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Secrets from "The Millionaire Next Door"

BY TONY COOK

Note: *This is a* Reader's Digest *condensed excerpt taken from the original article by Tony Cook entitled "7 Secrets to Achieve Your Money Dreams (Even on a Modest Income)" which first appeared in* Money *magazine. The condensed* Reader's Digest *points are highlighted in green; the applicable points to Money Mastery principles are highlighted in yellow.*

Ask most people to name the quintessential American millionaire, and a regular guy like 41-year-old Paul Kieffer wouldn't even be in the running. Self-effacing and unremarkable in appearance, Kieffer lives in tiny St. Charles, Minn. (pop. 3,000) spends about $38,000 a year to support his wife and two kids, drives a used 1995 Camaro, refuses to sign up for $30-a-month cable TV and works six days a week at the local Red Wing shoe store. Oh, yes, Kieffer also happens to own the store, as well as five trailer parks in the St. Charles area, which gives him a net worth of $1.4 million. "But most people in these parts think I'm Al Bundy," quips Kieffer, referring to the struggling shoe salesman from "Married With Children."

Funny this is, the best selling new book *The Millionaire Next Door* by Thomas J. Stanley and William D. Danko (Longsreet, $22) reveals that people like Kieffer are far more typical of today's 3.5 million millionaires than the Wall Street honchos, spoiled sports stars and Hollywood glitterati whose free-spending ways are chronicled by celebrity sycophant Robin Leach on Lifestyles of the Rich and Famous. "We found that you can't tell from appearances whether someone is a millionaire," says Stanley. "People with real money usually don't show it off, and those who look like they're living the good life don't necessarily have much wealth." In fact, the single most striking revelation in Stanley and Danko's tome (which recently it No. 4 on the *New York Times* bestseller list and No. 1 on the *Business Week* business bestseller list) is that, contrary to F. Scott Fitzgerald's claim, the rich really aren't' all that different from you and me — with one major exception: They're an awful lot more careful about how they spend and invest their money.

To help you maximize your wealth and make your financial dreams come true, *Money* has distilled the traits of the wealthy Americans documented in *The Millionaire Next Door* into seven easy-to-follow rules. In essence, the keys to achieving millionaire status are extreme thriftiness; disciplined, prodigious investing; an aversion to debt; serious tax sheltering; help from at least one sharp financial adviser and hard work — ideally at your own business. (To see how well you're doing so far, find out how your net worth stacks up against other Americans of the same age and income by completing the worksheet following this article.)

Before we lay out the secrets of success of today's millionaires, however, you should know a little bit more about hat group. About two-thirds of those millionaires who still work are self-employed — vs. one in five for all Americans. Somewhat surprisingly, the types of businesses they own tend to be mundane, like welding contractors or dry cleaners. The overwhelming majority are not trust fund babies; eight out of 10 accumulated their riches in one generation. And most are frugal to the point of being chintzy. Although their average net worth is $3.7 million, they generally live so modestly that even their next-door neighbors don't have a clue about their wealth.

How do we know all this? To learn what America's millionaires have in common and how they accumulated their wealth, Stanley and Danko sent out 3,000 questionnaires to affluent Americans and then conducted 100 or so in-person focus-group interviews. They learned, for instance, that three out of four millionaires drive cars that are more than a year old (Fords are the most popular) and half have never spent more than $29,000 for an auto. They prefer Bud to Bordeaux, 50 percent haven't owned a wristwatch costing more than $235, and half the men have never spent more than $399 on a suit.

By contrast, Stanley and Danko found that many of the people who flaunt the trappings of success — like the prototypical Manhattan or Los Angeles yuppie who squanders a six-figure income on a $5,000-a-month apartment, a leased $75,000 Mercedes and lavish vacations — often have little wealth. When they studied people who live in affluent communities like Greenwich, Conn. And Shaker Heights, Ohio, where homes can sell for $1 million or so, they found that while 20 percent of the residents had a net worth of more than $1 million, 80 percent had relatively little set aside in investments. "I interviewed one woman," recalls Stanley, "who had 287 pairs of shoes in her closet but almost not savings," Texans have a term for a person who lives a flashy lifestyle but has no real wealth: but hat, no cattle.

