

THREE STEPS TO FINANCIAL FREEDOM

JOHANNESBURG: I was recently asked by a student why it is so important to spend so much time and energy on savings and investments when it seems like investors get no reward for their efforts. The point was made that people derive pleasure from spending on holidays, clothes, cars and entertainment, so why invest? This is a great question that most of us deal with every day in our own lives when we decide whether to buy, spend or save. Without a clear goal to inspire us, most people will spend - not save.

WHAT IS FINANCIAL FREEDOM

The final step towards financial freedom is when the income from your assets exceeds your expenses. Financial freedom is quite different from being wealthy because some people have financial freedom with an asset value of R5m whilst others who have assets of R50m are not financially free. It is not possible for everyone to become truly wealthy (despite the Hollywood fairy tales) but anyone can be financially free. I have met many people who have retired with relatively small amounts (under R5m in investments plus a paid off home) who are living fantastic lives as retirees. The real secret to their success is that they have accumulated sufficient capital to cover their expenses and they have controlled their expenses.

There are various degrees of financial freedom – I think the first step towards financial freedom is when you are debt free. Most people struggle to get past this step because they constantly increase their debt burden as their income increases. The average high income earner in South Africa is three months away from financial difficulty in the event of a loss of income because of this behaviour. They buy more expensive vehicles and houses because they can afford the higher monthly payments but they never pay off their debt until it is too late. If you can break this debt cycle by limiting your debt and paying it off more quickly as your income increases; you are already 80% of the way to financial freedom.

The second step in financial freedom is to build an asset base. The first asset you need is an emergency fund that you use in the event of a financial disaster. You should aim for an amount that is equivalent to half your annual expenses and this should be saved in a fixed deposit or 30 day notice account.

The third step is when you start building your income generating assets that will eventually pay your expenses in future. This is the step that most people focus on i.e. where is the best place to put your money to get the most growth with the least risk. There is one implicit aspect that most people ignore about this step; you must continue to spend less than you earn – try to save 15% of your total annual salary. It is important to understand that your initial capital will take the longest to build because you do not have the benefit of compounding yet. As an example it will probably take about 8 years to save your first R1m but your second million will only take 5 years and your third will only take three years. This is because of the effect of compound growth and not because you are saving more. Your greatest allies in this phase are patience and discipline.

FINANCIAL FREEDOM IS POSSIBLE FOR ANYBODY

If you need R10,000 per month to cover your expenses you only need R2.7m of investments to be financially free for the rest of your life. This is the real key to financial freedom, try to ensure that your

expenses are really low and you will be in a position where you don't need a salary far earlier than you think. I realise that most people don't want to live on R10,000 per month but if you get to this position, you will be able to make better decisions about your life without worrying about a salary. Most people who reach this position are able to change their lives substantially – these are some of the reasons why:

- You have less stress because you don't have to generate a salary every month,
- You have the freedom to do the work you choose e.g. start a business,
- You can do a job you like, rather than a job you hate that pays better,
- If you have a lousy employer, you can quit.

The only way you will have the necessary patience and discipline to take the three steps to financial freedom is if you give yourself a goal to work towards. Try to identify what will motivate you to spend less every month and not to buy the biggest best car you can afford. Make this goal your mantra and every time you get the urge to spend think of your mantra, within a few years, you will be on your way.