# THE ALGEBRA OF WEALTH

## A SIMPLE FORMULA FOR FINANCIAL SECURITY


**SCOTT GALLOWAY**

BESTSELLING AUTHOR OF *THE FOUR*

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## A Simple Formula for Financial Security

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*For Alec and Nolan.*
*Please read this book, and take care of your old man.*

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INTRODUCTION

# WEALTH

CAPITALISM IS THE MOST PRODUCTIVE economic system in history, and a rapacious beast. It favors incumbents over innovators, rich over poor, capital over labor, and it allocates joy and suffering in ways often more perverse than fair. Understanding—and navigating—capitalism and investing can bless you with choice, control, and human connections void of economic anxiety. This is not a book about what should be, but what is, and it outlines best practices for succeeding in this system.

There are many paths to wealth. Shawn Carter, a high school dropout from Brooklyn's public housing projects, turned his innate feel for lyrical flow into an empire branded Jay-Z, becoming the first hip-hop billionaire. Ronald Read, the first person in his family to graduate from high school, worked his entire life as a janitor, lived frugally, and invested in blue chip stocks. When he died at 92, he left behind an estate worth $8 million. Warren Buffett came from more affluent origins and applied the lessons he learned hanging out as a kid at an Omaha stockbroker's office toward an investing career that's netted him a personal fortune of over $100 billion.

My first piece of advice is you should assume you are not Jay-Z, Ronald Read, or Warren Buffett. Each was an outlier, not just in talent but in good fortune. Less romanticized, but more common, are the frugal janitors and prudent investors whose early trajectory was more consistent than explosive. Outliers make for great inspiration . . . but lousy role models.

When I was in my twenties, I aimed to become an outlier. I wanted the markers of capitalist success and was willing to work for them. In the midst of the striving, I had a conversation about finances with a close friend, Lee. He told me he'd contributed $2,000 to an individual retirement account. At that point, I had no retirement savings. "If $2,000 matters to me when I'm 65," I responded, "I'm going to put a gun in my mouth."

This was arrogant, and wrong. The "swing for the fences" strategy I chose was riskier, less pleasant, and more stressful than my friend's. Ultimately, it worked. Or did I just get lucky? The answer is yes. I've founded nine companies; several have been successful, and their success has led to a media business that is rewarding both economically and emotionally. Economic security is just a means to an end. Specifically, the time and resources to focus on relationships without economic stress. My friend's path to economic security was less volatile and stressful than mine. My path got me there, but a few key principles applied earlier could have put me in the same place sooner with less anxiety.

## THE ALGEBRA OF WEALTH

How do you get economic security? There is an answer—that's the good news. The bad news? The answer is . . . slowly. This book distills a great deal of information on markets and wealth creation into four actionable principles.

This is not a typical personal finance book. There are no spreadsheets for you to fill out, no page-long tables comparing the details of ten different retirement plans or mutual fund fee structures. I'm not going to tell you to cut up your credit cards or stick motivational quotes to your refrigerator. Not because that type of advice isn't valuable, or because you should expect to reach economic security without ever making a spreadsheet. But there are dozens of books, websites, YouTube videos, and TikTok accounts teaching these lessons and offering sound advice to get you out of reverse and back on a path. In sum, I'm not trying to beat Suze Orman at her own game—and if you've got bill collectors coming after you, start with her. This book is for those who have their act together and want to ensure they make the best of their blessings. Two people who make the same income today will likely end up in distinctly different places over the years based on their approach to career and money.

**WEALTH =**

Focus + (Stoicism × Time × Diversification)

We'll discuss how to build a foundation, not only of wealth but of skills, relationships, habits, and priorities that confer advantage. The concepts conveyed here have been tested and supported by science, but above all they are principles you can make your own. The last portion of the book provides a primer on the core concepts of our system of finance and markets. This is an important subject for anyone who lives and works in our system, yet it's poorly covered in schools and glossed over in most personal finance literature. Everything here is based on what I've learned during an up-down-and-up-again career, from founding companies, to hiring and working with hundreds of successful people, to observing generations of young people come through my classroom and graduate to lives that map to every point on the spectrum of success.

