you've got to tackle that as a long term goal, and nobody's going to ... you're not going to get a bill in the mail from your future self saying, "Hey, you've got to pay for me, too."

Tim Mullooly: Right. Yeah, that would be great if you did, but yeah, it's not going to happen that way unfortunately.

In the book, you talk about what's called the three phase path to financial independence. And I feel like this kind of lends itself to what we were just talking about in terms of putting things in priority and getting ready for the future. So can you explain to the listeners the three different phases of the three phase path to financial independence, and what each of those phases entails?

Chris Smith: Sure. Yeah, so I like simple visuals like a traffic light.

Tim Mullooly: Right.

Chris Smith: Red light, yellow light, green light.

Tim Mullooly: Easy to understand, yeah.

Chris Smith: And once people understand the bathtub, they say, "Okay, I get the object of the game, but there's all these different parts of my financial life, what do I do first?"

Well that's why the three phase path was invented. Everybody knows what your natural life is, it begins when you're born and it ends when you die.

Tim Mullooly: Yeah.

Chris Smith: Your financial life is different. Your financial life begins as soon as you are the one primarily responsible for your own financial condition. And it ends when you no longer are. So for most people-

Tim Mullooly: Right.

Chris Smith: Their financial life begins in like late teens or early 20s, it's like whenever somebody else stops being responsible for your financial condition, and you begin. So as soon as your financial life begins, you wake up in the red phase. Your goal in the red phase is to get the heck out of the red phase as fast as you can, and that means there are two requirements to get out. The first one is to build up an adequate emergency fund. I put that as one of the very first things that you need to do before you do investing or anything else. That's just the red hot priority. And how big that emergency fund needs to be, that's where I would direct you back to the website where you can use that calculator that will let you know, based on the amount of risk that you face in your life, how big your emergency fund needs to be.

So that's the first requirement. The second requirement is to get all of your non mortgage debt down to zero. So that means credit cards, that means car loans, that means student loans. And for some people, getting out of the red phase means really buckling down hard and paying down all that debt. Depending on how much debt you have in the red phase, that can take a long time to get out of the red phase, and if that's what you're facing, that's when you really want to manage your bathtub such that you're not sending very much money down the drain. For example, somebody that's just graduated from either college or graduate school, the advice I give is you've lived like a starving student all these years, once you graduate, just keep right on living like a starving student for a while.

Tim Mullooly: Right, keep doing it, yes.

Chris Smith: I mean, it's much easier to remain at a low spending level than it is to rise up to a high spending level, get used to all of that, and then have to crank it back down again, so just maintain-

Tim Mullooly: Yeah.

Chris Smith: That low spending level, if you can.

Tim Mullooly: Yeah.

Chris Smith: But once you've met those two things, building up the emergency fund and paying off your debt, that's when you go into the yellow phase. The yellow phase is really easy to explain. It's just earn money, save it, invest it, repeat. Over and over again. So that's when you do your serious bathtub filling is in the yellow phase.

Tim Mullooly: Right.

Chris Smith: And you just keep on repeating that until you hit that imaginary enough line in your bathtub. And as soon as you do-

Tim Mullooly: Yep.

Chris Smith: Then you've achieved financial independence, and that's the payoff.

Tim Mullooly: So is the green phase then the once you hit that enough line, and the financial independence, that would be entering the green phase?

Chris Smith: Yes.

Tim Mullooly: Yeah, that makes sense. I also saw that you've written that building a strong financial future requires two major life skills. Can you tell us what those two life skills are, and how the book can help them specifically with the second skill?

Chris Smith: Yeah. So this actually was one of the first things my dad taught me in one of those sessions, the concept of the two life skills. The first one is-

Tim Mullooly: Right.

Chris Smith: You've got to earn an income. That's where it all begins. Until you're earning an income, your financial life really hasn't begun yet, and you're financially dependent on somebody else.

Tim Mullooly: Right.

Chris Smith: So you've got to earn an income. But the second life skill is you've got to know what to do with that income. And the problem, the way our ... the way it's set up in most people's life, is the first of those life skills, earning an income, that's the one that gets all the attention and all the priority as you're growing up. Starting from the time when people ask you-

Tim Mullooly: Right.

