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THE BOOK THAT CHANGED MY FINANCIAL LIFE

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Hey friends welcome back to the channel today we're talking about 12 lessons about money that I learned from this fantastic book by Morgan Housel called the psychology of money and that's what we're talking about in this episode of book club the ongoing series where we distill and discuss highlights from some of my favorite books and we're going to do this in four parts we're going to talk about lessons about our attitudes towards money lessons about getting money lessons about spending money and then lessons about protecting our money once we've gotten it part one three lessons about our attitudes towards money so the first lesson I got from the book was that everyone has different attitudes towards money and because the way that those attitudes affects the way that they earn and spend their money we shouldn't be too quick to judge people based on what they do with their own money so let's think about people's behavior when it comes to investing in stocks for example if you were born in the 1970s the s p 500 which is the index fund that tracks the top 500 biggest companies in the us that increased by 10 times its starting amount between age 13 and age 30 for you but if you were born just 20 years earlier the market basically went nowhere so these two groups of people are going to go through life with radically different ideas of how the stock market works and obviously these views are going to affect how they behave like people born in the 1970s are much more likely to invest in stocks than people born in the 1950s for whom they think the stock market doesn't really do anything and so for example for someone like me it can seem a bit weird like why don't more people just just invest in the s p 500 it just keeps on going up why don't more people invest in crypto but what i realized after reading the book is that to be honest i need to not be a dick about it because people have different attitudes to money depending on their own circumstances lesson number two is don't underestimate the importance of luck when it comes to making money because basically any outcome that we're going for whether it's making money or anything else in life is some combination of luck and skill and unfair advantages if we take bill gates for example now he's obviously super talented but he was also pretty lucky to get to go to one of the very few high schools in the u.s that actually owned a computer and that's what helped him start messing around with coding and start working on the company that ultimately became Microsoft and so Morgan's point in the book is that we shouldn't focus too much on the individuals we shouldn't look too closely at what did Elon Musk do to get rich what did bill gates do to get rich we should instead look at the broader patterns that try and account for this fact that different people got lucky at different times lesson number three from the book is that we should learn to say this is enough now it's natural for us to humans to keep on moving our goal posts like once we achieve our goals whether it's financial goals or career goals or hot bot goals or pretty girl goals we always look forward to the next goal and generally the cycle doesn't end because we keep on comparing ourselves to the people who are above us in this invisible ladder now this doesn't really resonate with me because I've been chasing this entrepreneurship thing since like the age of 13 trying to make money on the internet and started off making basically zero money and then slowly so slowly over time my income has basically compounded to the point where i am way beyond the point that any reasonable person would say that this is enough but what I've been finding is that the comparator group keeps on changing it's like when my YouTube channel was just starting out and it was making a small amount of money here and there it was like oh that's cool you know it'd be cool to make maybe a hundred pounds here and there then it started making 100 pounds here and I was like oh that's cool but look at those channels that maybe have millions of subscribers like I wonder how much money they're making and what I like um that Morgan reminds us of is that we actually do need to recognize when enough is enough and not be continuously trying to pursue growth just for its own sake and in the book he gives a bunch of examples of really rich people doing very dodgy and shady things to chase even more money like Bernie Madoff for example who was already ridiculously rich but then built this pyramid scheme to try and become even more ridiculously rich and ended up in prison as a result of it and what Morgan says is that it's really about asking the question of when is enough enough do I really need this extra thing and there's a nice quote where he says there is no reason to risk what you have and need for what you don't have and don't need and this lesson actually applied in my life fairly recently so my housemate sheen if you might remember from previous videos moved to Dubai and I was strongly thinking why don't I move to Dubai and I spoke to my accountant he was talking about the low tax rates and all that kind of stuff and I was thinking oh I could wind down the company in the UK move to Dubai like not live in the UK for three years to become tax resident outside of the UK become tax resident in Dubai where I don't pay any corporation tax or vat or income tax and all this stuff and then I'd be making twice as much money because I have to pay half as much tax and I had all these thoughts going in my head and it was around that time that I read the psychology of money and started figuring out what my values in life and stuff and I realized that that is just like stupid thinking I don't need that extra money I quite like being in the UK I like the fact that my friends and family are here and I'd be sacrificing a large amount of stability here in the UK for the sake of just chasing a little bit more money but effectively tax avoidance in Dubai and so ultimately I decided against it um thank you Morgan for for the tip on that front part two lessons about getting money all right so this is obviously not a video on how to make money from scratch you can check out my video on nine passive income ideas if you want more information about that but Morgan does have some very solid chapters about how we actually get rich so lesson four is to appreciate the magic of compounding so let's say i put a thousand dollars into the s p 500 index fund and I get a decent return of about 10 per year that'll give me 1100 by the start of year 2 which means I'm then earning 10 on the 1100 so that at the start of year 3 i'll have 1 210 and as this compounds over time you're basically earning interest or gains only on your interest or gains and when you start playing with the big numbers here the results are absolutely insane now the example that Morgan uses in the book is warren Buffett who is famously very rich and at the time that the book was written warren Buffett's net worth was around 84.5 billion dollars but of that 84.5 billion dollars 84.2 billion of it actually came after his 50th birthday and of that amount 81 billion