Based on Stanley and Danko's research, *Money* has been able to draw this composite sketch of today's typical U.S. millionaire: He is a 57-year-old white make who grew up in a rural area in a middle-class, blue-collar household; has a Russian-American father and a mother with Scottish ancestry; attended public schools; and is a college graduate. He owns and still runs a boring business such as a scrap metal shop, lives in the Midwest in a house worth $320,000 and drives a two-year-old Ford F-150 pickup. He has three kids and has been married for more than 30 years to a woman who does not work outside the home but is every bit as thrifty as he is.

In reality, of course, American millionaires are a far more diverse lot than this composite suggests. Indeed, the next-door millionaires interviewed by *Money* staff writer Jim Reynolds and profiled throughout this story include people from virtually all segments of society who built their fortunes in an astounding variety of ways: Bryn Kaufman, just 31, whose Broomall, Pa. Computer-sales business gave him his first million; George and June

Marotta, both 70, of Palo Alto, who began putting away $10 a week nearly 50 years ago and now have a net worth of $2.4 million; 43-year-old John Shmilenko, a roofer whose father emigrated to the U.s. from the Ukraine in 1951 and who has built a newt worth of $1.1 million from buying, renovating, and selling rental properties; Kenneth Bardwell, a 35-year-old African-American circuit board entrepreneur in Detroit worth $2.5 million; and Mary-Edith Hill, a 50-year-old Boise real estate broker whose $1.3 million net worth includes a $933,400 stock portfolio.

What these millionaires' personal stories show — as do Stanely's *24 years of research* into the ways of the wealthy — is that you don't need a family pedigree, an advanced degree from an elite university or a fancy job title to become rich. But if you put the following seven rules into practice in your financial life; you'll be on the road to banking your first million:

1. Live below your means. Conspicuous consumption is the enemy of wealth accumulation. So the first thing a millionaire wannabe must do is get off the spending treadmill. Sure outfitting your home and yourself sumptuously will let you look like you're living large, but it can prevent you from achieving financial independence.

The best way to keep your spending in check is to create an artificial environment of scarcity for yourself. Cut back on high-status purchases, even if this requires you lower your current lifestyle a notch or makes you seem a bit more downscale than your neighbors. And remember — you must strive to cut not just your own spending but your entire household's. So make sure your spouse budgets as carefully as you do.

As a goal, you should shoot for the level of savings that the average millionaire achieves. Reduce your spending, if necessary, so that you can save 15 to 20 percent of your annual income before taxes.

When it comes to being a successful small spender, few can outdo 44-year-old Peter Uys (pronounced eyes), a confirmed tightwad with a $1.1 million net worth who runs a successful private investment fun out of the bedroom of his Atlanta house. "I view frugality as a sport," says Uys, who saves half his $140,000 income most years. "When I get something for a price lower than what other people paid, I get a thrill that's like scoring points in a big game." Uys drives a six-year-old Ford Taurus, which he bought secondhand for $7,500. After reading that his investing hero and multimillionaire John Templeton furnished his entire house, as a young man, by cruising auctions and picking up pieces no one else wanted, Uys did the same. A few years ago, he snagged an Oriental rug for $150 that he now estimates has a $1,200 retail value. The occasional times that Uys splurges on a meal out, he reads the restaurant menu from right to left, scanning the prices first so he can order the cheapest dishes. And doggy bags are a must. "I will not leave anything for the garbage man," admits Uys. "Leftovers make a great lunch the next day."

2. Budget your spending meticulously. Many people assume they're saving money because they're savvy shoppers who scout out the lowest prices, clip grocery coupons or buy in bulk at Costco. Trouble is, these same people brag about how much they save by buying Olives-in-a-Drum at a warehouse store often write bigger checks for their groceries than they would at the supermarket because they can't resist "bargains." They then end up with more items than they actually need. "This is what I call the fallacy of spending money to save money," says Stanley.

