

OUTSIDE THE FLAGS

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The Espresso Portfolio

When you haven't got much capital of your own, the road to financial security can seem long, hard and complex.

But the truth is that wealth building is relatively simple. All it takes is time and the price of a cup of coffee.

A son of a friend just graduated from university. Still in his early 20s and with student loans to pay off, Josh has hardly any savings or capacity to save much at all.

So Josh and I met for coffee and a chat. He had acquired a taste for espresso while studying and working at night waiting tables. (The coffee kept him awake).

"How much do you spend on espresso each week?" I asked him. After thinking for a moment, he replied that he averaged about two cups a day, each costing \$3. That equated to about \$40 a week or \$160 a month.

"Well, what if you sacrificed the coffee and put the cash into a savings scheme instead?" I suggested.

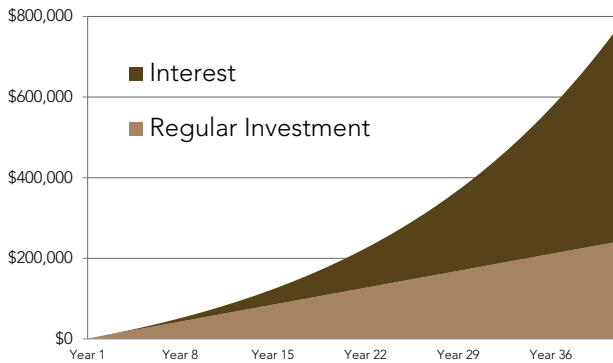
Josh looked doubtful. Kicking caffeine wouldn't be easy. Besides, he couldn't imagine that loose change spent on coffee would make much difference to his long-term financial position.

I dealt with the first problem by suggesting he make instant coffee at home and bring it into work each day in a flask. The second problem – that it wouldn't be effective – I dealt with by telling him about the miracle of compounding.

With initial balance of \$100, a monthly contribution of \$160 and a yield of 5%, his coffee money would gradually accumulate to a pool of a quarter of a million dollars by the time of his retirement. And this was without saving another cent.

Assuming Josh's salary was to rise on his graduation, he might bump up that monthly contribution to \$500. In this case, his savings pool would grow to three quarters of a million by his retirement. And this was a conservative estimate.

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This sounds too easy, he said. That's because it is easy, I replied. The interest he earned on his saving was paid into his account and included in the next calculation. So he was earning interest on interest.

The key was that firstly he was starting early. Secondly, he was saving a small amount consistently month after month. Thirdly, he was exercising patience. The rest of it was just the effect of time and compounding.

(Obviously, this young man's earnings will be subject to tax. But the purpose of this exercise was to show him that a small sacrifice, made regularly, would yield significant results over time.)

Josh now refers to his savings plan as his 'espresso portfolio'. The initial pain of kicking his expensive caffeine habit was made up for by the slow roast of a savings scheme that promised him a comfortable retirement.

Even for those of us much older than Josh, there are lessons here. We tend to underestimate the effect of gradual saving and patience in building wealth, just as we tend to over-rate gimmicks promoted in the media.

We can't control the ups and downs of markets or the daily noise of the media. We can control our own behaviour. With slow and steady saving, and a trusted advisor to keep us disciplined, there is no reason we can't succeed.

Now enough of this talk about money. How about a coffee? It's on me.



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