

Wealth Creation Dynamics



Learn how to
drastically
advance
your financial
future.

by Philip Siggelkow

Author of best seller 101 ways to get rich quicker.



Welcome

Module 4 Wealth Creation Formula

Welcome to module 4 of the Wealth Creation Dynamics Home Study Course - Wealth Creation Formula.

This module is number 4 of 24.

Each module is presented in the same layout and contains exercises that you can do in your own time.

The benefits of participating in this Home Study Course are:-

- You progress at your own pace.
- You can study in the privacy of your own home.
- You can ask questions regarding the course at questions@apin.com.au

We hope you enjoy the Wealth Creation Home Study Course.

Best regards,
The team at APIN

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Wealth formula

A person's wealth is NOT defined by the car they drive, by the home they live in nor is it defined by how much income one brings home.

To us, Wealth is defined as;

How long you could survive if you had to stop work tomorrow?

In other words, let's assume that you're going to stop work tomorrow ... and you weren't relying on receiving your pay packet next Wednesday or next Thursday ... how long could you live on what you've already accumulated?

We endeavoured to find that one thing the wealthy people do that enables them to achieve more financial success than others ... that one common thread, or several is explained on the following pages.

We did manage to discover several key elements they all did in some way or another a common denominator if you like ... and from that formulated our own wealth creation formula.

It became:

WEALTH

$$W = P + S + I + C$$

P = Plan S = Save I = Invest C = Compound.

It's not hard and it's not complicated ... in fact, it's really simple.

This basic four point formulae has generated much wealth for those that are not disappointed by its simplicity.



The seven investment and wealth laws to live by

Success is a habit and it's a discipline. It leaves clues and it's simple.

It's not easy and yet ... It's simple.

Success is not an accident. It's a skill, it's predictable and it can be learnt. It can be learnt by you and it can be learnt by anyone — and the sooner you learn the skills and the sooner you become an expert in wealth creation ... the sooner you'll achieve the great things you were born to accomplish.

Many people believe that you have to be very intelligent to be wealthy in life.

Exhaustive research, including that of our own, shows that many self-made millionaires have only average intelligence. The reason this helps them is because they never become impressed with how smart they are — they're always trying to learn more.

"They have a desire!"

If you follow a success system you'd be far more successful than if you don't ... and any system based on sound investment principles is certainly better than no system at all.

Do what wealthy people do and you will create wealth, do what the common person does and you'll stay common.

That's why some people are called commoners!

In the words of:

*"The philosophy of the rich versus
the philosophy of the poor is this:
the rich invest their money and spend what is left,
the poor spend their money and invest what is left."*

Jim Rohn

There are seven laws of Creating Wealth.



Exercise

What is the Wealth Creation Formula?

What is **YOUR** definition of Wealth?

Law # 1 - Develop a wealthy mind-set

Many of us believe that becoming wealthy is for the 'other guy' ... or it's just out of reach.

The first law of creating wealth is developing a Wealthy Mind-set. You need to believe three things:

1. That becoming wealthy is feasible, and
2. That becoming wealthy is feasible for YOU, and
3. It is not a sin to have money.

At least 80% of millionaires are self-made. That is, they started with nothing more than the ambition and desire to become wealthy.

Many of them never went to college, many only got average grades in school, many started with no advantages at all, some were orphans, some were immigrants that could barely speak English.

Attaining wealth

Anybody can attain more success and wealth in their lives if they simply do three things:

1. Realise that the past does not equal the future
2. Change your negative friends, they are holding you back
3. Make the decision to change

Most people never truly decide to be wealthy and that's why they retire poor. Sure, everybody you ask would probably say that they would like to be wealthy, but at the same time they never sat down and really made the mental decision that they were going to become wealthy.

Every single wealthy or successful person has always made the decision to become wealthy long before. Nobody tripped over success or came across wealth by chance or merely by accident.

Learn from the experts

If you want to be a great cook, then you'd study cooking. You don't try to figure it out for yourself, you'd firstly make the decision that you would like to be a better cook then you'd find out what good cooks do ... you would buy cook books and maybe even take some cooking classes or lessons.

If you want to be wealthy ... then you must study wealth. Study wealthy men and women and do what they do and chances are - you'll be wealthy too.

Take action

There's no use in making the decision to become wealthy, finding out exactly how to do it and then doing nothing.

Don't procrastinate all your life and then regret your decision to do nothing when it's too late. Remember, the one thing that is always in your favour is time ... and time is the fuel for compounding as we will see a little later on.

Law # 1 - Develop a wealthy mind-set

Your attitude will determine your outcome.