A better approach: Make a belt-tightening budget for everything you spend, and try to stick to it. Take Mary-Edith Hill. She knows that last year she spent $647 to heat her $4,300-square-foot Boise, Idaho house, shelled out $2,000 on clothes for herself and her two teenage sons and paid $578 for electricity and $83 for trash collection. How? Because she tracks virtually ever cent of her spending with software that her friend Doug Fisher, an accountant, introduced her to. The Peachtree Accounting program Hill relies on is designed primarily for business owners. But there are plenty of other inexpensive software budgeting programs at local computer stores — such as Quicken and Smart Home Manager — that can help you make a detailed budget and then monitor your progress at sticking to it.

3. Launch a disciplined savings and investing plan. Although Stanley says the median annual gross income of millionaires is a surprisingly low $131,000 members of this group are prodigious savers. For example, Ed Chin, 57, a self-made-millionaire insurance salesman in Moraga, Calif., puts away $10,000 a month for retirement. "I don't plan to ever retire, though," he says. "It's my rainy-day fund." Most millionaires sock away at least 15 percent of their income before taxes, and many put aside 20 percent or more.

They also tend to make their own investment decisions. Some 95 percent of millionaires own stocks, and most are confirmed buy-and-hold investors. A full 90 percent hold their shares longer than a year; nearly a third hang on to them for more than six years. Although millionaires devote considerable attention to their portfolios, they don't make it a full-time job. Stanley estimates that millionaires spend about 20 hours a month — roughly five hours a week — managing their present holdings and researching new investments.

If you're still in a spending mind-set, investing 15 percent of your income may seem daunting. But by starting with, say, 5 percent now and adding another percentage point each year, you can hit 10 percent in five years and work up to 15 percent in 10. More important than the amount of money you put away not is establishing the habit of regular investing that can lead to riches as your income grows. The simplest strategy: set up a systematic stock investment program with a mutual fund you like, so that the fund automatically siphons off a set amount each month from your checking or savings account. Some 95 percent of millionaires own stock, and most are buy-and-hold investors.

Alternatively, you could buy stocks directly from an estimated 300 companies through their so-called direct-purchase program. Most of these firms don't charge fees; those that do charge much less than the $36 to $50 commission you would pay at the typical discount brokerage. The majority will reinvest the dividends you receive in additional shares for free. You can also arrange with 200 companies to take money from your bank account at regular intervals to buy additional shares.

Disciplined investing is what started Elisabeth Taylor, 55, a high school computer science instructor in Kettering, Ohio, and her husband Billie, 56, a retired teacher, on their march to a $1 million net worth. In 1972, they threw away their credit cards and began making deposits of $50 a months into a Merrill Lynch systematic infesting plan that let them buy stock primarily in large companies. After Merrill closed the plan in the early 1980s the couple began investing on their own, eventually stashing $300 monthly into stocks as well as equity and bond mutual funds. "We always reinvested the dividends so we could take advantage of compounding," says Billie. That steady investing strategy — as well as savvy moves like investing $50,000 in NCR stock at $42 in 1991, just months before AT&T offered $110 a share for the company — has given the Taylor's portfolio of 29 blue-chip stocks, five equity funds and one tax-free bond fund worth a total of $750,000 today. "Our portfolio has gotten so big," says Billie, "that I retired from teaching last year so I could manage it."

4. Take on debt sparingly. With credit card sponsors sending out 2.4 million separate offers for credit cards each year and banks hawking home-equity lines of credit like mad, it's easy to get sucked into today's "gotta have it now" culture. The price of that attitude: the $70 billion in interest payments Americans make each year on their debt. But most millionaires — 66 percent of who are debt-free — realize that every dollar you pay in interest is one less that you have to invest.

That's a big reason why they generally buy far more modest houses than they can actually afford. Real estate agents will typically tell you can safely afford to spend up to three times your annual income on a house, since the mortgage interest will provide a sizable tax deduction. But if you limit the amount you spend on housing to, say, twice your annual income, you could cut your monthly mortgage payment by 35 percent, freeing up cash that you can then tuck away in growth stocks or mutual funds.

