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Better Decisions

A bulletin devoted to helping you make better and better financial decisions

Simply Divide by .03

by

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Last time I introduced you to a rather sweet financial concept I call the money-melon. To review: Your money-melon is the amount of money you have stored up by the time you stop working and retire.

As suggested by the title above, the fast way to come up with that number is to divide how much you're spending right now by .03.* Let's say you spend \$3,000 a month or \$36,000 a year. How much would you need to have saved up to replace the \$36,000? The quick answer is divide by .03 thusly:

$$\text{\$36,000} / .03 = \text{\$1,200,000}$$

You would need a money-melon on the order of \$1,200,000. This allows you to peel off \$36,000 a year forever with a good chance of never running out of money (and leaving \$1,200,000 behind when you die).

If you are accustomed to a grander lifestyle or have many mouths to feed, perhaps you're spending \$7,500 a month or \$90,000 a year. Divide \$90,000 by .03 and you end up with \$3,000,000. That's what you'll need if you want to keep a \$7,500/month lifestyle going in retirement.

Next, we'll add in Social Security. Say you're likely to receive \$1,300 a month in today's dollars from Social Security. Let's do the math: $\text{\$1,300} \times 12 = \text{\$15,600}$ per year divided by .03 = \$520,000.

Social Security benefits would reduce the needed money-melon in our first example from \$1,200,000 to \$680,000.

Still, you are left with a daunting task of saving aggressively if you want to hit your target (and we haven't even looked at taxes or inflation). If you plan to self-fund your retirement, save at least 20% of earned income for as long as you can.

If earned income is your sole source of cash-flow, see if you can develop alternative income streams for yourself to take some of the pressure off of saving an unrealistic percentage of your income. Whether in retirement or not, think of the picture as one of manufacturing an endless stream of money from:

- (1) work,**
- (2) income from savings, investments, and inheritances,**
- (3) alternative income streams,**
- (4) pensions, and**
- (5) Social Security.**

These are the main sources of funds to keep you going. These are also the ingredients for cooking up a life income strategy, a topic I'll discuss further in the next issue.

***Contact me if you want an explanation of how I computed this .03 number.**