Chris Smith: "What do you want to be when you grow up?" You're talking about what's your vocation going to be, what are you going to do to earn the income? Our entire educational-

Tim Mullooly: Yeah.

Chris Smith: System is set up just for that one life skill. The other side of the equation though, which is knowing what to do with the money that you earn, that gets ignored and neglected. And there's kind of this unspoken, well, if you just earn enough money, all those other questions like what to do with the money that you earn will somehow magically take care of themselves.

Tim Mullooly: Right.

Chris Smith: But they won't. You know, you have to-

Tim Mullooly: Yeah.

Chris Smith: You have to make an explicit objective of learning what to do with the money that you earn. And that's what I Am Net Worthy is all about. It kind of shows you step by step what's the object of the game here, how you go through the phases of your financial life to put yourself on a path to financial independence.

Tim Mullooly: The second skill is not taught in traditional school, so having a book like this is definitely a useful tool for people to figure out what to do once they get that money. And kind of along the same lines, one of the sections that I noted in the book talks about how to pay for what you buy. And I personally still struggle with this sometimes. So I wanted you to break it down for the listeners. It talks about what people should use cash for, what you should use debit cards for, and what you should use credit cards for. So how does the book kind of break down what to use, and for what purchases?

Chris Smith: Yeah, I love this topic because it's just so basic. It's like you step up-

Tim Mullooly: Yeah.

Chris Smith: To the cashier, and it's time to pay, and so what do you pay with? Do you pay with cash, do you pay with debit card-

Tim Mullooly: Right.

Chris Smith: Or credit card. Most of us face that decision hundreds of times a year. But somehow that's not the piece of it we put most of our attention on. As far as I'm concerned, the answer to that question, it doesn't depend on what you're buying. It doesn't depend on what the size of the transaction is. Instead, it depends on what your level of financial skill and maturity are. So here's what I mean by that. If you're just starting out in your financial life-

Tim Mullooly: Right.

Chris Smith: You probably don't even have a bank account, and so cash is all you got. The advantage of cash is you're not going to overspend. I mean, once your pocket is empty you can't spend anymore.

Tim Mullooly: Right, you have what you have.

Chris Smith: Yep, yep. But the next level of maturity, you have a bank account, now you have a debit card. You can start using that. I'll jump to the end. The end state, that I believe that everybody should shoot for once their financial skill and maturity allows them to, is to pay for everything with credit cards. That's what you should be shooting for, but don't do it until you have proven to yourself that you have the amount of financial skill and maturity to do that.

Tim Mullooly: Yeah, I was going to say, that could be a dangerous ... dangerous game for people who don't know how to responsibly manage their credit cards.

Chris Smith: Absolutely. Let's break it down a little bit. So why are credit cards better than debit cards? Well there are like a long list of advantages to credit cards. For one thing, you get cash back if you choose the right kind of credit card, you'll get cash back on every purchase.

Tim Mullooly: Right.

Chris Smith: You'll get protection from fraud. If you have a dispute with somebody that you've bought something from, if you bought it with a credit card, the credit card company will take your side in that dispute. If you buy it with a debit card, you're just on your own.

Tim Mullooly: Right.

Chris Smith: With credit cards, you get-

Tim Mullooly: Yep.

Chris Smith: Extended warranties without having to pay for extended warranties.

Tim Mullooly: Right.

Chris Smith: You're free from all these account holds, like at gas stations, or hotels, or rental cars, and all that that you get with debit cards. But the biggest advantage of using credit cards is if you use credit cards for everything, that's a huge opportunity to improve your credit score. So all those things-

Tim Mullooly: Right.

Chris Smith: That I just rattled off, none of those are possible with debit cards. However, credit cards have one huge disadvantage. And that is, of course, interest. And it's interest rates that are the highest legally allowed. So if you're not careful-

Tim Mullooly: Right.

Chris Smith: You can get caught up in credit card interest rate quicksand. So the golden rule for using credit cards without exception, every single card, every single month, pay off the entire balance in full. A lot of people-

Tim Mullooly: Yep.