# WHY WEALTH?

Wealth is a means to an end: economic security. Put another way, wealth is the absence of economic anxiety. Freed of the pressure to earn, we can choose how we live. Our relationships with others aren't shadowed by the stress of money. It sounds basic, easy even. It's not—we live in a globally competitive marketplace with a genius for creating problems that can only be solved by spending on bigger and better things.

This is the first lesson in this book: economic security isn't a function of what you earn but what you keep and knowing how much is enough for you. As the great philosopher Sheryl Crow once said, happiness isn't "having what you want, it's wanting what you've got." It's not about getting more . . . but ascertaining what you need and applying the right strategy to get you there, so you can focus on other things.

My objective for you is straightforward. Economic security is acquiring sufficient assets—not income, but assets—such that the **passive income** they generate exceeds the level of spending you choose for yourself—your **burn rate**. Passive income is money your money makes: interest you make on money you loan to someone else, appreciation in the value of your real estate, dividends paid by stocks you hold, rent paid by the tenant of an apartment you own. I'll talk more about these and other sources of passive income later, but, in short, it is any income that's not compensation paid for working at a job. And your burn rate is how much you spend, day to day and month to month. If your passive income is greater than your burn, you don't *need* to work (though you may want to), because you don't need the compensation to pay your expenses.

That's wealth. There are numerous paths to it; the reliable ones take time and hard work but are within the grasp of most people. And reaching for it should be a priority, early. Economic security is control. It is knowing that you can plan for the future, commit your time as you see fit, and provide for those who depend on you.

**ECONOMIC SECURITY =**

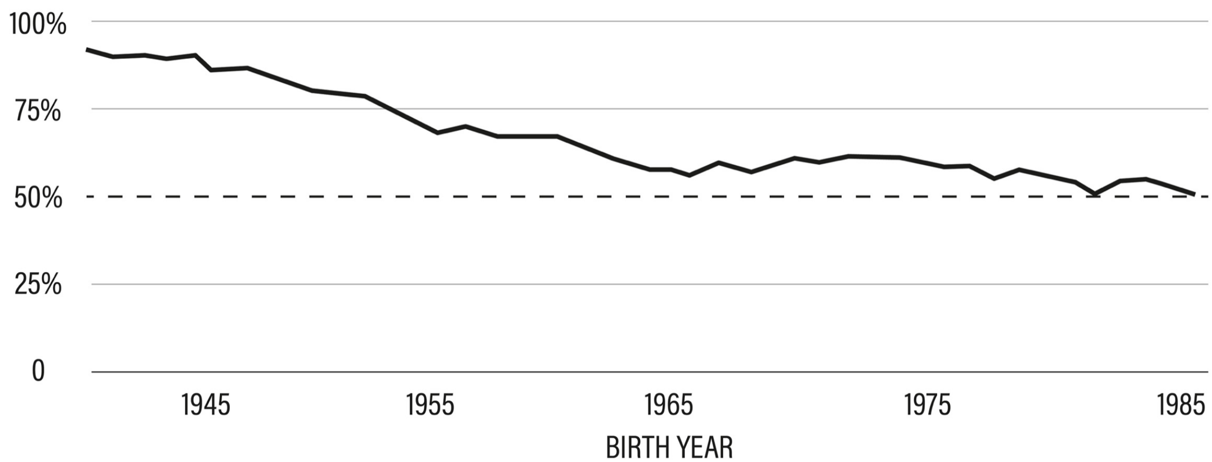
Passive income > Burn rate

## PERMISSION SLIP

Seeking wealth is not always in fashion. In a society correctly concerned about the acceleration of income inequality, wealth looks like the unfair allocation of a rigged system. “Every billionaire is a policy failure.” Maybe. Or maybe not. But it’s not relevant here. The urgent issue you face is your own economic security, not the virtues of anyone else’s.

