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Season 2. Building personal wealth

Episode 1.

Why do you want to save and invest?

Hi, Jason here. And to start this wealth building season, we're going to explore two of the biggest reasons why you might want to save and invest for your future. But before we do that - I need to remind you that you really must have your financial foundations in place, with spending under control, a good cash reserve for emergencies and any expensive debts repaid before you engage in any long-term investing.

Okay, so one of the best and most attractive ways to think about long-term investing is to focus on how it can give you the freedoms you want throughout your life. It's easy to forget that whatever we have going on in our lives today will not continue forever. And we seldom stop to think seriously about how our financial freedoms could be lost as we get older.

In our 20s, 30s and 40s and even in our early 50s, if our financial foundations are sorted and we have a reasonable income, then we really are quite free (within reason) to have exactly what we want and exactly when we want it. Just think of the things you could have right now (or at least, very soon) if you simply decided to buy them. Perhaps you could have an amazing exotic holiday? Or perhaps you'd like a newer car, even if the one you have is enough for your needs.

The truth is you're probably free to have any, or all of those things, even if you don't have the cash on hand. Simply by arranging a loan or extending your debt on a credit card. And let's be honest, most of us get tempted sometimes to buy some of these things on credit. But if you do this sort of thing and spend everything you earn throughout your working life, you won't get to have the freedoms you'll want later in your life. So, if you reach, say, 65 with very little set aside to fund your leisure years, you'll have to keep working - and quite possibly for a very long time. And whilst that might be okay if you really enjoy your work, you'll probably likely want some freedom from work whilst you're still young enough to enjoy it.

Okay. So, it's easy to see the need to save over the long term – if you want to be free to escape from work when you want to. So perhaps the more interesting question that most people ask is this: 'How much do I need to regularly save and invest to gain that freedom in the future?' And that's precisely what we'll cover in this series. But let's get a taste of those ideas now by looking at a simple example. Let's pretend that you're 35-years-old and that you'd like to build a fund to make work optional by the time you're 65. Now to keep this simple, let's assume that you've already worked out how much money you'll need to achieve that. And, don't worry, we'll show you how to work this out later in this season.

For now, let's just say that you're aiming to build a fund of three hundred thousand pounds. And whilst that might sound like a great deal of money, remember that you have a full 30 years ahead of you in which to build this amount. The question is, how much do you need to save each month to have a good chance of achieving this goal? Stop this video now and have a guess at the answer. Well, if we assume that you saved on your own without any input from your employer and that you saved into an ordinary bank or building society savings account, then you can work this out quite easily.

You simply divide your target of £300,000 by 30 (the number of years available to save for it) for your answer. So, that's £10,000 a year of savings required in this simple example. Now, I realise that this is a very large amount. But it really is a logical way to work this out if you're going to restrict your savings to simple bank deposits. You see, we've simply assumed that any interest you earn on your savings will only offset the effects of price inflation. And that's a reasonable assumption when we look at how interest rates and inflation have broadly followed each other - over time.

Of course, if you did base your financial plans on this 'cost' estimate of £10,000 a year, or £833 per month, you might think that making work optional is an impossible dream. And you might not bother saving anything for that longer-term goal. The good news is that you can apply much smarter thinking to this challenge. And you might even cut that estimated cost of your work escape fund by more than 75%. Here's how: First, let's assume that you'd 'go for' this goal by regularly investing in the Stockmarket instead of saving into bank savings accounts.

And, to be clear, your decision to save and invest this way would depend on it being suited to your personal attitude to and capacity to take stockmarket risk. But if that all checked out, as it would for many in this situation, then you could reasonably increase the assumed long-term return on your money by about 3.5% each year. And whilst that might not sound like a lot, this is where the magic starts to happen. Because with a 30-year time horizon, that small change to your assumption about the return on your money, could cut the estimated cost of your goal by more than half - to just £475 per month. Generous payments from your employer into your pension plan could mean that this figure is halved again, to around £238 per month. And with basic rate tax relief on your own contribution, the personal cost to you might start off at just £190 per month. Or, to put that another way. This very nice work 'escape' fund could cost you less than one quarter of what it would cost you if you tried to build it by saving your money in the bank.

Now, of course, there's more to this long-term financial planning game than this simple story suggests. And to be clear, this should not, in any way, be considered as personal advice, even if you are 35 and £300,000 is your target fund to escape from your work. To work these things out properly and to make these sorts of savings on the cost to fund your longer-term goals, without exposing your money to silly risks, you need a solid approach to planning your money. And that's what we'll start to explore next time. So, see you back here when you're ready for that. All the best for now.

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