

# How to give your kids \$1 MILLION



**Money's** extract from Ashley Ormond's\* book puts a new, rosy complexion on our prospects of setting our kids up for a sound financial future. As Ormond explains, it's simple maths – as long as you stick to the plan.

**I** **BEGAN DEVELOPING THIS** plan 12 years ago when my daughter was born. Now I'm following it with my son who was born six years later. If my wife and I stick to the plan we will be able to give them \$1 million – each. It's pretty simple and just about anybody can do it, starting with as little as \$1. And it won't cost you a cent. You can give them much more than \$1 million – you can also give them the knowledge and skills to keep it, manage it and make it grow.

You're probably saying to yourself: "It sounds too good to be true – it will never work!" This is a natural reaction and it's good that you're sceptical. But spend a couple of hours reading about how the plan works and you will agree it makes sense and be keen to get started.

Financial freedom would be a fantastic gift to give our kids. First I thought about some of the potential problems with the plan. Even if we are in a position to give them the money, how do we stop them spending it all as soon as they get it? How do we get them to appreciate the value of money, know how to manage money and make it grow? How do we help them avoid being ripped off by all the so-called experts who can't wait to get their hands on the money?

So I created a plan that would give the kids \$1 million each, but has some rules in place so they don't immediately spend it. It gets them involved in managing the money and making it grow. It gives them the skills and knowledge

to deal with so-called experts like accountants, lawyers, financial planners, brokers, insurance salespeople and dodgy investment schemes.

Almost any parent can start the plan, stick to it and invest well to build long-term wealth for their kids. But how do we come up with the \$1 million? Well, this is actually the easiest part. It's very simple. If we simply put aside \$1 every day, starting from the day the child is born, invest it in growth assets, reinvest all the earnings and never spend it, they can end up with \$1 million by the time they are 50.

If 50 years is too long to wait, \$2 a day would get them to the \$1 million five years sooner, at 45. If we began putting in \$2 a day and increased the contributions by 5% each year, that would cut another five years off the plan. If we wanted to get really serious, we could start by putting in \$5 and increase the contributions by 5% each year — this would reach \$1 million in only 32 years.

This plan works with any amount of money. The more we put in, the sooner we get to the \$1 million. But I will use the basic \$1-a-day plan because most families can probably afford it.

Keep in mind also the aim of this plan is not to give the kids a big bucket of cash now so they become spoil brats.

They should go to school, get a job, build their careers or businesses and do all the things we did – and more. But we also want them to have enough money behind them so

**TABLE 1: INVESTING \$1-A-DAY**

AGE	TOTAL CONTRIBUTIONS*	TOTAL FUND VALUE
10	\$3720	\$7000
15	\$5580	\$15,000
20	\$7440	\$28,000
25	\$9300	\$52,000
30	\$11,160	\$95,000
35	\$13,020	\$170,000
40	\$14,880	\$301,000
45	\$16,700	\$532,000
50	\$18,600	\$941,000
55	\$20,460	\$1,660,000
60	\$22,320	\$2,930,000

\*Assumes contributions of \$31 a month (because it's much more practical than depositing \$1 a day) and assumes 12% growth a year. Fund values have been rounded for simplicity's sake. By the time the child is 20 the parents and child have put in only \$7440, but it has compounded and grown to around \$28,000.



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they can have more control over their lives. The aim of the \$1 million is not so our kids don't ever have to work. Everybody needs to work to contribute to society, meet challenges and grow from them, meet friends and give them something to complain about at the pub on Friday nights!

The aim of the \$1 million is to allow them to do what they really want to do with their lives, rather than what they have to do just to make ends meet.

But what about it not costing us a cent? We, the parents, will make the \$1-a-day con-

tributions for the first 10 to 15 years of the plan. Then the kids can start to take over and contribute \$1 a day from their pocket money or part-time jobs. As they grow up they will learn more about the plan and will get into the habit of putting their own money away for their investment fund.