“Money doesn’t talk, it swears,” Bob Dylan said. My experience is that money changes its tone as it grows. It hurls expletives at you when there’s not enough and comforts you as it accumulates. But the swearing most of us hear is getting louder. The median home price in the U.S. is six times the median annual income—fifty years ago it was two times—and the share of first-time buyers is barely half the historical average and the lowest on record. Medical debt is the leading cause of consumer bankruptcy; half of American adults would not be able to cover a $500 medical bill without taking on debt. Marriage rates among all but the wealthiest cohort are down 15% since 1980, as people can’t afford to tie the knot, much less have kids. Despite record growth in our broader prosperity, just 50% of Americans born in the 1980s are making more than their parents did at the same age, the lowest share ever. Twenty-five percent of Gen Z’ers don’t believe they’ll ever be able to retire. Divorce, depression, and disability are all moths to the flame of financial strain.

## SHARE OF 30-YEAR-OLDS EARNING MORE THAN THEIR PARENTS EARNED AT AGE 30




Source: The Equality of Opportunity Project

In 2020, Dylan sold his song catalog for $400 million. Money ain't swearing at Bob no more. When he penned that lyric in 1965, an upper-middle-class life got you 90% of what the wealthy had. The wealthiest families had a bigger house than you, had a step up in wardrobe, and played golf at the private club instead of the municipal course. The sixty years since have witnessed the rise of the rich-industrial complex. When the wealthy vacation today, they don't just stay in a nicer room than a regular family; they fly on a different plane (Bob's is a Gulfstream IV), stay in a different resort, see different sights (often after-hours, when the public is not allowed). The 1% go to different doctors, eat at different restaurants, shop at different stores. Wealth used to be a better seat. Now it's an upgrade to a better life.

The key to happiness is our expectations, and unrealistic expectations guarantee unrealized happiness. Yet every time you leave your house or pick up your phone, society and its organizations are either serenading or swearing at you. The difference between the lives of the 1% and the 99% is thrown in your face every day—an entire industry of simulated, flaunted wealth has developed around "influencers." Wealth porn . . . a constant reminder: not of what you've achieved but what you haven't.

The system may need fixing; until then, you have to stand it. Better yet, work it and develop the skills and strategies to increase the likelihood you will prosper within it. What Churchill said about democracy—that it's the worst system except for all the others we've tried—is also true of capitalism. Inequality pricks ambition, incentives drive outcomes, and the wheel turns. If the system suits you, play it the best you can. If it doesn't . . . play the best you can. None of this is your fault. Society faces greater risks than you becoming a millionaire. And until you attain economic security, your time will not be your own and much of your stress will be unproductive. (See above: money swears at you.)

Pursuing wealth doesn't mean you are immoral, greedy, or selfish, and it doesn't require you to be so. Indeed, those qualities only make achieving economic security harder and undermine your happiness once you get there. To overcome the obstacles between you and wealth, you will need allies. You've likely been told to start saving/investing early. Start cultivating allies and fans early, too. In all aspects of your life, you want to have the home-field advantage. You should (and can) be front of mind when people are asked, "Who would be good for this job, this investment, this board?" And the ultimate objective is to enjoy a life rich in relationships, not to die with the biggest number in the bank.

## THE NUMBER

Typically, personal finance advice is built around "retirement" (a clear distinction between working and no longer working). It's an outdated construct and not central to our philosophy of wealth. I want you to obtain economic security *before* you stop working. The sooner the better. Once you've achieved economic security, you may decide to continue to focus on work and professional achievement. I have. But the stress surrounding work declines dramatically when it becomes a surfboard instead of a life preserver. We perform better when we are confident. Work is a bit like dating in this regard—the less you need your job, the more it needs you.

You could apply the principles of this book and, with some luck and a lot of hard work, be living on a boat in the Caribbean by age 40, never earning another dollar. Or you could be sitting on boards in your seventies and mentoring CEOs for four figures per hour. Economic security gives you options. And economic security boils down to a number: an asset base sufficient to fund your lifestyle. You may decide to continue to work, as there are numerous studies showing work can extend your life and well-being. What kills you is stress, and much of this stress is a function of not having economic security. Work without economic stress evolves from necessity to purpose.

