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November 2003 - Your Money Habits Will Reap Your Financial Destiny

The smallest things, if repeated enough times can become enormous. A small snowball rolling down a hill will pick up more and more snow and eventually become huge if allowed to roll far enough. This principle is especially true with money. Interest compounds the effects of regular repetition, it is like a huge magnifying glass. Its force is so powerful that Albert Einstein is credited with saying that compound interest “is the greatest mathematical discovery of all time.”

The Power of Small Daily Habits Over a Lifetime

My first example is inspired by a poster that Charles Reeve posted at Hurricane Electronics Lab about twenty years ago, “The \$500,000 Big Gulp”. The numbers have changed since, but the principle is still correct: Our decisions, even the smallest ones, can become very large when repeated enough times. If a person develops a habit of buying a large soft drink every day (which at the time cost about 39 cents) beginning at age 10, and does it for a lifetime (until, say, age 70), you would spend a little more than \$10 each month on soft drinks. I’m sure this doesn’t sound like much to most of you reading this. If the price of soft drinks never increases, over a sixty-year period you would spend about \$7,200. The snowball is growing. There might be some things you would rather do with \$7,200 over a lifetime than build a collection of 20,000 empty soft drink cups, or adding that many to the county landfill.

When you add compound interest, the results are dramatic. If you were to invest the \$10 per month at just over ten percent interest (10 1/8 %) instead of spending it on soft drinks it would grow to \$500,000 over a lifetime. The \$7,200 would earn \$492,800 in interest over 60 years! (If 10 1/8% interest sounds outlandish, consider what you used to pay for your home mortgage just a few years ago, and then think about what you still spend on credit card interest today.)

To be fair, let’s update the example, and show it with the lower interest rates available on most savings and investment programs today. At today’s prices, a large soft drink daily would cost about \$25.00 per month. Over a lifetime, if you saved the money instead of buying the soft drinks, you could accumulate the following amounts at the interest rates shown:

| Interest Rate | Total Amount You Saved | Total Interest Your Savings Earned | Total of Your Savings and Interest |
|---------------|------------------------|------------------------------------|------------------------------------|
| 2% | \$ 18,000.00 | \$ 16,752.18 | \$ 34,752.18 |
| 4% | \$ 18,000.00 | \$ 56,844.17 | \$ 74,844.17 |
| 6% | \$ 18,000.00 | \$ 158,357.80 | \$ 176,357.80 |
| 8% | \$ 18,000.00 | \$ 426,714.93 | \$ 444,714.93 |

I am not writing this to pick on those who enjoy soft drinks. It is simply an example to show the power of money habits over time. I could have as easily chosen anything that could be classified as a “want”: from buying music CDs, to extra clothing, to a daily donut, you get the idea. I am also not saying these things are bad, just that their long term cost may not be as important to you as other things might be.

The Habit of Buying New Compared With Near New

Cars and truck purchases are the easiest example to illustrate in this category, but the principle illustrated applies to many “big ticket” items. In most cases, you lose 25% of the value of a new car or truck as soon as you drive it off the dealer’s lot. If it is a fairly standard \$20,000 car, you’ve lost \$5,000. If it is a truck, SUV, or “luxury” car that costs \$40,000 and up, you’ve lost \$10,000, or more.

I will admit that the alternative has drawbacks too. If you buy a 2 or 3 year old vehicle, you will want to find out as much as you can about its service history and pay a mechanic you trust to thoroughly examine it before buying it to assure you are not buying a repair nightmare. It is obviously possible to lose a lot of time and money on repairs, but let’s also admit that new cars sometimes have repair problems as well and that new car warranties are only a partial solution. If you use vehicles (or other equipment) in a business to earn money, you can analyze for your own situation whether the time/repair savings justify the additional cost of new vehicles or equipment.

My own experience is that the extra repair costs of a “near new” vehicle amount to at most one-half of the savings you receive by not buying “new”. Let’s illustrate with a \$25,000 new car that you can buy 3 years old for \$15,000. The savings in this case is \$10,000, and I am saying that even with the additional repairs you will still realize at least \$5,000 in net savings on the purchase. If you have a habit of replacing cars every 4 years, over a period of 40 years, \$5,000 saved on each car adds up to \$50,000. Even if you only earn 6% on the money, that \$50,000 saved becomes over \$158,000 over 40 years. If you buy your cars on time, and pay more than 6% interest, the resulting savings in monthly payments will total an even larger number!

Important Note!

The information in this article is intended to inform you of some of the financial opportunities provided in the tax laws or elsewhere. It is not intended to give you specific advice for your personal situation. If you need such advice, please contact a qualified professional! Please call or e-mail me (doug@accuteksolutions.com) for an initial consultation to discuss your personal situation and how the tax laws might benefit you. Your first 30-minute visit is free to let you sample what we can do for you at no cost or obligation. We also invite you to submit questions you’d like to have answered in a future article!

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