Chris Smith: Especially young people, don't understand this key point, which is interest is not charged on what you buy, interest is only charged on what you carry over from the previous month.

Tim Mullooly: Exactly.

Chris Smith: So if you never carry anything over, you can buy everything with credit cards, and never pay a penny of interest.

Tim Mullooly: Yep.

Chris Smith: That's golden.

Tim Mullooly: Right.

Chris Smith: That's where you want to be. But, let's go back to this concept of don't try that until you have proven to yourself that you've got the financial skill and maturity to do that. The way to do that is-

Tim Mullooly: Right.

Chris Smith: If you can use a debit card for six consecutive months without a single overdraw, then you've proven it. Because that means you've mastered this very specific financial skill, which is looking ahead one, two, and three months out, and timing out when your income is going to be coming in, compared to when your major expenses are going to hit.

Tim Mullooly: Yeah. Yeah, I have to agree. Because you were talking about, it can really improve your credit score and help you a lot, but if you don't manage it properly it can really hurt your credit score, and cost you a lot of dollars in interest. So I definitely agree that credit cards have a lot of really good benefits, but you need to be able to use them properly before you get yourself in trouble.

Chris Smith: I tell people it's like credit cards are like cars. They're indispensable if you know how to use them safely, and extremely dangerous if you don't.

Tim Mullooly: Yeah, exactly. Well, kind of along the same lines, there's an entire chapter in the book dedicated to cars. For people buying cars, paying for cars, what are a few of the most important points that people should know when it comes to cars and everything that comes along with that?

Chris Smith: Let me be succinct for a change. So the most important point, never, ever buy a new car.

Tim Mullooly: Right.

Chris Smith: It's a sucker play.

Tim Mullooly: Yeah.

Chris Smith: It's the single biggest money grab in the economy today. The grabbers are the car dealers and the manufacturers, and the grabee is you. No matter what the advertising said, repeat after me, there is simply no such thing as a good deal on a rapidly depreciating asset.

Tim Mullooly: Yeah, yeah.

Chris Smith: I don't care how ... what kind of crazy sales the dealer is advertising. It's a rapidly depreciating asset.

Tim Mullooly: Yeah.

Chris Smith: Just to talk you through a quick illustration of that, the average price of a new car, if you take the average across all the different categories of car and everything, is about $34,000.00 in the US today. If you buy a brand new car at $34,000.00, the second you drive it off the lot, as soon as your front tire hits the property line of that car dealer-

Tim Mullooly: Yeah.

Chris Smith: Instantly it's not a new car anymore, and it's not worth $34,000.00 anymore. It's worth-

Tim Mullooly: Yeah.

Chris Smith: 15 to 30% less. So if you just be conservative and ... like let's say 20%, you've just lost $7,000.00 instantly. It's gone from $34,000.00-

Tim Mullooly: Yeah.

Chris Smith: Down to $27,000.00. Of course you pay sales tax on the $34,000.00. You pay for your registration and tags on the $34,000.00, not the $27,000.00. So that makes-

Tim Mullooly: Right.

Chris Smith: Really like more like $8,000.00 straight out of your bathtub and into the bathtub of the dealer. Now, let's say you own and operate that car for five years. The average amount of miles on a car in the US today is around 15,000 so that would take you from like mile zero to mile 75,000. The depreciation doesn't stop once you drive off the dealer's lot, it keeps going, and the newer the car is, the faster it's depreciating. So at the end of five years-

Tim Mullooly: Right, yep.

Chris Smith: On average, it's down to about $12,000.00 of retail value. So you have just gone ... you've paid $34,000.00 for a car, and five years later, if you resell it, you're going to $12,000.00. That's a difference-

Tim Mullooly: Yeah.

Chris Smith: Of $22,000.00.

Tim Mullooly: Yeah, exactly.

Chris Smith: And that comes straight out of your bathtub. The only way you can make that any worse, is to borrow money to lose that $22,000.00, and that's what most people do-

Tim Mullooly: Right.

Chris Smith: On top of it.

Tim Mullooly: Yeah, they finance the cars.

Chris Smith: Yeah.

Tim Mullooly: Yeah.