How big a number *do* you need in your bank account? There's no single answer, but there is an answer for you. Although it's more a goal than an answer, as economic security is not pass-fail. Getting most of the way to your goal will make life easier and more rewarding. Thomas J. Stanley said, "Wealth is not a matter of intelligence, it's a matter of arithmetic." Remember our math: passive income greater than your burn.

So what's your burn rate? Or, more precisely, what's the burn rate you aspire to maintain in perpetuity? This is easier to answer the older you are, as you're closer to perpetuity. But even if you are early in your career or still in school, you can get some idea by building a budget from the ground up, asking family members about their expenses, and researching the typical costs of housing, food, and other items. You don't need to project your spending forty years into the future down to the dollar, nor should you. It's neither possible nor necessary. A rough sketch is a good start; it's something you can refine as your target comes into view.

This exercise is in part financial, but it's also deeply personal. As you gain experience, you'll know yourself better and get a feel for what you need. Everyone's target burn rate is different. For my father, it's not much. Some practical requirements, a studio at the Wesley Palms (an assisted-living facility), a streaming network that offers Maple Leafs games, and a night out (home by seven) that includes Mexican food and a michelada. I'm not cut from the same cloth. My spending burns hotter. Like, supernova hotter. Anyway, whether you like Pabst or Prada, rough out your projected expenses for a year and add them up. Bump it 20% to cover taxes (30% if you expect to live in California, New York, or another high-tax state). That's your annual burn rate.

Now multiply that burn rate by 25. That's (roughly) your number—the asset base you need to generate passive income greater than your burn. Why 25? That assumes your assets produce income at a rate of 4% over inflation. Different financial planners will suggest slightly different numbers, but 4% is in the ballpark, and 25x makes the math easy. This is just a rough sketch. Our tax estimate is simplistic. Your burn rate will rise if you have kids in the house and fall when they move on. We haven't considered social security, which may or may not exist thirty years from now. (I think it will, because old people keep living longer, and they vote, so we're more likely to get rid of schools, the space program, and half the navy before we fail to fund social security.) But any work of art starts with a rough sketch.

If you need $80,000 a year to cover your burn rate, then $2 million is your number. If you hit that in invested assets, then you win—you've beaten capitalism. (Capitalism has some tricks up its sleeve, though: $2 million is your number *today*—if you're planning to accumulate that asset base 25 years from now, inflation will bump your number up to more like $5 million. We'll get to that.)

## TWO JACKETS AND A GLOVE

A few years ago, we went skiing, a hobby I endure to trap my boys on a mountain so they have to spend time with me. One afternoon, I'm in our hotel room in Courchevel, using work as an excuse to escape my on-piste obligations. My eldest, who was 11 at the time, comes in, and I know something is wrong. As a rule, both sons reflexively announce themselves whenever they enter a room with a question or bodily function. ("Can I watch TV?" "Where's Mom?" *Belch*.) But . . . silence, until he's in front of me. He's been crying.

"What's wrong?"

"I lost a glove." More tears.

"That's okay, it's only a glove."

"You don't understand. Mommy just bought me these. They cost €80. That's a lot of money. She's going to be angry."

"She'll understand. I lose stuff all the time."

"But I don't want her to buy me another pair—they were €80."

Easy for me to be empathetic here. My son's tendency to lose stuff is inherited. My ex-wife said if my penis wasn't attached, we'd run across it in SoHo on a card table next to secondhand books and a script for *Goodfellas.* I don't carry keys, what's the point?

So, I got this. We agree to retrace his steps. Along the way my mind races: *Is this a life lesson? Would buying him a new pair be coddling?* I look down—he's crying. The ground splits beneath me, and instantly I'm 9 again.

After my folks separated, economic stress turned to economic anxiety. Anxiety gnawed at my mom and me, whispering in our ears that we weren't valid, that we'd failed. My mom, a secretary, was smart and hardworking . . . and our household income was $800 a month. I told Mom, at the age of 9, that I didn't need a babysitter, because I knew we could use the additional $8 a week. Also, when the ice cream truck came by, my sitter gave each of her kids 30¢ and me 15¢.