As for credit cards, the best advice is never carry a balance. That way, you won't be hit with onerous 17 percent or higher annual interest charges. Clifford Johnson, a 77-year-old former postal worker in Los Angeles who accumulated $5 million largely by scooping up 200 rental units at bargain prices following the 1965 Watts riots, fees so strongly about avoiding interest costs that he hasn't owned a bank credit card for decades. "I don't believe in making payments to other people," says landlord Johnson. "I believe in other people making payments to me."

5. Hire an astute, independent financial adviser. The millionaires interviewed by Stanley and Danko reported that their most trusted source of financial advice is not their stockbroker or financial planner but their accountant. They say this pro (typical fee: $75 to $250 an hour) provides objective opinions on everything from clever tax strategies to investment planning. "My clients come to me for help managing the money they've made because they know I'm not going to try to sell them something," says Art Gifford, a partner with the Gifford Hillegass & Ingwersen accounting firm in Atlanta, which counts more than 300 millionaires among its clients.

Since the majority of millionaires are self-employed, they typically retain a CPA to help them with both their personal finances and those of their business. If you don't run your own company, you may instead prefer to hire a fee-only financial planner. Typical cost $75 to $200 an hour. Such a professional can assist you with a wide range of financial needs, ranging from making sure that your portfolio is properly diversified to assuring that you have a workable estate plan in place. And since a fee-only adviser receives no commissions for peddling products, the advice you get won't be tainted by a salesperson's inherent conflict of interest.

6. Pay as little as (legally) possible in income taxes. The wealthy are skinflints when it comes to handing over their cash to Uncle Sam. The average millionaire pays only 2 percent of his net worth annually in income taxes, while the average U.S. household shells out 11.6 percent. The main way millionaires pare their tax bills is by limiting the amount of taxable income they receive each year. One way they do this is by keeping much of their net worth invested in assets such as growth stocks whose gains come mostly in the form of price appreciation, which is not taxed until the property is sold. Similarly, many millionaires invest in rental real estate, which generates valuable depreciation deductions that shelter their property's income from taxes and, in some cases, produces losses that reduce the taxable gain when the building is sold.

There are several strategies that can help you lower your taxable income too. One easy way: Max out on your contributions to tax-deferred retirement accounts such as 401(k)s which reduce your taxable income and also let you rack up gains that are not taxed until you draw money from your account, typically at retirement. An estimated 90 percent of large and medium-size companies offer such plans, usually letting you contribute 6 percent of your gross salary, up to $9,500 a year. And here's an offer no self-respecting millionaire would refuse: Most large employers who offer 401(k)s will match up to half of what you contribute to the account, typically adding a maximum percent of your salary.

If your employer doesn't offer a 401(k) and you are willing to shelter some income for at least 15 years, consider a variable annuity. Essentially a tax-sheltered mutual fund, variable annuities don't offer a tax deduction, but their gains compound free of taxes until you withdraw them.

You can also limit the tax bill on the income and gains in your non-retirement portfolio by investing in shares of growth stocks whose share prices rise over time but generate little or nothing in taxable dividends. Since the price appreciation is not taxable until you unload the shares, you investment effectively compounds tax-deferred until you sell. Another benefit: You pay tax on your gain at the maximum capital gains rate of 28 percent; dividends and interest income are taxed at ordinary income rates as high as 39.6 percent…..

This strategy is more difficult to pull off with mutual funds, since funds are required by law to pass on virtually all their profits to shareholders each year. Still, index funds, which hold the stocks of a standard market benchmark such as Standard & Poor's 500, typically generate fewer short-term profits than actively managed fund because their mangers don't constantly trade stocks. As a result, most of their gains come in the appreciation of their share price, which makes them ideal for shareholders looking for the tax advantages of growth investing in a mutual fund.

7. Finally, start your own business. "Self-employed people are four times more likely to be millionaires than people who earn a paycheck working for others," says Stanley's co-author William Danko, a marketing professor at the State University of New York-Albany. The reason is simple: Salaried workers are pretty much limited to what an employer will pay them. Savvy business owners, on the other hand, can grow their business, which increases their income and can lead to even larger gains down the road when the venture is sold.