Chris Smith: So a second rule is never borrow money to buy a depreciating asset. I get it, a lot of times when I'm talking to young people they're saying, "I need a car to get to the job that's going to pay all of the bills." And there are times when you absolutely, positively have to borrow money to buy a car, and I get that. But if you do-

Tim Mullooly: Yep.

Chris Smith: The place to borrow it is from your credit union or your bank. Not from the dealer. The terms and conditions-

Tim Mullooly: Right.

Chris Smith: On dealer financing are really unfriendly to the buyer. You might get apparently a lower rate of interest, but if you are a minute late on any one payment, you could be in trouble. Whereas your bank-

Tim Mullooly: Yeah.

Chris Smith: Or credit union want you to succeed in paying off the loan.

Tim Mullooly: They're on your side there.

Chris Smith: Yeah, exactly. So just to finish this story, so let's follow the life of that one car. It was initially bought at 34,000, five years later it sold for 12,000. If you're buyer number two of that same car, if you buy it for 12,000 and own and operate it for five years, when you resell it, you're going to be able to resell it for maybe about 6,000. So depreciation-

Tim Mullooly: Right.

Chris Smith: Is still happening, but your five years only cost you $6.00 difference in the buy price from the sell price, compared to-

Tim Mullooly: Right.

Chris Smith: 22,000 if you're buyer number one.

Tim Mullooly: Right.

Chris Smith: So being buyer number two saves you almost $20,000.00. And when you think-

Tim Mullooly: Right.

Chris Smith: Of what that $20,000.00 can compound to if it stays in your bathtub-

Tim Mullooly: So a car is usually a big purchase in someone's life. Usually the bigger purchase would be buying a house. And in the book you give the readers five points ... or a five point house buying financial readiness test. Can you talk about those different points within the readiness test, and why they're so important to do before buying a house?

Chris Smith: Oh, sure. Yeah, so the big ticket items are cars and houses in peoples' lives.

Tim Mullooly: Right.

Chris Smith: I mean transportation and housing accounts for like half of what most people spend. So those are the two topics you really want to make sure that you're on solid ground here.

Tim Mullooly: Right.

Chris Smith: When it comes to buying a house, before you even get to the readiness test, is the question, am I a good candidate to buy a house? Well we talked about the financial nuggets earlier.

Tim Mullooly: Right.

Chris Smith: Net Worthy Nugget number 6.2 is buying a house is a very big decision, don't do it unless you can commit to staying in that house for at least five years. In today's world, that's not a no brainer. A generation ago, career paths were a lot different, and it was pretty common-

Tim Mullooly: Yep.

Chris Smith: To have a single employer or just a few employers, and you didn't need to move around that much. Today if you buy a house, that really limits your career options because you don't have the flexibility to move around as much. So first, before you even get to the five point readiness test, make sure that you ... you're in a position that you can commit to staying in the house for five years. People say-

Tim Mullooly: Right.

Chris Smith: That renting is throwing away money. If you buy a house and then have to sell it and move after two years, you're throwing away money even faster than if you rent. So-

Tim Mullooly: Right, yeah, a lot more money. Right.

Chris Smith: Yeah.

Tim Mullooly: Yeah.

Chris Smith: So those five points on the readiness test, there's a calculator on the website that will walk you through them, but just to quickly touch on each one, one is about is your emergency fund in good enough shape? Is your FICO credit score high enough? Do you have enough saved up for the down payment and closing costs? Is your income high enough for the housing market that you're considering? And have you thought through once you've bought the house and are now paying a mortgage, are you going to be able to build a monthly budget that still allows you to put money into your bathtub every month? So if you can say-

Tim Mullooly: Right.

Chris Smith: Yes to all five of those, then you're ready to buy.

Tim Mullooly: Those are definitely super important points to make sure before you buy a house, and especially that last one I think is very important, too. Like you might be able to afford your mortgage payment and the other payments that go along with having a house, but do you still have money ... like are you still net positive, and still have money to save and to invest, I think is very important and a lot of people overlook that point, too.

Chris Smith: Well people are eager to get into houses sometimes, and I understand that. But just know-

Tim Mullooly: Right.