The psychologist, William James, once said “Any person can alter his life, by altering his attitude.

Henry Ford understood this when he said “If you believe you can do a thing or you believe that you cannot — you are right”.

The sad truth is that the vast majority of people are living their lives with the wrong attitude and as a result they hinder their greatest potential to accumulate wealth and achieve what they are truly capable of.

Start taking responsibility for your future and invest in the greatest asset you possess and that is that space between your ears.

The one human quality that must be developed for success is self-discipline. The will power to force yourself to do what you know you should do, when you should do it — whether you like it or not, whether you feel like it or not.

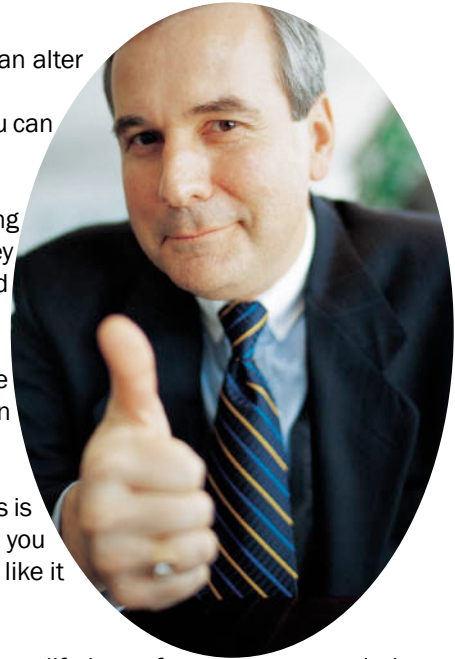
Napoleon Hill the author of Think and Grow Rich, after a lifetime of studying some of the most successful men and women in the world, came to the conclusion that the ability to exert self discipline on ones self was the master key to riches.

A famous study, spanning 12 years, concluded that successful people are simply those that make a habit of doing what unsuccessful people don't like to do — and what are the things that unsuccessful people don't like to do, they're exactly the same things that successful people don't like to do but successful people do it because they know that this is the price of success.

That is why the first law to wealth creation is about YOU.

For things to change, we must change and as Anthony Robbins (world's most successful life coach) says, you must take massive and immediate action now. Do not look at failure as failure – look at failure as a learning curve – when you do something wrong, it simply means two things:

1. You were unprepared with poor knowledge
2. Your timing was out.



Exercise

List the three things you can do to start to attain wealth?

Name some wealthy people you can study:

What is the first law of creation about?

Law # 2 - Have a plan

Planning for your future.

Now that you've made the decision that you really want to become wealthy, the second Law you need to abide by is: Have a written financial plan, and a life plan.

We've all heard the saying: "People don't plan to fail, they just fail to plan"

A plan is absolutely essential. When building a house, you don't go down to your local hardware store, buy a whole heap of building materials and then call in a builder on your vacant block of land and say, "build me a house". Because, we know that the first thing the builder will ask is: "Where are the plans?"

In exactly the same way, you need to plan your financial future.

There is a famous scene in the movie Alice in Wonderland where Alice asks the cat,

"Would you tell me, please, which way I ought to go from here?"

"That depends a good deal on where you want to get to" said the Cat.

"I don't much care where", said Alice.

"Then it doesn't matter which way you go" replied the Cat.

You must have a written financial plan ... a yellow brick road that will map out your destination.

In our seminars, I often ask people to put their hands right up in the air if they believe in planning and just about every hand in the room goes up. We then ask them to keep their hands in the air if they have a written financial plan right now, a plan that tells them what they're going to do, how they're going to do it and what outcome they expect to receive.

We think it's needless to say, but just about every hand in the room goes straight down. We always congratulate the few people (probably about 2%) that kept their hands up in the air.

Law # 2 - Have a plan

Importance of written goals

Please do not underestimate the importance of written goals.

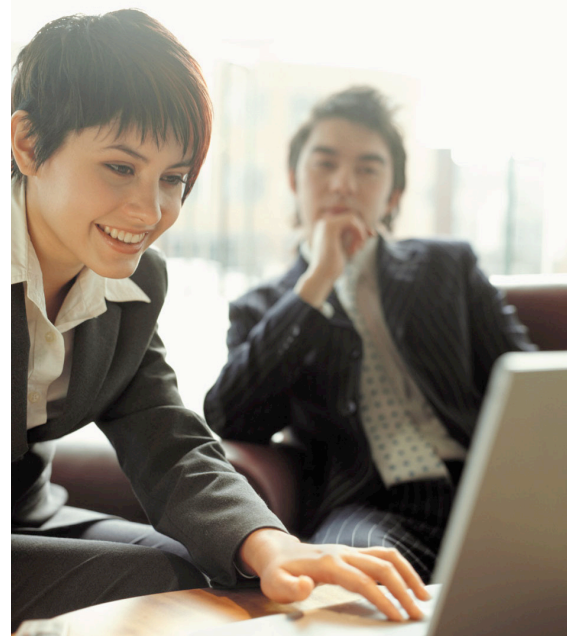
There are many great books written entirely on the importance of goal setting and are a 'must read' for anybody serious about controlling their financial future.