We will only be contributing around \$5000 over the first 15 years and this money is a loan, not a gift. The loan is to be repaid when the kids are, say, 30 or 40 years old – it's up to us to set the rules. By the time they reach 30 the \$1 a day will have grown to around \$100,000 and

by the time they reach 40 it will have grown to around \$300,000. So they can repay the loan of \$5000 and it will only put a tiny dent in their fund, allowing them to continue on the path to \$1 million.

### **It's simple maths**

The plan is simply based on the principle of compounding. That's it! There have been dozens of books written about the “miracle” of compounding and how money can grow over time. But it's not a miracle at all — it's just simple maths. There

are 365 days in a year, so over 50 years the \$1 a day will add up to \$18,250 (\$365 a year × 50 years). But, because all investment earnings are reinvested in the fund, that \$18,250 turns into \$1 million! That's the so-called miracle of compounding.

To reach \$1 million by investing \$1 a day when your child is born requires that the investments grow at an average rate of around 12% a year. This rate is commonly used for growth investments over the long term. In practice, the returns will vary from year to year.

For example, my daughter was born in 1994 and since then the returns have been well above 12% a year, because we have been in a “boom” market for most of this time. Over longer terms we can expect to go through some bad periods as well, but average returns of around 12% are more than achievable.

There are many ways to get to the \$1 million target more quickly or to reach a bigger

- If we start out with \$500 in the account, contribute \$50 a month, and increase the contributions by only 5% each year (to stay ahead of inflation) and find another \$300 to contribute each year (for example, a Christmas gift from grandparents), over 50 years the fund will reach \$3.4 million.

- If we start out with \$500 in the account, contribute \$62 a month (\$2 a day), and increase the contributions by 5% each year (to stay ahead of inflation) and make no additional annual contributions, over 50 years the fund will reach \$3.2 million.

So there are many ways of achieving great results, even if we only start out small. These tiny contributions in the early years can make a huge difference in the value of the fund over the years.

The main thing is to start small and stick to the plan. This is much better than starting big and not sticking to it. Once you and your kids

the money growing. I'll never forget trying to explain to my daughter (who was 10) how her mother and I had put less than \$4000 into the fund since she was born but it had grown into over \$10,000. “But where did the other \$6000 come from? It must be magic!” she kept saying. I told her that it was just compounding – leaving the money in there, never spending it and reinvesting all the earnings.

Just stick to this plan and watch it work — and keep control of it yourself. You and your kids will learn about a whole range of simple, low-fee, low-cost, tax-effective ways to invest your fund for great long-term growth.

## The ground rules

There are some ground rules with the \$1-a-day plan.

1. Make regular contributions.
2. Invest the money in growth assets.
3. Reinvest investment earnings in the fund.
4. Never spend it.

### Rule 1: Regular contributions

It's not practical to actually deposit \$1 into an account every single day; regular contributions should be set up, for example, \$31 a month or \$14 a fortnight. The fund will grow much more quickly if the regular contributions each year are increased to keep ahead of inflation, and if additional one-off contributions are made when possible.

### Rule 2: Invest the money

There is a range of different investments available. Parents (and the kids when they start to take over the process) will need to spend about one hour a month learning about and managing the investments. In my family I find it easiest to spend a few hours each school holidays, rather than doing it during the term. The time we put in will reap big rewards later on. The funds are invested in the two main types of growth assets – shares and property.

## We can expect to go through bad periods, but average returns around 12% are more than achievable

target. But for now I'll stick to the basic plan — starting with nothing in the account when the child is born and contributing \$1 a day. Table 1 (previous page) shows what the investment fund should look like over time.

### The inflation factor

It's important to keep in mind that \$1 million in 50 years time is not going to be worth the same as \$1 million today, because inflation will have eaten into its value. Assuming inflation keeps running at its present rate of around 2.5% a year, \$1 million received in 50 years will have lost around 70% of its value, so it would be the same as receiving about \$300,000 today.

For most families this is still a tremendous present for their kids and is certainly much better than having no plan at all. But if we want to aim for \$1 million after the effects of inflation, we need to aim for a target of around \$3.4 million over the 50 years, because that will be worth the same as \$1 million today if inflation continues at 2.5% a year. Fortunately, it is possible to reach this amount and we can still do it by starting out very small:

- If we start out with nothing, just the contributions of \$31 a month, and increase the contributions by 10% each year (to stay well ahead of inflation), over 50 years the fund will reach \$3.4 million.

start to see the fund growing, this will motivate you to contribute more whenever you can.