Chris Smith: That that last one, your real estate agent isn't going to push you to do that analysis, your mortgage banker isn't going to push you to do that analysis, the only one who's-

Tim Mullooly: Right.

Chris Smith: Really going to make that happen is you. You're ultimately responsible for that, and so the book will kind of point out why that's so important to realize that.

Tim Mullooly: Can you tell the listeners about your views on long term investing, and why it's so important to have a long term view, and how it kind of differs a lot from short term investing?

Chris Smith: Yeah, absolutely. So this is a point that most people have never been taught about, and they usually have some pretty big misconceptions about what investing is all about. But long term investing and short term investing are as different as night and day. And so that's-

Tim Mullooly: Yep.

Chris Smith: I usually spend time at the very beginning in a class, or when I'm working with people one on one making sure that they really understand this point. So a basic financial term is investment horizon. So your investment horizon is simply the length of time between when you buy and when you sell. Short term investing can mean an investment horizon of like maybe a year, or a few years, down to as short as micro seconds. Long term investing, here we're talking about horizons that are decades long, 20 years, or 30 years, or 40 years. A simple way to think about this I talk about, if you want to visualize long term investing, visualize planting redwood seeds. And you're just going to plant a few each month, each month, for years, and years, and years. And decades later, you're standing in a grove of tall redwood trees that you planted yourself.

Tim Mullooly: Right. Yeah.

Chris Smith: Is that thrilling and exciting? No. But it is super stable. I mean ... and it's super safe. As the market goes up and down, you could just think of that as well some years your redwood trees are going to face a lot of storms, and some years it's going to be nice and sunny, and the seasons will change. And you don't need to worry about that, because you know that your redwood trees are going to grow. There's no suspense-

Tim Mullooly: Right.

Chris Smith: Involved. If you think of short term investing, my mental image for that is ... I don't know, something like a NASCAR race, where there's like thrills, chills, and excitement, split second decisions, preparation is everything, if you make a bad move it can be ... it can be fatal.

Tim Mullooly: Right.

Chris Smith: That's short term investing.

Tim Mullooly: Yeah.

Chris Smith: Most people, when they hear the word investing, if they're not experienced at it, they think of short term investing because that's when you watch the financial media, everything from Mad Money to Wall Street Journal, tends to talk mostly about short term investing. And that's because-

Tim Mullooly: Right, yeah.

Chris Smith: Short term investors need all that information, and they thrive on it. And frankly, the financial services industry makes most of its money from short term investing. So it's in their interest to support those short term investors and to talk most about. For short term investing, short term investing is much riskier, because you have to pick the right thing to invest in, whether it's an individual stock, or a commodity, or a cryptocurrency, you've got to pick the one that you think is going to be higher when you sell it than when you buy it. Or, you have to try-

Tim Mullooly: Yeah.

Chris Smith: And time things right. It's like I want to buy it at the bottom and sell it at the top.

Tim Mullooly: Yeah.

Chris Smith: So you have to be smarter than other buyers and sellers in the short term market, and that's a tough thing because there are buyers and sellers in that short term market that have a lot of resources and a lot of experience at doing it. So-

Tim Mullooly: Right.

Chris Smith: Most individual investors have to hire somebody to do that for them, and that somebody is going to cost them a fee to do that. I don't want to make it sound like short term investing is bad, and long term investing is good. Instead I put it this way, you need long term investing to achieve financial independence. Short term investing is something that you can do also, but it is absolutely, positively not a substitute for long term investing.

Tim Mullooly: Yeah, I like the way you phrase that with ... you need to do long term investing, and the short term is just an extra layer on top if that's something that you want to do to try and bring in better returns or more money. I think that's the proper way to phrase that.

Chris Smith: Good, so people say, "Well how simple is it to do this long term investing that you're talking about?" And I say it is so simple.

Tim Mullooly: Start early and ... you know-

Chris Smith: Yeah.

Tim Mullooly: Just keep putting money in and kind of almost set it and forget it. To a degree.

Chris Smith: Yeah, you've got to put some thought into exactly how you set it, but once you've done that, you truly can set it and forget it. I mean, it's-

Tim Mullooly: Yeah.