One study I would like to share with you was a study that was done at Yale University back in 1953. It was the result of this study that has made all the difference in my view of goal setting and by sharing it with you I hope that it does the same for you.

You see, I had understood the importance of planning and for many years it was something I was going to do once I got around to it. Unfortunately, I never did until its absolute importance was identified to me in this 1953 study:

The graduating class of 1953 at Yale University was asked a series of questions. One of the questions that was asked of the thousand students was whether they had clear, specific financial goals written down with a plan for achieving those goals.

Only 3% had in fact answered 'yes' to this question. In 1973, twenty years later, the researchers went back and interviewed the surviving members of the 1953 class. What they had discovered is that the 3% that had written their personal goals and plans were worth more than the entire remaining 97% put together!



"People are not lazy. They simply have impotent goals — that is, goals that do not inspire them".

Anthony Robbins

Exercise

Why is it important to have a financial plan?

What goals have you set for yourself in the last 30 days?

Have you made progress towards achieving these goals?

Law # 3 - Save 10%

If you've followed Law 1 and Law 2 then by now you would have made the decision to become wealthy by altering your attitude and deciding to take positive action and you also have a clear plan that shows you exactly what you'd like to achieve and how you plan on achieving it.

The next Law to Creating Wealth simply states that you will put aside and Save 10% of your salary and use that 10% to help you accumulate future wealth.

It's difficult to get started in this day and age, and the hardest task of all is building your nest egg from nothing. Yet, if you were to put aside and save just 10% of your gross salary each week or month, then you will be on the road to wealth and heading in the right direction.

Focusing of your goals

Most people make the effort and save enough money to buy a new car, boat or caravan, usually just to keep up with the Jones's, and find that they never have enough money to make for a viable investment.

It is always most enjoyable and often requires the least amount of resistance to spend your entire weekly wage. However, once you have a written plan you will begin to understand the importance of saving and know exactly how much you can afford to spend.

The word save here does not just mean putting money aside in your bank account. Whilst all wealth is accumulated originally with the ability to put aside a certain percentage of your income, paying off your own home, hence increasing your equity is also a viable form of saving.

Law 3 is relatively simple yet difficult for many people to follow. Let me elaborate on this Law and expand it into two interrelated sections:

Firstly, you must save and put aside at least 10% of your gross earnings. I suggest you begin with a 'secret' bank account, begin slowly while you develop your new savings habit.

Many people I speak to say that this is impossible for them to do at the moment and they will start saving 10% once they start earning more money ... understand that you will never earn more money if you don't put aside 10% today!

There's an ancient belief that your expenses will always increase to your level of income. People earning \$100,000 a year or more find it just as hard to save as do people earning \$25,000 a year.

Let's put this into perspective. If your boss approached you tomorrow and said that the company is in trouble and that everybody, including you, will have to take a 10% reduction in wages. Would you still be able to live? Of course you would.

Law # 3 - Save 10%

Budget analysis

Sit down and work out your budget. Analyse where you're spending your money and see what you can minimise or eliminate completely, even if it's just for the time being.

Remember that the philosophy of the rich versus the philosophy of the poor is that the rich invest their money and spend what is left and the poor spend their money and invest what is left.

The lack of money could also be an incredible inspiration. You must learn to pay yourself first. This is difficult at first but please persevere.

Have you ever had to come up with your rent or risk being kicked out of your home and then somehow you found the money. Have you ever had to make a car payment by a certain date or they take your car away? And somehow, somehow you came up with the cash.

You've probably noticed that your expenses always expand to meet your income and that your income tends to expand to accommodate your expenses. If you're this type of person that seems to always just barely get by and barely pay your bills each month, you're probably the kind of person who waited until the last minute to finish your assignments at school.

So instead of fighting this habit, use it to make you more money. If you're the kind of person that just barely pays your bills, then simply increase your bills!