of it came after his 60th birthday and one of the reasons that warren Buffett was able to get so much wealth is that he started young and he kept going like he started investing at the age of 10 such that by the age of 30 he had a million dollars in investments and then he just absolutely kept on going well into his I think he's like 90 something now and there's some good maths in the book that shows that 99.9 of warren Buffett's wealth came as a result of compounding because he started early and he just did it for absolutely ages and there's a really nice quote from the book that describes warren Buffett's success with this Morgan writes that none of the 2000 books picking apart Buffett's success are titled this guy has been investing consistently for three quarters of a century but we know that that's the key to the majority of a success it's just hard to wrap your head around that maths because it's not intuitive lesson number five is to try and save as much as you can even when you don't have a specific reason to save Morgan writes that building wealth has little to do with your income or investment returns and lots to do with your savings rate so we naturally think that saving is basically income minus expenses but morgan says that the other way of thinking about it is that savings equals income minus ego and this is quite interesting I think it's an interesting way of looking at our expenses like if I look at my own spending how much of that spending is actually necessary and how much of it is based on ego I don't know maybe you can decide and he also talks about how really our savings rate is the only variable in this equation that we can really control like I can't really control how much money I'm making I can't to extend but not really I can't I can't at all control the returns of the stock market or the returns of bitcoin or the returns of the real estate market but I can absolutely control how much money what percentage of my income I'm saving myself and there's a related point that I came across from uh biology who was interviewed in Tim Ferriss's podcast recently where he says that if you can have a very high savings rate and you can keep your own personal expenses very low like you need little money to survive and thrive then it actually gives you a lot more freedom in life because there are a lot of people that are tied to jobs that they don't necessarily enjoy because they now have lifestyles that require them to have that high income from the job that they don't necessarily enjoy and kind of the point is what's what's the point of being miserable in your job for 80 000 hours of your life kind of for most of the time that you spend alive what's the point of being miserable in that for the sake of having a fancy house and having a fancy car it's probably not worth the trade-off and so really if we can just lower our personal expense rate increase our personal savings rate in you know whatever fashion we can uh that gives us more anti-fragility more freedom more autonomy to kind of do more of the things that we actually want lesson number six from the book is to focus on not screwing up rather than on making big gains so let's imagine two investors sue and jim sue invests one dollar into the stock market every single month no matter what whereas what jim does is that he invests money into the stock market as it's going up and then he sells his stocks as it's going down and he's trying to play the market in that sense this is what sue's portfolio looks like over time and unfortunately this is what jim's portfolio looks like over time and the reason why sue ends up better off than jim is not because she made big gains it's because she consistently did not screw up by selling her stocks in like a downturn and the other interesting point here is that when it comes to thinking about how we're spending and investing our money getting it wrong is a lot worse for us than getting it right because if we lose money we can then no longer go back into the game and we actually have consequences on our life whereas if we make twice as much money or twice as much as that or twice as much as that like there are significant diminishing returns to the value of extra money that we get and so morgan's point basically is you know to like think about the long term and try not to lose money rather than thinking oh my god i need to chase that next ponzi scheme or that next oh you know dogecoin is going to the moon therefore i'm going to put stuff in there it's far more important to just focus on not screwing up and not losing money and doing that consistently over time so that you can actually benefit from compounding all right let's turn to part three which is lessons about spending money and then lesson number seven is use money to buy freedom and he talks about how really the true value of money is in the flexibility and the optionality that it gives us rather than the fact that it helps us buy a fancy house or a fancy car he writes that money's greatest intrinsic value and this cannot be overstated is its ability to give you control over your time using your money to buy time and options has a lifestyle benefit that few luxury goods can compete with and the reason for this is that at the end of the day we all just want to be happy and live a happy and meaningful life and tons of studies have shown that your income has significant diminishing returns on your personal life satisfaction or happiness from life and that beyond a point depending on who you ask it's around about 75 000 in the u.s beyond a certain point more money stops buying you further increases in happiness and so ultimately given that time is our most valuable non-renewable resource we can always make more money but we can never make more time using our own money to buy extra time to buy our freedom is a very good use of that money rather than spending it on pointless luxury crap that we don't actually need lesson number eight is that getting wealthy is very different to staying wealthy now here morgan writes that getting money requires taking risks being optimistic and putting yourself out there but keeping money requires the opposite of taking risks it requires humility and fear that what you've made can be taken away from you just as fast and i was kind of thinking about this as i was thinking about like basically these days how much of my investment portfolio to take out of stocks in real estate and just put into crypto so crypto is obviously highly volatile and could go up significantly i have reasonably high conviction that it will um but i still have a decent chunk of savings in investments in stocks and shares and in real estate and reminding myself that right now my aim is not to continue to make more money my aim is actually to keep the money that i have and grow it slowly that means i want to be nicely diversified across these different asset classes and so i do have a fairly significant chunk of my portfolio i think like 30 or 40 30 probably 30 in crypto more on that in a future video coming but i am not withdrawing all my stock market returns and all of my kind of real estate investments to put money into crypto that would be a bad decision and even though it might go up it's like if it goes down then that will significantly