"It's winter, you need a jacket," my mom said; so off to Sears we went. We bought one a size too big, as my mom figured I could get two, maybe three years out of it. It cost $33. Two weeks later, I left my jacket at Cub Scouts, but I assured my mom we'd get it back at the next meeting. We didn't.

So off to get another jacket, this time to JCPenney. Mom told me this one was my Christmas present, as we wouldn't have the funds for gifts after buying another jacket. I don't know if this was true or if she was trying to teach me a lesson. Likely both. Regardless, I tried to feign excitement at my early Christmas present, which, incidentally, also cost $33.

Several weeks later . . . I lost the second jacket. I sat at home after school, in fear, waiting for my mom to come home and absorb another body blow to our already economically feeble household. I heard the key turn, she walked in, and I nervously blurted out, "I lost the jacket. It's okay, I don't need one . . . I swear."

I felt like crying, bawling really. But something worse happened. My mom began to cry. Then she composed herself, walked over to me, made a fist, and pounded on my thigh several times as if she were in a boardroom trying to make a point, and my thigh was the table she was slamming her fist on. I don't know if it was more upsetting or awkward. She then went upstairs to her room. She came down an hour later, and we never spoke of it again.

Economic anxiety is high blood pressure—always there, waiting to turn a minor ailment into a life-threatening disease. That's not a metaphor. Kids who grow up in low-income households have higher blood pressure than kids who live in wealthy ones.

Meanwhile, back in the Alps, a dad and his one-gloved son have been walking for thirty minutes in 8-degree weather. I attempt to take advantage of his weakened state and break into a song and dance about how *things* aren't important, but relationships are. In the midst of this bad Hallmark Channel scene, my son stops, then sprints to a small Christmas tree in front of the Philipp Plein store. The same store where, the day before, his 8-year-old brother tried to persuade me to buy him a €250 hoodie with a bedazzled skull on the back. On top of the tree, in place of the star, is one electric-blue boy's glove. A good—and creative—Samaritan had found it and placed it within eyeshot of any boy searching for the vibrant accessory. My son grabs the glove, sighs, holds it to his chest, and visibly feels a mix of relief and reward.

We live in an era of innovation in finance, but no cryptocurrency or payment app will offer what I want most—to send money back in time, to the people I loved who didn't have it. The insecurity and shame present in my childhood home will always be there. But that's okay, as it was motivating.

Your pursuit of wealth may be driven by something else. Perhaps validation, or a feeling of purpose. A passion for the good life, luxuries and experiences only money can bring. The desire to do something about the ills of the world. In my experience, noble intentions are a good motivation for hard work, and desire is also powerful—but fear bests them both. What drives you is your business. Find it, nurture it, and carry it with you.

You will need motivation, as there is hard work ahead.

## THE HARD WAY

So, how do you reach economic security? There are really just two ways. The smart way is to inherit it. Most of us will have to go the hard way. It's simple. Earn money by working hard. Save some. Invest it. If you maximize your income, minimize your spending, and invest the difference wisely, I can claim with reasonable certainty: you will achieve economic security.

Executing this plan is not as simple as stating it. That goes beyond finance, beyond what you can capture on a spreadsheet. Wealth is the product of a life well lived—hard work, frugality, wisdom. That doesn't mean being a monk—there's room for pleasure, for error, for life. But it does mean hard work, and it does mean a certain amount of discipline. And it's worth it. The Algebra of Wealth has four components:

**Stoicism** is about living an intentional, temperate life in and out of work. It's about saving money, for sure, but also developing strong character and connecting with a community. This stuff matters.

**Focus** is primarily about earning an income. As I discuss, income alone won't make you wealthy, but it's the necessary first step. And you're going to need a decent amount of it. So we'll help you plan and navigate a career and maximize the income it generates.

**Time** is your most important asset. It starts and ends with an understanding of the most powerful force in the universe: compound interest. We'll share how to make it work for you. Time is the real currency, the one asset we're all given at birth, and the foundation of wealth.

**Diversification** is our take on the traditional personal finance questions, a road map for making sound investment decisions and for being an educated participant in the financial marketplace.

Okay—let's light this candle.