Savings – The extra bill

In addition to your car payment or your rent, create a new monthly bill called 'savings'. Write down the figure equivalent to 10% of your income on a piece of paper and put it into your bills file (the place you go to once a month, if you're lucky, to pay your bills), and every month pay that bill called 'savings'.

Instead of ignoring it and deciding that you just don't have the money to save, treat it just like any other bill that won't go away.

No matter what stage of life you are in, there are bound to be many good reasons why you cannot save money at that particular time.

Law # 3 - Save 10%

The following list, produced by Elvic & Company Pty Ltd sums it up perfectly:

Age 18 –25 I CAN'T SAVE NOW. I'm just getting my start in life. I don't make a lot yet, and I'm entitled to a little fun while I'm young, and I'm saving for a new car. There is plenty of time. Wait until I start making a little more. Then I'll save.

Age 25 –35 I CAN'T SAVE NOW. The car registration is due and the brakes need replacing on the car. I've got a growing family on my hands. Children and a house cost a lot of money. It takes all I have to keep them going. As soon as they are a little older, it'll cost less, then I'll save.

Age 35 – 50 I CAN'T SAVE NOW. I've got two children in High School. It's all I can do to pay for their expenses. In fact, I had to borrow for their tuition last year. This is the most expensive period in a person's life. I can't save a cent; and the car needs new tyres!

Ages 50–65 I CAN'T SAVE NOW. I know I should but things aren't breaking like they were. My car is so old now that it costs a lot in maintenance. It's not easy for person my age to step out and get a better job. I'll have to ride along where I am. Maybe something will break.

Age 65 Over - I CAN'T SAVE NOW. We're living with my son and his wife. My pension doesn't go far. The only asset I have is my vintage car. I wish I had started saving twenty years ago, but it's too late now. You can't save when there's no income.



Law # 3 - Save 10%

Creating an estate

Secondly, you must never, ever, never touch or spend your savings.

Now, not spending is not the same as not investing. You must not spend your savings on cars, boats, holidays, etc, but rather ... invest that money. Use the laws of compounding and leveraging to help you build up your nest egg (more on this later).

Understand that in the early days the amount of increase will be relatively small and will become larger and larger as time passes. Unfortunately, too many Australians save some money and are immediately tempted to spend that money on all those little 'goodies' ... self is, once again, the key.

People fail because they do what is fun and easy rather than what is hard and necessary.

Anybody that puts away just 10% of their earnings consistently and invests it wisely will eventually create an estate that will provide a future income for them and/or their family.

And the more money you put aside and invest, the more readily and consistently money will seem to come to you and in ever increasing quantities. The money you put aside, save and then invest earns more money ... and those earnings will then earn more and so on.

Change your old habits for six months:

1. Cut all your credit cards up and learn to live on one card which has a \$4,000 limit.
2. If you are a PAYG earner, do not have a 'leased' motor car (more on that later).
3. An investment property (negatively geared) should not cost you more than \$50-\$100 per week (more on that later).
4. 'Do not' enter into any interest free store accounts, use the layby system, i.e. Own it before you receive it.
5. Keep this in mind: If I can't pay cash for it, I CAN NOT AFFORD IT.

Exercise

What Shouldn't you do with your savings?

What strategies can you put in place to ensure that you save 10% every month?

Law # 4 - Select the right investment

Investing

You've decided to take the appropriate action towards achieving your written plans.

You've also managed to successfully save and put aside no less than 10% of your earnings and are now in a position to invest.

Your choice of investment is probably one of your most important choices as it is the engine of your wealth creation strategy.

If you could make up a 'wish list' of the attributes of the perfect investment, you would probably come up with something along the lines of:

- High Capital Growth
- Security
- Tax Effective
- Low Maintenance
- Finance Effective
- Protection against Inflation
- Income Producing



We're sure you'd agree that if you could find an investment vehicle that demonstrated all of the above attributes ... then you would probably have a very good investment vehicle. We want you to know that these attributes are out there, they are achievable and as such you should not settle for anything less.

Aim to have your investment work for you ... aim to have it multiply in value over the years and produce an income.

Law # 4 - Select the right investment

Obtaining the right advice

The first thing you should do is get the right advice.

Do not be misled or influenced by people who really don't know what they are talking about. Obtaining advice or opinions from well meaning friends could also be very dangerous.

George Clason writes in his must read book the Richest Man in Babylon:

"My own investment was a tragedy to me at the time. The guarded savings of a year I did entrust to a brick maker, named Azmur, who was travelling over the far seas in Tyre agreed to buy for me the rare jewels of the Phoenicians. These we would sell upon his return and divide the profits. The Phoenicians were scoundrels and sold him bits of glass. My treasure was lost. Today, my training would show to me at once the folly of entrusting a brick maker to buy jewels.