Kenneth Bardwell, a 38-year-old, owns 69 percent of his computer parts company in Detroit. "I pay myself $30,000 a year," says Bardwell, whose net worth is $2.5 million. "Real excitement for me is walking into our new 40,000-square-foot facility and seeing the business I built come to life."

Since **most** millionaires have made their money in prosaic pursuits like paving companies and pest control, it's clear that the key here is finding a niche and filling it, as 40-year-old Bill Rucker has. He rebuilds engines for diesel tractors and Caterpillar earthmovers in Fort Worth. Although Rucker's net worth total $2.3 million, he's the kind of guy who lunches on triple-patty Wendy's burgers, sports a bear and wears clunky Doc Martens. On a typical day, he's got 150 Caterpillar motors crated in his back lot destined for a mineral dig in Australia. Here's the kicker: The gear hasn't even been shipped yet, but Rucker has already been paid for every one of them — in cash. "I'm a T-shirt and Levi's kind of guy," says Rucker. "If you saw me on the street, you probably wouldn't think I was a millionaire — and that's the way I like it."

What's the Money Mastery Point?

"The wealthy live well within their means and without any 'bad' debt. 'Bad' debt (high-interest consumer debt that costs money rather than helps make money) is a wealth destroyer because of the crushing power of compounding interest."

Sidebar:

A PC mogul at 31: Selling computers earned him plenty for one splurge.
Bryn Kaufman
Age: 31
Net worth: $1.5 million
Occupation: Owns CMP Express, a computer and Internet sales company in Broomall, Pa.
Biggest asset: His business
Best tip: "Start a business. Then take out only as much money as you need to live on and keep plowing the profits back into it."

"My 12-year-old computer business hit $6.2 million in sales last year, but I still pay myself an annual salary of only about $30,000. That's enough for me. I don't have a mortgage, either. I live in a $700-a-month, one-bedroom apartment. And I spend next to nothing on socializing. My girlfriend Dorothee and I usually hand out with friends at a coffee shop, or we take walks in the Ridley Creek State Park nearby. Most of my friends don't realize I'm a millionaire. Although I wear $1,000 Valentino suits at the office, much of the time I dress like a student. I don't pay cash for my suits. I get them by cashing in credit card bonus points that rack up from my business spending. I have allowed myself one big splurge: a 1985 red Lamborghini Countach. I had a picture of this same car from *Road & Track* tacked onto my wall when I was a kid. A couple of years ago I was kind of surprised to realize that I actually had enough money to get it. So I bought it from a guy in Los Angeles for $100,000. I don't think of the car as a status symbol. I see it more as a reminder that if you work really hard, you can get whatever you want."

The frugal investor: She digs up top stocks in her own backyard
Mary-Edith Hill
Age: 50
Net worth: $1.3 million
Occupation: Owner of Hill Real Estate Agency in Boise, Idaho
Biggest Asset: A $933,400 portfolio of stocks and bonds
Best tip: "Invest in the stocks of companies you know."

"I never set a goal of having $ million by the time I was 50. I started out saying I'm not gong to consume more than I can use and I'm not going to be frivolous. I was shopping for an outfit for a dinner party recently when I found a black beaded jacket and chiffon dress for $350. But when I discovered the $350 was for the jacket only and the dress cost another $300, I couldn't buy it. It just seemed so extravagant.

I also hate spending money on cars. My '86 Subaru has 106,000 miles. But if you wash, wax and vacuum a car regularly and don't let people eat or smoke in it, you can drive it for 20 years.

Watching my spending has allowed me to invest as much as half my income some years. I just put an $11,500 commission check into my Merrill Lynch account last week. I don't have a real philosophy about investing, except to stick to companies I'm familiar with. I began buying stock in Hewlett-Packard back in the 70's, when it was selling for the equivalent of $2.60 a share. My husband, John, who died in 1979, and I had both worked for the company, so we knew it made great products. Toddy, Hewlett-Packard is trading at $49.50, and I have about $68,000 in it.

The other recommendation I have about investing is to stay in for the long haul. When the market gets topsy-turvy, the best thing you can do is forget about the daily blitz."