It also helps to start early. If you delay starting until the child is 10 years old, the fund will only be worth \$300,000 when they turn 50. Think about that for a minute – if you miss out on the first 10 years of contributions you are putting in \$3720 less (\$31 per month × 12 months a year × 10 years), but the fund value at age 50 is a whopping \$640,000 less!

If the child is already, say, 10 and you want to start the plan now, you can still get back on track. Start with \$7000 in the account and begin the \$1-a-day plan from there (see the 10-year fund total in Table 1). That \$7000 gets you back on track for the \$1 million and makes up for the \$640,000 you would otherwise have been short.

If you don't have the \$7000 to kick the plan off, you could start from scratch but put in \$1.50 a day. Then you're back on track to reach \$1 million when the child is 50.

### The hard parts

There are three hard parts of the plan:

1. Making the commitment to start
2. Sticking to it
3. Learning (with our kids) how to invest the money well.

It does get easier after a while, once you see



### Rule 3: Reinvest all dividends

All income generated by the fund stays in the fund — all interest, dividends, distributions, capital gains or other income received from the investments. That way, the fund earnings grow by generating earnings of their own. The only reason money will need to be taken out is to pay tax on the investments. Tax can be kept to a minimum — and kids actually receive tax refunds in most years.

### Rule 4: Never spend it

This money is for the long term. Our kids get to learn the difference between:

- Investing — putting money away for the long term, never to be spent,
- Savings — money for future purchases,
- Spending money — for day-to-day purchases.

The money in the investment fund is not for buying boats, cars or houses, paying off the mortgage or paying for a holiday. Never spend it. By following this plan our kids can learn all sorts of financial techniques to help them avoid personal debts and pay off the mortgage quickly.

If we never spend the money, what is the point of having it? This money is there to buy something far more important than cars, boats and holidays — financial freedom for our kids. The \$1 million fund will generate investment income that can grow each year and the fund can keep growing in value. Let's say your child turns 50 and their fund has around \$1 million in it. At this point, he or she has some real choices in life. They could choose to:

- Work part-time or stop working altogether, and they could start living off the investment income from their fund. Their investment

fund of \$1 million could generate around \$50,000 income after tax and should still grow in value at around 5% to 8% a year

- Invest the fund in a different way that could generate around \$80,000 income to live on and still grow in value at around 3% each year
- Keep working and reinvesting all fund earnings back into the fund. If they continued to invest in growth assets, this would keep the fund growing at an average rate of around 12% each year. And if they continue to reinvest all earnings, the fund could grow to around \$2 million by age 57 or close to \$3 million by age 60. Therefore, if they avoid living off the fund earnings until they turn 57, the fund should

### FACT FILE

## What about superannuation?

This plan does not take the place of superannuation. Our kids will still be able to receive all the benefits of super later on. Super has its uses and should form a major part of investments later on in life, but they shouldn't rely on super. Having super will not teach kids how to be financially smart.

Many retirees today use their super payout to pay off their mortgage. This is one of the reasons for people taking on larger and larger mortgages when they are in their 40s and 50s — they know they can pay part of it off with their super payout when they turn 55. However, once they have done this they have to rely on the government age pension for the rest of their lives,

which could be another 30 or 40 years.

That's not what super was intended for. The super system is teaching bad financial habits instead of good ones.

The compulsory super system was introduced to help more people save for their own retirement. But it has done the opposite — 15 years after compulsory super was introduced the percentage of people on the government pension has increased to 80% of pension-age people. So we are going to need a plan other than compulsory super to stay off the government pension. The \$1-a-day plan should enable the kids to retire or semi-retire when they want to.



## FACT FILE

## How much is 'wealthy'?

Calculators on websites and in books are generally based on retirement and assume our living expenses once we finish work are going to be around 60% to 70% of our current living expenses. Don't make this assumption.

Take some time to decide what's important to you and what you would really like to do with your life. Then estimate how much that will cost – allowing for extras because everything always ends up costing more than you think!