Therefore, do I advise thee from the wisdom of my experiences: be not too confident of thine own wisdom in entrusting thy treasures to the possible pitfalls of investments. Better by far to consult the wisdom of those experienced in handling money for profit. Such advice is freely given for the asking and may readily possess a value equal in gold to the sum thou considers investing. In truth, such is its actual value if it save thee from loss".



This holds true, even though at times you may believe that you know exactly what you're doing it is far better and far wiser to learn first and become a more astute investor ... as the old carpenter's saying goes:

Law # 4 - Select the right investment

'Measure twice and cut once!'

And as far as investment vehicles go, select an investment that you understand.

I guess this explains the popularity of residential property as an investment vehicle with 9 out of 10 millionaires creating their wealth through property ... after all, they are as safe as ... houses!

And do not make the mistake of assuming that all property is the same ... learn how to calculate rates of returns and learn what attributes will affect capital growth and tax effectiveness.

Do your homework and you will reap the benefits of a good solid investment for many years.

Sales People!

Face it – everybody sells something, my dentist wants me to change my old fillings, my solicitor wants me to sue people to get my money back, my motor mechanic wants me to service my car every four months.

Do 'nots'!

1. Do not buy an investment property from a salesperson working for a marketing company selling you an overseas or interstate property.
2. Do not deal with anybody who is unlicensed or unqualified in any profession (ask for Diplomas, etc).
3. If a friend gives you advice, ask them to prove how much money they have.
4. Do not sign anything! Get the paperwork and take it to a solicitor then wait 48 hours while you think about it.



Exercise

What kind of investment should you choose?

What could you do to ensure that the investment you choose is suitable?

Law # 5 - Utilise the laws of compounding

Compounding

"If you should put even a little on a little, and do this often, soon this would become big"

- **Hesiod**

Compounding simply means the ability of earning money on your money or earning interest on your interest.

If you had the option of receiving \$10,000 a day for 30 days (Option 1) or the option to receive 1 cent on the first day and then doubling every day for 30 days (Option 2) ... which option would you take?

At least 80% of people, we're sure, would take Option 1.

Now, if you have selected Option 1 then you would have \$300,000 at the end of the month (Not bad for a months work!).

Undecided? Well, let's work through it together.

Option 1		Option 2	
Day	\$	Day	\$
1	\$10,000	1	\$0.01
2	\$10,000	2	\$0.02
3	\$10,000	3	\$0.04
4	\$10,000	4	\$0.08
5	\$10,000	5	\$0.16
6	\$10,000	6	\$0.32
7	\$10,000	7	\$0.64
8	\$10,000	8	\$1.28
9	\$10,000	9	\$2.56
10	\$10,000	10	\$5.12
Total	\$100,000	Total	\$10.23

Have you made a choice yet? Would you take the guaranteed \$300,000 or would you like to keep compounding your \$10.23 at 100%?

Law # 5 - Utilise the laws of compounding

Option 2 is not looking too good at this point ... so let's continue.

Option 1		Option 2	
Day	\$	Day	\$
11	\$10,000	11	\$10.23
12	\$10,000	12	\$20.46
13	\$10,000	13	\$40.92
14	\$10,000	14	\$81.84
15	\$10,000	15	\$163.68
16	\$10,000	16	\$327.36
17	\$10,000	17	\$654.72
18	\$10,000	18	\$1,309.44
19	\$10,000	19	\$2,618.88
20	\$10,000	20	\$5,237.76
Total	\$200,000	Total	\$10,475.52

20 days have passed and Option 2 is still only around 5% of the income of Option 1.

And with just 10 days to go ... have you made your mind up yet?

Option 1		Option 2	
Day	\$	Day	\$
21	\$10,000	21	\$10,475
22	\$10,000	22	\$20,951
23	\$10,000	23	\$41,902
24	\$10,000	24	\$83,804
25	\$10,000	25	\$167,608
26	\$10,000	26	\$335,216
27	\$10,000	27	\$670,433
28	\$10,000	28	\$1,340,866
29	\$10,000	29	\$2,681,733
30	\$10,000	30	\$5,363,466
Total	\$300,000	Total	\$10,726,932

Law # 5 - Utilise the laws of compounding

Selecting your option

Whilst we understand that it is practically impossible to compound your money at 100% a day, the above exaggerated example clearly demonstrates the power of compounding — and that's why it is so often referred to as the 'miracle of compound interest'.