negatively affect my life in a far greater way than if it just goes up 10x or goes to the moon for example lesson number nine from the book is don't be a flashy so morgan writes to his son you might think you want an expensive car or a fancy watch and a huge house but i'm telling you you don't what you want is respect and admiration from other people and you think that having expensive stuff will bring it it almost never does especially from the people that you actually want to respect and admire you now there's two main reasons for this and the first one is the man in the car paradox the idea is that people buy fancy cars and mansions and stuff because they think that this will get them respect and admiration from other people at the end of the day like if i'm driving the news tesla around people will think that i'm cool and rich and that kind of stuff but what people don't realize is that people don't actually admire the person with the fancy cora house instead they're just admiring the fancy kara house itself and imagining themselves having that tesla or having that mansion so buying expensive things to gain respect from people never actually works because respect and admiration can't be bought and the second point he makes about this is that there's no point being flashy about the money you're spending because true wealth is actually the money that you have not spent and then we turn to part four which is how to protect your money once you've got it any amount of money any amount of money at all needs some level of protection and so lesson 10 here is to leave room for error now broadly there are two bits to this idea of making room for error the first part is making sure that you can technically survive if your future returns are not very good so let's say i've got some money and i'm banking on it going up by seven percent i really should have a plan like if it does not go up by seven percent if it goes up by four percent or three percent or two percent or even if it goes negative i should be able to survive that likelihood but the second point is that it's not just about the physical survival it's all it's also about the emotional survival and would we want to live that kind of lifestyle so for example let's say you work your job and you save up two years worth of expenses so you can quit your job and become a full-time youtuber for two years and give that a go in theory you're telling yourself that you have two years worth of runway so that if worst case scenario you don't succeed as a youtuber then two years down the line your savings will run out and you can just get another job but what you're not taking into account there is the emotional pain of seeing your savings whittle down over time and it might just be that as you burn through 50 of your savings at that point you start to feel emotionally psychologically scarred and you just quit and go back to your day job because you couldn't handle the fact that you lost 50 of your savings and you're not succeeding on youtube just yet so the point that morgan is making in the book is that we need to make room for these kind of emotional decisions and the way that we behave as humans when it comes to money which is why it's called the psychology of money is that we act not necessarily in like fully rational economic logical terms but we also have to take our emotions into account lesson number 11 is to try and avoid extreme financial commitments for your future self and this is speaking to the kind of person that says you know what i know that i'm never going to buy a house therefore i can afford to splash money when i'm when i'm young or someone who says you know what i know i'm never going to have kids and therefore my expenses can be super high because i know i don't have to save for the kids college fund or whatever now this is kind of a bad thing because even if you are very sure that that's how you want to live your life chances are you are not correct and that you actually will change your mind at some point further down the line psychologists call this the end of history illusion it's the idea that when you ask people how much they've changed in the last 10 years we're pretty good at describing how we've changed but if you ask people to predict how much they're going to change in the next 10 years then we're really bad at doing that and we think that we are broadly the people we are now are roughly the same as the people that we're going to be 10 years from now and so given that we are really bad at predicting how our own goals and values and desires are going to change over time and given that we're kind of hoping that unless the crypto thing really goes to the moon and fiat currency completely dies we're still going to need money to make decisions 10 years from now we should keep that in mind we shouldn't make extreme financial commitments to ourselves right now we shouldn't blow all our money for this you know lift fast die young because by the time you're approaching the whole day young thing you might realize actually i kind of want to live for another 40 years and now you have no money and it's kind of a bit of a struggle and then lesson number 12 is to be reasonable rather than rational and the point that morgan's making here is that sometimes good decisions are not always rational but they are reasonable and that we have to remember that we're ultimately emotional creatures with emotional needs not just like rational economic machines making the absolute perfectly logical decision i think this lesson is what i really took home because before reading the book i could not imagine why anyone would bother paying off the mortgage on their house it just seemed like a dumb thing to do like why would you do that you can borrow money from a mortgage relatively cheaply if you stick that money in stocks and shares it will grow faster than the rate of the thing of the mortgage if your inflation happens over the more value of the mortgage does that goes down all of these like rational economic reasons for not paying off the mortgage on your house but I completely discounted the fact that there is a lot of emotional niceness to having paid the mortgage on your house you feel like you have this house that you can now live in without paying a mortgage you feel a sense of security it helps you sleep better at night and so if you can and you're in that privileged position and you want to put down a cash payment to pay off the deposit on a house yes technically it's kind of irrational it's not the most economically financially like legit decision to maximize your returns but if it's the thing that helps you sleep at night that is the thing that matters because ultimately if we're playing this game of you know getting and protecting and earning and continuing to retain our money rather than losing all of it we have to also optimize for the things and the decisions that will help us sleep at night and so maybe you might watch one of my crypto videos or you've got a crypto bro friend who says oh my god you should be putting 100 of your money into crypto but if that helps you sleep worse at night don't do it put however much of your money into crypto as a as you are personally comfortable with and that will be reasonable even if it's not fully rational