Include all the day-to-day expenses, as well as annual items, such as holidays, and other expenses you may incur every few years such as upgrading the car.

If your living expenses in your ideal future life are \$50,000 a year, you will need investments

of around 20 times that \$50,000 – that is, \$1 million. This \$1 million in investment capital can do three things for you:

1. Generate investment income of around 5% (\$50,000 per annum) after tax consistently and regularly.
2. Leave your investment capital intact (so it lasts forever).
3. Continue to grow in value – so your investment income can also grow each year – to counter the effects of inflation.

If you use a multiple of 20 times your annual expenses, you should never have to spend or eat into your investment assets.

Many "retirement" tables and calculators use other multiples such as 15 times or even as little as 10 times annual living expenses. Most assume you will also be eating into your investment capital and running it down to

### REQUIRED INVESTMENT ASSETS

LIVING EXPENSES PER ANNUM		INVESTMENT ASSETS REQUIRED AFTER DELETING DEBTS
\$20,000	X 20 =	\$40,000
\$30,000	X 20 =	\$60,000
\$40,000	X 20 =	\$80,000
\$50,000	X 20 =	\$1,000,000
\$60,000	X 20 =	\$1,200,000
\$80,000	X 20 =	\$1,600,000
\$100,000	X 20 =	\$2,000,000
\$120,000	X 20 =	\$2,400,000

zero according to the statistical life-expectancy tables.

But you or your kids don't want to eat into the investment capital and run it down till you are scheduled to die! What if you live 10 years longer than the tables say? What if you want to leave some money for the kids or grandkids? What if you are going to need funds for major medical expenses?

We and our kids should plan to have enough investment capital to cover living expenses out of investment income alone, and still have the investment capital remaining intact and growing for as long as we want it to. The above table sets out the net investment assets we will need to support various levels of annual living expenses.

**It's what I mean by "Never spend it" – the assets remain intact and growing in value for as long as they want**

have doubled in size, to \$2 million, and they could then retire on an income of at least \$100,000 a year.

If the child chooses any of these options, they wouldn't actually be spending the investments or selling the investment assets, they would be living off the investment fund's earnings. The investment assets remain intact and keep growing in value for as long as they want them to. This is what I mean when I say: "Never spend it".

#### As the kids grow up

There are three stages in the \$1 plan:

1. Birth to age 10
2. Age 11 to age 20
3. Age 21 onwards.

#### Stage 1: Birth to age 10

In the first 10 years we put away \$1 a day in the kids' funds and spend about an hour a month learning and managing the fund. Each year we increase the contributions to stay ahead of inflation. We also try to put additional money into the account whenever possible – for example, from Christmas and birthday presents.

The fund is in the parents' names, but we are simply holding it on the child's behalf. If

the kids do chores around the house, we can pay them pocket money and also say that we are putting money away in their investment fund. At this stage we are responsible for the fund – investing the money in simple, low-cost, growth assets and learning more about investments.

My six-year-old son is aware that some money is going into a fund for him because we mention it occasionally, and also because he hears his older sister talking about it.

#### Stage 2: Age 11 to age 20

By age 10 the kids should have started to appreciate money and what it does. They are probably ready to begin helping us by looking at different investments, checking statements and some of the paperwork. During this stage we can also start handing the responsibility for the fund over to them.

They can begin making regular contributions and learning to put money from chores or gifts into the three categories mentioned earlier – investing (long term), savings (major items) and spending (day-to-day items).

They should also start to take an interest in how the investments are going and begin coming up with some ideas of their own – and

lots of questions. We continue to spend an hour a month together on the investment planning, monitoring and learning. My 12-year-old daughter is currently in stage two.

### Stage 3: Age 21 onwards

By stage 3 the kids should be ready to take over complete responsibility of the fund. They will have been contributing regularly for several years now – out of pocket money, then part-time jobs, then their full-time jobs as they enter the workforce.

### Repaying our loan

By sticking to the \$1 a day we are putting in about \$5000 over the first 15 years. When the kids agree to take over the plan they also agree to repay this loan when they turn, say, 40.