Here's another good example that demonstrated a very similar phenomenon:

There's a story about an Indian Rajah who wanted to reward one of his workers for a job well done, so the Rajah called his worker in and asked him what he asks of his Rajah.

In reply, the worker pulled out a chess board and handed it to the Raja: "I ask that only one grain of rice be placed on the first square of the board, two grains of rice on the second, four grains of rice on the third and so on keep doubling until all 64 squares are covered".

The Rajah agreed (obviously unaware of the power and effects of compounding), but soon discovered that all the rice in India would not be enough to cover the final square. The Rajah was outraged and ordered his deceitful worker be beheaded!

Let's have a look at how compounding can help you.

Wealth Creation Formula

The Wealth Creation Formula suggests to one Plan, Save, Invest and Compound. However, in order to have the capacity to Invest, one must first Save. And this is often the hardest part.

Compounding cannot only help the growth of your investment, it can also help you save much more quickly. Let's have a look at a young brother and sister, Olga and David, both 18 years of age.

Olga begins to put aside and save \$1,000 a year into an interest bearing account. 13 years later at the age of 30, Olga stops contributing her \$1,000 so that she can use her savings to buy her home. However, she doesn't touch her savings and allows them to accumulate over the years.

David on the other hand, hasn't really saved a dime. At age 30, David realises that he'll need to catch up to his sister and decides to contribute \$2,000 a year into the same term deposit.

Assuming that both Olga and David receive a net return of 10% on their investment, who would have the greatest amount of money at 65?

Olga would have \$690,000 (for an investment of \$13,000) whilst David would have only \$542,000 (but for an investment of \$70,000!). This is only because time was in Olga's favour.

By the time David decided to start saving, Olga's total savings (now \$24,500) was already giving her an annual return of \$2,450 — that's \$450 more than David was contributing.

Law # 5 - Utilise the laws of compounding

The key factor here is you won't get rich overnight, but you will get rich over time.

Now that you have a better understanding of how compounding works, let's have a look at the two interrelated factors that help build your long-term assets. The two essential ingredients are:

1. Time, and
2. Capital Growth.

The problem with too many people is that they are not patient and everybody wants their savings to accumulate quickly. People start saving three or four thousand dollars a year and within three or four years they have just \$12,000.

In the story about the Indian Rajah, one grain of rice in the first square was next to nothing. Even after 10 full squares had been completed, that was still only a spoon full of rice. So the most important element for compounding to work is time.

You need to have the discipline to put your savings aside and let your interest earn interest.

The second element, Capital Growth, also makes a significant difference over the years. This is often referred to as the rate of return on your investment.

Let's have a look at how a different growth rate can also affect your investment.

There's an old economic rule known as the Rule of 72 that tells us how many years it would take for something to double in value.

72 / growth rate

Simply divide the growth rate or the interest rate into 72 and the answer will tell you how many years it would take for your investment to double in value.

Let's say that you have \$100,000 in a fixed term deposit growing at 10%. What you do is divide 10% into 72 and this will give you 7.2 years. So, in 7.2 years, ignoring any bank charges and the effect of taxation, your investment will grow to \$200,000.

If the bank was only giving you a return of 7% rather than 10% then you would divide 7% into 72 and the answer would be 10.2 years.

The difference of just 3% compounded over the years will mean the difference of your investment growing to \$196,715 in 10 years at 7% as opposed to \$259,374 at 10%.

The difference of \$62,659, is the difference between the money you would have made ... or lost depending upon what rate of return you were receiving.

Law # 5 - Utilise the laws of compounding

Ratio of time vs wealth

It is therefore important to not only aim at maximising your time by starting right away, but to also aim at maximising your returns. This is done by engaging in some research and study. Explore the various investment vehicles but also explore all the variable attributes of each investment vehicle.

It is in this area that you should seek the services of a qualified professional so as to obtain additional information that you may have possibly overlooked or not considered.

By utilising the laws of compounding in your favour, you will accumulate wealth more quickly and easily.

Use your money wisely or your money will use you. Consider today who you spend most of your time with, are they contributing to your success. If not, then consider spending time with new people who will bring out the best in you.

If you are in a hole, stop digging!



Exercise

If you keep doing what you are doing today, will you be better off in 3 years or worse off?

What does 'compounding' mean?

Law # 6 - Leverage your income and your assets

Obtaining the highest returns

The most powerful tool available to create wealth is undoubtedly the concept of leverage.

Leverage ... or Gearing ... as it is commonly known, is simply the principle of using something small to move and obtain something much bigger.

