The 'wealth iceberg' – how being wealthy is the opposite of being rich

BY PAUL NIXON
Head: Behavioural Finance,
Momentum Investments

Ronald James Read was a petrol attendant until his death at age 92 – and made headlines as one of the top 4 000 wealthiest Americans. He died in 2014 with a net worth of $8m. He lived in a tiny house and drove the same car most of his life.

Ronald was wealthy but not rich, as Morgan Housel in *The Psychology of Money* puts it. The difference leads us to a profound understanding of how important savings are, and highlights the trap of waiting to save until we earn more.

Human beings are hardwired to be visual creatures. From the moment we open our eyes, almost 50% of our brain is involved in visual processing. Even though we have five senses, around 70% of all sensory reports come from our eyes[1]. Unfortunately, this predisposes us to a cognitive processing error that we explore with the concept of a 'wealth iceberg'.

It is precisely because we are visual creatures that our investment aspirations are often linked to what we can see. What we see are possessions. The paradox here is, however, that it's what we don't see that is actually important.

Much like the iceberg, a large portion of its mass remains hidden. For this reason, judgement is particularly difficult for sailors and is usually based on the part that sticks out of the water. In much the same manner, the rich are often the role models, and not the wealthy. We see the tip of the iceberg – the material possessions – and not the biggest part hidden beneath the surface – the hard work of saving and investing rather than spending.

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Wealth comes from not spending on things or possessions. The premise here is that wealth is not a function of income, but rather a function of saving.

Ronald James Read teaches us this valuable lesson. He was undoubtedly wealthy with a sizeable asset base at death, but he was not rich. He was wealthy because he didn't use his hard-earned, yet modest, income to buy possessions. He used it to save.

What do we do about all this? The first step in creating wealth is creating 'space' for saving. There is a deceptively simple rule of thumb that can help us to create this space. The 50/20/30 rule provides guidelines for our after-tax income. No more than 50% of this income should be spent on contractual obligations (home loan, car repayments, cell phone etc). Then, at least 20% of this income should be spent on savings. The remaining 30% can then be spent on discretionary items like clothing, eating out or planning for holidays. Note that 'savings' is second on the list, so if you're spending more than 50% on contractual spend, this should not be at the expense of savings, but rather discretionary spend.

In 2014, popstar Rihanna sued her accountant and financial adviser Peter Gounis for 'allowing' her to squander $9m that nearly resulted in her bankruptcy. His quip in response to the lawsuit was priceless, "Was it really necessary to tell her that if you spend money on things, you'll end up with lots of things and no money?"

We should help our clients to be more like Ronald James Read.

[1] *Housel, M., 2020. The Psychology of Money: Timeless lessons on wealth, greed, and happiness. Harriman House Limited.*

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