Chris Smith: It's not intuitive, but it's true. And it's amazing about long term investing. The way to do it that's ridiculously simple and gives you a great return with little risk, that's what I recommend. If you'd like, you can choose a more complicated or sophisticated method. And if you do, your return will go down and your risk will go up.

Tim Mullooly: Right.

Chris Smith: So why would anybody do anything other than the ridiculously simple way?

Tim Mullooly: Yeah, and I'd have to agree with that, and hopefully that point is ... gets hammered home for the listeners and the readers and the book as well.

I wanted to touch on one last thing about the book. It wraps up by talking about a person's gap. Can you explain to the listeners briefly what the gap is, and how does it impact a person's view on their own personal finances?

Chris Smith: Yeah, so a gap is a simple concept. Gap is the difference between a person's average monthly income and their average monthly expenses.

Tim Mullooly: Right.

Chris Smith: Your gap is positive if your average monthly income, and I'm talking about take home pay, if your average monthly take home pay is consistently higher than your average monthly expenses, that's a positive gap.

Tim Mullooly: Right.

Chris Smith: If it's the other way around, you've got a negative gap. And the reason I shine a big spotlight on that definition is until you achieve a positive gap, your financial ship is sinking. You can't get anywhere until you establish a positive financial gap.

Tim Mullooly: Right.

Chris Smith: Once you've got a financial gap that's positive, now your financial ship is afloat and the next question is, how do I deploy that gap? Well that's where I Am Net Worthy kind of walks you through here's the first thing you do with it, here's the second thing you do with it, and up through a series of seven steps that you do with your financial gap. But until you've got a positive one, you can't get anywhere, and in fact, your financial ship is sinking. The difference between a positive gap and a negative gap can be really minor. There's this famous quote from ... you don't think of Charles Dickens as being a personal finance expert, but-

Tim Mullooly: Right, yeah.

Chris Smith: He's got a quote that I think sums up the philosophy of personal finance succinctly better than anybody else. And the quote is ... I might paraphrase here a little bit.

Tim Mullooly: Right.

Chris Smith: Annual income, 20 pounds. Annual expenses, 21 pounds. Result, misery. Annual income, 20 pounds. Annual expenses, 19 pounds. Result, happiness. That's it.

Tim Mullooly: Yep.

Chris Smith: So to go from a negative gap to a positive gap might mean a relatively small change in your spending. But unless you're measuring it and knowing that you're positive, and have tools in place to keep it positive, you're not going to move your financial ship anywhere. So the gap is kind of like the fundamental concept that all the rest is based on.

Tim Mullooly: So I have one more question for you before we wrap up, I like to ask every guest before the show ends. So whether it's a personal thing for you, or a professional thing, or maybe it touches a little bit of both, what's one piece of advice that you've received over the span of your life that has always just stuck with you?

Chris Smith: Don't rush major decisions. Whether they're financial, career, family, life. Don't rush a major decision. Sometimes you're forced to, but unless you are forced by external forces to rush it, take your time with them, think them over carefully, seek input from people who have your best interest at heart, and whose opinions you trust. And, one of those people you seek opinions from should be your own future self.

Tim Mullooly: Yep.

Chris Smith: I actually recommend, and I've read a lot of articles about this and they're easy to find, having an imaginary conversation with your future self on a regular basis, and that immediately allows you to kind of, what I call, zoom out and look at a much broader perspective. Life forces you ... life will kind of make you think of the immediate perspective, automatically. A conversation with your future self allows you to see it from a much broader point of view, and it might change the decision you make in a positive way.

Tim Mullooly: Yeah, I definitely agree, it'll help you plan for the long term and the future, and most likely almost always lead to better decisions. So that's a great piece of advice to share with the listeners, and that's a great piece of advice to end on. Chris, that was all the questions that I had for you today, thanks for coming on the podcast.

Chris Smith: It's been a pleasure, talk to you later.

Tim Mullooly: For the listeners out there, like I said throughout the episode, I'm going to be linking in the show notes to iamnetworthy.com, you can check out the book, the e-book, the website, and all the different tools that Chris mentioned during this episode. So thanks for listening to this episode of Living With Money, and we'll see you on the next one.