Here's what I mean:

Let's say that you have \$60 a week in surplus income and you're unsure as to whether you should save the \$60 into an interest bearing account or whether you should use the \$60 a week to service the loan on an investment portfolio worth \$100,000 (albeit shares or property).

Let's also assume, for the purpose of this exercise, that both options are giving you a return of 10%.

If you chose to save the money into an interest bearing account, at the end of the year you will have saved \$3,120. At a return of 10%, you would have earned \$312 by the end of the year.

Negative Gearing

On the other hand, you can choose to borrow \$100,000 and invest the full amount into a property or a portfolio shares. Of course, the cost of borrowing (i.e. interest) would be serviced by the returns from the investment (rent or dividends) and the shortfall of \$60 would be your contribution (this is commonly referred to as Negative Gearing).

Once again, at the end of the year you will be 'out-of-pocket' \$3,120. With this investment giving you a return of 10% - the question is - what have you made 10% on?

You've made 10% on the value of your investment NOT on the amount of your contributions of \$3,120.

And that's \$10,000 for a total investment of \$3,120 ... a net return of 220%!!

So, for exactly the same weekly investment, you've increased your 'wealth' by \$10,000 in the leveraged investment as opposed to a measly \$312 in your non-leveraged investment. Of course, you would then use the laws of compounding to increase your wealth even more in the future by having that money continue to grow.

Of course, we've ignored the effects of taxation and bank charges here for ease of calculation but if you had allowed for any timing and taxation adjustments, then you would have actually ended up with less than half of the \$312 - after tax!

Law # 6 - Leverage your income and your assets

Ratio of accumulated wealth

Understand that it is much easier to accumulate \$1,000,000 worth of real estate than it is to save \$1,000,000.

Leverage, if used wisely, can and will, regardless of your current financial situation, make you more wealth, more quickly than you ever thought possible. Saving, as a long-term investment vehicle simply does not work.

Leveraging helps you obtain a big advantage by using a small amount of effort. In much the same way that the pedals on a bicycle, with a small rotation, enable you to turn the wheel, through gears, having a much larger rotation and hence moving the bicycle forward much more quickly.

The best way to further demonstrate the concept of leverage is to use the simple 'lever'. If you wanted to move a 1,200kg weight, you would use maybe 20kg of 'effort', with an appropriate length lever, to move the weight.

Leverage formula

The extent to how much leverage is required is measured in the engineering circles by the following formula:

$\text{Leverage} = \text{Load (kg)} \times \text{Effort (kg)}$

So in the above example, the gearing ratio would be $1,200\text{kg} / 20\text{kg} = 60$.

It was Archimedes, the Greek mathematician, once said:

"Give me a lever long enough and a place to stand, and I can move the world".

From a financial point of view, the principle is exactly the same. The only differences, of course, relate to the individual items concerned ... the amount of your loan becomes the 'lever' ... the Load becomes the Asset Value and the Financial Commitment replaces the Effort.

The Financial Leveraging formula therefore becomes:

$\text{Financial Leverage} = \text{Asset Value (\$)} \times \text{Your Commitment (\$)}$

One of the many problems that face many investors is their limited availability of cash. For instance, if you only had \$20,000 to invest you really have two fundamental options:

You can use your \$20,000 and invest in either shares or cash and maybe get a 10% return – hence increasing your wealth by \$2,000.

or

You can use your \$20,000 to borrow \$100,000 and invest in property and still get the same 10% return. But how much have you increased your wealth by now? That's right, by \$10,000.

That is leveraging.

Law # 6 - Leverage your income and your assets

Principle of obtaining the highest returns

It's the principle of using 'Other People's Money' to increase your returns. By using borrowed funds you are combining your assets with that of a financial institution, hence giving you the ability to move and control a larger portfolio of assets than you could on your own.

Let's have a closer look at exactly how leverage can work for you and help you accumulate more wealth and security through property by using our Financial Leverage formula.

Let's assume you have \$100,000 in the bank. Referring back to the two options available to us we could either:

1. Use the \$100,000 to invest in a single property and own it outright, or
2. We could use the \$100,000 to borrow (or leverage) \$500,000. With our now available funds of \$500,000 we can go and buy 5 of the \$100,000 properties.

If we divide the variables of the first option into our Financial Leverage formula:

$$\begin{aligned}\text{Financial Leverage} &= \text{Asset Value} \times \text{Your Commitment} \\ &= 100,000 / 100,000 \\ &= 1\end{aligned}$$

Therefore this option has a leverage factor of 1 ... or a gearing ratio of 1:1 (which means no leverage).

