Targeting a Million Dollars

A solid early trading goal is getting to a million dollars. Not a million in total net worth either, but a million liquid, accessible via trading account.

There are a number of substeps between here and there. And for some the target goal may be higher (for reasons relating to living expenses).

But a few quick things to know are:

- The goal may sound a stretch but is absolutely reachable.
- There is a clear means of getting “from here to there.”
- It doesn’t matter if you are starting from zero or close to it.
- A million is just an *early stretch goal*, not an end point.
- The size (seven figures) is important for a number of reasons.

You may have heard this old joke:

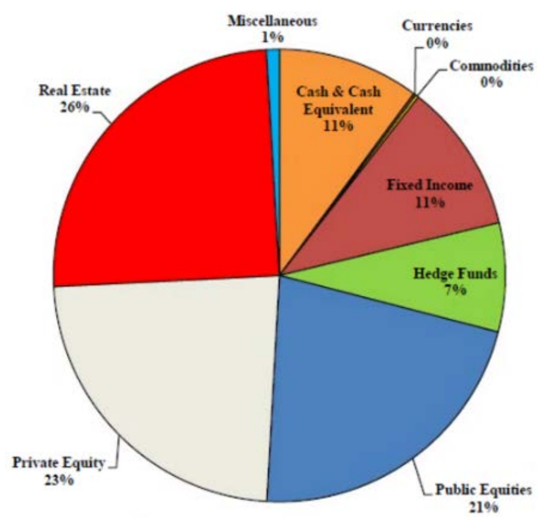
> *“To make a small fortune, start with a large one.”*

It’s funny because the second half catches you by surprise. The statement implies losing money rather than making it, e.g. inheriting a huge sum and throwing most of it away.

But the “joke” is actually good advice from another perspective – in the sense that:

- It “takes money to make money…”
- And it takes money to maintain stability…
- And a large base means larger return streams.

Wealthy people tend to think about their portfolio as a pie – a pool of assets with different slices allocated to different areas. For example, the graphic at right shows the average asset allocations for Tiger 21 members (a high net worth investment club).



“Cash and cash equivalents” represents assets in the form of currency or t-bills or money market accounts – the kind of liquidity that can be accessed immediately.

Wealthy people also think about lifestyle expenses as a percentage of assets. Let’s say, for example, you have a $100 million portfolio and a lifestyle that costs $1 million a year – roughly $83,000 a month for mortgages, vehicles, private school tuition for the kids, fine dining, charitable giving, etcetera and so on.

This ratio would mean your lifestyle expenses are "1% of assets," i.e. 1% of $100 million is $1 million. So if the portfolio can generate more than a 1% return each year, it becomes possible to fund one's lifestyle from portfolio gains, while still growing the portfolio year by year.

This is the way to think about living expenses – as a percentage of assets that is smaller than annual portfolio growth.

If your living expenses are only a small percentage of total assets, you can grow your asset pool and endure volatility at the same time. A lifestyle where expenses are 1% of assets can have a setback month, quarter or year – or even two years – without trouble. A lifestyle where expenses are 100% of assets, with no other income, is a whole other story.

For many traders, the early goal is trying to make a living by churning a small account. Somebody hoping to make and spend $100K a year by daytrading the S&P with a $25K base, for example, would have lifestyle expenses representing 400% of assets (because the money made and spent is four times the capital base).

That is crazy. It's not mathematically or logistically viable – like trying to feed 10 people off an acre of land. And that kind of pressure to generate consistent month-to-month returns is emotionally destabilizing. Among the wealthy, nobody does it that way, which should probably tell you something.

Back to the million dollar goal:

- With a million dollars liquid, it becomes possible to live off a small fixed percentage of assets.

- Taking out $5,000 per month, for example, would represent a withdrawal of one half of one percent of assets.

- A $60K a year draw on a million dollars would only be 6 percent of assets...

- And the portfolio on the whole should be increasing size at a faster rate than that over time.

There are different ways to play with the math. You could have higher or lower living expenses… a bigger or smaller capital base, and so on. Withdrawing 1 percent would be more stable than 6 percent. The concept is key, not specifics.

Point being, the smaller your percentage of assets withdrawal relative to your capital base, the more stable you are. This stability, in turn, has a wonderful impact on your psychology:

- It gives you the ability to handle volatility, which is an absolute must.

- It gives you the ability to be patient for extended stretches, another absolute must.

- It allows you to pursue "lumpy" returns, which are far more in line with how market returns are distributed.

- It gives you the psychological freedom to take aggressive (highly aggressive) positions when warranted.

- It gives you an extra cash cushion at all times (because additional liquidity is in your account when needed).

This too explains why a million dollars is only a starting point. Taking 5K per month out with a million dollar base is just an example, a very early one. Presumably you will want to continue building the size of your capital base… expanding your pool of assets as much as you can… and expanding the amount of discretionary capital available.

And thus we see another truth. The way to get to a wealthy person's lifestyle – e.g. spending a million dollars a year – is not to build a trading account to a few hundred thousand dollars and then churn the snot out of it. The idea is to build a much, much larger base – and then take only a very modest (ideally tiny) fraction out in a given year.

Once again, this is the "harder" pathway relative to what is typically imagined. How do you get to a million? Or if your lifestyle expenses are already higher, how do you get to $2 million, or $5 million, or whatever your reasonable base target is, as such that you can fund lifestyle expenses at a highly stable and replenishable level?

Well, this is where things like alternative cash flow streams… ability to save… ability to take early aggressive risks.. ability to work through a "transition period"… and ability to trade "friends and family money" comes in.

The path to full viability is not unlike the path for a business that starts out as a home-based stealth venture (because trading IS a business, with lots in common with typical entrepreneurship as we like to emphasize). This means thinking in certain ways and creating rough planning trajectories that extend months or years out.