Only 5% of the fund value is the money put in as contributions. The other 95% has been generated through continually reinvesting the earnings. If our loan of \$5000 is repaid at this point, it would reduce the fund balance from \$301,000 to \$296,000 – so the impact is less than 2% of the fund balance, enabling the fund to continue on its path to \$1 million.

The \$5000 repaid in 40 years is not going to be worth the same as it is today. But this shouldn't be a concern because you will have learned to build the budget around the \$1 contributions. Think of the loss of buying power as our "gift" to the kids.

There are several good reasons for making our contribution a loan instead of a gift:

- It teaches the kids that there is no such thing as a free ride in life.
- A loan sounds more commercial and more of a commitment if they have to pay it back.
- It gives them an added incentive to continue with the plan and grow the fund, because they know they have to repay the \$5000. The bigger they can grow the fund, the less of an impact repaying the loan will have on the fund.

When the loan is repaid, some of the things we could do with it include:

- Shouting ourselves (or the kids) a holiday,
- Leaving it to grow in the kids' fund,
- Putting it towards their mortgage,
- Starting a fund for our grandkids,
- Using it to help out other kids less fortunate than our own (and even get a tax deduction if we donate to a registered charity).

### The learning process

My kids go to two different schools in Sydney and they aren't learning about investing and building financial wealth. Kids certainly don't learn about saving and investing from watching television either. They are bom-

barded with advertisements to get them to spend, spend, spend. It's up to us, the parents, to show them and teach them.

Happiness most often comes from having control over our lives – being able to decide what we want to do, when and how.

Being financially wealthy means having enough investments that generate investment income to pay for all our living expenses, so we can do what we really want to do with our lives.

### Investment assets

What should be included as investment assets?

- Superannuation
- Shares
- Managed funds
- Investment properties (be careful estimating values – if it includes flats bought "off the plan" in the last few years they may be worth a lot less than the purchase price)
- Savings and education bonds
- Vested shares or options in the company you work for that can be exercised now, and don't forget to deduct any tax payable
- Other investments.

The following items should not be included because they are not investments:

- Money saved to pay upcoming bills, or to pay for a holiday or new television.
- If you own a business, don't put any value on it if you actually work it.
- Your house – it's not an investment unless it's rented out.
- Holiday house – it's only an investment if it is rented out.
- Cars, boats or household items – they're not investments, because they don't appreciate in value or generate income.
- Tax obligations.

Add all the investment assets up to find the total and then subtract all debts. These may include:

- Mortgages and home loans
- Investment property loans
- Lines of credit
- Overdrafts
- Margin loans
- Credit cards
- Car or boat loans
- Personal loans
- Store discount cards
- "Buy-now-pay-nothing-for-two-years" loans on household goods
- Money owed to friends and family
- Loans from business partners
- Any loans or debts that were signed as "guarantor"
- Any other loans or debts owed.

The total investment assets minus the total



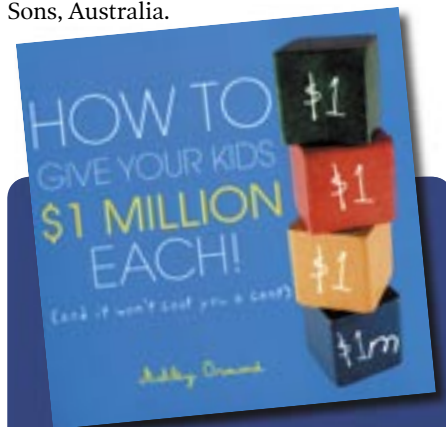
debts equal the net investment assets. If you have enough net investment assets to cover 20 times all our expected living expenses in our ideal future life, you are financially wealthy.

Most Australian families have negative net investment assets using this test. It's a tough test because it doesn't count the family home as an investment asset (because it doesn't generate income), but it does include the home mortgage as a "debt". The test does this because, in order to be truly wealthy and spend your life doing what you really want to do, you don't want to have to sell your house and move into a much cheaper house in a cheaper part of the country.

If the family has negative net investment assets, there is no need to panic just yet. There is still time to do something about it. And our kids have about 30 years more than we have to get their financial affairs in order.

### How to Give Your Kids \$1 Million Each!

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