For the second option:

$$\begin{aligned}\text{Financial Leverage} &= \text{Asset Value} \times \text{Your Commitment} \\ &= 500,000 / 100,000 \\ &= 5\end{aligned}$$

The gearing ratio now becomes 5:1.

Law # 6 - Leverage your income and your assets

For ease of calculation, let's assume that the property increases by 10% each year and then let's compare your accumulated wealth over the next ten years on each one of your two options:

Years	Option 1		Option 2	
	Value	Growth	Value	Growth
1	\$100,000	\$10,000	\$500,000	\$50,000
2	\$110,000	\$11,000	\$550,000	\$55,000
3	\$121,000	\$12,100	\$605,000	\$60,500
4	\$133,100	\$13,310	\$665,500	\$66,550
5	\$146,410	\$14,641	\$732,050	\$73,205
6	\$161,051	\$16,105	\$805,255	\$80,526
7	\$177,156	\$17,716	\$885,781	\$88,578
8	\$194,872	\$19,487	\$974,359	\$97,436
9	\$214,359	\$21,436	\$1,071,794	\$107,179
10	\$235,795	\$23,579	\$1,178,974	\$117,897

As you can clearly see, the returns you receive on Option 2 are much greater than the returns from Option 1 by a factor of five ... and from exactly the same investment.

Please don't misunderstand this and automatically assume that a high gearing ratio is necessary. Other factors you will need to take into consideration are your other financial commitments and your income levels to establish proper serviceability.

You now have a basic understanding of how you can utilise the laws of compounding and leveraging to help you engage a true wealth creation process.

Exercise

If you had \$100,000 to invest, what would you do to **LEVERAGE** your investment?

What is the 'lever' in a financial situation?

Law # 7 - Aim to create wealth slowly

Why people fail

"To be successful you should find out what failures do and don't do it".

Jim Rohn

Why is it that some people fail? Economists say that the inability to delay gratification, is a primary attribute of failure later in life.

The basic law of human nature is that people will always tend to seek the easiest way to get the things they want, and usually to get the things they want right now. Brian Tracy calls this 'The Expediency Factor' or "The 'E' Factor" and it explains the reason why some people succeed and why others fail.

Because of the unwillingness to delay gratification, the vast majority of people immediately act to get the things they want now — even if the long term consequences of their actions would be under achievement and failure to reach their true financial potential.

A perfect example would be where a young man drops out of high school to take a job - to buy a car - to impress the girls. And the long-term price is possibly a life-time of low wages and frustrating work.

Another example would be 'fast food'. Rather than go to the effort of cooking a nice healthy meal, society in large have turned to the convenience of junk food. You eat to satisfy your hunger and fast food gives you instant gratification.

Criminals engage in robberies, burglaries and theft to get immediate funds - at the price of a possible ruined life in society.

All these 'band-aid' solutions are called 'short term gains for long term pains'.

People do only what they have to do to earn a pay cheque and then spend their time socialising and watching television at the long-term price of failure.

We are all looking for a 'get-rich-quick' opportunity ... a way to riches and financial security with the least amount of effort. Unfortunately, it often doesn't quite work like that in the real world.

Why is it that the average age of a millionaire in Australia is 54 years of age?

It is because when people are young they believe that there is a fast way to wealth so they lose a great deal of money trying many different things. Yet, when they become older and much wiser they realise that the surest way to wealth is, unfortunately, quite often also the slower road.

Law # 7 - Aim to create wealth slowly

Property investment security

Property Investment is NOT a get rich quick investment ... it is, however, a very viable 'get-rich slow' investment.

Many people would argue that business is a faster way to wealth. This is sometimes true — and more often untrue. I'm sure you've heard the startling statistic that 80% of businesses fail in the first five years of operation!

Would you like your retirement income to be subject to something as risky?

"Gold flees the man who would force it to impossible earnings or who followeth the alluring advice of tricksters and schemers or who trusts it to his own experience and romantic desires in investment.

George Clason

Fanciful propositions that thrill like adventure tales always come to the new owner of gold. These appear to endow his treasure with magic powers that will enable it to make impossible earnings. Yet heed ye the wise men for verily they know the risks that lurk behind every plan to make great wealth suddenly".

Resist the temptation to do things the fast and easy way.

Stick to what you know to be right until you win through. Do not expect to receive impossible earnings but rather building your wealth on a good solid foundation will make you far wealthier in the future.

final reflections

What key points have you learnt from this module?

What are you going to do today to start saving your 10%?

How do you create wealth?



You are ready for the next module.